Meeting:	**Audit and Governance Committee**
Meeting date:	**19 March 2015**
Title of report:	**Energy from Waste (EfW) loan update**
Report by:	**Head of corporate finance**

Classification

Open

Key Decision

This is not an executive decision.

Wards Affected

Countywide

Purpose

To brief the Audit and Governance Committee on the status of the Energy from Waste (EfW) loan arrangement commenced on execution of the waste PFI contract variation in May 2014, following approval to proceed with the variation by Cabinet in December 2013.

Recommendation(s)

THAT:

(a) The Audit and Governance Committee note and monitor the current position in regards to the Energy from Waste (EfW) loan arrangement as required under the additions to the Committees terms of reference.

Alternative options

1 None, the loan arrangement was contractually agreed in May 2014, no breaches 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.

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

Reasons for recommendations

2 Following the establishment of a loan arrangement with Mercia Waste Management Limited (Mercia) regular updates will be reported to this Committee. This is the first of regular updates and will include;-

- Progress updates from financial advisors (Deloitte) and lenders technical advisors (Fichtner Consulting Engineers).

- The current risk register (Appendix A).

Key considerations

Background

3 Following the approval to provide financing of the construction of an Energy from Waste (EfW) plant this committee is to have oversight of the loan actions with Mercia Waste Management Ltd (Mercia). This committee is responsible for reviewing and recommending decisions that may be required in relation to the loan facility as advised by external financial and legal advisors on behalf of the council's statutory officers. Critical issues will be escalated to Council. The day to day management of the loan will be provided by agreement of the Section 151 Officers of both authorities.

4 Appendix B details the additions to the Committees terms of reference. No decisions or courses of action are being requested, this report is to update the Committee on the loan, the risk mitigation and granting of waivers actioned to date.

Key Features

5 Both councils are funding the EfW plant through the use of Prudential Borrowing. Drawdowns of funding from Mercia will continue over a 33 month construction period, between 2014 and 2017, before loan repayments fall due. Repayments are forecast to commence when construction completes in February 2017.

6 The total loan facility is for £163.5m, with Hereford providing 24.2% of the loan value, £40m. The loan facility is split between two tranches being an interest only loan facility and a repayable loan value. The interest only principal loan value is equivalent to the written down value of the plant when it is returned to the councils in 2023. The plant has an economic life of 25 years, it is returned to the council after 6 years of operation therefore the written down value is equal to the remaining 19 year life of the plant. The loan tranches are as follows;-

- £9m repayment loan and

- £31m interest only (bullet) loan

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.

8 Herefordshire will obtain loan finance in line with its Treasury Management Strategy.

This will include short term borrowings and longer term finance from the Public Works Loan Board where interest rates are aligned to long term gilt prices. Commercial banks rates are based on the London Inter Bank Offer Rate (LIBOR). The differential between the long term gilt price and LIBOR rates are typically 3% therefore the cost of debt incurred will be less than the cost charged to Mercia resulting in an estimated surplus of approximately £4.6m for Herefordshire. This surplus has been reflected in council budgets approved by Council in February.

9 The outstanding loan balance in 2023 reflects the expected net book value of the plant at that date. There are strict handover and regular testing arrangements in place that escalate when nearing the end of the contract protecting the return condition of the plant.

10 The remaining loan principal balance of £31m will be repaid after the end of the PFI contract period (2023) until the end of the plants useful life (2042).

Waivers and Consents

11 One administrative waiver has been granted to date for an extension of time for Mercia to file the financial close financial model with the elected custodian.

Updates

12 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.

13 Fitchner Consulting Engineers are the technical advisors to the lenders during the construction phase of the plant. No significant issues have arisen during the period and the construction completion date is not deemed to be at risk.

14 This committee is tasked with reviewing the risks as a result of the funding provided by the council to Mercia. This includes ensuring the risks are considered reasonable and appropriate. Attached, Appendix A, is a risk register detailing the unmitigated and mitigated risks arising as a result of the council being lender to Mercia. All risks are typical of a long term senior funder to waste projects and are aligned to best banking practice.

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 objectives:

- Managing our finances effectively to secure value for money and deliver a balanced budget
- Making best use of the resources available to us in order to meet the council's priorities (includes money, buildings, IT, information).

Equality duty

16 This update and its recommendations do not have an impact on Equality or Human Rights.

Financial implications

17 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 2015.

18 All costs incurred by advisors are recharged to Mercia.

Legal implications

19 The council received specialist legal advice from Ashursts, solicitors, before agreeing to enter the loan arrangement. No specific legal implications arise from this update report.

Risk management

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

- Counterparty risk
- Security package
- Key income generation assumptions in the financial model
- Specific project risks
- Interest and foreign exchange rate risk

21 The councils negotiated a security package that has left minimal risk that costs would be borne by the councils should issues occur during the construction phase. The loan arrangement security package mirrors that expected in a commercial bank arrangement. Advisors completed a risk fall away analysis and in recognition of this during the construction phase Herefordshire will retain 50% of its loan surplus in its waste disposal reserve should any construction period risk materialise. This reserve balance is included in the Councils Medium Term Financial Strategy approved by Council in February.

22 Risks are retained where they resided in the 1998 contract and any new risks have been transferred to Mercia and its supply chain. There are actions that can be taken if a default situation were to arise, for example taking shares or assets in Mercia in lieu of loan repayment. No indications of default are currently present.

23 Existing compensation on termination contract clauses ensure that the lender is repaid the majority (90%) of any outstanding debt balance if any termination event should occur during the PFI contract period.

24 Attached at Appendix A is the risk register detailing the controls in place safeguarding the council's position in the lending arrangement.

Consultees

25 Similar updates are reported to Worcester County Council's Waste Credit Governance Committee.

Appendices

Appendix A Risk Register

Appendix B Additions to Audit and Governance Committee terms of reference

Background papers

None identified.