COMMUNITIES, ENVIRONMENT AND HIGHWAYS SELECT COMMITTEE

WEDNESDAY, 5 JULY 2023

Green Finance Strategy

Purpose of report: This report seeks Select Committee approval of the approach set out in the updated *Greener Futures Finance Strategy* which includes a framework, investment principles and governance to support the delivery of our net-zero 2030 and 2050 targets. The 2030 net zero finance approach has been well developed and is underpinned by a Finance Model. It is important to note that this model has been produced to provide intelligence on the quantum of the overall costs required, and operational savings achieved, in relation to this target. Decisions will be made on individual business cases and not on the model.

Introduction:

1. In 2019 Surrey County Council declared a climate change emergency and committed to becoming a net zero carbon county by 2050 or sooner. Surrey County Council committed to reducing its organisational emissions to net zero by 2030. Surrey's Climate Change Strategy was published in May 2020 and the Climate Change Delivery Plan (2020 – 2025) was published in November 2021.

2. An Initial Finance Strategy was produced in 2021 and was set out alongside the Surrey's Greener Futures Climate Change Delivery Plan 2021-25. It was informed by a finance model, produced by consultants Atkins in collaboration with officers in Environment, Land & Property and Finance and aimed to provide an evidence-based estimated cost, based on current knowledge, data and modelling for the Council's 2030 and 2050 net zero pathways.

3. The Initial Strategy was informed by a number of principles, which focused on the balancing of carbon emission reduction and financing, with the key aim of ensuring that the Council's net zero targets were cost neutral and offered best value for money.

4. During the first eighteen months of implementation of the Initial Finance Strategy there has been some good progress with £60m leveraged in grant funding from the public sector and investment from the private sector. The Council has also accelerated the delivery of several decarbonisation programmes on our own estate, which has given officers a better

understanding of the actual costs and financial barriers in achieving the net zero targets.

5. Due to the scale and complexity of such a wide range of decarbonisation projects, the cross-departmental nature of delivery, alongside rapidly changing costs and delivery constraints resulting from factors outside of the Council's control, it has become necessary to update the Initial Strategy, and the finance model which supports it. This has been done with a particular focus on the 2030 target, as these are the emissions for which the Council is directly responsible.

6. The updated Greener Futures Finance Strategy will be taken to Cabinet in July 2023 and will align with the Climate Change Delivery Plan to 2025. The Strategy is included in Annexe A below.

7. An annual financial review of costs across the 2030 programme forms a key part of the approach; enabling effective management of financial risk despite rapidly changing market and delivery conditions. The first review is set out in Annexe B below. A Financial Review will be brought to Cabinet each year alongside the review of the Climate Change Delivery Plan. In addition, quarterly update reports will be produced for Capital Programme Panel, Asset Strategy Board and the Greener Futures Member Reference Group.

8. A 2030 Investment Plan is currently being developed by officers, which sets out the buildings which are expected to have decarbonisation measures installed over the next two years. The Investment Plan will be appended to the Cabinet report and will be shared with the Greener Futures Member Reference Group for review.

9. Cabinet is asked to delegate decisions on the Greener Futures 2030 Investment Plan (2023 – 2025) to the Cabinet Members for Environment and Property and Waste, in collaboration with the Cabinet Member for Finance, Executive Directors for Environment, Transport and Infrastructure (ETI) and Resources, Greener Futures Member Reference Group and the Capital Programme Panel *(alongside Asset Strategy Board, Major Projects Board and the SIP Programme Board as appropriate).*

The Greener Futures Finance Strategy

10. The overall approach is based on an annual review 2 step process to ensure that funding for the Climate Change Delivery Plan is maximised through ambitious delivery, but financial risk to the Council is effectively identified and managed. The first step checks progress of projects against the pace and scale needed to meet our net-zero targets. The second reviews the costs for the

whole programme, updating our financial model using the latest project and market data. These two are brought together to steer project delivery for the next financial year.

Net Zero 2030 programme

11. The financial approach to the 2030 Net Zero Programme focuses on the management of capital funds to deliver a mixed portfolio of retrofit, refurbishment and renewables projects, to achieve cost and carbon neutrality in the Council's corporate estate and fleet.

12. Eight 2030 finance principles, guide the Council to ensure that decisions are consistent with meeting our net zero targets in the most cost effective way whilst also maximising additional benefits where possible.

