

**Manchester City Council
Report for Information**

Report to: Resources and Governance Scrutiny Committee – 7 March 2024
Executive – 15 March 2024

Subject: Manchester Energy Network: 2024/25 Business Plan – **PART A**

Report of: Deputy Chief Executive and City Treasurer

Summary

The purpose of the report is to provide an overview of the operation and delivery of heat and power Manchester Energy Network since trading commenced in July 2021. The report will also outline priorities for the Network for the 2024/25 financial year, with a business plan for the next 12 months being brought forward for approval under an accompanying Part B report.

Recommendations

The Resources and Governance Scrutiny Committee is recommended to note the content of the report and comment and question as appropriate.

The Executive is recommended to:

- (1) Note the content of the report and comment and question as appropriate.
 - (2) Refer to the accompanying Part B report, which outlines the 2024/25 Manchester Energy Network Business Plan, for approval.
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Wards Affected:

All

Environmental Impact Assessment -the impact of the issues addressed in this report on achieving the zero-carbon target for the city	The Manchester Energy Network will be a key contributor towards the delivery of the 2038 Manchester zero carbon target. The Energy Network has a number of actions to delivery within the Council Zero Carbon Action Plan, with updates provided on progress to supporting the 2038 zero carbon journey on a quarterly basis.
Equality, Diversity and Inclusion - the impact of the issues addressed in this report in meeting our Public Sector Equality Duty and broader equality commitments	Not applicable for this report.

Manchester Strategy outcomes	Summary of how this report aligns to the Our Manchester Strategy/Contribution to the Strategy
A thriving and sustainable city: supporting a diverse and distinctive economy that creates jobs and opportunities	Not applicable.
A highly skilled city: world class and home grown talent sustaining the city's economic success	Manchester is one of a small number of UK cities that have agreed a science-based target and is leading the way in transitioning to a zero-carbon city. The Manchester Energy Network may provide the city with opportunities in the green technology sector.
A progressive and equitable city: making a positive contribution by unlocking the potential of our communities	Not applicable.
A liveable and low carbon city: a destination of choice to live, visit, work	Manchester Energy Network is a key contributor towards the Manchester Climate Change Action Plan and the delivery of the 2038 net zero carbon target for the city.
A connected city: world class infrastructure and connectivity to drive growth	Not applicable.

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

- Equal Opportunities Policy
- Risk Management
- Legal Considerations

Financial Consequences – Revenue

There are no capital consequences associated with this report.

Financial Consequences – Capital

There are no capital consequences associated with this report.

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Background documents (available for public inspection):

Executive: The Manchester Civic Quarter Heat Network, 17th March 2021
[Civic Quarter Heat Network update.pdf \(manchester.gov.uk\)](#)

Executive: Civic Quarter Heat Network Business Case (Part B report), 2nd June 2021

1. Introduction

- 1.1 The purpose of this report is to provide an overview of the operational position of Manchester Energy Network since it commenced to trade from July 2021. The report sets the scene for an accompanying Part B report in order for the Council as Shareholder to approve the Manchester Energy Network Business Plan for the 2024/25 financial year.

2. Background

- 2.1 The Manchester Energy Network, formally known as Civic Quarter Heat Network, has been developed to provide heat and power to buildings within the Civic Quarter using a highly efficient Combined Heat and Power (CHP) engine.
- 2.2 Through the installation of the Network's CHP, this has negated the need to replace individual heat and power units in Council and commercial buildings, which the Network now supplies, that were coming to the end of their useful life.
- 2.3 A key objective of the Network is to assist with the decarbonisation of assets within the Civic Quarter which are difficult to address through other means due to the historic nature of the buildings and / or the restrictions around development / alterations to these buildings. It is to be noted, at present, the CHP is fuelled by natural gas but there is ongoing work to put in place a decarbonisation strategy for the Network, outlined later in the report.
- 2.4 In a report to the Executive on 21st March 2018, approval was given to establish a Special Purpose Vehicle (SPV) to operate the Network. The company structure for governing and managing the Network was designed to enable the sale of heat and power to any buildings, public or private, on the route of the network. The SPV comprises of the following entities:
- A holding company for the Energy Network entities (Manchester Heat Network HoldCo Limited 11954438),
 - A trading company (Manchester Heat Network TradeCo Limited 11954693), which will supply heat and power to private sector companies. TradeCo will hold the primary generation assets and the associated contracts with Vital, gas and electricity providers and other suppliers as required; and
 - A 'Teckal' company (Manchester Heat Network SupplyCo Limited 11958857), which will procure heat and power from TradeCo to supply to Manchester's local authority buildings.
- 2.5 An overarching SPV Board has been established to govern the operations of the Network, along with a number of subject matter specific sub committees, details of which is further outlined in section 3 of this report.
- 2.6 The Network is wholly owned by the Council, with a blend of equity and debt funding provided by MCC to be repaid over a 30-year term. In addition to the initial MCC funding, a grant was also received via the government

administered Heat Network Investment Project (HNIP) in 2018. The current funding arrangements for the Energy Network is as follows:

