ITEM 11

GM COMBINED AUTHORITY

AGMA EXECUTIVE BOARD

30th November 2012

GM GREEN DEAL BUSINESS CASE

Report Of	**Charlie Parker** Lead Chief Executive for Environment Issues, AGMA
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Wider Leadership Team Lead Officer:	**Charlie Parker** Lead Chief Executive for Environment Issues, AGMA

PURPOSE OF REPORT

To present the attached GM Green Deal business case to GMCA/AGMA Executive Board, and agree to the set up of a GM Green Deal & ECO delivery partnership.

RECOMMENDATIONS

That the GMCA/AGMA:

1 Approves the creation of a GM Green Deal &ECO Delivery Partnership as set out in the attached business case, with the lead Authority to be determined.

2 Approves up to £1.29m revenue funding for procurement and start-up costs which will be met from within AGMA/CA resources, with the £305k for 2012/13 being met from an in-year allocation from available AGMA resources and requires the AGMA/ CA Treasurer to ensure that the remaining £985K is identified and included in the AGMA/CA budgets for 2013/14.

3 Agrees to move immediately into the procurement stage of the project;

4 **Agrees that a joint Manchester CC /Salford CC team** procures a panel of Green Deal accredited private sector delivery partners, to whom all other Green Deal

Provider roles and responsibilities including accessing ECO funding would be outsourced.

5 Works with GM Local Authorities to draw up Green Deal plans across GM to align with other priority spatial programmes and policies

6 Notes the estimated £17m capital funding requirement required to act as a junior debt layer in the Green Deal Finance Company, to facilitate the draw down of up to £68m of Green Deal loans. The final detail and funding arrangements will be reported back to the AGMA/GMCA when the final results of the procurement exercise are known in 2013/14 and the business case has been subject to due diligence.

7 Requests that outcome of the procurement process be reported back to GMCA/AGMA so that the Business Plan can be re-validated alongside an updated analysis of risks and strategies for managing these, in the light of actual market-based proposals.

PRIORITY

A low carbon economy: Achieve a rapid transformation to a low carbon economy.

BACKGROUND DOCUMENTS

GM Green Deal Business Case report to GM WLT 15th September 2012

GM Green Deal Business Case report to GM Environment Commission 10th October 2012

RISKS/IMPLICATIONS	Nationally there are a number of concerns about implementation of the Green Deal, particularly around finance and levels of take-up in early years. This is a principal reason why a public/private partnership is proposed in GM. Consequently there are a number of risks associated with this approach and these are set out in Section 8 of this report and the risk register within the Business Case
Financial:	A maximum of £0.895M procurement and £0.395M start up costs could be at risk if the programme did not proceed. Whilst it is proposed that £17M capital is invested into the Green Deal Finance company as junior debt, investment will be proportionate to delivery. As it is estimated that 20% of the programme will be

	delivered in the first year, On this basis approximately £3.4M could be at risk should TGDFC fail.
Staffing:	Staff and project management costs are included within the business case. However there will be a requirement for local staff support to maximise delivery at a district level.
Policy:	There are no specific policy risks.
Equal Opportunities – Has a Diversity Impact Assessment been conducted?	No.

1 Introduction

The Green Deal is the coalition government's flagship environmental policy, due for national launch in October 2012, followed closely by the Energy Company Obligation (ECO). This paper proposes that AGMA authorities take a proactive role in the establishment of the GM Green Deal: kick-starting a GM approach over 3 years that will help our poorest and most vulnerable households, improve our coldest homes, and create economic opportunities and benefits for local businesses.

In November 2011, AGMA agreed that a business case should be prepared to explore whether local authority involvement in the Green Deal could bring added value benefits to the local area, and if so, the optimum approach for Local Authorities in Greater Manchester to influence delivery. The attached Business Case prepared with the support of Ernst and Young, sets out the approach taken, stakeholders engaged, the direct and indirect costs and benefits of action and inaction and risks associated with the creation of a Green Deal Delivery Partnership.

If created, this partnership will:

- Catalyse over £100m of activity across the whole supply chain
- Generate £36m of GVA
- Support 1000 jobs across the supply chain, whilst opening up opportunities for new GM apprenticeship and training activities.
- Assist 15,000 households over three years make their homes warmer, with at least 2000 of these households being supported out of fuel poverty,
- Offering potential savings in the NHS alone of £1m per annum.

