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Worcestershire County Council

Agenda

Waste Credit Governance Committee

Monday, 20 October 2014, 9.30 am
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
Monday, 20 October 2014, 9.30 am, County Hall, Worcester

Membership: Mr W P Gretton (Chairman), Mr L C R Mallett (Vice Chairman), Mr R C Adams, Mrs S Askin, Mr M L Bayliss, Mr M H Broomfield, Mr P Denham, Mr J W Parish and Mr P A Tuthill

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 17 October 2014). Further details are available on the Council's website. Enquiries can be made through the telephone number/e-mail below.	
4	**Waste Credit Governance Committee - Terms of Reference**	1 - 4
5	**General overview of the waste project**	5 - 20
6	**Questions on the Cabinet Report to Council - 16 January 2014**	21 - 60
7	**Progress summary from Technical Advisors**	61 - 64
8	**Waivers granted**	65 - 66

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 766621, slewis@worcestershire.gov.uk

All the above reports and supporting information can be accessed via the Council's website at http://www.worcestershire.gov.uk/cms/democratic-services/minutes-and-agenda.aspx

Date of Issue: Thursday, 9 October 2014

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Waste Credit Governance Committee
20 October 2014

4. WASTE CREDIT GOVERNANCE COMMITTEE – TERMS OF REFERENCE

Recommendation

1. **The Head of Legal and Democratic Services recommends that:**

   a) the Terms of Reference for the Waste Credit Governance Committee as set out in the attached Appendix 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.

Introduction

2. At the meeting of Council on 15 May, Council agreed to the establishment of a Waste Credit Governance Committee to have oversight of the actions of the Council acting as lender to the waste project and its waste contractor Mercia Waste Management Ltd (Mercia). The Terms of Reference as agreed by Council are set out in the Appendix.

3. 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.

4. The Committee will be advised by external financial and legal advisers on behalf of the Council's s151 officer and will also seek advice as appropriate from the Council's statutory officers including the Council's Monitoring Officer and Section 151 Officer.

Membership

5. Council has 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.

Frequency of meetings

6. 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 is therefore proposed that meetings of the Committee be

arranged on this basis.

Supporting Information

- Appendix - Waste Credit Governance Committee Terms of Reference

Contact Points

County Council Contact Points
Worcester (01905) 763763, Kidderminster (01562) 822511 or Minicom: Worcester (01905) 766399

Specific Contact Points for this Report
Simon Lewis – Committee Officer
01905 766621, slewis@worcestershire.gov.uk

Background Papers

In the opinion of the proper officer (in this case the Head of Legal and Democratic Services) the following are the background papers relating to this report:

Agenda papers and Minutes of Council on 15 May 2014

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Final: May 2014

Appendix E: Waste Credit Governance Committee Terms of Reference

To have oversight of the actions of the Council acting as lender to the waste project and its waste contractor Mercia Waste Management Ltd (Mercia);

(a) To review, in conjunction with external advisers advising the Council as lender, 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;

(b) To monitor the administration of the loan to the waste project in line with best banking practice having regard to any such external advice, including the terms of any waivers or amendments which may be required or are desirable;

(c) To consider what steps should be taken to protect the interests of the Council as lender in the event of a default or breach of covenant by Mercia, and make recommendations as appropriate to Full Council, the Council's statutory officers or Cabinet as appropriate to ensure the appropriate enforcement of security and litigation in relation to the loan to Mercia;

(d) To consider and recommend appropriate courses of action to protect the position of the Council as lender to the waste project;

(e) To make recommendations as appropriate to Council with regard to its Budget and Policy Framework and the loan to the waste project;

(f) Generally to take such other steps in relation to the loan within the scope of these Terms of Reference as the Committee considers to be appropriate.

Notes

- The Committee will be cross-party with 9 members established in accordance with the legal requirements of political balance
- The Committee will not contain any current members from time to time of the Cabinet
- The Committee will be chaired by a Councillor appointed by full Council. The Vice-Chairman will be from a Group other than that forming the present administration
- The Committee will be advised by external financial and legal advisers on behalf of the Council's s151 officer and will also seek advice as appropriate from the Council's statutory officers including the Council's Monitoring Officer and Section 151 officer
- The Committee will meet in public (unless the grounds for exemption are met under the Access to Information legislation) and upon at least 5 working days notice (unless called sooner as a matter of urgency) in accordance with that legislation
- The Committee will not be responsible for decisions in respect of the operation of the waste contract or any waste disposal authority executive functions
- The Committee will not be accountable to the Cabinet
- The Committee may decide matters within its terms of reference or refer them to full Council, statutory officers or Cabinet for determination

As the Committee regulates or controls the finance of the Council (in relation to the funding provided to Mercia) the law does not permit co-optees to sit as members of the committee by virtue of s102(3) LGA 1972.

However, in order to benefit from a clearer separation of roles, the Committee may be advised by an external financial expert who will report to the Committee, attend its meetings and provide expert advice to it. As necessary, the Committee may also receive legal advice from an external firm of solicitors with expertise in banking law. The Council's s151 officer and Monitoring Officer will retain their overarching statutory roles in respect of the Committee.

The Cabinet, not the Committee, will continue to be responsible for exercising the role of the Council's executive, acting as a waste disposal authority within the overall Budget and Policy framework set by the Council. The Cabinet will have no supervisory or other responsibility for the Committee.

[As approved by County Council - May 2014]

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Waste Credit Governance Committee
20 October 2014

5. GENERAL OVERVIEW OF THE WASTE PROJECT

Recommendation

1. **The Chief Financial Officer recommends 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.

Introduction

2. The Chief Financial Officer will present an overview of the waste project to the Committee. The presentation will clarify 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 provide a reminder of what the loan facility is for. A copy of the slides for the presentation is attached as an Appendix.

Site visit

3. Members of the Committee may find it beneficial to visit the site of the proposed Energy from Waste plant in Hartlebury therefore it is proposed that a site visit is arranged accordingly.

Supporting Information

Appendix – General overview of the waste project – presentation slides

Contact Points

County Council Contact Points
Worcester (01905) 763763, Kidderminster (01562) 822511 or Minicom: Worcester (01905) 766399

Specific Contact Points for this Report
Sean Pearce – Chief Financial Officer
01905 766268. 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 this report.

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First briefing for the Waste Credit Governance Committee

Sean Pearce – Chief Financial Officer

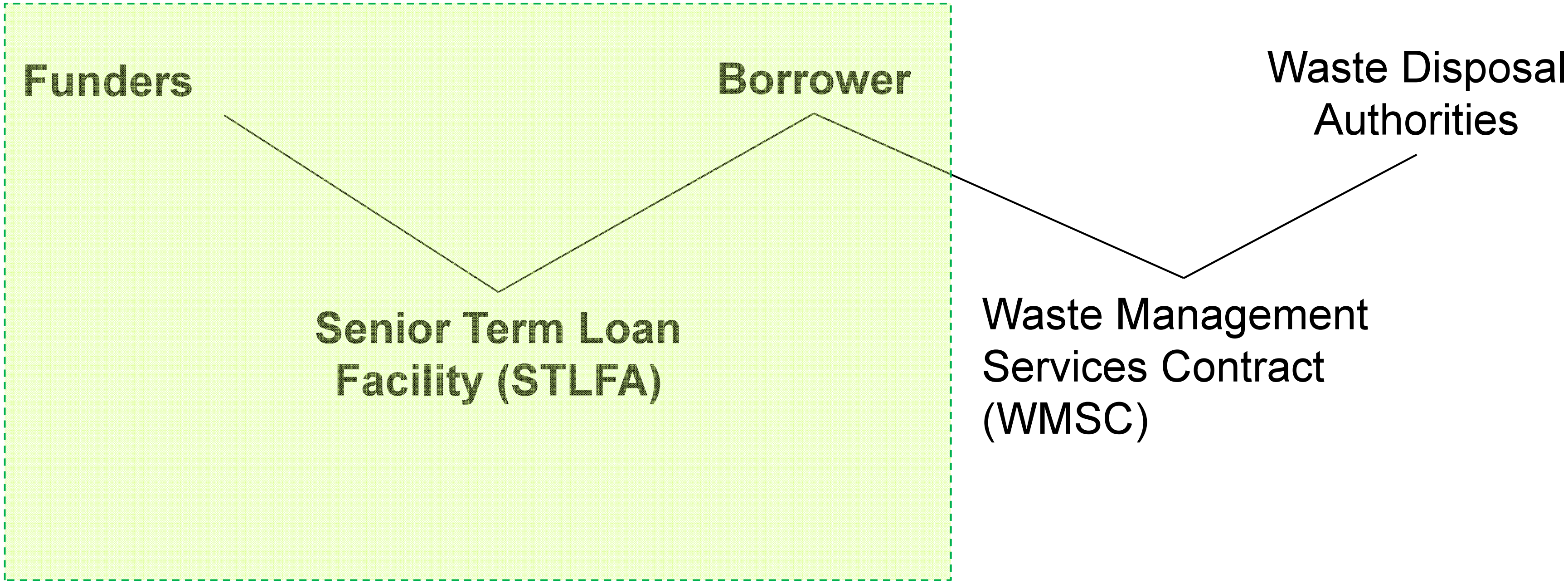
Plan for briefing to the Committee

1. Clarification of the financing relationship with Mercia Waste Management Limited
2. Committee relationship with Full Council, Cabinet and Officers
3. Features of the loan facility to Mercia Waste Management Ltd the Senior Term Loan Facility (STLFA)
4. Retained advisors to support the Committee and officers
5. Waivers and Consents
6. Reminder of what the loan facility is for

The financing relationship with Mercia Waste Management Limited

Role	Loan Facility	Borrower/ Service Provider	Waste Disposal Authority
Organisation	County of Herefordshire Council Worcestershire County Council	Mercia Waste Management Services (the Special Purpose Vehicle or SPV)	Worcestershire County Council County of Herefordshire Council
Governance	Waste Credit Governance Committee (WCC) Audit Committee (HCC)	Contracts Meetings	Joint Waste Advisory Steering Group Respective Cabinets

The financing relationship with Mercia Waste Management Limited



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The intended Committee's relationship with Full Council, Cabinet and Officers

Full Council

- Subcommittee of Full Council with periodic reporting of work undertaken by Committee
- Escalation of critical issues such as potential defaulting of the loan arrangements

Cabinet

- Complete separation required by the STLFA between this Committee and the Cabinet's responsibilities as the Waste Disposal Authority
- Any conflict of interest between this Committee and Cabinet is formally intended to be handled at Council level

Officers

- Delegation of day to day management including waivers and consents that are not material to the STLFA to the Section 151 Officers