13. In an effort to create a more robust and sustainable financial framework officers in Finance, Environment and Land & Property have tested, developed and updated the 2030 finance model with actual market costs and have run sensitivity analysis to update the financial assumptions (such as energy costs and borrowing costs) and technical assumptions (such as the percentage of buildings that are suitable for the decarbonisation measures) upon which the model is based.

14. A summary of the changes are included below. More detailed information on this work is included in the financial review of the 2030 programme, set out in Annexe B.

Key changes since original costing:

- Increase in energy prices.
- Addition of staff costs design fees and electricity grid network connection costs.
- Updated range of offsetting costs.
- Exclusion of fleet transition costs as these will be funded by services
- Revised delivery constraints for ground mounted solar.
- An updated view of buildings that are suitable candidates for decarbonisation measures and are not at risk of disposal. (core, non-core flex)

15. The model indicates that to achieve the 2030 target the rate of delivery over the next seven years is approximately 13 to 20 buildings per year. Since 2021, 39

buildings have been, or are in the process of being decarbonised, with a further 32 subject to a funding bid. As mentioned above, a 2030 Investment Plan is currently being developed which will demonstrate the speed of implementation. The Investment plan will be updated every two years to 2030.

16. The model considered two scenarios based on the emerging Asset Strategy produced by Land and Property. The first includes the decarbonisation of only the ‘core’ buildings which are likely to be retained. The second scenario includes the core buildings and ‘flex’ buildings, those with an uncertain future.

17. Table 1 below includes a high level summary of the 2030 programme business case. A more detailed explanation of this table is included in Annexe 2.

Table 1: Summary of costs of the 2030 programme

	Original Model	**Latest Model (core – buildings to be retained)**	**Reason for Change**	**Latest Model (core+flex – flex is buildings with uncertain future)**
Capex	£68.3	£87.7m	£30m increase in heat pumps offset by £5.5m fall in retrofit costs and £0.2m fall in rooftop solar and £2.6m fall in ground mounted solar.	£109.4m
Operational Spend	£71.8m	£29.2	Reduction due to removing green fleet vehicles from the model, and the associated cost of charging EVs, which will be funded by services rather than a central GF budget	£36.5m
Borrowing Costs	£12.6m	£24.3m	Increase due to higher borrowing rate and increase in capex.	£31.3m

Revenue	£97.5m	£67.5m	Lower solar farm revenue due to lower electricity price.	£67.9m
Operational Savings	£73.5	£76.6m	Higher savings on LEDs due to higher electricity prices offset by reduced savings on rooftop solar due to smaller solar panel sizes.	£102.6m
NPV after counterfactuals (what would have been spent any way) excluding green fleet	£21.4 (This was -£3.1m in original model)	£12.1m	NPV has improved from -£3.1m to +£12.1m due to removing borrowing costs from the calculation as these had been included previously in error.	£6.4m
Payback		26 years		28 years

18. Although under the new scenarios (core, core&flex buildings) there is an increase in the capital expenditure required across the two scenarios compared to the original model, the Net Present Value of the programme (to 2050) is positive and the project pays back in 26 – 28 years from the operational savings and revenue generated.

19. It is important to note that the costs in the model are pessimistic and there are several factors which could improve the financial position of the model and make the business case more favourable, these include;

- Increase in gas prices which will increase operational savings (Government has committed to removing carbon taxes which are currently linked to electricity rates to gas over the next ten years as the country moves away from fossil fuels)

- Reduction in cost of decarbonisation measures such as heat pumps as these become more standardised

- Potential reductions in costs to connect to the electricity grid due to Government reforms

- Grant funding from Government which has not been included in the model, to date £6M has been awarded with a bid for a further £5M in development.

- Improvements in national grid capacity will enable the Council to invest in additional solar farms beyond those which are built into the model. All of the land parcels owned by the Council have been assessed to determine suitability for solar farms (avoiding restrictions related to biodiversity, habitat, agriculture, heritage and development) and the shortlisted sites are currently being assessed to determine suitability and cost. Currently no sites have planning consent. In addition officers are exploring developing solar capacity potential using private wire, avoiding connection to the grid.

20. Officers are also exploring a number of finance mechanisms which could be used to strengthen a return on investment which could be used to offset any future increases in costs. These finance mechanisms are included in more detail in the Finance Strategy.

