

**MOBILISING LOCAL ENERGY INVESTMENT**

**FINANCING THE WORK OF THE ENERGY INVESTMENT UNIT -  
TRANSFORMATION BID**

*To:* **General Purposes Committee**

*Meeting Date:* **28 May 2019**

*From:* **Graham Hughes, Executive Director, Place and Economy**

*Electoral division(s):* **Not applicable**

*Forward Plan ref:* **2019/035**      *Key decision:* **Yes**

*Purpose:* **To consider a Transformation Fund bid for supporting the work of the Energy Investment Unit until March 2022.**

*Recommendation:* **Members are asked to approve Appendix A, the Transformation Bid proposal of £989,000 for financing the Energy Investment Unit up to March 2022.**

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## **1 BACKGROUND**

- 1.1 The County Council led a successful bid in 2012 for European funding to cover the cost over 3 years of the Mobilising Local Energy Investment (MLEI) project. The objectives of the MLEI project were to build capacity of staff and members to develop and invest in energy projects, set up an investment fund and prove the potential for investment in low carbon energy measures.
- 1.2 The MLEI project started by delivering energy efficiency and renewable generation measures in schools and developing the procurement and contracting mechanisms for the Soham solar farm. By the end of the period of European funding, the MLEI project had successfully met its targets by commissioning roughly £3.5m of energy measures in schools & Council offices and a £10m solar farm at Soham.
- 1.3 The EU funding finished in August 2015 and both Economy & Environment Committee (21/04/15) and General Purposes Committee (19/05/15) agreed that work done under the MLEI project on the schools and corporate buildings would continue as part of the Energy Investment Unit (EIU) but in addition focus on developing larger projects that would generate revenues for the Council. An initial five year business case to 2020/21 was approved for the EIU based on calculations that showed that the full costs of the EIU delivering the schools programme and initial scoping for larger projects, could be recovered over time from the margin charged on loan costs paid by schools.

## **2 DEVELOPMENT OF THE ENERGY INVESTMENT UNIT**

- 2.1 Since 2015 the EIU has significantly expanded its scope of work reflecting the ambitions of the Council. It has:
  - grown the schools programme from 10 schools in 2015 to over 50 schools in 2019 totalling more than £8.7million investment;
  - taken responsibility for the procurement and management of utilities for the Council's buildings, schools and services to help manage our costs;
  - taken responsibility for legislative compliance for the Council's energy standards for its buildings;
  - managed an investment fund of £1million into energy reduction projects across its corporate buildings which is delivering annual revenue savings;
  - scoped a pipeline of major investment projects on Council land that are currently under development to generate revenues for the Council in the medium term and support the Council's budget;
  - responded to Cambridgeshire communities to co-develop energy projects that benefit local people such as Swaffham Prior;
  - developed the Council's Energy Strategy and Action Plan and collaborating with Peterborough City Council on shared projects;
  - influenced the government energy policy agenda and strategies; and
  - enhanced the energy infrastructure locally to support growth, working in partnership with local stakeholders.
- 2.2 The EIU has grown from 2.3 FTE in 2015 to a total of 5.7FTE in 2019 to cover the variety of work detailed in 2.1 above. The Council's Energy Team, formerly hosted in the Council's

Property Service, joined the EIU in 2017 and new staff were recruited during 2018 to help deliver energy investment projects and forecast income for the Council's budget.

