



Cabinet

30th January 2019

Item
9(i)

Report of	Assistant Director of Policy and Corporate	Author	Michael Woods
Title	Northern Gateway Heat Network Project: Revised delivery structure to retain assets in Council ownership		
Wards affected	Highwoods & Mile End		

1. Executive Summary

1.1 The Northern Gateway Heat Network is a flagship project for low carbon heat generation of its type in the UK and has the support of the Department of Business, Industry and Industrial Strategy (BEIS) Heat Network Project (HNIP). This report sets out the recommended revised delivery and governance structure for the Northern Gateway Heat Network and outlines any financial and risk implications for the Council arising from the new proposals. The revised structure is recommended as it provides the opportunity for the Council's wholly owned energy company, Colchester Amphora Energy Ltd (CAEL), to be able to claim Renewable Heat Incentive (RHI) from the Office of Gas and Electricity Markets (OFGEM), which will support the financial returns on the project. The revised proposal will enable the project to spend grant money from the Heat Network Investment Project (HNIP) and claim RHI for which two entities is required.

2. Recommended Decision

- 2.1 To approve the revised delivery structure set out below for the Northern Gateway Heat Network project
- 2.2 Note that further work will be required to be undertaken to ensure that HNIP grant and RHI funding conditions are fulfilled; minimising the risk to both organisations.
- 2.3 To note the financial and risk implications for the Council arising from the revised structure.

3. Reason for Recommended Decision

- 3.1 To allow CAEL, when the project is complete and selling heat, to be able claim the Renewable Heat Incentive (RHI) and still use the BEIS HNIP Grant money in the construction and installation without any State Aid implications arising.
- 3.2 To ensure the programme of development remains on track to deliver the heat network infrastructure and to meet the BEIS funding milestones
- 3.3 To benefit from government revenue funding which supports low carbon developments such as the Northern Gateway Heat Network.

4. Alternative Options

- 4.1 Various ways of delivering the project in two entities have been explored including setting up a new company for the infrastructure development and using one of the other CBC owned companies, but all other options have been discounted due to financial or risk reasons.
- 4.2 Not to agree the recommended revised structure would miss the opportunity to provide a sustainable funding stream into the project, which will add to viability of this ultra low carbon scheme.

5. Background Information

- 5.1 Cabinet approved the full business case for the development of the Colchester Northern Gateway Heat Network on 15 March 2017. This approved the setup of a Company “to develop the infrastructure and manage the project going forward including the billing and maintenance. The Company would therefore manage the build contract and take a lease direct from the Council for the land, paying the Council a modest rental income.” Colchester Amphora Energy Limited (CAEL) was subsequently launched on 1st April 2018.
- 5.2. The Northern Gateway Heat Network is one of 9 pilot schemes funded by Department of Business Energy and Industrial Strategy (BEIS) through HNIP grant funding, across the country and has national significance due to the innovative use of ground water to generate heat. The Council and CAEL have consulted with and will continue to have an ongoing dialogue with BEIS who sees the scheme in Colchester as having the potential to be “rolled” out on a more national basis following the completion of the scheme. Whilst the technology within the scheme is used widely in Scandinavia and is very successful in generating localised heat, its use in the UK is new.
- 5.3 Since March 2017, in line with the Cabinet report recommendation, further due diligence has been carried out as part of the company set up and to progress the key elements of the project, including the loan from the Council, which is required as match funding for the project. This work has provided more clarity on the ability for CAEL to be able to spend HNIP grant money, and has led to the understanding that with certain conditions, it would be possible to comply with the spend grant money and claim RHI conditions. This is a change from the position stated in the original business case (Paragraph 5, Cabinet report 15 March 2017) as it was previously understood that by claiming full HNIP grant for the project, RHI could not be claimed.
- 5.4 The ability to claim RHI has now been fully investigated and it is deemed important to try to secure this additional income flow as it would benefit the financial rate of return for the project during the 20 year duration of the RHI accreditation, but will also provide a secure income stream for CAEL in the early years of company operation and make the company more financially sustainable, which will be important to the Council as the sole shareholder.

6. The Due Diligence Process

- 6.1 The due diligence work has involved the consideration of alternative delivery structures and the development of the proposed delivery structure; including governance compliance for RHI subsidy. Bevan Brittan LLP were engaged to undertake legal advice and Scrutton Bland Ltd were engaged to undertake the review of any tax implications.
- 6.2. Bevan Brittan has advised that in order to secure the most financial support for the project i.e. HNIP Grant and RHI, the use of two entities to deliver the project is required;
- One entity that deploys the HNIP grant and owns the Energy Centre and the distribution pipe network.
 - A second entity which procures the heat pump and associated equipment, leases the Energy Centre, the distribution pipe network from the first entity, operates the scheme and claims the RHI on heat sold.

6.3 The following alternative structures were considered to achieve the two entities:

- Setting up a new sister company to CAEL
- Using one of the companies already set up and owned by the Council.

6.5 The primary reason for this structure is that RHI cannot be claimed where heat has been generated by equipment that has been purchased with grant funding and this must be clearly demonstrated to OFGEM in an RHI application.

7. The Proposed Structure

7.1 Therefore, in summary the proposed structure is:

- The Council will develop the heat network primarily funded from HNIP. On completion of the scheme the Council will own the Heat Centre and associated distribution infrastructure. The assets will be recorded on the Council’s balance sheet. The Heat Centre, the backup system and associated distribution network will be leased to CAEL on a commercially viable lease arrangement.
- CAEL will undertake the borehole work and purchase the heat pump and associated equipment, operate the scheme and sell heat to businesses and residential customers, claiming RHI.
- CAEL leases the completed infrastructure from the Council.

