

**Report of:** Chief Officer of Sustainable Energy & Air Quality (SEAQ)

**Report to:** Director of Resources & Housing

**Date:** 16<sup>th</sup> August 2019

**Subject:** Waiver of CPRs 8.1 and 8.2 & ATP for on-going maintenance of Merrion House gas-fired generators

Are specific electoral wards affected? If relevant, name(s) of ward(s):	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Is the decision eligible for call-In?	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No
Does the report contain confidential or exempt information? If relevant, access to information procedure rule number: Appendix number: N/A	<input type="checkbox"/> Yes	<input checked="" type="checkbox"/> No

## Summary of main issues

1. The council installed gas fired generators as part of the Merrion House refurbishment, which were designed to be operated at peak times to generate electricity to create an income stream to the council and to reduce running costs for the building.
2. However, the current O&M agreement with Edina – arranged by the O&M agent of Merrion House as a whole (BAM Construction) – expired on the 30<sup>th</sup> of June 2019.
3. There was an option to incorporate the inclusion of the O&M for the generators into an overall O&M contract for The Merrion Centre as a whole. However, the framework being used – Fusion 21 – included no specialist provision for generators and hence was not fit-for-purpose, as the winning bidder would have sub-contracted out the work. In addition, Town Centre Securities – who were going to run the procurement on our behalf – would have charged an on-going service fee, which wouldn't have represented best value-for-money.
4. The council requires an interim solution until such time as a procurement can be concluded for an O&M provider.
5. The purpose of this report is therefore twofold:
  - i. To retrospectively waive the contract procedure rules (CPRs) to extend the current operations and maintenance (O&M) arrangement with Edina until January 2020, up to a value of £45k.

- ii. To seek approval to procure a new contract for the on-going O&M of the gas fired generators at Merrion House. The value of this is estimated to be £300K, based on a 3 year initial contract period plus a possible addition of 2 subsequent 12 month extensions.

## **Recommendations**

The Director of Resources & Housing is recommended to:

1. Approve the invocation of CPR 27 in order to waive CPRs 8.1 and 8.2 and
2. Give authority to procure a new contract for the maintenance and servicing of Merrion House's gas fired generators.
3. To note that we are varying the energy contract with Engie to incorporate the optimisation service.

## **1 Purpose of this report**

1.1 The purpose of this report is twofold:

- To waive CPRs 8.1 and 8.2 to extend the current O&M arrangement with Edina until January 2020; and,
- To seek approval to procure a new contract for the on-going O&M of the generators at Merrion House.

## **2 Background Information**

2.1 The council undertook a deep retrofit of its offices in Merrion House (MH) as part of a major overhaul, completed in early 2018. As part of this refurbishment, the council installed two 1MW gas-fired power generators in the new plant room, with a view to improving site resilience and tapping into industry based revenue schemes.

2.2 Merrion House previously had a gas-fired boiler plant rated at 6MW, which provided space and hot water heating to the building. The building consumed approximately 880kW peak of electricity in the old set-up and drew its power from the National Grid, with a maximum supply capacity of 1MW.

2.3 The floor-plate of the building was increased by >30% as part of the refurbishment but the potential increase in energy demand was reduced somewhat through improvements in insulation, lighting equipment, controls and general building services. The building has been fully occupied for around a year and the baseload for power is speculated to be just under 1MW.

2.4 Linked to the above, assuming grid gas is available, MH can run continuously on the generators, at any time, should the need arise (e.g. during a power outage or in order to avoid paying very high prices for peak electricity).

2.5 The cost of the gas-fired generator associated kit and general assembly was £3.1 million but had the generators not have been installed an essential oil-fed back-up generator would still have been required as a contingency and the cost of that would have been £832K. As such, the back-up generator cost was included as a 'pseudo-credit' against the main scheme cost, giving a 'net' outlay of £2.3 million.

2.6 The capital requirement of £2.3 million was prudentially borrowed at an interest rate of 4.5%, over 25 years, and the annual repayments are £152,937.

2.7 The annual maintenance costs put forward in the original financial model were anticipated to be £24K. However, the costs with the incumbent (Edina) would be £91.5K, if we were running the generators at their full potential.

