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| <b>Item No.</b><br>12.             | <b>Classification:</b><br>Open | <b>Date:</b><br>15 May 2012   | <b>Meeting Name:</b><br>Cabinet |
| <b>Report title:</b>               |                                | Gateway 2 – Contract Award Approval<br>Southwark Heat Network from South East<br>London Combined Heat and Power plant<br>(SELCHP)<br>Additional Services Contract |                                 |
| <b>Ward(s) or groups affected:</b> |                                | Rotherhithe, Riverside, Grange, South<br>Bermondsey, Livesey.   |                                 |
| <b>Cabinet Member:</b>             |                                | Councillor Barrie Hargrove, Transport,<br>Environment and Recycling   |                                 |

## **FOREWORD – COUNCILLOR BARRIE HARGROVE, CABINET MEMBER FOR TRANSPORT, ENVIRONMENT AND RECYCLING**

This project offers an exciting opportunity for Southwark to take a lead in using low carbon, renewable energy to provide lower cost heat to residents in almost 3000 homes on Southwark estates. It is the biggest single carbon saving project that the Council currently plans to undertake.

Almost 25 years ago the South East London Combined Heat and Power (SELCHP) plant was built and commissioned just outside our borders in Lewisham. Built to burn waste and convert it into useful heat and power, it can only operate efficiently when the heat can be used as well as the electricity. Unfortunately, until now, SELCHP has only generated electricity, and despite a number of earlier attempts, no project to make use of the heat has been brought into reality.

Finally, this project means that Southwark is in a position to make use of the wasted energy and take the lead in making the SELCHP plant realise its full potential. This project will be of local, regional and national importance, and will open up opportunities for significant expansion of district heat networks in London, by demonstrating that they can be made to happen.

The project will take heat that is produced from the incineration of waste that cannot be recycled, at the SELCHP energy from waste plant. This heat is currently wasted and this contract will instead enable some of it to be delivered through a network of underground hot water pipes to the boiler houses on several Southwark Council estates. The heat will provide heating and hot water, and will replace gas which is currently burned in the boilers, saving an estimated 6,000 to 10,000 tonnes per annum of Carbon Dioxide (a 70% reduction) and 2 tonnes per annum of Nitrous Oxides (a 90% reduction).

The project has been developed so that all costs relating to the installation of the pipe work and associated equipment will be met entirely by the contractor. In return, Southwark will agree to buy heat until 2033 and the price will be set at a level lower than the cost of providing heat using the current gas boilers.

Not only will Southwark residents benefit from a secure, renewable energy supply, they will also have lower heating costs and will see a major reduction in local pollution and CO<sub>2</sub> emissions. In addition, as the network of pipes can be extended, opportunities will be opened up to use significantly more of the low carbon energy generated at SELCHP to heat other residential and commercial premises in the area.

Cabinet approved a Gateway 1 report in January 2011, and the key principles of the project are set out in this report.

This project represents an important development in the provision of low carbon, renewable decentralised energy in district heating schemes. The project supports and contributes to policies outlined in the Council Plan, to policies on energy and carbon reduction and the provision of warmer homes and reduction in fuel poverty. Remarkably, all of this will be achieved whilst at the same time reducing the cost of energy to the Council and our tenants and leaseholders. I am delighted to be able to recommend the approval of this report to take it forward.

## **RECOMMENDATIONS**

### **Recommendations for the Cabinet**

1. That Cabinet approves in principle the award of the Southwark Heat Network Contract to Veolia Environmental Services Southwark Ltd (VESS) on the basis of the Heads of Terms set out in paragraph 11 of this report and paragraph 9 of the closed report. There is no additional cost to the Council but the contract is for the long-term purchase of heat from VESS (replacing the cost of purchase of gas and boiler maintenance). There is no capital cost to the Council. The financial value of the contract is contained in the closed version of this report.
2. That the Cabinet agree that the contract commence in September 2012 and expire in 2033.
3. That the Cabinet agree that the supply of heat commence in late 2013.

### **Recommendation for the Leader of the Council**

4. That the Leader of the Council delegates authority to finalise the outstanding points on the Heads of Terms to the Cabinet member for transport, environment and recycling, on the advice of the Finance Director and the Strategic Director for Environment and Leisure.
5. That the Leader of the Council delegates authority to agree the contract to the Cabinet member for transport, environment and recycling, on the advice of the Finance Director and the Strategic Director for Environment and Leisure.