### **3 PRESENT FINANCIAL POSITION OF ENERGY INVESTMENT UNIT**

- 3.1 When the EIU took its current form after the completion of the MLEI project, it was set up to act as a trading unit, i.e. any surpluses or deficits associated with its activity would be carried forward and operate on a full cost recovery basis. Full cost recovery in this case includes not just the salary and social costs but also a £19,500 overhead payment per full time member of staff to cover costs such as IT, bills, management overhead and accommodation. To give context, for 2019/20 the overhead cost for the Unit alone is £111,150.
- 3.2 A five year business plan was originally approved by Economy and Environment Committee on the basis that the EIU breaks even by 2020/21 through contributions from the schools contracts. The EIU has contracted with fifty one schools to deliver total income of just over £1.7million for the Council which provides an average annual income of £155,000 for the EIU over the next 10-15 years to support ongoing work with schools. At the same time the investment is delivering income/savings for the schools of over £700,000 per annum. This provides a benefit to the value of greater than £10,500,000 for the schools over the next 10-15 years and can be viewed as a success for the schools and transformative in the way we collaborate and deliver change.
- 3.3 However, the costs of the EIU have risen, mainly in response to the need to develop larger income generating projects for the Council. To date, the additional costs have been offset in 2 ways:
- from 2017 the energy team joined the EIU. A corporate contribution is provided that reflects the work done by this team on legislative compliance and the procurement and management of the Council's energy and water bills; and
  - the staffing costs associated with larger projects are now being covered by development cost budgets agreed by Commercial and Investment Committee as part of the authorisation of each individual project.
- 3.4 However, the above does not cover the EIU's activities in relation to developing community energy projects or strategic interventions to help unlock the challenges with the local grid. It also does not cover strategic influence of energy policy and market shaping required to build a new energy system and market, all of which is required to both open up opportunities for the Council to deliver energy projects but also to support growth ambitions.
- 3.5 As already acknowledged in paragraph 3.2 above, the initial five year business case for the EIU was scheduled to break even in 2020/21. This was agreed on the basis that building a business requires the upfront development and construction of projects ahead of financial returns. However, the total EIU deficit at the end of 2017/18 was £233,000 and the projected deficit at the end of 2018/19 is £374,000. In addition to the increase in its responsibilities outlined above, there are two specific timing issues which have resulted in the significant expected increase in the deficit this year:

- costs incurred on the St Ives project – if ERDF funding is eventually agreed for this, these costs will be recovered in 2019/20; and
- delays in the final completion of projects at several academy schools. Unlike maintained schools, repayments by academies only start when all project works are completed. This does not affect the total repayments expected over time from each school, but has meant a slippage in income compared to original budget projections.

3.6 It is also important to note that the UK electricity system is going through one of its biggest changes for 100 years. The infrastructure that distributes electricity needs upgrading to be smart and efficient to facilitate growth and to manage the shift from fossil fuels to clean decentralised energy. The electricity system and associated industry, is going through major disruption whilst also ensuring security of electricity supply to existing customers. This disruption is creating uncertainty and risk for developing and growing our energy investments but also bringing opportunity to shape new business models and integrate energy projects developed by the Council into the future smart energy system to create income.

3.7 Key risks moving forward in the short term include policy and regulatory change, identifying revenue streams that do not yet exist but that will emerge as the market develops, accessing government grants to build new business models and more locally securing planning approvals. Government policy has been changeable. In part due to the complexities moving from the current system to a future system, learning how to plan and manage this change and gathering new insights and knowledge of new technologies to help shape an emerging pathway. The implication for the Council is it needs to take a long term view to overcome short term volatility and change currently experienced in the energy market and ensure a strong understanding of what the future electricity system should look like and shape this with government. Developing new business models in partnership with government is a way of informing government thinking and policy whilst learning and building knowledge locally.

## **4 PROPOSED USE OF TRANSFORMATION FUND**

4.1 There are three strategic transformations that the EIU is looking to deliver over time. These include:

- a substantial net income for the Council through income generation from the current large energy projects approved with development budgets. While some of these schemes are still at an early stage and expected returns are subject to significant change, the overall projected net return to the Council over the 25 year expected lives of these projects is over £100m. This is a factor of ten greater than the schools benefit described in paragraph 3.2 above. This only takes account of proposals currently under development and many more projects would be expected to be delivered over this period;
- Shifting rural communities from fossil fuel heating onto low carbon alternatives. This will benefit our communities financially over the lifetime of a heating system, saving households and communities money that can be spent locally in our economy; and
- Supporting the 'tripling of the local electricity network' to unlock clean growth and investment opportunities for the Council. This will facilitate further energy projects on

our assets and help shape a future smart energy system for Cambridgeshire, contributing to the doubling of gross value added (GVA) by 2040 identified in the Devolution Deal for Cambridgeshire and Peterborough.

