Waste Credit Governance Committee
Monday, 20 October 2014, 9.30 am, County Hall, Worcester

	Minutes
Present:	Mr W P Gretton (Chairman), Mr L C R Mallett (Vice Chairman), Mr R C Adams, Mrs S Askin, Dr K A Pollock and Mr P A Tuthill
Available papers	The Members had before them the agenda papers (previously circulated).
1 Named Substitutes (Agenda item 1)	Dr K A Pollock for Mr M H Broomfield.
2 Apologies/ Declarations of Interest (Agenda item 2)	Apologies were received from Mr M H Broomfield and Mr P Denham.
3 Public Participation (Agenda item 3)	None.
4 Waste Credit Governance Committee - Terms of Reference (Agenda item 4)	The establishment of the Committee was intended to underline the separation between the Council's two roles as lender and as waste disposal authority. The Cabinet, not the Committee, would remain responsible for decisions in respect of the operation of the waste contract or any waste disposal authority executive functions. The Cabinet would have no supervisory or other responsibility for the Committee. Council had agreed that Mr W P Gretton would be appointed Chairman and Mr L C R Mallett as Vice-Chairman. Council also agreed that the Committee would be cross-party with 9 members established in accordance with the legal requirements of political balance and would not include any members of Cabinet. At the meeting of Council on 15 May, it was reported that meetings of this Committee would be anticipated to be held approximately every other month during the construction phase of the Energy from Waste plant, and less frequently thereafter. It was therefore proposed that meetings of the Committee be arranged on this basis.

The Chief Financial Officer made the following points in introducing the terms of reference:

- The Chief Financial Officer explained that the Committee needed to understand the risks associated with the contract and be comfortable with how the risks were being discharged or mitigated. A report on the risk register would be brought to a future meeting
- The Committee needed to be satisfied that the loan repayment targets were being met by Mercia Waste Management (Mercia). It was likely that in the future, Mercia would wish to vary the contract (by means of a waiver or consent). In most circumstances such a request would be delegated to the Chief Financial Officer, however he would bring significant matters to the Committee for example, matters that could lead to default in repayment. However all such matters would be reported to the Committee, whether delegated or not
- There were various actions that the County Council as lender could take in a default situation to provide security for the loan for example, taking on shares or assets in Mercia in lieu of repayment of the loan. However he anticipated that such arrangements would not be necessary.

In the ensuing debate, the following principal points were raised:

- Who had responsibility for monitoring the project management aspects of the contract and for delivering the project on time and to cost? The Chief Financial Officer explained that Mercia Waste Management were responsible for ensuring that the project was delivered on time and to cost. Even if the facility was not built on time, Mercia was still committed to repaying the loan. In addition a number of obligations had been included in the contract (termed a "security package") to protect the loan arrangements. The Council had managed to negotiate arrangements that were better than the market could provide
- In response to a query about the governance arrangements associated with the contract, the Chief Financial Officer commented that governance of the loan arrangements for the contract had been separated from the executive function of the Council. Council had established this Committee to oversee the loan arrangements

whilst Cabinet oversaw the purchaser side of the arrangements. It was important that there was a separation of these responsibilities for example, should the loan repayments be at such a risk that the senior term loan facility may enter into default. This would impact on the service provision and therefore there might be a potential conflict of interest if both duties were discharged by Cabinet. The decision to call on loan default was therefore reserved for Council

- Would the Committee meeting every two months be too frequent? The Chief Financial Officer stated that it was potentially too early to judge at this stage but a clearer picture would be given after the first couple of meetings once the Committee were able to consider the items arising at each meeting.

RESOLVED that:

a) **the Terms of Reference for the Waste Credit Governance Committee be noted; and**

b) **meetings be held approximately every other month during the construction phase of the Energy from Waste plant, and less frequently thereafter.**

5 General overview of the waste project (Agenda item 5)

The Committee received a presentation by the Chief Financial Officer which clarified the financial relationship with Mercia Waste Management Limited, the relationship of this Committee with Council, Cabinet and officers, features of the loan facility to Mercia Waste Management Ltd, the retained advisors to support the Committee and officers, waivers and consents, and provided a reminder of what the loan facility is for.

It was proposed that members of the Committee visited the site of the proposed Energy from Waste plant in Hartlebury.