Key features of the loan facility

- The Councils are funding the Facility through their own Prudential Borrowing
- Funds are obtained by the Councils shortly before issuing to Mercia
- Drawdowns occur over a 33 month construction period, interest is rolled up over that period. Current drawdowns to date are circa £22 million
- Repayments are forecast to commence around February 2017 – this is a risk taken by Mercia
- The Council's main controls are around:
  - Authorisation of drawdowns
  - Technical reports on the progress of the Project by the Owners Engineer that are independently tested
  - Quarterly Construction Period Cash flow tests on Mercia
  - Cover Ratios that have to be maintained by Mercia

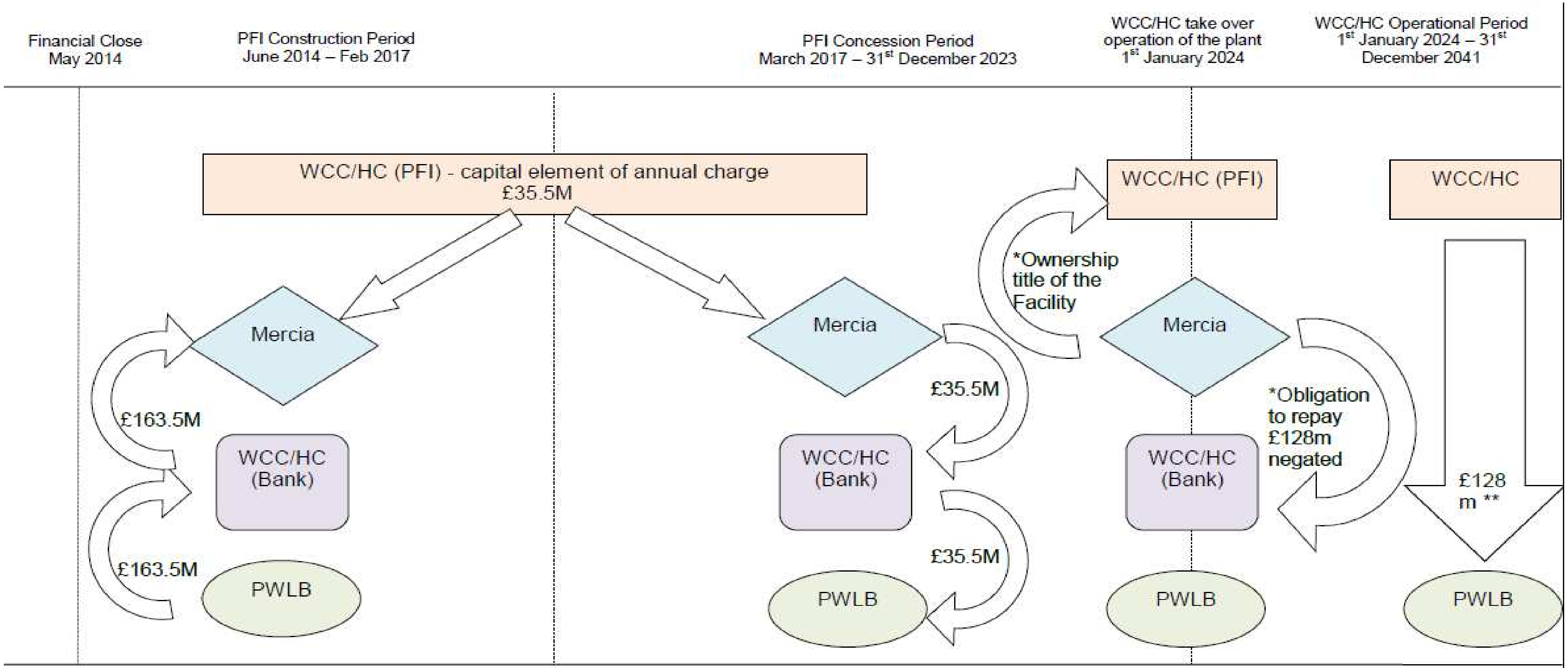
Retained advisors to the Chief Financial Officer

- Joint duty of care to both Councils
- Two contracts novated at financial close:
  - Fichtner Consulting Engineers Limited – Technical Advisors
  - Ashurst – Legal Advisors
- Financial Advisors are now subject to an Invitation to Tender – announcement of preferred provider is pending with contract award due shortly before the first meeting of the Waste Credit Governance Committee
- All costs are recharged to Mercia Waste Management Limited – any cost overruns are their risk

Key features of the loan facility

- £163.5 million - Total Facility size, split into:
  - £35.5 million repayment loan over 10 years
  - £128 million Bullet Tranche
- £163.5 million – Total Facility size, split by funder:
  - £123.9 million (75.8%) Worcestershire County Council
  - £39.6 million (24.2%) Herefordshire Council
- Life of Loan is 10 years with the amortising tranche having been repaid by Year 10 and the Bullet Tranche being refinanced by the Councils
- At Year 10 the Bullet Tranche = the forecast Net Book Value of the Energy from Waste plant

Senior Term Loan Principal Flow Chart



* WCC/HC (Bank) relieves Mercia of their obligation to pay the bullet payment to WCC/HC (bank) on 31/03/2023. Mercia pass over to WCC/HC the ownership title of the Facility, with NBV of £128m, on 31/03/2023.

**The £128m repaid by WCC/HC to PWLB during the WCC/HC Operational Period continues on an amortising basis.

Note: Loan interest charges and receipts not included

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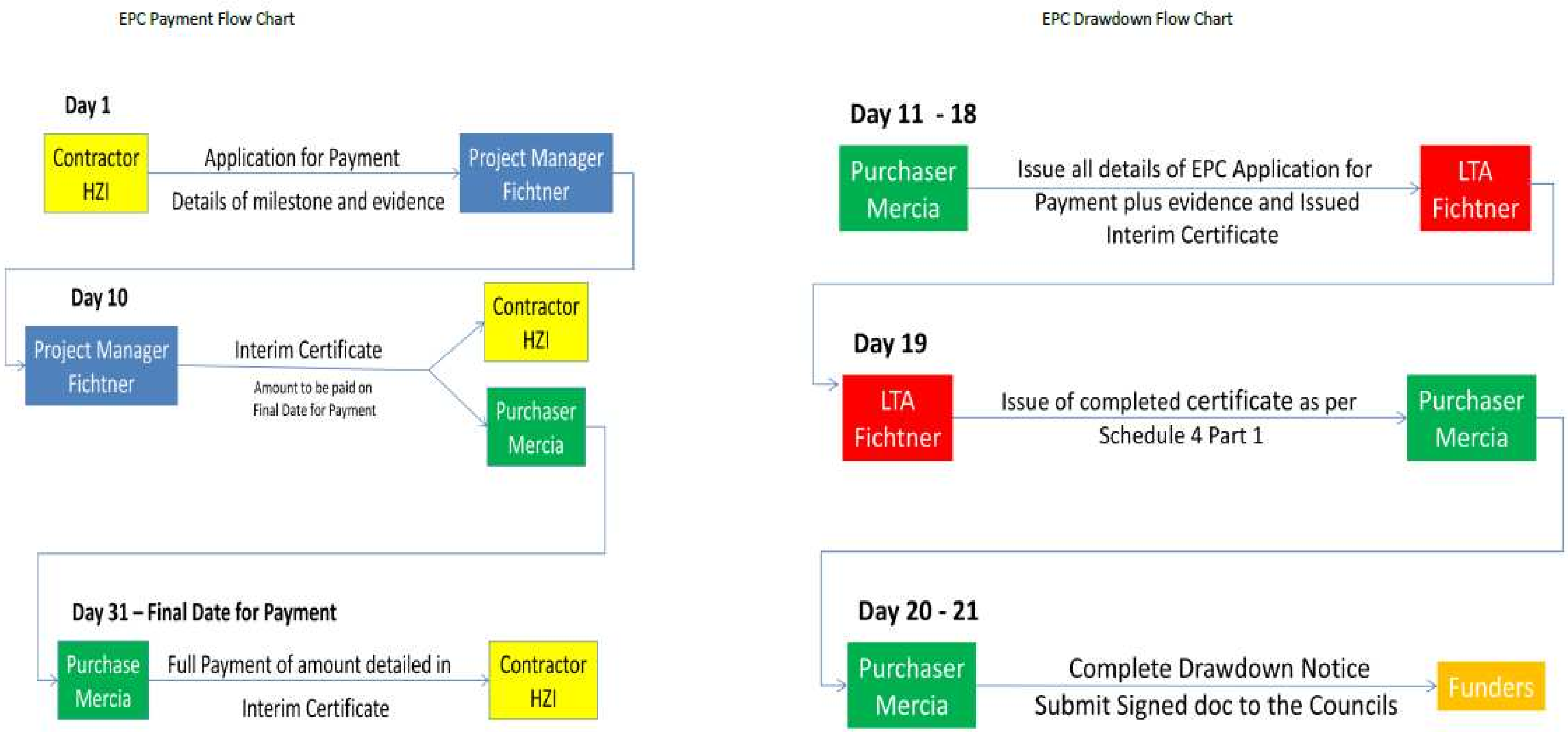
EPC Payment Application and Drawdown Flow Chart



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Mercia Principal and Interest Payments to WCC/HC (Bank)

	units	total	01-Jan-17 31-Mar-17	01-Apr-17 30-Jun-17	01-Jul-17 30-Sep-17	01-Oct-17 31-Dec-17	01-Jan-18 31-Mar-18	01-Apr-18 30-Jun-18	01-Jul-18 30-Sep-18	01-Oct-18 31-Dec-18	01-Jan-19 31-Mar-19	01-Apr-19 30-Jun-19	01-Jul-19 30-Sep-19	01-Oct-19 31-Dec-19	01-Jan-20 31-Mar-20	01-Apr-20 30-Jun-20
Annuity Tranche																
£ 35,445																
Principal repaid	£ 000s	35,445	-	1,373	-	2,584	-	3,333	-	2,355	-	3,356	-	2,312	-	3,644
Post Construction Interest paid	£ 000s	6,670	160	484	471	471	425	430	389	389	354	369	324	324	287	287
Total	£ 000s	42,116	160	1,857	471	3,054	425	3,763	389	2,744	354	3,725	324	2,636	287	3,931
Bullet Tranche																
£ 128,049																
Post Construction Interest paid	£ 000s	55,214	0	2,661	0	4,073	0	4,007	0	4,073	0	4,007	0	4,073	0	4,018
Total	£ 000s	66,214	-	2,661	-	4,073	-	4,007	-	4,073	-	4,007	-	4,073	-	4,018
Total Principal and Interest		97,330	160	4,518	471	7,128	425	7,770	389	6,817	354	7,732	324	6,709	287	7,949

	01-Jul-20 30-Sep-20	01-Oct-20 31-Dec-20	01-Jan-21 31-Mar-21	01-Apr-21 30-Jun-21	01-Jul-21 30-Sep-21	01-Oct-21 31-Dec-21	01-Jan-22 31-Mar-22	01-Apr-22 30-Jun-22	01-Jul-22 30-Sep-22	01-Oct-22 31-Dec-22	01-Jan-23 31-Mar-23	01-Apr-23 30-Jun-23	01-Jul-23 30-Sep-23	01-Oct-23 31-Dec-23
Annuity Tranche														
£ 35,445														
Principal repaid	-	1,903	-	4,079	-	3,065	-	4,241	-	3,201	-	-	-	-
Post Construction Interest paid	237	237	206	208	152	152	107	111	48	48	0	0	0	0
Total	237	2,140	206	4,287	152	3,216	107	4,352	48	3,249	0	0	0	0
Bullet Tranche														
£ 128,049														
Post Construction Interest paid	0	4,062	0	4,007	0	4,073	0	4,007	0	4,073	0	4,007	0	4,073
Total	-	4,062	-	4,007	-	4,073	-	4,007	-	4,073	-	4,007	-	4,073
Total Principal and Interest	237	6,202	206	8,294	152	7,289	107	8,359	48	7,322	0	4,007	0	4,073

Additional Income

£4.1m of front end fees received in May 2014.

