

MUNICIPAL YEAR 2018/2019 REPORT NO. **92**

MEETING TITLE AND DATE:

Cabinet – 17 October 2018

REPORT OF:

Director of Commercial

Contact officer and telephone number:

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Agenda – Part: 1	Item: 10
Subject: Energetik Funding Options	
Wards: All	
Cabinet Members consulted:	
Cllr Nesil Caliskan, Cllr Ahmet Oykenen	

1. EXECUTIVE SUMMARY

- 1.1. Energetik is seeking guidance and approval to update the objectives and values of its business plan so that it may add to its primary goals the reduction of inequality in the borough by helping to alleviate fuel poverty, noting that its other primary goals are to improve the environment and health within the borough through the significant reduction of carbon and NOx levels within the atmosphere.
- 1.2. The company is at a crucial point regarding its funding strategy and requires a decision to be made by the Council as shareholder on how it should proceed. Both the initial delay and the recent progress with the Meridian Water development offers the Council the opportunity to re-assess the company's sources of future funding and the company's forecast profit with respect to its primary goals.
- 1.3. This report seeks to establish how the Council wishes to fund the remainder of Energetik's business plan (tranche 2) and outlines the options the company has identified. Depending on the option selected, Energetik could reduce its heat tariff charged to customers, providing the opportunity to be cheaper than gas, offering a chance to provide additional social benefit and contribute further to the Council's wider strategic aims of delivering good homes, sustainable and healthy communities and to help build the local economy.
- 1.4. Energetik have identified three practicable funding routes, of which option 3 is the company's preferred route - 1) the Council funds the company directly as per the existing business plan; 2) the company secures external funding or 3) the company secures low-cost external funding with a guarantee from the Council – each has its own advantages and disadvantages. It should be noted that all options are subject to further state aid advice and due diligence, which the company will undertake and refine once the Council has selected a preferred option.

2. RECOMMENDATIONS

- 2.1 To note the different funding options set out in this paper and confirm the Cabinet's preferred option aligns with that of the company.
- 2.2 Aligned with 2.1 above, approve Energetik's proposal to seek a formal proposal from the Mayors Energy Efficiency Fund (MEEF) to establish the details of such alternative funding
- 2.3 To note that change to the company's primary goals and to agree to the company's intention to update its business plan objectives accordingly.
- 2.4 To note that a second paper will be submitted to cabinet early in 2019 detailing the three practicable funding options set out in this report and recommending which funding option the company believes is most suitable and why. This will include details of any possible tariff reduction. The options will be subject to external financial due diligence (as was the case with tranche 1).

3. BACKGROUND

Overview & context

- 3.1. See part 2 report
- 3.2. In the last 12 months:
 - The Meridian Water development strategy has changed from appointing a master developer for all phases to the Council being responsible for driving the development programme by tendering individual phases to the market
 - The Meridian Water team has obtained a planning permission for the first 725 dwellings, phase 1
 - The Meridian Water team has commenced the procurement of the phase 1 developer with a programme to appoint in Spring of 2019 and commence building by the Spring of 2020
 - The Meridian Water team has developed a dwelling build programme for subsequent phases
- 3.3. See part 2 report
- 3.4. See part 2 report
- 3.5. See part 2 report
- 3.6. It was noted in the two-phase drawdown approach was adopted to help the Council manage its investment risk, until more certainty could be gained on the Council's investment (3.33, part 2). The key points that the Council wished to better understand were:

