Worcestershire County Council

Agenda

Waste Credit Governance Committee

Friday, 29 July 2016, 2.00 pm
County Hall, Worcester

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DISCLOSING INTERESTS

There are now 2 types of interests:
'Disclosable pecuniary interests' and 'other disclosable interests'

WHAT IS A 'DISCLOSABLE PECUNIARY INTEREST' (DPI)?

- Any **employment**, office, trade or vocation carried on for profit or gain
- **Sponsorship** by a 3rd party of your member or election expenses
- Any **contract** for goods, services or works between the Council and you, a firm where you are a partner/director, or company in which you hold shares
- Interests in **land** in Worcestershire (including licence to occupy for a month or longer)
- **Shares** etc (with either a total nominal value above £25,000 or 1% of the total issued share capital) in companies with a place of business or land in Worcestershire.

NB Your DPIs include the interests of your spouse/partner as well as you

WHAT MUST I DO WITH A DPI?

- **Register** it within 28 days and
- **Declare** it where you have a DPI in a matter at a particular meeting
  - you must **not participate** and you **must withdraw**.

NB It is a criminal offence to participate in matters in which you have a DPI

WHAT ABOUT 'OTHER DISCLOSABLE INTERESTS'?

- No need to register them but
- You must **declare** them at a particular meeting where:
  You/your family/person or body with whom you are associated have a **pecuniary interest** in or **close connection** with the matter under discussion.

WHAT ABOUT MEMBERSHIP OF ANOTHER AUTHORITY OR PUBLIC BODY?

You will not normally even need to declare this as an interest. The only exception is where the conflict of interest is so significant it is seen as likely to prejudice your judgement of the public interest.

DO I HAVE TO WITHDRAW IF I HAVE A DISCLOSABLE INTEREST WHICH ISN'T A DPI?

Not normally. You must withdraw only if it:

- affects your **pecuniary interests OR**
  relates to a **planning or regulatory** matter
- **AND** it is seen as likely to **prejudice your judgement** of the public interest.

DON'T FORGET

- If you have a disclosable interest at a meeting you must **disclose both its existence and nature** – 'as noted/recorded' is insufficient
- **Declarations must relate to specific business** on the agenda
  - General scattergun declarations are not needed and achieve little
- Breaches of most of the **DPI provisions** are now **criminal offences** which may be referred to the police which can on conviction by a court lead to fines up to £5,000 and disqualification up to 5 years
- Formal **dispensation** in respect of interests can be sought in appropriate cases.

Simon Mallinson Head of Legal and Democratic Services July 2012 WCC/SPM summary/f

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Waste Credit Governance Committee
Friday, 29 July 2016, 2.00 pm, County Hall, Worcester

Membership: Mr P Grove (Chairman), Mr L C R Mallett (Vice Chairman), Mr R C Adams, Mrs S Askin, Mr R W Banks, Mr P Denham, Mr A I Hardman, Mr P A Tuthill and Vacancy

Agenda

Item No	Subject	Page No
1	**Named Substitutes**	
2	**Apologies/Declarations of Interest**	
3	**Public Participation** Members of the public wishing to take part should notify the Head of Legal and Democratic Services in writing or by email indicating the nature and content of their proposed participation no later than 9.00am on the working day before the meeting (in this case 28 July 2016). Further details are available on the Council's website. Enquiries can be made through the telephone number/e-mail below.	
4	**Confirmation of Minutes** To confirm the Minutes of the meeting held on 12 April 2016. (previously circulated – pink pages)	
5	**Actual construction period cash flow test**	1 - 16
6	**Progress summary from technical advisors**	17 - 20
7	**Risk register**	21 - 28
8	**Waivers/consents**	29 - 30
9	**Deed of Amendment**	31 - 32

Agenda produced and published by Simon Mallinson, Head of Legal and Democratic Services, County Hall, Spetchley Road, Worcester WR5 2NP

To obtain further information or a copy of this agenda contact Simon Lewis, Committee Officer on 01905 846621, slewis@worcestershire.gov.uk

All the above reports and supporting information can be accessed via the Council's website

Date of Issue: Wednesday, 20 July 2016

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AGENDA ITEM 5

WASTE CREDIT GOVERNANCE COMMITTEE
29 JULY 2016

ACTUAL CONSTUCTION PERIOD CASH FLOW TEST

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **The result Actual Construction Period Cash Flow Test be accepted; and**

   b) **The Committee consider whether to report any matters to Council.**

Introduction

2. The Actual Construction Period Cash Flow Test (ACPCFT) is prepared by Mercia Waste Management on a quarterly basis and reviewed by Deloitte, acting in the capacity as Financial Advisers to the Councils in relation to the Senior Term Loan Facilities Agreement (STFLA), 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 amount 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."

Review performed by Deloitte

3. In performing the review Deloitte have agreed the terms of the calculation to the STLFA:

- Agreed the "model" Operating Cash generated during the period to the Base Case Financial Model
- Agreed the actual Operating Cash generated during the period to management information
- Re-performed the calculation of the ACPCFT
- Compared the senior term loan facility drawdowns against those forecast in the Base Case Financial Model.

Summary of Results

4. The result of the ACPCFT performed by Mercia for the period under review is an Excess Cash Flow amount as at 31 March 2016 of 377k. The result shows that in the period from 1 May 2014 to 31 March 2016, the operations have produced £377k more than was forecast for this period in the Base Case Financial Model.

