

Item No. 12	Classification: Open	Date: 14.02.2006	Meeting: Executive
Report title:		District Heating Account	
Ward(s) or groups affected:		All	
From:		Strategic Director of Housing	

Summary

1. The Heating Account is a notional ring-fenced account within the HRA, comprising the expenditure and income associated with the provision of district heating to tenants and leaseholders.
2. At its meeting on January 18 2006, the Executive considered a motion referred from Council Assembly, and as a consequence resolved to receive a further report on District Heating Account charges.

Recommendations

3. Executive is asked to note the attached report.

Background

4. Executive considered a report on District Heating Charges on 11 October 2005. This report is attached as Appendix B. The recommendations of the report were agreed.
5. Following that decision, a motion on Heating Charges for Council Tenants was submitted to Council Assembly on December 7 2005.
6. On January 16 2006, Executive considered the motion, which had been referred from Council Assembly, and resolved to instruct officers to prepare a further report, containing additional information as to the context of increases in heating charges and fuel costs (Appendix D).

History

7. The Heating Account was ring-fenced within the HRA by the Housing Committee in November 1994, effective from 1 April 1995.
8. The intention of this approach was to smooth out fluctuations in heating costs, as the variable length and intensity of the winter had a direct impact on energy expenditure. Also, this formed a mechanism for ensuring that cross-subsidising other elements of the HRA from District Heating charges was avoided.
9. The Heating Account has been maintained on a trading account basis, whereby the gap between yearly income and expenditure is expressed as a surplus or deficit. Any surplus may be applied across future years, whilst income and/or expenditure should be adjusted to meet any deficit.
10. The account reflects energy consumption levels and is therefore sensitive to the length and severity of the winter period. Expenditure on repairs and maintenance of heating systems does not pass through the Heating Account, but is held separately within the main HRA.
11. Surpluses from the account following mild winters were used to subsidise additional expenditure consequent to colder ones, with the proviso that they could also be ring-fenced to fund further energy efficiency measures.
12. Since its inception, the heating account has aggregated savings mainly on the expenditure side, through a combination of reduced consumption and lower energy prices derived through industry deregulation and increased competition in the sector over the last decade. Due to the effect of applying the resultant surpluses, there was no need to increase charges from 1994/95 until 2004/05, when an RPI-based increase of 2.8% was agreed. A further RPI-related increase of 3.1% was initially agreed for 2005/06.
13. It became clear at a late stage in the 2005/06 budget-setting process that rapidly increasing energy costs were likely to move the account into deficit. A 6-month review was set in train to establish what was required to re-balance the account, and the Council was able to warn tenants of this probability in their rent increase letters for 2005/06.

Status

14. The carry-forward surplus for the Heating Account at the end of 2004/05 had declined to £1.5m, which was sufficient only to fund higher costs in the short-term i.e. during 2005/06 itself.
15. The following table indicates the projected position for the Heating Account at the end of 2005/06. A small cumulative surplus of £189k would result, which would be insufficient to ensure that any short-term additional costs could be met without a deficit resulting. It therefore became prudent to look at increases in income, as the medium-term view of energy costs was an inflationary one. The table also shows the indicative budget for 2006/07, as part of the overall HRA Budget as approved by the Executive on January 31 2006.

Heating Account Budgets	Base 2005/06 £'000	Indicative 2006/07 £'000
Heating and Hot Water Charges	(5,816)	(7,163)
Buyback of excess supply	(208)	(208)
INCOME	(6,024)	(7,371)
Energy Costs	7,185	7,283
Energy Efficiency Measures	186	87
EXPENDITURE	7,371	7,371
(Surplus)/Deficit for Year	1,347	-
Balance brought forward	(1,536)	(189)
Balance carried forward	(189)	(189)

16. In order to keep the account in balance in 2005/06 and 2006/07, it was necessary to increase charges to tenants by 29%, which Executive agreed on October 11 2005 and implemented on November 28 2005.