## **BACKGROUND INFORMATION**

6. Southwark Council signed a contract with Veolia Environmental Services Southwark Ltd (VESS) in February 2008 to build a new waste facility on the Old Kent Road (OKR) and deliver an integrated waste management contract. Greater London Authority (GLA) and Southwark planning policies dictate that this facility should have 20% of its energy consumption supplied from renewable sources. Because this was not considered to be feasible at the OKR site itself, a section 106 agreement required VESS to 'offset' the renewable energy

requirement, using low carbon renewable heat generated from waste. The OKR facility will send “solid recovered fuel” (SRF) generated from waste to the South East London Combined Heat and Power (SELCHP) plant.

7. At Cabinet on 25 January 2011, approval was given to a Gateway 1 report that sought to open negotiations with VESS for a contract to develop the heat supply network. The contract will be a contract for additional services as part of the waste PFI Contract, as noted in the Gateway 1 report, and to satisfy planning conditions imposed as part of a s106 agreement.
8. Further background and information about the project is contained in the Gateway 1 report.
9. The project is based on the development of a district heating network, essentially a pair of highly insulated underground pipes that take hot water from the SELCHP plant, deliver it to heat exchangers in boilerhouses on the Southwark estates, where the heat is extracted to provide heating and hot water, and the cooler water returns to the SELCHP plant for recirculation.
10. The district heating system consists of heat exchangers at the SELCHP plant where steam is produced through the burning of waste that cannot be recycled. The steam is used to heat water that is pumped through pre-insulated pipes, buried about 1.5 meters underground. The pipes deliver the hot water to a second set of heat exchangers, located in boilerhouses on the Southwark estates, where the heat in the water provides central heating and hot water to the Southwark homes.
11. Prior to negotiating the Heads of Terms (HOTs) for the contract, details of which are set out in paragraphs 21-27 of this report, officers set out a number of key principles that summarised our minimum requirements and which had to be met by Veolia before the project could progress. These key principles included:
  - a. The cost of heat could be no more than the cost of heating using the current gas boilers. This has been agreed.
  - b. A price indexation mechanism should ensure that the cost of the heat rises less than the expected rise in energy prices. This has been agreed.
  - c. There could be no capital investment required from the Council. This has been agreed.
  - d. The full operational risk of the system should be taken by the contractor. This has been agreed.
  - e. There should be significant environmental benefits including a reduction in CO<sub>2</sub> emissions and local pollution. This has been agreed.
  - f. The project should meet the requirements of the s106 agreement in connection with the waste treatment facility on the Old Kent Road. It is designed to do that.
  - g. The Council should share in the benefits of any expansion of the heat network. This has been agreed.
  - h. There should be a cap on the level of profitability for the contractor. This has been agreed.
  - i. The project can only go ahead if it satisfies the requirements of the Leasehold Valuation Tribunal (LVT) to dispense with the need for a s20 consultation. The project has been designed to do this and an application is being made to the LVT.

Agreement to these key principles has been reached through extensive negotiation with Veolia and is reflected in the HoTs. This agreement ensures

that as a minimum the Council saves money, avoids financial outlay and achieves its environmental objectives.

12. The HoTs set out the basis on which the Council will agree a contract to purchase heat, through the connection of almost three thousand Southwark Council properties to the SELCHP plant in north Lewisham, providing a more energy efficient method of heating to these dwellings. The properties that will be included in the scheme are situated on a number of Southwark Council estates: Rouel Road, Keetons, Four Squares, Pedworth, Abbeyfield, Silverlock and Tissington.
13. In 2005 a feasibility study commissioned by the Greater London Authority (GLA) indicated the potential viability of the project.
14. To build on the 2005 study, the Council has now commissioned the development of an initial financial model to assess the viability of the project, and VESS independently developed its own initial and final financial models which have been shared with the Council. The Council has also commissioned a technical review of the feasibility of the project, which confirms that the project is technically deliverable. Technical advisers to the Council have reviewed the VESS technical model and are satisfied that it meets the requirements of the Council.
15. Officers have engaged in a process of presentations and consultation with a wide range of stakeholders in the project. Presentations have been made to meetings of the Home Owners' Council, Rotherhithe and Bermondsey Community Councils, the Rotherhithe and Bermondsey Area Housing Forums and the Friends of Southwark Park (FoSP). Because of its ability to deliver cheaper, low carbon heating, and to reduce local pollution, the project is widely supported by all the groups that officers have presented to. The Friends of Southwark Park initially supported the project but not a route that would have run through a part of the park. Now that an alternative route has been found the FoSP are also supporting the project.
16. The estimated annual cost of contract is included in the closed version of this report.
17. The Project Board comprises the Finance Director and the strategic directors of Communities, Law and Governance; Housing; and Environment and Leisure. Day-to-day management of the project and negotiations is led by the Project Manager and a Project Team comprised of Officers from a number of Council departments. The Project Team and Board are supported by external professional legal, financial and technical advisers. The Cabinet Member for Transport, Environment and Recycling, and the Cabinet Member for Housing are, and will continue to be regularly briefed on the progress of the project.
18. The Council wishes to contract with VESS to enable VESS to meet the Section 106 planning obligations that it has, as described above. The SELCHP plant is the sole potential supplier of renewable CHP heat for distribution to the Council's properties in this area. Both of these considerations mean that the Council has been negotiating with a sole supplier, which means that the Council has been especially vigilant in ensuring that it, and its leaseholders and tenants, achieve value for money.