5. Based on this result the ACPCFT for the period under review is satisfied.

Contact Points

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Supporting Information

- Appendix 1 – Actual Construction Period Cash Flow Test
- Appendix 2 – Timetable for the production and review of the Actual Construction Period Cash Flow Test.

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.

Senior Term Loan Facility Agreement

Actual Construction Period Cash Flow Test

For the period:
01 January 2016 to 31 March 2016

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Herefordshire Council

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Actual Construction Period Cash Flow Test

Background

Mercia has a Waste Management Services Contract ("WMSC") with the Councils. Mercia secured planning consent for a new facility and re-negotiated the WMSC for the design, construction and operation of a Waste to Energy ("WtE") plant over the remainder of the WMSC, due to expire in 2023. Financial close was reached in May 2014.

In order to ensure the funding solution demonstrated VfM, the Councils used their prudential borrowing powers to debt fund Mercia's WtE Plant.

Based on a capital structure of 85% debt and 15% equity, the Councils issued a senior loan facility.

Within the Senior Term Loan Facility Agreement ("STLFA"), the Councils included an Actual Construction Period Cash Flow Test ("ACPCFT"). This test is carried out on a quarterly basis following financial close (the first quarter ending 30 September 2014) and is used 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 amount 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."

Should a shortfall occur, Mercia will be required to remedy this shortfall by means of an equity injection equal to the amount of the shortfall in accordance with the contractual documentation.

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement.

Scope of review

Deloitte has reviewed the calculation provided by Mercia for the ACPCFT. In doing so Deloitte has:

- Agreed the terms of the calculation to the STLFA;
- Agreed the "model" Operating Cash generated during the period to the Base Case Financial Model;
- Agreed the actual Operating Cash generated during the period to management information;
- Re-performed the calculation of the ACPCFT;
- Compared the senior term loan facility draw downs against those forecast in the Base Case Financial Model.
- We have not received any technical reports for the period to 31 March 2016.

Summary of results

The result of the ACPCFT performed by Mercia for the period under review is an Excess Cash Flow amount as at 31 March 2016 of £377k, which has increased by £110k from the cashflow flow test in the previous period.

This shows that from 1 May 2014 to 31 March 2016, the operations have produced £377k more than was forecast for Q1 2016 in the Base Case Financial Model, which is an increase in Excess Cash Flow, following four consecutive periods of under-performance against the modelled forecast.

Based on the above, the ACPCFT for the quarterly period under review would be satisfied. In completing our work set out above, we have not identified any inconsistencies between Mercia's calculation and the underlying information.

Calculation

Actual Construction Period Cash Flow Test

Metric (£000)	May – Sep 14	Oct – Dec 14	Jan - Mar 15	Apr - Jun 15	Jul - Sep 15	Oct - Dec 15	Jan - Mar 16
Base case financial model							
b/f cash attributable to Ops	*4,254*	*4,793*	*7,051*	*9,123*	*11,246*	*13,203*	*15,388*
Gross revenue	18,603	10,448	10,847	11,813	12,374	10,627	11,140
Operating costs	(14,893)	(8,111)	(8,320)	(8,961)	(9,253)	(8,590)	(8,821)
Changes in working capital	(1,212)	320	(18)	(252)	(37)	451	138
Cell preparation assets	(612)	0	0	0	(632)	0	0
Corporation tax	(1,346)	(400)	(437)	(477)	(494)	(303)	(363)
Total change	**539**	**2,258**	**2,072**	**2,122**	**1,957**	**2,185**	**2,094**
c/f cash attributable to Ops	**4,793**	**7,051**	**9,123**	**11,246**	**13,203**	**15,388**	**17,482**
Actuals							
b/f cash attributable to Ops	*4,637*	*6,480*	*11,674*	*10,423*	*12,333*	*14,218*	*15,655*
Gross revenue	19,688	13,341	10,578	11,929	12,091	10,523	11,091
Operating costs	(15,557)	(8,588)	(8,509)	(9,372)	(9,682)	(8,916)	(9,245)
Changes in working capital	(1,392)	1,363	(3,018)	(171)	(131)	(341)	358
Cell preparation assets	(333)	(286)	0	0	(189)	0	0
Corporation tax	(563)	(636)	(302)	(476)	(204)	171	0
Total change	**1,843**	**5,194**	**(1,252)**	**1,910**	**1,885**	**1,437**	**2,204**
Variance	**1,304**	**2,936**	**(3,324)**	**(212)**	**(72)**	**(748)**	**110**
Excess cash flow a/c b/f	383	1,687	4,624	1,299	1,087	1,015	267
Excess cash flow a/c c/f	**1,687**	**4,624**	**1,299**	**1,087**	**1,015**	**267**	**377**

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement.

Note: The £3,672K early Unitary Charge Payment (December 2015), noted in the Q4 2015 report, has been adjusted from working capital in Q4 2015 and recognised in Q1 2016.