Energy Costs

17. The Executive report contained the following table, which details the status of the relevant energy supply contracts. It can be seen that the underlying trend for energy costs is steeply upward.

Utility	Contract	Renewal date	% contract price increase
Electricity	100kw+ sites	31 Oct 2005	44% (actual)*
Electricity	100kw- sites	31 Mar 2006	50% (indicative)
Gas	Interruptible supply	31 July 2005	104% (actual)
Gas	25kt+ sites	31 Jan 2007	53% (actual)
Gas	25kt- sites	31 Oct 2006	40% (actual)

* This contract was undergoing procurement at the time of the Executive report.

18. Over the last few years, tendered prices for the Council gas supplies have been rising by around 30 – 50% per year. This is wholly due to the rise in wholesale prices for gas traded in the market. The chief causes for this rise have been:
- The opening of the gas interconnector between the UK and mainland Europe in 2000. This has linked the UK gas market to the EU (and international) market. EU gas prices are strongly linked to international oil prices, this means that UK gas prices are subject to the same political and socio-economic forces as oil (in addition to weather conditions);
 - The decline of UK north sea gas production – the UK is now a net importer of gas; and
 - Strong sustained demand for oil in China, this has pushed up oil and gas prices.
19. Gas is traded as a commodity, and there is subsequently great volatility in prices according to traders' perceptions of how the market may move in the future. It is important to realise that competition among gas suppliers now has far less influence on the prices offered than the timing of the tender. For this reason, the Council keeps the timing of the tender process flexible, and acts according to the best market advice from its agent.

Future Pressures

20. Any forecast for future gas prices must be treated with extreme caution. The UK Government launched a second energy review in January 2006 – among other issues, this will address the growing dependence of the UK on imported gas supplies. A number of investment projects have already started which may ease the rate of increase in gas prices:
 - UK link to the Norwegian gas fields; and
 - Increased storage capacity for shipping LNG (liquefied natural gas) from the Middle East.
21. What the Council cannot expect is any sustained downward trend in prices. Price volatility is also here to stay as UK gas and oil prices are part of the wider international energy commodity market.
22. Nor would Council tenants be better off having their own individual gas boilers. Domestic prices tend to be less volatile than commercial prices, but this is only because gas suppliers build future price risk into the tariffs offered to customers. Domestic prices are overall higher than commercial prices.

Community Impact Statement

23. This report is concerned with provision of part of the Council's landlord services and previously agreed charges for district heating. Members of disadvantaged communities are statistically more likely to be council tenants and in need of temporary accommodation services than the general population as a whole. Therefore, the likely impact of this service for disadvantaged groups is high. An individual tenant's heating charge liability is not compromised by any membership of a specific minority group or groups – though their ability to pay their heating charge may well be.
24. The Council has improved its communication with minority groups with regard to the rent and additional charge-setting process. Notwithstanding the well-established consultation process with Tenant Council, Leaseholder Council and the Area Forums, the Council now follows good practice in ensuring that the statutory notification letters that tenants receive setting out the new rent and charge levels are simply written and are printed in a large font size by default. Further good practice ensures that the rent letters also come with a significant number of "translation tags", giving minority ethnic groups the means by which they can receive further information. They also include contact information for benefit support – though it should be noted that district heating charges do not qualify for housing benefit.

Resource Implications

27. This report is entirely concerned with the Council's ring-fenced Heating account for 2006/07.

Consultation

28. The original decision on district heating charges was subject to extensive consultation, involving Tenant Council, Area Forums and Leaseholder Council before being presented to the Executive for consideration.

Supplementary Advice from Other Officers

29. This report supplies additional information for the Executive on a specific element within the HRA budget, which has already been approved, and so advice from other officers over and above that supplied with the HRA Budget and Rent-Setting Report on 31 January 2006 was not felt to be necessary.