## **3 Main issues**

3.1 The generators at MH need to be maintained on a regular basis to ensure that the income they generate is optimised. The current arrangement with Edina expired on the 30<sup>th</sup> of June 2019. There is now only provision via an informal agreement with Edina to continue on the same terms, pending the waiving of CPRs in order

to extend the agreement, retrospectively, with the intention of creating enough time to carry out a procurement process in order to create new provision.

3.2 The cost of the servicing and maintenance is broken down into 2 components; a fixed daily charge and an hourly usage charge on top of this static fee:

- The static daily charge covers the basics of the contract, including: 'uninterruptible power supply' ('UPS') maintenance, high voltage (HV) switch gear, 24 hour remote monitoring (via installed phone line), monthly service reports, and so on.
- The rest of the service fee is dependent on the engine running hours; the more hours the engines run for the higher the costs. However, if the engines do not run then this part of the service fee would remain at £0.

3.3 To achieve an optimum level of potential revenue for the generators requires them to run for roughly 3,000 hours per annum. Based on this level of usage, Edina's associated O&M costs will be roughly £45K for the 6 month arrangement created by the retrospective waiver request forming one of this report's recommendations.

3.4 Separate to the above but still linked to the overall premise, the projected net income to the council – resulting from the operation of the generators – has so far not been in line with expectations.

3.5 As a result, we have separately commissioned Engie, through the existing electricity and gas supply contracts, to apply their expertise to managing the assets, for what has been deemed to be a reasonable fee. The exact fee will be variable based on relative performance – which cannot be forecast at this stage – but it is anticipated to be around £10K per annum, given that the overall profit is envisaged to be £120K, annually, and of this overall figure, just under £20K is 'protected' as a minimum income to the council.

3.6 Although the profit projections in Engie's proposal are inclusive of the cost of gas for running the generators, and for the **usage** O&M costs specifically (£65K), they don't cover the fixed daily costs of £26.5K per annum, as these are not under Engie's express control.

3.7 As a result, the council's annual costs for the generators – including borrowing repayments and excess O&M charges – will be £179,500 (based on **current** O&M costs). On the other hand, the estimated income – from Engie's optimisation service – is likely to be in the region of £110K, meaning a net deficit of around £70K per annum – with further indexation and industry 'reward' scheme risks, for the next 25 years.

3.8 In the summer, the generators aren't used a great deal. However, although income generation opportunities are lower during the summer, it is still imperative to initiate the Engie work as soon as possible during the coming autumn, otherwise the financial model for the generators will continue to be compromised. This can only happen if the foundations are in place, which are as follows:

- a working/reliable asset;
- a fully functional control system; and,

- an underpinning contract to dictate how the associated mechanisms work (which is being dealt with separately, with a view to having an agreement in place with Engie by the start of September 2019).

3.9 The absence of a long-term contract for the O&M of the generators, tied to our current inability to meet the original business case, makes it vital for the council to go out to tender to test the market. This will ensure that we have obtained best value-for-money, where the hope is that competitive marketplace tensions will drive O&M costs down, and hence reduce or overturn the deficit in the financial position.

## **4 Corporate Considerations**

### **4.1 Consultation and Engagement**

4.1.2 The PACS team will provide advice and guidance on the procurement process.

4.1.3 All service areas affected by this change have been consulted and have no objections.

### **4.2 Equality & Diversity / Cohesion & Integration**

4.2.1 An Equality Impact Assessment (EIA) screening tool has been undertaken for the purposes of this recommendation and has indicated that an EIA does not need to be carried out. There will be no adverse effect on any particular groups of people within the city posed by this proposed course of action.

### **4.3 Council Policies and City Priorities**

4.3.1 It is vital that any procurement process within the council is undertaken with a view to ensuring openness, transparency and fairness. As such, the contract will be procured in line with the council's procurement policies and procedures.

4.3.2 In terms of the council's climate change emergency declaration, the electricity created by the generator assets is most probably more carbon intensive than the overall mix within the grid. However, onsite power generation doesn't require national level distribution and hence, doesn't incur losses from transmission and the stepping up or down of voltages. In addition, the generators will respond to peak demand, so will reduce the need for additional gas or coal generation, rather than offsetting renewables. As such, it is difficult to categorically say whether or not the generator power is of a higher or lower overall carbon impact.

