

BRIDGEND COUNTY BOROUGH COUNCIL

REPORT TO CABINET

19 JANUARY 2021

JOINT REPORT OF THE CORPORATE DIRECTOR COMMUNITIES AND THE CHIEF OFFICER – FINANCE, PERFORMANCE AND CHANGE

BRIDGEND TOWN HEAT NETWORK PROJECT

1. Purpose of report

- 1.1 The purpose of this report is to update Cabinet on progress made with regards to the development of the Bridgend Town Heat Network Project and secure a number of key decisions regarding the progression of the project.

2. Connection to corporate well-being objectives / other corporate priorities

- 2.1 This report assists in the achievement of the following corporate well-being objectives under the **Well-being of Future Generations (Wales) Act 2015:-**
1. **Supporting a successful sustainable economy** – Taking steps to make the county borough a great place to do business, for people to live, work, study and visit, and to ensure that our schools are focussed on raising the skills, qualifications and ambitions for all people in the county borough.
 2. **Smarter use of resources** – ensure that all resources (financial, physical, ecological, human and technological) are used as effectively and efficiently as possible and support the creation of resources throughout the community that can help to deliver the Council's well-being objectives.

3. Background

- 3.1 BCBC initially started looking at the opportunities for the development of heat networks in Bridgend in 2012 with drivers for the projects identified as:
- **Decarbonisation:** Heat networks offer a key mechanism to help public sector buildings in Wales meet the Welsh Government and our Council's ambitious 2030 decarbonisation of the public sector target.
 - **Economic:** UK Government have set ambitious targets for the development of heat networks across the UK and this will create a supply chain demand for new skills in the creation and operation of heat networks. This has also led to BCBC working in partnership with Bridgend College to create a Heat Academy that will support the development of a supply chain in Wales.
 - **Social:** The ability to manage bills and utilise local resources via a heat network has the potential to create local benefits in terms of lower bills and better managed homes and buildings leading to health benefits and reductions in fuel poverty.
- 3.2 The Bridgend Town Heat Network Project is included as a project within the BCBC Smart Energy Plan (SEP) (approved by Cabinet February 2019). The Smart Energy

Plan details the projects that BCBC will participate in during the period 2019 – 2025. This proposes to test various technologies, consumer propositions and business models to provide a pathway to the decarbonisation of Bridgend County Borough. It is also a key contributor to the Welsh Government's decarbonisation strategy (published March 2019) "*Prosperity for All: A Low Carbon Wales*".

- 3.3 The Bridgend Town Heat Network Phase 1 Project proposes to deliver heat (via a gas combined heat and power engine located within the Bridgend Life Centre) to the Bridgend Life Centre, Civic Offices and the Bridgend Bowls Hall. The project will also provide electricity to the Life Centre, Civic Offices and Bowls Hall.
- 3.4 A report was submitted to Cabinet in April 2018 seeking approval, in principle, for the financial case of the Outline Business Case for the project and to submit an application to UK Government through its Heat Network Investment Programme (HNIP). The report was approved by Cabinet on the 24th April 2018.
- 3.5 Following that report to Cabinet, a revenue grant application was made to UK Government through the Heat Networks Delivery Unit (HNDU) in July 2018 which was successful. A procurement process was carried out to appoint technical (AECOME) and financial consultants (AECOM sub-contracted this work to BDO) and legal advisors (Brodies LLP) to deliver a RIBA Stage 3 Design for the project in preparation for the HNIP Capital grant application for the project. After appointment BDO indicated that they were to disband the infrastructure side of their business and the personnel within the infrastructure team formed a separate business (Asteros), who AECOM appointed under the same terms and conditions as for BDO.
- 3.6 A capital grant application was made to UK Government via the Heat Network Investment Programme (HNIP) in April 2019 and this was approved in December 2019 for £1,000,000 capital investment towards the construction of the heat network and £241,000 for pre-construction activities.
- 3.7 Throughout 2020 the project has been progressed through the creation of a new financial model, preparation of a planning application for the thermal store, development of an environmental permit for the energy centre and the creation of a tender pack for the procurement of a design build operate and maintain (DBOM) contractor to manage the construction and operation of the network.

