Meeting:	**Audit and governance committee**
Meeting date:	**4 July 2017**
Title of report:	**Energy from waste loan update**
Report by:	**Chief finance officer**

Classification

Open

Key decision

This is not an executive decision.

Wards affected

Countywide

Purpose

To provide assurance to the audit and governance committee on the status of the energy from waste (EfW) loan arrangement.

Recommendations

THAT:

(a) the risks to the council, as lender, are confirmed as being reasonable and appropriate having regard to the risks typically assumed by long term senior funders to waste projects in the United Kingdom and best banking practice; and

(b) arrangements for the administration of the loan are reviewed and, having regard to the advice of external advisors, confirmed as satisfactory.

Alternative options

1 None, the loan arrangement was contractually agreed in May 2014, no breaches or areas of concern have taken place during this reporting period.

Reasons for recommendations

2 To fulfil the functions delegated to the committee in relation to governance of the waste loan arrangement.

Further information on the subject of this report is available from
Josie Rushgrove, head of corporate finance, on tel (01432) 261867

Key considerations

Background

3 Following the approval to provide financing for the construction of an energy from waste (EfW) plant Council delegated to the audit and governance committee the responsibility to review the loan arrangements (including waiver terms) and risks to the council as lender and make recommendations as necessary.

4 No decisions or courses of action have been identified for recommendation to the committee.

Key loan features and update

5 Herefordshire and Worcestershire councils are funding the EfW plant through the use of prudential borrowing. Drawdowns of funding from Mercia continued over the 33 month construction period.

6 The total loan facility was agreed at £163.5m, with Herefordshire providing 24.2% of the loan value, being £40m, with drawn downs complete and repayments now falling due.

7 Total loan interest and fees chargeable to Mercia are fixed and are representative of commercial bank charges. These total £69m (£17m for Herefordshire) during the loan period. These charges are repayable before the PFI contract ends in 2023 and are recharged to the councils by Mercia through the unitary charge for waste disposal.

8 The facility achieved take over on 2 March 2017, two days after the contractual take over date of 28 February 2017. The delay was due to the failure to complete a number of required tasks by 28 February which did not impact the loan agreement.

Financial advisor update

9 The latest progress update from the financial advisors show that Mercia have met all senior term loan facility agreement (STLFA) requirements during this reporting period. Cover ratios and cash flow test requirements that ensure Mercia have equity and cash balances sufficient to cover loan repayments have been complied with.

10 Part of the loan conditions is the actual construction period cash flow test (ACPCFT) which confirms Mercia have sufficient cash flows in relation to Mercia's equity contribution to the EfW. The ACPCFT is prepared by Mercia on a quarterly basis and reviewed by Deloittes acting in the capacity as financial advisors to the councils in relation to the STLFA to determine whether:

"actual operating cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds… the amounts of operating cash projected to be generated during that period plus the brought forward cash balance attributable to operations as shown in the base case financial model."

11 The ACPCFT performed by Deloittes, attached at appendix a, reports a result of an excess cash flow amount of £3.2m as at 31 December 2016. This means that overall operations have produced £3.2m more than forecast in the base case financial model and the ACPCFT test is satisfied.

12 Mercia are able to use existing business as equity for cash flow purposes. The cashflow Mercia sets aside during the construction phase qualifies as Mercia's contribution of equity capital. Mercia have achieved their required contribution of equity capital to the project that takes risk ahead of the councils STLFA. A higher cash flow offsets the need for Mercia to draw down funds and the council has the ability to lock up Mercia's equity if Mercia fails to achieve an adequate level of excess cash. At present Mercia has the right level of equity to satisfy the tests required under the loan agreement. The ACPCFT test is satisfied.

Technical advisor update

13 As set out in its terms of reference, the committee will be advised by external financial, technical and legal advisers on behalf of the council's section 151 officer. Fichtner consulting engineers have been appointed as technical advisor to the lender during the construction phase of the EfW. The company has produced a summary report up to the takeover date of 2 March 2017 for consideration by the committee and this is attached at appendix b.

Waivers and consents

14 The committee are asked to note that since the previous update the following waivers and consents have been requested and approved:

a) In March 2017 the partner councils provided a waiver/consent under clause 18.4(b)(K) of the Senior Term Loan Facility Agreement (STLFA) in relation to the issuance of a take-over certificate without the prior written consent of the Lenders. The waiver/consent was provided by the partner councils on the basis of appropriate expert advice

b) In March 2017 the partner councils provided a waiver/consent under part c of schedule 6 of the STLFA in relation to a time deductible per occurrence contained within the Business Interruption Insurance Policy procured by the Borrower. The waiver/consent was provided by the partner councils on the basis of appropriate expert advice.

Community impact

15 There is no additional community impact as a result of this progress update report. The loan arrangement will contribute to the following council corporate plan priority to secure better services, quality of life and value for money.

Equality duty

16 Under section 149 of the Equality Act 2010, the 'general duty' on public authorities is set out as follows:

A public authority must, in the exercise of its functions, have due regard to the need to -

a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act;

b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it;

c) foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

17 The public sector equality duty (specific duty) requires us to consider how we can positively contribute to the advancement of equality and good relations, and demonstrate that we are paying ‘due regard’ in our decision making in the design of policies and in the delivery of services. As this is a decision on back office functions, we do not believe that it will have an impact on our equality duty.

Financial implications

18 There are no financial implications arising from the recommendations.

19 The loan arrangement is progressing to plan with the financial implications being reflected in the medium term financial strategy and treasury management strategy approved by Council in February 2017.

20 All costs incurred by advisors are recharged to mercia.

Legal implications

21 The terms and arrangements for this loan agreement are set out in the senior term loan facilities agreement. There are no specific legal implications arising from this report.

Risk management

22 The partner councils have undertaken an assessment of risk in its role as lender working with legal advisors (Ashursts), finance advisors (Deloitte) and technical advisors (Fichtner) to understand the basis on which commercial banks reserve elements of their margin against risks. The review considered:

a) Counterparty risk

b) Security package

c) Key income generation assumptions in the financial model

d) Specific project risks

e) Interest and foreign exchange rate risk

23 Attached at appendix c is the current risk register detailing the controls in place safeguarding the council’s position in the lending arrangement. The majority of risks are now closed following the EfW achieving actual takeover on 2 March 2017. The two remaining open risks are substantially mitigated and are therefore assessed as green.

24 The risk register is shared with Worcestershire County Council and is therefore in a jointly agreed format.

Consultees

25 None.

Appendices

Appendix A Financial advisor update (ACPCFT)

Appendix B Technical advisor update

Appendix C Risk register

Background papers

- None identified.

Further information on the subject of this report is available from
Josie Rushgrove, head of corporate finance, on tel (01432) 261867