Leeds CITY COUNCIL

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**Report of the Director of City Development and the Director of Resources**

**Report to the Executive Board**

**Date: Wednesday 18th July 2012**

**Subject: RE:FIT Phase 2**

| | | |
|---|---|---|
| Are specific electoral Wards affected?<br>If relevant, name(s) of Ward(s): | ☐ Yes | ☒ No |
| Are there implications for equality and diversity and cohesion and integration? | ☐ Yes | ☒ No |
| Is the decision eligible for Call-In? | ☒ Yes | ☐ No |
| Does the report contain confidential or exempt information?<br>If relevant, Access to Information Procedure Rule number: N/A | ☐ Yes | ☒ No |

## Summary of main issues

1. This report provides the Executive Board with an explanation of proposals for a 2nd phase of 'RE:FIT', following the implementation of a previous pilot initiative and the identification of further potential to retrofit council buildings with energy efficiency measures.

2. The scheme requires the injection and subsequent expenditure of £1.5 million of unsupported prudential borrowing. However, the financial model is guaranteed to be cost neutral or better for the council, by virtue of the contractual provisions for risk transfer within the RE:FIT framework.

3. The awarded contractor must meet a minimum threshold of energy cost savings, which is set at a level that balances the council's annuity repayments within a 7 year repayment period.

4. The contract must be awarded prior to the end of 2012, at which point the RE:FIT framework expires.

## Recommendations

5. Approve the project proposals for RE:FIT phase 2, including the associated portfolio of buildings;

6. Approve the injection of £1.5 million into the capital programme, to be fully funded by unsupported borrowing;

7. Approve the expenditure of up to £1.5 million on this project;

8. Delegate authority to the Director of City Development to approve any changes to the portfolio of buildings falling under the RE:FIT phase 2 proposals, in terms of additions or removals; and,

9. Delegate authority to the Director of City Development to approve the award of the contract.

## 1 Purpose of this report

1.1 This report seeks the support of Executive Board to participate in RE:FIT phase 2 and to also agree the scope of the procurement. The pilot project was originally ratified at Executive Board held on Wednesday the 5th of January 2011.

1.2 Based on its previous experience – as part of the pilot project – the public private partnerships unit (PPPU) will programme manage the second wave of RE:FIT on behalf of the council.

1.3 The key objectives of the project are to:

- Specify a minimum of 19% overall energy cost savings across a portfolio of 11 selected buildings;
- Secure a reduction in carbon emissions from those nominated buildings; and,
- Support council and city-wide priorities in respect of environmental policy commitments.

## 2 Background information

2.1 RE:FIT was developed by the London Development Agency (LDA), with support from the Clinton Climate Initiative. Leeds City Council previously ran a pilot on behalf of the 'core cities group' to test RE:FIT. Phase 1 is already well underway, wherein E.ON – an energy services company (ESCo) who participate in the framework – were awarded a contract to deliver substantial energy efficiency measures across a portfolio of chosen buildings. Leeds' climate change and NI185 action plans both specifically reference the RE:FIT initiative and in undertaking this second procurement process, we seek to extend the council's exemplary work in this area whilst continuing to support national and international policy aims at the local level.

2.2 RE:FIT is an approved procurement framework that allows the public sector to retrofit buildings with energy saving products and measures to reduce energy consumption, carbon emissions, and ultimately, energy-centric utility costs as well. In terms of procuring the works, tender documents will be issued to an existing framework of 12 suppliers. Under the procurement framework, the risk of achieving a set amount of energy savings is transferred to the private sector for the pre-agreed payback period. Therefore, participating in this procurement will result in significant energy savings and will hence save the council money.

2.3 Eleven council buildings across the city have been identified for retrofitting based on a number of factors, such as high energy consumption and medium to long-term asset retention.

2.4 This procurement offers a financial model that will fund the capital and project management costs of the scheme; moreover, once the initial investment has been repaid, the energy savings thereafter represent an ongoing cost saving to the council through reduced utility bills.