- The construction and phasing programme of the then preferred bidder to become the Master Developer
 - Network Rail's programme for the new Meridian Water train station
 - The NLWAs timetable for its new ERF facility on the Eco Park
 - The completion of Energetik's suite of contract documents, including the on-lending agreement between the Council and the business, and the works required under phase 2 of the Meridian Water DBO contract
- 3.7. By means of a progress update on the above items, which the company considers to be practically complete:
- The Council has amended its delivery strategy for Meridian Water as noted above
 - Network Rail are currently constructing the train station at Meridian Water, and it is expected that this will be completed in the summer of 2019
 - The NLWA is currently planning to complete its ERF facility in 2026, at which point Energetik will connect. This is supported by the coordination of early utility diversion works carried out by both Energetik and the NLWA to facilitate the construction of both the new ERF and Energetik's energy centre
 - Energetik's suite of legal and commercial documents have been completed, including the necessary on-lending agreements, The DBO contract has been executed and has progressed to the planning submission stage
- 3.8. The company's original business plan currently offers Enfield Council and its residents up to £225 million in benefits by providing:
- better value for money
 - better, trustworthy service to customers
 - significant environmental improvements
- 3.9. In addition to these benefits, the company provides the Council with a financial return, and value for money on its investment. However, whilst updating and amending Energetik's business plan with the latest known information, a chance to further improve the benefit provided to Enfield residents has been identified, by reducing the cost of heat to be cheaper than gas. If the Council is willing to allow Energetik to amend its business plan values and strive to achieve this, then it could contribute significantly to Enfield's fuel poverty agenda.
- 3.10. See part 2 report
- 3.11. The option to enhance the benefits for customers in this way is a step away from the existing business plan values, which maximised Council returns whilst offering a fair deal to customers. However, by doing so the Council has a chance to offer real and positive benefits to its residents.

Revised and new information

Results of Energetik's re-run of the financial model

- 3.12. The original business plan was approved in 2017 and assumed Meridian Water would complete its first homes in 2018/19. The main change that has affected Energetik's financial requirements for its Tranche 2 drawdown is the commencement of Meridian Water two years later than originally modelled, the model now assuming that Meridian Water will complete its first homes in 2020/21.
- 3.13. See part 2 report

Why not delay building Energetik's infrastructure?

- 3.14. Energetik received fixed price tenders for the design and construction of its Meridian Water energy centre and network in early 2016. The fixed price for works expires on 31st December 2020. Any works undertaken after this will be indexed based on construction market price increases (ONS data reported via the BEAMA Indices).
- 3.15. In early 2016 when it became apparent that Meridian Water may be delayed, Energetik agreed to fix prices to 31 December 2020 at an additional cost of circa £1 million. This has turned out to be a good decision as market prices according to the BEAMA Indices have increased by 22% as of June 2018, which would have resulted in a cost increases to July 2018 of £3 million. This is predominantly due to material prices increasing due to the drop in the value of sterling.
- 3.16. If Energetik went back to the market and retendered this scope, then this additional £3 million would be reflected in the tendered costs the company would receive. In addition, the design work undertaken by the current contractor to the planning stage of £500k will be duplicated to some extent, as the new contractor would not simply adopt the previous contractor's designs without significant due diligence and reworking. Therefore, Energetik intends to continue with the present contractor.
- 3.17. See part 2 report

Updated Assumptions

- 3.18. Energetik's 2017 approved business plan was based on an identified 13,500 connections that would be connected to one of its Meridian Water heat network and a further 2,078 connections at its other smaller heat networks. This included some connections at Edmonton Green that were not in the Council's gift to deliver, but Energetik believed that these connections were achievable.
- 3.19. However, to provide a very conservative approach, Energetik has re-run its financial model only with connections that the Council can deliver via its estate renewal and new build programmes. Accordingly, the table below shows the

number of connections originally assumed in the Energetik business plan in 2017 and the most recent connection numbers that have been used when re-running the financial model to determine its revised borrowing requirements:

Development	No. connections (2017 cabinet report)	No. connections (2018 updated conservative base case)
Meridian Water	10,000, delivered by the Master Developer + 26,000m2 of commercial space	10,000 homes delivered by Enfield Council + 25,000m2 of commercial space* - 925 homes between 2020 – 2024 - 9075 homes between 2025 and 2047 - 25,000m2 commercial space at Meridian Water between 2021 and 2026*
Westward extension (now identified as Snells & Joyce)	2,000	2,850
Edmonton Green extension	1,500	Not included in conservative base case
Alma Road	992	992*
Electric Quarter	167	167
New Avenue	402	402*
Ladderswood	517 + hotel	517* + hotel
Total	15,578	14,928

* Energetik is aware that there may be additional homes delivered at these developments, however this is subject to planning. Any additional connections would be considered upside to the base case.