Equity:	£6,630,000
Loan:	£14,500,000
HNIP Grant:	£2,870,000
Total:	£24,000,000

- 2.7 The business model for the Network is structured in a way to provide heat and power to customers whilst ensuring sufficient revenue is generated to operate the company, as well as repaying the principal debt and interest to the Council. The company is required to operate as a Going Concern and not rely on Shareholder support. However, there have been additional Shareholder monies injected into the SPV since the commencement of trading, which is outlined in more detail in section 3 of the report.
- 2.8 With regards to the construction and operation of the Network, Vital Energi, an experienced provider of sustainable and renewable energy schemes, were appointed to deliver the Network under a Design, Build and Operate and Maintain (DBOM) contract signed on the 31 December 2018, which was procured via the “Carbon and Energy Fund” (CEF) Procurement Framework. The duration of the contract is for a 30 year duration and includes a full replacement of the CHP engine in 2039.
- 2.9 Manchester Energy Network officially commenced supply of energy to a portfolio of Council and commercial customers in July 2021. The customers currently being supplied by the Network are as follows:
- Town Hall Extension and Central Library (heat and power)
 - Manchester Art Gallery (heat only)
 - Heron House (power only)
 - Manchester Central (heat and power)
 - Bridgewater Hall (heat and power)
- 2.10 All contractual arrangements relating to Manchester Energy Network were novated from Manchester City Council to Manchester Heat Network TradeCo Limited in December 2022. The reason as to why the novation had to take place was to enable the trading of heat and electricity on a commercial basis to external customers, which the Council would not be able to undertake directly itself within its powers.
- 2.11 Following the departure of the Director of Commercial and Operations and Contract & Commissioning Lead for Neighbourhoods from the Council, the Head of Commercial Governance, Assurance and Initiatives was asked to take over strategic responsibility for the operation of the Network from July 2023. Since this time, there has been a thorough review of both the business and operational model of the Network to ensure:
- that it will be utilised to its optimum potential;
 - that there is a clear pathway for decarbonisation activity to take place; and

- ensure that the Network is fit for the future given the Heat Zoning policy which will come into force from 2025, which will have significant impacts for Heat Networks across the country.

3. Manchester Energy Network: Current Position

3.1 The Manchester Energy Network commenced trading to customers in 2021. Since this time, the fortunes of the Network have been mixed given the recent turmoil in the international energy markets. Significant work has been undertaken to stabilise the business following this period of volatility, with the 2024/25 business plan acting as a strong foundation for the Network to operate from.

3.2 The next sections of the report provide an overview of the current trading position of the company in order to provide sufficient context for the Part B report and the business plan.

3.3 Financial and Trading position

3.3.1 As outlined, the trading context has been challenging for the Network due to the volatility of the energy market, coupled with the delay of the connection of the Town Hall, which is set to be a significant offtaker and was a key element of the overall commercial case for the Network. There has also been issues with decoupling the Town Hall Extension absorption chillers due to technical matters that are in the process of being resolved, resulting in a lower than expected offtake from the Network and less revenue than originally forecast. These issues have had a negative impact on the trading position and overall finances of the Network.

3.3.2 Since trading commenced, the Network has been reporting annual deficits:

- 2021/22: £230,202 loss (published in audited accounts)
- 2022/23: £1.094m loss (published in audited accounts)

For 2023/24 accounts, there is also likely to be a loss but this will not be published publicly until December 2024 when the SPV's accounts have been filed at Companies House.

3.3.3 Given the factors outlined above, a further £1.7m has been made available, following approval by the Executive on 14th February 2024, to the SPV to draw upon, if required. An element of the funds will be utilised to assist with company cashflow. It is to be noted that this additional finance will be recovered through an extension to the loan currently provided by the Council to the SPV. A provision has been built into the 2024/25 accounts for the increased level of loan repayments that will be due.

3.3.4 In order to set a prudent budget for 2024/25, there has been a line by line budgetary analysis undertaken on all income and expenditure of the SPV to present a comprehensive picture of the costs of the business. This includes ensuring that there is a clear correlation to the pricing strategy which the SPV puts in place with its customers as part of the stabilisation plan. Through this

work, it has ensured that the Network has competitively priced heat and power and is able to fulfil its financial obligations.

