

Agenda

Waste Credit Governance Committee

Friday, 14 July 2017, 10.00 am
County Hall, Worcester

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(Kurdish) کوردی سۆزانی، نەگەر ناتوانی تێبەگەیی لە ناوێرۆکی نەم بێلگەییە و دەستت بە هیچ کەس ناکەیت کە وەبێگێڕیتووه بۆت، تەکنیە تەلەفۆن بکە بۆ ژمارەی 01905 765765 و داوای پێنوێنی بکە.

ਪੰਜਾਬੀ। ਜੇ ਤੁਸੀਂ ਇਸ ਦਸਤਾਵੇਜ਼ ਦਾ ਮਸ਼ਹੂਨ ਸਮਝ ਨਹੀਂ ਸਕਦੇ ਅਤੇ ਕਿਸੇ ਅਜਿਹੇ ਵਿਅਕਤੀ ਤੱਕ ਪਹੁੰਚ ਨਹੀਂ ਹੈ, ਜੋ ਇਸਦਾ ਤੁਹਾਡੇ ਲਈ ਅਨੁਵਾਦ ਕਰ ਸਕੇ, ਤਾਂ ਕਿਰਪਾ ਕਰਕੇ ਮਦਦ ਲਈ 01905 765765 'ਤੇ ਫ਼ੋਨ ਕਰੋ। (Punjabi)

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.

Waste Credit Governance Committee

Friday, 14 July 2017, 10.00 am, County Hall, Worcester

Membership: Mr P Grove (Chairman), Mr R C Adams, Mr R W Banks, Mr A I Hardman, Dr C Hotham, Mr L C R Mallett, Mr P Middlebrough and Mr P A Tuthill

Agenda

Item No	Subject	Page No
1	Apologies and Named Substitutes	
2	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 13 July 2017). 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 24 March 2017. (previously circulated – pink pages)	
5	Actual construction period cash flow test	1 - 14
6	Risk Register	15 - 22
7	Waivers/consents	23 - 24

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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, 5 July 2017

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WASTE CREDIT GOVERNANCE COMMITTEE

14 JULY 2017

ACTUAL CONSTRUCTION PERIOD CASH FLOW TEST

Recommendation

- 1. The Chief Financial Officer recommends that:**
 - a) The result of the Actual Construction Period Cash Flow Test be considered.**
 - 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 2017 of £2,223k. The result shows that in the period from 1 May 2014 to 31 March 2017, the operations have produced £2,223k 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 – 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:
1 January 2017 to 31 March 2017

Important notice

Deloitte LLP ("Deloitte") is acting for Worcestershire County Council ("WCC") and the County of Herefordshire Council ("CoHC") (together "the Councils" or "the Clients") on the terms set out in the engagement letter dated 13 November 2014 (the "Engagement Letter") in connection with the financial advisory services in relation to the Senior Term Loan Facility Agreement ("STLFA" or "Agreement") with Mercia Waste Management Limited ("MWM" or "Mercia") (in total, the "Project") and has no responsibility to anyone other than the Clients for providing advice in relation to the Project.

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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 an Energy from Waste ("EfW") plant over the remainder of the WMSC, due to expire in 2023. Financial close was reached in May 2014 and takeover in March 2017, in line with the contract.

In order to ensure the funding solution demonstrated Value for Money ("VfM"), the Councils used their Prudential borrowing powers to debt fund Mercia's EfW Plant.

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

Page 5
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."

The cash flow that is assessed in this report relates to Mercia's complete business, which includes not only the EfW plant mentioned above but two other plants that are more recycling focussed.

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.

The plant completed its takeover in March 2017 as expected and has since been undergoing performance tests. These are so far going to plan, with no issues discovered, and are scheduled to last until the end of June in line with the EPC contract.

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; and
- 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 1 January 2017 to 31 March 2017.

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 2017 of £2,223k, which has decreased by £963k from the Cash Flow flow test in the previous period. This drop is due to timing differences between Q4 2016 and Q1 2017, and marginally lower recyclable volumes and prices.

The revenue and cost figures differ quite significantly from the forecasted numbers due to a change in recognition of the loan bullet payment, which was previously excluded (see subsequent pages for more detail). This is a non-cash item, however, and has been reversed in the cash flow calculation. It does therefore not affect the test that this report is assessing.

