London Borough of Enfield

18 March 2021

Subject: **Energetik – HNIP March 2021**
Cabinet Member: **Cllr Nesil Caliskan**
Executive Director: **Fay Hammond – Executive Director, Resources**

Key Decision: **5307/U232**

Purpose of Report

1. The purpose of this report is to enable the Council to enter into a grant and loan agreement with The Secretary of State For Business, Energy and Industrial Strategy (BEIS) to facilitate an expansion of the Council's company, Lee Valley Heat Network Operating Company ltd (trading as 'Energetik').

2. Due to the BEIS timescales for allocation of the Heat Networks Investment Project (HNIP) grant funding, this report proposes entering into a grant agreement immediately with a condition subsequent, requiring that Council approval is obtained by the end of July 2021. This enables the Council to draw down the funding while Energetik and the Council conduct full due diligence on the grant and loan and a revised business plan for the company.

Proposal(s)

3. To delegate authority to the Executive Director of Resources to enter into a HNIP Grant agreement for £12 million and a related HNIP loan agreement for £11.859 million and draw down the associated funding from BEIS, the funds to be held in the Council's bank accounts pending a decision by Council on the related expansion proposal by Energetik, and returned to BEIS in full should that expansion be rejected by Council.

4. To note the ongoing due diligence review of the grant and loan agreements and their implications for Energetik and for the Council. And that the timescale for the condition subsequent is the end of July 2021.

Reason for Proposal(s)

5. Energetik's existing network serves isolated sections of the borough via a large Energy Centre at Meridian Water, and smaller satellite schemes in different parts of the borough. This both limits the capacity of Energetik to serve residents of the borough as a whole and to reduce the borough's carbon emissions, as well as leaving a relatively narrow critical success path for company profits and financial return to the Council as shareholder.

6. The Heat Networks Investment Project is a government funding and financing package to support district heating schemes of the highest quality deliver both

carbon savings and consumer benefits while also attracting further investment. HNIP grant and loan support will enable Energetik to connect existing satellite schemes in Southgate and Arnos grove with the low-carbon heat network located in Edmonton. This improves the carbon savings achieved through Energetik for those satellite schemes.

7. An expanded pipe network also has the potential to attract further customers along the route of the pipework, which would provide a higher financial return in the form of retained profits across the 40-year business plan and spread the risks of the company across more developments and connections, increasing the chances of company success.

8. The grant funding potential has only recently been confirmed; the announcement was delayed by government priorities around BREXIT and the pandemic. Full due diligence on the grant, loan and required match funding cannot be undertaken in the government's timescales for funding allocation. To secure the potential HNIP package while due diligence and appropriate governance is completed, the grant agreement proposed to be signed in this report contains a condition subsequent, requiring that full corporate and executive approval is obtained by the end of July 2021.

9. For clarity, this report does not authorise the use of any funds drawn down from BEIS. It does not authorise the funds to be passed to Energetik, nor does it authorise any action by the company. These matters will be brought for decision to Council and are currently scheduled for consideration in May 2021. This report permits the Executive Director of Resources to comply with BEIS timeframes for draw down of awarded funding, following which the funds will be held in the Council's bank accounts until a full governance process has been observed to reach a decision on the expansion proposal. Should the expansion not be approved to progress, the HNIP funds will be returned in full, as permitted by the agreement negotiated with BEIS by officers. This arrangement negotiated with BEIS enables the Council to access substantial low-cost external funding, while permitting time for expansion proposals to be properly analysed and fully considered with appropriate governance.

Relevance to the Council Plan

10. In line with Enfield Council's Vision to make Enfield a better place to live and work, delivering fairness for all, growth, sustainability and strong communities, Energetik provides the Council with the opportunity to reach and exceed its 60% carbon reduction target as businesses and properties connect over time.