21. This includes a solar Power Purchase Agreement (PPA) that is currently being piloted with five schools. Modelling on the income generation potential of delivering solar PPA to Surrey schools, with a good potential for large solar arrays, has been estimated. Two scenarios show that it is possible to generate sufficient income to offset the increased costs in the 2030 model and generate income which could be used for other Greener Futures/Council priorities over 30 years. Other Greener Futures finance mechanisms are also being explored however are less mature at this stage.

22. As it will be impossible to completely reduce the Council's emissions from all sources by 2030 it is acknowledged that offsetting will be necessary. Estimated carbon offset costs are built into the Finance Model from 2030 as a revenue pressure to the Council. One key consideration is the unpredictability and fluctuation of offset prices. The volatile nature of offset markets introduces uncertainty into long-term planning and budgeting. Currently, the lowest traded carbon price stands at £60, and it is expected to steadily increase. In specific cases, such as carbon offsets within the London boroughs, the price is as high as £252t/CO_2. Reducing emissions as much as possible reduces the need to offset and reduces the ongoing financial risk.

23. As a result of the updated work to the finance model four options are available to the Council;

    1. The Council abandons the 2030 net zero target.

    2. The Council only installs decarbonisation measures which have a strong return on investment (such as solar) to reduce capex, accepting that this

will increase the cost to the Council for carbon offsets from 2030 onwards.

3. The Council builds the projected increased costs of achieving the 2030 target into the Medium Term Financial Plan.

4. The Council continues with the current approach to achieving the 2030 target, which includes being open and transparent with costings and balancing the delivery of high cost and quick pay back measures. This approach includes the development of finance mechanisms with the purpose of generating a return on investment to offset any future potential cost increases to the Council, or to be used for other Greener Futures priorities.

24. The four options have been evaluated by officers and the recommendation is for the Council to adopt option 4. This option enables the Council to achieve the 2030 target, whilst talking on the lowest financial risk. As assessment of the approaches taken by other Local Authorities for their 2030 net zero carbon targets, through the ADEPT network, has shown that many Authorities have not estimated the cost of the target. For those that have only a few are looking at ways to balance costs and operational/revenue savings while others are building the costs into their budgets.

Net Zero 2050 programme

25. The financial approach to meeting our 2050 targets have has not fundamentally changed since it was agreed by Cabinet in October 2021. This is set out in the Finance Strategy in Annexe A.

26. The approach to the financial management of the 2050 target starts with the principle that the most cost-effective delivery relies on all Council activity being consistent with reducing carbon emissions and supporting a low carbon transition. Where there are additional opportunities to reduce financial barriers for residents and businesses, they will be prioritised based on their impact, deliverability and ability to become self-financing.

27. Several funding sources to date have been utilised to finance the 2050 delivery plan targets, the current funding sources are not sufficient to meet the targets for the Climate Change Delivery Plan. The national level funding opportunities for the 2050 targets are continuously evolving as National government policy to reach net-zero evolves. Several funding mechanisms are being explored to support delivery of the 2050 delivery plan targets. These are set out in more detail in the Finance Strategy.

28. Table 2 below includes a summary of priority funding mechanisms under development to support delivery of the 2050 delivery plan.

Table 2

Delivery Plan section	Priority funding mechanisms to be developed
GF communities	• Insetting opportunities within Surrey (Authority Based Insetting, ABI) • Exploring the development of a local carbon offset/inset market to secure aviation sector finance for local decarbonisation projects in partnership with Heathrow (fuel poor homes, EV vehicles, schools)
GF Communities Decarbonising of privately owned homes	• Solar Together phase 2 • One-stop-shop to support able to pay households to decarbonise their homes
GF Communities, schools and community groups	• A rent-a roof scheme is being developed support school's decarbonisation, Surrey commercial buildings and decarbonisation of the Council's commercial estate
GF Communities Decarbonising small business	• Small Business loan scheme to replace the LoCASE grant scheme, due to end in April 2023. Discussions with boroughs and districts may enable the seed funding to come from the shared prosperity fund
GF Communities Decarbonising transport	• Innovate UK funding to do feasibility on financial models to remove barriers to private investment for decarbonisation projects. Surrey focus is on transport and housing decarbonisation. Next stage £8m to do a pilot scheme
Build Back Greener	• Outcomes based budgeting will enable best use of capital infrastructure programme • The implementation of a low carbon planning policy may allow for carbon offset funding to be generated through planning, which would fund carbon reduction projects.
Build Back Greener	• Outcomes based budgeting will enable best use of capital infrastructure programme • The implementation of a low carbon planning policy may allow for carbon offset funding to be generated by Local Authorities through planning, which would fund carbon reduction projects.