## Procurement project plan (Key decisions)

| Activity   | Comment                        | Completed   |
|--|--------------------------------|-------------|
| Approval of Gateway 1  | Cabinet                        | 25/01/2011  |
| Agreement to key principles  | Delegated to IDM               | May 2012    |
| Submit application the LVT for s20 dispensation  | Managed by HOU                 | May 2012    |
| <b>Gateway 2:</b> Agree HoTs subject to final amendments and contract award in principle | Cabinet                        | May 2012    |
| Call-in period   | Min 5 days plus x if called in | May 2012    |
| Final Clarifications   |                                | 01/08/2012  |
| LVT dispensation from s20 requirement  |                                | Aug 2012    |
| <b>Gateway 2:</b> Contract award approval  | Delegated to IDM               | Aug 2012    |
| Alcatel standstill period  | Ten days                       |             |
| Mobilisation   | Up to 12 months                | Sept 2013   |
| Transitional arrangements  | 8 weeks                        | Oct 2013    |
| Service operational  |                                | Autumn 2013 |

19. As described in the concurrent report from the Head of Home Ownership Unit, the Council needs to apply to the Leasehold Valuation Tribunal for dispensation from the requirement to consult under s.20 of the Landlord and Tenant Act. Officers estimate that this process may take three months, but the duration is uncertain and it could take longer. If the process takes longer than the three months allowed in the plan above, subsequent dates will also move back.

### Description of procurement outcomes

20. The Heads of Terms (HoTs), which will form the basis of the contract, are summarised below.
21. Background
- The SELCHP plant was designed and constructed to operate as a combined heat and power (CHP) plant which since its construction in 1993 has only exported electricity to the national grid, but it has always been the ambition of those who own and operate the plant (Veolia, CNIM and the London Boroughs of Greenwich and Lewisham) to realise its original purpose.
  - The HoTs do not create any legally binding obligations but set out the framework for negotiations for the contract.
22. Principal Heat Services Obligations
- The carbon dioxide emissions from the provision of heat will be less than the current emissions.
  - The design of the system will meet the s106 obligations in connection with the waste management facility at the Old Kent Road.
  - The system will meet 100% of the Council's heat demand for the estates that are connected to the network. There will be contingency arrangement for top-up and back-up heat supply.
  - VESS will own the pipe network and be responsible for its maintenance.

- e. If third parties connect to the network in future, a mechanism will be agreed by which the Council shares the financial benefit through a reduction in the price of heat.
  - f. If the project becomes eligible for any government subsidy the Council will share the benefit (in a proportion to be agreed).
23. Duration of the contract
- g. The anticipated start date for the supply of heat is autumn 2013.
  - h. The contract will expire in 2033 at the same time as the waste PFI contract.
  - i. On expiry of the contract, the Council will have the option to take ownership of the network.
24. Consents
- j. VESS is responsible for obtaining all necessary consents and the Council (in its capacity as a waste disposal authority and as a housing authority) will assist a discussion between Council departments and VESS to obtain the consents.
25. Repairs and maintenance
- k. VESS will repair and maintain all aspects of the network.
  - l. VESS will be responsible for the maintenance of gas boilers required for back-up provision of heat in case of failure or interruption to the heat network.
26. Heat service charges
- m. The charges will consist of a fixed charge element, designed to cover the capital costs of the network, and a variable charge element designed to cover the cost of heat from SELCHP and any back-up gas supply.
  - n. Some of the fixed charges will be indexed annually at RPI or similar, other fixed charges will not be indexed. The variable charges will be indexed using gas and electricity price indices.
  - o. Negotiations are continuing to agree a price cap at a level below the cost the council would incur if providing heat through gas boilers.
  - p. A cap has been agreed on the IRR (level of profitability) of the project to VESS.
  - q. The heat pricing mechanism is described in more detail in the closed version of this report.
27. Parent company guarantee
- r. VESS will provide a parent company guarantee.