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	Apr – Jun 16	Jul – Sep 16	Sep – Dec 16	Jan-Mar 17
Base case financial model												
b/f cash attributable to Ops		4,254	4,793	7,051	9,123	11,246	13,203	15,388	17,482	19,801	22,115	24,242
Gross revenue		18,603	10,448	10,847	11,813	12,374	10,627	11,140	12,046	12,640	10,861	14,496
Operating costs		(14,893)	(8,111)	(8,320)	(8,961)	(9,253)	(8,590)	(8,821)	(9,439)	(9,671)	(8,775)	(7,823)
Changes in working capital		(1,212)	320	(18)	(252)	(37)	451	138	134	(216)	359	(4,234)
Cell preparation assets		(612)	0	0	0	(632)	0	0	0	0	0	0
Corporation tax		(1,346)	(400)	(437)	(477)	(494)	(303)	(363)	(423)	(439)	(318)	(426)
Total change		539	2,258	2,072	2,122	1,957	2,185	2,094	2,319	2,314	2,127	2,013
c/f cash attributable to Ops		4,793	7,051	9,123	11,246	13,203	15,388	17,482	19,801	22,115	24,242	26,255
Actuals												
b/f cash attributable to Ops		4,637	6,480	11,674	10,423	12,333	14,218	15,655	17,860	20,197	23,165	27,428
Gross revenue		19,688	13,341	10,578	11,929	12,091	10,523	11,091	13,078	12,487	8,991	12,231
Operating costs		(15,557)	(8,588)	(8,509)	(9,372)	(9,682)	(8,916)	(9,245)	(9,812)	(9,847)	(6,409)	(6,875)
Changes in working capital		(1,392)	1,363	(3,018)	(171)	(131)	(341)	358	(928)	332	1,683	(4,307)
Cell preparation assets		(333)	(286)	0	0	(189)	0	0	0	0	0	0
Corporation tax		(563)	(636)	(302)	(476)	(204)	171	0	0	(4)	(3)	0
Total change		1,843	5,194	(1,252)	1,910	1,885	1,437	2,204	2,338	2,968	4,262	1,050
Variance		1,304	2,936	(3,324)	(212)	(72)	(748)	110	20	654	2,135	(963)
Excess cash flow a/c b/f		383	1,687	4,623	1,299	1,087	1,015	267	377	396	1,050	3,186
Excess cash flow a/c c/f		1,687	4,623	1,299	1,087	1,015	267	377	397	1,050	3,186	2,222

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 £2,223k.
- That means in the period from 1 May 2014 to 31 March 2017, the operations have produced £2,223k more Excess Cash Flow than was forecast in the Base Case Financial Model.
- We note that in this quarter there has been an under-performance against the Base Case Financial Model of £963k.
- Based on the above, the ACPCFT for the period under review is satisfied, given the cumulative balance remains in excess of the modelled amount. We have not identified any inconsistencies between Mercia's calculation and the underlying information.
- The main driver behind the worse than modelled performance is the revenue, which fell short of expectation by £2,265k (£12,231k vs. £14,496k). This was partially mitigated by the positive performance in operating costs (£948k lower than expectations). Additionally, there was again no corporation tax charge, despite £426k being budgeted.

Revenue and operating costs down against modelled forecast

- We note that for the quarter under consideration, revenue actuals were 16% below the modelled forecast, and operating costs 12% below the modelled forecast.
- The majority of the variance of revenue compared to the forecasts is driven by the change in recognition of the bullet payment as described above. However, as stated on p.3, this does not affect the cash flow position.
- The remainder of the variance (that not explained by the amortisation) is due to lower landfill volumes (for which Mercia is charged and then recharges) and recycling prices.

- The EfW site began commissioning activities in Q3 2016, with minimal volumes diverted from landfill. This continued at a greater level through Q4 and Q1 until the plant reached take-over in March 2017.