£2.7m commitment fees to be rolled up into loan

Waivers and Consents

One non material waiver granted to date as follows:

- Extension of time to lodge the financial close financial model with the custodian as this is largely administrative

What the Loan Facility is being used for

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Waste Credit Governance Committee
20 October 2014

6. QUESTIONS ON THE CABINET REPORT TO COUNCIL – 16 JANUARY 2014

Recommendation

1. **The Chief Financial Officer invites questions on the Cabinet report to Council on 16 January 2014 in relation to the Waste Management Services Contract.**

Introduction

2. Members will recall that Council considered the Cabinet report on the Waste Management Services Contract at its meeting on 16 January 2014. This report provides a useful overview of the background, context, details of the proposed loan arrangements, the funding risk management, additional requirements of the Capital Programme, changes required to the Treasury Management Policies, impact on the Medium Term Financial Plan, the proposed governance arrangements to safeguard the provision of funding, and Defra and her majesty's Treasury. A copy of the report and associated appendices is attached as an Appendix.

3. As this is the first meeting of this Committee, it was considered beneficial to remind members of the content of the report and provide members with an opportunity to ask questions around the loan relationship which will help them discharge their roles. Members are reminded that the purpose of this Committee is not to review the decision-making process.

Supporting information

- Appendix – Cabinet Report to Council – 16 January 2014

Contact Points

County Council Contact Points
Worcester (01905) 763763, Kidderminster (01562) 822511 or Minicom: Worcester (01905) 766399

Specific Contact Points for this Report
Sean Pearce – Chief Financial Officer
01905 766268. spearce@worcestershire.gov.uk

Background Papers

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

Agenda papers and Minutes of the meeting of Council on 16 January 2014

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16 January 2014

7. REPORTS OF CABINET

(a) MATTERS WHICH REQUIRE A DECISION BY COUNCIL

Waste Management Services Contract

Recommendation

1. The Cabinet recommends that having regard to any further report direct from the Director of Resources on the details of the Council's position as potential providers of appropriate funding for the project, to:

i. amend its Treasury Policy Strategy and associated Treasury Management Statements and authorise a loan of up to £125 million (noting that Herefordshire Council intend to loan £40 million) to Mercia Waste Management Ltd (Mercia) for the purposes of the varied Waste Management Service Contract (WMSC) (Option 2);

ii. add up to £125 million to the Council's Capital Programme in order to enable the Council to provide such a loan to Mercia;

iii. authorise the Director of Resources to take all necessary steps to obtain the funding for Option 2 from the Public Works Loan Board;

iv. amend the Medium Term Financial Plan as appropriate;

v. consider whether any arrangements are appropriate to ensure that the Council is able to properly take account of its interests as both the Waste Disposal Authority and as the funder; and

vi. authorise the Director of Resources to finalise a loan agreement with Mercia and advance funds as authorised above to Mercia by way of stage payments, properly authorised by the Councils' independent certifier, as a loan repayable over the remaining life of the WMSC.

2. The Cabinet has considered recommendations for handling residual waste for Herefordshire Council and Worcestershire County Council. All Councillors will have had

a copy of the full report and Appendices considered by the Cabinet on 12 December 2013 and are referred to it for detail. Waste management is an executive function, and Cabinet has agreed to pursue Option 2 (variation of the existing WMSC to build an EfW at Hartlebury Trading Estate, funded by prudential borrowing). Council is now being asked to approve the related budget decisions to put this into effect.

3. The report considered by the Cabinet advised that doing nothing would cost the two councils £128m (Net Present Cost) more than the recommended option. The report included the background to the current Waste Management Service Contract (WMSC) with Mercia Waste Management (Mercia) that was let in 1998 for the disposal of all Local Authority Collected Waste arising within the two counties. This contract was for 25 years and whilst focused on recycling and recovery outputs it included the provision of waste management infrastructure, including: a Mixed Waste Material Reclamation Facility (MRF), Transfer Stations, Pre-Sorted MRF, Household Waste Sites (now Household Recycling Centres), Operations and Management of Hill and Moor Landfill, Construction and operation of a Waste to Energy Plant (the more modern terminology is Energy from Waste) and Composting facilities. In 1998 this was a pathfinder PFI project for waste disposal and it is important to remember that it was based on an EfW solution for dealing with residual waste (albeit in Kidderminster).

4. As set out in previous reports, the original Kidderminster Waste to Energy Plant site did not receive planning consent, and Mercia were asked to develop further proposals for the disposal of residual waste. Mercia proposed the construction and operation of an Energy from Waste (EfW) plant processing 200,000 tonnes of residual waste per annum. The EfW proposal had been supported in principle by the two Councils since 2009 and officers were authorised to negotiate a variation to enable the EfW proposal to be progressed. Following a call-in Planning Inquiry by the Secretary of State, planning permission was secured by Mercia in July 2012 to locate the proposed EfW plant at a site on the Hartlebury Trading Estate. Recognising this was at a different time and location to that initially envisaged in the 1998 WMSC, it would be progressed as a lawful variation to the existing contract. In December 2012, the two Councils authorised officers to pursue proposals for alternative methods of finance for the EfW plant at Hartlebury.

5. Further to previous Cabinet reports, a value for money assessment of various options had been carried out. In addition, a number of potential financing options had also been considered. The options considered were:

Option	Description

Option 1	EfW Variation to WMSC with Commercial Finance
Option 1a	EfW Variation to WMSC financed by Private finance and Council's Prudential Borrowing ("co-financing")
Option 2	EfW Variation to WMSC financed by Councils' Prudential Borrowing
Option 3	Continue 'As Is'
Option 4	Termination of the WMSC and Councils procure an EfW Plant and other services through a new Design, Build and Operate Contract
Option 5	Terminate the WMSC and re-procure existing services Without the construction of an EFW

6. The recommendations to Cabinet were based on:

- Various potential solutions for dealing with residual waste had been investigated and a revised Joint Municipal Waste Management Strategy (JMWMS) adopted in 2009. The Residual Waste Options Appraisal ranked EfW highly, particularly with Combined Heat and Power
- In line with the JMWMS, Mercia had proposed an EfW and selected the site at Hartlebury Trading Estate as the best available. This proposal had been supported in principle by the Cabinet since December 2009 and officers authorised to prepare a contract variation to give effect to the proposal. In December 2012, Cabinet authorised officers to pursue proposals for alternative methods of finance for the EfW plant, having regard to a refresh by external experts of the JMWMS which continued to rank EfW highly. The current proposal was therefore in line with the refreshed JMWMS
- The previously agreed parameters being substantially met
- Doing nothing would expose the Councils to significant risk of having no capacity for treating or disposing of waste in 2023, when the WMSC expired. Residual waste would continue to be landfilled in the meantime, leaving the only available landfill site in the two counties close to being full, exposing the Councils to additional landfill tax, the expiry of the EfW planning permission and failing to achieve national landfill diversion targets. The additional cost impact was estimated at more than £100m (Net Present Cost) and over £400m (Nominal Costs) over 25 years compared with the preferred option
- Planning Permission for the proposed EfW Plant was secured by Mercia in July 2012. This followed a comprehensive call in Planning Inquiry by the Secretary of State
- The EfW plant was part of the national plan to achieve landfill diversion targets
- Forecasts that the Councils' existing landfill may well be full in 2024
- Not varying the WMSC may lead to additional (immediate) termination costs, and the prospect of having to pay £100 per tonne landfill tax in 2023.

7. The recommended option – Option 2 – showed the best value for money for the whole-life cost (to 2042 and the lowest Net Present Cost). The costs included the construction and operation of an EfW plant as well as the other aspects of waste disposal and management as per the existing WMSC. In addition, there was less risk associated with delivery of this option over those requiring commercial/private finance. Progressing with this option would mean that construction could start in 2014 including the satisfaction of planning conditions ahead of July 2015 (when planning permission would expire if development had not commenced). The EfW plant would be operational in early 2017 diverting residual waste from landfill. Progressing with this option would incur a £6.6m uplift in the Unitary Charge from the point of operation of the EfW Plant as compared to the £6m indicative affordability envelope that had been set by both Councils. As part of recommending this option it was recognised this would result in a reduced level of Waste Infrastructure Grant (previously called PFI credits).

8. The EfW, along with other operational facilities, would be handed back to the Councils at the end of the WMSC in 2023. The EfW would still have considerable operational life remaining at that point and would be a valuable asset for waste disposal from 2023 onwards.