## **KEY ISSUES FOR CONSIDERATION**

### **Key/Non Key decisions**

28. Award of this contract in principle is a Key Decision as a result of the value of the contract and because it has a significant impact on a large number of Southwark residents.

### **Policy implications**

29. This project will be seen as a significant and important project on a national scale in relation to a number of policy objectives. Combined Heat and Power

(CHP) is an efficient means of energy generation and use, reducing environmental impacts, in particular carbon and nitrogen emissions. It supports policies on sustainability and climate change.

30. Recent UK policy (“Strategy for Household Energy Management”) has recommended policy options for existing public sector buildings to connect to district heating schemes and/or provide “anchor” heat loads from which to develop new district heat networks. Current local and regional planning policy is strongly supportive of district heating as a carbon reduction approach.
31. The reduction in emissions and the use of renewable heat has the potential to contribute significantly to the achievement of the Council’s policies set out in the Council Plan. Schedule H in the Council Plan states that the Council will “Reduce carbon emissions and NOx pollution from five Southwark housing estates by connecting to new heat network from SELCHP”. In addition the project will contribute to the provision of energy security and warm homes, and to reducing CO<sub>2</sub> emissions and improving air quality in the borough.

### **Tender process**

32. Regulation 14 of the Public Contracts Regulations 2006 permits the Council to procure this service as a contract for additional services to the waste PFI contract which does not require advertising.
33. Because the project is associated with the waste PFI contract, the Council was unable to run a competitive procurement process. This means that the Council will have to apply to the Leasehold Valuation Tribunal (LVT) for dispensation from the section 20 requirement to obtain competitive quotations. In order to do this, the Council has begun a process of consultation with Leaseholders on the proposed change in energy supply. The Council will obtain the necessary dispensation from the LVT before signing the contract.
34. The first draft of the contract has been developed by the Council’s legal and procurement teams, supported by Eversheds as legal advisers to the project. Final drafting will be agreed by the Council’s legal and procurement teams.

### **Community impact statement**

35. This project will contribute to a reduction in energy costs and a reduction in fuel poverty, as well as a greater energy security, and will help to assure warmer homes in the affected properties. Concerns about running the pipework through Southwark Park, have been eliminated by finding an alternative route for the pipework. Officers now believe that all the community groups consulted and presented to, are supportive of the project.

### **Sustainability considerations**

36. The project makes a significant contribution to the sustainability of housing and energy use in Southwark. Under the PFI contract 28,500 tonnes (rising to 60,000 tonnes per annum from 2017) of waste that cannot be recycled from Southwark is sent to the SELCHP energy from waste plant. Heat energy that is currently wasted at the plant will be used to provide heat and hot water back into Southwark properties. The project will also meet a key goal within Southwark’s Energy and Carbon Reduction Strategy, approved by cabinet in September 2011 and will reduce carbon emissions produced by the Council’s housing stock by

3.9%.

37. Officers are also working with the GLA to identify potential opportunities for other decentralised energy and district heating projects in the borough. The work will result in a 'heat map' that will plot potential heat loads in the borough alongside existing and planned district heating schemes.

### **Economic considerations**

38. The project will have a positive economic impact for Southwark and its leaseholders and tenants. First, heat energy that is currently wasted will be used productively. Second, there may be 'spin off' opportunities to use heat energy based on Southwark as an 'anchor customer' for a major heat load. Finally, all of this can be achieved whilst ensuring that the cost of heat energy supplied to the Council, its tenants and leaseholders is lower than the alternative cost of heating using gas.

### **Social considerations**

39. The project will contribute to a reduction in fuel poverty and energy security in an area that suffers from deprivation.

### **Environmental considerations**

40. The project will have significant environmental benefits as described in the Foreword and in the sections on Policy Implications, Community Impact, and Sustainability above. The contractor will be required to manage the construction phase and deliver the project in an environmentally sensitive manner.

### **Market considerations**

41. The contractor is a private organisation with more than 500 employees and has a national area of activity. The contractor is the same legal entity as for the Waste PFI contract previously awarded.

### **Plans for transition from the old to the new contract**

42. This project will involve civil engineering and renewable energy technology. The Sustainable Services' management team have knowledge and experience in both these areas as a result of managing the construction of the Integrated Waste Management Facility at the Old Kent Road. The team will therefore manage the project throughout the construction and commissioning phase, calling on industry expertise as needed through relationships built during the construction of the waste facility.
43. Once the project is complete and functioning correctly, management of the contractual relationship with VES will transfer to the Housing Engineering team as Housing will be the consumer of the heat produced.

