
A separate report is submitted in the private part of the agenda in respect of this item, as it contains details of financial information required to be kept private in accordance with Schedule 12A of the Local Government Act 1972. The grounds for privacy are that it refers to the identity, financial and business affairs of an organisation and the amount of expenditure proposed to be incurred by the Council under a particular contract for the supply of goods or services.

Cabinet
Council

14 February 2012
21 February 2012

Name of Cabinet Member:

Cabinet Member (Sustainability and Local Infrastructure) - Councillor A. Khan

Director Approving Submission of the report:

Director of City Services & Development

Ward(s) affected:

St. Michaels
Cheylesmore

Title:

Coventry's District Heating Scheme, Heatline – Appointment of Commercial Energy Partner

Is this a key decision?

Yes

The proposal will affect two electoral wards in the City and have financial implications in excess of £500k per annum

Executive Summary:

As part of the sustainability and low carbon agenda for the City, the Council is developing a district heating network called Heatline. Initially this is for the city centre in partnership with Coventry University and their estate. The aspiration is that the scheme will grow and expand over the next 25 years providing a number of locations across the City Centre with a renewable source of energy.

The initial aim of the project is to utilise the steam which is a by product of the incineration process, to be supplied by Coventry and Solihull, Waste Disposal Company (CSWDC) and to maximise carbon dioxide savings for the City. Utilising steam to generate heat, in this way has a number of benefits, it reduces carbon dioxide emissions, conserves natural resources, reduces the carbon tax liability (Carbon Reduction Commitment (CRC) Energy Efficiency Scheme carbon tax), improves the carbon footprint for individual participants and the city as a whole, helps to

meet Government carbon reduction targets and improves Coventry's credentials both nationally and internationally as a green dynamic city. This in turn can bring added benefits such as inward investment and job opportunities.

The scheme itself will comprise of a network of insulated underground pipes to deliver heat, in the form of hot water, from the point of generation (the Energy from Waste (EfW) plant based on London Road) to end users.

The Council has secured £1.6m grant funding from the Homes and Communities Agency (HCA) to part fund the cost of installing the main heatline pipe from the EfW plant into the city centre. In addition numerous feasibility studies have been done showing the clear viability and opportunity of the scheme. The total estimated cost of the capital investment is £10million and the commercial energy partner is expected to finance the remainder after the HCA grant.

An enabling report was approved by the Cabinet in January 2011 to secure the HCA grant and take the scheme into procurement. The Council has now entered into procurement in order to appoint a commercial partner to design, build, finance and operate Heatline. The main end users of the heat in the city centre will initially be the Council offices and leisure facilities such as the city centre sports centre, the transport museum and the Herbert, the University and Cathedral, with the potential to expand the network over future phases. The plan for the future is to expand the district heating network to residential properties in the vicinity of the city centre, the proposed Friargate and Royal Mail sorting office developments and the wider City Centre redevelopment.

Short listed bidders will return tenders by the closing date of 16th January, they will be evaluated using the fixed evaluation criteria throughout January/February and a decision on whether to proceed with the scheme and which bidder to appoint will be made at the end of February/beginning of March to ensure we satisfy the conditions of the HCA grant. This report outlines a proposed framework and set of tolerances for making those decisions within the timescales required under the HCA agreement.

Recommendations:

Cabinet is recommended to request Council to:

1. On completion of the tender evaluation to enter into contracts with the selected contractor within the financial parameters set out and on terms detailed in this report ; and
2. Give delegated authority to the Cabinet Member (Sustainability and Local Infrastructure), Director of City Services and Development and Director of Finance and Legal Services to complete and award a contract to the selected contractor based on the recommendations of Officers who will undertake the evaluation of bids received.
3. Complete supply agreements with the University and the Cathedral conditional upon completion of the Heatline infrastructure by the selected contractor.
4. To underwrite the known project management costs for Heatline of up to £150,000

Council is recommended to

5. On completion of the tender evaluation to enter into contracts with the selected contractor within the financial parameters set out and on terms detailed in this report.
6. Give delegated responsibility to the Cabinet Member for Sustainability and Local Infrastructure, Director of City Services and Development and Director of Finance and Legal Services to complete and award a contract to the selected contractor based on the recommendations of Officers who will undertake the evaluation of bids received.