2 Background

The GM Climate Change Strategy commits AGMA to reduce greenhouse gas emissions by at least 80% by 2050. As 36% of GM's carbon emissions currently arise from the domestic sector and with an estimated 930,000 of today's housing stock still inhabited in

2050, the challenge and opportunity for GM to retrofit these houses to be more energy efficient is significant.

Energy prices are being driven up by increasing insecurity of supply. GM's total energy bill has quadrupled to £5bn since 2000: a trend that is set to continue. In difficult economic times for UK households, energy bill increases of this scale are pushing more homes into fuel poverty (21% average across GM). A new Save the Children report, *Child Poverty: it shouldn't happen here* highlights Greater Manchester as having highest levels of Child poverty outside of London, and identifies rising energy costs as a particular burden on low income families.

Reports on the potential for a GM Green Deal have been presented to AGMA Leaders, GM Wider Leadership Team, GM Treasurers, GM Heads of Procurement, the GM Environment Commission and the GM Housing and Planning Commission.

3 Green Deal and ECO

The Green Deal seeks to unlock private investment in both domestic and non-domestic buildings. This will be achieved by funding energy efficiency measures at no up-front cost to the consumer, through a loan which is linked to the electricity meter rather than the individual. The loans are repaid over time (up to 25 years), based on a 'golden rule' where projected savings in energy bills are greater than the cost of repayments.

Existing programmes and subsidies that have driven growth in the domestic energy efficiency market in the last 5 years will cease in December 2012. These include the Carbon Emissions Reduction Target (CERT) funding which has supported the GM 'Toasty' scheme in providing free loft and cavity insulation to households in GM, and the Warmfront scheme that has funded energy efficiency measures for vulnerable households including older people. They will be replaced by the Energy Company Obligation (ECO): distributed by the energy companies and funded through a levy on all our energy bills. Implemented alongside the Green Deal, £1.3bn of ECO pa will be used to support those in fuel poverty, in the poorest neighbourhoods and in the UK's hardest to treat houses.

Levels of take-up of ECO in particular will be crucial if Local Authorities and partners are to maintain effective fuel poverty strategies and reporting against newly restored Home Energy Conservation Act (HECA) obligations.

4 Proposals for a GM Green Deal Programme

A 3 year local authority led GM programme is proposed and recommended for the GMCA. By taking early action in an emerging market, local authorities would be catalysing locally focussed activity.

GM local authority branding and local knowledge would be used to attract and engage local residents in the Green Deal. A panel of Green Deal Providers would be procured and managed by a Lead Authority, to deliver Green Deal loans, the installation work and ongoing warranty requirements, on behalf of participating Local Authorities. The existing GM Energy Advice Service would be adapted to create and manage customer demand, paid for by successful referrals, and working alongside local networks and staff.

Green Deal loan finance would be provided by The Green Deal Finance Company, with any local authority investment into this company acting as a junior debt. All project costs, including procurement and set up costs and costs of finance, would be recovered over the lifetime of the programme (28 years), subject to risks set out in section 8. At the end of this 3 year period, local authorities might choose to extend, continue or end their involvement – based on the development of the market and the success or otherwise of the programme.

It is assumed that 15,000 properties across GM would be retrofitted over the life of the programme, requiring £68m loan finance to fund the Green Deal loans. The current analysis works on the basis that this is a GM wide programme, delivering proportionately across all local authorities as outlined in the business case.

By working together at a GM scale, individual Local Authorities will realise efficiency savings in terms of start up and procurement costs. In addition, AGMA's scale and brand, particularly when considered alongside other low carbon projects and investment opportunities, is attracting significant market interest from existing buying frameworks, social landlords, energy companies and potential Green Deal Providers.

5 Benefits of this approach

Over a 3 year period, the programme will:

- Catalyse over £100m of activity across the whole supply chain
- Generate £36m of GVA, and
- Support 1000 jobs across the supply chain, whilst opening up opportunities for new GM apprenticeship and training activities.

A focus on local business in the supply chain would enable GM enterprises to establish themselves and upskill in this growth sector, whilst ensuring that economic benefits are retained locally and reinvested in the GM economy creating a multiplier effect.