### **Plans for monitoring and management of this contract**

44. When the heat network is successfully commissioned and becomes operational, contract management will be taken over by the Housing Engineering team, so that performance of the contract (the quality and continuity of supply) can be monitored.

45. Engineering & Compliance comprises of a number of specific disciplines including a commercial team and a dedicated technical resource for heating. We anticipate that the SELCHP contract will fit neatly into current contract management processes. The existing team have the necessary experience to closely monitor this type of contract to ensure that value for money and high performance is achieved at all times. The SELCHP contract will be added to the heating team portfolio and regular formal meetings will be set-up, this process will also develop appropriate KPI's to ensure that performance is accurately measured inline with the contract provisions.

**Identified risks in awarding this contract**

46. The project is being managed through a Project Board (consisting of senior Directors and Officers) and a Project Team with day to day responsibility for managing the project and the procurement. The Project Board reports to Corporate Management Team and to Members. A comprehensive Risk Register has been developed and has been reviewed and updated through the life of the project. A named Council Officer is assigned as the appropriate 'risk owner', and is required to report on steps being taken to mitigate the risk.
47. The Project Team is managing the mitigation of these risks and they are considered by the Project Board as a standing item on the Board agenda. Key risks identified include the following:

| <b>Risk</b>  | <b>Mitigation</b>  |
|--|--|
| The risk to obtaining value for money when negotiating with a single supplier  | Negotiations with VESS have been based on establishing transparency of pricing. The Council has developed its own pricing model to enable it to evaluate the VESS proposal. External professional advisors have been engaged and consulted throughout the negotiation process. A pricing mechanism indexed to conventional energy costs has been agreed. |
| Risk that the heat network is not delivered, resulting in the loss of an opportunity of saving approximately 10,000 tonnes of CO2 emissions per annum, and reducing local pollution by turning off the gas boilers that heat 3,000 properties. Failure to deliver the project will also result in the loss of an opportunity to reduce fuel poverty. | The project is being actively driven by Council officers, using PRINCE2 project management methodology and aiming at a solution that delivers the benefits of the scheme for the council whilst allowing Veolia to make an appropriate return on their investment.   |
| Risk that the heat network is not delivered, resulting in Veolia being required to pay £500k into a green fund under the s106 agreement related to the Old Kent Road waste facility. Under the PFI   | The project is being actively driven by Council officers, using PRINCE2 project management methodology and aiming at a solution that delivers the benefits of the scheme for the council whilst allowing Veolia to make an appropriate return on their investment.   |

| <b>Risk</b>  | <b>Mitigation</b>   |
|--|---|
| contract terms this cost would be passed back to the Council   |   |
| Failure or delays in obtaining permissions to carry out the infrastructure works required                            | Council officers are working to ensure that Veolia are engaged with TfL and Network Rail. Consent/planning milestones and monitoring are being/will be required. Risk of obtaining easements is with VESS.  |
| Potential conflicts with other Council priority projects   | The Board structure, with updates to CMT, enables links with other projects. The Board ensures that the project has a high profile in the Council and all departments are aware of interfaces.  |
| Uncertainty over the life of the estates to be heated through the project  | The HoTs set out which costs will be recovered through fixed charges and which through variable charges, to balance demand risk against pricing level.  |
| Risk that the heat network fails to operate, breaks down or fails to perform adequately.                             | During the period of the heat supply contract Veolia will be required to maintain Southwark's gas fired boilers so that they can be used for back-up or top-up heat as required, and also to hand the system back at the end of the contract in a state which allows Southwark to revert to using its gas fired boilers to provide heat to the network. Therefore it may be considered that if the system fails or Veolia is in breach of the contract, Southwark can simply return to using the gas boilers. |
| Risk that agreement cannot be reached on items delegated to Cabinet member for transport, environment and recycling. | Agreement on Heads of Terms minimises the substantive matters to be agreed in the final contract and detailed negotiations with VESS planned for prior to contract close.   |
| Risk that the LVT process takes more time than anticipated, or that the LVT refuses to grant s.20 dispensation.      | Officers have engaged in extensive consultation with leaseholders and tenants, and a comprehensive file of information supporting the application will be submitted. This information will demonstrate, as set out in the HoTs, that the price of heat purchased through the contract will be lower than the cost of providing heat using gas boilers.  |

48. Cabinet may take the view that the downside risks associated with this project are minimal and that there are appropriate mitigations in place, whilst the potential benefits, in environmental and financial terms, are significant.