9. The Cabinet report set out the following issues, in some detail, for its consideration:

- the background to the WMSC from the signing of the contract between Herefordshire Council and Worcestershire County Council and Mercia in December 1998 for 25 years, to the report in 2013 regarding proposals for financing and procuring the proposed EfW plant (either by variation of the existing Waste Contract or fresh procurement) to enable Cabinet to take a final decision by weighing up the options

- the purpose of contract variation to enable the delivery of the EfW

- an analysis of waste flows which showed that the total Local Authority Collected Waste was set to increase from 362,273 tonnes in 2012/13 to a forecast 404,177 tones/year by 2023/24. Based on this, it was forecast that the current contracted landfill space in both counties would be full by 2023/24

- the options (as outlined in the table above) which the Councils had considered. The options were detailed in Appendix B to the Cabinet report, which included key assumptions and associated risks

- the key benefits of the Energy from Waste solution

- the key features of the proposed Contract Variation

- the issues raised falling under the following headings: environmental; contamination; recycling; whole-life costs; technology options; grid connection; food waste, and emissions

- in order to maintain a consistent approach to the management and closure of issues and risks, the planning, financial (value for money and affordability of all of the options), contractual and technical parameters. Appendix A to the Cabinet report provided the current position regarding the parameters. In the main these were satisfied

- the deliverability of the proposals. The value for money analysis demonstrated that Option 2 - EfW financed through prudential borrowing - was the best value for money. It also had a number of further benefits over the other options in terms of deliverability and mitigating risk

- the Councils had continued to work with DEFRA, the detail of which had been shared with Her Majesty's Treasury (HMT). The Councils were still awaiting a final position from both DEFRA and HMT. Since the Cabinet decision, DEFRA have indicated that they are satisfied with the Councils adopting Option 2 and have agreed to continue WIG (PFI credits) at a reduced level for the remainder of the waste contract subject to certain conditions

- a summary of key Programme Milestones should the recommendations be accepted

- a small number of outstanding matters which meant that the recommendations were based on various conditions.

10. Members of the Cabinet had received a public briefing by officers (together with Herefordshire Council's Cabinet members) immediately before the formal commencement of the Cabinet meeting. Non-Cabinet members of both Councils had been invited to attend the briefing. The Cabinet had agreed the recommendations before it and was now recommending that the full Council consider and approve the

Council's ability to provide project funding into Mercia to improve the deliverability, affordability and Value for Money of the variation. Similar approvals would also be required from Herefordshire Council.

11. The Director of Resources has produced a supplementary report providing some further background on the budgetary and funding arrangements which is contained in the Appendices attached.

Supporting Information

- Appendix – Waste Management Services Contract – Supplementary Report by the Director of Resources

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Background Papers

In the opinion of the proper officer (in this case the Director of Resources) the following are the background papers relating to the subject matter of this item:

Agenda papers for the meeting of the Cabinet held on 12 December 2013

APPENDIX

Council - 16 January 2014

Agenda item 7 (a)

REPORTS OF CABINET - MATTERS WHICH REQUIRE A DECISION BY COUNCIL - WASTE MANAGEMENT SERVICES CONTRACT

Supplementary Report by the Director of Resources

Context

1. The recommended decision to provide the funding for Mercia to deliver the Energy from Waste Contract Variation under the Waste Management Service Contract (WMSC) represents a significant decision for the Council. The Cabinet has recommended the Contract Variation on the basis of it offering Value for Money to the Council from a Waste Disposal Authority perspective. The Cabinet is responsible for Waste Disposal functions, but has made recommendations to Council with regard to budgetary and funding arrangements, having regard to any further report of the Director of Resources. This report provides some further background on those financial matters. Members are referred to the agenda report and minutes of the Cabinet meeting on 12 December for further detail.

2. The provision of Council funding obtained from the Public Works and Loans Board (PWLB) to Mercia would enable the Contract Variation to be delivered at a better Value for Money in Net Present Value terms than funding procured from the commercial market. This is based on a net surplus generated by the Council after setting aside some of this surplus for risks that Worcestershire County Council and Herefordshire Council ('the Councils') take on. If approved, the Councils would lend to Mercia at a commercial rate but source the funding from the PWLB at a lower rate. Value for Money is still equivalent with a Commercial Bank-financed variation because this net surplus is balanced by a reduced level of Waste Infrastructure Grant Credits (formerly known as PFI Grant), now agreed with Defra, as private finance is replaced by public finance.

3. Whilst it should be recognised in terms of the revenue budget the cost of financing the Contract Variation through public rather than private finance will result in a lower cost to taxpayers, at the same time, the Council is proposing to place at risk circa £125 million of funding that it itself (together with

Herefordshire Council lending £40 million) will obtain from the PWLB. This supplementary report sets out in some detail the information and work undertaken to confirm this risk is managed and mitigated where possible to enable the Council to consider the recommendation to approve the provision of lending to Mercia.

4. Council is reminded that the provision of funding is not meant to re-examine the value for money Waste Disposal decision but instead should consider approving the necessary funding arrangements and focus on the ability of the Council and controls it intends to put in place to safeguard the lending that is intended to be provided to Mercia. The Councils have received appropriate advice that they can act in the capacity of Lender to this Contract Variation and have determined the appropriate set aside of funds to manage Construction Phase Risk. Existing Compensation on Termination provisions within the WMSC ensure that the Lender is repaid the majority of any outstanding debt in any termination event during the operating period of the varied contract.

5. The decision as to whether the Councils should become the Lender requires that the Councils:

a) Make changes to their Treasury Policy Strategies and associated Treasury Management Statements to permit the provision of funding to Mercia including the increase in Authorised Borrowing Limits and Council credit ceilings;

b) Make changes to their Statement of Prudential Indicators, Minimum Revenue Provision Plans and Capital Programmes in advance of the years where funding will be advanced to Mercia to support the construction payments profile;

6. These powers are reserved to each Council's Full Council, and the details set out below are subject to Council approval to the recommendations set out in Recommendation 1 of the Cabinet report to Council, which this supplements.

Details of proposed loan arrangements

7. The particulars of each Council's lending arrangements, subject to the Council approval for lending, with Mercia will be set out in a standard Lender's Term Sheet and Credit Agreement. Both documents will be concluded and signed off at Financial Close later in the calendar year.

Relationship with Herefordshire

8. The Councils intend to provide funding on the same terms and conditions to Mercia, to be referred to as a Senior Term Loan Facility based on an approximate split of 75% and 25% respectively in accordance with the Joint Agreement between

the Councils.

Why a Loan is required

9. The Cabinet Report on the proposed Contract Variation to construct and finance an Energy from Waste Plant through the Council's existing WMSC was approved by the 2 Councils' Cabinets on 12 December 2013. The Option chosen to finance this is based on the Councils:

a) providing loan finance to Mercia in the period 2014 to 2023 that the Councils obtain through the PWLB; and

b) continuing to repay the outstanding debt finance at 2023 at the current conclusion of the WMSC until the debt finance is paid off in 2042.

10. The rates of interest offered by the Councils will be substantially equivalent to those that could be obtained by Mercia from Commercial Banks. The Councils, supported by appropriate legal, technical and financial advice, are also negotiating terms and conditions that would be expected by Commercial Banks in order to protect the repayment of the debt finance.

11. The Councils intend to make use of funding from the PWLB due to the historic low levels of interest associated with public sector borrowing. The public sector borrows money on the basis of long term gilt prices (Government Issued Debt Instruments) whilst the Commercial Banks costs of finance are based on the London Inter Bank Offer Rate (LIBOR). In rough terms the difference between the cost of public sector borrowing and that which could be obtained through Commercial Banks is a 3%.

12. The cost of debt finance incurred by Mercia to fund the EfW through the variation of the WMSC is a cost to the Councils through the Unitary Charge. Therefore Mercia as the Councils' contractor effectively passes through such debt costs that they incur in full to the Councils. This means that the Councils incur any risk of debt finance costs increasing or enjoy any benefit in full of reductions, whilst the effect on Mercia is neutral. It is therefore extremely beneficial for the Councils to work alongside Mercia to consider the lowest cost option for debt finance.

13. The provision of funding to Mercia is not risk free. In normal circumstances, the provider of a Senior Term Loan Facility bears the risk of financial loss should those losses not be mitigated within the SPV and the SPV fails.

14. The Councils have been advised that the risk of SPV failure is lower in this case as this WMSC was a pathfinder project alongside Defra (then DETR) in 1998 and therefore the financing agreements were lender-friendly in two key ways to ensure Commercial Banks would support the project in 1998:

a) During the operating phase, at least 90% of any outstanding debt finance would be repaid to the lender were the contract to be terminated for any reason – known as a 'hell or high water' clause; and

b) During the construction phase, the Councils the Waste Disposal Authority owns a number of risks that in financing deals being agreed in today's market would normally sit with the lender.

15. The Councils intend to take advantage of the comparatively lower rates of finance costs available to the public sector whilst at the same time making use of standards demanded by Commercial Banks to ensure the debt finance being provided to Mercia is repaid in the context of the Lender starting from a position of being exposed to less risk than normal.

<u>Description of loan facilities to be provided & linkage to the Capital Expenditure (given its size)</u>

16. The December Cabinet Report indicated a requirement to authorise capital expenditure of up to £125 million for the variation. This is based upon current estimates from the SPV and a small element of headroom to cater for any unexpected additional costs. The current structure of the Senior Term Loan Facilities provided to Mercia will mirror the structure that would be provided to Mercia by Commercial Banks and will comprise of two elements:

a) A interest only loan to the value of circa £92 million (£123 million when combined with Herefordshire Council) that will be taken on by the Councils in 2023 at a value equivalent to the forecast Net Book Value of Assets and then repaid to 2042; and

b) A loan that is repaid by Mercia to the Value of £28.5 million (£38 million when combined with Herefordshire Council) between 2017 and 2023 (when the WMSC concludes).

17. Both facilities will be drawn down by Mercia over the construction period for the EfW between 2014 and 2017. The profile of draw downs by Mercia will be subject to final negotiation with its Construction (EPC) Contractor and will mirror expenditure being incurred on the construction of the Energy from Waste Plant. The current profile is set out in Appendix C and will be matched by the Council's draw down from the PWLB.

18. The Council will borrow from the PWLB based on a repayment basis to maximise the efficiency and affordability of borrowing. The Councils have received QC confirmation (exempt) that the Councils can take on the lending role to Mercia under the WMSC in compliance with procurement and

local government law.

19. As the costs of financing are effectively being treated as a pass-through cost, the proposals would not alter the return on investment achieved by Mercia and are therefore neutral from Mercia's point of view – therefore there is no advantage conferred on Mercia by the proposals regarding financing. The Councils were able to act as Lender within their general powers of competence conferred by the Localism Act 2011.

20. The QC advice indicated a number of factors that the Councils needed to consider in agreeing to provide funding to Mercia. These have been incorporated into the negotiations with Mercia to date so that effectively the Councils agree financial and risk sharing positions with Mercia that in broad terms are reflective of the requirements that a Commercial Bank would make. The Councils have supported the discharge of this action through engaging technical, financial and legal advisors who advise Commercial Banks in normal circumstances.

<u>Surplus forecast and its use</u>

21. The forecast gross surplus that the Council will generate from the provision of funding is approximately £17 million. This represents approximately 75% of the total gross surplus estimated for the project that will be received by both Councils. This forecast surplus will be:

a) used to compensate the Council for the reduced level of WIG (previously known as PFI credits) and therefore ensure that the project remains affordable; and

b) Set aside to manage any potential risk during construction that is not absorbed by either Mercia or its sub-contractors.