Commentary

Summary

- The calculation is the result of a methodology agreed between parties (the Councils and Mercia) as per the STLFA signed on 21 May 2014.
- The outcome of the ACPCFT performed by Mercia for the quarter under review is an Excess Cash Flow amount of £377k.
- The period from 1 May 2014 to 31 March 2016, the operations have produced £377k more Excess Cash Flow than was forecast for this period in the Base Case Financial Model.
- We note that in the period there has been the over performance against the Base Case Financial Model of £110k, following four consecutive periods of under-performance against the modelled forecast.
- Based on the above, the ACPCFT for the period under review is satisfied. We have not identified any inconsistencies between Mercia's calculation and the underlying information.
- Following four consecutive quarterly periods of under-performance against the modelled forecast, it has been noted that there has been an increase in Excess Cash Flow of £110k.
- The increase in the Excess Cash Flow amount has been principally driven by a £221k movement in working capital and a £363k movement in corporate tax compared to modelled forecast.
- From discussion with Mercia 26th May 2016, the underperformance of revenue and higher operating costs reflects tighter recyclable materials pricing and reduced revenues and increased costs to third parties in early January as a result of volumes exceeding capacity for the new glass-breakers.

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement.

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Revenue down and operating costs up against modelled forecast

- We note that for the quarter under consideration, revenue actuals were 0.4% below the modelled forecast, but operating costs were 5% above the modelled forecast.
- Quarter 1 2016 saw a fall in recycling revenue due to a contractual deduction applied, leading to a refund to the Council in the period. A Deed of Amendment is being drafted to resolve the differences noted and Mercia expect to recover these revenues for relevant periods detailed in the contract.
- Following a discussion with Mercia 26th May 2016, operating costs increased in comparison to the modelled forecast due to glass volumes in early January exceeding the capacity of the installed glass-breakers on site. This resulted in increased fees to third parties to process the excess capacity.

Changes in working capital and corporation tax

- The increase in the Excess Cash Flow amount has been principally driven by favourable movements in working capital and the position achieved in respect corporate tax, reflective of favourable position on deductions and allowances compared to the modelled forecast.
- As detailed previously, in Q4 2015 there was an early payment of the January Unitary Charge and as such the working capital in the period is reflective of this. Aside from the impact of the early payment, there has been a net increase in working capital of £221k, compared to the modelled forecast.

Commentary (continued)

ACPCFT trend

- It has been noted that whilst the Excess Cash Flow amount is still positive at £377k (an increase of £110k from the previous period), prior to this there was four consecutive periods of under-performance against the modelled forecast (i.e. an in period negative variance of actuals against the model).
- Mercia stated that recyclable materials pricing remains below modelled prices but has seen some stabilisation and some small increases in some recyclables pricing, though Deloitte have not validated this.
- As a result of these factors and completion of operational improvements, Mercia are projecting a stable or increased Excess Cash Flow Account for the next quarter.
- As a result, Mercia believe that there is no cause for concern with regard to the ACPCFT trend over 2016.
- In any case, should the ACPCFT be failed in subsequent quarters, the process to resolve this has been extracted and included in Appendix 2.

Senior Term Facility Loan draw downs

Actuals vs Forecast in the Financial Model

The table below shows the actual Senior Term Facility Loan draw downs against those forecast in the financial model.

Model	May - Sep 14	Oct - Dec 14	Jan - Mar 15	Apr - Jun 15	Jul - Sep 15	Oct - Dec 15	Jan - Mar 16	Cumulative
Model								
Facility A	5,241	2,341	1,725	5,633	3,205	4,249	2,355	**24,749**
Facility B	18,898	8,426	6,190	20,288	11,490	15,241	8,382	**88,917**
Total	**24,139**	**10,767**	**7,916**	**25,921**	**14,695**	**19,490**	**10,737**	**113,665**
Actual								
Facility A	4,576		1,713	2,375	3,289	4,746	5,180	**21,880**
Facility B	16,532		6,187	8,581	11,883	17,145	18,715	**79,042**
Total	**21,108**	**0**	**7,900**	**10,957**	**15,172**	**21,891**	**23,895**	**100,923**
Difference	**(3,031)**	**(10,767)**	**(16)**	**(14,965)**	**477**	**2,401**	**13,158**	**(12,743)**

Facility A is the amortising loan. Capital repayment begins in the quarter ended 30 June 2017 following the end of the construction period. Facility B is the bullet loan which is forecast to be repaid in the quarter ended 31 December 2023.

From discussion with Mercia management, the lack of draw down in October 2014 to December 2014 period reflects both a delay in the WtE build (meaning less cash was required for the WtE build) and the lower than expected capital expenditure in non-WtE build (meaning that more cash can be used on the WtE build).

From discussions with Mercia management, the drawdowns against the facilities are lower due to the fact that there has been delays in the timing of some of the EPC milestone payments. In addition the asset replacement programme is a little behind schedule due to the lead times for delivery / installation. These are delays in the timing of capital expenditure payments and these were seen increasing previously in Q3 and Q4 2015. In Q1 2016 a number of EPC milestone payments have been paid reflecting an increase in draw downs compared to the modelled forecasts.

Source: Mercia; Financial Model

Appendix 1

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Mercia's calculation (£000)

Cash Flow Test Calculation

	1 Jan 16 to 31 Mar 16 ACTUAL	1 Jan 16 to 31 Mar 16 MODEL
Profit Before Depreciation and Tax	**1,846**	**2,320**
Working Capital Movement (Operating)	**-3,314**	**138**
Corporation Tax (Cash)	-	-363
Operating Cash Flow	**-1,468**	**2,094**

Excess Cash Flow	1 Jan to 31 Mar 2016		
	Actual	Model	Var
Operating Cash Opening Balance	19,327	15,388	3,940
Operating Cash Flow (as above)	-1,468	2,094	(3,562)
Operating Cash Closing Balance	**17,860**	**17,482**	**377**

Mercia's cash flow notice

Excess Cash – Opening Balance (Dec 2015)	*267*
Gross Revenue	*-49*
Operating Costs	*-425*
Changes in Working Capital	*+221*
Corporation Tax	*+363*
Total	*+110*
Excess Cash – Closing Balance (Mar 2016)	*377*

Source: Mercia; Mercia also provided the workings behind this calculation so that the calculation could be reconciled to the company's trial balance and so it could be presented in a manner mapping to the description in the Senior Term Loan Facilities Agreement (see page 4).