7. Complete supply agreements with the University and the Cathedral conditional upon completion of the Heatline infrastructure by the selected contractor.
8. To underwrite the known project management costs for Heatline of up to £150,000

List of Appendices included:

None

Other useful background papers:

None

Has it been or will it be considered by Scrutiny?

Yes, SB4 - Environmental and Community Safety, requested an update on the project at their meeting on 29 February 2012

Has it been or will it be considered by any other Council Committee, Advisory Panel or other body?

Yes, Heatline Cabinet Advisory Panel - tbc

Will this report go to Council?

Yes, 21 February 2012

Report title:

Coventry's District Heating Scheme, Heatline – Appointment of Commercial Energy Partner

1. Context (or background)

- 1.1 The Heatline project is currently in a restrictive accelerated procurement process to appoint a commercial energy partner to design, build, finance and operate this contract over a 25-year period. There are four bidders who have been invited to tender (ITT) following a Pre-qualification Questionnaire (PQQ).
- 1.2 The bidders returned tenders in mid-January and they are currently being evaluated against the criteria set out within the ITT documentation. Following the evaluation process, the Council will need to decide whether or not to proceed with the scheme, and if so who to appoint as the preferred supplier. This is a partnership project with Coventry University and as such the Council's agreement to proceed requires Coventry University to seek approval with its Board of Governors which is happening at the same time as the Council's process.
- 1.3 A contract will only be awarded if both the Council and Coventry University both agree to appoint the preferred supplier, following the evaluation of the ITT bids.
- 1.4 Due to the requirements of the HCA grant, if in agreement to proceed, the Council needs to appoint at the beginning of March to ensure that they retain the grant. Any delay will put the HCA grant at risk of claw back.
- 1.5 The sections below in this report consider the options available to enable the Council to reach a decision on whether to proceed, and if so which commercial partner to appoint within the required timescales.

2. Options considered and recommended proposal**2.1 Bring a report on the outcome of the evaluation to Cabinet and Council in March**

- 2.1.1 The key issue here is the timescales in which the project needs to take place. By waiting until Cabinet and Council meet in March there is a high risk that the project will be unable to meet the tight restrictions and constraints associated with the HCA grant. The consequence is that the £1.6million HCA grant will have to be returned and the ability of the Council to find a commercial partner at the end of this procurement process is put at significant risk.

2.2 Bring a Report to Cabinet and Council in February and Delegate authority to award a contract

- 2.2.1 Given the constraints with regards to the timescales for approval, a second option is for the Council to agree a framework within which a decision to both proceed and subsequently select a commercial partner can be made by delegation.
- 2.2.2 Within this option Council officers and Coventry University officers would review the bids received against evaluation criteria published in the ITT. The evaluation criteria will assess bids against the minimum and maximum ranges for key variables that the successful bidder would have to meet in order to be selected as the preferred supplier.
- 2.2.3 The ITT Commercial and Financial evaluation for will review financial robustness of the solution, price and financial implications of the proposal and the deliverability of the funding package.

- 2.2.4 The overall objectives of the financial evaluation are to ensure, the successful bidders solution will:
- Provide financial savings for the Council and other end users for the overall cost for heating and electricity compared to the current costs for such services. Lower costs will be as a result of a reduction in the volume of kilowatt units required for heating and the price per unit.
 - Provide price security for the duration of the contract through the proposed pricing mechanism.
 - Reduce carbon emissions for the city, resulting in a lower carbon tax liability for end users.
- 2.2.5 Bidders will need to demonstrate they are able to secure the finance to fund the capital investment in the infrastructure over the life of the contract and that the financial solution is robust, with all expected costs included at an appropriate rate.
- 2.2.6 Bidders will need to demonstrate an ability to deliver with all the constraints detailed within the ITT, including no work taking place on major routes, or junctions into and around the City Centre during the Cathedral celebrations or Olympics and associated events.
- 2.2.7 Bidders will be required to ensure that they can meet the milestones associated with the use of the HCA grant as part of their compliant bid.
- 2.3 The recommended option is the second option as described in the paragraphs under section 2.2.