3.20 – 3.31 See part 2 report

4. GOVERNANCE AND RISK MANAGEMENT

Further Work Required and Next Steps

- 4.1. Following a decision from Cabinet as requested by this paper, there are several actions the company must undertake including, but not limited to:
- Energetik will seek a formal proposal from the Mayors Energy Efficiency Fund (MEEF) to establish the details of such alternative funding
 - Energetik will investigate the reduction of its tariff to offer heat to customers that is cheaper than gas at the expense of potential dividend payments to the Council
 - Return to Council within 3 months for Tranche 2 approval with further detail and a recommendation as to which funding option should be followed, by how much Energetik’s tariff can be reduced whilst maintaining the viability of the company, and options for extending the heat network to further residents in Enfield. This will include a refresh of the business plan with updated baseline figures and the preferred investment option

5. ALTERNATIVE OPTIONS CONSIDERED

5.1 – 5.8 See part 2 report

6. REASONS FOR RECOMMENDATIONS

6.1. See part 2 report

6.2. The updated delivery and phasing strategy at Meridian Water means that the assumptions and associated finances in the 2017 approved business plan needed to be updated. In doing so the company has had the ability to re-assess the best ways to finance Energetik's second tranche of investment.

6.3. The company has identified alternative finance solutions that offer the Council the ability to genuinely reduce heat tariffs by reducing retained earnings in the business, thereby substantially increasing the social benefit generated by the delivery of Energetik's business plan.

6.4. See part 2 report

7. COMMENTS OF OTHER DEPARTMENTS

7.1. Financial Implications

7.1.1. The Finance team has not seen the financial model on which the figures quoted in the financial summary above are based, as such is not able comment on the impact of the Council's finances. The report is not seeking additional funding at this stage. Prior to approval being sought for additional funding, the Finance team will review the model and seek external advice as required to undertake financial due diligence on the options being proposed.

7.1.2. The options cannot be properly appraised without reviewing the supporting financial assumptions which underpin the figures in the report. Further work will be required to establish the validity of the proposed options as well as the impact on the Council's finances in the context of the Tranche 1 funding of £15M previously approved. The different scenarios will also need to be stress tested with different economic / financial outcomes.

7.1.3. The report is not seeking additional funding at this stage. Prior to approval being sought for additional funding, the Finance team will review the model and as stated in the recommendations external due diligence will be carried out of on the different options and the financial impact on the Council of each one.

- 7.1.4. The Council would also need to assess the risk of Energetik being able to generate sufficient revenue income to service the loan repayments. The assumptions will also need to be stress tested.
- 7.1.5. Assurances will need to be gained that the company is 'a going concern' before any further borrowing is undertaken. Otherwise the Council as guarantor for the proposed loans will be liable for all or part of the costs, which will directly impact on the Council's general budget.

7.2. Legal Implications

- 7.2.1. The Council has the power under s.1(1) Localism Act 2011 to do anything which individuals generally may do provided it is not prohibited by legislation and subject to public law principles. Further statutory powers exist to establish and invest in Energetik, and S.1 of the Local Government Act 2003 permits the Council to borrow and lend (subject to complying with the Prudential Code for Finance in Local Authorities).
- 7.2.2. The introduction of the 'general power of competence' under the Localism Act 2011 enables local authorities to explore innovative solutions to deliver more with less, generate income by charging and trading and to provide indemnities and guarantees. The legislation provides that 'a local authority has power to do anything that individuals generally may do'. This includes giving guarantees. However, other restraints of public law still apply. The most relevant of these is that local authorities have a fiduciary duty to act prudently with public monies entrusted to them and must establish (and maintain a full audit trail to support) that the underlying transaction being guaranteed by the Council is itself 'intra vires' and that it has been given due and proper consideration in accordance with the normal public law considerations.
- 7.2.3. When deciding whether to provide a Parent Company Guarantee (PCG) / or further loan, the Council should carefully consider the associated risks also ensuring it considers 'Best Value Principles' under the Local Government (Best Value Principles) Act 1999. The terms of any PCG and/or loan should be subject to legal and commercial due diligence and the final terms of any associated agreement should be in a form approved by Legal Services. In making its decision the Council must also be mindful of the impact of such a decision on any existing loan / funding agreements and PCGs already in place.
- 7.2.4. The proposals in the 'Options Paper' (appended to this Report), including a decision by the Council to:
- i. provide funding directly;
 - ii. provide a PCG
 - iii. a combination of the above;