Change in recognition of bullet payment

- From a discussion with Mercia on 25 May 2017 and 15 June 2016, the under performance of revenue and lower operating costs is as a result of the change in recognition of the bullet payment.
- Facility B of the loan is to be repaid in full (£128m) at the contract expiry date (2023) and is therefore unwound as income on a straight line basis over this period.
- This matches the depreciation of the asset, which also had an initial value of £128m and has a useful life until 2023.
- Previously, this depreciation and unwinding of the deferred income were not included in the numbers assessed in this report as they cancelled each other out.
- Now, however, that the plant has passed takeover date, they have been included due to different methods being used. Mercia's actual figures unwind the deferred income between takeover date and contract expiry whilst the plant continues to be depreciated since financial close. The model forecasts these two treatments remaining the same. This accounts for £1.7m of the £2.3m revenue variance in this quarter.
- NB: this does not affect the cash flow variance due to being a non-cash item.

Commentary (continued)

Changes in working capital and corporation tax

- The decrease in the Excess Cash Flow amount has been principally driven by unfavourable movements in the Revenue as highlighted above (excluding the bullet payment treatment as this is a non-cash item). This was partially offset by lower than forecasted Operating Costs and corporation tax, reflective of favourable positions on deductions and allowances compared to the modelled forecast.
- Working capital performed broadly in line with expectations, with a £4,307k downwards movement in the quarter, compared with a modelled £4,234k downwards movement.
- At the time of writing, Mercia is working with its advisors to project the corporation tax calculations going forward.

Page 8 ACPCFT trend

- It has been noted that despite a decrease in the Excess Cash Flow of £964k from the previous period, the cumulative total is still positive at £2,223k and therefore the requirements are satisfied.
- Prior to Q1 2016 there were four consecutive periods of under-performance against the modelled forecast (i.e. a negative variance of actuals against the model). However, in 2016 there were four consecutive quarters of over-performance, leading to the substantial positive cumulative balance now.
- Mercia stated that there was a slight downwards shift in the pricing of recyclable materials during the period, though Deloitte has not validated this.
- Similarly, the recyclable volumes have fallen marginally; a trend that is not expected to continue. Deloitte has not validated this.
- Mercia is projecting a stable or increased Excess Cash Flow Account for the next quarter.
- 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	Apr – Jun 16	Jul – Sept 16	Oct – Dec 16	Jan – Mar 17	Cumulative
Model												
Facility A	5,332	2,419	1,836	5,797	3,433	4,530	2,683	2,821	1,262	970	4,362	35,445
Facility B	19,262	8,738	6,633	20,941	12,403	16,364	9,694	10,191	4,559	3,505	15,759	128,049
Total	24,594	11,157	8,469	26,738	15,837	20,893	12,377	13,012	5,821	4,475	20,121	163,495
Actual												
Facility A	4,576	-	1,713	2,375	3,289	4,746	5,180	5,626	-	2,021	5,919	35,445
Facility B	16,532	-	6,187	8,581	11,883	17,145	18,715	20,324	-	7,300	21,383	128,049
Total	21,108	-	7,900	10,957	15,172	21,891	23,895	25,950	-	9,321	27,302	163,495
Difference	(3,486)	(11,157)	(569)	(15,781)	(665)	997	11,518	12,938	(5,821)	4,846	7,181	0

Facility A is the amortising loan. Capital repayments begin in the next quarter, i.e. ending 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 ending 31 December 2023, and is unwound over the period until that date (see explanation on page 5 of Mercia's different recognition vs. the financial model).

From discussions with Mercia management, the lack of a draw down in the quarters 1 October 2014 to 31 December 2014 and 1 July 2016 to 30 September 2016 reflects both a delay in the EfW build (meaning less cash was required for the EfW build) and the lower-than-expected capital expenditure in non-EfW build (meaning that more of the cash can be used on the EfW build). Overall the actual loan drawdowns are still expected to match those forecast in the model.

At the end of Q1 2017 i.e. by the takeover date, the drawdown actuals match the modelled forecast. The difference in timing of the drawdowns is as a result of the above factors; predominantly differences between the programme and the milestones assumed in the model.

