worcestershire countycouncil

AGENDA ITEM 5

WASTE CREDIT GOVERNANCE COMMITTEE
12 OCTOBER 2018

TECHNICAL UPDATE – EFW PLANT REPORTING REQUIREMENTS

Recommendation

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

   a) **the main categories of reports or information that the Borrower has to regularly produce and the Senior Term Loan Facility Agreement (STLFA) Assurance Statement for the Council attached as Appendix 1 be noted;**

   b) **the Performance operating report attached as Appendix 2 be noted;**

   c) **The Committee note and comment on the STFLA ratio calculation review conducted by KPMG as per exempt Appendix 3; and**

   d) **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. This report covers the reporting requirements post completion.

3. The Council commissioned Ashurst LLP to identify the Borrower's Regular Reporting Obligations under the Herefordshire and Worcestershire Waste Facility Agreement for the post construction Energy For Waste (EFW) period, as set out in the STLFA

4. The main categories of reports or information that the Borrower has to regularly produce going forward are:

- the Ratio Calculations report;
- the Ratio Compliance Certificate;
- reports in relation to financial and project information; and reports during the operating period

5. At the last meeting of the Committee in March 2018, members were informed that the first ratio testing was to be performed on the 30 June 2018 as the EfW Plant achieved Completion on 2 August 2017, following testing. Mercia Waste Management (MWM) has 40 working days to provide the output of their ratio analysis and then a review of these ratios are conducted by the lender (being the Council).

STLFA ratio calculation

Context

6. Ratios are a financial covenant imposed by Lenders as a monitoring mechanism to provide early warning of project distress and potential Borrower default on their repayment obligations. The ratios provide a measure of the project's historic and future performance in relation to its ability to service current and upcoming debt liabilities. In the event the ratios fall below a prescribed level, often referred to as the 'Lock-Up' level, then the Borrower will be unable to distribute any surplus cash within the project until a date when the ratios are above the required level. The 'locking-up' of cash incentivises the Borrower to rectify any operational issues which resulted in the ratios falling below the Lock-Up level in the first instance, whilst at the same time providing a level of buffer for Lenders to cover debt service in the short-term. There are principally three ratio calculations used by Lenders:

1) **Historic Annual Debt Service Cover Ratio ("ADSCR"):** A historic periodic measure used to assess the project's ability to service its current debt obligation over the preceding 12 month period.

2) **Projected ADSCR:** A forecasted periodic measure used to assess the project's ability to service its upcoming debt obligations for the proceeding 12 month period.

3) **Loan Life Cover Ratio ("LLCR"):** A forecasted measure used to assess the project's ability to repay the outstanding loan from future cash flows over the remaining life of the loan.

7. The Council commissioned KPMG to review the STLFA ratio calculation and their report is attached at exempt Appendix 3. The key points are highlighted in section 3 of the report which has received a red rating for the LLCR and projected ADSCR and amber for historic ADSCR. KPMG have stated the reason is due to the absence of an updated financial model. However, both the Council and Mercia Waste Management (MWM) were aware of this and the likely impact that this may have on the report outcome before requesting KPMG to conduct the ratio analysis. It is worth updating the Committee of the current position in relation to the variation model

Current position / variation model / savings & contract extension

8. A varied Model was presented to the Council by MWM in May 2015 and although ongoing discussions have taken place the Council only set out its final response during the summer of 2018. MWM has since prepared a comprehensive response, which the Council will need to respond to. Until both sides agree then the financial model cannot be updated and unfortunately was outside the timescales needed to use as a basis to update for the Ratio Testing. However, it is worth highlighting that the perceived variation(s) has no material effect on the Ratio Information.

9. Given the above circumstances, without an updated Model, the Base Case is a valid Model as per the Loan Facility (STLFA) and the Council has been in agreement with this approach taken by MWM and worked with MWM over several months on this basis.

10. The next ratio review is as at the 31 December 2018. Therefore based on the fact that MWM will provide the information after 40 working days and the Council will then need to have this externally verified, it is likely that the outcome would be around April 2019 on the basis that there has been an agreed updated financial model between both parties. The Committee should be aware that the Council is in negotiation with MWM as regards savings and the contract extension. These are likely to impact on the availability of an updated financial model in time for the next required ratio analysis testing.

KPMG Conclusions

11. It should be stressed that the Council has been working alongside MWM over many months regarding the STLFA and how to approach the ratio analysis required in the absence of an updated financial model. The Council is disappointed with the KPMG report and in particular that they did not liaise with MWM on the background and facts' regarding what was happening on the existing contract negotiations.

12. Although the overall KPMG outcome is red, the Council has gained assurance on the financial performance of the company from its annual accounts as well as the assurance statements provided as part of this report. This together with the evidence that MWM have continued to meet their repayment obligation in full and on time provides sufficient assurance from a Council perspective.

13. In order to ensure that a more robust ratio analysis report is bought back to Committee in future it will not request the analysis to be conducted until an approved financial model has been approved.

Assurance Statement

14. It was agreed that twice a year, for the March and September Committees, Mercia Waste Management (MWM) would produce a short, high level assurance statement (Appendix 1). The aim being to reassure the Lender (the council) that there is no material matters which would impair MWM's ability to repay the Loan in accordance with the Financial Model in the coming period. Another purpose of the statement is to cover the deficiency of the Loan Agreement Reporting in respect of the "Non – EFW" part of the MWM business.

15. Also as part of the contract post completion a performance operating report is required quarterly. This is attached as Appendix 2 to this report.

16. **Please note that Appendix 3 contains exempt information (on salmon pages) and should members wish to discuss the information included in this Appendix they would need to consider passing the appropriate resolution and moving into exempt session.**

Contact Points

County Council Contact Points
County Council: 01905 763763
Worcestershire Hub: 01905 765765

Specific Contact Points for this report
Rob Wilson
Pensions Investment, Treasury Management & Capital strategy manager
Tel: 01905 846908
Email: RWilson2@worcestershire.gov.uk

Supporting Information

Appendix 1 - the Senior Term Loan Facility Agreement (STFLA) Assurance Statement
Appendix 2 - Performance Operating Report to November 2017
Appendix 3 - STLFA ratio calculation review conducted by KPMG **(Exempt information – Salmon pages)**

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.