2.5 The council has proposed a portfolio of 11 buildings for the 2nd phase of RE:FIT, with total energy spend of £1.498m in 2011/12. These buildings are included in the table below:

| | Energy data based on actual payments made through the council's financial management system (2011-12) | | | | | | |
|---|---|---|---|---|---|---|---|
| Proposed building | Gas costs | Gas consumption | Associated CO2 emissions | Electricity costs | Electricity consumption | Associated CO2 emissions | Total energy costs |
| John Charles Sports Centre | £200,307.18 | 8,346,133 kWh | 1,555 tonnes | £187,893.17 | 2,348,665 kWh | 1,232 tonnes | £388,200.35 |
| Civic Hall | £54,027.97 | 2,251,165 kWh | 419 tonnes | £181,243.74 | 2,265,547 kWh | 1,189 tonnes | £235,271.71 |
| Tropical World | £121,815.44 | 5,075,643 kWh | 946 tonnes | £30,845.35 | 385,567 kWh | 202 tonnes | £152,660.79 |
| City Art Gallery & Central Library | £38,251.18 | 1,593,799 kWh | 297 tonnes | £80,238.16 | 1,002,977 kWh | 526 tonnes | £118,489.34 |
| Rothwell LC | £52,536.98 | 2,189,041 kWh | 408 tonnes | £60,261.66 | 753,271 kWh | 395 tonnes | £112,798.64 |
| Town Hall | £51,704.38 | 2,154,349 kWh | 401 tonnes | £53,472.13 | 668,402 kWh | 351 tonnes | £105,176.51 |
| Scott Hall LC | £50,581.45 | 2,107,560 kWh | 393 tonnes | £49,029.70 | 612,871 kWh | 322 tonnes | £99,611.15 |
| Fearnville LC* | £44,758.15 | 1,864,923 kWh | 348 tonnes | £42,786.94 | 534,837 kWh | 281 tonnes | £87,545.09 |
| John Smeaton LC | £31,238.80 | 1,301,617 kWh | 242 tonnes | £54,057.86 | 675,723 kWh | 354 tonnes | £85,296.66 |
| Kippax LC | £38,161.85 | 1,590,077 kWh | 296 tonnes | £40,064.13 | 500,802 kWh | 263 tonnes | £78,225.98 |
| St. George's Centre* | £9,756.43 | 406,518 kWh | 76 tonnes | £24,574.98 | 307,187 kWh | 161 tonnes | £34,331.40 |
| Grand totals | £693,139.81 | 27,015,902 kWh | 5,033 tonnes | £804,467.82 | 9,521,011 kWh | 4,995 tonnes | £1,497,607.62 |

* Data source: *Team Sigma (provided by the Energy Unit)*

2.6 The pilot initiative set a guaranteed minimum energy savings threshold of 23% across a portfolio of 9 buildings with a maximum payback period of 7 years. Pertinently, the winning bidder was able to exceed this baseline target, improving the financial viability of the project.

2.7 The threshold chosen for RE:FIT phase 2 is 19%, which again will have a maximum payback period of 7 years. It is fully appreciated that this is lower than that which was required during the pilot (23%). However, this is largely due to the fact that the portfolio in phase 2 has already received some prior investment – in terms of energy efficiency measures – through the use of Salix funding. Nevertheless, analysis shows there is still considerable scope to obtain energy savings across this 2nd portfolio of buildings and the savings potential is sufficient to cover the annuity repayments that the council will incur. This provides ample justification for pursuing a further wave of RE:FIT investment. Furthermore, as with the pilot, the tender process should result in bidders providing guaranteed savings that are substantially higher than the 19% baseline, due to the competitive nature of the procurement process.

2.8 It should be noted that the financial model underpinning the RE:FIT phase 2 proposals was generated via rigorous analysis of the potential scope for energy savings interventions within each of the 11 sites. This work also included consultation with a suitably qualified project team and has been checked for feasibility by the council's asset management department. The model takes into consideration buildings that have either already received or are pending energy efficiency funding from alternative sources, such as those funded through Salix,

discounting them so that only relevant potential energy conservation measures are considered within our proposals.

2.9 The buildings within our portfolio were selected from a list of one hundred council 'owned' buildings, taking into account both high energy consumption and relative longevity, i.e. those sites that are likely to be retained by the council in the medium to long term (longer than 7 years). The selected buildings have commitment from the respective service areas, who are being continuously engaged.

