

## CABINET

20 June 2023

<b>Title:</b> B&D Energy Ltd Business Plan 2023/24	
<b>Report of the Cabinet Member for Finance, Growth and Core Services</b>	
<b>Open Report with Exempt Appendix 1</b> (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972)	<b>For Decision</b>
<b>Wards Affected:</b> All	<b>Key Decision:</b> Yes
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<b>Accountable Executive Team Director:</b> James Coulstock, Strategic Director of Inclusive Growth	
<b>Summary</b> <p>This report seeks Cabinet approval of the B&amp;D Energy Limited (company no. 10088491) 2023/24 Business Plan, in line with the requirements of their Shareholder Agreement.</p> <p>This Business Plan has been scrutinised by the Shareholder Panel, the advisory body created to monitor and to report to Cabinet on the performance of Companies that the Council has a shareholding interest in. Performance against this plan will be monitored through the Shareholder Panel.</p> <p>The role of B &amp; D Energy is to act as the Council's strategic energy vehicle. It identifies and invests in low carbon energy generation projects to help support a sustainable low carbon energy future for the borough. This report highlights the key objectives to be delivered by B&amp;D Energy with the detailed financial commitments to be delivered set out in the exempt Appendices. Since the last iteration of the Business Plan, the company has chartered a really challenging global market and accrued 700 customers, delivered £25M of infrastructure and leveraged in more than £15m of grant. While it has endured many growing pains, and is still tackling legacy issues, the prospects for the business to grow and reach profit remain credible missions.</p> <p>The Council commissioned a review of B&amp;D Energy in 2022 which provided independent assurance that the financial model and business case were built on a reasonable set of assumptions and re-confirmed that the economic and environmental case for heat networks is still strong, despite rising energy costs and inflation. The coming five years are ones of expected significant growth in the homes connected to B&amp;D Energy following the completion of the new Barking Town Centre District Heating Scheme expected in June 2024.</p> <p>The Business Plan is contained at Appendix 1 which is in the exempt section of the agenda as it contains commercially confidential information (relevant legislation: paragraph 3 of Part I of Schedule 12A of the Local Government Act 1972) and the public</p>	

interest in maintaining the exemption outweighs the public interest in disclosing the information.
<b>Recommendation(s)</b>  The Cabinet is recommended to:  (i) Approve the B&D Energy Limited Business Plan 2023/24 as set out at Appendix 1 to the report.  (ii) Delegate authority to the Strategic Director, Inclusive Growth, in consultation with the Shareholder Panel, to take all necessary action to enable B&D Energy to implement its proposals within the Business Plan and to agree any variations to the business plan, legal agreements or shareholder agreement as necessary, subject to the provisions of the Subsidy Control Act 2022.
<b>Reason(s)</b>  To assist the Council with delivering the Inclusive Growth Strategy and delivering a well-run organisation. This proposal is in line with Recommendation 8 of the independent Growth Commission's report published in February 2016 and is therefore aligned to the Council's 'Inclusive Growth' priorities.

## 1. Introduction and Background

- 1.1 The approval of the B&D Energy business plan is reserved to the Council as shareholder under a shareholder agreement entered into with B&D Energy in 2020. This is an executive function exercised by the Cabinet on behalf of the Council as shareholder. In line with that agreement this Business Plan has been produced for Cabinet approval as outlined in the recommendations. The Business Plan was approved by the B&D Energy Board in May 2023 and has been scrutinised and endorsed by the Shareholder Panel on the 22 May 2023.
- 1.2 The UK government plans to introduce regulations for the heat network market in the coming years. The Energy Security Bill (ESB), currently passing through the House of Lords, is expected to receive royal assent by Summer 2023 and contains primary powers to enable regulation by Ofgem. Further details of the secondary legislation, covering price protections, cost recovery, decarbonisation, and complaint processes to which B&D Energy will be required to meet will be outlined in consultations by BEIS and Ofgem in Spring 2023.
- 1.3 B&D Energy have outlined it will prepare for this by working on its quality management system and subscribing to the Barbour index for legislation updates. The company is also a member of the UK District Energy Association and regularly engages with Ofgem's head of heat networks implementation and policy to stay informed. The company are assuming that Ofgem will adopt the heat trust standards already signed up to, but that remains an assumption rather than a fact at this stage.
- 1.4 In addition to the changing regulatory environment the UK has set an ambitious target of net-zero emissions by 2050, and the Council has also declared a climate

emergency. The heat sector is considered to have a significant role to play in helping to achieve this goal. B&D Energy therefore has an obligation to decarbonize its networks, and they have reflected that their approach is to prioritize the development of low carbon heat sources, such as water source heat pumps and waste heat recovery, to achieve our decarbonization goals. The business plan notes the securing of £6m additional grant funding as well as a request for in principle further loan of £4m to enable them to continue to invest in decarbonisation.