iv. agreeing to a reduction in heat tariffs

7.2.5. All have the potential to represent illegal state aid – as they would confer a benefit on Energetik. Before any decision is made, the Council must ensure it obtains full state aid advice in relation to the project as a whole.

7.2.6. The Council must ensure that it adheres to its Constitution at all times, when making decisions. In addition, as the content of this Report constitutes a key decision, the Council must ensure the Key Decision process is followed.

8. PROPERTY IMPLICATIONS

8.1. Due to the subject nature of this Report, there are no Property Implications.

9. KEY RISKS

9.1. See part 2 report

9.2. Doing nothing is not possible, as Energetik has current commitments to its existing customers and clients at its active and in development heat networks.

9.3. Delayed decision to invest will mean significant cost increases to the company to deliver its infrastructure, which in turn reduces the potential retained earnings in the business and increases the amount of loans required.

10. IMPACT ON COUNCIL PRIORITIES

10.1. Good homes in well-connected neighbourhoods / Sustain strong and healthy communities / Build our local economy to create a thriving place

10.2. Energetik's business plan is aligned with Council priorities. The company was set up to improve the service offered to its residents living on heat networks developed in the borough by offering better quality standards at an affordable price, whilst being better for the environment.

10.3. Energetik is helping contribute to the Council's regeneration aspirations, providing a low-carbon and sustainable heating solution.

10.4. In addition, the company's profits will eventually contribute to the Council's income, as it generates revenue and begins to accumulate retained earnings.

11. EQUALITIES IMPACT IMPLICATIONS

11.1. Due to the subject nature of this Report, there are no Equality Impact Implications.

12. PERFORMANCE AND DATA IMPLICATIONS

12.1. The company reports to the Council regularly and will soon commence reporting to the Shareholder Committee.

13. HEALTH AND SAFETY IMPLICATIONS

- 13.1. The majority of Energetik's works are carried out by sub-contractors. Contractors working for Energetik are required under the terms of their agreements to manage H&S in accordance with all applicable law with respect to all works carried out.
- 13.2. The Energetik management team has the responsibility to ensure it takes appropriate advice and carries out the required audits of contractors to ensure they are adhering to all H&S requirements. Energetik's project manager is responsible for the day to day management of this function and reports directly to the Technical Director. Both team members have ca. 30 years' experience delivering large scale construction projects in line with all H&S requirements.

Energetik H&S monitoring and reporting

- 13.3. Energetik has appointed Frankham's as an independent H&S consultant to provide advice to Energetik when required on the adequacy of the contractor's H&S role, performance and documentation etc., which will include carrying out audits on the works when relevant.

14. HR IMPLICATIONS

- 14.1. N/A at present – no employees.

15. PUBLIC HEALTH IMPLICATIONS

- 15.1. The delivery of Energetik's business plan will create substantial carbon savings due to the avoidance of gas being installed across the heat networks. It is estimated that over the business plan, Energetik will save over 230,000 tonnes of CO₂ (5,000 tonnes per annum avg.). Over the same period, 65 tonnes of harmful NO_x will be avoided, which is the equivalent of taking 2,000 cars off the road each year.

16. Background Papers

None

17. Appendices

Appendix 1 - See Part 2 Report

Appendix 2 - See Part 2 Report