3. Results of consultation undertaken

- 3.1 The Low Carbon Energy Study, a detailed consultation document produced by AECOM on request of the council and other partners (Advantage West Midlands, Coventry University, University of Warwick, The Carbon Trust and the Chamber of Commerce) states that "making the maximum use of heat from the EfW facility makes sense financially as it enables the facility to earn a significant revenue stream (up to £0.9 million per annum, for a heat load of 40,000Wh per annum) from the sale of green electricity certificates". The use of heat from the EfW plant makes the generation of electricity more efficient as less energy/ power is lost through the process.
- 3.2 The initial consultation for this scheme confirmed that when the district heating network is expanded across the City through further phases to its maximum size it could save over 25,000 tonnes of Carbon dioxide per year, or the equivalent of over 40% of the current emissions from the Councils operations.
- 3.3 A technical feasibility study for the EfW plant district heating system undertaken by SKM Enviros confirmed this scheme was operationally viable. Further technical surveys on the pipe route have also confirmed the viability of laying pipework and connecting the EfW to City Centre buildings.
- 3.4 KPMG completed a gateway review of Heatline's business case, specifically looking at energy costs savings, the delivery of carbon security and the long term price certainty of heat. In all cases they reports positively in favour of the Council and the University. KPMG did highlight a potential gap in finances for the commercial energy partner, which is dependant on how the successful bidder finances the scheme. However depending on the solutions put forward by bidders to finance the scheme, this gap may or may not be there.

4. Timetable for implementing this decision

4.1 The project will be managed by the 'Heatline Project Team', led by the Council and made up of officers from the Council and Coventry University. This group will monitor the project through evaluation, construction and implementation of Heatline.

4.2 The timetable for implementing the decisions in this report are as follows:

Agree selected contractor	24 Feb 2012
Publish intention to award contract	27 Feb 2012
Award contract to selected contractor	9 March 2012
First connection in place	31 August 2012
Completion of initial scheme	28 February 2013

5. Comments from Director of Finance and Legal Services

5.1 Financial implications

5.1.1 It is estimated that the capital expenditure for the project will be c £10m, of which £1.5m will be met from the Low Carbon Infrastructure Fund (LCIF) grant awarded by HCA to the Council. All other funding will be provided by the private sector, and the ability to secure the gap finance will be assessed as part of the ITT evaluation process. The Council is not contributing towards the capital costs and will not be prudentially borrowing to fund any elements of the project.

5.1.2 A business case was completed by SKM Enviros, and a further gateway review was undertaken by KPMG, which demonstrated there was a case for the project. Due to the number of variables which impact on the project, it is only by testing the market that it will be possible to determine if there is the appetite and financial resources available in the private sector to deliver this district heating scheme.

5.1.3 The key variables which will only be known following the procurement includes the total capital costs of the scheme, as these will vary depending on the private sectors ability to secure finance and the specification of their design. Bidders may propose an innovative solution which may help to reduce their operational costs. CSWDC are investigating the possibility of accreditation, which would enable them to claim a number of financial Government incentives available for district heating schemes. If such revenue is received, an element will be passed to the Commercial Energy Partner delivering the project.

5.1.4 All bids will be assessed against the evaluation criteria, which includes key technical criteria, project management including risk, as well as Commercial and financial requirements.

5.1.5 Based on the commercial and financial criteria, a contract will only be awarded if the proposed solution demonstrates:

- (i) The bidder is able to secure the capital funding required to deliver the project.
- (ii) The financial model and the underlying assumptions are credible and robust, with the revenue generated from the project being sufficient to cover all operational costs as well as meet any capital repayments.
- (iii) The overall project is financially viable from the perspective of the Commercial Energy Partner.