Appendix 2

Extracts from Senior Term Loan Facility Agreement

"Actual Construction Period Cashflow Test" means the quarterly test to be carried out on each Actual Construction Period Cashflow Testing Date, in relation to the preceding quarter period to determine whether:

(a) actual Operating Cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds:

(b) the amount 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;

"Actual Construction Period Cashflow Testing Date" means each Quarter Date following Financial Close, up to and including Completion;

"Actual Construction Period Cashflow Shortfall" has the meaning given to it in clause 15.9 (Actual Construction Period Cashflow Test);

"Actual Construction Period Cashflow Remedy Amount" means the minimum amount necessary following a failure by the Borrower of the Actual Construction Period Cashflow Test, to pass such test;

"Actual Construction Period Excess Cashflow Amount" means the amount of Operating Cash generated in any quarter during the Construction Period which is greater than the amount required to satisfy the Actual Construction Period Cashflow Test;

"Base Case Financial Model" means the computer model, agreed between the Lenders and the Borrower at Financial Close, as amended from time to time by agreement between the Lenders and the Borrower and delivered pursuant to paragraph 11.1 (Part I – Initial Conditions Precedent) of schedule 3;

"Current Assets" means:

(a) cash held by the Borrower;

(b) any balance on the Debt Service Reserve Account;

(c) any balance on the Maintenance Reserve Account;

(d) any prepayments received;

(e) amounts owed to the Borrower and/or the amounts of any accounts receivable (in each case from trade debtors or HMRC in respect of VAT);

(f) amounts in respect of deferred taxes;

(g) inventory; and

(h) any cell preparation assets;

"Current Liabilities" means:

(a) amounts owed by the Borrower and/or the amounts of any accounts payable (in each case to trade creditors or HMRC in respect of National Insurance and VAT);

(b) the amount of any accruals or provisions made;

(c) the amount of any deferred tax liability;

(d) any cell restoration liabilities;

(e) any aftercare liabilities; and

(f) liabilities in respect of Corporation Tax;

Source: Senior Term Loan Facility Agreement

Appendix 2 (continued)

Extracts from Senior Term Loan Facility Agreement

"Gross Revenue" means, at any Ratio Testing Date and without double counting, the sum of:

(a) operating revenue including the Unitary Payment, any interim service payments (if applicable) and any actual or guaranteed third party income, but excluding, for the avoidance of doubt, the Bullet Payment; plus

(b) interest earned on all cash accounts (other than the Distribution Account); plus

(c) Damages;

(d) Insurance Proceeds to the extent received as compensation for loss of revenue;

(e) income earned on Authorised Investments (other than any Authorised Investments in respect of the Distribution Account (if any);

(f) rebates of Tax actually received or projected to be received in the latest Approved Budget; and

(g) all other income or proceeds of a revenue nature from whatever source;

assumed in the Approved Financial Model to be receivable by the Borrower in the period commencing with such Ratio Testing Date and terminating on the Final Repayment Date or, in respect of any Ratio Testing Period ended on that Ratio Testing Date, all such revenues actually received during such Ratio Testing Period;

"Operating Cash" means:

(a) Gross Revenue; less

(b) Operating Costs; plus or minus

(c) changes in Working Capital; less

(d) Corporation Tax.

in each case, in respect of that Financial Year, as reflected in the operating cashflow calculation in the Approved Financial Model;

"Working Capital" means Current Assets minus Current Liabilities.

"Operating Costs" means, without double counting any of those costs, and including any VAT thereon, costs identified as, or as the case may be, falling within the category of:

(a) costs and expenses of administering, maintaining and operating the Borrower, SWSL and BWL and the Project including, without limitation, all operating costs accrued prior to, or arising after Financial Close relating to the Borrower's, SWSL's and BWL's existing operations under, or related to, the Waste Management Services Contract all costs relating to Environmental Matters and the costs of complying with the requirements of Environmental Laws and the terms and conditions of Environmental Authorisations (together in all cases with any applicable VAT thereon which is irrecoverable VAT);

(b) the cost of insurance premia (other than in relation to insurances covering the construction and commissioning of the Plant) and all property and occupation charges and rates to which the Project may be subject (together in each case with any applicable VAT thereon which is irrecoverable VAT);

(c) sums payable by the Borrower under the terms of the Project Documents to which it is a party, other than in relation to construction and commissioning of the Plant (together with any applicable VAT thereon which is irrecoverable VAT);

(d) Taxes payable (excluding VAT other than "output tax" within the meaning of Section 24(2) of the Value Added Tax Act 1994) other than in relation to the construction and commissioning of the Plant; and

(e) development costs,

and in all cases, the equivalent lines thereafter in each Approved Budget and each Approved Financial Model;

(b) The Borrower may only withdraw sums from the Excess Cash Flow Account:

(i) to meet Project Costs at any time on or after the Take-Over Date, but prior to Completion; or

(ii) to transfer any amount standing to the credit of Excess Cash Flow Account on Completion to the Distribution Account, provided that no Event of Default is continuing.

