

**Manchester City Council
Report for Resolution**

Report to: Executive – 10 January 2018

Subject: The Manchester Civic Quarter Heat Network

Report of: Strategic Director (Development) and the City Treasurer

Summary

The Purpose of this report is to report back on the terms of the agreement to be entered into with Vital Energi, outlines the steps to be taken in order to progress through to financial close of the project (March 2018) and seeks the approval of the Executive to the entering into of the contract.

This report also provides an update to Members on the progress that has been made to date in respect of the Civic Quarter Heat Network (CQHN) project and provides further detail on the proposed structure and contractual relationships to facilitate the delivery of the project.

Recommendations

The Executive is recommended to:

1. Note progress that has been made to date
2. Endorse the proposal to establish the 'Heat Network Holdco' structure as set out in section 3.2 of this report
3. Note that a business plan and any associated financial matters associated with the establishment of the Heat Network Holdco structure will be submitted to a future meeting of the Executive for approval
4. Delegate authority to the Strategic Director Development and the City Treasurer, in consultation with the Executive Member for the Environment and the Executive Member for Finance and Human Resources, to finalise the detailed terms of the arrangements to give effect to this structure
5. Authorise the City Solicitor to enter into and agree and complete on behalf of the Council all the necessary legal documentation giving effect to the above.

Wards Affected: City Centre

Manchester Strategy Outcomes	Summary of the contribution to the strategy
A thriving and sustainable city: supporting a diverse and distinctive	Investment into a Heat Network within the City Centre will help to reduce costs to businesses

economy that creates jobs and opportunities	and improve their resilience to climate change.
A highly skilled city: world class and home grown talent sustaining the city's economic success	The delivery of a series of Heat Networks within the City Centre should facilitate the creation of employment opportunities at a range of skill levels.
A progressive and equitable city: making a positive contribution by unlocking the potential of our communities	Work with the community sector to find ways of reaching communities to create a thriving active neighbourhoods
A liveable and low carbon city: a destination of choice to live, visit and work	The delivery of Civic Quarter Heat Network within the City Centre will help improve the environmental quality and attractiveness of the city, reduce energy and resource costs for residents, and help create attractive places that residents and businesses will choose to locate to.
A connected city: world class infrastructure and connectivity to drive growth	Manchester's Civic Quarter is already consists of established transport links throughout; cycling lanes, metro link, bus corridor. Car Parking primarily located within Manchester Central. The CQHN will include provision for high performance fibre communications to be installed along its route.

Environmental and Climate Change Impacts

The Civic Quarter Heat Network will reduce the City's CO₂ emissions by over 3500 tonnes per year and will operate for at least 30 years. It will improve air quality in the city centre by reducing the emissions of oxides of nitrogen currently generated by unabated combustion plant (boilers).

Full details are in the body of the report, along with any implications for:

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

Financial Consequences – Revenue

The Executive report in July 2015 approved use of funds from the Climate Change Innovation Fund (CIF) Reserve for project development to financial close. A proportion of the estimated gross costs will be recovered from a European Local Energy Assistance (ELENA) grant.

The ELENA revenue funding provides the opportunity to fund 90% of eligible external technical /legal /financial services costs (the balance to come from the benefiting

client – the Council). The eligible work streams for such funding support includes heat networks.

The proposed operating vehicle that will operate and manage the distribution of heat will be a separate legal entity to the City Council. It is proposed to set up a wholly owned City Council company, and the company will be responsible for funding both the ongoing operational costs and overheads of the company. The income will be funded through the revenues raised from the sale of heat to customers.

The final business case is currently being finalised and the details will be reported to the March Executive meeting as part of the final business case approval process. As part of the business case the working capital requirement of the SPV will be determined and any approval of financial support from the City Council will be set out in the March report.

It is forecast that over the duration of the business plan the company will generate a surplus from its trading activity, this will be set out in the final business case.