- (iv) Financial savings and price security for the Council, Coventry University and other end users, including the costs for heat, electricity, maintenance and carbon tax liability. The costs for utilities for the Council buildings will be met from the existing budgets for these services.
- (v) CSWDC is left as a minimum in a financially no better or no worse situation. This protects the council as a shareholder of the company.

5.1.6 Utilising the Heatline scheme for the initial Council buildings could save approximately £0.08m per annum, made up of both savings on current energy prices and savings on the council's carbon reduction commitment (CRC) tax.

5.1.7 The project costs to date for external advisors have been met from £100,000 provided by HCA and £50,000 from Growth funding. This budget has been expended and it is envisaged that there is a funding gap for the current year of up to £50,000, which needs to be funded. If a contract is awarded, there will be additional costs including project management, construction and design and contract management (CDM) for which there is no budget available. This report seeks approval for up to £100,000 to cover the additional costs following contract award and a further £50,000 for the current costs for which there is no available budget.

5.2 Legal implications

5.2.1 The Council has undertaken a formal procurement using the accelerated restricted procedure under the Public Contracts Regulations 2006. Under this procedure there is no ability to negotiate throughout the tender process and the evaluation criteria set out in the invitation to tender is fixed

6. Other implications

None

6.2 How will this contribute to achievement of the Council's key objectives / corporate priorities (corporate plan/scorecard) / organisational blueprint / Local Area Agreement (or Coventry Sustainable Community Strategy)?

Heatline contributes directly against the priority outcome '*Coventry, proud to be a City...that works for jobs and growth*'. Specifically against the objectives:

- Increase Coventry's share of the low carbon industry
- Create jobs through the growth of business and investment in the city
- Help more residents get jobs

Our current research shows that in the initial phase of connecting Heatline to specific Council and University buildings will reduce the city's carbon emissions by 3,500 tonnes. As Heatline expands across the City the figure will only increase over time.

The construction of the initial and future phases will bring jobs into the City over the 25 year period.

Heatline will be the most significant source of renewable energy available to new investors and developments across the City centre, making it an attractive place to invest and enabling investors to meet the requirements on them for low carbon sustainable energy sources.

How is risk being managed?

- 6.2.1 A comprehensive risk assessment is part of the project development and procurement process. Within the ITT we have identified number of risks that bidders are currently considering how they deal with them. The key risks to the Council and the how we are dealing with them are outlined below:

Risk	Mitigation
1. Restrictions on works due to Cathedral and Olympic 2012 events	No work will take place on major routes, or junctions into and around the City Centre during the Cathedral celebrations or Olympics and associated events.
2. Recent public realm improvements will have to be redeveloped to accommodate Heatline	Worked with Highways to ensure that Heatline does not interfere with any public realm improvements and in cases will work around the public realm improvements.
3. Failure to agree contract negotiations with the university may affect the feasibility of the project.	High level engagement with the University and involvement in the project team and procurement process.
4. Failure to procure a private sector partner within the agreed timescales, with the relevant expertise and ability to provide/secure capital or equity and achieve a project viability	Early engagement of the market in the vision and aspiration of the project through Industry day. External advice on the market appetite for similar projects in the UK. 4 top bidders now at the table.
5. Private sector bidders unable to secure a commercial deal with CSWDC in procuring the heat	CSWDC have been involved in the project development, the preparation of the ITT and all information relating to the plant has been either provided by them or signed off by CSWDC. Private sector bidders are liaising directly with CSWDC to secure their own supply deals with the company.
6. Failure to meet HCA Grant conditions and have to return grant	Clear project timetable in place, constraints part of the ITT and HCA engaged on project team. HCA timescales currently being met. Seek approval in advance for delegated decision making by Council and University.
7. Capital costs exceed estimates due to conditions outside the Council's control and therefore ESCo unable to raise finances	The private sector will be responsible for funding and managing the capital costs. A contingency been put in place and a ground investigation will be completed pre-ITT to reduce this risk. Publication of a preferred route rather than a fixed route.
8. Unable to secure an electricity solution , particularly for Coventry University	Commissioned work into options to provide an agreement solution to University's electricity supply issues by engaging in Heatline. The University are partners and have been involved in developing and agreeing the publication of the ITT. Asked the market to provide a solution
9. Financial exposure to CSWDC if they fail to supply heat to ESCo	Heat supply is being provided as part of a property transaction, between the landlord (CSWDC) to the tenant of the heat station. As such there are no financial penalties for CSWDC if they fail to supply the heat. CSWDC as a minimum need to be left in a no better, no worse position.