Source: Senior Term Loan Facility Agreement

Appendix 2 (continued)

Extracts from Senior Term Loan Facility Agreement

Actual Construction Period Cashflow Test

(a) On each Actual Construction Period Cashflow Testing Date, the Borrower will provide evidence satisfactory to the Lenders (acting reasonably) that the Actual Construction Period Cashflow Test has been satisfied.

(b) Where there is a failure by the Borrower to satisfy the Actual Construction Period Cashflow Test on any Actual Construction Period Cashflow Testing Date (an "**Actual Construction Period Cashflow Shortfall**"):

(i) the Borrower shall serve a Standby Equity Funding Notice on each Shareholder pursuant to clause 4.2 (Standby Equity Funding Notice) of the Equity Agreement and through such notice request that each Shareholder contribute Equity in an amount equal to its Standby Contribution in accordance with clause 4.1 (Provision of Standby Equity) of the Equity Agreement; and

(ii) in the event that *[Shareholder A]* fails to contribute Equity in accordance with clause 15.10(b)(i) above, the Borrower or the Security Agent shall be entitled to make a claim under the Equity Guarantee ([Shareholder A]) for an amount equal to *[Shareholder A's]* Standby Contribution of the Actual Construction Period Cashflow Remedy Amount within the relevant period that such Equity is required to be paid pursuant to clause 8.1(b) (*[Shareholder A's parent] Guarantee*) of the Equity Agreement.

Source: Senior Term Loan Facility Agreement

Quarter End Date	MWM to send test and back up	Deloitte questions on test	Deloitte report ready	Report to Credit Committee	Credit Committee Meeting
	Quarter End + 6 weeks	*Quarter End + 7 weeks*	*Quarter End + 8 weeks*	*CC Meeting – 2 weeks*	*CC Meeting*
30/06/2016	By 11/08/2016	By 18/08/2016	By 25/08/2016	By 15/09/2016	29/09/2016
30/09/2016	By 11/11/2016	By 18/11/2016	By 25/11/2016	By 30/11/2016	14/12/2016
31/12/2016	By 10/02/2017	By 17/02/2017	By 24/02/2017	TBC	TBC

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AGENDA ITEM 6

WASTE CREDIT GOVERNANCE COMMITTEE
29 JULY 2016

PROGRESS SUMMARY FROM TECHNICAL ADVISORS

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **The summary report from Fichtner Consulting Engineers – Technical Advisors be noted; and**

   b) **The Committee consider whether to report any matters to Council.**

Introduction

2. 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.

3. Fichtner Consulting Engineers have been appointed as technical advisor to the lender during the construction phase of the Energy from Waste plant. The company has produced a summary report up to 30 April 2016 for consideration by the Committee and this is attached as an Appendix.

Contact Points

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Email: worcestershirehub@worcestershire.gov.uk

Specific Contact Points for this report
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Tel: 01905 766268
Email: spearce@worcestershire.gov.uk

Supporting Information

- Appendix – Summary reports from Fichtner Consulting Engineers – up to 30 April 2016

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.

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MEMORANDUM

To:	Mark Forrester	**Organisation:**	Worcestershire County Council
cc:	Simon Lewis	**Organisation:**	Worcestershire County Council
From:	Kerry Booth	**Our Ref:**	S1291-2300-0007KSB
Date:	13th July 2016	**No. of Pages:**	2
Subject:	Mercia LTA Construction Progress Summary – July 2016		

1 INTRODUCTION

Mercia Waste Management Limited ("Mercia") is constructing the 200,000 tonnes/year, 18 MWe Mercia EnviRecover EfW Plant in Hartlebury, Worcestershire. Fichtner Consulting Engineers Ltd (Fichtner) has been appointed as lender's technical advisor (LTA) for the construction phase of the plant. This summary memo covers relevant activities and progress based on review of latest available reports from and Mercia (covering 1st – 31st May 2016).

2 PROJECT PROGRESS

The latest programme provided to the LTA for review shows a target Take Over date of 29th December 2016, which is nine weeks ahead of the contractual Take Over date of 28th February 2017. Current progress suggests this is optimistic. However, it is considered likely that Take Over will be achieved in advance of the contractual Take Over date.

Civil work activities, including erection of tipping hall steelwork and cladding, have continued in recent months. Delays in cladding have required extended working hours, and have led to plasterboard damage in areas where cladding was not completed. Damage has been noted in the observation list. The boiler/FGT hall is expected to be watertight by mid-July, but this has not been confirmed. Slow progress has affected installation of drainage and road construction, which will potentially cause delay to the first waste deliveries and Take Over.

Installation of the fire suppression and detection system is progressing well and building services installation has also commenced.

Erection of the water steam cycle pipework has been completed and pressure tested throughout the facility. Insulating of pipework is largely complete.

Electrical installation has been delayed, and is not expected to be completed before mid-July.

The 66kV cable was energised on 3rd May 2016 and the 66/11kV transformer was energised on 11th May 2016. This satisfied the contractual requirement for Mercia to provide an energised grid connection.

3 KEY PROJECT RISKS AND OBSERVATIONS

Ongoing delays to the civil engineering works have delayed road construction, which has the potential to delay some commissioning activities.