11. Energetik follows the same values and principles as the Council: working to improve Enfield for the long term. The company's activities play a key role in creating good homes in well-connected neighbourhoods: Energetik provides an essential service to residents in an innovative way, whilst supporting the borough's ambitious regeneration and housebuilding programme.

12. With an active focus on investigating connection opportunities with existing local businesses as well as potential new entrants, Energetik is already

working with local partners to build Enfield's local economy and create a thriving place.

Background

Energetik

13. Lee Valley Heat Network Operating Company was incorporated in 2017, with a business plan to deliver a heat network connected to Meridian Water developments, with an Energy Centre situated at Edmonton EcoPark.

14. Subsequently a number of smaller satellite networks across the borough were added to plans, and the build of the Meridian Water network will allow further connection to development at Joyce and Snells, should this go ahead.

15. This required a total initial investment of £52m. The first instalment of funding, consisting of the Council on-lending facilities to the company in the amount of £15m, sourced from a combination of London Energy Efficiency Fund and Public Works Loans Board, was approved in 2017. In September 2019, a second tranche of funding to construct the network was approved. These facilities awarded the remaining funding, sourced from £5m HNIP grant funding, and £32m lending sourced primarily between HNIP and MEEF.

16. The Council's Capital Programme also includes an allocation of £32m to fund expansion of the main heat network. The use of this allocation has not been approved for any specific project to date. The governance rules of the company require the approval of a project to be added to the business plan before the company can draw down or utilise this allocation of funding.

Heat Networks Investment Project

17. The Council submitted an application to HNIP for a funding round in October 2020, requesting £17m grant and £6m low cost loans, to ascertain whether HNIP funding could be obtained. The October 2020 funding round represented the first application point at which both the Council and company assessed there to be sufficient comfort that developments on the proposed pipe routes of the size required to render the project viable were very likely to receive planning permission and go ahead.

18. The HNIP grant and loan, combined with a match investment, could deliver

- A 'green line' extension; this would proceed from the energy up the east corridor of the borough, connecting to future developments at Edmonton Green and Southbury, and existing Energetik networks at Alma Road and Electric Quarter. The extension would then lead from Southbury westward towards Enfield Town, with the potential to connect to the Civic Centre.
- A 'yellow line' extension; this would lead along the South of the borough, connecting to Energetik's existing network at Ladderswood, as well as upwards to Southgate Village proposed development, which would connect to the existing network at Oakwood.

19. While the Council lobbied for a rapid decision on the application, a final award decision was not received from BEIS until 17th February 2021. This award offer was for facilities of £11.859m loan and £12m grant funding. The full Terms of the offer, including applicable conditions, was not received until the end of February. The terms and conditions included entering into the grant and loan agreements by 31 March 2021, which requires the Council to submit a draw down request by 19th March 2021.

20. The HNIP grant and loan package arising in these agreements supports the expansion of the company with £12m grant funding and a very low-cost loan of £11.859m to specifically finance the connection of the existing Edmonton network with the existing satellite networks in the west of the borough. The agreement requires match investment of £24m from another source to further expand the network; this is currently envisaged in the finance documentation to be Council borrowing from the PWLB but options will be evaluated through due diligence and the arrangement can be varied with the consent of BEIS.

21. Officers advised BEIS that proper approval of the project would not be possible under this timescale given the governance requirements of the Council's Constitution and the need for the Council to undertake full due diligence, including re-modelling of finances to account for the discrepancy between the application and offer funding split. The Council could therefore not accept the offer unless an extension were granted for appropriate governance.

22. A compromise position was negotiated whereby the conditions relating to project and match funding approval would be granted an extension to 31st July 2021; however, the HNIP funding is still be required to be drawn down by the Council prior to 31st March 2021. Clauses were agreed within the Terms proposed for draw down which allow the Council to repay the funding in full before 31st July 2021, should approval not be granted. This would carry some administrative costs, assessed to be of minimal value.