4. Current situation/proposal

- 4.1 The Bridgend Town DHN project has reached a critical stage with several crucial milestone decisions needed to ensure progression in line with the Conditions Precedent laid out in the Grant Funding Offer provided by the Dept. of Business, Energy and Industrial Strategy to BCBC as part of the HNIP grant conditions. The commercialisation phase of the project involves the procurement of a design, build, operate and maintain (DBOM) contractor to deliver the physical infrastructure required for the project. Significant progress needs to be demonstrated in the procurement of the DBOM contractor before the construction capital grant funding can be drawn down. This must happen by 19 March 2021 and therefore, it is essential, that the procurement must be underway by March 2021. In order to achieve this, the procurement notice must be launched in February 2021.

- 4.2 It must be recognised that whilst progress is required to meet the HNIP grant conditions, the business case to date is based on financial modelling. The full financial cost and implications of delivering this scheme will only be known once the procurement process is undertaken and a contractor selected. It is then that a full business case will be prepared and will be subject to Cabinet approval before the appointment of any contractor would take place. During the procurement process the Council will explore different options and innovation from the market to consider in the final business case. In the knowledge of this, the work that now needs to be progressed includes procuring a contractor, submitting the planning application for the thermal store, the environmental permit for the energy centre, as well as progressing with the creation of the Special Purpose Vehicle (SPV). The details of the SPV to be established will be subject to a further report to Cabinet for approval in February 2021. Following this Cabinet Report, the tender documents for the appointment of the DBOM will be released, but no appointment will be made until Council approve the scheme and additional loan amount as part of the Capital Programme, to be reported to Council in February 2021. The detail of these individual tasks are set out below from section 4.4 onwards.
- 4.3 It must also be noted that the delivery schedule of the project needs to remain on track with the project plan, as any further delays could increase costs within the project. An example of this is the need to work within buildings, making them ready for connection, outside of the heating season i.e. in the summer months. Failure to do this could result in increased scheme cost. Similarly with the construction timetable for the highway network and the need to cross major road arteries outside of busy periods, failure to meet these windows of opportunity could also increase costs.

Environmental Permitting

- 4.4 BCBC is required to secure an environmental permit from Natural Resources Wales (NRW) under the Environmental Permitting (England & Wales) Regulations 2016 for the gas combined heat and power engine which forms the energy centre for the heat network. The gas CHP engine falls under the Medium Combustion Plant Directive which requires BCBC to secure a bespoke permit for the energy centre. The work on the permit will dictate the height of the flue and this will in turn influence the planning application made to the Bridgend Planning Authority. The Environmental Permit will be submitted to NRW shortly and authority to do so shall be sought from under the Scheme of Delegation.

Planning Permission

- 4.5 The thermal store is a tank of water that plays an important role in the operation of a heat network by bridging the gap between energy supply and energy demand through shifting peak load demand to off-peak hours through the use of stored energy. The height of the thermal store requires planning permission for its location at the rear of the Bridgend Life Centre. The Planning Permission will be submitted to the Planning Authority by the end of January 2021 and authority to do so shall be sought from under the Scheme of Delegation.

Utility Regulations

- 4.6 The construction of a heat network is covered within Regulation 9 of the Utilities Contracts Regulations 2016 BCBC is therefore required to procure the DBOM contractor for the heat network through the Utilities Contracts Regulations 2016. For

the procurement of works, goods and services, BCBC normally utilises the Public Contracts Regulations 2015. However, Regulation 7 of the Public Contracts Regulations 2015 provides that those regulations do not apply to public contracts when public contracts are being awarded or organised under the Utilities Contracts Regulations 2016 in exercise of one or more of the activities referred to in Regulations 9 to 15 and for the pursuit of those activities. Consequently, the Public Contracts Regulations 2015 do not apply to the procurement of the DBOM contractor for the heat network but instead BCBC must follow the Utilities Contracts Regulations 2016. BCBC's Contract Procedure Rules deal solely with the conduct of procurements under the Public Contracts Regulations 2015. Therefore, in order to conduct a procurement under the Utilities Contracts Regulations, the Contract Procedure Rules will need to be suspended and approval is sought from Cabinet to suspend the Contract Procedure Rules and carry out a procurement under the Utilities Contracts Regulations 2016.

- 4.7 It is recognised that BCBC is not experienced in the use of the Utilities Contracts Regulations 2016. In order to manage the procurement of the Design Build Operate & Maintain contractor, it is proposed that Brodies shall run the procurement on the Council's behalf, with AECOM's assistance in the development of the tender documentation pack and the procurement process to appoint the DBOM contractor .