Appendix 1

Mercia's calculation (£000)

Cash Flow Test Calculation

	1 Jan 17 to 31 Mar 17 ACTUAL	1 Jan 17 to 31 Mar 17 MODEL
Profit Before Depreciation and Tax	5,356	6,673
Working Capital Movement (Operating)	-4,307	-4,234
Corporation Tax (Cash)	-	-426
Operating Cash Flow	1,050	2,013

Excess Cash Flow

	1 Jan 17 to 31 Mar 17 ACTUAL		
	Actual	Model	Var
Operating Cash Opening Balance	27,428	24,242	3,186
Operating Cash Flow (as above)	1,050	2,013	(963)
Operating Cash Closing Balance	28,478	26,255	2,223

Mercia's cash flow notice

Excess Cash – Opening Balance (Dec 2016)	3,186
Gross Revenue	-2,264
Operating Costs	+948
Changes in Working Capital	-73
Corporation Tax	+426
Total	-963
Excess Cash – Closing Balance (Mar 2017)	2,223

Appendix 2

Extracts from Senior Term Loan Facility Agreement

“Actual Construction Period Cash Flow Test” means the quarterly test to be carried out on each Actual Construction Period Cash Flow Testing Date, in relation to the preceding quarter 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;

“Actual Construction Period Cash Flow Testing Date” means each Quarter Date following Financial Close, up to and including Completion;

“Actual Construction Period Cash Flow Shortfall” has the meaning given to it in clause 15.9 (Actual Construction Cash Flow Test);

“Actual Construction Period Cash Flow Remedy Amount” means the minimum amount necessary following a failure by the Borrower of the Actual Construction Period Cash Flow Test, to pass such test;

“Actual Construction Period Excess Cash Flow 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 Cash Flow Test; and

“Base Cash 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

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;
- b) interest earned on all cash accounts (other than the Distribution Account);
- 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 the Financial Year, as reflected in the operating cash flow 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 costs 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;
- e) development costs; and
- f) in all cases, the equivalent lines thereafter in each Approved Budget and each Approved Financial Model.

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.

Appendix 2 (continued)

Extracts from Senior Term Loan Facility Agreement

Actual Construction Period Cash Flow Test

- a) On each Actual Construction Period Cash Flow Testing Date, the Borrower will provide evidence satisfactory to the Lenders (acting reasonably) that the Actual Construction Period Cash Flow Test has been satisfied.
- b) Where there is a failure by the Borrower to satisfy the Actual Construction Period Cash Flow Test on any Actual Construction Period Cash Flow Testing Date (an “**Actual Construction Period Cash Flow 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 Cash Flow 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.

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WASTE CREDIT GOVERNANCE COMMITTEE

14 JULY 2017

RISK REGISTER

Recommendation

- 1. The Chief Financial Officer recommends that:**
 - a) The open and closed risks set out in the Risk Register be considered.**
 - 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 was established which set out the unmitigated and mitigated risks associated with the loan arrangements. Now that takeover is complete and all but two of the risks have expired, they have been reclassified into open and closed. The two remaining open risks have been substantially mitigated.
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. Members should note that only two risks at this point remain open as the EfW Plant has now achieved Actual Takeover and both assessments of these risks are Green.
6. A copy of the Mercia Waste Loan Facility Repayment Analysis is attached as Appendix 2.

Contact Points

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Specific Contact Points for this report
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Supporting Information

- Appendix 1.1 – Risk Register Open Risks
- Appendix 1.2 – Risk Register Closed Risks
- Appendix 2 - Mercia Waste Loan Facility Repayment 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 - Open Risks

July 2017 - 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 have entered 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. An example is where ACS Construcción and Services S.A., through its subsidiary ACS Servicios y Concesiones S.L., executed the sale recently of its total interest in URBASER S.A. To Firion Investments S.L.U, a company controlled by a Chinese group. The Councils then obtained legal advice that reassured lenders that no action was required by any parties arising from this change in ownership, as there were no changes to the Shareholder (Urbaser Limited).	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.
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.