Main Considerations for the Council

23. Given the HNIP grant and loan package acceptance timescales, the consideration of this report is primarily whether to accept the package with conditions subsequent, or to reject the HNIP package.

24. Accepting the package with conditions subsequent secures the allocation for Energetik and enables the Council to conduct due diligence on the proposal and the impact on the company's business plan and the Council and for confirmation or rejection to happen with appropriate governance. It is stressed that this report and decision does not permit any use of drawn down funds by either the Council or Energetik. The maximum cost which could be incurred by the Council as a result of this report, without further Council approval over the expansion proposals, is assessed to be £50,000.

    Benefits & costs – Indicative

25. The table below sets out the anticipated benefits and costs of supporting expansion of Energetik through the HNIP package and the match funding

required in time. This is an initial analysis of a revised business plan which needs to be tested and explored through due diligence.

26. In broad terms, the green line provides the vast majority of economic benefit, while the yellow line provides additional environmental benefit, and helps to futureproof the network in terms of potential future capacity. In either case 121 in-borough jobs are estimated to be created.

	Current approved business plan	**Scenario 1 – Green line extension**	**Scenario 2 – Green line + Yellow line (HNIP)**
No. of connections	Ca. 15,000	Ca. 18,500 (+23.33%)	Ca. 18,500 (+23.33%)
Additional Funding Requirement above current approval	N/A	£25m	£26m plus £12m HNIP loan = £37m (plus £12 million grant from HNIP)
Retained earnings in Energetik	£39 million	£74 million (+ 89.74%)	£74 million (+ 89.74%)
Full LBE loan repayment	2055	2050	2049
Net profitable	2034	2027	2027
IRR	5.32%	5.53%	5.3%
Carbon savings – trees planted equivalent	522,337	694,640	758,540
Nitrous Oxide savings – cars off road equivalent	75,491	99,281	119,934
Additional Jobs	Small number	121	

Safeguarding Implications

27. There are no safeguarding implications arising from this proposal.

Public Health Implications

28. There are no public health implications arising from this proposal. The implications arising from expansion of the network more broadly will be addressed in a subsequent report. They are assumed to be positive as the network replaces NOx emissions from gas boilers and supports the fuel poor

through its funding and customer service, which increases use of heat and thereby supporting public health.

Equalities Impact of the Proposal

29. There are no equalities implications arising from these proposals. The implications arising from expansion of the network more broadly will be addressed in a subsequent report.

Environmental and Climate Change Considerations

30. One of the primary purposes of the HNIP initiative is to reduce carbon emissions from heat networks by connecting them to low carbon heat sources. The application to HNIP includes a commitment to saving over 22,000 tonnes of carbon per annum through the associated expansion of the network.

31. The Energetik Edmonton network will operate on CHP and gas boilers until connection to the Edmonton Energy From Waste (EFW) facility in 2026, at which point the heat will be sourced from waste heat. From 2026 it is forecast that at least 95% of the heat delivered to customers will be generated via the EFW, providing an 93% carbon reduction compared with the counterfactual.

32. The Arnos Grove Heat Network is operating with CHP with gas boiler backup but this will be connected to the Meridian Water Heat Network via this Project, and so from 2026 it is forecast that at least 95% of the heat delivered to customers will be generated via the EFW, providing an 93% carbon reduction compared with the counterfactual.

33. The Ponders End Heat Network and the Oakwood Heat Network will operate CHP with gas boiler backup from 2021, but this will be connected to the Meridian Water Heat Network via this Project, and so from 2026 it is forecast that at least 95% of the heat delivered to customers will be generated via the EFW, providing an 93% carbon reduction compared with the counterfactual

Risks that may arise if the proposed decision and related work is not taken

34. If the Council rejected the grant and loan package at this time, it may not be able to secure a package in future rounds of HNIP and the potential for Energetik to grow will be severely limited. The funding from government is limited and there is high demand.