4.3.3 A genuine carbon reduction could be achieved if the waste heat was used for hot water and space heating in the building itself and the wider Merrion Centre complex; however, there are no plans to do this in the near future. There is also the opportunity to connect into phase 2 of the district heating network, which will be investigated.

### **4.4 Resources and Value-for-Money**

- 4.4.1 A procurement process will be undertaken in order to ensure that the council obtains best value for money, in terms of securing a quality service at the best price.
- 4.4.2 Any contract entered into as a result of the procurement exercise will be regularly reviewed to ensure continuing value for money.
- 4.4.3 Resources are available from the Sustainable Energy and Air Quality (SEAQ) team to meet the requirements of this procurement exercise.
- 4.4.4 The finance is already in place for this business-as-usual activity, as the requirement is covered by an established budget for the site.
- 4.4.5 The council's annual costs for the generators – including borrowing repayments and excess O&M charges – will be £179,500 (based on current O&M costs). On the other hand, the estimated income – from Engie's optimisation service – is likely to be in the region of £110K, meaning a net deficit of around £70K per annum – with further indexation and industry 'reward' scheme risks, for the next 25 years.
- 4.4.5 Having a usable generation asset onsite at Merrion House helps to make our flagship building more resilient to grid outages, which could be a possibility in the future given that significant infrastructure improvements are required to cater for the rise of EVs, the internet of things (IoT), smart cities, the possible creation of hydrogen as a decarbonised fuel, as well as for other potential changes in societal energy use that might come into play.
- 4.4.6 Crucially, if we don't have well-maintained generators we will be unable to operate them optimally. This is vital as we rely on income accrual linked to the generators running during key periods, where the council gets potential rewards from tapping into demand side response based incentivisation schemes, such as the 'short-term operating reserve' ('STOR'), the 'capacity market', day-ahead auctions, and potential high frequency response mechanisms in the future.
- 4.4.6 Linked to the above, the generators must be capable of running for at least 3,000 hours each year, which requires a very involved maintenance regime. If the generators break down, the 3rd party optimisation service that Engie will soon manage on our behalf will no longer be enforceable, which would impact the business case.
- 4.4.7 In addition, the interest rate for the borrowing was set at 4.5% in the model, and this is much higher than the actual rate the council borrows at. If the interest rate applied could be reduced to 2% – for accounting purposes – the real deficit could be reduced to closer to £20,000.

## **4.5 Legal Implications, Access-to-Information, and Call-In**

- 4.5.1 This is a significant operational decision as defined under article 13 of the council's constitution.
- 4.5.2 The procurement must be in line with the Procurement Regulations 2015, and it is expected that an open procedure will be utilised to secure a new contract for this provision.
- 4.5.3 There are no access-to-information implications and call-in does not apply.

## **4.6 Risk Management**

- 4.6.1 There are no access-to-information implications and call-in does not apply. The MH refurbishment has created a scenario wherein more than 50% of the council's city centre staff are now based in just one building. This increased concentration of staff in a single place increases the risk of disruptions to business continuity. Investment in the generators was a risk management strategy for overcoming this potential situation whilst also providing the council with an invest-to-save opportunity. As such, it is imperative to keep the generators in full working order.
- 4.6.3 Having working, reliable assets allows us to reduce any funding shortfall as far as is feasible. In addition, by going out to tender for the future O&M contract we will seek to reduce the associated costs, which would help to narrow the budgetary gap.

## **5 Conclusions**

- 5.1 There is a continuing need for maintenance and servicing in respect of the generators.
- 5.2 In order to put a new contract in place, a procurement process needs to be undertaken to find a suitable provider. Approval is required to take this step but in the interim we also need to continue the existing relationship with Edina for 6 more months, to allow us the time to undertake a procurement exercise and to award a contract.

## **6 Recommendations**

The Director of Resources & Housing is recommended to:

1. Approve the invocation of CPR 27 in order to waive CPRs 8.1 and 8.2 and
2. Give authority to procure a new contract for the maintenance and servicing of Merrion House's gas fired generators.
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## **7 Background Documents**

None.