The progress of electrical installation was delayed compared to the programme, and completion was not achieved by mid-May as previously anticipated. Additional manpower was employed to accelerate installation and prioritise systems required for commissioning. Quality of the cable installation is also a concern, with the number of quality observations increasing. Poor safety practices have also been observed This area is being closely monitored by the owner's engineer.

4 FINANCIAL AND COMMERCIAL

The cumulative amount which has been certified to date is £103,359,568.68. The LTA has issued ten payment certificates to allow drawdown on the senior loan.

To date forty-two Variation Orders have been issued. To date the net reduction to the contract price is £55,405, which covers all Variation Orders. There has been no extension of time for any Variation Orders issued to date.

5 Health and Safety

Health and safety standards have improved steadily on site in recent months, with a focus on good housekeeping, which has had a positive impact on site cleanliness. However, there have been poor safety practices surrounding the electrical installation. There is still room for improvement, and the owner's engineer will continue to monitor standards.

Key performance indicators for April 2016 show that one minor injury was reported and two minor injuries were reported in May.

43 Site Safety Observation Reports (SSORs) were raised in May (of 1,504 to date), with the most common categories of report concerning scaffolding and mobile towers, safe access and egress, traffic management, personal protective equipment and housekeeping. Three yellow cards and one red card were issued in April, and twenty-four yellow cards and four red cards were issued in May. The increase in May was largely due to a new electrical installation subcontractor on site. This subcontractor's activities will continue to be closely monitored.

6 Planned Activities Next Period

The following activities are planned from May 2016:

- Detailed engineering of remaining packages (including several civil work packages and design review meetings);
- Continued work on civil packages including construction of access roads, drainage, tipping hall, waste bunker, boiler hall, admin building, weighbridges, firewater tank, and firewater pump house; and
- Continued work on process packages including boiler hall steelwork installation, continued installation of the FGT system, and closing out of turbine hall snags.

Yours sincerely
FICHTNER Consulting Engineers Limited

Kerry Booth
Consultant

Phin Eddy
Commercial Director

worcestershire
countycouncil

AGENDA ITEM 7

WASTE CREDIT GOVERNANCE COMMITTEE
29 JULY 2016

RISK REGISTER

Recommendation

1. **The Chief Financial Officer recommends that:**

   a) **The unmitigated and mitigated risks set out in the Risk Register be accepted; and**

   b) **The Committee consider whether to report any matters to Council.**

Introduction

2. As set out in its Terms of Reference, the Committee will need to review the risks being borne as a result of the funding provided by the Council to Mercia and consider whether the risks being borne by the Council, as lender, are 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.

3. A Risk Register has been established which sets out the unmitigated and mitigated risks associated with the loan arrangements.

4. Members will recall that at the meeting of the Committee on 15 December 2014, it was agreed that a report on the Risk Register would be brought to each meeting of the Committee (Minute no. 15 refers). An updated version of the Risk Register has therefore been produced and is attached as Appendix 1. Members are asked to consider the risks set out in the Register.

5. A copy of the Mercia Waste Loan Facility Drawdown Analysis is attached as Appendix 2.

Contact Points

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Specific Contact Points for this report
Sean Pearce – Chief Financial Officer
Tel: 01905 766268
Email: spearce@worcestershire.gov.uk

Supporting Information

- Appendix 1 – Risk Register
- Appendix 2 - Mercia Waste Loan Facility Drawdown Analysis
-

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) the following are the background papers relating to the subject matter of this report:

Agenda papers and Minutes of the meeting of the Waste Credit Governance Committee held on 15 December 2014.

Waste Credit Committee Risk Register

July 2016 - Corporate Scoring Terms

Risk Reference	Description of risk	Gross Impact	Gross Likelihood	Gross Risk Score	Risk control approach	Mitigating Actions	Residual Impact	Residual Likelihood	Residual Risk Score	Assigned to (Risk Owners)
a	Default of loan repayments by borrower to lenders due to SPV (Mercia) or HZI falling into administration.	Critical	Medium	15	Risk transferred	Due to the security package negotiated by the Councils a fall away analysis indicated that Mercia, its Shareholders and HZI would need to enter administration at the same time to put at repayment at risk during the construction phase. The maximum exposure to the Councils has been calculated and included within the sufficiency assessment of the Council's reserves. All press articles are scanned regularly for indications of financial strength issues and followed up to ensure counterparty risk is not increased.	Substantial	Very Low	6	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default and Deloitte to monitor Mercia's actual quarterly cash flow tests and cover ratios that have to be maintained by Mercia.
b	Construction completion date of EFW is delayed and delays repayment of loan to lenders.	Substantial	Medium	11	Risk transferred	Under the contract terms agreed with Mercia, Mercia take all material risk on EFW construction delay and repayment of loan will commence around February 2017, as set out in the SLFLA and agreed final financial model. Repayments are not tied to the actual construction completion date, rather the planned date. The Council as lender has the right to call the loan into default if construction is not completed by a long stop date. The Lender's Technical Advisor has confirmed that the expected Takeover Date is now the Planned Take Over Date, 28th February 2017.	Substantial	Very Low	6	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.
c	PWLB borrowing rates increase more than estimated in the Councils' prudential borrowing model. Higher rates would reduce the surplus generated on the loan arrangements with Mercia.	Substantial	Low	10	Risk treated	The cost of purchasing a financial product to remove this risk (a swaption) from an investment bank was quoted at £20m. The Councils decided to manage the risk through forecasting the forward price for its debt draw downs over the construction period and hold in reserve monies to mitigate this risk where required. Currently the rates accessible by the Councils are lower than this estimate as the continued low gilt rate environment pervades.	Substantial	Very Low	6	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.
d	Loan drawdowns are slower than set out in the STFLA. Delayed drawdowns would result in reduced interest payments to the Councils and potentially reduced surplus if PWLB loan rates increase between the expected draw date and actual.	Negligible	Medium	4	Risk treated	The Councils plan to borrow from PWLB at dates in line with drawdown requests from Mercia. Therefore although the Councils would receive reduced interest receipts, less interest would also be paid to PWLB. The Councils are monitoring market gilt rates actively and have the option to borrow from PWLB up to a year in advance of expected drawdown requests. Regular progress reports are being reviewed to ensure the construction programme and the loan drawdowns are requested in line with the plan	Negligible	Very Low	2	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.