35. The company and Council may suffer reputational damage in the event the package is rejected. The company has undertaken extensive negotiations with developers at key developments that would connect to the network, and their development planning applications have been submitted on the basis of such connections. Not accepting the HNIP package would substantially hinder the ability of Energetik to connect to these developments.

Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks

36. Entering into the grant and loan agreement and drawing down the funding comes with conditions subsequent. If Council approval is not obtained by the end of July, the Council will technically be in default under both agreements. However, in terms of practical effects; the Council can repay the loan and any liabilities or costs incurred are likely to be minimal. There is no provision in the grant funding agreement expressly permitting the Council to repay the grant in these circumstances and will therefore be left to the parties to work out a way forward.

Financial Implications

37. If corporate confirmation of approval is not obtained by July, there will be minimal administrative and legal costs to repay the grant and the loan.

38. Full financial analysis of the implications of the grant and loan and the match funding are currently underway. These will be contained in the subsequent approval report.

39. However, the current position is:

- The £12m grant funding would be invested in the company via equity purchase. This is in line with the previous decision regarding Tranche 2 of the base business plan, in which £5m of HNIP grant funding was invested via equity purchase.
- While the Council could provide this funding as a loan and charge interest, this would reduce the likelihood of company success; the Council's risk exposure in the event of company failure would be significantly higher than the return received from a loan at a sustainable interest rate, therefore equity purchase is assessed to be the best overall option in terms of risk management for the Council.
- The loan amount of £11.859m is lent by HNIP to the Council at a rate of 0.01% over 28 years, with repayments biannually in June and December. Until June 2024, the scheduled repayments are interest only; from June 2024 onwards, repayments consist of interest plus capital. The final repayment occurs in June 2049 (assuming no early repayments). The Council may make repayments earlier than schedule under the offered Terms of the loan.
- The Council will then on-lend the full amount to Energetik, at a rate compliant with Subsidy Control regulation. This will include a 'premium' amount of interest above the rate paid by the Council, meaning that the Council will receive more in interest payments from Energetik than it pays to HNIP, providing a source of revenue income over the life of the loan.

Legal Implications

40. The Council has the power under Section 1(1) of the Localism Act 2011 to do anything which individuals generally may do provided it is not prohibited by legislation and subject to public law principles (the 'general power of competence'). Further statutory powers exist to establish and invest in

Energetik, and Section 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).

41. The terms and conditions are based on those previously agreed and accepted by the Council for the 2020 HNIP funding.

42. As the Council will be the signatory to the finance documentation with BEIS, it will be responsible for ensuring compliance with the terms and conditions of those agreements. Accordingly, the obligations and requirements imposed on the Council should be mirrored and passed down via documentation between the Council and Energetik.

43. As part of the due diligence exercise to be undertaken by the Council, financial and legal advice will be obtained to ensure that the proposed arrangements are lawful under the new Subsidy Control regime.

Workforce Implications

44. There are no workforce implications arising from this proposal. The implications arising from expansion of the network more broadly will be addressed in a subsequent report

Property Implications

45. There are no property implications arising from this proposal. The implications arising from expansion of the network more broadly will be addressed in a subsequent report.

Other Implications

46. None

Options Considered

47. Not to enter into this agreement would lose £12m of grant and £11.859m of low-cost loans to support expansion of Energetik. This would be substantially greater loss than the minimal assessed cost should this decision be made, but the expansion fail to proceed.

Conclusions

48. Entering into the grant and loan agreement with conditions subsequent immediately in March 2021 is a compromise position agreed between BEIS and the Council to secure the allocation of the funding to Energetik given the change to the loan/grant package and these extreme time pressures instituted by government.

49. Full due diligence and sensitivity testing on the changed funding package is ongoing and will be concluded in time for the Council to make a considered decision with appropriate full governance by the end of July 2021.

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Appendices

Background Papers

The following documents have been relied on in the preparation of this report: