


Cabinet Wednesday, 24 July 2024	 TOWER HAMLETS
Report of: Paul Patterson, Corporate Director of Housing and Regeneration	Classification: Part Exempt
Barkantine Heat and Power Company Private Finance Initiative (PFI) Transitional Agreement	

Lead Member	Councillor Shafi Ahmed Cabinet Member for Environment and the Climate Emergency
Originating Officer(s)	Abdul Khan – Head of Sustainability
Wards affected	Canary Wharf;
Key Decision?	No
Reason for Key Decision	This report has been reviewed as not meeting the Key Decision criteria.
Forward Plan Notice Published	4 June 2024
Exempt information	<p>This report and/or its appendices include information that has been exempted from publication as the Monitoring Officer:</p> <ul style="list-style-type: none"> • has deemed that the information meets the definition of a category of exempt information as set out in the Council’s Access to Information Rules; and • has deemed that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. <p>The exempt information is contained in Appendix 5</p> <p>The exempt information falls into this category: 3. Information relating to the financial or business affairs of any particular person (including the authority handling the information)</p>
Strategic Plan Priority / Outcome	Working towards a clean and green future

Executive Summary

The Barkantine Heat and Power Company (BHPC) is a district heating energy centre located behind Tiller Leisure Centre, the scheme is managed by Dalkia a subsidiary

company of EDF energy, the 25-year PFI agreement was signed in March 2000 and expiring in October 2025. It is the only district heating PFI scheme in the country.

When the PFI agreement expires the energy centre, plant, assets and network is intended to be handed back to the Council. To enable the continued provision of heat to the existing customers, new arrangements will need to be put in place to manage the network. New contracts will also need to be renegotiated with existing customers in line with the contract expiration date.

To prepare for contract expiry is complex process and requires the council to take several actions in advance of expiry. First, the council has a duty to ensure that Dalkia have completed any scheduled or reactive maintenance, including any rectification work required to bring the energy centre up to the condition stipulated in the contract. Second, the council need to decide how the scheme will be maintained, and the services to be provided, after the contract expiry.

In preparedness for contract expiry the Council is working closely with Department of Levelling Up Homes and Communities (DLUHC) and the Infrastructure Project Authority (IPA). We have procured WSP as our technical advisors who have completed an asset condition survey and will complete a detailed decarbonisation and expansion strategy. We have also procured Sharpe Pritchards as our legal advisors who have completed a PFI contract review, will support on transition to a new two-year contract, and the re-procurement of a new long-term contract from 2027.

As this project is a very early PFI scheme the process to close the contract and have new provisions in place to ensure continuous supply of heat and with the added complication of requirement to decarbonise the network and take in to account the requirement to add new connections to the scheme makes it a very complex project.

Given the importance of this project to the Council and DLUHC we have received some support in the form a dedicated specialist team from Local Partnership to complete the contract expiry preparation work, we have also recently secured £197,350 of funding from central government to complete the decarbonisation strategy. On completion of the decarbonisation strategy, we will have the opportunity to apply for further government funding to improve the efficiency of the system and move to a low carbon source of fuel.

The current PFI agreement states that the plant, assets and network must have a two-year working life beyond the PFI expiry and Dalkia EDF Energy is responsible for any breakdowns within this period, the best way to fully utilise this clause is to enter into a transitional agreement with the current incumbent contractor to manage the network for a further two-year period.

We have carried out some soft market testing to procure the two-year contract in the open market and the feedback we received was that contractors would not be interested in managing a scheme of this nature for a short period of time and further complicating the matter where another contractor is responsible for the breakdowns.

We have completed an asset condition survey and in the short-term period (2-5 years) some of the equipment needs to be replaced, these works amount to approx. £3.8m this investment will come from government grants and private sector investment and

this is only financially viable on a long term contract, this investment will be secured in the two-year transitional period and the longer term procurement of the scheme. Appointing a new contractor now will require this investment to be made up front by the local authority to reduce their risk. The two-year transitional period will also enable the Council to secure external funding from the Heat Network Efficiency Scheme and Green Heat Network Fund.

The energy centre currently runs on natural gas and new energy legislation coming in from 2025 will require the network to be decarbonised, given the location of the energy centre decarbonisation options are limited to using waste heat from data centres and using heat pumps, initial technical options appraisal has concluded waste heat from an adjacent data centre is the most viable option and to secure this solution we will need to work quickly to sign a memorandum of understanding with the data centre to secure the waste heat. The Council requires additional time beyond October 2025 to fully work up the decarbonisation solution.