Special Purpose Vehicle

- 4.9 The creation of a Special Purpose Vehicle (SPV) as the delivery mechanism for the Bridgend Town Heat Network project is one of the Conditions Precedent within the HNIP grant offer from UK Government for the project. Advice is being sought on the creation and establishment of the SPV and a report will be presented to Cabinet in February 2021 for a decision.

Phase 2

- 4.10 In line with the BCBC Local Area Energy Plan, which indicates that heat networks are the most technical and economically advantageous option for the decarbonisation of heat within Bridgend Town, the Council is seeking to develop a Phase 2 of the heat network. Phase 2 would be a more ambitious project than Phase 1 and would have the potential to connect two hospitals, four schools and a care home as well as potential new development within Bridgend Town centre.
- 4.11 The Council made an application for grant funding from UK Government (Business, Energy & Industrial Strategy) through its Heat Network Delivery Unit (HNDU) in June 2020 for £132,150 to contribute towards the cost of preparing an Outline Business Case for Phase 2 of the project (£102,150) and Project Management resource support (£30,000).
- 4.12 BEIS approved the funding application in September 2020 and a tender pack is being developed to procure the technical, financial and legal consultants needed to prepare the outline business case for Phase 2. The cost of developing the outline business case has been estimated as £150,000. The remaining £47,850 needed to prepare the outline business case is being provided by the Council. The £47,850 will be funded from the Heat (SEP) Programme budget within the Strategic Regeneration Fund.

5. Effect upon policy framework and procedure rules

5.1 This report has no effect on the policy framework and procedural rules

6. Equality Impact Assessment

6.1 An initial equality impact assessment screening has been completed and has identified that there will be no negative issues related to this report.

7. Well-being of Future Generations (Wales) Act 2015 implications

7.1 The Bridgend Town Heat Network Project is a positive step in regard to the Council's role in complying with the Well-being of Future Generations (Wales) Act 2015. The project demonstrates BCBC taking a positive proactive role within the decarbonisation agenda in Wales which will ensure that the significant environmental, social and economic opportunities created through the decarbonisation transition of the energy market will be captured for Bridgend as well as the area being able to demonstrate its compliance with national carbon reduction targets.

7.2 The Well-being of Future Generations (Wales) Act 2015 has been completed. A summary of the implications from the assessment relating to the five ways of working is as follows:

1. **Long Term:** The Bridgend Town Heat Network Project will provide the foundation for Bridgend Town to develop a decarbonised heat system that meets the UK 2030 decarbonisation targets in line with BCBC's Local Area Energy Strategy and Smart Energy Plan.
2. **Prevention:** The Bridgend Town Heat Network Project will provide an opportunity for all to benefit from the decarbonisation transition and ensure that solutions are designed and available for everyone within Bridgend Town.
3. **Integration:** The Bridgend Town Heat Network Project offers an opportunity to develop a heat network that serves Bridgend Town and that offers carbon reductions, reduced whole life cost of heat (capital and revenue) and creates economic opportunities through a clearly identified value chain for the area supporting business and local employment.
4. **Collaboration:** BCBC is working in partnership with both UK Government and private and public sector partners to deliver the project.
5. **Involvement:** The Bridgend Town Heat Network Project involves working with a variety of stakeholders to deliver a sustainable solution for the decarbonisation of heat within Bridgend Town.

8. Financial implications

8.1 The Cabinet Report in April 2018, had the Phase 1 Year 1 capital outlay as £1.959 million, this increased to £4.229m in April 2019 when an amended financial model was created as part of the grant submission to UK Government through the Heat Network Investment Programme. The increase was driven primarily by the inclusion of the new Sunnyside development. The withdrawal of the development from the scheme has meant that the Year 1 capital outlay is currently £3.389 million. The costs within the project are different to those presented in the original outline business case to Cabinet in April 2018 and those presented to Corporate Management Board in April 2019 due to a number of factors most notably withdrawal of the Sunnyside

development from the project, upgrades to the transformer required at the Bridgend Life Centre, inflationary impacts and future proofing of the further network connections. A summary of the variations between the project funding and interest rates presented as part of the April 2019 position and the current report is shown in Table 1 below:

Table 1 Project Funding and Interest Rates

Funding Source	April 2019 Model	Current Model
BCBC Capital Programme	£500,000	£500,000
BCBC Prudential Borrowing	£1,079,563	£1,821,367
HNIP Grant	£1,934,000	£1,000,000
Linc Cymru/Halo Contribution	£716,000	-
Connection Charges		£67,366
BCBC shares	£1,000	£1,000
TOTAL	£4,230,563	£3,389,733
PWLB Interest Rate	2.1%	2.6%
Interest Rate to BCBC	4.65%	2.6%
Repayment Loan Period	50	40
Financial Evaluation Period	50	50