22. Following the commissioning of the EfW asset, a review will be undertaken of any remaining gross surplus that has not been used for either a) or b) to consider any potential further use.

Funding Risk Management

23. The Councils have undertaken an assessment of risk of becoming the Lender. From a VFM perspective, the Councils have worked with their advisors on the lending side, in this case, Ashursts as legal advisors, Deloitte as financial advisors and Fitchner as technical advisors to understand the basis on which Commercial Banks reserve elements of the margin they make from providing debt finance against risks that may emerge. This has included a review of the following areas of risk:

a) Counterparty risk with Mercia's Shareholders and the major Construction and Operation subcontractors;

b) The Security package available from the Construction team and the Shareholders to cover the Construction period risk;

c) Key income generation assumptions in the Financial Model;

d) General Industry Risk;

e) Specific risks to this particular project; and

f) Interest Rate and Forex Risks.

24. The Councils have effectively negotiated a security package with Mercia and its EPC Contractor during the construction phase that has left only a minimal risk that costs are borne by the Councils should issues occur during construction. From a funding perspective, almost all of the debt finance is repayable during the operating period should termination on any basis occur.

25. The Councils have therefore worked to ensure risk is effectively retained where it resided in the 1998 contract or any new risk is transferred to Mercia and its supply chain.

26. The one area where the Councils are taking more risk when compared to the 1998 contract is during the Construction Phase. For this reason, the Councils are taking a prudent approach by not recognising in the Value for Money Assessment the full forecast surplus generated from providing funding from the PWLB. Instead, a reduction of 50% has been made to this surplus based on the need to recognise that the Councils may be exposed to residual risks that costs rise during the construction phase that may not be covered by either the EPC Security Package or Security Package provided by Mercia.

27. Whilst the Councils advisors have estimated that this residual risk is low, the already established Waste PFI Reserve will be maintained at a level of at least £10 million through the construction phase to provide a reserve should this risk materialise.

28. A full analysis of risks and how these have been mitigated or absorbed is contained in Appendix A.

Additional requirements to the Capital Programme

29. The Council is required to add the value equivalent to the funding being provided to support the Energy from Waste Contract Variation to its Capital Programme to comply with external financial reporting standards.

30. The Council sets its Capital Programme in February each year (updated as necessary through the year) as well as setting out its Prudential Indicators. The key objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable. The February 2013 Capital Programme covered the period to the end of the 2015/16 financial year.

31. Subject to the approval of Council, an amount of up to £125 million will be added to the Council's Capital Programme in the financial years 2014/15 to 2017/18. The precise value and profile of these additions will be finalised by Financial Close, intended for around 31 March 2014.

Changes required to the Treasury Management Policies

32. This variation represents the largest single construction project that the Council has entered into. In addition, whilst there is uncertainty over the timing of a rise, the Bank of England and economic commentators are forecasting a rise in interest rates at some point in 2015 as well as gilt yield increases as the Bank of England programme of quantitative easing is tapered off.

33. The provision of funding for such a significant project will be aligned in this case directly to the asset that the lending is being used to create. This will ensure that risk is most appropriately managed as well as ensuring that the transaction can be seen in the round from a procurement perspective.

34. Therefore the Council will obtain its funding from the PWLB directly in line with the draw down requirements of Mercia to ensure that any interest rate risk and gilt yield increase risk are minimised to ensure the affordability of the project is controlled. Repayments by Mercia will be ring-fenced to directly repay the debt that specifically relates to this project. In accordance with Financial Regulations and the Council's Treasury Management Policy Statement, the Director of Resources is required to report annually on the activities of the Treasury Management operation. Subject to the approval of Council, a change set out in Appendix B will be made to the current Treasury Management Strategy to enable the Council to undertake its role as Lender to the SPV. This will create the framework within which the Council can provide the lending to the SPV.

35. The Council is required to set specific parameters, known as Prudential Indicators, each year to control the extent of its borrowing. The essential purpose of this requirement is to ensure that the Council always has the means to repay and doesn't borrow beyond its ability to service associated debts.

36. The Council incurs revenue costs in relation to Capital Expenditure through its Minimum Revenue Provision (MRP). These MRP costs flow through to be met by Central Government funding or local taxpayers. The Cabinet recommended the approval of the contract variation funded by public finance on the basis of it being the lowest forecast cost to the Council and therefore taxpayers, therefore the financing costs paid directly where the contract variation is supported by public finance are lower than the financing costs that would be paid through Mercia to a Commercial Bank for a contract variation supported by private finance.

37. It is important to recognise that the Council is able to

undertake significant investments due to its size and balance sheet strength, but there is always a limit to which its balance sheet can support investment, based on a judgement on the requirement to set aside revenue to repay the costs of debt finance increase against revenue budget to support in-year revenue expenditure.Having created the framework for lending, the budget report in February 2014 will include the full set of Prudential Indicators taking account of the above adjustments as well as reflecting the latest capital programme and borrowing rates. The Council will need to consider carefully future commitments to Capital beyond 2017 as the percentage of costs allocated towards paying for debt increase.

38. The Director of Resources confirms that the Council will be able to change its Prudential Indicators including the Authorised and Operational Borrowing Limits to accommodate this lending without compromising the requirements of its Prudential Code.

Impact on Medium Term Financial Plan

39. The Medium Term Financial Plan (MTFP) approved by Council in February 2013 included provision in 2016/17 for the uplift in Unitary Charge indicated at that time by the negotiations with Mercia. Since that time the timescales have slipped for construction to 2017/18 and the forecast uplift has reduced for the Council from £6 million to £4.5 million (75% of the £6 million affordability envelope referenced in the December 2013 Cabinet Report). This included the forecast cost of debt financing.

40. The February 2014 Budget Report will therefore reflect a movement of the future budget growth previously included in 2016/17 to 2017/18. As a result of the reduction in forecast Unitary Charge from the value indicated at February 2013 there is a slight reduction in the MTFP requirement due to the proposed contract variation.

Proposed Governance Arrangements to safeguard the provision of funding

41. In order to ensure that there is sufficient separation of roles and responsibilities between the Council as a lender and the Council as a waste disposal authority and address any conflicts of interest, the Director of Resources recommends the establishment of a special Waste Contract Credit Committee post Financial Close that will operate over the life of the WMSC to 2023.

42. The proposed terms of reference are set out in full within Appendix E. It is suggested that Council considers creating such a committee following financial close of the variation.

43. In order to benefit from a clearer separation of roles, the Committee may be advised by an external financial expert who will report to the Committee, attend its meetings and provide expert advice to it. As necessary, the Committee may also

receive legal advice from an external firm of solicitors with expertise in banking law. The Council's s151 officer and Monitoring Officer will retain their overarching statutory roles in respect of the Committee.

44. The Cabinet will continue to be responsible for exercising the role of the Council's executive, acting as a waste disposal authority within the overall Budget and Policy framework set by the Council. The Cabinet will have no supervisory or other responsibility for the Waste Contract Credit Committee.

Defra and Her Majesty's Treasury

45. The Councils have been working with HM Treasury and Defra to confirm the basis on which the Councils have the powers to provide funding to Mercia, the required safeguards that need to be put into place as well as how to arrive at a robust valuation of risk that it will take on. HM Treasury has not raised any concerns with the negotiated position reached with Mercia and the actual transfer of risk, but HM Treasury have fed back through Defra that an issue exists with how risk is assessed in Central Government Accounting.

46. Since the 12 December 2013 Cabinet Report recommending the Contract Variation supported by Public Finance, the Councils have concluded negotiations with Defra on the level of retained Waste Infrastructure Grant credits. The Councils agreed a reduction in line with that reported in the 12 December 2013 Cabinet Report. The confirmation letter from Defra is appended as Appendix D. Defra has since confirmed through email on 23 December 2013 that that HM Treasury (including their ministers) have given their approval.

Supporting Information

- ***Appendix A***: Assessment of Counterparties and Risk
- ***Appendix B***: Treasury Management Strategy 2013/14
- ***Appendix C*** Current forecast drawdown profile
- ***Appendix D*** Defra Letter
- ***Appendix E*** *Draft Waste Credit Control Committee Terms of Reference*

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Background Papers

In the opinion of the proper officer (in this case the Director of Business, Environment and Communities) the following are the background papers relating to the subject matter of this report:-

Waste Management Services Contract Report approved by Cabinet on 12 December 2013

Joint Municipal Waste Management Strategy including Annex D – Residual Waste Options Appraisal

Agenda papers and background documents accessible to the public for the meetings of the Cabinet held on: 17 September 2009, 17 December 2009, 9 February 2012, 13 December 2012

Planning Decision by Secretary of State on Hartlebury EfW

Appendix A: Assessment of Counterparties and Risk

1 Purpose of Review

1.1.1 Waste Services for Herefordshire and Worcestershire were procured in 1998 by both Councils from a Special Purpose Vehicle (SPV) established for this Contract. There is a track record of delivery within this Contract over the last 15 years by the SPV. The SPV shareholders (Sponsors) are two well known and large environmental services companies:

- FCC Environment Limited (Fomento de Construcciones y Contratas) – formerly known as FOCSA in 1998, based in Northampton and now part of the worldwide FCC S.A Group; and
- Urbaser Ltd formerly known as Dragados Ltd in 1998, based in Cheltenham and now part of the worldwide ACS Group S.A headquartered in Spain.

1.1.2 The 1998 Deal was a pathfinder deal in the Waste Market. To ensure that the pathfinder Contract was attractive to the market, a number of Lender Friendly variants to what is now expected in a standard Waste PFI contract were negotiated.

1.1.3 The purpose of this review of Counterparties and Risk is to provide Full Council with information to consider and if thought fit approve a change in the Treasury Management and Capital Programme of the Council.

1.1.4 If approved, the Policy changes will be formalised in February 2014 will then provide a revised framework that creates the flexibility to allow the credit facility to be provided at Financial Close. The Credit Facility will be approximately £161 million and is subject to final negotiations and this encompasses:

- The Capital Expenditure Forecast of the Energy from Waste Plant including associated development costs;
- The buy-out of existing SPV shareholder subordinated debt; and
- Interest and transaction charges relevant to the variation.

1.1.5 The Credit Facility will be repaid by the SPV at the expiry of the PFI Contract in 2023 and the remaining unamortised debt of approximately £123 million will continue to be paid down by the Councils in line with their Treasury Management Strategy.

1.1.1 The Councils separate advisor team have supported negotiations with the SPV and the Council's review from a Funding perspective of the Contract Variation. The advisor team are set out below:

- Lenders Technical Advisor Fichtner
- Lenders Insurance Advisor Aon
- Lenders Financial Advisor Deloitte
- Lenders Legal Advisor Ashurst

1.1.6 All necessary consents including Extant Planning Permission have been achieved. The Council is familiar with the regulatory, legislative and industry background for the Facility given its role as Waste Disposal Authority.