6.3 What is the impact on the organisation?

- 6.3.1 The Council would initially connect the following buildings to the Scheme
- Council House
 - Civic Centres 1,2,3 and 4
 - Herbert Art Gallery and Museum
 - Sports Centre (tbc)
- 6.3.2 By proceeding with the project the Council will be signing up to a 25 year agreement with a commercial partner for the supply of heat to initially the buildings detailed above. The price of heat will be regulated and track energy prices always being cheaper than purchasing energy on the open market.
- 6.3.3 Utilising the Heatline scheme for the initial Council buildings could save approximately £0.08m per annum, made of up of both savings on current energy prices and savings on the council's carbon reduction commitment (CRC) tax.
- 6.3.4 Given the price security that Heatline will bring over the 25 year period and the increasing CRC tax the long term impact and potential savings for the Council are considerable. This project will enable the City to lead the way in innovation and sustainability.

6.4 Equalities / EIA

- 6.4.1 The Council's duty under section 149 of the Equality Act 2010 is not affected by this project and it is anticipated that any equality issues will be positive by the implementation of this scheme. As the scheme will be designed to include public sector, commercial, education and residential buildings the opportunity to supply heat at a competitive basis will benefit all users and will target fuel poverty especially in residential properties. Future phases of the scheme will target deprived communities in and adjacent to the City Centre with the aim of removing the effects of fuel poverty.

6.5 Implications for (or impact on) the environment

- 6.5.1 The district heating system proposed under the Heatline plans will enable buildings to be heated using a low carbon source of energy. In phase 1 this is expected to reduce the total carbon dioxide emissions from City Council and Coventry University buildings by around 3,500 tonnes per year. This will help sustain the city's good level of performance in reducing carbon dioxide emissions from commercial and industrial sources which has seen emissions fall by 30 per cent between 2005 and 2009 - the deepest cuts of any of the top 20 cities in Britain. Low carbon initiatives such as Heatline are seen as one of the key ways in which local authorities can help achieve Government-set carbon reduction targets of 80 per cent by 2050 and 34 per cent by 2020.
- 6.5.2 The provision of a low carbon energy source will help to ensure that carbon dioxide emissions do not increase as general levels of commercial activity increase with time. This first phase of Heatline will allow subsequent expansion of the network which could eventually see around 25,000 tonnes of carbon dioxide emissions being eliminated. By reducing the number of discrete sources of air pollution through eliminating the need for separate boilers in city entire buildings it is expected that local air quality levels of pollutants such as nitrogen dioxides will also reduce.

6.6 Implications for partner organisations?

- 6.6.1 CSWDC will receive income for the heat sold to the commercial energy partner to ensure that as a minimum CSWDC remain financially whole.
- 6.6.2 Coventry University is a partner in the scheme and will connect a significant part of their estate to Heatline initially with the option to connect more buildings in the future.
- 6.6.3 Coventry Sports Trust, the Herbert Art Gallery, the Transport Museum and the Cathedral are all likely additional beneficiaries, as they are all within the target areas.
- 6.6.4 Occupants of existing and future new Registered Social Landlords, e.g. Whitefriars, Orbit, and privately owned housing units in the city centre will eventually benefit from low energy costs.

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Councillor A Khan	Infrastructure)			
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