7.2 To clarify the revised governance arrangements, a summary of the proposal is detailed below for the two entities:

CAEL	CBC
<p><i>Construction</i></p> <p>To design, build, and own the:</p> <ul style="list-style-type: none"> • Investigation and implementation of the boreholes • Water Source Heat Pump (WSHP) and associated pipework. <p>The development of the scheme will be managed by CAEL for a fee.</p> <p><i>Funding of Capital Costs</i></p> <ul style="list-style-type: none"> • Capital Contribution from the Council from the RIF programme, initially identified at £2.5m <p>To manage the HNIP commercialisation grant</p> <p><i>Ongoing Operational Arrangements</i></p> <p>To design, build, and own the:</p> <ul style="list-style-type: none"> • WSHP only. <p>To operate and maintain the:</p> <ul style="list-style-type: none"> • energy centre building; • Water Source Heat Pump; • back-up system; and 	<p><i>Construction</i></p> <p>To design, build and own the:</p> <ul style="list-style-type: none"> • energy centre building; • Gas boiler back-up system; and • distribution pipe network <p>The development of the scheme will be managed by CAEL for a fee.</p> <p><i>Funding of Capital Costs</i></p> <ul style="list-style-type: none"> • Application of HNIP Grant in line with grant conditions. • Funding support to CAEL initially identified at £2.5m <p><i>Ongoing Operational Arrangements</i></p> <p><u>To lease the Energy Centre, Backup system and the distribution network to CAEL on a commercial rent basis.</u></p>

<ul style="list-style-type: none"> • distribution network. <p>To distribute heat to all customers and collect associated income. To claim RHI subsidy from OFGEM</p>	
CAEL Revenues	CBC Revenues
Heat and Electricity Sales to consumers RHI Funding from OFGEM.	Use of system charge from CAEL Rental for use of energy centre space from CAEL.
CAEL Operating Costs	CBC Operating Costs
All fuel costs Use of system payment to CBC Rental costs for energy centre space to CBC Costs to operate, maintain, repair and replace entire system (all Assets) Metering and billing Management (general and finance) and audit	Associated borrowing costs for any capital expenditure not funded from government funding. Management and audit

7.3 Agreements will need to be put in place. The primary agreement being for the use of the system / lease agreement between the Council and CAEL, where CAEL will pay a lease payment for use of the Energy Centre, the backup boiler system and the pipe distribution network and allow CAEL to install the heat pump in the Energy Centre.

7.4 Also given the specialist skills retained in CAEL it is proposed that it will manage the work and contracts on behalf the Council for the construction / installation of the Energy Centre, backup boiler system and pipe distribution network in line with the terms of grant funding.

8. Financial implications

8.1 The revenue budget for 2018/19 had assumed that the Council would have incurred borrowing costs and in turn income from the providing loan finance to CAEL. This net income and also assumptions in respect of the lease income are also included in the 19/20 budget and MTFF. The revised structure to delivering the project does not affect the total cost of the capital scheme but as the Council will incur more costs directly it means that the net income from providing loan finance will be lower by c£16k. This has been allowed for in the 19/20 budget.

9. Strategic Plan References

9.1 The project relates directly to the vision, themes and objectives of the [Strategic Plan 2018-21](#) of “Encourage green technologies through initiatives such as SMART Cities” of

which district heating with a low carbon heat source is an example, and the emerging Local Plan 2017-2033 Policy CC1: Climate Change which specifically mentions the Northern gateway.

10. Consultation

10.1 To date no public consultation has been carried out but the project will form part of public consultation for planning consent for the Northern Gateway south side development.

11. Equality, Diversity and Human Rights implications

11.1 None

12. Publicity Considerations

12.1 The Heat Network project is part of the wider Northern Gateway development and will be included the “communication plan” for the whole development. Additionally, there will be some primarily B2B publicity communication to companies / groups interest the heat network delivery and particularly those companies who have expressed interested in becoming suppliers of services and equipment to the scheme. When an installation contractor is selected and ground breaking occurs for the Energy Centre a more specific and intense communication programme on the Heat Network will commence.

12.2 There continues to be much interest in the technology being used on a national and international scale, so the scheme features in a number of trade publications and marketing and publicity being disseminated by BEIS.

13. Community Safety Implications

13.1 None

14. Health and Safety Implications

14.1 None – every health and safety standards will be complied with during the construction process regardless of who the client is.

15. Risk Management Implications

15.1 The following risks have been identified in respect of the whole project;

Risk	Consequence	P	I	Total	Mitigation	Action Owner	Start Date
RHI and State Aid issues complexity	Not able to receive RHI & higher financial return with RHI are not met.	2	4	8	Consultation with HNIP and OFGEM, RHI pre-registration. Careful development & monitoring of budget.	MW	May 2018
Complexity of contractual arrangements	Increased administration costs,	2	2	4	Appropriate legal and technical advice, review of	MW	May 2018

Risk	Consequence	P	I	Total	Mitigation	Action Owner	Start Date
	unforeseen contractual issues				other experience, CAEL is ultimately owned by CBC.		
Delay in decision	Unable to claim RHI	2	4	8	Timely decision	MW	Jan 2019

15.2 The risks associated with the recommended procurement strategy to the time, cost and quality of the project have been minimised in this approach but there remains the risk of unforeseen events such as weather or ground conditions that might affect overall progress of the project. There is a contingency budget in the wider project to allow for any budget overspends in this respect. The costs are tightly managed by the consultant and through the contract and on-site supervision will ensure contractors adhere to this.