## 3 Main issues

3.1 The building portfolio is being kept under constant review by asset management and if appropriate, buildings earmarked for disposal or found to be unsuitable will be substituted for alternatives. As part of the procurement process, contractors will carry out desktop assessments on all buildings using key data provided by the authority – as well as site visits – in order to prepare their tender submissions. Our prior analyses, aligned with our openness and transparency with bidders, in terms of providing site specific details, should mitigate the risk of including particular buildings where only limited scope is available for the introduction of energy saving measures. Indeed, some sites might see no energy efficiency interventions if the contractor can demonstrate that better value is engendered by incorporating a greater number of measures at specific sites showing more potential. This will give bidders greater flexibility in terms of enabling them to achieve our 19% energy savings threshold.

3.2 The council will meet the borrowing costs through the savings made on energy budgets at each of the participating sites. However, once all the associated loan repayments have been made, the sites included will benefit fully from the associated energy cost savings, which will be at least 19% across the portfolio (and potentially higher).

3.3 All of the bidders on the framework have been informed of our tentative intention to tender this scheme, which will give them the necessary time to prepare the resources they need to have in place to prepare a complex bid of this nature. The 'invitation to tender' is anticipated to be issued in late July 2012, pending Executive Board approval. Contract award should be concluded in December 2012 and all works are due for completion by the end of the 2013/14 financial year. Due to the fact that the LDA framework expires as the end of 2012, it is imperative that there is no slippage in the timetable outlined below.

| Key milestones | Date |
|---|---|
| Internal executive board approval – authority to spend | Wednesday 18th July 2012 |
| Invitation to tender (ITT) released | Late July 2012 (11.5 week tender period) |
| Bid preparation (including site visits) | Late July-October 2012 |
| Deadline for tender submission | Wednesday 10th October 2012 |
| Evaluation of tenders | Mid-late October 2012 |
| Interviews with tenderers | Early November 2012 |
| Preferred ESCo identified | November 2012 |
| Contract award approval | Early December 2012 |

| | |
|---|---|
| Detailed survey and construction programme commences | January 2013 |
| Works programme completed | End of 2013-14 financial year |

## 4 Corporate considerations

### 4.1 Consultation and engagement

4.1.1 In terms of the council's obligation that decision-making pays due regard to consultation carried out directly with the public, the requirement can be designated as 'not applicable' in this case.

4.1.2 Disruption to building users – stemming from the works – will be kept to a bare minimum through requiring retrofitting work to be completed out of hours or during quiet periods. In addition, site employees will be fully consulted and briefed regarding their roles and responsibilities throughout the process.

4.1.3 Due to the fact that we won't know which energy conservation measures will be included in RE:FIT phase 2 until the contractor is selected and has fully assessed each site for suitability, we can't be sure of the exact scope and potential impact of the works at this point. Therefore, although internal consultation is already underway, we may elect to carry out focussed consultation with any affected members of the public once the specific nature of the works is known.

### 4.2 Equality and diversity / cohesion and integration

4.2.1 A screening document was completed in respect of this scheme and that process established that a full equality impact assessment was not required. The justifications for arriving at this decision are summarised in the items below.

4.2.2 The impact of the works is likely to be low in terms of equality concerns, especially given the fact that the commissioning process itself will be used to stipulate compliance with the procurement unit's contractors' code of conduct, which addresses many relevant issues.

4.2.3 Since this is not an existing service, it's felt that the proposal doesn't affect how our services and/or procurement activities are organised, provided, or located. We're not changing the way a service is delivered to the public since this is a standalone project, which doesn't affect anyone directly. Furthermore, the changes made to the building will have no discernable effect on service users, providing only benefits to the council itself and taxpayers in general.

4.2.4 As with item 4.1.3, due to the fact that we won't know which energy conservation measures will be included in RE:FIT phase 2 until the contractor is selected and has fully assessed each site, we can't be sure of the exact scope and potential impact of the works at this point. Therefore, we may elect to carry out further equality screening once the specific nature of the works is known. This commitment should give further assurances that equality issues will be fully considered throughout the commissioning process.

