City of Richmond

Report to Committee

To:	Finance Committee	**Date:**	August 17, 2023
From:	John Irving, P.Eng., MPA General Manager, Engineering and Public Works Chief Executive Officer, Lulu Island Energy Company Jerry Chong, CPA, CA General Manager, Finance and Corporate Services Chief Financial Officer, Lulu Island Energy Company	**File:**	03-1200-08/2023-Vol 01
Re:	**2023 Q2 Financial Information for the Lulu Island Energy Company**		

Staff Recommendation

That the Lulu Island Energy Company report titled "Lulu Island Energy Company – 2023 2nd Quarter Financial Information", dated July 24, 2023, from the Chief Executive Officer and Chief Financial Officer, be received for information.

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General Manager, Engineering and Public Works
Chief Executive Officer,
Lulu Island Energy Company
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Jerry Chong, CPA, CA
General Manager, Finance and Corporate Services
Chief Financial Officer,
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REPORT CONCURRENCE	
CONCURRENCE OF GENERAL MANAGER	
REVIEWED BY SMT	INITIALS:
APPROVED BY CAO	

Richmond

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Lulu Island ENERGY COMPANY

6911 NO. 3 ROAD
RICHMOND, BC V6Y 2C1

Report

To:	Board of Directors	**Date:**	July 24, 2023
From:	Jerry Chong, CPA, CA, Chief Financial Officer		

Re: **Lulu Island Energy Company – 2023 2nd Quarter Financial Information**

Staff Recommendation

That the 2nd Quarter Financial Information as presented in the report titled "Lulu Island Energy Company – 2023 2nd Quarter Financial Information", dated July 24, 2023, be approved.

Background

Lulu Island Energy Company (LIEC), a corporation wholly-owned by the City of Richmond, was established to provide district energy services on behalf of the City. Information regarding LIEC's district energy utility (DEU) operations can be found in Attachment 1. All capital and operating costs are recovered through revenues from user fees, ensuring that the business is financially sustainable. City Council is the regulator and thus sets customer rates.

This report provides pre-audited financial information to the Board of Directors and LIEC's shareholder, represented by Richmond City Council.

Analysis

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS). LIEC's pre-audited Q2 financial information consists of the interim statement of financial position as of June 30, 2023 (Attachment 2) and the interim income statement for the period ended June 30, 2023 (Attachment 3).

Financial Position

The interim statement of financial position provides a summary of assets, liabilities and shareholder's equity. Total assets are comprised of current assets (cash, investments and receivables) $16,020,433 and non-current assets (plant and equipment) $47,269,509. The total assets are $63,289,942.

The total liabilities of $27,067,461 include outstanding invoices, deferred contributions and Project Agreement liabilities. Included in the accrued liabilities is an amount totalling $645,709, which pertains to the unplanned environmental remediation work related to the pipe construction defect, which resulted in a leak and subsequent clean up of the released heat transfer fluid in the Alexandra District Energy Utility (ADEU). The expenses were accrued in the prior years and there are no additional accruals mid way through 2023. The environmental remediation of the site has progressed significantly and is near completion. LIEC has taken steps to recover the remediation and repair costs from the responsible parties. Year-to-date budget to actual numbers are shown in Attachment 4.

Revenues

The metered billing revenue is the total energy sales of ADEU, and City Center District Energy Utility (CCDEU) service areas (OVDEU is now combined under the CCDEU service area). The year to date metered billings revenue is $1,430,487 from the ADEU and $2,448,876 from the CCDEU. Overall, the first six months of metered billing revenue of $3,879,363 increased by 22% over 2022. This reflects the addition of one new building connection, increased energy use from customers due to increased occupancy, and the approved 2023 rates.

Cost of Sales

The cost of sales is the accumulated total expenses attributable to the metered billing revenue, which includes contract services, utilities (electricity and natural gas), and amortization expenses. The contract expense increased by 69% over 2022 due to the additional operations and maintenance work as a result of more buildings being serviced, including two on-site low carbon energy plants (LCEP); compared to budget, the actual is 14% below budget. The growth in energy demand is due to the addition of more buildings, and operation of the first two on-site LCEP's, resulted in higher use of electricity and natural gas to run distribution pumps, geo-exchange heat pumps, on-site LCEP air source heat pump, auxiliary equipment and boilers, which are used to deliver energy to customers' buildings. This increased demand paired with electricity and gas rate increases caused the utility expense to increase 14% compared to 2022, but within the budget. The amortization expense decreased due to a change in accounting estimate, where LIEC is matching the amortization life of the assets to be the same as in the CCDEU Project Agreement and the Financial Model. The year-over-year cost of sales has increased by 14%. The gross margin as a percentage of revenue is 46% for 2023 compared to 44% in the first six months of 2022.