Reason for Lateness

30. The reason for lateness is on order to reflect the desire of the Executive for a report to be tabled for them as soon as practically possible. The original Executive decision (Appendix D), was for this to be at "*the next meeting*" after January 18 2006, but in terms of the Council Diary, that was not possible. The meeting of February 14, being within 1 calendar month, is the earliest opportunity to meet that request.

Background Papers	Held At	Contact
Executive Report - District Heating Account – Review of Charges (October 11 2005)	9 Larcom Street	Shaun Regan 51232

LIST OF APPENDICES

- Appendix A** Audit Trail
Appendix B Executive Report October 11 2005
Appendix C Motion from Council Assembly December 7 2005
Appendix D Executive Decision January 18 2006

APPENDIX A

Audit Trail

Lead Officer	Keith Broxup (Strategic Director of Housing)	
Report Author	Ian Young (Senior Finance Manager Housing)	
Version	Final version	
Dated	2 February 2006	
Key Decision?	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	Comments Sought	Comments included
Borough Solicitor & Secretary	No	No
Chief Finance Officer	No	No
List other Officers here	None	None
Executive Member	No	No
Date final report sent to Constitutional Support Services	2 February 2006	

APPENDIX B – EXECUTIVE REPORT OF OCTOBER 11 2006

Item No.	Classification: Open	Date: 11.10.2005	Meeting: Executive
Report title:		District Heating Account – Review of Charges	
Ward(s) or groups affected:		All	
From:		Strategic Director of Housing	

Summary

1. The Heating Account is a notional ring-fenced account within the HRA, comprising the expenditure and income associated with the provision of district heating to tenants and leaseholders.
2. At its meeting on 1st February 2005, in addition to agreeing the HRA budget for 2005/06, the Executive resolved to receive a further report on District Heating Account charges in the autumn following further assessment of the impact of changes to relevant gas supply contracts (agenda item 21, resolution part 5).

Recommendations

3. Executive is requested to agree the proposed increase of 29% in district heating charges arising from industry wide fuel price rises. This equates to an increase of £1.80 per week on average, and takes effect from 21st November 2005.
4. Executive are requested to consider the recommendations of Tenant Council (if any), who considered this report on both 15th August and, following consultation with Area Forums, 6th October 2005. Any relevant decision of Tenant Council will be circulated separately.
5. Leaseholder Council were also consulted on this report, considering it at their meeting of 26th September 2005. They did not submit a specific response.

Background

6. Housing Committee on 14th November 1994 agreed to establish a 'notional' heating account within the HRA with effect from 1st April 1995. The purpose was to ring-fence the costs and income associated with the provision of district heating in a separate account, comprising gas, electricity, oil & energy management, etc., offset by income from tenants & leaseholders, and recharges to other departments for non-HRA buildings linked to the district heating system.

7. Surpluses or deficits were to be retained within the heating account for future years - the intention being threefold. Firstly, to ensure that fluctuations in demand for heating due to the severity of the weather or other circumstances, could be smoothed out between years. Secondly, that cost savings arising from contract negotiations or price variations could not be used to cross-subsidise mainstream HRA activities; and thirdly, that surpluses could be used to fund energy efficiency measures to the district heating system which would in turn generate further savings over the long-term. The cost of repairing and maintaining the district heating system remains outside the scope of the heating account.
8. The Council's policy is to recover the full cost of fuel used by district heating systems and energy management costs through a heating charge, which is additional to tenant's rent and forms a separate element of the annual service charge to leaseholders. Heating charges are fixed annually in line with the rent setting timetable, by comparing projected income against projected expenditure with the aim that the two should balance.
9. The main factors affecting the heating account are:
 - Fuel prices
 - Length of the heating season
 - Weather severity
 - System reliability
 - Energy efficiency
 - Balance between tenanted and leasehold properties.
10. Since its inception, the heating account has aggregated savings mainly on the expenditure side, through a combination of reduced consumption and lower energy prices derived through industry deregulation and increased competition in the sector over the last decade. Surpluses generated have been appropriated to a specific reserve, with the balance being periodically applied to fund investment in energy efficiency measures on district heating systems.
11. A key driver for the heating account is the weather and length of the heating season. The core heating season is from 1st October to 30th April (7 months inclusive), with flexibility to extend by up to eight weeks either at the beginning or end of the season, or a combination of both, depending on weather conditions. Typically, over recent years, where it has been necessary to extend the season, this has only been for a few days and therefore the additional costs were limited. However, at the maximum (9 months inclusive), the cost implications would be significantly greater and would create additional pressure on the heating account budget.

