

CRC (CARBON REDUCTION COMMITMENT) ENERGY EFFICIENCY SCHEME PHASE II PURCHASE OF CARBON ALLOWANCES

Cabinet Member(s)	Councillor Jonathan Bianco
Cabinet Portfolio(s)	Finance, Property and Business Services
Officer Contact(s)	Richard Coomber, Residents Services
Papers with report	None

1. HEADLINE INFORMATION

Summary	Cabinet approval is sought on the strategy to purchase CRC carbon allowances in Phase II of the CRC Energy Efficiency Scheme (April 2014 to March 2019.)
Contribution to our plans and strategies	Fulfil the Council's statutory obligations under the CRC Energy Efficiency Scheme.
Financial Cost	£604,781 of CRC carbon allowances for 38,768 (tCO ²) April 2014 to March 2017 (Purchase June 2014)
Relevant Policy Overview Committee	Corporate Services & Partnerships
Ward(s) affected	All

2. RECOMMENDATION

That Cabinet:

- 1) Authorise officers to order £604,781 of CRC carbon allowances in the April 2014 forecast sale for the projected carbon emissions in the first three compliance years of the CRC Energy Efficiency Scheme Phase II (2014-2015 to 2016-2017). Payment for these allowances will be made in June 2014 and;
- 2) Note that officers will review the strategy and forecasts annually for purchasing CRC carbon allowances for the future compliance years of CRC Phase II (April 2017 - March 2019) in future allowance sale windows.

Reasons for recommendation

The price of carbon in the April 2014 forecast sale of £15.60 per tonne of carbon dioxide (tCO²) will be at its lowest point during Phase II of the CRC Energy Efficiency Scheme (April 2014 to March 2019.) In the 2012 Autumn Statement Government stated that the price of carbon would

rise in line with the RPI (Retail Price Index) from 2015-16 and in subsequent years of the scheme.¹

The recommendation will ensure compliance with the CRC Energy Efficiency Scheme Order 2013.

Alternative options considered / risk management

The Council could decide to purchase CRC allowances in the forecast sales in the April of each compliance year, but this approach would increase costs as the price of carbon is due to increase by RPI (Retail Price Index) from 2015-16.

The Council could decide to purchase CRC allowances retrospectively in the July following each compliance year in the buy to comply sale, but this approach would increase costs further due to the differential in the price of carbon compared to the forecast sale (80 pence per tCO² in 2014-15) and the impact of RPI (Retail Price Index) from 2015-16 onwards.

The risks associated with advanced purchasing are considered minimal as the CRC allowances for the future years of Phase II (2017-2019) will not be purchased in April 2014. Due to the Government's 2016 review of CRC, the 2014-17 period is being considered as part of this report.

Policy Overview Committee comments

None at this stage.

3. INFORMATION

Supporting Information

As reported to Cabinet on 26th September 2013, the London Borough of Hillingdon is required to participate in Phase II of the CRC Energy Efficiency Scheme. Registration for Phase II of the scheme was fully completed on 25th November 2013. As in Phase I of the scheme participants are required to submit an Annual Report to the Environment Agency and purchase and surrender carbon allowances for their emissions (tonnes carbon dioxide tCO²) from DECC (Department of Energy and Climate Change).

The Government's simplification of the CRC Energy Efficiency Scheme introduced changes effective in Phase II (April 2014 to March 2019).

The most significant change from the commencement of Phase II of the scheme is the removal of state funded schools from CRC and the inclusion of all emissions from un-metered (UMS) street lighting supplies. A projection of annual emissions based on the revised rules for CRC Phase II is given in Table 1 below.

