Herefordshire Council

Meeting:	**Audit and governance committee**
Meeting date:	**Wednesday 14 October 2020**
Title of report:	**Energy from waste loan update**
Report by:	**Chief finance officer**

Classification

Open

Decision type

This is not an executive decision

Wards affected

(All Wards);

Purpose

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.

Further information on the subject of this report is available from
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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 2019 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 £1.5m in principal and £2.2m in interest. A summary of repayments received to date is shown in the table below:

Date	Interest (£m)	Principal (£m)	Total (£m)
December 2019	1.1	0.6	1.7
June 2020	1.1	0.9	2.0
Totals	**2.2**	**1.5**	**3.7**
Previous repayments received	5.4	3.2	8.6
Total to date	**7.6**	**4.7**	**12.3**

Covid 19 Impact

9. During March the effects of the Covid 19 pandemic began and on March 24th both Councils instructed Mercia Waste Management Limited (the Company) to close Household Recycling Centres (HRCs) in both Counties. During late March and early April the Company saw commercial waste volumes plummet and there were fears that waste collections would be reduced to a significant degree which could lead to problems having sufficient waste for the EfW to continue operating. The Company took measures including securing new temporary commercial waste contracts whilst the situation improved. There was an impact of staff availability due to self - isolation but this has been managed successfully. Nearly all HRCs have reopened albeit with restrictions on the number of cars on site and observance of social distancing measures. There has been no threat to the ability of the Company to continue to make the loan repayments falling due with the June loan repayment being paid as expected.

Assurance Statement

10. The company is required to 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 is attached at appendix 1. The Company anticipates being able to continue to make payments as per the Loan Agreement and no material problems exist which would require the Lenders attention at any of Mercia's Facilities.

Plant Performance Operating Report

11. Attached at Appendix 2 is an update of the operating performance of the energy from waste plant prepared by external advisors Fichtner Consulting Engineers Limited. The report confirms that for the second year of operation the plants overall availability were above annual average guarantees. One minor item remains from construction and payment is being withheld until this has been completed. During the defects liability period, 332 defects were raised and of these, 82 remain open. The final certificate will not be issued until all open defects have been closed. The report confirms that it cannot currently foresee any performance issues with the plant that are likely to impact ongoing operations.

12. The Company has subsequently confirmed that the work in respect of the air handling unit has been done, but some minor issues need to be addressed before the system is accepted as compliant with the contract. Thirty three defects remain open and it is anticipated that all items will be addressed by the end of September and closed out by the end of October.

Community impact

13. 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.

14. The loan arrangement supports the continued viability and affordability of the contracted waste disposal arrangement.

Environmental Impact

Herefordshire Council provides and purchases a wide range of services for the people of Herefordshire. Together with partner organisations in the private, public and voluntary sectors we share a strong commitment to improving our environmental sustainability, achieving carbon neutrality and to protect and enhance Herefordshire's outstanding natural environment.

This is a factual update on an existing loan arrangement and will, in isolation, have minimal environmental impacts. However consideration to minimise waste and resource use in line with the Council's Environmental Policy is considered as part of the overall waste collection and disposal service provision.

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.

15. 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

16. There are no financial implications arising from the recommendations of this report.

17. 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 2020.

Legal implications

18. 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.

19. 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

20. The two open risks that have been substantially mitigated and are assessed as green remain on the risk register as reported last time, see appendix 3. All risks, including closed risks, are regularly reviewed.

21. Part of the senior term loan facility agreement refers to debt ratio calculations that demonstrate that the Company has the required funds to meet the loan repayments falling due.

22. A historic periodic ratio calculation is performed to assess the project's ability to service its current debt obligation over the preceding 12-month period. In addition a cash flow after debt servicing within the current base financial model is compared to the actual cash flow after debt servicing position. This has showed a positive picture where the actual cash flow in the Company has been more than the current base financial model.

23. The Councils are currently reviewing the service provision contract. The loan arrangement ends when the private finance initiative contract ends in 2023. The Councils are considering the options available at contract end which includes a contract extension. If an extension were to be agreed then a new finance model would be negotiated.

24. An updated financial model is expected to forecast immediate contract savings, discussions are being held with KPMG to support the Councils in understanding the updated model in terms of savings delivery and also any implications that this may have on the affordability of the future loan repayments.

25. To reflect this a new risk has been added to the risk register in relation to the impact on the ratio analysis testing of an updated financial model. There is currently no clear deadline for agreeing a contract extension and therefore no date to expect an updated financial model.

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

Consultees

27. None

Appendices

Appendix 1	Assurance Statement
Appendix 2	Plant Performance Operating Report
Appendix 3	Risk Register

Background papers

None identified

Further information on the subject of this report is available from
Josie Rushgrove, Tel: 01432 261867, email: jrushgrove@herefordshire.gov.uk