

RESOURCES & DELIVERING VALUE SCRUTINY BOARD - 6 March 2023

MINUTES

Present Councillors: M Parker (Chairman), R Holt, J Tildesley, D Gibbin, N Moses, A Adeyemo, A Hodgson, A Mackenzie

Officers Paul Johnson: Acting Chief Executive
Alan Brown: Assistant Director, Highways & Environment
Perry Wardle: Assistant Director, Growth & Development
Martin Clayton: Head of Investment & Commercial Partnerships
Lisa Whitton: Project Manager, Economy & Infrastructure
Alan Smith: Head of Growth Programmes
Alex Heath: Group Manager, Programme Development
Paul Rogers: Democratic Services

Guests Mike Cooke: Vital Energi Limited
Andrew Hirst: Womble Bond Dickinson

1. APOLOGIES FOR ABSENCE

Apologies were received from Councillor Y Clements, for whom Councillor A Mackenzie was substituting.

2. DECLARATIONS OF PECUNIARY OR CONFLICTS OF INTEREST

No declarations were received.

3. QUESTIONS AND DEPUTATIONS

No questions or deputations were received.

4. MINUTES

The Resources and Delivering Value Scrutiny Board:

RESOLVED:

To agree the Resources and Delivering Value Scrutiny Board Minutes arising from the meeting held on 2nd February 2023 as a true record.

5. MINUTES

To consider the draft Minutes arising from the Resources and Delivering Value Scrutiny Board meeting held on 2nd February 2023.

6. SOLIHULL TOWN CENTRE LOW CARBON ENERGY NETWORK

The Scrutiny Board received a presentation from the Project Manager, Economy & Infrastructure, which highlighted key matters within the Scrutiny

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Board report and provided further context. Members were invited to ask questions after the Project Manager, Economy & Infrastructure had presented each theme within the presentation. Members raised a number of questions through the course of the presentation, which are summarised as follows:

Strategic Case

Councillor Gibbin queried what incentive was there for future phase customers to connect if there is a potential additional for connection cost of up to £0.50M. Members were advised that a connection could become mandated through the future creation of Heat Network Zones however, the greatest incentive was that there was no need to de-carbonise their own buildings at significant capital expense, the energy centre can also more quickly decarbonise further as technology develops. In respect to Touchwood Centre, the majority of the business tenants already had their own electric energy systems in place and therefore would not necessarily be compatible with connection to the Heat Network.

Economic Case

Councillor Adeyemo questioned the lifespan of the Heat Network plant and equipment/power units, specifically in relation to the 40-year investment period for the Heat Network project. Mike Cooke (Vital Energi) clarified that each component had a different design life but are all maintained by Vital Energi through their Operation and Maintenance contract. An example provided was that the lifespan of the Heat Network pipes is more than 50 years, with heat pumps more than 20 years.

The Head of Investment & Commercial Partnerships further advised that fiscal provision for the lifecycle of the Heat Network components had been accounted for in terms of replacement and renewal of key components.

Councillor Adeyemo noted that the term of the ESCo was for 15 years only and questioned whether the Council would be expected to request Vital Energi to supply and replace Heat Network equipment at the end of its life cycle over 15 years. Scrutiny Board were advised that the initial ESCo contract period was 15 years with provision to extend for a further 10 years. The key test was that whether the company can afford to run for 40 years since that is the period that is required to repay the debt. The company has the long term capacity to replace the Heat Network components.

Councillor Tildesley welcomed that the report provided to the Scrutiny Board did also include as part of the strategic case examples of other local authorities experiencing fiscal challenges through operating a Heat Network citing Robin Hood Energy, Bristol Energy and Together Energy as examples. However, Councillor Tildesley also stated that greater detail could have been provided detailing other local authorities liabilities with similar schemes.

Examples of Council's operating successful schemes were also referenced by Councillor Tildesley, specifically the Aberdeen scheme, with supporting data

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over 21 years, and the Gateshead scheme, which operated from waste heat via small electricity generation plant but was a slightly different concept to this Heat Network.

In terms of risk and liabilities, Councillor Tildesley sought clarification should the company go out of business would the Council be completely indemnified, or subject to any legal costs or future compensation claims.

In respect of those local authorities experiences of poorly performing Heat Network schemes, these are quite different to that proposed here and was not necessarily attributable to technology failures but the fiscal case and financial assumptions for the projects.