There is a high demand for district heating solution in the Isle of Dogs, with a need for energy infrastructure improvement to meet the demands of the anticipated level of development in the area. The energy centre has the potential to become a flagship project supplying most of the Isle of Dogs area with heating and hot water. There are parallel works being completed to look at the impacts of heat zoning regulations and to fully investigate the future needs of the energy infrastructure of the Isle of Dogs area, the proposed two-year transitional period ties in with the timeline for this work to conclude.

The main residential customer base of the heat network is One Housing Group, and they are currently working on regeneration plans, and we need to ensure their plans align with the plans of the Council in terms of energy infrastructure needs and the Barkantine heat network.

A local authority maintained primary school (Seven Mills) and Tiller leisure centre is also served by the energy centre and we require time to fully assess the future needs of these two buildings.

The transitional agreement will be based on the existing terms of service and therefore there will be no change for the customers, the agreement will have provisions to work collaboratively with Dalkia to find financial savings and improve the service and customer experience for the residents. The customers of the scheme e.g. those who connected as a result of planning requirement have a different type of contract compared to those who connected to the scheme from the start as part of the PFI agreement, the transitional period will be used to align all the different types of contracts.

The availability fee for the transitional agreement and the work required for the decarbonisation and expansion strategy, the legal and technical work and procurement will be met by existing funds made up of grants, build-up of Barkantine heat and power company reserves and profits and therefore the report is not seeking any additional funding.

The Barkantine heat and power energy network is a key project in delivering our net zero carbon targets.

This option to enter into a transitional agreement and extend the contract by two years is legally and procurement compliant and is supported by DLUHC.

Recommendations:

This report summarises the action the council has taken in preparedness for the PFI contract expiry. The Mayor in Cabinet is therefore recommended to:

1. Authorise the Corporate Director of Housing and Regeneration in consultation with the Mayor to enter into a 2-year transitional period to extend the existing agreement under appropriate commercial terms.
2. Note a detailed decarbonisation and expansion strategy will be developed.
3. Note a future report will be brought to Cabinet for approval to reprocure a new long-term contract from 2027.

1 REASONS FOR THE DECISIONS

- 1.1 As the council prepares for the upcoming Barkantine Heat and Power Company PFI contract expiry it has a responsibility to ensure that the energy centre and the district heating network is operational as a number of customers rely on the scheme for their heating and hot water.
- 1.2 District heating systems are essential to tackling climate change as they generate electricity and provide heating and hot water efficiently reducing carbon emissions.
- 1.3 Barkantine energy centre is conveniently located in a part of the borough with the highest cluster of new developments requiring connection to district heating systems.
- 1.4 There are no alternative options, and arrangements must be in place for the energy centre to continue to remain operational post PFI contract expiry October 2025.
- 1.5 The heat network will need to comply with new forthcoming energy legislations for decarbonisation from 2025.

2 ALTERNATIVE OPTIONS

- 2.1 An alternative would be to do nothing and let the contract come to a natural end, this would be a huge reputational risk to the council as the homes and non-domestic properties connected to the scheme would be left without a supply of heating and hot water.

- 2.2 The Council could reprocore the proposed two-year transitional period extension in the open market, our soft market testing has showed contractors would not be interested in a short-term contract, a change in contractor will require some of the assets such as Heat Interface Units (HIU) and energy meters to be renewed now requiring upfront capital costs. EDF Energy are required to ensure plant has a working life of 2 years beyond contract expiry and therefore a change of contractor would relieve them of this obligation, with the aging assets and a new contractor this risk will fall on to the Council.
- 2.3 The costs to reprocore a new short-term contract will require additional staff resources and will have huge procurement costs, the Council will need to take the risk of any capital or plant replacement works required resulting in higher costs overall in comparison to extending the contract for a further two years with the current incumbent contractor EDF Energy.