Grow back greener	• Income generation potential of the Council-owned farms forests. • Opportunities for carbon offset and income generation through biodiversity net gain. • Further funding opportunities through the Rural Prosperity Fund.

Risk management and implications

1. Delivery of the Council's net-zero 2030 programme has shared responsibility across a number of Departments. The risks, and how they will be addressed, are set out in the Finance Strategy and are summarised below.
    (1) The uncertainties inherent in predicting likely changes to prices, borrowing rates, supply constraints will be managed through the annual review of costs that forms a key part of our governance process.
    (2) Where the cost of delivering net-zero has the potential to impact services, net-zero options are designed in early, which will reduce additional costs later and allow for informed decision-making with high quality cost and carbon information.
    (3) Risks that projects will not deliver carbon savings anticipated is being managed through active monitoring of projects delivered and a developing approach to offsetting.
    (4) Innovative finance mechanisms that hold significant commercial risk for the Council will be piloted before full-scale roll out.

Consultation:

29. The Finance Strategy and Finance review were developed jointly by officers in Greener Futures, Land and Property and Finance. The following Boards have been consulted;

- Greener Futures Member Reference Group
- CEH Select Committee
- Asset Strategy Board
- Greener Futures Partnership Steering Board
- Capital Programme Panel
- Greener Futures Steering Board
- Climate Change 2030 and 2050 Boards

Conclusions:

30. With strong investment principles, a clear governance framework underpinned by a regular review of costs and progress at a programme level complemented

by a renewables income generation programme designed to offset cost, the Council can continue to deliver an ambitious climate change programme and be able to manage the significant levels of investment in a robust and sustainable way.

Recommendations:

1. It is recommended that the CEH Select Committee endorse the following proposed Cabinet Recommendations:

   i. Agree the updated approach and investment principles, that support the delivery of the Council's 2030 and 2050 net zero carbon targets, as set out in the Green Finance Strategy.

   ii. Agree with the recommended option for the delivery of the Council's 2030 net zero target, including exploring additional renewables investment initiatives to offset potential future costs.

   iii. Subject to performing quarterly reporting to relevant Boards and an annual financial review for Cabinet, delegate authority to make decisions on the capital expenditure contained in the Greener Futures 2030 Investment Plan and the 2050 pilot finance mechanisms (in the Finance Strategy) to the Cabinet Members for Environment and Property and Waste, in collaboration with the Cabinet Member for Finance, Executive Directors for ETI and Resources, and relevant member and officer boards/groups

Next steps:

31. The report will be considered by Cabinet on 25 July 2023. If approved the following next steps will be taken:

    i. Commission consultants to undertake an audit review of the assumptions and data in the Finance model
    ii. Continue to develop the Finance model, feeding in commercial data (including costs) to improve accuracy
    iii. Continue to develop the 2030 Investment Plan alongside colleagues in Land and Property
    iv. Produce quarterly reports for CPP, Asset Strategy Board and the Greener Futures Member Reference Group
    v. Following the trial the solar decarbonisation offer, scale up the scheme to support the implementation of the 2030 programme
    vi. Continue to develop the finance mechanism pilots

vii. Undertake a financial review in the next financial year to report to Cabinet.

Report contact

Sadam Farley-Kiwanuka, Greener Futures Manager

Contact details

Sadam.farley-kiwanuka@surreycc.gov.uk

Annexe A

Annexe A Surrey Green Finance Strategy

Annexe B Explanation of the finance model and CCDP annual review

Annexe C 2030 Investment Plan (2023 – 2025) - *to follow*

Sources/background papers

[1] Surrey's Climate Change Strategy, May 2020; https://www.surreyclimate.org.uk/sites/default/files/Surrey%27s%20Climate%20Change%20Strategy%20%28240420%29%20%281%29_0.pdf

[2] Greener Futures Climate Change Delivery Plan, January 2022; https://s3-eu-west-2.amazonaws.com/commonplace-customer-assets/surreysgreenerfuture/Final%20Climate%20Change%20Delivery%20Plan%20Full%20Document%202022.pdf

[3] Cabinet report containing the initial Greener Futures Finance Strategy; October 2021, Item 9 Annexe 4; https://mycouncil.surreycc.gov.uk/documents/g7768/Public%20reports%20pack%20Tuesday%2026-Oct-2021%2014.00%20Cabinet.pdf?T=10

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