#### **Performance bond/Parent company guarantee**

49. A parent company guarantee will be provided by VESS.

### **Staffing/procurement implications**

50. There are staff resource implications which are noted, along with mitigating measures, in the Board's Project Plan and Risk Register. More broadly, the Project Board, chaired by the Strategic Director for Environment and Leisure, is responsible for taking the decisions which manage the procurement process. A Project Team (including Officers from Sustainable Services, Finance, Legal, Housing, Planning, Procurement and other staff as well as contracted in technical specialists and external professionals as required) manage the project on a day-to-day basis. A Project Manager leads the Project Team and reports to the Project Board.
51. On the basis that before the contract there are no council or contractor employees dedicated to the management, operation or maintenance of the boiler houses and the rest of the procurement exercise does not involve the transfer of any other activity or assets, there are no TUPE implications arising from this procurement.

### **Financial and charging implications**

52. A financial analysis has been undertaken to ensure that the proposal represents good value for the council. The financial assumptions presented by Veolia have been challenged and as a result the scheme financial model has been revised to the council's satisfaction for this stage of the procurement, and will continue to be revised during the negotiations.
53. The capital cost of the scheme is set out in the Closed version of this report and will be funded by Veolia. The council is not making any capital contributions to the proposed scheme and will reimburse Veolia for its capital investment through the heat charge payable for the service, which will also include an element for the scheme lifecycle and repairs requirements.
54. The Veolia financial model produces a charge to the council at a level set out in the Closed version of this report. This is based on a mutually agreed anticipated heat consumption level. It is recognised that the final agreed charge will contain an element of demand risk to the council, however the extent of this will be mitigated through Veolia's provision of substitute heat during any necessary maintenance periods and through advance notification of changes in stock numbers by the council.
55. The council anticipates revenue savings arising from the new contract when compared to the current total cost of providing heat to the four estates. In the case of leaseholders any savings arising will be passed directly to individual leasehold units at the end of each financial year; in the case of tenants, savings will be pooled and redistributed within the HRA heating account on a borough-wide basis in accordance with council policy.
56. Financial, legal, technical and project management advice has been sought to support council officers in progressing the procurement and is budgeted at a cost of £0.5m for the full procurement. Advisors have been procured via competitive tender to generate the best value for the council and the cost of this advice, along with officer time will be resourced from existing budget allocations.

57. The former Executive received a detailed report on 14 February 2006 regarding the operation of the Heating Account, and charging policies therein. In short, the budgeted costs for the forthcoming year are identified (principally under the gas supply contract noted above), a contribution from relevant leaseholders is evaluated, and alongside the balance remaining on the ring-fenced account the resultant total cost required to be recovered is applied to a matrix of charges dependent on both bed-size and the particular type of district heating received.
58. There is no disaggregation of these charges on a geographic basis – a tenant liable for a district heating charge will pay the same no matter their location within the borough. Leaseholders are charged on an actual costs incurred basis, in common with other aspects of their variable service charges in line with their lease, as opposed to the budgeted basis outlined above. The difference between the anticipated contribution from leaseholders and the actual sum identified after the financial year-end is applied as an adjustment to the following year's budget.
59. It is felt that since the original policy perspective behind establishing a ring-fenced approach to heating charges was to ensure both fairness and transparency across borough, that this should be preserved. However this would only be possible if SELCHP are able to provide differential costing information in order to identify utility costs (for inclusion within the heating account) and other costs (for exclusion).
60. With regard to leaseholder charges, since these are actualised, and calculated on a block or estate basis, it is likely that leaseholders residing within the areas directly supplied by SELCHP will see a reduction in their charges over time. Other leaseholders in the borough will not see these benefits.

### **Legal implications**

61. Please see paragraphs 67 to 69 below.

### **Consultation**

62. A communications plan forms an important part of the Project Plan. There has been extensive consultation with a wide range of stakeholders including residents and tenants and home owner councils, and commercial occupiers of the estates, third parties such as TfL, GLA and the Mayor's Office, Defra, DECC, Southwark housing associations and private developers, and Lewisham Council.
63. Officers have made presentations for meetings of local tenants and leaseholders through the relevant Area Housing Forums, Home Owners Council and Community Councils. Ten meetings with local residents have been held in total. Residents of the estates that will be connected to the scheme have been supportive of the project, recognising the benefits in terms of the environment and potential cost savings. Residents of estates that are not scheduled for connection to the scheme have asked why and/or when connection will become feasible.
64. The Friends of Southwark Park have always supported the project, but objected to the original proposed route which passed through the park, raising concerns about potential disruption and long-term damage to trees and planting. Officers have now agreed a route that avoids Southwark Park altogether.