3.4 Decarbonisation

- 3.4.1 One of the key aspects which the original business case for the Network centred around was the provision of low carbon / zero carbon heat and power. At the time of the original business case, it was presented that a CHP engine fuelled by gas and supported by Renewable Gas Guarantees of Origin (RGGOs) was the optimal way in which to facilitate a low carbon provision. However, technologies advanced rapidly and by the time the CHP engine was up and running, alternative technologies were already facilitating lower carbon solutions. In addition, RGGOs are not currently recognised as contributors to the science based carbon accounting that the Council is following. This has been advised by both the Department of Energy Security and Net Zero (DESNZ) and the Tyndall Centre, who verify the Manchester Zero Carbon performance, and therefore cannot be incorporated in any reporting around carbon factors.
- 3.4.2 Despite this, the installation of the Network did replace old, inefficient, end of life equipment in Council and commercial buildings which would have required significant investment, with replacement of boilers creating some efficiency in terms of carbon output / intensity. Furthermore, the piping for the Network has a c100 year lifespan, so as alternative green fuels are used in the future, the Network infrastructure already in place can be utilised to supply both current and potentially new customers.
- 3.4.3 The Network was seen as a key contributor to the delivery of the Council's Zero Carbon Action Plan, with a clearly defined target for carbon reduction included in the plan – an annual carbon savings target of 1.600t. To ensure that the Network can meet fulfil the required targets, a Decarbonisation Working Group has been established and is actively working on the development of a decarbonisation strategy to clearly articulate how the Network will play its part in ensuring that Manchester can meet 2038 net zero targets. The initial plan is due to be published in Summer 2024, with further details on the current thinking around the potential decarbonisation pathway outlined within the accompanying Part B report.

3.5 Policy Context

- 3.5.1 Over the last 12-18 months, the policy context for heat networks has changed significantly, especially with regards to current heat zoning proposals. Under zoning, central and local government will work with industry and local stakeholders to designate zones where heat networks are identified as the most effective solution to decarbonising heat. This provides a significant opportunity for Manchester Energy Network given its location and the buildings which run along the route of the Network.
- 3.5.2 It is understood that in order to become the incumbent network in a zone, then there needs to be a robust decarbonisation plan put in place to meet the

requirements of the zoning policy. The exact requirements are to be stipulated when the policy is formalised but the Network is already actively undertaking this work to ensure that all necessary obligations will be met ahead of policy implementation.

3.6 Governance and Accountability

- 3.6.1 There is a strong governance and accountability framework in place for the SPV to operate to. An overarching SPV Board takes place on a six weekly basis, which has four Non-Executive Directors appointed to it in order to provide specialist industry insight and ensure that the Network is taking sound business decisions in relation to operational processes and business policies.
- 3.6.2 In addition to the SPV Board, there have been three sub-committees established for the focussing on key matters in detail, which are all critical to the successful operation of the business and delivering key priorities:
- Commercial Committee – remit of procurement and pricing.
 - Finance & Audit Committee – oversight of the finances of the company, as well as managing business risk and responsibility for key operation policies.
 - Decarbonisation Working Group – responsibility for formulating and implementing the Networks approach to decarbonisation.
- 3.6.3 To underpin the governance of the SPV, there has been a refresh undertaken of the Delegations Matrix which provides a clear framework for the SPV and its sub committees to work within, as well as being clear what matters are referred up to the Shareholder for approval.
- 3.6.4 With regards to Shareholder oversight of the entity, the Head of Commercial Governance, Assurance & Initiatives attends the Board on behalf of the Council and there is a monthly monitoring group in place, chaired by the Deputy City Treasurer, which reviews the overall performance of the SPV.
- 3.6.5 For the financial years 2022/23 and 2023/24, there has been no business plan presented to the Shareholder for approval. From this point forward, there will be an annual performance report and business plan presented to the Executive and Resources and Governance Scrutiny Committee. There will also be more formal bi-annual performance reports presented to the Council's Commercial Board and a performance briefing provided to the Leader and Executive Members for Environment and Finance & Resources. This will further strengthen the accountability and oversight of the entity.
- 3.6.6 It is to be noted that despite the reported trading position of the entity, the SPV remains a Going Concern. The SPV has been through a thorough review processes to ensure that improvements have been made to further strengthen a number of aspects of operation and advice from subject matter expert external advisors has been taken on board to ensure that recognised industry practice adopted and balanced business decisions are taken. It is to be noted that once the Town Hall is connected to the Network, then the Network will

begin to deliver the anticipated outcomes from the original business case, fulfilling the Shareholders expectation of the SPV's trading outputs.

3.7 2024/25 Business Plan

3.7.1 The Manchester Energy Network business plan for 2024/25 is presented alongside the accompanying Part B report. The business plan is commercial confidential and therefore needs to be a restricted item. The business plan covers the following headlines:

- Vision and objectives for 2024/25
- Policy and Strategic Context
- Corporate Structure and Governance
- Company Resourcing
- Physical Assets and Connections
- Decarbonisation
- Gas Procurement and Hedging Strategy
- Pricing Strategy
- Financial Performance and Monitoring inc. 2024/25 budget
- Key Performance Indicators
- Risk Register

4. Recommendations

4.1 The recommendations associated with this report is to note the content of the report and comment and question as appropriate.

5. Appendices

5.1 There are no appendices relating to the Part A report on the Manchester Energy Network Business Plan 2024/25. The Part B report provides a copy of the business plan as it cannot be shared publicly due to the commercially confidential content.