## **2. B&D Energy Group performance highlights in 2022/23**

2.1 Since the last iteration of the Business Plan, the company has chartered a really challenging global market and accrued 700 customers, delivered £25M of infrastructure and leveraged in more than £15M of grant. While it has endured many growing pains and is still tackling legacy issues the prospects for the business to grow and reach profit remain credible missions.

2.2 In spite of the unsettled market conditions B&D Energy has reached some notable and encouraging milestones in its development since the last Business Plan, which include:

- The investment of £25M into heat network infrastructure to deliver the core business of the company;
- 772 dwellings now having live connections to the heat network and this continues to grow;
- Connection and Supply contracts in place covering 2,087 dwellings as construction progresses;
- 2.5 km of primary pipework serving the symbolic Barking Town Centre Strategic Heat Network has now been installed across the west of Barking;
- A contemporary-styled new energy centre being constructed alongside the River Roding which could home a strategic water-source heat pump – a key piece of low carbon infrastructure helping to decarbonise the network;
- Secured a further £6m in funding from Low to Zero Carbon (LZC) infrastructure at the new Barking Town Centre energy centre by the Department for Energy Security & Net Zero (DESNZ, previously known as BEIS);
- Leveraging in £15.4m of external grant into the Barking Town Centre scheme through the Heat Network Improvement Programme and Public Sector Decarbonisation Scheme funding;
- Added to the network's strategic value through its selection by the Department of Energy Security & Net Zero for its Advanced Zoning Pilot. The program aims to support low carbon heat networks in zones where they provide the lowest cost to consumers through regulation, mandating powers, and market support.

2.3 However the last few years have also seen a number of significant challenges. While the forecasts in the last Business Plan assumed that the company's cumulative earnings before interest, tax, depreciation and amortization (EBITDA) would be in the region of £2.9m by now, significant delays in the construction of some developments due for connection, the impact of Covid-19 and inflation which has impacted the cost of the energy centre development, has meant this objective has not been met. The company is operating with a cumulative loss of £897,000 and are now forecasting to commence issuing a dividend to the Council in 2025/26. It must be noted this is totally reliant on the pace of construction and the associated

speed by which homes connect to the network albeit the aim is for the company to be more ambitious and meet the connections earlier.