The Head of Investment & Commercial Partnerships advised Members that from a Council perspective the Heat Network project was a Capital investment regardless and would have the accompanying liability for repaying the debt over the 40-year period. The Company is a separate entity and has its own legal form. The Council's liability to the Company is limited to its equity holding. The drafting of the Shareholders agreement and the contract was especially important to ring fence risk and that the legal liability ultimately rests with the Company.

Regarding financial liability, Councillor Gibbin noted that the report before the Scrutiny Board referenced that Cabinet was to seek delegated authority on the basis that a number of clearly expressed pre-criteria were met. Councillor Gibbin questioned if any of the pre-criteria failed to materialise would that draw to an end the Heat Network project. The Head of Investment & Commercial Partnerships clarified that in such a scenario in the short term the project would not proceed unless all the pre-criteria were met but longer term there may be other funding opportunities or different circumstances that prevail.

Councillor Adeyemo noted a change in the original proposals for the project to using combined heat and power and the use of boilers. In light of this, Councillor Adeyemo questioned whether an assessment on the impact on air quality in Solihull Town Centre would be undertaken, taking into account the switch to the use of natural gas.

Members were advised by the Project Manager, Economy & Infrastructure that this had been addressed within the project development case i.e. a ground source heat pump being replaced with air source heat and power. It is anticipated that the gas combined heat and power part of the solution would be replaced with another lower carbon source in the future. Regarding air quality, this was assessed as part of the planning application process. Emissions from the energy centre would also be monitored throughout the life of the project. Furthermore, when customers connect to the heat network, their individual gas boilers are replaced resulting in a net benefit for air quality for Solihull Town Centre.

Councillor Parker observed he did not see reference to engagement with schools in the report, nor any detailed references to the Solihull Town Centre

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Masterplan or wider economic benefits arising from the Heat Network. Councillor Parker also referenced Westgate as part of the Town Centre masterplan proposals and stated that there was a need to make the case for the broader value arising from the Heat Network. Members were informed that a number of Heat Network engagement events with schools had been facilitated by the Council, including on-line and in-school conferences. The project's external consultants had also delivered presentations and careers events to local schools. The Social Value element of the project was recognised as being significant, with many Social Value opportunities arising via the Council's partnership arrangements with Vital Energi. The Heat Network was recognised as one opportunity to support the development of the Solihull Town Centre Masterplan.

Councillor Adeyemo referenced the projected low but positive internal rate of return of 2.95% before tax for the project and highlighted that paragraph 4.65 of the report (Inflation) stated the base case assumed CPI at 2% per annum. Considering such an expected marginal rate of return to the Council, Councillor Adeyemo questioned how Members could be given the confidence to expect that the Heat Network would produce a positive return across future years of the project.

Members were advised that the above would be addressed in the next (financial) section.

The presentation to Members continued to address the project case across the following areas:

- Commercial
- Financial
- Due Diligence
- Risk, Sensitivities & Mitigation

Councillor Holt questioned whether project funding arrangements were subject to further bank loans to the Company. The Head of Investment & Commercial Partnerships clarified that the only loan assumed was the Council loan to the Company, otherwise no further loans were envisaged.

In terms of project risk, Councillor Holt considered whether the project risk was worth the potential reward once implemented and questioned whether the Council was sufficiently commercially astute to see the project through to delivery. The Head of Investment and Commercial Partnerships advised that the fiscal return could go either way in terms of a positive return or negative. In terms of delivering the project's goals of supporting one of the Council's Council Plan priorities which was carbon reduction, there was an element of financial risk but the question was whether the potential financial risk was acceptable to deliver carbon savings.

Councillor Holt advised that he struggled to understand the extent of the potential downside position and what the extent of the uncertain variables

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associated with the project were, such as future energy prices, inflation and the on-going war in Ukraine. Members were advised by the Head of Investment and Commercial Partnerships that the project variables could not be escaped, such as demonstrated by the current energy market prices, and that Councillor Holts perception around the project variables could not be dismissed but these are made transparent within the report. The Head of Growth Programmes and the Project Manager, Economy & Infrastructure, both further clarified that the risk of fluctuating energy prices is mitigated by the customer tariff methodology (the counterfactual) whereby the variable component of the customer tariff will be pegged against the ESPO rates (the bulk energy purchasing framework that the Council already utilises) so the tariffs will reflect market conditions.. Furthermore, if gas prices were to move in a significant downward trend in future this would be to the detriment of the Heat Networks current fiscal case.

Councillor Allen welcomed the report and recognised the question whether the project benefits outweighed the risks. Good efforts had been made to mitigate the project risks, but good management in the future would determine how successful the project is.