3 DETAILS OF THE REPORT

- 3.1 The Barkantine Heat and Power Company energy centre is located behind Tiller Leisure Centre, it was originally built to supply heating and hot water to 700 homes in high and low-rise blocks, Tiller leisure centre swimming pool and a primary school. The existing homes served by the district heating system were transferred over to Housing Associations during the stock transfer. Since the scheme went live in 2000 there have been additional connection to the network as a requirement of planning policy in our Local Plan and London Plan.
- 3.2 The scheme was first of its type in London to retrofit a district heating system as a refurbishment project replacing old boiler systems. The scheme is an environmentally friendly way of generating electricity and heat making it more efficient than using individual central heating systems and the national grid.
- 3.3 The energy centre is located in an Edwardian substation building, the Energy Centre contains a 1.4MWe combined heat and power engine and two 1.4MWth heat only boilers that distribute heat through 2.4 kilometres of pipework mains. The engine is designed to provide the winter heat load which maximises engine running hours to produce electricity at times when there is greatest demand. Two large hot water storage cylinders at the Energy Centre are used as a heat store enabling the Combined Heat and Power unit to generate electricity when there is low hot water demand, this can meet later heat and hot water needs.
- 3.4 The scheme is managed by Dalkia a subsidiary of EDF energy, the 25-year PFI agreement was signed in March 2000, The Council sought investment through PFI and funding from Defra as a National Pathfinder scheme in support of the Home Energy Conservation Act. A sustainable Combined Heat and Power district heating scheme was developed that would replace the existing plant, and address the issues of fuel poverty, affordable energy and global warming, and support urban renewal.

- 3.5 Through OJEU process EDF energy were appointed to design and build the energy centre and then operate and maintain the scheme as an Energy Services Company (ESCo) on a 25-year contract. EDF energy and its subsidiary company Dalkia own 100% equity in the scheme for the duration of the contract.
- 3.6 The Contract will expire in October 2025 and assets of the Network are intended to be handed back to the Council. To enable the continued provision of heat to the existing customers, new arrangements will need to be put in place to manage the Network or alternative provisions made. New contracts will also need to be renegotiated with existing customers in line with the Contract expiration date.
- 3.7 To prepare for contract expiry is complex process and requires the council to take several actions in advance of expiry. First, the council has a duty to ensure that EDF Energy have completed any scheduled or reactive maintenance, including any rectification work required to bring the energy centre up to the condition stipulated in the contract. Second, the council need to decide how the scheme will be maintained, and the services to be provided, after the contract expiry.
- 3.8 In preparedness for contract expiry Central government recommends that local authorities begin their preparation for PFI contract expiry as early as possible before contract expiry. The Council reports to DLUHC through the PFI reporting mechanism. An initial preparedness risk assessment completed by the infrastructure Projects Authority (IPA) in October 2022 scored the project a RED Rating (High Risk), with support from DLUHC and IPA further works were completed, and the project received an AMBER rating in a follow up review by the IPA in October 2023, a further review is planned by DLUHC in November 2024.
- 3.9 The national context surrounding PFI and Heat Networks has changed significantly since Barkantine Heat Network was first established. Against this backdrop, there is significant growth planned within Tower Hamlets and the scale of growth represents a challenging increase for the supply of energy for heating, electricity, and transport. This situation is not unique to Tower Hamlets but ownership of BHPC provides a unique opportunity to overcome some of these issues. However, the Council and BHPC customers have their own decarbonisation programmes and therefore any new arrangements will need to examine the feasibility, demand, cost and benefits of decarbonisation.
- 3.10 As a result, the Council's strategic objective is to ensure continuation of services to existing customers to prevent loss of service (heat, billing, and maintenance). Facilitate a route to decarbonisation and expansion of the network.
- 3.11 To enable continued provision of heat to existing customers, new arrangements will need to be put in place to manage the network or alternative provisions made. Supply contracts will also need to be renegotiated with existing customers in line with the PFI expiration date.

3.12 At present, BHPC is responsible for the delivery of heat to the customers, maintenance and operation of all plant, and the metering and billing of customers. If the Council were to “Do Nothing”, i.e. let the contract expire without securing alternative service provision, this would result in existing customers having to source alternative solutions for existing services. Feedback from customers to date indicates that this will not be possible before Contract expiry and may result in a loss of service to those customers. As such, the Council are considering the options available for future delivery of existing services.

Economic Analysis

3.13 Using the options framework the project team has identified and developed a long list of options. This includes self-delivery, outsourcing services and selling the existing asset. To progress to a short-list of options, the advantages and disadvantages of individual choices have been considered, together with how well they are likely to meet the strategic objective and critical success factors agreed for the delivery of the strategic objective. There are two dimensions to possible delivery options:

- Short term service contract or Minimum Viable Product (MVP) to enable a deliverable procurement in line with PFI expiry.
- Longer term decarbonisation options post PFI expiry.

3.14 The project team have determined that it is not possible to deliver a full review of longer-term decarbonisation options within the timescales to Contract expiry. It is therefore recommended that the Council develop an MVP, the scope of which are determined by:

- Asset condition and investment required.
- Access to existing delivery models.
- Market appetite.
- Council drivers.
- Customer requirements (both existing and potential future customers).

