



Department for
Business, Energy
& Industrial Strategy

The Rt Hon Claire Perry MP
Minister of State for Energy and Clean Growth
Department for Business, Energy and Industrial Strategy
1 Victoria Street
London
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Meg Hillier MP
Chair, Committee of Public Accounts
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22 June 2018

Dear Minister, Dear Chair,

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Our ref: AC/MB0819

Accounting Officer Memorandum: Heat Networks Investment Project (HNIP) Main Scheme Outline Business Case

The Heat Networks Investment Project is a Government Major Project which will invest £320m of capital funding in heat network projects through grants and loans. This is provided as 'gap funding' to grow the UK heat networks market, overcome the barriers to market growth and deliver the cost-effective carbon savings required to meet our future carbon reduction commitments.

Government's investment will kick start the heat networks market, driving down costs, improving skills and capability, and demonstrating to investors that heat networks are a viable proposition in the UK context. The overall aim is for the market to be self-sustaining without further direct Government subsidy post-2021, and to increase the long-term growth rate of the market.

It is normal practice for Accounting Officers to scrutinise significant policy proposals or plans to start or vary major projects, and then assess whether they adhere to the standards set out in Managing Public Money. From April 2017, the government has committed to make a summary of the key points from these assessments available to Parliament when an Accounting Officer has agreed an assessment of projects within the Government's Major Projects Portfolio.

Background and context

Department for which the accounting officer who made the assessment is responsible: Department for Business, Energy and Industrial Strategy

Project title: Heat Networks Investment Project (HNIP) Main Scheme

Main scheme project stage: Outline Business Case - approved April 2018

Objectives: The project aims to help create a self-sustaining heat network market¹ that does not require direct Government subsidy by:

- Increasing the volume of strategic, optimised and low carbon heat networks built, by providing central Government funding which will draw in significant additional investment.
- Improving the quality of heat networks that meet local needs and consumer needs.
- Building capability of project sponsors and the supply chain to develop systems of the right type and quality.

Mechanics: Through a delivery partner, HNIP will deploy capital grants and loans to public, private, and third sector heat network developers to support the construction of heat networks² in England and Wales. HNIP's capital budget will be allocated through competitive funding rounds which will compare applications in terms of their anticipated contribution towards HNIP benefits. HNIP's scope also includes ongoing grant funding and guidance to priority local authorities to develop a pipeline of strategic heat networks provided by BEIS's Heat Networks Delivery Unit (HNDU)³, and a number of enabling actions developing the UK heat networks supply chain and improving investor confidence. These activities will maximise the benefits from the capital funding and contribute towards a self-sustaining heat network market.

How heat networks fit into the wider UK decarbonisation strategy: The UK has legally-binding targets to reduce greenhouse gas emissions by at least 80% by 2050 from 1990 levels, and by 57% over the 2028-2032 period (the 5th carbon budget). The Clean Growth Strategy makes it clear that heat networks will play a vital role in the long-term decarbonisation of heating in all of the illustrative 2050 scenarios. It demonstrates a strong commitment to significantly expanding the sector. The Committee on Climate Change estimate that some 18% of buildings heat will need to be supplied by heat networks by 2050 if we are to meet our carbon budgets cost effectively.

At present, heat networks deliver just 1% of heat in the UK, and this market is growing at around 2% per year. The policy and program objectives are to significantly increase this growth rate and consequently the carbon savings anticipated by the Clean Growth Strategy and Carbon Budgets 4 and 5.

¹ A market where a sufficient volume of strategic, optimised and low carbon heat networks are economically attractive without direct Government subsidy and are operated without significant consumer detriment

² A heat network is a system of insulated pipes that takes heat from a central source or sources and supplies it to residential, commercial and public sector buildings to provide hot water, space heating and/or cooling.

³ The HNDU is staffed by experts who have gained experience developing heat networks outside the civil service working on technical or commercial aspects of heat networks for consultancies or local authorities.