Councillor Parker highlighted the importance of managing the associated project risk, with the need for strong resilience to be embedded in risk arrangements and strong governance arrangements. These arrangements were especially required considering the projects commercial nature in the energy market. Should the Heat Network proceed, there would be further requirements for robust auditing arrangements, hands on management and strong Executive oversight of the project to be put in place.

Councillor Gibbin asked the Acting Chief Executive whether he thought the risk associated with the project was tolerable. The Acting Chief Executive advised Members that as could be seen from the report before the Scrutiny Board, Officers had undertaken as much due diligence as had been possible. It was now effectively a policy decision pertaining to the Heat Network project presented to Cabinet, which asks whether the carbon reduction benefits deriving from the Heat Network justified the financial and risk sensitivities associated with the project. Regarding the level of exposure to the Council for the borrowing requirement, the Acting Chief Executive stated that this risk is not at a level that will create a problem for the Council should the project go into deficit. However, there was no desire for that scenario to occur nor to create any undue fiscal pressures on the Council.

The decision to be taken in respect of the Heat Network was a policy decision which has to consider whether attaining the Councils net zero carbon emission objectives was too great a fiscal risk or not. Consequently, this was a policy decision only Members could make. The Acting Chief Executive reminded Members that taking alternative measures to achieve net zero could be far more costly than this and also that over £9m external funding has been secured for this project.

Councillor Adeyemo sought clarification as to whether the appointed Chair of the Company Board was also counted as a Board Director, and this was

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confirmed to be the case. Councillor Adeyemo questioned why it was the case the Council representative on the Board was proposed to be non-voting. The Project Manager, Economy & Infrastructure advised that this was not a Member position, this Council representative was proposed to be the Head of Investment & Commercial Partnerships and he had no voting rights in the ESCo governance structure but would be immersed within the ESCo itself,

The Project Manager, Economy & Infrastructure, confirmed that points raised by Councillor Adeyemo and Councillor Allen regarding Councillor and resident representation on the ESCo Board would be given further consideration following the Scrutiny Members comments.

Councillor Parker concluded that following consideration of the report, there was a need to ensure strong project management and governance arrangements supporting the Heat Network project were put in place; that safeguards be embedded to protect taxpayers' money and to ensure Value for Money was delivered through the Solihull Town Centre Low Carbon Energy Network.

Having considered the report, the Resources and Delivering Value Scrutiny Board:

RESOLVED:

- (i) To consider and note the latest developments of strategic significance in the heat network market and key drivers for the Council in delivering the Solihull Town Centre Low Carbon Energy Network;
- (ii) To consider and note the latest commercialisation position and in particular the procurement outcome, the affordability position, sensitivities undertaken and the financial risk assessment;
- (iii) To consider and note the draft Shareholder Agreement that will direct the relationship and decision-making processes between the Special Purpose Vehicle (i.e. the Energy Services Company or ESCo) and Solihull Council as sole shareholder in the Energy Network and Business Plan for the ESCo;
- (iv) To consider and note the programme and key milestones for entering the contract with the Design, Build, Operate and Maintain (DBOM) contractor and the delivery of the Energy Network to the Council and external customers (subject to Cabinet approval);
- (v) To RECOMMEND to Full Cabinet at its meeting scheduled for 9th March 2023 that consideration be given to appointing a Member of the Council

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to the Energy Services Company (ESCo) Board with full voting rights via the Annual Council meeting appointments process.

- (vi) To receive a Solihull Town Centre Low Carbon Energy Network Update Report as part of the Resources and Delivering Value Scrutiny Boards Annual Work Programme for 2023/24.

7. EXCLUSION OF THE PRESS AND PUBLIC

The meeting was not open to the public during discussion of the following item because the report contained exempt information as defined in Schedule 12A to the Local Government Act 1972.

8. APPENDIX 5A - PRIVATE TEMPLATE ELECTRICITY CONNECTION AND SUPPLY AGREEMENT

9. APPENDIX 5B - PRIVATE TEMPLATE HEAT CONNECTION AND SUPPLY AGREEMENT

10. APPENDIX 6 - PRIVATE BURO HAPPOLD FINANCIAL REPORT

11. APPENDIX 7 - PRIVATE BURO HAPPOLD CASHFLOW

12. APPENDIX 8 - PRIVATE COUNCIL CASHFLOW

13. APPENDIX 9 - PRIVATE CUSTOMER PRICING STRATEGY