General and Administration Expenses

General and administration (G&A) expenses are expenditures that LIEC incurs with respect to supporting operations which includes salaries and benefits, administration expenses, professional fees, etc.. Salaries and benefits are higher than last year and 7% higher than budget due to benefits associated with an approved leave of absence and extra support during the year-end audit from City staff. The administration expense increased compared to Q2 2022 mainly due to the CCDEU Project Agreement structure with Corix and CIB; compared to the budget, the administration expense is 14% below budget. The administration expense includes the overhead allocation paid to the City of Richmond for the day-to-day support that LIEC receives from City staff. Insurance expense increased due to the general insurance rate increase, additional assets being insured, and the additional insurance coverage (comprehensive environmental liability) and deductions required under the CCDEU Project Agreement. Professional fees have increased in comparison to Q2 2022 due to expenses related to CCDEU Project Agreement structure with Corix and CIB, as well as additional audit fees in line with the company's growth as additional audit work was required.

Overall, the G&A expenses as a percentage of revenues is 21% compared to 15% in 2022. This is the first year of implementation of the Project Agreement. As with the ADEU and OVDEU projects, the CCDEU initial years' general and administration expenses are projected to increase in the relation to the revenue received from customers. This is due to the initial project operation and administration setup costs necessary for the infrastructure expansion and operation for a project of this scale, as well as the costs required to administer low-interest financing from CIB. As more customers are connected to the utility, the general and administration expenses in relation to the revenue will decrease.

Contributions and Financing Expenses

The contributions and financing expense section represents other sources of income and costs for the business. The developer contributions are lower compared to the 2022 Q2 due to a change in accounting estimate and adjustment for values in 2023. Developer contributions are recognized as revenue over a longer period as the rate matches the amortization rate and adjustments are required to recognize the actual value of the equipment contributed by developers. The developers' contributions are below budget due to the adjustment between estimated and actual value of the equipment contributed by developers and due to the change in accounting estimate.

Other income is made up of energy model review fees. The energy modeling review fee revenues are lower than 2022 due to less than anticipated building permit reviews. The net finance cost is the result of year-to-date finance costs on project agreement liabilities, offset by interest income. Interest income has exceeded the full year budget for 2023, due to the timing of when the budget was prepared and how quickly the interest rates have increase over the past 18 months. LIEC has taken advantage of the higher interest rates and have invested in short term, term deposits which have yielded much higher returns compared to 2022. This has resulted in a variance in the net financing costs in both year-over-year and actuals to budget comparison, which is positive for LIEC.

LIEC's EBITA (earnings before interest, tax, and amortization), used as a proxy to measure the company's financial performance, as a percentage of revenue decreased to 44% compared to 56% in Q2 2022. This is due to the initial operation and administration setup costs necessary for the CCDEU project infrastructure expansion and operation. This is expected and has been encountered in the past with the existing OVDEU and ADEU projects. As more customers are connected to the system, revenues and EBITA will increase. EBITA has exceeded the budget by 15%.

The year-to-date net income of $1,194,321 has exceeded Q2 2022 ($956,168) and the budget ($165,197). Consistent with the company's financial plan objectives, any net income will be maintained in LIEC's equity in order to fund future capital projects and infrastructure replacements.

Financial Impact

None.

Conclusion

The pre-audited financial information shows that LIEC's financial position is positive. This report will be presented to Council for information.

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Att. 1: District Energy in Richmond
2: Interim Statement of Financial Position as of June 30, 2023 (unaudited)
3: Interim Income Statement for the period ending June 30, 2023 (unaudited)
4: Year-To-Date Budget vs. Actual Comparison (unaudited)
5: LIEC Second Quarter Income Statement (unaudited)

District Energy in Richmond

Richmond's 2041 Official Community Plan (OCP) establishes a target to reduce GHG emissions 50 percent below 2007 levels by 2030 and 100 percent by 2050. The City identified district energy utilities (DEUs) as a leading strategy to achieve the City's GHG reduction goals and incorporated Lulu Island Energy Company Ltd. (LIEC) in 2013 for the purposes of carrying out the City's district energy initiatives on the basis of the following guiding principles:

1. The DEU will provide end users with energy costs that are competitive with conventional energy costs, based on the same level of service; and
2. Council will retain the authority of setting customer rates, fees and charges for DEU services.