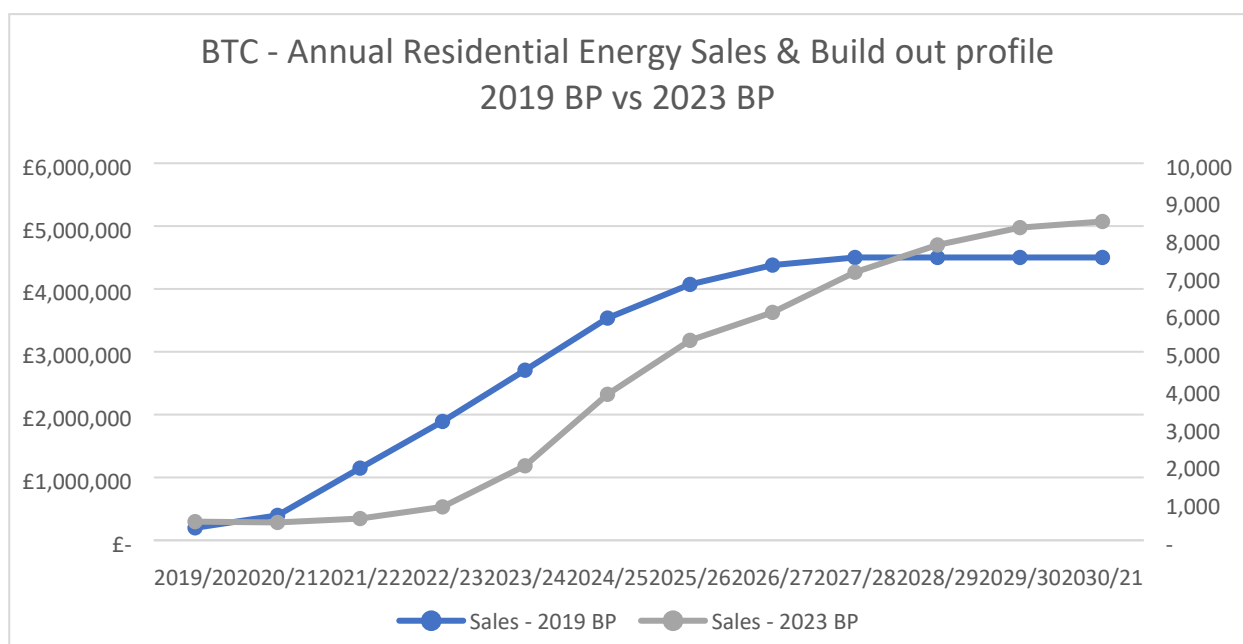
- 2.4 The main drivers for the lower than anticipated revenue are as noted above the slower pace of connections due to construction delays but the prices the company have been able to charge its customers has also been heavily impacted by government price caps during the 2022/23 winter. The plan notes however that the current planning and regulatory environment are still favourable for district heat networks and serves as an incentive for developers to connect.
- 2.5 The development of the Barking Town Centre Energy Centre had an unexpected discovery of significant amounts of asbestos leading to prolonged contractual negotiation over liabilities and an additional cost of £400k for remediation. Increasing levels of aged debt caused by the impact of cost of living and energy bill crises and the Government's poor administration of the Energy Bill Support Scheme Alternative Funding, is still affecting the company's customers.
- 2.6 Despite the challenges, B&D Energy have reported significant progress against its key 2019 business plan commitment which was the development of the district energy network in the Barking Town Centre. The Barking Town Centre (BTC) scheme remains by far the largest of the potential networks in the original business plan and the company note that phase 1 (laying of the pipes) has been concluded and phase 2, the development of the energy centre, initially equipped with gas-fired boilers and CHPs, is set to be completed in Feb 2024.
- 2.7 Energy Performance Contracting (EPC) was the second biggest commitment in 2019 but in the interim the Council has outsourced the energy performance contracting of its non-residential buildings to an external company as part of a separate corporate retrofit programme. This therefore means that B&D Energy will not be undertaking EPC work as it would result in duplication of effort and therefore this objective had been removed from the 2023/24 business plan.

### **3. B&D Energy Business Plan Commitments 2023/24**

- 3.1 The Council commissioned a strategic review of the energy company in 2022 which was tasked with delivering an overall health check as well as a number of other objectives including providing the Council with assurance about the challenges the company faced given the turmoil in energy markets; assessing whether all of the company's original strategic objectives remain relevant and whether the business can diversify its role in the energy sector.
- 3.2 The independent review confirmed there remained a compelling case for investing in district heat networks, with the government targeting 20% of homes to be heated by such networks by 2050. It also notes that the Advanced Zoning Pilot provides opportunities for Barking & Dagenham to lead future development and investment and the new building regulations being introduced in 2025 and the Future Homes Standard may incentivise developers to connect to existing networks such as B&D Energy, creating a ready market for the company to grow its customer base by accelerating its search for sustainable and decarbonised heat and power supplies.
- 3.3 The 2023/24 business therefore sets out its aspiration in the short term will be to continue building and consolidating the Barking Town Centre Strategic Heat

Network, with a goal of reaching 8,900 customers by 2030 and thus in term achieving an operating profit. The company have outlined an approach to work with third-party developers and Be First to pursue connections and sales in the district and seek further funding through the Green Heat Network Fund to decarbonize the network.

- 3.4 The business plan sets out its future income assumptions based on potential connection of 8,900 units between now and 2030 and notes that 5,008 pf those already covered by connection and supply agreements. This means that there is an in-principle commitment to B&D Energy amounting to 56% of the total connections assumed in the plan. As such, although there is some concern the timeline for some connections may slip and therefor the speed at which the company will reach an operating profit may be optimistic, there is a reasonable level of robustness regarding the company’s future pipeline. The table below illustrates the current timeline to reach the 8,900 connections.



- 3.5 The plan also addresses the ever-growing urgency to decarbonise its sources of heat and power which will be needed to meet wider Council objectives on delivering a net zero carbon borough and to incentivise developers to connect to its network. It recommends support for the installation of a water source heat pump installed in the River Roding, adjacent to the energy centre to which additional grant of £6m has been secured. The Business Plan asks for a further £4M investment from the Council thus enabling a highly strategic water source heat pump to be installed which will serve a large swathe of the Barking Town Centre Network.

- 3.6 In the medium term, B&D Energy has also set out an aspiration to diversify its commercial offerings, potentially by providing technical expertise for Operation & Maintenance services to managing agents and housing providers.