Financial Consequences – Capital

The approved capital programme includes an approval for £18m capital cost associated with the delivery of the CQHN. The final costings are currently being prepared and the March report will set out details of the final capital requirement.

An application for a capital grant was made in November 2016 to the Heat Network Investment Project (HNIP) which is funded by Department Business Energy and Industrial Strategy (DBEIS).

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Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the contact officers above.

- Manchester City Council Climate Change Action Plan 2015/16 - 2017/18, Executive, 18th March 2015
- Civic Quarter Heat Network Proposal, Executive, 1st July 2015
- Capital Programme (Budget 2017/18 – 2021/22), Executive, 11th January 2017
- Civic Quarter Heat Network Proposal, Executive, 8th March 2017

1.0 Introduction

- 1.1 Manchester – A Certain Future (MACF) is the city's Climate Change Action Plan, setting out what all organisations and individuals in the city will need to contribute to collective, citywide action to enable Manchester to realise its aim to be a leading low carbon city by 2020. It has the following aims:
- To reduce the city's carbon emissions by 41% by 2020;
 - To engage all individuals, neighbourhoods and organisations in a process of cultural change that embeds low carbon thinking into the lifestyles and operations of the city;
 - To prepare for and actively adapt to a rapidly changing climate; and
 - To make a rapid transition to a low carbon economy.
- 1.2 The Council has committed to contribute to the delivery of the city's MACF plan, setting out its commitments in the Council's Climate Change Action Plan, the most recent of which was approved by the Executive in March 2015. Within that Action Plan it identifies that the energy consumed within the Council's operational buildings estate contributes 66% (from 2009/10 baseline) of the Council's direct CO₂ emissions. As such this is a key area for the Council to secure reduction.
- 1.3 The Council's Climate Change Action Plan highlighted the intention to develop and deliver a heat network in the Civic Quarter. This report sets out the progress made to date on the delivery of the Civic Quarter Heat Network (CQHN) project and provides further detail on the proposed Special Purpose Vehicle (SPV) structure and contractual relationships. It also outlines the steps to be taken in order to progress through to contract completion / financial close (anticipated March 2018).

2.0 Background: Development of the Project

- 2.1 At its meeting in July 2015 the Executive considered and approved the use of the "Carbon and Energy Fund" (CEF) Procurement Framework to procure a delivery partner to deliver the CQHN. The Carbon and Energy Fund (CEF) provide project, procurement and management support together with the necessary technical, commercial and procurement experience within the City Council to deliver such a project.
- 2.2 On the 11th November 2015, under the Carbon and Energy Fund Procurement Framework the Council undertook a mini-competition to select a delivery partner.
- 2.2 At its meeting in March 2017 the Executive considered and approved the appointment of Vital Energi, who are one of the country's best known providers of sustainable and renewable energy schemes as Preferred Bidder to develop the CQHN project within the city. When implemented this will reduce CO₂ emissions by circa 3,500 tonnes per annum and improve air quality whilst generating a revenue stream for the Council to potentially invest in future projects.

- 2.3 The scheme, which will include the creation of a low-carbon energy centre and 2km district heating network will connect several iconic Manchester buildings, including Manchester Town Hall & Extension, Manchester Central Convention Centre, Central Library, Manchester Art Gallery, The Bridgewater Hall, and Heron House.
- 2.4 Heat created during electricity generation will be distributed through a highly efficient underground network of insulated pipes. The electrical power generated will also be distributed to buildings connected to the heat supply
- 2.5 It is proposed that the Energy Centre will be situated within the external car parking area of Manchester Central Convention Complex Limited. The project, includes the construction of an architecturally designed energy centre and also include a 40m flue and will be a permanent addition to Manchester's skyline.
- 2.6 Four of the UK's most renowned architecture practices were shortlisted to submit designs as part of a competition to ensure the energy centre and flue would be a positive addition to Manchester's Civic Quarter. After presentations were made to a selection panel made up of council representatives and relevant industry experts, the submission by award-winning architects Tonkin Liu and structural engineers Arup was chosen to deliver this stunning design, named the Tower of Light.
- 2.7 The March 2017 report also considered funding routes for the project and the establishment of a wholly owned SPV structure to "own" the project.
- 2.8 The current approved capital programme includes an £18m capital budget for the completion of this project. The detailed business case is currently being finalised a further report will be brought back to the meeting of the March Executive setting out details of the overall capital costs of delivering the scheme. In advance of any release of capital funding, the Council capital checkpoint forms are being prepared, this will provide more details on the finalised delivery timetable and cost plan