The Chief Financial Officer made the following points in his presentation:

- The Committee's role was to consider how non material issues had been discharged between meetings by the Chief Financial Officer and to consider for escalation to Council any critical issues such as potential defaulting of the loan arrangements. This was a matter that could not be delegated to officers given its consequence and implications for the Council in its Waste Disposal Authority role

- Complete separation of roles was required in relation to the Senior Term Loan Facility (STLFA) between this Committee and the Cabinet's responsibilities as the Waste Disposal Authority. Members should be aware of this element of separation when considering matters of confidentiality at this Committee
- The day-to-day management of the STLFA including waivers and consents was delegated to the Section 151 Officer. However he would consult the Chairman and Vice-Chairman of the Committee before taking action in relation to any consents and waivers that were significant in nature
- The loan arrangements had to be at a commercial rate because the Council could not be seen to be providing Mercia with a commercial advantage. If Mercia were unable to pay back the loan then it was necessary for them to have access to other means of payment
- Quarterly construction period cash flow tests would be undertaken to ensure that Mercia were turning over enough money to cover their equity for the project. If there were concerns about the company's turnover then controls could be put in place to secure the loan arrangements that were set out within the STLFA
- Cover ratios had to be maintained by Mercia to ensure that they had enough money in reserve to cover future payments. If there were any concerns about the Cover Ratio, then controls would be introduced to secure the loan arrangements
- Fichtner Consulting Engineers Limited had been appointed as the technical advisors to the project. There were two parts of this company, one of which was advising Mercia. The Council had received guarantees from the company regarding confidentiality and 'chinese walls'
- Ashurst had been appointed as the legal advisors to the project and had lowered their fees to government rates to ensure that their bid to undertake the work demonstrated good value
- Subject to the agreement of Cabinet, it was intended to appoint Deloitte as the financial advisor to the contract
- All costs associated with the work of the advisors were recharged to Mercia and any additional costs would also be borne by Mercia

- The repayment of the loan was the responsibility of Mercia over the 10 year loan period. There was a risk that when the facility was handed over to the Council it would not be worth the payment of £128m. There was a very strict handover regime and regular tests would be undertaken to envisage the value of the plant to be handed over at the end of the contract. These tests would be escalated nearer the end of the loan period. Mercia could be penalised by withdrawal of funding if the Council was not satisfied with the handover arrangements. (This was a Waste Disposal Authority responsibility/risk rather than loan) In addition, when the Council takes over the operation of the facility in 2023, the Council would be in the position to offer capacity to other users. With the change in attitudes to waste recycling following the recession, it was important to have a facility to deal with anticipated residual waste and this was set out in the December 2013 Cabinet Report
- The intention was that on 31 December by 2023, the plant would be handed over to the councils. The STLFA contained a mechanism that could be used to negate the obligation for Mercia to repay the outstanding loan facility and in return for the Council to review the asset for nil consideration to avoid the need to borrow £0.25 billion on one business day
- There was a 31 day cycle to cater for the request from the Mercia's EPC contractor for payment until the money being made available for payment by Mercia to the Contractor (after drawing down on the STLFA) to minimise any working capital costs in the Mercia supply chain.

In the ensuing debate, the following principal points were raised:

- What was the role of Herefordshire Council in any consideration over a potential default in repayment of the loan? The Chief Financial Officer advised that both councils would need to work closely with each other and arrive at the same conclusion before any decision could be made in relation to a default situation
- How would the Council gain a surplus from the loan arrangements? The Chief Financial Officer explained that the Council would be lending at a higher rate than it borrowed. When the original PFI arrangements were agreed for the contract in

1998, the Council took up a significant proportion of the risk associated with the project and therefore the Council was already taking much of the risk that a bank now took on PFI projects as funder. This was explained in full within the January 2014 Council report

- How close was the Council to its prudential borrowing limit as a result of these arrangements? The Chief Financial Officer stated that the Council had a prudential borrowing limit of around £450m. Within this the Council had obtained internal borrowing of £200m. Therefore significant headroom remained within the Credit Ceiling/Borrowing Limit. The January Council had extended the credit ceiling by the value of the loan – by around £125 million
- Was the anticipated completion date of February 2017 the trigger date for the repayment of the loan? The Chief Financial Officer advised that this date related to the completion of the construction with the plant up and running. There were a limited number of situations that could lead to an extension of this date but Mercia would need to prove that such an event could be classed as a 'relief event'
- What impact would a fire at the plant site have on the loan arrangements? The Chief Financial Officer commented that events of this nature were insured by Mercia and Mercia remained committed under the STLFA to meet the loan repayments as planned
- Were the arrangements for the loan unique? The Chief Financial officer explained that the arrangements were not unique but it was the first time that they had been introduced in the context of a waste PFI contract
- In response to a query, the Chief Financial Officer explained that it was important that the Council made arrangements to handle its waste within the county. At present it was difficult to arrange contracts with external providers. The Council was only able to arrange short term contracts at present for example with Coventry City Council for the disposal of residual waste
- Were there any issues that had an impact on the loan arrangements arising from the original plans to locate the facility at the British Sugar plant site in Kidderminster? The Chief Financial Officer commented that planning permission for this site had been refused and as a result the Council was required to take more waste to landfill. The

government had already funded the project under a PFI agreement and this money had therefore been used to pay for alternative disposal arrangements in the absence of this infrastructure. This was fully explained in the December 2013 Cabinet Report
- A visit by members of the Committee to the location of the EfW plant was welcomed. If possible, members would wish to see a video of how the plant would operate.