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

Waste Credit Committee Risk Register - Closed Risks
July 2017 - 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)	Reason why risk is closed
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 the loans commenced on planned takeover date 28th February 2017, as set out in the SLFLA and agreed final financial model. Repayments are not tied to the actual construction completion date of 2nd March 2017, rather the planned date. The Council as lender also had the right to call the loan into default if construction was not completed by a long stop date.	Substantial	Almost Impossible	5	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.	Takeover took place on 2nd March 2017.
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. The rates accessible by the Councils were lower than the estimate as the low gilt rate environment.	Substantial	Almost Impossible	5	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.	Takeover took place on 2nd March 2017. All loan payments have been made to Mercia Waste and the rates gained from PWLB were below those estimated in the prudential model.
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 borrowed from PWLB at dates in line with drawdown requests from Mercia. Therefore although the Councils will receive reduced interest receipts, less interest will also be paid to PWLB. The Councils monitored market gilt rates actively and had the option to borrow from PWLB up to a year in advance of expected drawdown requests. Regular progress reports were reviewed to ensure the construction programme and the loan drawdowns are requested in line with the plan.	Negligible	Almost Impossible	1	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.	Takeover took place on 2nd March 2017. All loan payments have been made to Mercia Waste.
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 were 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 were all 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.	Substantial	Almost Impossible	5	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.	Takeover took place on 2nd March 2017. All loan payments have been made to Mercia Waste within the required contracted time period.
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 provided assurance that they believe HZI undertook the right processes to replace the final ICL work packages and that there was no financial risk to the Sponsors. 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 had the right to call the loan into default if construction was completed by a long stop date, at which point the negotiated security package, set out in section 'a' above, would have taken effect.	Substantial	Almost Impossible	5	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.	The final ICL work packages were replaced and takeover took place on 2nd March 2017.

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 remained in place. Due Diligence was undertaken by Sponsors and the Council as Lender (with the Financial Advisor) confirmed the financial strength of HZI in light of events. There was 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 had sign off rights and requests were made to the Councils prospectively for Schedule 7 services and retrospectively (based on Sponsor Assurance) for non-Schedule 7 services. Meetings were held for sign off and Council advisors were retained to provide advice. The Councils clearly articulated to Sponsors that there should not be any weakening on the Security Package in place with regard to the Civil Engineering Work. All ICL work packages were replaced and there was no financial impact on Sponsors and therefore no financial impact on the Council as Lenders.	Substantial	Almost Impossible	5	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.	The final ICL work packages were replaced and takeover took place on 2nd March 2017.

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

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Very Low	2	6	13	17
Almost Impossible	1	5	7	16
	Negligible	Substantial	Critical	Extreme

Impact

LOAN DRAWDOWNS

Mercia Waste Loan Facility Repayment Analysis **July 2017**

Key

	Contracted WCC loan repayment paid to WCC
	Contracted WCC loan repayment overdue

Contracted Repayment Date	Contracted WCC Facility A (Amortising Loan) Repayment Principal (£)	Contracted wcc Facility A (Amortising Loan) Repayment Interest (£)	Contracted WCC Facility B (Bullet Loan) Repayment Interest (£)	Contracted WCC Total Loan Repayments (£)	Actual Repayments WCC Total Loan Repayments (£)	Actual Repayment Date
	£	£	£	£	£	
30/06/17	-1,040,534	-492,126	-2,047,115	-3,579,775		
31/12/17	-1,958,461	-713,478	-3,087,452	-5,759,391		
31/03/18	0	0	0	0		
30/06/18	-2,526,486	-648,624	-3,037,114	-6,212,224		
31/12/18	-1,785,384	-589,580	-3,087,452	-5,462,417		
31/03/19	0	0	0	0		
30/06/19	-2,544,044	-547,524	-3,037,114	-6,128,681		
31/12/19	-1,752,253	-491,419	-3,087,452	-5,331,125		
31/03/20	0	0	0	0		
30/06/20	-2,762,092	-436,013	-3,053,893	-6,251,999		
31/12/20	-1,442,458	-361,020	-3,087,452	-4,890,931		
31/03/21	0	0	0	0		
30/06/21	-3,091,770	-314,147	-3,037,114	-6,443,031		
31/12/21	-2,322,963	-230,047	-3,087,452	-5,640,462		
31/03/22	0	0	0	0		
30/06/22	-3,215,011	-164,927	-3,037,114	-6,417,051		
31/12/22	-2,426,131	-73,138	-3,087,452	-5,586,721		
31/03/23	0	0	0	0		
30/06/23	0	0	-3,037,114	-3,037,114		
31/12/23	0	0	-3,087,452	-3,087,452		
Total	-26,867,587	-5,062,043	-41,898,743	-73,828,373	0	

Please note that on 31st December 2023 the obligation for Mercia Waste to repay the Principal value on the Facility B (Bullet loan) of £97,061,268 will be negated as the ownership of the EFW Waste Plant is transferred to the Councils.

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WASTE CREDIT GOVERNANCE COMMITTEE

14 JULY 2017

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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