Table 1 Phase II Annual CRC Emissions (tCO²)

Annual Emissions CRC Phase II	15,507
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¹ HM Treasury Autumn Statement 5th December 2012 p71

Phase II of the CRC will also revise the process for the purchase of CRC allowances with a 'forecast sale' in the April of each compliance year, in addition to the retrospective 'buy to comply' sale in the July following each compliance year. The price of carbon will be lower in the forecast sale than the buy to comply sale to incentivise participants to forecast their carbon emissions. The 2013 Autumn Statement confirmed that for the compliance year April 2014 to March 2015 CRC allowances will be £15.60 per tonne of carbon dioxide in the forecast sale and £16.40 per tonne of carbon dioxide in the buy to comply sale. ²

The April 2014 forecast sale presents the Council with an opportunity to purchase CRC allowances for future years of CRC Phase II (2014-2015 to 2016-2017) at the price of £15.60 per tonne of carbon dioxide. CRC allowances ordered in April 2014 will remain valid for all compliance years within Phase II (2014-2015 to 2018-2019). The price of carbon will rise in line with the RPI (Retail Price Index) from the 2015-16 compliance year onward. In April 2014 therefore the price of carbon will be at its lowest point during Phase II of the scheme (April 2014 to March 2019).

There is a planned Government review of the effectiveness of the CRC in 2016, therefore it is proposed to purchase two and a half years allowances based on current annual emissions, in the 2014 advance sale. This aligns with guidance of a prudent approach from the London Energy Project.

Table 2 below sets out the projected annual emissions and CRC allowance cost in Phase II and the proposed cost of a three year CRC allowance order made in April 2014. The allowance costs presented are based on the April 2014 forecast sale price of £15.60 per tonne of carbon dioxide.

Table 2 Phase II CRC Allowances

£ 'Forecast sale' Carbon Price (£/tCO²)	Annual Emissions (tCO²)	£ Annual CRC Allowances	Emissions tCO² (2014-2015 to 2016-2017)	£ CRC Allowances (2014-2015 to 2016-2017)
15.60	15,507	241,909	46,521	725,727
Two and a half years (based on current annual emissions) in April 2014			38,768	604,781

CRC allowances cannot be transferred between Phases of the scheme and therefore there is a risk of over purchasing allowances if emissions projections are not accurate. This risk is managed in the recommendation by only ordering CRC allowances in April 2014 for the first three years of CRC Phase II (2014-2015 to 2016-2017). Purchase of CRC allowances for the future years of Phase II (April 2017 - March 2019) can be reviewed and made at subsequent allowance sale windows and adjustments made for any reductions due to energy efficiency measures or changes to the property portfolio. This strategy allows for possible changes in the 2016 review to be considered, as more information becomes available and therefore takes a prudent approach to avoid over purchase of allowances.

Emissions are unlikely to vary dramatically between compliance years as the Civic Centre (4,540 tCO²) and street lighting (5,387 tCO²) combined account for 64% of overall emissions (or

² HM Treasury Autumn Statement 5th December 2013 p.93

£154,861 in allowances at the rate of £15.60 per tCO²).³ Emissions from street lighting are expected to grow in the region of 1-1.5% per annum in spite of energy reduction measures due to the requirement to provide street lighting for new developments.

Financial Implications

The report above is proposing a procurement strategy for the purchase of carbon allowances for Phase II of the CRC Energy Efficiency Scheme which runs from April 2014 to March 2019.

The cost of purchasing 38,768 (tCO²) CRC allowances in advance for the CRC compliance years 2014-2015 to 2016-2017 will be £604,781. This figure is based on the projected annual emissions outlined in Table 1 and the purchase being made in the April 2014 'forecast sale' window at the rate of £15.60 per tonne of carbon dioxide. Payment for these allowances must be made to DECC (Department of Energy and Climate Change) between 2nd June and 20th June 2014.

There would be a cash outflow in June 2014 with the purchase in advance. However, with low interest rates, the RPI increase and the benefit of the price differential between the 'advance' and 'buy to comply' price, by purchasing allowances for 38,768 tCO² for 2.5 years in advance the amount paid for CRC allowances would be reduced by £44,832 based on an assumed rate of RPI of 2.7%. The estimates for emissions will be reviewed for future advance purchases for the remainder of 2016/17 and future years to take advantage of the price differential where possible, however, there is anticipated to be an amount purchased at the 'buy to comply' price, at the end of the phase, to avoid over purchasing.

Table 3 below indicates the impact that 2.7% RPI increase would have on the purchase price of CRC allowances over the phase II period being considered. This illustrates that although the RPI rate is uncertain, ordering allowances in April 2014 will secure the lowest purchase price.