RESOLVED that:

a) The content of the presentation by the Chief Financial Officer be noted; and

b) Arrangements be made for members of the Committee to visit the proposed site.

6 Questions on the Cabinet Report to Council - 16 January 2014 (Agenda item 6)

Members were provided with an opportunity to ask questions around the loan relationship for the Energy from Waste contract. Members were reminded that the purpose of this Committee was not to review the decision-making process.

In the ensuing debate, the following questions were raised:

- Did the £6.6m uplift in the Unitary Charge from the point of operation of the EfW plant, as compared to the £6m indicative affordability envelope, mean that the Council could benefit from an extra £600,000 per annum? The Chief Financial Officer commented that at the closure of negotiations, an uplift of £3.5m had been agreed which was significantly below the £6 million affordability
- In response to a query, the Chief Financial Officer explained that a security package had been negotiated with Mercia and the EPC Contractor that protected the Council as the lender from risks associated with the construction of the plant to the extent that would be expected within an STLFA negotiated by a commercial bank
- Was the interest rate on the loan to Mercia variable? The Chief Financial Officer explained that the loan was at a fixed rate
- Would an increase in the interest rate on the PWLB loan have an impact on the financial arrangements for the Council? The Chief Financial Officer commented that such an increase would have an impact on the Council's surplus

generated from the loan arrangements however if the rate decreased, it would benefit the Council. The Council's balance sheet had £12m set aside to cover risks of this nature

- Within the contract, the Council was liaising with Swiss and Spanish companies, had the impact of exchange rates been taken into account in the funding of the loan arrangements? The Chief Financial Officer stated that Mercia's construction firm contractor had entered into forward contracts for the purchase of foreign currencies to mitigate this risk
- What was the reason for the Council taking over the banking arrangements for the loan? The Chief Financial Officer stated that at the time the arrangements were being negotiated, banks were unwilling to make loan arrangements for these types of projects or offering them at a significant premium due to the impact of the global financial crisis. In addition, the Council was able to put the loan arrangements into effect at a faster rate than a commercial bank would be able to do.

RESOLVED that the contents of the Cabinet Report to Council on 16 January 2014 be noted.

7 Progress summary from Technical Advisors (Agenda item 7)

Fichtner Consulting Engineers had been appointed as technical advisor to the lender during the construction phase of the Energy from Waste plant and were part of the Council's separate advisor team that had supported negotiations with the Special Purpose Vehicle and the Council's review from a funding perspective of the contract variation. The company had produced a summary report for consideration by the Committee.

In the ensuing debate, the following principal points were raised:

- The Chief Financial Officer undertook to circulate an update on the activities of the Council's legal advisors to members of the Committee
- Had the clay deliveries to the adjacent brick works been concluded? The Chief Financial Officer commented that the matter had not been flagged by Fichtner as an ongoing risk however he would provide an update for members
- Was the Chief Financial Officer able to provide an update in relation to milestones 2 and 4 which the report indicated would be achieved in October? The Chief Financial Officer indicated that there had been no drawdown request to the lender. It

was possible that the arrangements could slip into November. Either way, the arrangements would benefit the Council in terms of the financial arrangements for the loan – and the Technical consultants at this point had not flagged a construction completion date risk

- The report was dated 6 October and yet it referred to arrangements in September as being in the future. The Chief Financial Officer undertook to discuss the style of the report with Fichtner.

RESOLVED that the summary report from Fichtner Consulting Engineers – Technical Advisors be noted.

8 Waivers granted (Agenda item 8)

Part of the Committee's Terms of Reference was 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.

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

One non material waiver had been granted to date for the extension of time to lodge the financial close financial model with the custodian as this was largely administrative procedure. The Committee was asked to endorse the decision to grant the waiver.

In the ensuing debate, it was requested that a future report be brought to the Committee on behalf of the newly appointed Financial Advisors.

RESOLVED that the decision by the Chief Financial Officer to grant a waiver for the extension of time to lodge the financial close financial model with the custodian be endorsed.

The meeting ended at 11.05 am

Chairman …………………………………………….