15,000 households will be helped to make their homes warmer, with at least 2000 of these households being supported out of fuel poverty, offering potential savings in the NHS alone of £1m per annum.

6 Financing the programme

The recommended approach for resourcing the GM programme is for it to be funded from The Green Deal Finance Company (TGDFC). This will minimise the level of local authority prudential borrowing and mitigates risks that a forthcoming state aid enquiry may find that it is anti-competitive for local authorities to pass on the benefit of their lower borrowing rates directly to consumers.

TGDFC plans to act as a national aggregator of Green Deal loan finance. Expected to be fully operational by summer 2013, TGDFC aims to provide 80% of national Green Deal loan finance. Its aspirations are to work with all Green Deal Providers regardless of scale, providing finance to all at the same cost of borrowing, and through its scale aims to re-finance its loan book regularly on the bond market.

Ongoing discussions are taking place with representatives from the TGDFC to understand how GM could access finance and services. TGDFC is still in discussion with DECC and UKGI (the Green Investment Bank) and it is clear that without significant investment of junior debt from Government, local authorities, pension funds or other public sector bodies, there is some doubt as to whether TGDFC could lend on the scale required to drive this programme nationally. GM is leading the Core Cities' engagement with TGDFC and DECC to ensure a co-ordinated response to this issue. Although one of the options evaluated within the Business Case, a decision by GM to draw down finance from TGDFC without investing in the company could trigger similar responses from other Core Cities, hereby significantly impairing the only current Green Deal finance model. This is a dilemma that GM is raising with Government at the highest level.

Opportunities could provide a return on investment ranging from 4-11% over the cost of borrowing, dependent on level of risk. As a result, the business case sets out a route whereby

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- The programme finance would be accessed through TGDFC
- GMCA and/or GM local authorities would invest 25% of the total finance into the GDFC as a junior debt layer. This would equate to £17m.
- GM's procured delivery partners would access Green Deal finance directly from TGDFC, eliminating the need for GM to handle Green Deal loan finance, or to develop and run its own loan book management systems.

Whilst the development of TGDFC is progressing, final confirmation of its business model will not be available until early 2013. The proportion of GM investment required could therefore reduce once the whole debt profile has been finalised. It is also prudent to have a contingency arrangement in case the GDFC finance route is not available. The proposed contingency for GM would be to find the total Green Deal Finance required through GM local authorities prudential borrowing and other sources.

7 Procurement and start up costs

Following further work to reduce these initial costs, the maximum budgeted start-up costs for the programme, and therefore exposure across all GM local authorities is estimated to be £1.29M,. The phasing of this expenditure over 2012/13 and 2013/14 is detailed in sections 8.1.1 and 8.1.2 of the Business case, and summarised below.

Item	Total / £	2012/13	2013/14
Procurement	£895,000	£305,000	£590,000
Running Costs	£395,000	£0	£395,000
Total	**£1,290, 000**	**£305,000**	**£985,000**

GMCA and AGMA revenue funding is available in 2012/13 and 2013/14 to cover these initial start-up costs which could be reduced further with input of staff time from local authorities.

Significant work has been done to analyse the relative merits of different procurement routes and their appropriateness to this programme. Given the immaturity of the Green Deal market and the need to be flexible, it is recommended that a bespoke OJEU procurement process is undertaken, rather than use of existing frameworks. A restricted tender approach is recommended on the basis that there is now a better understanding of the Green Deal and ECO market and potential to learn from the experience of similar tender processes. This procurement process will also be significantly quicker and cheaper to deliver than a full competitive dialogue OJEU process.

This results in potential procurement costs of £0.895M, compared to previous estimates of £1.9m, which have been developed in consultation with representatives from Procurement and Legal departments within GM.

The business case sets out a range of potential set up costs, including direct marketing, call centre and energy advice activity needed to generate demand, as well as programme management costs. The model assumes the use and adaptation of the existing GM Energy Advice Service and that referral fee income from GM ECO activity and potentially from acting as a customer interface for the GM Energy switching initiative, will offset start-up costs in 2013/14.