## 4.3 Council policies and city priorities

4.3.1 Current national and European legislation calls for continued downward pressure on carbon emissions, energy, and water consumption. In December of 2009, the council's Executive Board agreed a 'climate change action plan' for Leeds, which called for a 40% reduction in carbon emissions from the council's operations by April 2021 (compared to a baseline established in 2008-2009). The full council passed a further resolution in January 2010 to extend this aspiration to carbon emissions stemming from the whole city. As part of its 'carbon and water management plan', which covers the period 2011-21, the council wishes to achieve significant annual energy savings and to reduce its carbon emissions.

4.3.2 Leeds' climate change and NI185 action plans both specifically reference the RE:FIT initiative and in undertaking this second procurement process, we seek to extend the council's exemplary work in this area whilst continuing to support national and international policy aims at the local level.

4.3.3 The 'carbon reduction commitment' (CRC) scheme has also been changed following the 'comprehensive spending review' in autumn 2010. The revenue from allowance sales will be used to support public finances, rather than being recycled to participants as was originally intended. This effectively converts the scheme into a tax which means that the liability of the council has increased. Aside from direct energy cost savings, it's estimated that this scheme will save around 1,905 tonnes of carbon per annum, which equates to a financial saving to the council of approximately £22,860 a year in terms of our obligations under CRC. This saving is not encapsulated by RE:FIT phase 2's financial model but offers an additional indirect benefit to the council outside of its principal remit.

## 4.4 Resources and value for money

4.4.1 The Executive Board are asked to approve, in principle, the 'authority to spend' for £1.5 million of unsupported borrowing for this scheme. This figure is based on an assessment of indicative capital costs for works of this nature. The capital/revenue profile for the seven years is shown in the table below:

| Payback year | Financial years | Capital repayment | Financing costs | Annuity due | Energy savings to the council (assuming 19% guaranteed minimum) |
|---|---|---|---|---|---|
| 1 | 2012/13 | 214,286 | 54,417 | 268,703 | 284,545 |
| 2 | 2013/14 | 214,286 | 54,417 | 268,703 | 284,545 |
| 3 | 2014/15 | 214,286 | 54,417 | 268,703 | 284,545 |
| 4 | 2015/16 | 214,286 | 54,417 | 268,703 | 284,545 |
| 5 | 2016/17 | 214,286 | 54,417 | 268,703 | 284,545 |
| 6 | 2017/18 | 214,286 | 54,417 | 268,703 | 284,545 |
| 7 | 2018/19 | 214,286 | 54,417 | 268,703 | 284,545 |
| | **Totals** | **£1,500,000** | **£380,918** | **£1,880,918** | **£1,991,818** |

4.4.2 It is recommended to Executive Board that the payback period is calculated in terms of setting a minimum 19% of energy savings as an average across the portfolio of buildings. The evaluation criteria will subsequently award higher marks

for any bidder who can achieve a higher percentage saving for the same capital outlay, therefore reducing the payback period of the contract.

4.4.3 As alluded to, under the procurement framework the risk of achieving the energy savings is transferred to the private sector for the pre-agreed payback period. This is achieved via the inclusion of a performance bond as set out in the framework agreement.

4.4.4 The savings have been calculated on current energy prices although it is highly likely that prices will significantly increase over the next seven years. As energy prices rise, the return on investment calculated for RE:FIT phase 2 becomes even more attractive, even though those additional savings to the council that have not been included in the financial appraisal (since energy cost hikes cannot be accurately forecast at this point). Nevertheless, the impact of these inevitable rises will significantly improve the financial viability of the project by helping to reduce the payback period.

4.4.5 The energy saving measures fitted will also lead to the improvement of each building's condition. Typical energy saving measures are likely to include: high efficiency condensing boilers; energy efficient lighting; improved building controls; optimised heating, ventilation, and air conditioning systems; better insulation; microgeneration technologies; and so on. The exact nature of the energy saving measures included at each site will not be confirmed until the end of the procurement, when a preferred ESCo has been selected.

4.4.6 Any reduction in carbon emissions as a result of actions taken under this procurement will reduce the liability of the council under the CRC scheme. This in turn will help to reduce the payback period, which is solely calculated on energy savings.

