

CABINET MEETING – 16 MARCH 2023
EXECUTIVE SUMMARY SHEET – PART I

Title of Report:

Sunderland Heat Network – Update and delivery strategy

Author(s):

Executive Director of City Development

Purpose of Report:

To update Cabinet on progress to date and seek approval to procure and appoint a Heat Network Operator to jointly develop the project and continue towards delivery of a strategic heat network in Sunderland.

Description of Decision:

Cabinet is requested to note progress with the project to date, and authorise the Executive Director of City Development (in consultation with the Deputy Leader) to:

- procure an experienced Heat Network Operator to progress development of the proposed heat network; and
- negotiate and agree the terms of a Joint Development Agreement that will govern the relationship between the Council and the appointed Heat Network Operator.

Is the decision consistent with the Budget/Policy Framework? Yes

If not, Council approval is required to change the Budget/Policy Framework

Suggested reason(s) for Decision:

The UK Heat Network market is continuing to evolve rapidly, and Sunderland is playing an important role in this emerging market as a pilot Heat Networking Zone area. The proposed new delivery strategy will allow an operator to become meaningfully involved in the development stage of this project and bring their expertise and commercial awareness to support the construction and operation of a Sunderland Heat Network.

This approach allows for faster progress towards delivery of a City Centre Heat Network and will help to meet the targets in the City Plan and Low Carbon Action Plan. It also allows the Council to explore alternative funding options for the construction of the Heat Network that a commercial operator may be able to facilitate.

Alternative options to be considered and recommended to be rejected:

- i. Continue with the existing consultancy led design and public sector delivery model.

This option is rejected because it does not allow the Council to benefit from the additional expertise and commercial knowhow that an experienced heat network operator will bring as a partner to the project.

There is also a risk that the consultants' detailed design solution may not be entirely acceptable to an experienced commercial operator, which could lead to significant delays and additional costs at the construction stage of the project.

Impacts analysed;

Equality

Privacy

Sustainability

Crime and Disorder

Is the Decision consistent with the Council's co-operative values? Yes

Is this a "Key Decision" as defined in the Constitution?

Yes

Is it included in the 28 day Notice of Decisions?

Yes

CABINET – 16 MARCH 2023

SUNDERLAND HEAT NETWORK – UPDATE AND DELIVERY STRATEGY

Report of Executive Director of City Development

1. Purpose of the Report

- 1.1 To update Cabinet on progress to date and seek approval to procure and appoint a Heat Network Operator to jointly develop the project and continue towards delivery of a strategic heat network in Sunderland.

2. Description of Decision (Recommendations)

- 2.1 Cabinet is requested to note progress with the project to date, and authorise the Executive Director of City Development (in consultation with the Deputy Leader) to:
 - procure an experienced Heat Network Operator to progress development of the proposed heat network; and
 - negotiate and agree the terms of a Joint Development Agreement that will govern the relationship between the Council and the appointed Heat Network Operator.

3. Introduction/Background

- 3.1 The Council, with the support of WSP (technical consultant), Teno Energy (financial consultant), Pinsent Masons (legal consultant) and the Coal Authority (specialist advisor) prepared an Outline Business Case and 'Techno Economic model' for a mine source heat network. The heat network ambitions are featured in the Sunderland City Plan and the Low Carbon Action Plan, recognising that a district energy scheme could deliver multiple benefits including jobs and employment, a catalyst for regeneration and growth, heat decarbonisation and improving energy security.
- 3.2 The work concluded there is a viable City Centre Heat Network as a public sector led scheme but owing to the relatively low projected rate of return, the public sector led and funded approach was considered the only feasible delivery model. The Business Case also concluded that mine water source could outperform river source, owing to higher and more consistent source temperature enabling the heat pumps to operate more efficiently. The Council subsequently secured £2.220m of funding from Green Heat Networks Fund (GHNF) – Transition Scheme funding from the Department for Business, Energy and Industrial Strategy (BEIS – now Department for Energy Security & Net Zero).
- 3.3 There is a potentially viable heat network utilising mine water heat from the former Wearmouth Colliery, but the heat resource must first be proven by drilling exploratory boreholes and performing water pump tests. £1.6m of the funding from GHNF is available for this purpose. Alternative heat sources will also continue to be explored.

4. Project Update and Market Developments

- 4.1 Recent volatility in the construction market, particularly steel prices, has meant the price of drilling casing has been prohibitively costly. The exploratory drilling works were therefore paused until recently. The market has since stabilised sufficiently to allow the procurement of an exploration drilling contractor to recommence, and the project team has applied for planning consent to drill beneath the Green Car Park at the Stadium of Light. Subject to tender returns and statutory permissions, it is anticipated that exploratory drilling will commence in Summer 2023.
- 4.2 For the past year the Council has continued to work with its appointed consultants and engage with BEIS/Department for Energy Security & Net Zero and the wider heat network industry. The Council has also been selected as one of 28 cities to assist BEIS/Department for Energy Security & Net Zero in their Heat Network Zoning (HNZ) Pilot Programme. The HNZ Pilot Programme is a desk top data lead exercise, looking at heat demand and sources across the administrative boundary.
- 4.3 As part of its Energy White Paper, the Government set a target to deliver HNZ legislation in England by 2025 and have confirmed Ofgem are to be appointed as regulator. Department for Energy Security & Net Zero define a HNZ as follows:

“A heat network zone will be an area, designated by local government (with national government support), within which heat networks are the lowest cost, low carbon solution for decarbonising heating.