2 The Council's specific Balance Sheet provision for Risk

2.1.1 The Council together with Herefordshire Council (the Councils) have developed an optimised solution for the provision of Prudential Borrowed Finance into SPV over the construction and operational period of the contract variation. The Council will hold a PFI Risk Reserve of approximately £16 million at Financial Close. An element of this reserve, approximately £6 million will be used to compensate the revenue budget over the period to 2023 for the reduced level of Waste Infrastructure Grant Credits referenced in the December report to Cabinet. The Council's remaining Reserve of approximately £10 million will be available to absorb any financial impact of risks set out in this risk review. This represents approximately 10% of the level of the Senior Term Loan Facility provided to the SPV and over 50% of the forecast surplus that will be generated for the Council from the provision of the Senior Term Loan Facility.

2.1.2 Should any of this Waste PFI Risk Reseve remain following Hot Commissioning of the Energy from Waste Facility then this will be used to further offset the increased cost to the Councils of the Energy from Waste Variation uplift on the Unitary Charge from 2017 in terms of either support for future Unitary Payments or a Capital Contribution to reduce down directly the unamortised debt within the SPV.

3 Analysis of the proposed project for the purpose of providing the loan facility

3.1 Project Summary

Asset being financed

3.1.2 The main asset to be financed by the provision of the Credit Facility is the Energy from Waste Plant with a cost of financing of £161 million for the Councils. This equates to approximately £120 million for the Council against a recommended approval of £125 million as contained in the December Cabinet Report that allows some headroom for unforeseen costs. The Credit Facility will be secured across all assets, including those were credit facilities are not amortised at the time of Financial Close. Work has therefore been undertaken n relation not just to the Energy from Waste Facility but also on the existing services provided as part of the Waste Management Services Contract that has been operating for over 15 years.

Parties involved

3.1.3 The Shareholders and Sponsors of the SPV on a 50/50 basis are:

a) FCC Environment Limited; and

b) Urbaser Limited.

3.1.4 Whilst existing Shareholders in the established SPV, appropriate due diligence has been conducted on each Partner and is set out later in this report. The Shareholders agreed as part of the 1998 Deal to provide a Joint and Several Guarantee and Performance Bond on the Project that is being refreshed as part of this Contract Variation. This diligence will continue to Financial Close.

3.1.5 The Construction Contract (EPC) proposed Preferred Bidder is a Joint Venture between two significant construction companies. The SPV is in the final stages of negotiations with the EPC Joint Venture and therefore the names of these companies are unable to be made available in the public domain at the time of writing. However, provided below is a description of the work undertaken to satisfy the Councils on the strength, covenants and security package from the EPC Joint Venture. This supports in depth due diligence that has been undertaken by the SPV who will enter into the EPC contract with the that has been reviewed by the Councils alongside the Council's own assurance process. This includes for each Joint Venture Partner:

- Review of Business Undertakings;
- Financial Standing;
- Ownership Structures;
- Credit Ratings and reports from recognised Ratings Agencies;
- Short Term Cashflow reviews from Dunn and Bradstreet;
- Balance sheet Review; and
- Revenue review, EBITDA, and Profit after Tax.

3.1.6 The Joint Venture Partners are providing Joint and Several Guarantees from Parent Companies as part of the EPC Contract which provides additional strength to the protections available to the Council and the SPV in the event that one of the partners enters into any financial or operational difficulty.

3.1.7 The Operations and Maintenance Contract is being procured from Severn Waste Services Ltd (SWS), a wholly owned subsidiary of the SPV. SWS Ltd was incorporated at the same time as the PFI Contract was awarded in 1998 and absorbed the assets and liabilities of the Herefordshire and Worcestershire Council Local Authority Waste Disposal Corporation, Beacon Waste. This provider of services has a track record of over 15 years in the delivery of existing services.

<u>Gross surplus forecast in excess of cost of borrowing from PWLB</u>

3.1.8 The Councils are intending to provide the Credit Facility at a rate commensurate which may be offered by the commercial bank market to ensure that Mercia are not unduly benefitting from the provision of the Credit Facility by the Councils. Whilst the impact of any change in Credit Facility margins are borne not by the SPV but by the Councils in terms of changes to the Unitary Charge, the Councils feel that it is prudent to maintain this equivalence. The Councils will charge a rate equivalent to what a Commercial Bank may charge. The margins and applicable fees will be finalised at Financial Close by reference to the latest available information. The Margins, Arrangement and Commitment Fees have been tested against the Commercial Bank Market in the following ways:

- A soft market testing by Credit Agricole;
- Knowledge of recently closed Waste to Energy deals from the financial and legal advisors to the Council as Lender;
- Information contained in the Infrastructure Journal; and
- Recently closed and anonymised Waste to Energy Deals known to Defra.

3.1.9 The rates have been compared to primary research undertaken by the SPV's financial advisor and cross-checked to industry knowledge from the Lender's Financial Advisor.

Summary of risk assessed in providing the credit facility

3.1.10 Schedule 13 of the existing Waste Management Services Contract sets out the compensation on termination arrangements that will be enacted should termination occur during the Construction Phase. Termination could occur due to:

a) Council (as Purchaser) default;

b) No Fault; or

c) SPV default.

3.1.11 In the case of SPV Default a formula set out in Schedule 13 applies that does potentially expose the Council as Lenders to some risk that it was not exposed to in its Waste Disposal Authority role. The Council as Lender has therefore negotiated with the SPV and members of the EPC Joint Venture to ensure the risks that Schedule 13 exposes the Council as Lender to be mitigated as far as possible. The following section sets out these risks and then summarises the Council as Lenders view on the Residual Risk the Councils as Lender is exposed to.

3.2 Sponsors review

3.2.1 Each Sponsor is supported by a Parent Company Guarantee (PCG) that has been in place since 1998 and will be refreshed as part of this Contract Variation. In addition to the Council's experience of the Sponsors, the Council has undertaken an overarching diligence exercise on the Sponsors' Parent Companies to confirm there is nothing that provides concerns to the Council from continuing their relationship with the Sponsors. This has included a high level review of balance sheets, operating performance and industry news and commentary as well as inquiries of representatives from the Sponsors.

FCC UK Limited

3.2.2 FCC SA provides a Parent Company Guarantee to FCC UK Limited. FCC SA is a leading Spanish construction company based in Barcelona. It is publicly traded and is part of the IBEX 35. Over 50% of the shares are owned by a company controlled by Esther Koplowitz, a billionaire businesswoman philanthropist. FCC SA is one of the leading diversified Spanish groups, employing around ninety thousand people. The business has the following divisions:

- Construction;
- Environmental services;
- Urban services (Versia);
- Cement;
- Real estate (Realia); and
- Energy.

3.2.3 Diligence in September 2012 identified a significant adjustment to earnings of approximately 0.7 billion Euro at FCC SA and significant restructuring plans. Assurance was sought from the FCC UK Limited Group Director to confirm that this did not affect FCC UK Limited. In response the following statement was received:

'For FCC, the UK business is an important part of the FCC SA strategy and FCC Environment S. UK is seen as a key asset for the group per Strategic Plan 2013/2015 (Quote, extract of Strategic Plan " Boosting of the activity of waste treatment and management services in the UK " and " Services (Division) will

strengthen its leadership in its domestic markets and enhance waste management and treatment activities in the UK'

3.2.4 The main reasons for the earnings adjustments were due to write downs in other parts of the group (Austria) and in the Group's Renewable Energy Division. Over the winter period FCC SA sold 51% of the company that owns its renewable energy assets. This transaction fulfilled two of the objectives set out in its Annual Strategic Plan: to focus Group activities on water, environmental services [including FCC UK] and infrastructure, and to reduce interest-bearing debt to below 5 billion euro. This sale came just after FCC completed refinancing of the debt of FCC Environment, its UK environmental services subsidiary, amounting to 381 million pounds sterling (456 million euro) for a period of four years.

3.2.5 This agreement is part of the very substantial progress made by FCC to refinance the entire group, which is expected to be completed in the short term and will provide it with "a sustainable financial structure adapted to the cash flow envisioned for the various businesses".

3.2.6 A review was undertaken of Dunn and Bradstreet Reports on FCC to gain an understanding of the short term cashflow position of the Sponsor and Group.

3.2.7 There were no issues that require reporting to members from this review.

<u>Urbaser Ltd</u>

3.2.8 Urbaser SA provides a Parent Company Urbaser Ltd. Urbaser Ltd is an environmental services company, who work internationally as one of the main operators in the environmental sector and a leader in waste management. Urbaser is part of Spain's largest builder, ACS (Actividades de Construcción y Servicios) Group. Urbaser specialise in providing local councils, boroughs, autonomous regions and industries all types of environmental services.

3.2.9 The group ACS, is a worldwide reference in infrastructures, industrial services, energy and environment. The ACS Group, through its environmental company Urbaser, is leader in waste management and treatment. It specialises in Street Cleaning, waste removal and transporting, urban waste treatment and recycling and comprehensive management of the water cycle and urban landscape and gardening.

3.2.10 Urbaser SA achieved a business turnover of 1.5 billion Euros in 2010 with a staff of more than 30.000 people and over 160 subsidiary companies forming the group. It provides services to more than 50 million people and is active in 4 continents.

3.2.11 A review was undertaken of Dunn and Bradstreet Reports on FCC to gain an understanding of the short term cashflow position of the Sponsor and Group.

3.2.12 There were no issues that require reporting to members from this review.

3.3 Industry and Project summary

3.3.1 An analysis of the project, as normally considered by a Commercial Bank has been reviewed by the Section 151 Officer. A summary of details considered by the Section 151 Officer are referenced in summary below. Some specific information has not been provided below where it may compromise ongoing negotiations with the SPV or the potential preferred EPC Joint Venture.

3.3.2 The Energy from Waste PFI market has developed over the last 15 years since the Council first entered into the Waste Management Services Contract with Sponsors. The technology has been reviewed in detail by advisors and represents a standardised and reliable technology that has proven successful in a number of recent and similar projects. Detailed reports have been provided to the Council outlining the satisfaction of Technical Advisors.

3.3.3 Assurances have been received from the Lender's Technical Advisors that there are not any particular aspects of the industry and project that create additional risk over and above the standard risk profiles of a moving grate Energy from Waste Facility in the UK.

3.4 Key Project risk assessment during the Construction Phase of the Contract Variation (2014 to 2017)

Sponsor risk and Equity

3.4.2 The analysis of the risks inherent in the existing SPV Sponsors has been undertaken and is referenced in Section 3.2.