Supply Contracts

12. Southwark Council is a founder member of the London Utilities Consortium (LUC), which was established following the de-regulation of the utilities markets in the 1990's. The primary aim of the consortium is to procure contracts for utility supplies on the most favourable terms through the combined purchasing power of member authorities, and this has operated successfully over the period to achieve value for money for the Council.
13. The UK now has fully competitive gas and electricity markets across all sectors (from domestic to industry). Wholesale prices are highly volatile and the market operates and fixes prices on a daily basis, in relation to both UK and international economic conditions.
14. UK gas prices were at historic low values during the 1990's due to competition within the utility markets. However, in 2000 gas prices more than doubled and have demonstrated a steadily increasing trend since then. Current market analyst predictions are that 2005 contract prices will be approximately 60% higher than 2003 contract prices. Likewise electricity contracts are predicted to be a minimum 40% higher than the 2004 contract prices.
15. Southwark has, or is in the process of procuring 7 principal energy contracts, of which 5 have direct relevance to the district heating account, predominantly gas supply contracts. Suppliers are holding tender prices for very short periods, requiring tenders to be assessed and selected in extremely short timescales. For contract letting purposes, it is necessary to establish a baseline against which bids can be assessed. The percentage price increases quoted represent the increase over the prices when these contracts were last let, based on similar volumes. All of these contracts run for 2 years. The table below sets out the position with regard to these contracts.

Utility	Contract	Renewal date	% contract price increase
Electricity	100kw+ sites	31 Oct 2005	42% (estimated)
Electricity	100kw- sites	31 Mar 2006	50% (indicative)
Gas	Interruptible supply	31 July 2005	104% (actual)
Gas	25kt+ sites	31 Jan 2007	53% (actual)
Gas	25kt- sites	31 Oct 2006	40% (actual)

Source: Corporate Procurement - Strategic Services

Charging Issues

16. There are approximately 18,400 dwellings that receive heating and hot water services via the district heating system, broadly comprising 15,200 tenanted and 3,200 leasehold.
17. For tenants, costs are pooled and a matrix of standard charges has been established, to reflect the size of property and the type of heating/ hot water services provided. In principle these are updated annually to cover inflation. In practice, charges were frozen for a number of years, until 2004/05, when they were raised by RPI @ 2.8% and again in 2005/06 by RPI @ 3.1%. The current schedule of charges for 2005/06 applicable to tenants is shown below.

18. For leaseholders, there is no standard charge; they are charged on a full cost recovery basis. At the beginning of each financial year, estimates setting out all aspects of their service charges (of which heating and hot water is one) are produced and sent to leaseholders. Once the accounts for that year are closed and signed-off by the Audit Commission as part of its annual audit of the Council's accounts, leaseholder bills are actualised to reflect the actual costs incurred costed down to estate or block level, and apportioned in relation to the number of bedrooms in each property.
19. Unlike for tenants, the timetable for leaseholders presented the opportunity to incorporate an estimated increase in fuel prices as the start of this financial year, whereas the increase for tenants has been delayed until the autumn.

