

<b>Meeting:</b>	<b>Audit and governance committee</b>
<b>Meeting date:</b>	<b>Tuesday 24 September 2019</b>
<b>Title of report:</b>	<b>Energy from waste (EfW) loan update</b>
<b>Report by:</b>	<b>Chief finance officer</b>

## **Classification**

Open

## **Decision type**

This is not an executive decision

## **Wards affected**

(All Wards);

## **Purpose and summary**

To provide assurance to the audit and governance committee on the current status of the energy from waste loan arrangement to enable the committee to fulfil its delegated functions.

Herefordshire and Worcestershire are partners in a joint waste disposal private finance initiative contract that was varied in May 2014 to enable the councils to finance the construction of an Energy from Waste plant through the use of prudential borrowing. A total loan facility was agreed at £163.5m, with Herefordshire providing 24.2% of the loan value, being £40m.

The current status of the loan arrangement is considered satisfactory.

## **Recommendation(s)**

**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 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. This report provides an update on the arrangement to the Audit and Governance Committee in its role as the waste loan governance committee which entails reviewing risks to the lender and monitoring administration of the loan.

## Key considerations

2. In 1998 Herefordshire Council, in partnership with Worcestershire County Council, entered into a 25 year contract with Mercia Waste Management Limited for the provision of an integrated waste management system using the Private Finance Initiative.
3. A variation to the contract was signed in May 2014 to design, build, finance and operate an Energy from Waste plant. Both councils provided circa 82% of the project finance requirement from their own planned prudential borrowing with the remaining 18% being provided by the equity shareholders of Mercia Waste Management Limited.
4. This report ensures the committee fulfils the functions delegated to it in relation to the governance of the waste loan arrangement; specifically to review the risks to the council as lender and to monitor administration of the loan.
5. Since the last report to the committee in September 2018 the loan arrangement has continued to be repaid in line with expectations. No decisions or courses of action have been identified for recommendation to the committee.

### Key loan features and update

6. Herefordshire and Worcestershire councils provided a loan facility of £163.5m in total, with Herefordshire providing 24.2% of the loan value, £40m.
7. Total loan interest and fees charged to Mercia are fixed and are representative of commercial bank charges. These total £69m, £17m for Herefordshire.
8. During the last year, since the previous report to the committee, loan repayments of £3.7m have been received, representing £1.4m in principal and £2.3m in interest. A summary of repayments received to date is shown below:

Date	Interest (£m)	Principal (£m)	Total (£m)
June 2017	0.8	0.3	1.1
December 2017	1.2	0.6	1.8
June 2018	1.1	0.9	2.0
December 2018	1.2	0.6	1.8
June 2019	1.1	0.8	1.9
<b>Totals</b>	<b>5.4</b>	<b>3.2</b>	<b>8.6</b>

## **Senior Term Loan Facilities Agreement (STLFA) ratio calculation**

9. Mercia is required to produce an assurance statement, ratio calculations and ratio compliance certificate during the loan repayment phase. These are attached at appendices 1, 2 and 3.
10. Ratios are a financial covenant imposed by Lenders as a monitoring mechanism to provide early warning of project distress and potential Borrower default on their loan repayment obligations. The ratios provide a measure of the project's historic and future performance in relation to its ability to service current and upcoming debt liabilities. In the event the ratios fall below a prescribed level then the Borrower will be unable to distribute any surplus cash within the project until a date when the ratios are above the required level. The Borrower can then rectify any operational issues which resulted in the ratios falling below the prescribed level in the first instance and continue to cover debt service costs.
11. There are principally three ratio calculations used by Lenders:
  - Historic Annual Debt Service Cover Ratio ("ADSCR"): A historic periodic measure used to assess the project's ability to service its current debt obligation over the preceding 12 month period. This ratio is currently 1.73 which positively exceeds the target of 1.35 and default of 1.05.
  - Projected ADSCR: A forecasted periodic measure used to assess the project's ability to service its upcoming debt obligations for the proceeding 12 month period.
  - Loan Life Cover Ratio ("LLCR"): A forecasted measure used to assess the project's ability to repay the outstanding loan from future cash flows over the remaining life of the loan.
12. It should be noted that the ratio calculations have been calculated using the base case financial model. The committee should be aware that the councils are in negotiation with Mercia with regards to disposal contract cost savings and a possible contract extension and these are impacting on the availability of an updated financial model however the likely impact of perceived variation(s) on an updated financial model is considered to have an immaterial effect on the ratio information.
13. The council has gained assurance on the financial performance of the company from its annual accounts as well as the assurance statements provided as appendices to this report. This together with the evidence that Mercia have continued to meet their repayment obligations in full and on time provides sufficient lender assurance.
14. Also at appendix 2 provided is the 'cash flow after debt servicing' within the current base financial model compared to the 'actual 'cash flow after debt servicing'. This shows a positive picture where the actual cash flow has been in excess of the financial model at the end of each quarter for 2018.

## **Assurance Statement**

15. Twice a year Mercia produce a short, high level assurance statement with the aim being to reassure the Lender (the council) that there is no material matters which would impair Mercia's ability to repay the loan in accordance with the financial model in the coming period, this attached at appendix 1.

## **Plant Performance Operating Report**

16. Attached at Appendix 4 is a post completion plant performance operating report prepared by external advisors Fichtner Consulting Engineers Limited. The report confirms that the availability of the plant was above the annual availability guarantee. There are two minor items remaining from construction and payment is being withheld until these items have been completed. The plant continues to operate in line with performance and availability targets therefore there are no concerns likely to affect Mercia's ability to honour loan repayment obligations.

## **Community impact**

17. In accordance with the adopted code of corporate governance, Herefordshire Council must ensure that it has an effective performance management system that facilitates effective and efficient delivery of planned services. Effective financial management, risk management and internal control are important components of this performance management system. The committee's assurance that any risks associated with the loan arrangement have sufficient mitigation actions applied supports adherence to the code.
18. The loan arrangement supports the continued viability and affordability of the contracted waste disposal arrangement.

## **Equality duty**

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.
19. 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 factual update, we do not believe that it will have an impact on our equality duty.

## **Resource implications**

20. There are no financial implications arising from the recommendations of this report.
21. The loan arrangement is being repaid as expected, the implications of the agreed loan arrangement are reflected in the council's medium term financial strategy and treasury management strategy as agreed by Council in February 2019.

## **Legal implications**

- 22. 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.
- 23. The function of the committee is set out in the constitution under 3.5.13. This report relates to functions (a) to review risks as lender and (b) to monitor the administration of the loan.

## **Risk management**

- 24. There are two open risks that have been substantially mitigated and are assessed green as shown on the risk register attached at appendix 5.
- 25. The risk register is shared with Worcestershire County Council and is therefore in a jointly agreed format.

## **Consultees**

- 26. None

## **Appendices**

- Appendix 1      STLFA assurance statement
- Appendix 2      Ratio compliance certificate
- Appendix 3      Ratio calculation
- Appendix 4      Performance operating report
- Appendix 5      Risk register

## **Background papers**

- None identified