e	Drawdown requests from Mercia are not actioned by the Councils or not actioned within the required contracted time period.	Substantial	Low	10	Risk treated	The Council's treasury teams have been fully briefed on the actions required to fulfil drawdown requests, checks required and the contracted timeline by the Section 151 Officer and their teams. Drawdowns to date have been actioned inline with requirements. Since the last Committee, two further drawdowns have been provided and there is a separate analysis available for the Committee outlining planned vs actual drawdowns made to date.	Substantial	Very Low	6	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.
f	Mercia loan principal and / or interest repayments are below the required values as per the rates agreed in the STFLA .	Substantial	Very Low	6	Risk treated	The Council's treasury team maintain a spreadsheet detailing drawdowns to date and expected future principal and interest payments. This is reconciled to Mercia's repayment spreadsheet and will be matched to principal and interest repayments received from Mercia during the post construction period.	Substantial	Almost Impossible	5	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.
g	Default of loan repayments by borrower to lenders due to HZI termination of Interserve Construction Limited (ICL) delaying project completion to after long stop date.	Critical	Medium	15	Risk treated	Sponsors have provided assurance that they believe HZI have undertaken the right processes to replace the final ICL work packages and that there is no financial risk to the Sponsors from the work underway. Sponsors confirmed that their Due Diligence on HZI had not raised any concerns around the company's viability or going concern. The Council as lender has the right to call the loan into default if construction is not completed by a long stop date, at which point the negotiated security package, set out in section 'a' above, would take effect.	Substantial	Very Low	6	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.
h	HZI termination of ICL may weaken negotiated security package due to no single new supplier exceeding £10 million contract value, and therefore triggering EPC Contract Schedule 7 requirements for Collateral Warranty and professional indemnity insurance requirements. The risk is that the Council as lender does not receive the same security package as it had when ICL was in place.	Substantial	High	12	Risk treated	In terms of Collateral Warranty, the HZI Collateral Warranty is in place and remains in place. Due Diligence has been undertaken by Sponsors and the Council as Lender(with the Financial Advisor) to confirm the financial strength of HZI in light of events. There are no issues arising from these reviews. Sponsors agreed to review on a case by case basis the requirement for additional security protections and advised the Council as to its rational for its decision. The Council as Lender has sign off rights and requests have been made to the Councils prospectively for Schedule 7 services and retrospectively (based on Sponsor Assurance) for non-Schedule 7 services. Planned meetings have been held for sign off and Council advisors have been retained to provide advice. The Councils have clearly articulated to Sponsors that there should not be any weakening on the Security Package in place with regard to the Civil Engineering Work. There is no financial impact on Sponsors from events to date and therefore no financial impact on the Council as Lenders.	Substantial	Low	10	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.

Key

High 19 – 24	Unacceptable Risk: Immediate control/improvement required
Medium 8 – 18	Acceptable Risk: Close monitoring and cost effective control improvements sought.
Low 1 –7	Acceptable Risk: Need periodic review, low cost control improvements sought if possible.

Scoring Matrix

Likelihood

Very High	9	19	21	24
High	8	12	20	23
Medium	4	11	15	22
Low	3	10	14	18
Very Low	2	6	13	17
Almost Impossible	1	5	7	16
	Negligible	Substantial	Critical	Extreme

Impact

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Mercia Waste Loan Facility Drawdown Analysis
July 2016