The City established three DEU service areas: ADEU, OVDEU, and CCDEU. Table 1 below provides a summary of the developments connected to the DEU service areas to-date. Table 1 – DEU Service Areas - Current and Projected Connected Space

	Buildings To-Date	Residential Units To-Date	Floor Area To-Date	Floor Area Build-out
Alexandra DEU	13	2,200	2.4M ft^2	4.4M ft^2
Oval Village DEU	14	3,174	3.7M ft^2	6.4M ft^2
City Centre DEU	2	728	0.8M ft^2	48.0M ft^2
Total	29	6,102	6.9M ft^2	58.8M ft^2

The ADEU provides heating and cooling services to ten residential buildings, the large commercial development at "Central at Garden City", the Richmond Jamatkhana temple, and Fire Hall No. 3, comprising of 2,200 residential units and over 2.4 million square feet of floor area. While some electricity is consumed for pumping and equipment operations, most of this energy is currently produced locally from the geo-exchange fields in the greenway corridor and West Cambie Park, and highly efficient air source heat pumps.

The OVDEU services 14 buildings, containing over 3,100 residential units. Energy is currently supplied from the three interim energy centres with natural gas boilers which provide 16 MW of heating capacity. LIEC received a $6.2 million grant from the CleanBC Communities Fund for the design and construction of the sewer heat recovery technology and a permanent energy centre for the area. Once completed, the system will be able to produce up to 80% of low-carbon energy from the Gilbert Trunk sanitary force main sewer.

The new CCDEU currently services two buildings, comprised of 728 residential units and approximately 800,000 ft^2 of floor area. To-date, future developments in the City Centre service area have already committed 5.5M ft^2 of building floor area for future connection. As permanent energy centres progress through development, CCDEU utilizes on-site low carbon energy plants as a source of energy production. At full build-out, 176 developments, 28,000 residential units and approximately 48M ft^2 of floor space will be serviced by 5 permanent energy centres with over 130 MW of heating and 115 MW of cooling capacity. The built out system is estimated to reduce over 1,000,000 tonnes of GHG emissions compared to conventional service.

Interim Statement of Financial Position (Unaudited)

	As of June 30 2023	As of December 31 2022
Assets		
Current assets:		
Cash and cash equivalents	$ 723,007	$ 3,191,380
Accounts receivable	2,705,546	2,240,807
Investments	12,591,880	12,324,233
	16,020,433	17,756,420
Non-current assets:		
Plant and equipment	47,269,509	45,745,053
	$ 63,289,942	$ 63,501,473
Liabilities and Shareholder's Equity		
Current and non-current liabilities:		
Accounts payable and accrued liabilities	$ 1,579,744	$ 3,852,889
Deferred developer contributions	12,814,901	13,017,815
Government grants	264,742	241,051
Project Agreement liability	12,408,074	11,361,558
	27,067,461	28,473,313
Shareholder's equity:		
Share capital and contributed surplus	27,397,115	27,397,115
Retained earnings	8,825,366	7,631,045
	36,222,481	35,028,160
	$ 63,289,942	$ 63,501,473

Interim Income Statement (Unaudited)

	June 30 2023	June 30 2022	$ Changes	% Change
Revenues				
Metered Billings (Quarterly)	$ 3,879,363	$ 3,189,623	$ 689,740	22%
Service fee	490,743	490,750	(7)	0%
	4,370,106	3,680,373	689,733	19%
Cost of Sales				
Contracts	783,039	464,395	318,644	69%
Utilities	927,183	812,075	115,108	14%
Amortization	659,958	801,424	(141,466)	(18%)
	2,370,180	2,077,894	292,286	14%
Gross margin	**1,999,926**	**1,602,479**	**397,447**	**25%**
General and Administration Expenses				
Salaries and benefits	542,095	431,455	110,640	26%
Administration expenses	172,687	42,720	129,967	304%
Insurance	122,391	47,627	74,764	157%
Professional Fees	90,921	33,750	57,171	169%
	928,094	555,552	372,542	67%
Net income before other items	1,071,832	1,046,927	24,905	2%
Contributions and Financing expense				
Developer contributions	180,774	184,055	(3,281)	(2%)
Other income	394	45,862	(45,468)	(99%)
Net financing cost	(58,679)	(320,676)	261,997	(82%)
	122,489	(90,759)	213,248	(235%)
Net Income	**$1,194,321**	**$956,168**	**$238,153**	**25%**