- 4.2 Noting the EIU's projected break even for March 2020/21 was based on delivering the schools programme, when scaled up to deliver the £100million income and build the strategic transformations described in paragraph 4.1 above, it is acknowledged that this is not deliverable on the original five year business case, supplemented with project specific resources to cover staff costs. There are a number of problems associated with the current funding methodology that need to be taken into account. In particular:
- development cost budgets are tied to individual projects. This makes it harder for the EIU to react and reprioritise if it is necessary to delay a project – as happened with the proposed scheme at Trumpington Park & Ride which became subject to a public consultation;
  - developing the future project pipeline beyond 2022 is interlinked with creating a new smart energy system for Cambridgeshire and identifying and shaping the market opportunities. This business development and support for the growth agenda is very important but piecemeal depending on when time permits; and
  - all significant capital projects carry risks, e.g. in relation to planning permission, ground conditions, state aid etc. That means there is a possibility that projects may have to be aborted for reasons that are beyond the control of the County Council. The Council recognises this may happen, but balances those risks by undertaking a programme of projects – allowing possible losses from an aborted project to be set against the potential future gains from the programme as a whole. As the EIU does not share in future gains though, it currently has no means to recover any losses within its budget.
- 4.3 To illustrate the challenge of funding being tied to specific projects, the EIU is projecting a total recovery of £340,000 from the scheme at St Ives Park & Ride. It is expected that costs incurred on the scheme since November 2016 will be recoverable from the ERDF grant being negotiated with the Ministry of Housing, Communities and Local Government (MHCLG). However, while the future of the scheme now looks optimistic, discussions with MHCLG over state aid delayed it by over a year and a half.
- 4.4 It is proposed that for the period 2019/20 to 2021/22 the EIU seeks funding from the Transformation Fund set out in table 1 below. The funding being sought for the EIU team budget is the same value as that currently provided by the staff costs approved with individual development project budgets but the linkages would not exist. This allows the funding to support other aspects of the EIU work, such as community energy projects and influencing the strategic direction of energy policy, should projects be delayed or changed.

Table 1: Funding for the Energy Investment Unit up to March 2022

Item	Funding required
EIU mobilisation for school schemes, energy projects and investment deficit	£374,000
Large Energy investment projects deficit to date	£40,000
Future anticipated revenue costs of project development to March 2022	£300,000
Contingency for aborted capital schemes	£200,000
Developing a programme of community energy projects	£50,000
Shaping the strategic energy agenda for sustainable growth	£25,000
<b>Total funding required</b>	<b>£989,000</b>

- 4.5 If the use of the Transformation Fund is approved, the parts of the existing development cost budgets relating to EIU funding would be cancelled as this would no longer be needed. The financial projections show that the net effect of providing the Transformation funding and cancelling the existing development cost budgets would be to bring the EIU into financial equilibrium in 2021/22, i.e. having repaid the existing deficit, subject to no unexpected events changing the projected costs incurred or income generated.
- 4.6 As projects proceed towards construction, the internal costs that have been incurred to develop the asset will be capitalized, which means the costs will be transferred out of the EIU's budget.
- 4.7 Whether funding is provided through individual development cost budgets or through an overall allocation from the Transformation Fund makes no difference to the overall County Council finances. The difference is in the operational flexibility of the EIU to deliver.
- 4.8 On 26<sup>th</sup> April 2019, Commercial and Investment Committee unanimously supported the submission of a Transformation Fund bid to GPC for financing the EIU to March 2022 subject to this paper including paragraph 3.5 and 3.6 on future risks.