65. Other stakeholders are supportive of the project which is consistent with local, regional and national policies on reducing CO<sub>2</sub> emissions, developing low carbon heat networks and decentralised energy.
66. As part of the process of applying to the LVT for dispensation from the s.20 requirement to consult (see the concurrent from the Head of Home Ownership Unit below) a letter has been sent to approximately 3000 homes on the estates that will be connected to the heat network, inviting them to a public meeting on 08 May 2012 to discuss the project and its implications for them as leaseholders and tenants. Comments from this meeting will be fed back to Cabinet.

## **SUPPLEMENTARY ADVICE FROM OTHER OFFICERS**

### **Strategic Director of Communities, Law & Governance (KM0412)**

67. This report seeks the Cabinet's approval to the award in principle of the Heat Network Contract to VESS, subject to agreement of those matters noted in paragraph 3, and asks the Leader to delegate agreement to the award of the contract to the cabinet member for transport, environment and recycling following finalisation of those outstanding issues.
68. The nature and value of these services are such that they are subject to the full application of the EU procurement Regulations. The report however explains the preferred option to entering into an additional services contract with VESS to provide these services. Regulation 14 of the Public Contract Regulations 2006 permits the council to negotiate with a current provider to provide additional services in certain circumstances. The cabinet is advised that the council has sought external legal advice from Leading Counsel whose advice supports the use of the negotiated procedure.
69. External legal advisors are appointed and will assist the council in the final negotiations and agreement of the final form of contract with VESS.

### **Finance Director (AV0412)**

70. This report is recommending the approval of the award of the Southwark Heat Network contract to Veolia Environmental Services Southwark Ltd, and that the Cabinet delegates authority to sign the contract to the Cabinet Member for Transport, Environment and Recycling following finalisation of the agreement on price and indexation by officers.
71. The financial implications of the report are noted. Areas of financial and technical risk and complexity remain which should be fully resolved before a final contract can be agreed. The assets in this proposal will be used solely by the Council and there are accounting issues relating to their accounting treatment, which will need to be addressed. The council will need to be confident that the solution proposed by Veolia represents good value for Southwark residents in the context of its charging regime for residents, and housing investment programme. To ensure this confidence officers and advisors will continue to challenge and scrutinise Veolia's proposals in depth.
72. The cost of specialised advisors supporting officers with the procurement is significant, but required for a scheme of such complexity. It is acknowledged that by properly resourcing the project a successful procurement is more likely,

with council risk exposure being mitigated during the process. The cost of officer and advisor time will be met from existing budget allocations.

### **Procurement Issues**

73. A Gateway 1 report approved by Cabinet in January 2011 gave authority for the Council to enter into negotiations with VESS for a contract for a Southwark Heat Network. This Gateway 2 report now seeks approval for the Council to enter into the contract subject to final agreement on price and indexation.
74. As set out in the report, the heat services agreement will take the form of an additional services contract as part of the waste PFI contract as well as satisfying the planning conditions imposed as part of the s106 agreement.
75. The report confirms that Regulation 14 of the Public Contracts Regulations 2006 allows the Council to procure this service as a contract for additional services to the waste PFI contract and did not require advertising.
76. The contract provides that the capital cost of installing the heat mains will be met entirely by VESS, and the Council will agree to buy heat until 2033. The price of the heat will be set at a level lower than the alternative cost of heating using the existing gas boilers. Agreement has yet to be reached on the final price and indexation and delegated authority is therefore sought for contract approval once this is achieved.
77. Expert advisers have been engaged to work with Council officers to deliver the project and appropriate advice has been received to confirm that the proposals meet the Council's requirements and is cost effective. The report confirms that detailed governance and risk management protocols were established to manage the project.
78. The report confirms that plans will be developed for the monitoring and management of the contract so that management processes are in place when the project becomes operational.
79. The report confirms that extensive consultation with a wide range of stakeholders has been undertaken and that the proposed scheme is supported with recognition of the benefits to be derived from it in terms of the environment and potential cost savings.

