City of Richmond

Report to Committee

To:	Finance Committee	**Date:**	May 19, 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 Q1 Financial Information for the Lulu Island Energy Company**		

Staff Recommendation

That the Lulu Island Energy Company report titled "2023 Q1 Financial Statements for the Lulu Island Energy Company", dated May 19, 2023, from the Chief Executive Officer and Chief Financial Officer, be received for information.

John Irving, P.Eng., MPA
General Manager, Engineering
Public Works
Chief Executive Officer,
Lulu Island Energy Company
(604-276-4140)

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: ACI
APPROVED BY CAO	

Richmond

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Lulu Island ENERGY COMPANY

6911 NO. 3 ROAD
RICHMOND, BC V6Y 2C1

Report

DATE: May 2, 2023

TO: Board of Directors

FROM: Jerry Chong, CPA, CA, Chief Financial Officer

Re: **Lulu Island Energy Company – 2023 1st Quarter Financial Information**

Staff Recommendation

That the 1st Quarter Financial Information as presented in the report titled "Lulu Island Energy Company – 2023 1st Quarter Financial Information", dated May 2, 2023, be approved.

Background

In 2022, Lulu Island Energy Company (LIEC) terminated the Concession Agreement and entered into a new project agreement (Project Agreement) with Corix Utilities Inc. (Corix) and the Canada Infrastructure Bank (CIB) to design, build, finance, operate, and maintain City Center District Energy Utility (CCDEU) infrastructure providing heating and cooling services to over 170 new residential and mixed-use commercial developments by 2050. The concession agreement was re-negotiated, re-financed, and included within the new project agreement. The first two developments in the CCDEU service area comprising of over 790,000 square feet and over 720 residential units was connected in 2022. The CCDEU project is expected to reduce green house gases (GHG) emissions by one million tonnes by 2050 (Attachment 1).

LIEC owns and operates district energy utility (DEU) infrastructure within the service areas. 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 as noted in the principles above.

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 Q1 financial information consists of the interim statement of the financial position as of March 31, 2023 (Attachment 2) and the interim income statement for the period ended March 31, 2023 (Attachment 3).

Financial Position

The interim statement of the financial position provides a summary of assets, liabilities and shareholder's equity. Total assets are comprised of current assets (cash, investments and receivables) $16,022,379 and non-current assets (plant and equipment) $46,513,803. The total assets are $62,536,182.

The total liabilities of $26,808,884 include outstanding invoices, deferred contributions and Project Agreement liabilities. Included in the accrued liabilities is an amount totalling $694,748, which pertains to the unplanned environmental remediation work related to a pipe construction defect, which resulted in a leak and subsequent clean up of the released heat transfer fluid in the Alexandra DEU service area. The expenses were accrued in the prior years and there are no additional accruals in the first quarter. 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.

The shareholder's equity represents the net worth of the company. It is equal to the total assets minus its total liabilities and measures the company's financial health. As of March 31, 2023, LIEC's shareholder equity is $35,727,298, showing good financial health of the company. Year-to-date budget to actual numbers are shown in Attachment 4.

Revenues

The metered billing revenue is the total energy sales of Alexandra District Energy Utility (ADEU), Oval Village District Energy Utility (OVDEU) and CCDEU service areas. The year to date metered billings revenue is $723,358 from the ADEU, $1,014,955 from the OVDEU and $232,904 from the CCDEU. Overall, the first three months of metered billing revenue of $1,971,217 increased by 23% over 2022. This reflects the addition of three new building connections in 2022, increased energy use from customers due to increased occupancy, and the approved 2023 rates. The year-to-date metered billings revenue has exceeded budget due to increased energy use as a result of increased occupancy.

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 76% 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 32% below budget. The growth in energy demand, due to the addition of more buildings, and operation of the first two on-site

LCEP's, resulted in an increased use of electricity and natural gas to run the generation, distribution and auxiliary equipment used to deliver energy to customers' buildings. This increased demand paired with electricity and gas rate increases caused the utility expense to increase 15% compared to Q1 2022, and by 1% lower compared to budget. The amortization expense decreased due to an adjustment to the capital asset additions from 2022. The year-over-year cost of sales has increased by 17%. The gross margin as a percentage of revenue is 49%, which is in line with last year.

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 15% 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 Q1 2022 mainly due to the Project Agreement structure with Corix and CIB, compared to the budget, the administration expense is 9% below budget. The administration expense also 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 Project Agreement. Professional fees have increased in comparison to Q1 2022 due to expenses related to Project Agreement structure with Corix and CIB, as well as additional audit fees in line with the company's growth as additional audit work is required.

Overall, the G&A expenses as a percentage of revenues are 23%, compared to 16% last year. 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 higher than 2022 due to additional onsite assets being placed into service. The developers' contributions are below budget due to the adjustment between estimated and actual value of the equipment contributed by developers.

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 48% compared to 58% in 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 30%.

The year-to-date net income of $699,139 has exceeded Q1 2022 ($519,609) and the budget ($68,094). 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.