#### 4. Consultation

- 4.1 The B&D Energy Business Plan has undergone the following consultation:

- Endorsed by the Strategic Director of Inclusive Growth
- Endorsed by the Shareholder Panel on 22 May 2023

## 5. Financial implications

Implications completed by: David Dickinson, Investment Fund Manager

5.1 The B&D Energy Business Plan (BDEBP) follows on from the 2019 Business Plan and covers a number of significant changes that have occurred around regulation changes, energy cost increases and build cost increases, as well as the cost-of-living crisis. Currently the BDE business plan is insufficient in detail to fully analyse the financial implications and it is essential that work is carried out to improve reporting, risk assessment and incorporate a loan drawdown and repayment schedule that can be fully analysed and agreed.

5.2 It is important to note that the Council is both the parent and shareholder for BDE and therefore it has a greater requirement to have reporting on performance after tax and interest repayment (rather than earnings before interest, tax and dividends) and BDE need to report the impact of debt to the Council.

5.3 The Business Plan, when compared to the 2019 Business Plan requires £18.863m more gross expenditure, although some of this requirement has been reduced by the additional grant to a net requirement of £8.371m. A comparison is provided below. There is currently very little detail around why the costs have increased so much, although a large driver behind the costs is the capex cost for the additional customers.

<b>Projected Capital costs</b>	<b>2019 forecast</b>	<b>Forecast to 2028/2029</b>	<b>Difference to 2019 Business Plan</b>	
BTC LOT1	9,237,784.80	14,825,123.38	5,587,338.58	
BTC LOT2	14,573,520.00	19,809,176.84	5,235,656.84	
Remdiation works		500,000.00	500,000.00	<i>Asbestos</i>
D&PM (WSP)	1,210,235.00	1,210,235.00	-	
Dev Costs	800,000.00	800,000.00	-	
Gascoigne East	3,000,000.00	3,000,000.00	-	<i>Expansion</i>
<b>Total Capex</b>	<b>28,821,539.80</b>	<b>40,144,535.23</b>	<b>11,322,995.43</b>	
<b>Other CAPEX costs</b>				
<b>Additional customers</b>		<b>7,500,000.00</b>	7,500,000.00	<i>Estimate</i>
<b>BTC - Water source heat pump</b>		<b>40,000.00</b>	40,000.00	<i>Estimate</i>
		<b>7,540,000.00</b>	<b>7,540,000.00</b>	
<b>Total Gross Capital expenditure</b>	<b>28,821,539.80</b>	<b>47,684,535.23</b>	<b>18,862,995.43</b>	
<b>Grants</b>				
HNIP	-5,000,000.00	-7,500,000.00	-2,500,000.00	
PSDS	-	-1,991,766.00	-1,991,766.00	
HNIP 2023	-	-6,000,000.00	-6,000,000.00	
<b>Total grants</b>	<b>-5,000,000.00</b>	<b>-15,491,766.00</b>	<b>-10,491,766.00</b>	
<b>Total Net Borrowing Requirement</b>	<b>23,821,539.80</b>	<b>32,192,769.23</b>	<b>8,371,229.43</b>	

## Loans

- 5.4 Currently there are three loans to BDE. The loans and the drawdowns are below. The £1.7m loan has expired and only £897.5k was drawn down. This loan is scheduled to be repaid by 31/3/2027 and currently interest is being capitalised. In addition, a loan of £3m was issued and only £1.835.8k was drawdown and no further drawdowns are possible on this loan. Interest is being capitalised but a repayment schedule will start in 2023, with the final repayment by 31/3/2042. The main loan of £25.5m is at a fixed rate of 4.5% with a capitalised interest period during the drawdown phase and then a repayment schedule to 31/3/2047.

<b>Working capital Loans</b>	Loan Amount	Drawn Down (incl. Capitalised interest)	Loan Rate	Loan Use
Loan £1.7M	1,700,000.00	1,005,512.09	Base Rate plus 3%, repayment date 31/3/2027	Becontree
Loan £3M	3,000,000.00	2,056,713.03	Base Rate plus 3%, repayment date 31/3/2042	BLC + ABLC
Loan £25.5M	25,500,000.00	4,197,026.42	Fixed at 4.5%, repayment date 31/3/2047	BTC