Within these zones consumers can be confident heat networks are the optimum solution, with some types of building required to connect within given a timeframe (subject to cost/technology exemptions).”

Participation in the HNZ Pilot Programme does not commit Sunderland to being an early adopter of zoning but, does give earlier insight into what this could mean for the city.

- 4.4 Government commitment to HNZ, combined with the energy crisis, has resulted in significant interest in large city heat network schemes such as in Sunderland.
- 4.5 The current approach to heat network delivery in the UK has however proven to be slower than anticipated. The industry opinion is that some early development stages often result in abortive work, and delivery could be expedited through earlier involvement of an experienced heat network operator.
- 4.6 All of the above, combined with the change in financial climate and increased competing demand for Council capital funding, has led the project team to explore alternative delivery options.

5. Key Objectives of New Approach

- 5.1 With the support of our appointed consultants, it is considered that that any new delivery approach should look to satisfy the following objectives:

Timing – the new approach should allow for a private sector operator to be appointed at an early stage, on the basis that they can also help drive forward the next phase of the project by bringing their own resource and expertise.

Funding – the new approach allows the funding for the development, construction and operation of the Network to potentially be provided by the private sector. This would not however preclude any capital investment from the Council in the project, should this be considered desirable.

Control – the ultimate delivery structure for the project will allow the Council to retain an appropriate degree of oversight and control of the heat network (in addition to any statutory roles the Council will have as planning authority / heat network zone co-ordinator for the city). The Council will remain in a position to influence and support the delivery and expansion of the heat network.

6. The New Approach – Joint Development Agreement

- 6.1 The proposal is to procure and appoint an experienced heat network operator at this development stage of the project.
- 6.2 It is anticipated that the Council and the appointed operator will enter into a Joint Development Agreement (JDA). The JDA will be a contractual joint venture arrangement under the terms of which the Council and the operator will agree to collaborate and develop the project, up to the point at which the Council and the operator can make a final investment decision on whether to proceed to construction. In addition, the operator will be invited to explore feasibility for expansion and other network opportunities within the city.

The JDA will contain important contractual provisions and protections, but it will be more focused and proportionate than a typical full joint venture agreement and should be capable of being finalised without a significant additional time or resource commitment from either the Council or the prospective bidders.

- 6.3 The ultimate aim is to secure a Funder/Operator with the same objectives and mindset as the Council, well ahead of HNZ legislation coming into effect.

During the term of the JDA, WSP and Teno Energy will remain engaged in specialist technical and financial advisory roles, assisting the Council in evaluating its options during this period.

- 6.4 It is intended that this procurement and subsequent collaboration under the JDA, will continue in parallel to exploratory drilling. Findings from both pieces of work will inform the most appropriate solution for any Sunderland heat network.

7. Reasons for the Decision

- 7.1 There have been significant market developments within the heat network industry, as well as financial market changes, resulting in a need to re-evaluate the Council's delivery options for such a significant capital scheme.
- 7.2 The earlier involvement of an experienced Funder/Operator should help to address the technical and commercial challenges facing the project, with the aim of

expediting delivery and accelerating a wider programme for low carbon district heating.

- 7.3 The new approach should allow the funding for the development, construction and operation of the Network to be provided by the private sector, taking the burden off the Council to fund the balance that cannot be met from GHNF.
- 7.4 Seeking earlier Funder/Operator involvement ahead of HNZ legislation would allow the Council opportunity to select a Funder/Operator with similar vision, values and commitment to deployment. The JDA period would also provide opportunity to work collaboratively and explore how a future arrangement could work, prior to either party committing further.
- 7.5 This will continue progress towards delivery of a City Centre Heat Network, in support of the ambitions set down in the City Plan and Low Carbon Action Plan.

8. Alternative Options

- 8.1 The alternative options considered and recommended for rejection are:
- i. Continue with the existing consultancy led design and public sector delivery model.

This option is rejected because it does not allow the Council to benefit from the additional expertise and commercial knowhow that an experienced heat network operator will bring as a partner to the project.

There is also a risk that the consultants' detailed design solution may not be entirely acceptable to an experienced commercial operator, which could lead to significant delays and additional costs at the construction stage of the project.

9. Other Relevant Considerations / Consultations

- (i) **Financial Implications** – The cost of the developing the alternate delivery approach will be met by the residual commercialisation grant funding from BEIS GHNF-TS, funding will be utilised to further develop a compliant tender and associated technical documents, with the remainder as a contribution towards network design costs during the JDA period. BEIS/Department for Energy Security & Net Zero are supportive of Sunderland using existing GHNF-TS grant funding to develop and pioneer a new delivery approach and have previously encouraged the full application for construction funding to be submitted as quickly as possible.
- (ii) **Legal Implications** – The Assistant Director of Law and Governance has been consulted on the proposals and her comments are included in the report.
- (iii) **The Public / External Bodies** – Stakeholder engagement has been carried out with Sunderland Royal Hospital, University of Sunderland, Gentoo and Sunderland College.
- (iv) **Procurement** – The Corporate Procurement Team has been consulted on this proposal and agree to the procurement approach.