Commercial Structuring

3.15 The Council evaluated four primary options for short-term contracting options:

- Option 1 – Strategic Extension of the Contract for Long-Term Planning
- Option 2 – Competitive Procurement for a new contract.
- Option 3 – Direct award of a new contract; and
- Option 4 – Allow Project Agreement to expire and agree a separate contract with a new provider.

A detailed paper in terms of procurement risk and legal challenge risk for each of these four options has been produced by the Council’s legal advisors.

- 3.16 Option 3 was excluded due to the risk of challenge. Option 4 was also excluded due to technical and practical factors and in the shorter-term as it was not thought appropriate to transfer ownership to another network operator for a short-term period.
- 3.17 Option 1 is considered the preferred option with, Option 2 retained as the back-up option. The primary reason for this is that Option 1 places less risk with the Council and preserves the status quo while longer term options are fully appraised. Further, the current Contract and supporting documents can be clarified by any extension arrangement. Option 2 is not excluded and will be the fall back if commercial terms cannot be agreed with BHPC. This will preserve competitive tension and enable the Council to maintain a stronger negotiating position.
- 3.18 Option 1 may also enable initial capital works and enhancements to be carried out to facilitate longer term decarbonisation plans in advance of a robust and comprehensive procurement process for October 2027. Option 2 may well preclude this as the specifications would need to be worked up in partnership.
- 3.19 In parallel, an independent asset condition survey has been commissioned by the Council to determine the state of premises/assets and estimate any necessary maintenance or asset replacement. This survey estimates that the level of investment required to bring defective or near end-of-life building elements, plant or equipment up to the prevailing standard until the PFI expiry plus two years (October 2027).

Financial Analysis

- 3.20 The Council currently pays an Availability Charge for the ongoing operations and maintenance of the Network. This revenue payment is supported by PFI grant provided by the Department for Levelling Up, Housing and Communities (DLUHC). This revenue support will cease at the current PFI expiry date.
- 3.21 The level of investment required to sustain the asset in good working order has been estimated at £3.8m, based on a replacement strategy. There is the possibility that some of the capital investment required could be funded by grants from the Heat Network Efficiency Scheme (HNES). However, the Council will need to ensure that any grant application made does not relieve BHPC of their responsibilities around asset condition at Contract expiry.

Management Arrangement

- 3.22 To enable the successful delivery of the extension of the current PFI contract and to deliver a credible business case for the decarbonisation and expansion of the network, the Council has created a fully resourced project team.

Heat Networks and Heat Decarbonisation

- 3.23 Government legislation, regulation and funding seeks to support decarbonisation of all sectors of the UK economy and the nation achieving net

zero by 2050. This includes delivery of low carbon heat from heat networks, which will need to transition away from the use of natural gas driven heat generation to low carbon alternatives.

- 3.24 In 2019, the UK Government and the devolved administrations committed to a national target of Net Zero emissions by 2050, as recommended by the Climate Change Committee (CCC).
- 3.25 Since October 2021 the UK Government has developed a range of policies and interventions to decarbonise all sectors of the UK economy by 2050. These can be found in the following documents:
- *Net Zero Strategy: Build Back Greener*
 - *The Heat and Buildings Strategy*
 - *Energy Security Strategy*
- 3.26 Heating buildings constitutes around a quarter of all UK emissions. Heat Networks are a key part of the Government's low carbon strategy. The Government Strategies highlight the need to move away from burning fossil fuels for power and heating and continue to grow and decarbonise the UK Heat Network market.
- 3.27 According to the Department of Energy Security and Net Zero (DESNZ) analysis, heat networks could provide up to 20% of total UK heat by 2050. This is supported by new funding initiatives to support the development and optimisation of heat networks, including the Green Heat Network Fund (GHNF) and Heat Network Efficiency Scheme (HNES), as part of the wider Heat Network Transformation Programme providing £338 million over 2022/23 and 2024/25.
- 3.28 The Energy Act 2023 was passed in October 2023. The Act, which has now become law, aims to improve security of energy supply in the UK and introduce sector regulation, through consumer protections and frameworks, with Ofgem appointed as the UK's official regulator of heat networks.
- 3.29 The Act formally appoints Ofgem as the heat networks regulator and establishes an authorisation regime for regulating organisations that supply heat through a heat network or operate a heat network. It provides for the introduction of authorisation conditions and other regulations set by the government and Ofgem. These conditions and regulations will include provision for fair prices and transparent information for consumers, a high quality of service, and minimum technical standards and carbon limits. The exact contents of future regulation remain unclear at present.
- 3.30 In addition to the above the Act gives Ofgem powers to:
- Monitor compliance and take enforcement action where heat networks are not meeting the required standards.