Johana Vuletin　　　　　*Cody Lan*

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Att. 1: District Energy in Richmond
2. Interim Statement of Financial Position as of March 31, 2023 (unaudited)
3: Interim Income Statement for the period ending March 31, 2023 (unaudited)
4: Year-To-Date Budget vs. Actual Comparison (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 District Energy Utility	13	2,200	2.4M ft^2	4.4M ft^2
Oval Village District Energy Utility	13	3,007	3.5M ft^2	6.4M ft^2
City Centre District Energy Utility	2	728	0.8M ft^2	48.0M ft^2
Total	**28**	**5,935**	**6.7M 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 over 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 13 buildings, containing over 3,000 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.

Interim Statement of Financial Position (Unaudited)

	As of March 31 2023	As of December 31 2022
Assets		
Current assets:		
Cash and cash equivalents	$ 933,028	$ 3,191,380
Accounts receivable	2,605,593	2,240,807
Other investments	12,483,758	12,324,233
	16,022,379	17,756,420
Non-current assets:		
Plant and equipment	46,513,803	45,745,053
	$ 62,536,182	$ 63,501,473
Liabilities and Shareholder's Equity		
Current and non-current liabilities:		
Accounts payable and accrued liabilities	$ 2,227,422	$ 3,852,889
Deferred developer contributions	12,906,723	13,017,815
Government grants	241,051	241,051
Project Agreement liability	11,433,688	-
Concession Agreement	-	11,361,558
	26,808,884	28,473,313
Shareholder's equity:		
Share capital and contributed surplus	27,397,115	27,397,115
Retained earnings	8,330,183	7,631,045
	35,727,298	35,028,160
	$ 62,536,182	$ 63,501,473

Interim Income Statement (Unaudited)

	March 31 2023	March 31 2022	$ Changes	% Change
Revenues				
Metered billings (Quarterly)	$ 1,971,217	$ 1,603,403	$ 367,814	23%
Service fee	245,372	245,375	(3)	0%
	2,216,589	1,848,778	367,811	20%
Cost of Sales				
Contracts	311,704	177,277	134,427	76%
Utilities	453,305	394,165	59,140	15%
Amortization	362,760	394,502	(31,742)	(8%)
	1,127,769	965,944	161,825	17%
Gross margin	**1,088,820**	**882,834**	**205,986**	**23%**
General and administration expenses				
Salaries and benefits	289,357	208,573	80,784	39%
Administration expenses	92,045	21,093	70,952	336%
Insurance	70,159	28,750	41,409	144%
Professional fees	49,220	33,750	15,470	46%
	500,781	292,166	208,615	71%
Net income before other items	588,039	590,668	(2,629)	0%
Contributions and financing expense				
Developer contributions	111,092	85,539	25,553	30%
Other income	394	1,944	(1,550)	(80%)
Net financing cost	(386)	(158,542)	158,156	(100%)
	111,100	(71,059)	182,159	(256%)
Net Income	**$ 699,139**	**$ 519,609**	**$ 179,530**	**35%**

Earnings before interest, taxes and amortization (EBITA)				
Net income per above	$ 699,139	$ 519,609	$ 179,530	35%
Net financing cost	386	158,542	(158,156)	(100%)
Amortization expense	362,760	394,502	(31,742)	(8%)
EBITA	$ 1,062,285	$ 1,072,653	($ 10,368)	(1%)

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Notes:

	Ending March 31 2023	Ending March 31 2022
Percentage of Revenue		
Gross margin percentage	49%	48%
General and administration percentage	23%	16%
Net income percentage	32%	28%
EBITA percentage	48%	58%

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

	2023 Q1 Budget	2023 Q1 Actual	$ Variance	%Variance
Revenues				
Metered Billings (Quarterly)	$ 1,837,356	$ 1,971,217	$ 133,861	7%
Service fee	245,371	245,372	1	0%
	2,082,727	2,216,589	133,862	6%
Cost of Sales				
Contracts	457,594	311,7047	(145,890)	(32%)
Utilities	456,609	453,305	(3,304)	(1%)
Amortization	487,858	362,760	(125,098)	(26%)
	1,402,061	1,127,769	(274,292)	(20%)
Gross margin	**680,666**	**1,088,820**	**408,154**	**60%**
General and Administration Expenses				
Salaries and benefits	252,137	289,357	37,220	15%
Administration expenses	100,630	92,045	(8,585)	(9%)
Insurance	83,681	70,159	(13,522)	(16%)
Professional Fees	49,750	49,220	(530)	(1%)
	486,198	500,781	14,583	3%
Net income before other items	194,468	588,039	393,571	202%
Contributions and Financing expense				
Developer contributions	126,272	111,092	(15,180)	(12%)
Other income	6,750	394	(6,356)	(94%)
Net financing cost	(259,396)	(386)	259,010	(100%)
	(126,374)	111,100	237,475	(188%)
Net Income	**$ 68,094**	**$ 699,139**	**$ 631,045**	**927%**

Earnings before interest, taxes and amortization (EBITA)

Net income per above	$ 68,094	$ 699,139	$ 631,045	927%
Net Financing cost	259,396	386	(259,010)	(100%)
Amortization expense	487,858	362,760	(125,098)	(26%)
EBITA	$ 815,348	$ 1,062,285	$ 246,937	30%

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