Key

(green)	Planned drawdown paid to Mercia
(amber)	Planned drawdown overdue

Planned Drawdown Date	Planned Facility A Loan Drawdown (£)	Planned Drawdown Date	Planned Facility B Loan Drawdown (£)	Planned Total	Actual Drawdowns	Actual WCC share	Actual Drawdown Dates
	£		£	£	£	£	
22-May-14	3,437,681	22-Apr-14	12,418,893	15,856,574	15,858,574	12,020,799	Drawdown 21/05/2014
31-May-14	1,138,388	31-May-14	4,112,516	5,250,904	5,250,904	3,980,185	Drawdown 05/06/2014
30-Jun-14	-	30-Jun-14	-				
31-Jul-14	-	31-Jul-14	-				
31-Aug-14	471,567	31-Aug-14	1,703,572	2,175,139			
30-Sep-14	284,368	30-Sep-14	1,027,302	1,311,670			
31-Oct-14	-	31-Oct-14	-				
30-Nov-14	956,758	30-Nov-14	3,456,362	4,413,120	7,899,929	5,988,146	Drawdown 11/02/2015
31-Dec-14	1,462,041	31-Dec-14	5,281,740	6,743,781			
31-Jan-15	425,251	31-Jan-15	1,536,253	1,961,504			
28-Feb-15	488,132	28-Feb-15	1,763,415	2,251,547	10,956,832	8,305,279	Drawdown 17/06/2015
31-Mar-15	922,698	31-Mar-15	3,333,319	4,256,017			
30-Apr-15	2,366,620	30-Apr-15	8,549,600	10,916,220	15,172,237	11,500,556	Drawdown 23/07/2015
31-May-15	2,400,673	31-May-15	8,672,622	11,073,295	11,073,295	8,393,558	Drawdown 21/10/2015
30-Jun-15	1,029,449	30-Jun-15	3,718,966	4,748,415			
31-Jul-15	1,315,749	31-Jul-15	4,753,246	6,068,995	10,817,410	8,199,597	Drawdown 25/11/2015
31-Aug-15	908,118	31-Aug-15	3,280,647	4,188,765			
30-Sep-15	1,209,552	30-Sep-15	4,369,603	5,579,155	9,767,920	7,404,083	Drawdown 01/02/2016
31-Oct-15	1,511,878	31-Oct-15	5,461,779	6,973,657			
30-Nov-15	1,550,833	30-Nov-15	5,602,507	7,153,340	14,126,997	10,708,264	Drawdown 25/02/2016
31-Dec-15	1,466,965	31-Dec-15	5,299,526	6,766,491			
31-Jan-16	567,125	31-Jan-16	2,048,785	2,615,910			
29-Feb-16	1,094,791	29-Feb-16	3,955,019	5,049,810	14,432,211	10,939,616	Drawdown 27/04/2016
31-Mar-16	1,021,353	31-Mar-16	3,689,717	4,711,070			
30-Apr-16	1,475,647	30-Apr-16	5,330,890	6,806,537	11,517,607	8,730,346	Drawdown 01/06/2016
31-May-16	1,197,470	31-May-16	4,325,954	5,523,424			
30-Jun-16	147,926	30-Jun-16	534,393	682,319			
31-Jul-16	139,033	31-Jul-16	502,267	641,300			
31-Aug-16	536,246	31-Aug-16	1,937,231	2,473,477			
30-Sep-16	586,749	30-Sep-16	2,119,676	2,706,425			
31-Oct-16	347,437	31-Oct-16	1,255,142	1,602,579			
30-Nov-16	166,670	30-Nov-16	602,109	768,779			
31-Dec-16	456,064	31-Dec-16	1,647,566	2,103,630			
31-Jan-17	1,002,431	31-Jan-17	3,621,359	4,623,790			
28-Feb-17	3,359,702	28-Feb-17	12,137,189	15,496,891			
Total	35,445,365	**Total**	128,049,165	163,494,530	126,873,916	96,170,428	

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worcestershire county council

WASTE CREDIT GOVERNANCE COMMITTEE
29 JULY 2016

WAIVERS/CONSENTS

Recommendation

1. **The Chief Financial Officer recommends that the waivers/consents granted during the period under review be noted.**

Introduction

2. As set out in its Terms of Reference, the Committee will need to monitor and administer the loan to the waste project in line with best banking practice, including the terms of any waivers or amendments which might be required or are desirable.

3. The Chief Financial Officer has delegated authority for the day to day management of the waste management contract including waivers and consents that are not material to the STLFA to the Section 151 Officers.

Waivers/Consents requests

4. For the period under review no waivers/consents were requested by the Sponsors and approved by the Councils.

Contact Points

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Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.

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AGENDA ITEM 9

WASTE CREDIT GOVERNANCE COMMITTEE
29 JULY 2016

DEED OF AMENDMENT

Recommendation

1. **The Chief Financial Officer recommends that the Deed of Amendment agreed during the period under review be noted.**

Introduction

2. The Deed of Amendment corrects three errors contained in the Variation Agreement signed on 21 May 2014:

a) In respect of the Annual Discount of £250,000 which did not reflect the intention that the reduction would only be deducted from the planned take-over date and not from the date of financial close. The discount has been taken to date and the Deed states the remedy payment to Mercia (May 2014 – May 2016) and the correct payments going forwards;

b) The omission of a copy of CV29, which had led to Mercia not being able to invoice Aggregate Levy costs to the Council. Both the Councils and Mercia Waste agree that this variation should have been included in Annex 4 of the Variation Agreement (Non-EfW Contract Variations). However this was omitted from the formal documentation at Financial Close. Therefore the Deed of Amendment is rectifying this omission and including it in Annex 4 with effect from 21-May 2014, thereby enabling Mercia to make the appropriate claims for any payment due under this variation; and

c) A couple of minor referencing errors in respect of the Excess Revenue Sharing arrangements.

Legal Review

3. The Lenders' legal adviser, Ashurst, have reviewed the Deed of Amendment and are content with the document.

Financial Impact

4. Amendments 'a' and 'b' are in favour of Mercia Waste and therefore from a Lenders' perspective only improve the position in terms of Mercia Waste meeting the quarterly cash flow test. The amendments also bring the contract into line with the financial model.

Contact Points

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Sean Pearce – Chief Financial Officer
Tel: 01905 766268
Email: spearce@worcestershire.gov.uk

Background Papers

In the opinion of the proper officer (in this case the Chief Financial Officer) there are no background papers relating to the subject matter of this report.