- Investigate and intervene where consumer prices appear to be disproportionate compared with heat networks with similar characteristics, or if prices are significantly higher than those consumers would expect to pay if they were served by an alternative and comparable heating system.
 - Grant licences that give heat network developers rights and powers similar to those held by other utilities.
- 3.31 These provisions only came into full force and effect in October 2023 and so the exact nature of how they will be applied by way of future regulation remains unclear.
- 3.32 The Act provides powers for the government to implement Heat Network Zoning (HNZ) in England. This includes powers to:
- Develop a nationwide methodology for identifying and designating areas as heat network zones.
 - Establish a new zoning co-ordinator role with responsibility for designating areas as heat network zones and enforcing requirements within them.
 - Require heat networks developed in zones to meet a low-carbon requirement and for certain buildings and heat sources within zones to connect to a heat network within a specific timeframe.
- 3.33 Heat Network Zoning (HNZ) is a policy solution which aims to support the development of district heating networks by identifying and designating where heat networks provide the lowest-cost, low carbon heating option. This policy will mandate larger, non-domestic heat demands (currently the threshold is set at 100MWh heat demand p.a.) to connect to networks within certain designated zones (to be defined by a process set up by DESNZ) where heat network heat provision can be demonstrated to be the least-cost low-carbon option.
- 3.34 By designating zones, local authorities and heat network developers should be able to quickly identify where new large-scale strategic heat networks should be built and have a far higher degree of confidence in the customer base that they will be able to sell heat to.
- 3.35 A second public consultation on HNZ was launched in December 2023 and regulation is expected to be in place to support these arrangements by 2025. As policy is still being developed, the nature of the regulatory regime for heat networks from 2025 is uncertain. However, any changes are judged likely to support the potential expansion of the Barkantine network when its heat supply is decarbonised.

EXPANSION AND DECARBONISATON

- 3.36 There is a high demand for district heating solution in the Isle of Dogs area, there is a real need for energy infrastructure in the area to meet the demands

of the anticipated level of development. The GLA have commissioned a report to look into the energy infrastructure needs in the area.

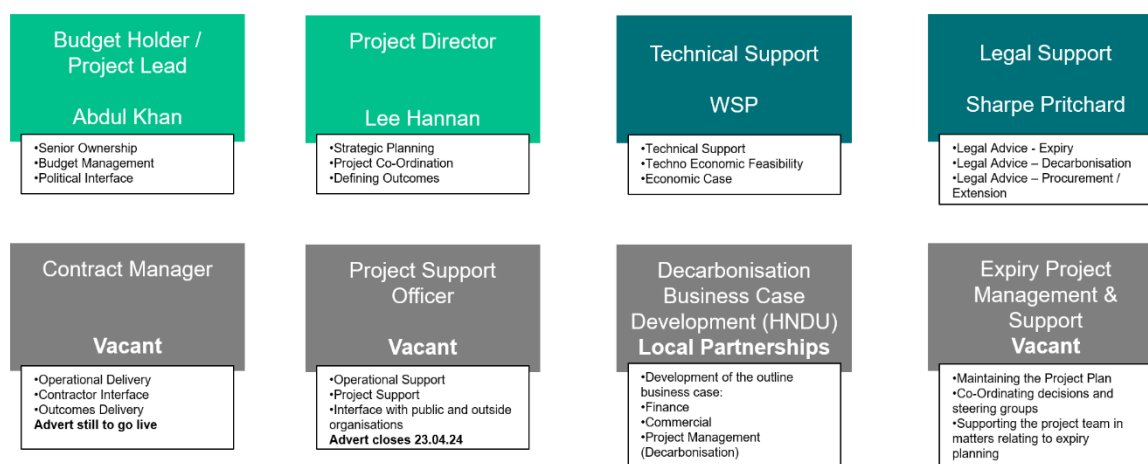
- 3.37 A report commissioned in May 2019 by the Council with funding from BEIS to look into the feasibility of expansion and decarbonisation of the system has identified three possible solutions including using waste heat from the data centre, heat pumps using dock water and air source heat pumps.
- 3.38 The report is now over 5 years old, and the costs and circumstances of the potential partner organisations needs to be refreshed. This will form part of the options appraisals and development of the business case with costed and risk assessed preferred option that can then be taken to cabinet for a formal decision, as there are some large investment costs required but at the same time some very attractive benefits.
- 3.39 The WSP 2019 study would require quick review of this report to confirm the three main choices and then produce the business case which then also includes the route to market through procurement (which will have to be coordinated with the financial and legal advisors).