Heating Account Budget

20. The district heating account budget was set as part of the overall HRA budget for 2005/06, and charges were increased in line with general inflation (RPI @ 3.1%), from April 2005. At the time, the Council was aware of the potential scale of industry wide price increases, but there was insufficient lead-in time to consider the implications fully, given the budget timetable. The Executive in February 2005 agreed to receive a report back in the autumn, once proper consideration of the implications had been assessed.
21. In assessing the budget gap and consequent increase in charges required to balance the account, it should be borne in mind that there are a number of variables, which influence the position. It is necessary to make judgements in relation to these variables based on current and historical data and experience, and assess the associated risks inherent in those judgements and estimates.
22. Another factor to be considered is the comparative trading position of the heating account over recent years. On the positive side, due to a combination of factors, but predominantly linked to lower consumption, this has provided scope within the budget to absorb some of the cost increase. At the end of 2004/05, the accumulated balance was £1.536m, which is available to fund higher costs in the short-term. Current expectations are that a trading loss will occur in 2005/06, estimated at £1.2m to £1.5m, although this will be dependant on the severity of the weather and length of the heating season.
23. The projected shortfall between costs and income at its present level is £1.3m which equates to an increase of 29% overall. This represents a prudent balance between higher fuel prices and potential fluctuations in demand due to the weather, and the need to ensure the account is kept in balance over the medium term to April 2007, when charges will again be reviewed, taking on board subsequent contract re-tendering and further contract price increases.

24. Currently, the average weekly charge for tenants is £6.21 (£323 annually). The budget is predicated on the estimated number of district heating units at the mid-point of the financial year, having regard to movements between tenanted and leasehold stock or other stock changes. The tables below compare the existing charging matrix for tenants, against the revised matrix incorporating the proposed increase.

Existing Weekly Charges (£p)	0	1	2	3	4	5	6	7	8	9	10
Central Heating + Hot Water	3.98	5.58	6.91	8.27	8.93	9.59	10.28	10.92	11.72	16.52	18.96
Weatherfoil Heating & Hot Water	3.35	4.80	5.99	7.18	7.78	8.35					
Weatherfoil Heating only	2.53	3.13	3.77	4.40							
Central Heating only	3.11	3.91	4.68		5.86	6.26					
Hot Water only			2.24	2.77							
LRB Heating	2.70	4.02	4.36	4.70							
Partial Heating	2.12	2.60									
Electric Heating	3.17	3.52	3.87	4.22							

Average weekly charge	6.21
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Source: iWorld via ISMS

Proposed Weekly Charges (£p)	0	1	2	3	4	5	6	7	8	9	10
Central Heating + Hot Water	5.13	7.20	8.91	10.67	11.52	12.37	13.26	14.09	15.12	21.31	24.46
Weatherfoil Heating & Hot Water	4.32	6.19	7.73	9.26	10.04	10.77					
Weatherfoil Heating only	3.26	4.04	4.86	5.68							
Central Heating only	4.01	5.04	6.04		7.56	8.08					
Hot Water only			2.89	3.57							
LRB Heating	3.48	5.19	5.62	6.06							
Partial Heating	2.73	3.35									
Electric Heating	4.09	4.54	4.99	5.44							

Average weekly charge	8.01
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Source: iWorld via ISMS

Consultation

25. The Council has, under its Tenancy Management Agreement agreed to consult with stakeholders in respect of its rent and charges. The timetable for consultation is set out below.
26. Tenant Council were asked to give preliminary consideration to the report on 15th August and the report was then referred to all Area Forums and Leaseholder Council. Tenant Council then reconsidered the report on 6 October, with the intention of making consolidated recommendations to the Executive for consideration at this meeting.

27. Variations to tenants' rents and other charges are subject to a statutory 28 day notification period under the secure tenancy agreement. Pending agreement by the Executive on the 11th October, the schedule of revised district heating charges will become effective from 21st November 2005.