## **5 ALIGNMENT WITH CORPORATE PRIORITIES**

### **5.1 A good quality of life for everyone**

The successful operation of the EIU should help improve the price and availability of future clean energy for Cambridgeshire businesses and communities.

### **5.2 Thriving places for people to live**

The ambitions of the Council to support the development of clean energy projects will reduce carbon emissions and help mitigate the impact of climate change on our communities.

### **5.3 The best start for Cambridgeshire's children**

The energy investments supported by the Council will provide income to support frontline services for residents, reduce local air pollution and continue to support energy measures in school to reduce bills and limit the increase of school budgets spent on energy.

## **6 SIGNIFICANT IMPLICATIONS**

### **6.1 Resource Implications**

The report sets out that there would be a transfer of costs from development cost budgets (funded by borrowing) to the Transformation Fund. In addition, it is important to note that the transition of the UK's energy infrastructure to low carbon energy brings volatility to projects being developed and the Council's energy projects are working within this challenging environment.

### **6.2 Procurement/Contractual/Council Contract Procedure Rules Implications**

There are no significant implications.

### **6.3 Statutory, Legal and Risk Implications**

See paragraphs 3.5 and 3.6

The energy market is subject to many influences including regulatory change, testing of new business models and trialling new technologies. It is also a changing market with some fragility. For example, BEIS' 'capacity market' mechanism has been suspended due to a legal challenge on state aid. No payments to energy projects contracted under this mechanism are allowable whilst a review is underway. This type of challenge brings uncertainty to investors.

### **6.4 Equality and Diversity Implications**

There are no significant implications.

### **6.5 Engagement and Communications Implications**

There are no significant implications.

### **6.6 Localism and Local Member Involvement**

There are no significant implications.

### **6.7 Public Health Implications**

There are no significant implications of the funding bid but positive benefits will arise from the implementation of energy projects on local air pollution and climate change

<b>Implications</b>	<b>Officer Clearance</b>
<b>Have the resource implications been cleared by Finance?</b>	Yes Name of Financial Officer: Tom Kelly
<b>Have the procurement/contractual/ Council Contract Procedure Rules implications been cleared by the LGSS Head of Procurement?</b>	Yes Name of Officer: Paul White
<b>Has the impact on statutory, legal and risk implications been cleared by LGSS Law?</b>	Yes Name of Legal Officer: Amy Brown
<b>Have the equality and diversity implications been cleared by your Service Contact?</b>	Yes Name of Officer: Elsa Evans
<b>Have any engagement and communication implications been cleared by Communications?</b>	Yes Name of Officer: Jo Shilton
<b>Have any localism and Local Member involvement issues been cleared by your Service Contact?</b>	Yes Name of Officer: Emma Fitch
<b>Have any Public Health implications been cleared by Public Health</b>	Yes Name of Officer: Stuart Keeble

<b>Source Documents</b>	<b>Location</b>
1. First EIU Quarterly Monitoring Report March 2019 2. Budget Build 19_20_ Energy Investment Unit 3. Salary Spreadsheets 19_20 4. Cashflow projections schools programme 5. OFGEM RIIO-2 consultations  6. Government's Industrial and Clean Growth Strategies	<a href="http://www.cambridgeshire.gov.uk">www.cambridgeshire.gov.uk</a> Internal EIU folders As above As above <a href="https://www.ofgem.gov.uk/net-work-regulation-riio-model/network-price-controls-2021-riio-2/riio-2-publications-and-consultations">https://www.ofgem.gov.uk/net-work-regulation-riio-model/network-price-controls-2021-riio-2/riio-2-publications-and-consultations</a> <a href="https://www.gov.uk/government/topical-events/the-uks-industrial-strategy">https://www.gov.uk/government/topical-events/the-uks-industrial-strategy</a>