8 Level of Risk and Risk Management

A risk workshop was held on 15th October and a full risk register has been produced. The £68M would be drawn down from the TGDFC as Green Deal Plans are agreed and GM Local authorities would not therefore be exposed to this level of finance risk. GM is however being asked to provide £17m of investment into TGDFC as a ‘first loss’ junior debt layer in the Company. The worst case scenario is therefore that GM could lose **£1.29M** revenue in aborted procurement and start up costs, if for any reason, the delivery phase is not reached and /or **£17M** capital (greater if costs of finance are included). Whilst it is assumed that interest received on the junior debt over and above borrowing costs will, over time, offset start up costs, this is not guaranteed.

As junior debt in the GDFC, LA borrowing would create the first loss layer in their financial model. As a result, LA borrowing would be at risk if:

- Default rates on loan repayments from householders to TGDFC are higher than anticipated in their business model
- Demand for loans is lower than anticipated. This would impact on recovery of investment into the GDFC as loan administration costs would be spread over a lower volume of loans increasing their cost of loan finance and hence viability. It would also reduce the speed / frequency of refinancing of their loan book on the bond market, a key selling point of this aggregated approach.

As TGDFC will have a national focus it's financial performance will relate to national rather than local trends. This may have positive implications for GM if for example, national losses on debt recovery were lower than GM’s. Overall take-up levels however would be out of GM’s control; in other words, GM’s £17M would be part of a national debt pool and success in delivering an enhanced GM programme would not guarantee a return on this investment. Enhanced GM take-up would however result in higher levels of income from referral fees.

In reality, GM would not invest in TGDFC until full due diligence and other financial checks were undertaken. Also, If GM can agree a phased draw-down of funding with the GDFC, based on the phased volume of activity in GM, then the level of funding into the GDFC and total monies at risk, would be staggered, growing in line with activity over a 3 year period. For example it is anticipated that the year 1-3 programme would develop on a 20%; 30% 50% basis which could limit year 1 exposure in terms of LA finance to **£3.4m** across GM (20% of £17m). Depending on the agreement reached with TGDFC, could allow GM to suspend further phase of investment, limiting risk of further losses.

There would also be potential revenue implications arising from the £17M capital investment. Each LA in undertaking their annual ‘impairment of assets’ assessment would need to determine whether there had a devaluation in their share of the £3.4M, based on the performance of the Green Deal market and the Green Deal Finance company at a national level. Any reduction in valuation would need to be ‘written down’ and treated as a charge to the revenue account. There are also risks associated with GDFC raising long term debt through bond issues. If the market prices higher than provided for in the model, the risk to GM’s interest and return on investment increases.

The risk assessment in section 10 of the business case highlights the probability of these risks occurring, and losses being incurred by GM Local Authorities. The GDFC is currently undergoing an assessment of likely default rates by region to understand the likely levels and any regional variation. These findings will be fed into their model and costing structure, to help mitigate this risk. Results early 2013 (estimated).

If for whatever reason the GDFC does not come into being, a further decision process will be required on whether GM uses prudential borrowing to continue with a GM Green Deal delivery partnership or, whether to withdraw from the market and write-off abortive procurement and start up costs. Without TGDFC there would also be significant additional costs of loan book management and administration. Other Core Cities such as Newcastle, who would be in the same situation as GM, have discussed collaborating, to share these costs, should such a system be required.

9 Managing market transition

During this interim period, GM will promote the wider market and manage the transition of its current loft and cavity insulation offer and fuel poverty services, into the new ECO market. A good example, is a successful GM bid to DECC for £3M to fund a programme of Green Deal ‘Go Early’ low carbon retrofit projects in social and private housing across at least seven GM local authority areas over the next six months. A referral fee model created to promote delivery of ECO could help to offset start up costs as set out above.

10 Conclusion and next steps

Whilst there are many questions and uncertainties around the Government's Green Deal and ECO framework, most notably around availability of funding and appetite of households to take on Green Deal loans; it is also clear that this will be the only national public policy framework which addresses domestic energy efficiency and fuel poverty. All current funding streams, including Warmfront and CERT funding of loft and cavity insulation will end this financial year. Without direct influence in this emerging market, GM will be dependent on others to deliver against important GMS priorities and will be significantly less able to direct support to our most vulnerable people or places.

Procurement timescales mean that a GM Green Deal delivery partnership is unlikely to be in place before end of 2013, whereas the market is expected to start to roll out Green Deal plans from mid to late 2013.

Commencing the procurement process before end of 2012 will ensure the earliest possible 'go live' date for GM, maximising opportunities for local supply chain development and local economic benefit.