3.4.3 The Council has undertaken significant and detailed negotiations with the Sponsors to agree a Security Package with the Sponsors to ensure risk is appropriately placed with the Sponsors and managed across the Construction Phase. A Security Package from the Sponsors describes the way in which the Sponsors will support the SPV during the Construction Phase by way of Equity Investment that will take first loss should issues arise in the SPV.

3.4.4 Whilst the detail of the Security Package will be set out in the Contract Variation and the details are at this stage Commercially Sensitive the Councils have secured significant increases in the level of Equity and Equity Guarantees from Sponsors to ensure there is adequate protection for the Councils through the Sponsors Equity prior to any risk being borne by the Councils.

EPC Joint Venture Security Package

3.4.5 The Sponsors have worked with the Council as Lender to identify and secure an appropriate market standard Security Package from the proposed EPC Joint Venture Partnership. This has included ensuring the EPC Joint Venture have supplied evidence of appropriate products and protections that a Commercial Bank would demand. These have included:

- Insurances;
- Performance Bond Guarantees and replacement protocols from reputable providers rated with appropriate investment grade ratings; and
- Parent Company Guarantees.

3.4.6 The Lender's Advisors have confirmed that all requests made by the Councils are equivalent to those demanded by Commercial Banks. The Councils and Sponsors are now reaching final negotiations with the proposed EPC Construction Joint Venture. There are a small number of points that remain outstanding, however it is anticipated that in the round a Security Package will be agreed that would be acceptable to a Commercial Bank should it have been providing the Senior Term Loan Facility.

Failure to complete construction, construction delay and cost overrun

3.4.7 The Council will be taking on residual risk during the construction phase should any issues arise. It is important to note though that in terms of the risk hierarchy, the following stakeholders are required to mitigate any risks that arise before those risks are needed to be managed by the Councils.

- EPC Joint Venture Partnership and their Subcontractors; and
- Sponsors and their Parent Companies.

3.4.8 In particular, the Council's Advisors have confirmed that the Councils benefit from a much stronger covenant from these two sets of stakeholders as their exists a Joint and Several Liability agreement between both the EPC Joint Venture Partners and then also between the two established Sponsors.

3.4.9 Attached below is an extract of advice received from the Council's Legal Advisors to confirm the position this leaves the Council in.

As the Councils are aware, the [proposed] EPC [Construction] Contractor is an unincorporated joint venture between two companies of reasonable size and financial strength. Each of these companies will procure a parent company guarantee in respect of its obligations under the EPC Contract.

These two contractors have accepted the concept of joint and several liability for all matters arising under the EPC Contract and therefore, if one of the JV partners becomes insolvent, Mercia [the SPV] will always have recourse to the other JV partner for the full amount of any liabilities arising under the EPC Contract.Therefore, in the event that one of the Contractors is unable to perform or becomes insolvent, there are a number of alternatives which would be available for Mercia:

- *in the first instance, the remaining contractor will be keen to replace the defaulting/insolvent contractor as quickly as possible, so as to manage its own liability - therefore there will remain one part of the JV which is capable of performing its obligations and will have a very real incentive to remedy the situation <u>before</u> Mercia takes any action under the EPC Contract;*
- *one possible outcome is that the insolvent/defaulting Contractor may actually be sold to a new owner, in which case the situation will be remedied without Mercia having to take any further;*
- *if the financial position of the defaulting/insolvent Contractor is not rectified and the remaining JV partner does not replace its partner with a suitable replacement, Mercia will have the option of terminating the EPC Contract in the usual way and engaging a replacement contractor to build out the facility. If this occurs, Mercia will have a claim against the outgoing EPC Contractor for any losses it suffers (to the extent that these are not covered by the Performance Bond and Advance Payment Bond). However, as compared to many other such projects, even if one of the JV partners has become insolvent, Mercia will have a claim for the full amount outstanding against the solvent partner and, ultimately, against its parent under the applicable guarantee.*

As the EPC Contractor is an unincorporated joint venture, this gives Mercia the opportunity to bring any claims against either one of the JV partners or both of them jointly and therefore the insolvency of one of these parties will not preclude a claim being made in full against, and recovered from, the other JV partner.

For this reason, the structure which has been adopted should be more robust than that typically found on other EfW projects, where there may only be one EPC Contractor.

3.4.10 The Lender's Technical Advisors have undertaken a 'Fall Away' analysis that is typically provided to a Commercial Bank in order to assess quantitatively the costs that the SPV may be exposed to should their be a failure by, in this case, both EPC Joint Venture Partners at the same time – and therefore a much lower risk than where a Joint and Several Liability does not apply.

3.4.11 The Lender's Technical Advisors indicated the maximum financial exposure to the SPV occurs between months 15 and 17 of the construction period and that this maximum exposure is significantly less than the Equity injected by both Sponsors into the SPV. The Equity injected by the Sponsors absorbs any financial risk that cannot be mitigated by its subcontractors (like the Construction Joint Venture) before any risk is borne by the Councils.

3.4.12 Therefore, it can be concluded, that whilst a significant set aside has been retained by the Council within its Balance Sheet (the PFI Risk Reserve), £7.5 million, 75% of the total adjustment referenced in the Value for Money Analysis of £10 million, the scenarios modelled by the Council's advisors indicate that this is unlikely to be required in any scenario whereby the Construction Joint Venture defaults on its responsibilities to the SPV. The Fall Away analysis is modelled on a prudent basis, however, the Councils intend to retain this contingency in its balance sheet to mitigate any unforeseen risk.

3.4.13 The Councils and their Advisors shared this methodology in detail with Her Majesty's Treasury (HMT) as part of the Defra and HMT review. A range of potential worst case scenarios were worked through and the finding was that the Councils as Lender were not exposed to any loss event.

3.4.14 That said, in a scenario, that has not to date occurred on a similar project, could result in loss being borne by the Councils as Lender but those present at the meeting could not construct a scenario where this loss would result without moving into the scenarios that in reality have not occurred and would have only an extremely small possibility of occurring – to the point that the scenarios were not realistic.

3.4.15 Whilst risks is not eliminated, in summary, based on internal work within the Councils and on the advice of Financial, Technical and Legal experts, the Council as Lender has undertaken sufficient work to minimise the risks that they are exposed to in the Construction Period.

4 Key Project risk assessment during the Operational Phase of the Contract Variation (2017 to 2023)

4.1.1 From a lending perspective, at least 90% of any outstanding Senior Term Loan Facility is repayable in the event of any default within the contract period, whether that be due to default within the SPV, by the Councils or by both. The 10% difference to 100% will be due to any deductions the Councils may make in their role as the purchaser of services.

4.1.2 Therefore there are no further material risks during the Operating Phase that the Councils would take on in addition to those risks that the Councils have managed during the first 15 months of the Waste Management Services Contract.

4.1.3 A full review has been undertaken of the following areas though to ensure that the arrangements put into place by Sponsors would be acceptable to a Commercial Bank in the round including work on:

- Assumptions on Electricity Generation (Power Off-take) and the sale of Spare Capacity;
- The Key Subcontractors financial standing and operational performance; and
- Technical risks associated with the operation of the Facility.

4.1.4 There are no existing subsidies that present a risk to the facilities revenue generation. The Council's Advisors are now working with the SPV to confirm how the Operational and Maintenance Contract should be drafted as well as the performance regime for the availability and operation of the facility. The Councils will ensure that through appropriate advice, the requirements of the SPV are rigorous and appropriate manage and mitigate risk during the operational period.

5 Councils' further risk management

5.1 Interest rate risk

5.1.1 The Council's intention is to finance the provision of the Credit Facility through making draw-downs during the Construction Phase of the Contract (2014 to 2017 to match the SPV's requirements to pay the Construction Joint Venture.

5.1.2 The Council will incur some interest rate risk during the construction period in order to obtain these draw downs at various times. The expectation is that Gilt Rates should not move materially over the three year construction period. However, this will continue to remain under review and the Council may choose to draw down cash advances early from the PWLB to mitigate any interest rate risk in the short term..

5.2 Foreign Exchange Risk

5.2.1 The Councils incur risk in Foreign Exchange movements on the element of the costs to be financed that are in Euro. Approximately 60% of the costs to be financed are in Euro. The Councils take risk on the Euro movements up until Financial Close with the SPV and EPC entering into appropriate hedging arrangements post Financial Close to manage this risk.

5.2.2 As it stands the financial model takes a prudent assumption on the Sterling to Euro exchange rate and therefore there remains a limited amount of headroom in the amount to be financed before costs start to increase. Whilst even in the short term exchange rates can fluctuate, it is not anticipated that the Euro will appreciate against Sterling over the next three months to the extent to put the financial model assumptions at risk. This position will however, continue to be monitored. From a lending perspective, the only impact will be that additional funding may be required to be made available.

5.3 PWLB drawdown

5.3.1 PWLB draw down will be undertaken as part of the Council's usual Treasury Management activities and in accordance with an agreed schedule of advances to be made to the SPV alongside Herefordshire Council.

5.4 Bullet repayment financing

5.4.1 The Councils as Waste Disposal Authorities will need to refinance the Credit Facility in 2023 as they would do if Commercial Finance existed. The Council as part of its report on the Energy from Waste Contract Variation will confirm its intention to make this payment. Once this payment is made in 2023, there will be an immediate repayment to the Council as Lender to settle the Bullet Tranche.

5.4.2 Whilst the SPV will repay the bullet tranche on a maturity basis (one repayment at the end of the Contract), the Council will alongside Herefordshire Council on a several basis enter into either an annuity loan from the PWLB (repaying the Capital during the last 7 years of the Concession) or enter into a series of short dated maturity loans to manage its exposure to interest rate risks. Therefore the repayment by the SPV of the Bullet Tranche in 2023 will in turn just form part of the normal Treasury Management activities of the Council.

5.5 Joint Agreement with Herefordshire Council

5.5.1 The Joint Agreement between the County Council and Herefordshire Council will revised to incorporate the arrangements outlined in this paper.

Treasury Management Strategy 2013/14

1. Background

1.1. In accordance with the County Council's Treasury Management Practices (TMPs) and The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice the County Council is required to approve the Treasury Management Strategy and Annual Investment Strategy for 2013/14. The Treasury Management Strategy is reflected in the Personal Assurance Statement given by the Director of Resources concerning the 2013/14 budget calculations.

1.2. Treasury management is undertaken by a small team of professionally qualified staff within the Resources Directorate. In addition the County Council employs Treasury Management advisors, Sector, who provide information and advice on interest rate movements which is used to inform borrowing and investment decisions. The advisors are engaged on a fixed term basis after a tendering procedure.