- 8.2 The interest rate chargeable on the loan by the Council to the SPV was initially set at 4.65% to avoid State Aid implications. This rate was considered high, but was based on the assumption that the Council is the 100% owner of the SPV and any reduced returns made by the SPV through a higher interest cost would be offset by increased interest payments received by the Council. The main impact of the higher interest rate is that financing payments need to be made by the SPV and this causes cash flow difficulties in the early years of the SPVs existence. So, the interest rate to the Council was reduced in the current financial model to avoid the SPV going into negative cash flows. Apart from the timing of money flowing to the Council, the change doesn't affect overall Council returns (dividend plus interest) and advice from the Council's advisors (Brodies & Asteros) is that this rate would still be State Aid compliant under the old EU State Aid rules and that at present nothing has changed to make this project any less compliant with state aid rules. The rate would still be state aid compliant at present (noting that state aid rules are in a state of flux at the moment and any changes will need to be closely monitored).
- 8.3 Due to the increased level of borrowing by the Council to the SPV proposed, from £1 million to £1.82 million, it will be necessary to make an amendment to the Treasury Management Strategy (TMS) to enable this to happen. At present the threshold for non-treasury investments, such as loans, investments in subsidiaries and investments in property is limited to £1 million. This limit will need to be increased to enable the loan to the SPV to be undertaken. The draft TMS 2021-22 will be presented to Governance and Audit Committee on 28 January 2021, and to Council in February 2021 for approval.

8.4 A re-worked financial model was prepared and presented to the BCBC Finance Department (September 2020) following which a number of queries were raised. It was decided that the model should receive an independent review by a third party. PeopleToo were appointed to carry out the financial review of the model and concluded their review in November 2020. The main findings of the review are presented in table 2.

Table 2 Current Base Case for Phase 1 of the Bridgend Town Heat Network

Key Financial Metric	OBC 2018 (50/50)	Current Base Model 2020
Funding Sources	£4.23m	£3.32m
EBITDA	£10.82m	£10.23m
Dividends	£1.1m plus £0.969m on interest gain	£4.076m
Capital Expenditure Over Life	£9.83m	£6.79m (£5.87m if £0.91m residual value is not included)
Loan Capital Repayments	£1.08m	£1.82m
Loan Interest Repayments	£1.802m	£1.1m
Corporation Tax	£0.69m	£0.70m
Council Return inc. Residual Value	Not Modelled	£2.48m
Council IRR Inc. Residual Value	Not Modelled	2.73%
Council Return excl. Residual Value	£2.07m	£1.567m
Council IRR excl Residential Value	3.45%	2.22%

8.5 Under the model the dividends to the Council (£4.076 million across the life of the scheme) will not start to be paid until the 2024-25 financial year, and this will impact on the net profit of the SPV which will not return a net profit then until 2035-36 when dividends cease for a number of years. Dividends are not payable every year in the model and include a significant payment of £1.092 million at the end of the 50 year project. Dividends in the first 10 years of the scheme are estimated to be around £191,000.

8.6 The conclusions of both Asteros and the PeopleToo review was that the project is viable with a positive IRR. The margins on the project are tight but Table 2 shows that dividends on the project have increased with the increase largely due to three main factors:

- First, approximately £900k of residual value in the assets was excluded from the original return calculation. Including them does assume they could realise this value, which is unknown at present.
- Secondly, the reduction in interest rate from 4.65% to 2.6% increases the dividend return, however, further advice is required as to whether this will fall in line with State Aid rules.

- Thirdly, there have been changes to the input assumptions to the model including reduced capital expenditure costs. If additional capital expenditure is required (eg back up boilers) this will affect the profitability and returns on the scheme.

8.7 In line with the Bridgend Local Area Energy Plan it is the long term (10+ years) intention to extend and connect additional buildings to the Phase 1 network. The Bridgend Town DHN is envisaged to play a key role within the decarbonisation of public buildings within Bridgend Town. Currently funding obtained from the Public Works Loan Board is intended to form part of the project finance package. Recent guidance (Public Works Loan Board Guidance) requires the S.151 officer to formally confirm that the Bridgend capital programme for the current and following 2 financial years as not involving any investment in assets “primarily for yield”. Given that the primary drivers for this project are environmental (decarbonisation) and economic (development of a DHN supply chain in partnership with Bridgend College) the project is not an investment primarily for yield. Therefore advice from Asteros has been that it is legitimate for the Council to use PWLB finance to decarbonise public buildings within the Council boundaries.