3.0 Contract Terms and Next Steps

- 3.1 The contract to be entered into with Vital Energi is a 30-year energy performance contract, whereby all carbon and financial savings are guaranteed by Vital Energi.
- 3.2 Contained within the terms of the contract, the Design, Build, Operation & Maintenance (DBOM) responsibilities will also be undertaken by Vital Energi for the duration of the contract period.
- 3.3 Once established the contract entered into between the City Council and Vital Energi will be novated into subsidiary company 2 (Tradeco) as further set out in section 4.7 of this report.

3.4 The Council's legal team, together with the appointed external legal advisors, will continue to work with the Project Team to finalise the contractual and corporate arrangements with Vital Energi.

4.0 The Special Purpose Vehicle – Recommended Structure

4.1 As set out in the report to Executive of March 2017, the CQHN is to deliver a number of key outcomes, namely:

- Provide reliable supplies of low carbon heat and power over a period of at least 30 years;
- Reduce the cost of energy increases to the City Council;
- Improve low air quality through a reduction in the emissions of oxides of nitrogen (NOx) over a period of at least 30 years;
- Generate a revenue surplus for the City Council;
- Avoid the cost of replacing ageing plant in individual buildings; and
- Be the first modern heat network in Manchester, delivering heat and power to multiple owned sets of buildings and therefore act as the trailblazer for other such similar initiatives.

4.2 In order to support and promote a flexible platform to deliver the aims of the project, it is proposed to establish a Heat Network Holdco Structure. This structure will comprise three wholly owned subsidiary companies: (1) a Heat Network Holdco Company (Holdco) which will take overall responsibility for the subsidiary companies:
(2) subsidiary company 1 (CouncilCo) which will provide supplies and services to the Council; and
(3) subsidiary company 2 (TradeCo) which will undertake all the commercial activity and provide services and supplies to all third parties.

4.3 The focus of HoldCo will be to:

- Provide leadership to the CQHN within the City harnessing the activities of the range of the agencies involved, identifying gaps in provision and bringing forward strategies for filling them;
- Consolidate the essential "back office" functions to deliver maximum efficiencies for the activities for the group as a whole; and
- Take overall responsibility for subsidiary structures – CouncilCo and TradeCo.

4.4 This HoldCo will be structured as a company wholly owned by the Council but with the flexibility to bring partners on with the right skills and capacity (and if necessary finance) to enable the Council and the sector to deliver objectives

and maximise the potential of the CQHN. The intention will be to seek an appropriately qualified Independent Chair of the Board along with other independent members who add value to the work of the company and the sector.