Table 3 Impact of RPI on £ CRC Allowances

	Apr-14	Apr-15	Apr-16	Apr-17	Apr-18
Buy in advance £ April	15.60	16.02	16.45	16.90	17.35
Buy to comply £ September	16.40	16.84	17.30	17.76	18.24

There is currently a budget of £1,146k in the Medium Term Financial Forecast for CRC allowances over the Phase II period. For the period 2014-15 to 2016-17 the budget is £704k. This includes an assumption of an annual reduction of 5% for energy efficiency. This assumption will be reviewed annually as part of the MTFF process to ensure that these savings are being achieved. The growth of developments in the Borough and therefore street lighting is mentioned in the report and the impact of this and other portfolio changes are the reason an annual review is part of this strategy.

By purchasing allowances for 38,768 tCO² for the first three CRC compliance years (2.5 years of current emissions) and annually reviewing the emissions for future purchase for future years, this procurement strategy is flexible to changes in energy saving measures and the property portfolio. It is not possible to transfer allowances between phases, however CRC allowances

³ 2012-13 CRC Annual Report data.

can be traded to other participants within the CRC Registry which helps to mitigate the risk of over purchasing.

Current accounting guidance requires that a provision is made in the accounts for the financial year they are incurred. The CRC allowances will be a pre purchase to be drawn upon once the Annual Report for CRC is submitted, after the financial year has ended and bills have been finalised for the period.

4. EFFECT ON RESIDENTS, SERVICE USERS & COMMUNITIES

What will be the effect of the recommendation?

In April 2014 the price of carbon will be at its lowest point during Phase II of the CRC scheme (April 2014 to March 2019). Purchasing CRC allowances in advance for the CRC compliance years 2014-2015 to 2016-2017 will help reduce the financial impact of the CRC on Council resources.

Consultation Carried Out or Required

None.

5. CORPORATE IMPLICATIONS

Corporate Finance

Corporate Finance have reviewed this report and concur that in the MTF period, 2014/15 to 2018/19, there is a contingency provision of £1,146k set aside for CRC allowances, with £240k in 2014/15.

The proposal to purchase 2.5 years worth of allowances in advance at a cost of £605k would require expenditure of £365k in excess of the allocated budget within 2014/15. However, as detailed in the Treasury Management Strategy, agreed by Council on 20 February 2014, the Council has sufficient funding available to purchase these allowances without the need for borrowing. The Council's average rate of return on investments is currently around 0.5%, therefore the loss of interest foregone would be less than £3k over this period, compared to the £45k gain derived from the lower purchase price through buying in advance.

As there is uncertainty surrounding the 2016 review of the CRC scheme, the proposal to purchase 2.5 years in advance limits the level of this risk.

Legal

The Climate Change Act 2008 provides for the introduction of domestic emissions trading schemes through secondary legislation. The CRC Scheme was brought in by the CRC Energy Efficiency Scheme Order 2010 and Phase II (and all subsequent phases) is governed by the CRC Energy Efficiency Scheme Order 2013. Participation in the CRC is mandatory for all public sector bodies and large businesses who meet the qualifying energy usage criteria, which as stated in this report includes the Council for the purposes of Phase II.

The Council is required to measure and report its electricity and gas related carbon emissions annually, following a specific set of measurement rules. Following that measurement and reporting the Council is required to buy allowances for every tonne of carbon they emit (relating to electricity and gas), the purchase of those allowances for the years 2014-2015 to 2016-2017 being the subject of recommendation 1 of this report. Officers will review the strategy and forecasts annually for purchasing CRC carbon allowances for the final compliance years of CRC Phase II (April 2017 - March 2019), being the subject of recommendation 2 of this report. A reduction in the Council's consumption of electricity and gas could decrease the level of spending on the CRC in year 2018-2019 and in later phases.

As in Phase I of the scheme participants are required to submit an Annual Report to the Environment Agency and purchase and surrender carbon allowances for their emissions (tonnes carbon dioxide tCO²) from the Department of Energy and Climate Change (DECC). Payment for these allowances must be made to DECC between 2nd June and 20th June 2014. If the Council fails to meet the above requirements, a very significant financial penalty can be imposed on it pursuant to Article 77 of the CRC Energy Efficiency Scheme Order 2013.

Corporate Property and Construction

There are no property and construction implications resulting from the recommendations set out in this report

6. BACKGROUND PAPERS

NIL