By investing in heat networks, the government is shaping this new market in line with our ambitious, modern Industrial Strategy. Heat networks represent a significant opportunity to upgrade part of the UK's energy infrastructure and seize the opportunity for business that new technology presents. They support local growth and reeneration, and generate new revenue streams for UK industry and local authorities. As heat is generated and consumed locally, the benefits of more affordable heat delivered through networks are felt by the communities they serve. Investing in heat networks is a good example of how the government's Industrial Strategy is creating an economy that boosts productivity and earning power throughout the UK.

Rationale for Government Intervention and why HNIP: HNIP will address a significant number of market failures and barriers to the creation of a self-sustaining heat network market. By using HMG's funding (including the pilot) to draw in around £1bn private and other investment, HNIP will significantly increase the annual market growth rate and have a lasting impact on the post-HNIP market by increasing the volume of heat network construction, improving the quality of design and operation for better customer outcomes, reducing costs, increasing the capability and capacity of sponsors, and increasing investor confidence.

Assessment against the accounting officer standards

Regularity

HNIP is assessed as regular. It relies on existing primary legislation, is within BEIS agreed spending budgets⁴, and will comply with UK and European law. Whilst Government is familiar with provision of grants and loans, one element of the project loan offering (the connection delay repayment grace feature) is classed as novel. Design of this feature will reduce the risk of default by providing a repayment grace period up to a maximum of three years to projects whose expected customers have delayed in connecting to the network. Applicants will have to provide evidence to support the need for this feature and this will be monitored on an ongoing basis by the appointed Delivery Partner. The provision of this feature has been agreed with Her Majesty's Treasury and will support HNIP's contribution to creation of a self-sustaining heat network market by addressing demand risk, a key risk for heat networks.

Propriety

HNIP is assessed as proper. It is compliant with parliamentary control procedures and expectations. Careful consideration has been given to interaction with other parts of the public sector. HNIP does not frustrate other initiatives.

Value for Money

The cost benefit analysis conducted for the Outline Business Case shows HNIP represents good value for money for the Exchequer and UK society as a whole against other alternative courses of action. It is recognised that given the nascent nature of the UK heat network market there are uncertainties around some of the figures in the quantitative assessment but, even taking these into account, the analysis indicates the project is a sound use of public funds.

⁴ NB funding profile spans two Spending Review periods, and the Government has announced that there will be a review of spending in 2019.

Feasibility

The design of the HNIP main scheme has benefited from the earlier pilot scheme. HNIP's delivery confidence assessment from the last Gateway Review in October 2017 was Amber/Red. All of the recommendations from this review have now been addressed. The HNIP pilot has provided important lessons that have been incorporated into the main scheme design - for instance with regard to the application process, loan and grant design (provision of novel project loan delay mechanism), funding agreements and arrangements to ensure project quality.

Conclusion


I have considered this assessment of HNIP against the four accounting officer standards of regularity, propriety, value for money and feasibility. I am satisfied that HNIP relies on clear legal powers, meets the standards in Managing Public Money and accords with the generally understood principles of public life, represents good value for money for the Exchequer as a whole and is feasible to deliver. Whilst one element of the loan offer is novel, the risks associated with this feature have been minimised. I am therefore satisfied that HNIP is a good use of public resources.

As the Accounting Officer for the Department for Business, Energy and Industrial Strategy, I considered this assessment of the Heat Networks Investment Project (HNIP) Main Scheme and approved it on 22 June 2018.

I have prepared this summary to set out the key points which informed my decision. I will prepare a further summary to accompany the Full Business Case approval.

If any of these factors change materially during the lifetime of this project, you should expect to receive a revised summary and assessment.

This summary will be published on the government's website (GOV.UK). Copies will be deposited in the Library of the House of Commons and House of Lords and sent to the Comptroller and Auditor General and Treasury Officer of Accounts.

Best wishes,


Alex Chisholm

22 June 2018