Earnings before interest, taxes and amortization (EBITA)

Net income per above	$ 1,194,321	$ 956,168	$238,153	25%
Net Financing cost	58,679	320,676	(261,997)	(82%)
Amortization expense	659,958	801,424	(141,466)	(18%)
EBITA	$1,912,958	$2,078,268	($165,310)	(8%)

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Notes:

	Ending June 30 2023	Ending June 30 2022
Percentage of Revenue		
Gross margin percentage	46%	44%
General and administration percentage	21%	15%
Net income percentage	27%	26%
EBITA percentage	44%	56%

Year-To-Date Budget vs. Actual Comparison (Unaudited)

	2023 Q2 Budget	2023 Q2 Actual	$ Variance	%Variance
Revenues				
Metered Billings (Quarterly)	$3,718,663	$ 3,879,363	160,700	4%
Service fee	490,743	490,743	-	-%
	4,209,406	4,370,106	160,700	4%
Cost of Sales				
Contracts	915,188	783,039	(132,149)	(14%)
Utilities	928,157	927,183	(974)	0%
Amortization	975,717	659,958	(315,759)	(32%)
	2,819,062	2,370,180	(448,882)	(16%)
Gross margin	**1,390,344**	**1,999,926**	**609,582**	**44%**
General and Administration Expenses				
Salaries and benefits	504,275	542,095	37,820	7%
Administration expenses	201,260	172,687	(28,573)	(14%)
Insurance	167,361	122,391	(44,970)	(27%)
Professional Fees	99,500	90,921	(8,579)	(9%)
	972,396	928,094	(44,302)	(5%)
Net income before other items	417,948	1,071,832	653,884	156%
Contributions and Financing expense				
Developer contributions	252,542	180,774	(71,768)	(28%)
Other income	13,500	394	(13,106)	(97%)
Net financing cost	(518,793)	(58,679)	460,114	(89%)
	(252,751)	122,489	375,240	(148%)
Net Income	**$165,197**	**$1,194,321**	**$1,029,124**	**623%**

Earnings before interest, taxes and amortization (EBITA)				
Net income per above	$165,197	$1,194,321	$1,029,124	623%
Net Financing cost	518,793	58,679	(460,114)	(89%)
Amortization expense	975,717	659,958	(315,759)	(32%)
EBITA	$1,659,707	$1,912,958	$253,251	15%

LIEC Second Quarter Income Statement

	2023 Q2 Actual	2022 Q2 Actual	$ Variance	%Variance
Revenues				
Metered Billings (Quarterly)	$ 1,908,146	$ 1,586,219	$321,927	20%
Service fee	245,372	245,375	(3)	0%
	2,153,518	1,831,594	321,924	18%
Cost of Sales				
Contracts	471,335	287,118	184,217	64%
Utilities	473,877	417,910	55,967	13%
Amortization	297,198	406,923	(109,725)	(27%)
	1,242,410	1,111,951	130,459	12%
Gross margin	**911,108**	**719,643**	**191,465**	**27%**
General and Administration Expenses				
Salaries and benefits	252,738	222,882	29,856	13%
Administration expenses	80,643	21,628	59,015	273%
Insurance	52,232	18,877	33,355	177%
Professional Fees	41,701	-	41,701	100%
	427,314	263,387	163,927	62%
Net income before other items	483,794	456,256	27,538	6%
Contributions and Financing expense				
Developer contributions	69,683	98,517	(28,834)	(29%)
Other income	-	43,917	(43,917)	(100%)
Net financing cost	(58,292)	(162,133)	103,841	(64%)
	11,391	(19,699)	31,090	(158%)
Net Income	**$495,185**	**$436,557**	**$58,628**	**13%**

Earnings before interest, taxes and amortization (EBITA)				
Net income per above	$ 495,185	$ 436,557	$ 58,628	13%
Net Financing cost	58,292	162,133	(103,841)	(64%)
Amortization expense	297,198	406,923	(109,725)	(27%)
EBITA	$ 850,675	$1,005,613	($154,938)	(15%)