8.8 The Scheme delivers lower cost heat, when considering both capital and revenue costs jointly, to the Council and the Special Purpose Vehicle (SPV) is anticipated to generate returns to the Council by way of dividends. There is a differential impact on Service budgets with increases in revenue budgets being more than offset by decreases in the Council's capital budgets. The combined gas and electric revenue costs for 2019-20 were £103k for the Civic Centre and any periodic major equipment replacement costs would currently need to be funded from Council capital budgets. The all-in cost of heat under the Scheme is estimated at £114k and this is inclusive of both the revenue and capital (at circa 14.5% of the total charge) expenditure associated with delivering heat and power presented as an annual charge, but would be paid on metered usage. The Council is not able to meet any revenue costs from its capital expenditure therefore it is anticipated that the increase in the revenue budget assumed from the outline business case of £11k per year could be offset by returns to the Council from the SPV over time. However, as noted above, the Council may not receive returns in some years. There may also be increased revenue charges for the Bridgend Life Centre which may also be passed on to the Council, though these have yet to be quantified. This will be reviewed at the Final Business Case stage.

9. Recommendation(s)

9.1 It is recommended that Cabinet:

- Approves the continued delivery of the Bridgend Town District Heat Network project.
- Agrees that a report be taken to Council for its approval to amend the Capital Programme for the inclusion of the Bridgend Town District Heat Network project within the Capital Programme and agrees the loan to the SPV, subject to approval to changes to the Treasury Management Strategy.
- Notes that the Treasury Management Strategy will need to be revised to enable the Council to make a loan of £1.821 million to the SPV, and this will be reflected

in the draft Treasury Management Strategy 2021-22 that will be presented to Audit Committee on 28 January 2021, and to Council for approval in February 2021.

- Approves the procurement of and subsequent appointments of technical/financial consultant and a legal advisor to prepare an Outline Business Case for Phase 2 of the Bridgend Town Heat Network Project.
- Delegate authority to the Corporate Director Communities to tender for the technical/financial consultant and Legal Advisor to prepare an Outline Business Case for Phase 2 of the Bridgend Town Heat Network Project and award the contracts to the successful tenderers, the contractual terms of the contracts to be approved by the Corporate Director Communities in consultation with the Chief Officer – Legal, HR and Regulatory Services.
- Suspend the relevant parts of the Council’s Contract Procedure Rules which require procurements to be conducted under the Public Contracts Regulations 2015 and approve the procurement of a Design Build Operate Maintain contractor for the Bridgend District Heat Network by utilising the negotiated procedure with prior call for competition under the Utilities Contract Regulations 2016.
- Approves Brodies LLP running the procurement of the Design Build Operate Maintain Contractor under the the negotiated procedure with prior call for competition under the Utilities Contract Regulations 2016 on behalf of the Council.
- Delegate authority to the Corporate Director Communities to tender the contract for the Design Build Operate Maintain contractor for the Bridgend District Heat Network, in consultation with the Chief Officer – Legal , HR and Regulatory Services using the negotiated prior call for competition under the Utilities Contract Reulations 2016 and note that a further report shall be presented to Cabinet following the conclusion of the procurement of the Design Build Operate Maintain contractor for a decision on whether to award the contract.
- Note that a report shall be presented to Cabinet in February 2021 on the creation of the Special Purpose Vehicle which will provide the commercial delivery mechanism for the project.

Janine Nightingale
Corporate Director Communities
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Gill Lewis
Chief Officer – Finance, Performance and Change
19 January 2021

Contact officer: Michael Jenkins
Team Leader Sustainable Development

Telephone: (01656) 643179

Email: Michael.jenkins@bridgend.gov.uk

Postal address: Civic Offices, Angel Street, Bridgend.

Contact officer: Nigel Smith
Group Manager – Chief Accountant

Telephone: (01656) 643605

Email: Nigel.smith@bridgend.gov.uk

Postal address: Raven's Court, Brewery Lane, Bridgend.

Background Documents:

Cabinet Report April 2018

Bridgend Local Area Energy Plan