- 4.5 In order to ensure flexibility that will allow for further addition of new “Heat Network Projects” and third party investment it is proposed that the project HoldCo will be a company limited by shares. The precise nature and form of the legal entity is currently being determined however it will ensure, amongst other things, that:
- appropriate governance and risk management arrangements are established;
 - the financial and tax position is maximised; and.
 - it takes account of the most efficient way to procure and deliver services
- 4.6 The company will deliver its objectives through the agreed business plan. The articles of the company will provide that certain strategic matters would be reserved matters requiring the approval of the member(s) of the company. The reserved matters will include:
- the business plan;
 - any change to the articles of the company;
 - borrowing;
 - expenditure above certain limits;
 - employing employees above a certain salary; and
 - entering into partnership arrangements.
- 4.7 As noted above, the project HoldCo will seek to establish two subsidiaries:
- (1) subsidiary company 1 (Council co) which will provide supplies and services to the Council; and
 - (2) subsidiary company 2 (Tradeco) which will undertake all the commercial activity and provide services and supplies to all third parties.
- 4.8 It is proposed that the subsidiaries will be companies limited by shares, with Holdco being the sole shareholder. Such a structure will ensure maximum flexibility, growth in terms of future projects and third party investment.
- 4.9 Any subsidiary companies will be structured to ensure that the proposed legal structure is suitable to meet the needs of the Council and again, as with the HoldCo, if appropriate, any third party investor.
- 4.10 Under any SPV structure adopted, there will need to be appropriate governance arrangements to enable the business(es) to operate flexibly and without undue shareholder involvement, whilst at the same time being balanced with the necessary oversight and control to reflect the investment of public monies and overarching duties of the Council as a local authority. Therefore the structure will ensure that:

- There is a clear matrix of delegations and delineation of function between HoldCo, Council Co and TradeCo
- The governance arrangements include effective operational communication between HoldCo, Council Co and TradeCo and the Council – so that business decisions made by them are aligned with the wider body corporate
- All directors appointed to the boards of HoldCo, Council Co and TradeCo receive training in their duties as such; and

4.11 The Council will prepare a detailed business case and business plan that covers the objectives of the business, governance arrangements, the investment, the resources and any other risk which the business may face (and the significance of those risks) together with the financial and delivery outcomes to be expected. The business case will be presented to the Executive for consideration and approval before the delivery structure is legally established.

5.0 Conclusion

5.1 Approval of the business case at the March 2018 Executive Meeting and subsequent establishment of the SPV structure will be critical due to the requirements of the HNIP grant funding conditions set out within the grant Memorandum of Understanding (MOU). Under the terms of the grant conditions, the Council are required to complete all conditions precedent (Schedule 2 of MOU) submit a draw down request for the first phase of grant funding (£1m 17/18) and draw down the money by no later than 31.03.18 otherwise the grant funding will be 'lost' (returned to HM Treasury)

5.2 A further report will be presented to the March 2018 Executive Meeting setting out the financial, governance and operational background of the SPV structure to show how the SPV will deliver the project. A full business case in respect of the SPV structure will be set out in that report.

6.0 Contributing to the Manchester Strategy

(a) A thriving and sustainable city

6.1 Investment into a series of Heat Networks within the City Centre will help to reduce costs to businesses and improve their resilience to climate change.

(b) A highly skilled city

6.2 The delivery of a series of Heat Networks within the City Centre should facilitate the creation of employment opportunities at a range of skill levels.

(c) A progressive and equitable city

6.3 Work with the community sector to find ways of reaching communities to create a thriving active neighbourhoods.

(d) A liveable and low carbon city

- 6.4 The delivery of Heat Networks within the City Centre will help improve the environmental quality and attractiveness of the city, reduce energy and resource costs for residents, and help create attractive places that residents and businesses will choose to locate to.

(e) A connected city

- 6.5 Manchester's Civic Quarter already consists of established transport links throughout; cycling lanes, metro link, bus corridor. Car Parking primarily located within Manchester Central.

7.0 Key Polices and Considerations

(a) Equal Opportunities

- 7.1 An outcome will be to capture significant employment opportunities and ensure that local residents have the opportunity to compete for such job opportunities.

(b) Risk Management

- 7.2 Project risks and appropriate mitigations are addressed within the body of this report.

(c) Legal Considerations

- 7.3 Legal considerations are addressed within the body of this report. As at the date of this report the governance arrangements and funding of the SPV structure has not yet been finalised. The business case will articulate how the CQHN project has been structured and funded in a way which is compliant with all appropriate regulation.