### **Head of Asset Management and Investment Planning (DM0412)**

80. Housing management recognises district heating schemes as an effective means of delivering emissions reductions at least cost and in turn fully supports this project. Housing management also recognises the benefits this project will bring to residents in terms of a reduction in fuel costs and enhanced security of supply.
81. The contract as drafted means that VES will be responsible for the provision of heat to heat exchangers to the primary boiler houses. This will result in split responsibilities for the management and maintenance of the network. As a result the interface between the new heat network and Southwark's existing secondary network will require effective management. Engineering & Compliance comprises of a number of specific disciplines including a commercial team and a dedicated technical resource for heating. We anticipate that the SELCHP

contract will fit neatly into current contract management processes. The existing team have the necessary experience to closely monitor this type of contract to ensure that value for money and high performance is achieved at all times. The SELCHP contract will be added to the heating team portfolio and regular formal meetings will be set up, this process will also develop appropriate KPIs to ensure that performance is accurately measured inline with the contract provisions.

82. Technical analysis has considered, amongst other things, the compatibility of the heat exchangers and pipework infrastructure with the temperature outputs of the SELCHP generators as they are designed for specific flow and return temperatures.
83. As with all long-term schemes, there is an element of uncertainty as to what the future may hold with regards to investment, regeneration, or other initiatives which may impact upon the council's housing stock. This uncertainty will be reflected and the council's position protected for the term of the contract.

#### **Head of Home Ownership Unit (LT0412)**

84. The leaseholders on these estates are currently receiving a communal heating service, for which they are service charged. Where the Council proposes to enter into a long term agreement that is for a period of more than 12 months and which will result in a service charge of more than £100 per annum to any one leaseholder statutory consultation under section 20 of the Landlord and Tenant Act 1985 (as amended) is required, or the Council is unable to recharge in excess of the £100 per annum. However, due to the nature of the proposed contract the statutory consultation it is not possible so the Council is applying to the Leasehold Valuation Tribunal for a complete dispensation of its obligations under section 20, with the proviso that an alternative consultation process with leaseholders is being undertaken. It is anticipated that there will be no insurmountable objections provided that the cost of energy to tenants and leaseholders can be demonstrated to be below the alternative cost (of gas heating currently provided).
85. Whilst the outcome can never be guaranteed, the fact that the project will lead to lower energy costs for the duration of the contract than would otherwise be the case if gas were to continue to be used, a favourable outcome at LVT is anticipated.
86. In addition because the contractor will take over responsibility for boiler maintenance as part of the agreed heat price, leaseholders will no longer be recharged for this work, which can be expected to be seen as a significant benefit.
87. The costs of providing heating and hot water to each estate must be accurately identified and easily obtained for service charge purposes.

## BACKGROUND DOCUMENTS

| Background papers  | Held At                              | Contact   |
|--|--------------------------------------|---|
| Contract Register Update Form  | 160 Tooley Street,<br>London SE1 2QH | Ian Smith,<br>Head of Sustainable<br>Services,<br>020 7525 2484 |
| Southwark Combined Heat & Power Project, Project Initiation Document | As above                             | As above  |
| SELCHP Community Heating Scheme – Options Appraisal                  | As above                             | As above  |
| Gateway 1 report to Cabinet  | As above                             | As above  |
| Council Plan   | As above                             | As above  |
| Carbon Reduction Strategy  | As above                             | As above  |
| Waste PFI s.106 agreement  | As above                             | As above  |

## APPENDICES

| No.        | Title of appendix     |
|------------|-----------------------|
| Appendix 1 | Map of proposed route |

## AUDIT TRAIL

|   |  |  |              |
|---|--|--|--------------|
| <b>Cabinet Member</b>   | Councillor Barrie Hargrove, Transport, Environment & Recycling |  |              |
| <b>Lead Officer</b>   | Gill Davies, Strategic Director Environment and Leisure        |  |              |
| <b>Report Author</b>  | Ian Smith, Head of Sustainable Services, E&L                   |  |              |
| <b>Version</b>  | Final  |  |              |
| <b>Dated</b>  | 3 May 2012   |  |              |
| <b>Key Decision?</b>  | Yes  | <b>If yes, date appeared on forward plan</b> | January 2012 |
| <b>CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER</b> |  |  |              |
| <b>Officer Title</b>  | <b>Comments Sought</b>   | <b>Comments included</b>                     |              |
| Strategic Director of Communities, Law & Governance                     | Yes  | Yes  |              |
| Finance Director  | Yes  | Yes  |              |
| Head of AMIP  | Yes  | Yes  |              |
| Head of Home Ownership Unit   | Yes  | Yes  |              |
| <b>Contract Review Boards</b>   |  |  |              |
| Departmental Contracts Review Board                                     | Yes  | Yes  |              |
| Corporate Contracts Review Board  | Yes  | Yes  |              |
| <b>Cabinet Member</b>   | Yes  | Yes  |              |
| <b>Date final report sent to Constitutional Team</b>                    |  |  | 3 May 2012   |