4.4.7 By using an established procurement framework, the council will save a considerable amount of time and money. This is due to the fact that the framework has already been formally advertised and established, which negates the need to have a short-listing stage as part of the procurement process, i.e. we can approach the framework participants directly as a collective and engage in secondary competition as a means of achieving value for money.

4.4.8 It's anticipated that a budget of approximately £100,000 will be required to cover the project management costs of the PPPU as well as the site management of the works, which will be overseen by the council's asset management department. These costs are factored into the overall capital injection that we're requesting as part of this proposal (i.e. £1.5m). The remainder of the money is earmarked as the capital investment available to the chosen contractor to deliver the works that will result in the minimum energy cost savings percentage we impose.

4.4.9 The PPPU is project managing the delivery of RE:FIT phase 2 on behalf of the council in conjunction with colleagues from asset management, corporate property management, financial management, sport and active recreation, and procurement.

## 4.5 Legal implications, access to information, and call-in

4.5.1 In terms of legal implications, the council is bound to use the terms of conditions enshrined within the contractual provisions of the RE:FIT framework, as put in place by the LDA.

4.5.2 None of the content of this report falls under the access to information rules.

4.5.3 As a key decision, this report is subject to call-in.

## 4.6 Risk management

4.6.1 There is a risk that there's a change in the use of the buildings highlighted within the portfolio over the 7-year contract period. However, this risk is mitigated somewhat by the fact that the council's asset management department has reviewed the affected buildings and deemed that there are no changes planned for their usage.

4.6.2 A further risk might manifest if separate works are undertaken at one of the sites, which then conflict with the works that the RE:FIT contractor is tasked with. This risk will be reduced markedly via thorough consultation with site representatives and early stakeholder involvement. A comprehensive communication plan will also be implemented so that all associated works are carried out seamlessly and relevant stakeholders are kept abreast of new developments in a timely fashion.

4.6.3 A nominal risk is that future energy prices might fall compared to the baseline that RE:FIT phase 2 uses. Although energy prices might fluctuate in the short-term, the common trend in recent times has been for energy costs to rise. Industry projections show the reasons for this as being linked to Britain's increasing reliance on imported gas, infrastructure improvements required for the National Grid, and investment in renewable power generation needed in order for the UK to meet binding EU targets. Therefore, it would appear to be safe to assume that energy price changes will continue on an upward curve for the foreseeable future.

# 5 Conclusions

5.1 The identified portfolio of buildings represents a significant opportunity for the council in terms of reductions to energy consumption and associated carbon emissions through energy efficiency improvements. Use of the RE:FIT framework provides a unique opportunity to raise capital that might otherwise be unavailable, enabling swift energy and carbon reductions to take place whilst also supporting the council's environmental targets and aspirations. Given central government's current green agenda and its challenging targets for reducing carbon and energy in the medium to long term, the positive impacts of this project are considered to be very significant on a national level.

# 6 Recommendations

6.1 Executive Board are requested to:

- Approve the project proposals for RE:FIT phase 2, including the associated portfolio of buildings;

- Approve the injection of £1.5 million into the capital programme, to be fully funded by unsupported borrowing;

- Approve the expenditure of up to £1.5 million on this project;

- Delegate authority to the Director of City Development to approve any changes to the portfolio of buildings falling under the RE:FIT phase 2 proposals, in terms of additions or removals; and,

- Delegate authority to the Director of City Development to approve the award of the contract.

## 7 Background documents[1]

7.1 The following background documents are of relevance to the content of this report:

- Strategic Investment Board RE:FIT report (29th July 2010)
- Executive Board RE:FIT report (5th January 2011)
- RE:FIT official publication
- LCC Climate Change Action Plan (December 2009)
- LCC Carbon and Water Management Plan 2011-21
- Equality, Diversity, Cohesion, and Integration Screening Document (RE:FIT phase 2)

[1] The background documents listed in this section are available for inspection on request for a period of four years following the date of the relevant meeting. Accordingly this list does not include documents containing exempt or confidential information, or any published works. Requests to inspect any background documents should be submitted to the report author.