- 5.5 The net borrowing requirement is £32.193m for the Barking Town Centre. Therefore, against a current loan of £25.5m a further £6.693m of borrowing is required. In addition, this requirement will need to be increased to accommodate the capitalisation of interest and therefore a further £8m to £9m is required depending on the development period. The total borrowing expected would also be around £38m across the three loans when fully drawn.
- 5.6 Repayment of the loan is dependent on the various schemes connecting on the scale and periods in the business plan. There is a breakeven point that BDE need to focus and report on that will allow the net income before interest and debt repayment to be sufficient to cover the loans. This point needs to be RAG rated as several of the schemes within the pipeline are currently red, with significant delays expected before they can connect, with Vicarage Field one of the key risks.
- 5.7 The increase in borrowing requirement is concerning and needs to be explained in more detail as the 2019 assumptions were insufficient. There are issues around some of the pipeline assumptions that need to be addressed as, given the current market environment, several schemes that are scheduled to connect are struggling to progress or may be significantly delayed.
- 5.8 The Becontree Heath losses need to be reviewed and lessons learned as potentially these issues (schemes potentially adding a pipeline but this not progressing) could impact the BTC.

## Dividend and Debt Repayments

- 5.9 There are current discussion with BDE around the repayment of loans against the payment of a dividend to the Council. As there is still a significant amount of work required to complete the work on BTC and this decision has been delayed until more robust and detailed forecast data can be provided but there is an intention that the loan repayment schedule will remain as per the agreement, with a dividend potentially paid to the Council.

- 5.10 Although the long-term dividend potential of the ESCo remains positive once the network is completely built out and the pipeline of units are connected, this business plan demonstrates a significant shift in the timelines by which the Council should expect to see financial returns and confirms that none of the 2019 forecasts have been achieved other than in 2019 when it made a £60k surplus.
- 5.11 In the 2019 Business plan the ESCo forecasted to commence dividend returns in 2022, but in this plan cumulative losses do not turn positive to enable a dividend return until to 2025/26. In addition, the assumption of a positive cumulative cash flow being produced by that point (leading to a dividend being payable) is based on the profile of 5,000 connections in 2025/26 which given the current pace of development is unlikely. The MTFS does not have any assumption of dividend from the ESCo which is positive, so there is no direct impact on the Council's revenue position although assumptions have been made regarding loan repayments and those will need to be made.

### **Pipeline Connections and costs**

- 5.12 For future income assumptions this business plan assumes potential connection to 8,900 units between now and 2030 with 5,008 already covered by connection and supply agreements. This means that there is an in-principle commitment to connect to the energy centre amounting to 56% of the total connections assumed in the plan. As such, although the timeline for connections may be optimistic, there is a reasonable level of robustness regarding the pipeline and once the cumulative cash flows are positive and a dividend can be issued it would presumably continue to be capable of being profit making on an ongoing and perpetual basis from that point.
- 5.13 The Business Plan does not fully cover in great deal the potential costs from decarbonisation, the increased gas costs (although these have come off significantly since mid-2022) or the impact of the cost-of-living crisis on bad debts. There is potential for these to adversely impact the potential surpluses both in the short-term but also over the longer term for decarbonisation costs.

## **6. Legal Implications**

Implications completed by: Ian Chisnell, Major Projects Solicitor

- 6.1 The power to create B&D) and its regulation is set out in various previous cabinet reports.
- 6.2 The report does not deal with the issue of how close (in terms of electricity generation) the company's activities are to triggering the requirement for regulation under The Electricity (Class Exemptions from the Requirement for a Licence) Order 2001.
- 6.3 The company has a large amount loaned to it by the Council and it would appear that it requires more. As the company is working in a competitive industry and is an economic operator supplying customers other than the Council there is a probability that further loans could amount to Subsidy under the Subsidy Control Act 2022 and an analysis needs to be undertaken to determine whether or not the Council would be in breach of the Subsidy Control Act if it were to advance a further £4m without the agreement of the Subsidy Advice Unit.



6.4 Currently the company is regarded as a 'Teckal' company, i.e. it benefits from Regulation 12 of the Public Contracts Regulations 2015, which means it does not have to compete for energy contracts from the Council. That will change if more than 20% of its turnover is derived from the private sector as indicated in the business plan.

## **7. Other Implications**

7.1 **Contractual Issues** - Development of Business Plans is a contractual commitment for all of the Companies and is designed to set the framework by which the strategic direction of each Company is considered and approved or endorsed by the Council as either a major or minor Shareholder.

**Public Background Papers Used in the Preparation of the Report:** None

### **List of appendices:**

- **Appendix 1:** B&D Energy Business Plan 2023/24 (exempt document)