GOVERNANCE

- 3.40 A Barkantine Heat and Power PFI steering group has been set up to steer the project and make progress in preparing for expiry. Members of the group is as follows.

Name	Job Title	Role
Local Authority		
Karen Swift	Director Housing	Chair
John Harrison	Interim Director Finance, Procurement and Audit	Senior Finance Officer
Abdul Khan	Head of Sustainability	Project Lead
Paul Butler	Head of Finance	
Jonathan Fox	Contracts Lawyer	
Bola James	Procurement officer	
Department of Levelling Up Homes and Communities		
Andy Hobart	Commercial Director	Scrutiny
Liz Buck	PFI Portfolio Lead	Scrutiny
Infrastructure Projects Authority		
Nick Mackee	Project Director	Oversight
Local Partnerships		
Michael Berrington	Senior Director	Programme Lead
Lee Hannan	Strategy Director	Project Director
Vicky Kingston	Senior Director	Heat Network Specialist
Sharpe Pritchard		
Steve Gummer	Partner	Legal Advisor
WSP		
James Eland	Technical Consultant	Technical Advisor

3.41 A Project Team has been set up to deliver the expiry work and develop the decarbonisation and expansion strategy. The Project Team is as follows.



FINANCE

3.42 The initial Capital cost of the project was £3.95m and there is an annual unitary cost for the operation and maintenance of the project, from 2000/01 to 2023/24 the accumulated annual unitary charge was £20.1m, the future unitary charge for 2024/25 to October 2025 is predicted to be £1.7m. The unitary charge is funded through PFI credits and recharges back to One Housing.

3.43 The Council made an application for HNDU funding to develop a decarbonisation strategy and has been awarded £197,350. There is an opportunity to apply for HNES funding to fund some of the capital works for asset improvement and later GHF for decarbonisation of the network.

3.44 The financial model of Barkantine heat network allowed for a build up of reserve funds to meet the financial costs of the PFI expiry, there are also income from TRIAD and profit share, the combination of these funds are adequate to finance the expiry preparation, costs to extend the contract for a two year period, complete the decarbonisation and expansion strategy and re-procure a new long term contract for 2027 and beyond.

3.45 Discussions with the Dalkia on options to modify and extend the contract for a further two years have concluded. Dalkia continue to be collaborative, and solutions focused, whilst being mindful of the requirement for any extension to demonstrate value for money and be permitted as an extension. For the two-year period initial offer was circa £2.1m, through a number of negotiations rounds we have managed to reduce this value to £1.5m, this is their final offer and within the current budget available to Tower Hamlets.

3.46 The offer from Dalkia provides the same level of service as it is currently providing, however as the agreement was set in 2000 both parties agree that

there is room for value engineering out some of the costs further but that would require collaborative work. This would be a time intensive piece of work and Dalkia would only begin this piece of work once we have an agreement in principle for the extension of the contract.

- 3.47 The project team has carried out affordability analysis looking at the offer of the two-year extension and the project management costs required against the budget available, the model assumes the £576,000 PFI grant will fall away at expiry in October 2025, but the current recharges back to One Housing will continue at £186,000 per annum, the model also assumes the current TH budget of £128,000 per annum will increase by the indexation, if this is not the case there will be a total shortfall of £16,000 over the two year transitional period. The £68,000 HNDU match funding is recognised as income into the analysis of the project team costs and therefore needs to be funded out of the Barkantine Reserve as this is newly committed funds for the project.
- 3.48 The Project Team have negotiated strongly with BHPC and have a best and final offer from BHPC of £750k per annum. This equates to the removal of the capital element of the fee, and a 15% reduction in profit and overheads. This fee is indexed over the appraisal period based using the GDP deflator as per the arrangements in the existing concession agreement. This is assumed to be:
- 2025/26 – 3 %
 - 2026/27 – 2%
 - 2027/28 – 2%
- 3.49 The best-case scenario assumes all savings from BHPC negotiations are achieved. The current concession agreement availability fee dates back to 2000 when all the housing stock was owned by the Council, as all the housing stock were transferred during the stock transfer in 2005, the best case scenario also assumes the availability fee can be recharged in full back to the users of the network in line with best case practice elsewhere, this scenario also assumes the Council is successful in securing future rounds of the HNDU grant. It should be noted that Council always contributed to the availability fee and recharging the full amount back to the customers will require consultation and this can only go ahead once we have agreed the extension. Based on the analysis, the best-case scenario is summarised below:

Affordability - Best case scenario				
	2024/25	2025/26	2026/27	2027/28
BHPC Contract				
Expenditure	000's	000's	000's	000's
Availability Fee	1078	954	764	454
PFI grant, One Housing, Current TH budget	890	889	898	535
Required Council contribution above existing budgets	188	66	-135	-80
Project team costs	435	477	455	269
HNDU grant, Council match, IPA	285	286	265	158
Council Contribution above existing budgets - project team	150	192	188	112
Total required contribution above existing budgets	338	258	53	32
Funded Barkantine reserves				
Opening balance	691	1397	1102	1011
The Profit share	785	-	-	-
Triad	326	30	30	18
Contribution to deficit	-338	-258	-53	-32
Council match	-68	-68	-68	-40
Closing balance	1397	1102	1011	956

The analysis shows there will be a positive balance of £956,000 at the end of the transitional period.

- 3.50 The project team also looked at a worst-case scenario which assumes the Council continues to contribute to the availability fee and is not able to recharge this to the users of the network, recharging the full amount of the availability fee at once will result in significantly higher costs to the residents where there has not been an increase since 2000 and will result in fuel poverty issues for the residents, in the most likely case scenario it is proposed that a portion of this amount can be recharged back to the users and periodically increased. The worst case scenario also assumes we are unable to value engineer out any costs such as BHPC supply chain cost, and no improvement in efficiency of the system and no further HNDU funding is secured. based on the analysis, the worst-case scenario is summarised below:

Affordability - Worst case scenario				
	2024/25	2025/26	2026/27	2027/28
BHPC Contract				
Expenditure	000's	000's	000's	000's
Availability Fee	1078	954	764	454
PFI grant, One Housing, Current TH budget	890	654	321	191
Required Council contribution above existing budgets	188	300	443	264
Project team costs	435	477	485	269
HNDU grant, Council match, IPA	285	21	0	0
Council Contribution above existing budgets - project team	150	457	453	269
Total required contribution above existing budgets	338	757	896	533
Funded Barkantine reserves				
Opening balance	691	1397	670	-196
Profit share	785	-	-	-
Triad	326	30	30	18
Contribution to deficit	-338	-757	-896	-533
Council match	-68	-	-	-
Closing balance	1396	640	-288	-711

The analysis shows there will be a negative balance of £711,000 at the end of the transitional period.

The chance of the worst possible scenario playing out is low, the risk of the reserve not being adequate to support the council would look to alternative funding to mitigate any general fund pressure, including CIL (Community Infrastructure Levy), or S106 monies via the Carbon Fund.

- 3.51 The following table sets out the final position on the Barkantine Reserve under the various sensitivities suggested above.

Barkantine Heat and Power PFI Contract - remaining operations and potential Transitional Arrangements
Summary Affordability position - key scenarios
Final position on Barkantine Reserve at 31 October 2027 (3 year 7 month appraisal period)

	Council funds 100% availability fee		Council funds 50% availability fee		Council funds 0% availability fee	
	Base	Dalkia savings	Base	Dalkia savings	Base	Dalkia saving
HNDU Funding percentage						
100	-199	23	379	490	956	956
50	-455	-233	123	234	700	700
25	-583	-361	-5	106	572	572
0	-711	-489	-133	-22	444	444

3.52 This analysis demonstrates that – as long as a proportion of the Availability Fee can be negotiated over to heat off takers – then the proposed approach will not require additional funds from the Council over and above the current budget and what is available in the Barkantine reserve.

For this reserve to have a zero balance as 31 October 2027 then this would be a scenario where:

- 25% of the Availability Fee is picked up the heat off takers.
- Limited savings are achieved from further negotiations with Dalkia.
- HNDU only continue to fund at 25% of the current level.

The project team believes that over the three- and a half year period it will better this position significantly. However, to provide comfort, the project team will regularly report as to its progress to achieve the savings.

4 EQUALITIES IMPLICATIONS

4.1 The council will undertake the PFI contract expiry process with the aim of ensuring efficient, effective, and sustainable provision that enables the continuity of affordable energy supply to residents and commercial customers. A full EQIA has been completed and attached as Appendix 2.

5 OTHER STATUTORY IMPLICATIONS

5.1 **Best Value Implications** – It is essential for the council to ensure that the ESCo meet their contractual obligations through to the expiry of the PFI contract; and that there is an efficient and effective hand-back and take-forward process allowing for continuity of all required services on PFI expiry within a Best Value Framework. A two-year transitional period of the contract will enable the Council to adequately prepare for new energy legislations and re-procure a new long-term contract, the proposed extension provides the

best value for money, the alternative option to procure the extension on the open market is too risky and will cost more overall.