Forum	Date
Tenant Council	15 August 2005
Area Forums	August/September 2005
Leasehold Council	26 September 2005
Tenant Council	6 October 2005
Executive	11 October 2005

Supplementary Advice From Other Officers

28. **Borough Solicitor & Secretary** – statutory requirements as to the keeping of a Housing Revenue Account (HRA) are contained in the Local Government & Housing Act 1989. The provisions include a duty under Section 76 of the Act, to budget to prevent a deficit on the HRA and to implement and review the budget as required.
29. Under Section 24 of the Housing Act 1985, local authorities have the power to “make such reasonable charges as they may determine for the tenancy or occupation of their dwellings”. That statutory provision also requires local authorities, from time to time, to review rents and charges as circumstances may require.
30. Rent payable is excluded from the statutory definition of matters of housing management in respect of which local authorities are required to consult their tenants pursuant to Section 105 of the Housing Act 1985. However, as a term of the secure tenancy agreement with its tenants, Southwark Council has undertaken to consult with Tenant Council, “before seeking to vary the sums payable for rents and charges”.
31. **Chief Finance Officer** – the financial implications have been addressed in the main body of the report.

Background Documents

Background Papers	Held At	Contact
Housing Committee – District Heating report (14 November 1994)	Housing Finance – Larcom Street SE17 1RX	Ian Young 020 7525 7849
Executive – HRA Budget & Rent Setting report – (1 February 2005)		
Tenant Council – District Heating Account Review of Charges (15 August 2005)		
Corporate Procurement (Strategic Services) – Gateway 1 & 2 reports (various)		
iWorld (District Heating statistical analysis)		
SAP (Heating Account Budget and I&E)		

APPENDIX A

Audit Trail

Lead Officer	Keith Broxup (Strategic Director of Housing)	
Report Author	Ian Young (Senior Finance Manager Housing)	
Version	Final version	
Dated	29 September 2005	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER		
Officer Title	Comments Sought	Comments included
Borough Solicitor & Secretary	Yes	Yes
Chief Finance Officer	Yes	Yes
<i>List other Officers here</i>	None	None
Executive Member	Yes	No
Date final report sent to Constitutional Support Services		

APPENDIX C – MOTION FROM COUNCIL ASSEMBLY (DECEMBER 7 2005)

Motion 3 – Council Assembly 7th December 2005

MOTION FROM COUNCILLOR PAUL BATES Seconded by Councillor Charlie Smith

Heating Charges for Council Tenants

Council assembly condemns the proposed increases of 33% in hot water and heating charges to Southwark's tenants and residents.

While council assembly recognises increases in wholesale gas and electricity prices, council assembly believes the proposed increase to be excessive.

Council assembly believes such an increase to be an affront especially to those residents living on certain estates who have had to endure regular breakdowns and failures of the heating and hot water systems in recent years.

Council assembly calls upon officers to bring forward a new and comprehensive report as a matter of urgency which will be made available to members and tenant council outlining how the 33% increase was arrived at, and what additional increases were proposed and why they were deemed to be insufficient.

Council assembly calls upon the executive to re-examine the proposal of a 33% increase on heating and hot water charges, taking note of the overwhelming dissatisfaction with the new charges on the part of tenant council and individual tenants and residents associations.

Council assembly further requests the executive to closely examine innovative ways of supplying heating and hot water systems including application for government grants to fund feasibility studies to explore renewable energy schemes such as solar photovoltaic panels, wind turbines, solar water heating, ground source heat pumps, biomass and small scale hydro systems, and requests that a report be brought back to council assembly as quickly as practicably possible.

APPENDIX D – MINUTES OF EXECUTIVE MEETING (JANUARY 18 2006)

[The following is an extract from the full minute of Agenda item 7, which also related to other referred motions.]

7. MOTIONS REFERRED FROM COUNCIL ASSEMBLY – DECEMBER 7 2005

Heating Charges for Council Tenants

- RESOLVED:**
1. That the motion be noted.
 2. That officers bring to the next meeting a comprehensive report referred to in paragraph 4 of the motion which will be made available to provide those residents who are charged for district heating and hot water with a clear and comprehensive explanation of the increase setting it in the appropriate context in relation to time and increases in fuel costs.