5.2 **Risk Management** -The expiry phase of a PFI project brings new challenges as the council not only has to manage business as usual in terms of its PFI contract management, but also has to plan for the hand-back of assets and services under the contract and to ensure service provision post expiry. There are specific risks in the expiry phase, for example around the quality of assets on hand-back and the availability of data and information to manage assets and services post PFI expiry. A full risk register can be found in Appendix 1.

5.3 **Climate Change** - The scheme also contributes to the London Borough of Tower Hamlets 'Zero Carbon Policy' enabling a reduction in the boroughwide emissions, the scheme delivers on the Councils strategic priority and the Mayors manifesto pledge to achieve a more cleaner and greener Tower Hamlets.

6 COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 If approved, this transitional contract will run for 2 years from October 2025 to October 2027 and will bridge the end of the existing contract and the commencement of any new arrangement. It is intended to ensure there is no disruption to the supply of energy to the residents of the area, and to allow time for a new robust supply framework to be procured and implemented from October 2027.

6.2 The costs of this arrangement fall into two broad categories, an Availability fee (which tapers over the duration of the transitional period), and project support and consultancy costs. There is also a contribution of £68K 'matched funding' payable if the council is successful in securing future years HNDU grant receipts.

6.3 These costs are offset by various funding sources including grant funding (DLUHC, HNDU) and contributions from off takers. In addition to this there will also be a profit share (£0.8m), and a TRIAD contribution (£0.3m) for the final year of the PFI arrangement which will be taken to reserves in 2024/25.

6.4 Any net costs will be funded from a ringfenced reserve. This reserve currently holds a balance of £0.7m increasing to £1.8m after the profit shares mentioned above.

6.5 Several alternative scenarios have been modelled, using various assumptions on the level of expenditure and income (with the best and worst cases shown in paragraphs 3.49 and 3.50 above). This modelling indicates that a best-case scenario would cost the council £0.9m, and the worst-case costing £2.5m. After the application of reserves the initial scenario would leave a reserve balance of £0.9m, whereas the worst-case position will utilise the reserve in full and require additional funding of £0.7m on top and would result in a pressure on the general fund.

- 6.6 In the event the worst case scenario plays out, there is a risk of the reserve not being adequate to support the cost to a lesser degree. If this were the case the council would look to alternative funding to mitigate any general fund pressure, including CIL (Community Infrastructure Levy), or S106 monies via the Carbon Fund.
- 6.7 Any balance on the reserve would be carried forward to support the new contract.
- 6.8 These arrangements including the assumptions made in the financial models will be monitored and reviewed during the life of the contract and stakeholders will receive updates, including a revised affordability analysis.

7 COMMENTS OF LEGAL SERVICES

- 7.1 The Council has the legal power to undertake the activity referred to in this report.
- 7.2 Regulation 31 (6) allows the Council to award a new concession contract without advertising the opportunity where competition is absent due to technical reasons.
- 7.3 Technical reasons referred to above must be reasons that relate to the subject matter of the contract. In this case only the existing operator would be able to operate such a short-term contract as it would not be commercially viable for a replacement contractor to invest in the arrangement, nor would a new contractor be able to make any appropriate risk assumptions relating to the condition of the assets against such a short term contract.
- 7.4 In any event the uncertainty around the changes in law would make it commercially challenging for a new contractor to come into a long-term arrangement for the replacement of the assets and or delivery of the utilities in a different manner.
- 7.5 Notwithstanding the foregoing it is untenable to the Council to have a break in the provision due to the impact on residents so this short-term resolution to enable a proper fully worked through tendering opportunity is a pragmatic way forward in the circumstances.
- 7.6 The Council is obligated to ensure statutory Best Value when delivering its functions. In the absence of tendering the Council will look to ensure that the contract is supported by appropriate legal terms allowing the Council to monitor delivery as well as benchmarking the agreement against the current agreement and relevant market conditions.

Linked Reports, Appendices and Background Documents

Linked Report

- NONE

Appendices

Appendix 1: Risk Register

Appendix 2: EQIA

Appendix 3: Critical Path

Appendix 4: Heat Network Map

Appendix 5: (Exempt) Affordability position analysis

Appendix 5 exempt under Section 12A of the 1972 Act, paragraph 3 Information relating to the financial or business affairs of any particular person (including the authority handling the information)

Background Documents – Local Authorities (Executive Arrangements) (Access to Information) (England) Regulations 2012

- NONE

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