1.3. Relevant information is also obtained from other financial commentators, the press and seminars arranged by other organisations, for example CIPFA and the Local Government Association. Information received from these different sources is compared in order to ensure all views are considered and there are no significant differences or omissions from information given by the County Council's advisors.

1.4. All Treasury Management employees take part in the County Council's Staff Review and Development scheme, where specific individual training needs are highlighted training in Treasury Management activities and networking opportunities provided by both professional and commercial organisations are taken up where appropriate.

1.5. During 2012/13 to date the County Council has invested its surplus cash with the UK Debt Management Office and with other local authorities.

2. Economic Commentary

2.1. During the year, uncertainty within financial markets has continued to be present particularly in relation to the Eurozone sovereign debt crisis, particularly in relation to Greece and Spain. The situation in Europe is likely to depress growth in the UK's biggest export market and together with the plan to reduce the annual fiscal deficit has lead to little or no growth in 2012, with prospects for 2013 looking limited.

2.2. The bank rate has remained at the historically low level of 0.5% throughout the year. Most forecasters suggest that the bank rate will stay at its current level during 2013/14 and start to increase during 2015. However there are risks to these forecasts if economic recovery is slower than expected then any increase may be delayed. Equally concerns over increases in inflation may cause the rates to increase more quickly.

2.3. In November 2012, the PWLB launched the new "Certainty rate", which in exchange for summary information of the County Council's medium-term borrowing plans being submitted to HM Treasury, has given the County Council access to borrowing rates of 0.2% below those which would otherwise be available over all maturity periods. Rates applicable to early repayment of debt remain the same with the difference between these two sets of rates such that opportunities to reschedule debt are considerably limited.

3. Treasury Management Strategy

3.1. The Prudential Code for Capital Finance requires the County Council to set a number of Prudential Indicators. The Treasury Management Strategy has been developed in accordance with these indicators.

4. Borrowing Strategy

4.1. The outlook for borrowing rates is currently difficult to predict. Fixed interest borrowing rates are based on UK gilt yields and since national debt is now forecast to continue to increase until 2016/17 then so are gilt yields and therefore borrowing rates. However gilt yields are currently at historically low levels due to continued investor concerns over the Eurozone sovereign debt crisis and the UK's current perceived safe-haven status.

4.2. The County Council's Treasury Management advisors have produced forecasts which suggest that rates over all periods of borrowing will increase slowly in 2013/14. Rates on loans of 5 years are forecast to be around 1.7% while rates on longer term loans are expected to be around 4.1% by the end of 2013/14.

4.3. The County Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external debt as cash supporting the County Council's reserves, balances and cash flow has been used as a temporary measure.

4.4. The strategy will be to borrow in order to replenish a proportion of the reserves and cash balances used to support capital expenditure since October 2008. This will mitigate any interest rate risk in that borrowing and will be taken before borrowing rates increase significantly. The timing of the borrowing will depend on cashflow requirements and forecast future developments and on interest rate movements and the forecast for those future movements. A mixture of shorter and longer-term loans will be taken in order to fit with the County Council's debt maturity profile.

4.5. Interest rates will be monitored but as forecasts stand it is likely that borrowing will be undertaken towards the final third of the financial year.

4.6. The gross capital borrowing requirement is estimated to be £32.6 million. After the use of the minimum revenue provision to repay debt of £16.0 million, the net capital borrowing requirement is estimated to be £16.6 million.

4.7. The management of the County Council’s debt will be exercised in the most efficient manner taking into account maturing debt. The opportunity will be taken to reschedule any outstanding debt if rates are favourable, and make savings in the revenue budget. The cost of external interest of maintaining the County Council debt is estimated to be £12.6 million in 2013/14.

5. Annual Investments Strategy

5.1. The County Council's Investment Strategy has been drawn up having regard to both the Communities and Local Government's Guidance on Local Authorities Investments and the CIPFA Treasury Management in Public Services Code of Practice and CIPFA Cross-Sectoral Guidance Notes. This strategy will be revised and presented to County Council if changes occur outside those envisaged within this strategy.

5.2. The policy objective for the County Council is the prudent investment of its cash balances. The investment priorities are firstly the security of capital (protecting sums from capital loss) and secondly the liquidity of investments (ensuring cash is available when required). Only when these two priorities are met will the third, of achieving the optimum return on investments, be taken into account.

5.3. The County Council will not borrow money purely to invest. The County Council will only borrow up to 12 months in advance of cash being required to fund its capital expenditure and the amount borrowed will not exceed the annual borrowing requirement.

5.4. The investments, which the County Council are able to use for the prudent management of cash balances are categorised as 'Specified Investments' and 'Non-Specified Investments'.

5.5. A Specified Investment offers high security and high liquidity, must be in sterling and have a maturity date of less than a year. Any Specified Investment must be with the United Kingdom Government, a local authority in England or Wales or a similar body in Scotland or Northern Ireland, a parish or community council, a AAA rated Money Market Fund, a bank which is part owned by the UK Government, or with a body of high credit quality. The County Council defines a body of high credit quality as counterparties who achieve ratings with all three rating agencies as described in the table below.

Table 1: High Credit Quality Criteria

Agency:	**Long-Term:**	**Short Term:**
Fitch	AA	F1+
Moodys	Aa2	P-1
Standard and Poors	AA	A-1+

5.6. Non Specified Investments have a range of vehicles not covered by the definition of Specified Investments, which are set out in the Treasury Management Practices (TMPs) and generally carry more risk. Only investments where there is no contractual risk to the capital invested and where the rate of return justifies their use will be entered into. The only category of Non Specified investment identified for use for the coming financial year is a routine term investment with a counterparty as described above for Specified Investments, for a period of more than one year. This type of investment will be considered when rates are favourable and cash balances allow. The County Council's prudential indicators allow no more than £5 million to be invested in this category.

5.7. The credit ratings of Fitch, Moodys and Standard and Poors are monitored at least weekly, ratings watches and downgrades are acted upon immediately. Any other information that is deemed relevant to the creditworthiness of any Counterparty will be acted upon, in line with the revised code issued in 2009.

5.8. The County Council will aim to have not less than 50% of its investments returnable within 28 days with at least 20% within 7 days.

6. West Mercia Energy

6.1. With regard to the joint ownership of West Mercia Energy, the County Council may, if deemed in the best interest of prudent management of the West Mercia business, undertake transactions pertaining to foreign currencies, such as foreign exchange deals and investments. Such dealings must have relevance to the course of business of West Mercia Energy. These dealings will be classified as Non-specified Investments as they are not sterling denominated.

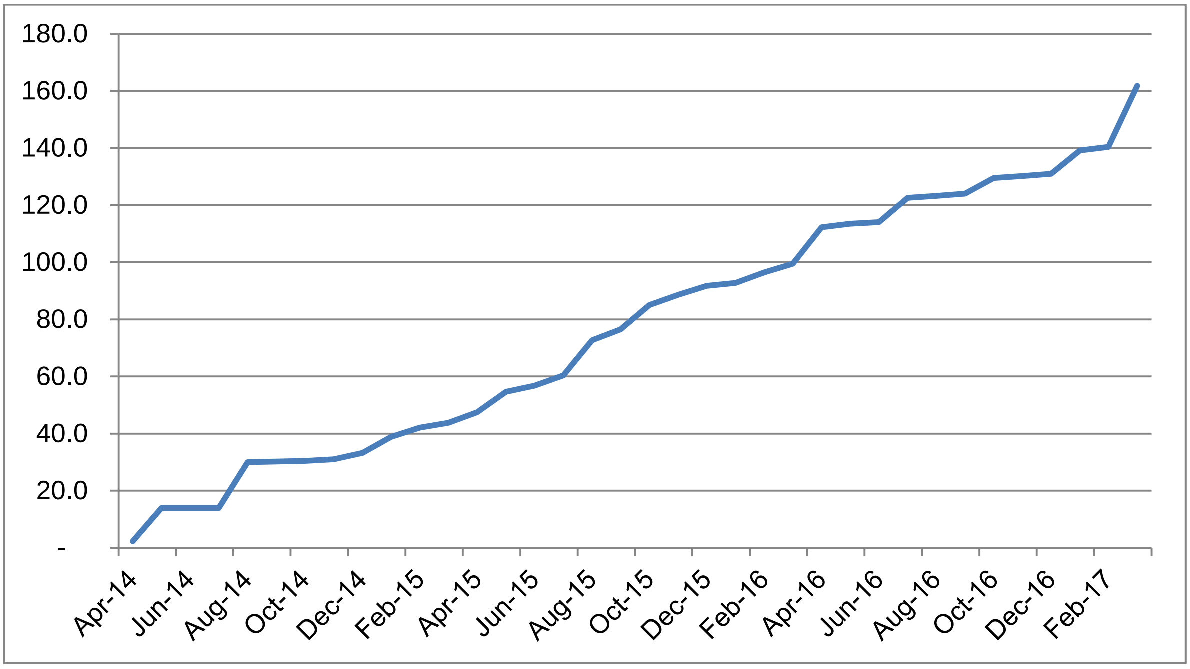
7. Waste to Energy Facility lending

7.1. With regard to the joint interest of the Waste Management Service Contract and the provision of lending to the Special Purpose Vehicle, Mercia Waste Management Services, the County Council may, if deemed in the best interest of prudent management of the Council, undertake transactions pertaining to the provision of funds, sourced by the Council from the Public Works and Loans Board, to enable the delivery of the Energy from Waste Facility Contract Variation. Such dealings must have relevance to the course of business of the Council to achieve the best value for money in its role as the Waste Disposal Authority.

Appendix C: Current Forecast Draw Down Profile from PWLB

Date	Amount (£m)	Cumulative (£m)
Apr-14	2.3	2.3
May-14	11.7	14.0
Jun-14	-	14.0
Jul-14	-	14.0
Aug-14	15.9	29.9
Sep-14	0.3	30.2
Oct-14	0.3	30.4
Nov-14	0.5	30.9
Dec-14	2.3	33.3
Jan-15	5.6	38.8
Feb-15	3.3	42.1
Mar-15	1.7	43.8
Apr-15	3.7	47.5
May-15	7.2	54.7
Jun-15	2.1	56.8
Jul-15	3.6	60.4
Aug-15	12.4	72.7
Sep-15	3.7	76.5
Oct-15	8.6	85.0
Nov-15	3.6	88.6
Dec-15	3.1	91.7
Jan-16	1.1	92.8
Feb-16	3.7	96.5
Mar-16	3.0	99.5
Apr-16	12.8	112.3
May-16	1.1	113.4
Jun-16	0.6	114.0
Jul-16	8.5	122.5
Aug-16	0.8	123.3
Sep-16	0.8	124.0
Oct-16	5.5	129.5
Nov-16	0.7	130.3
Dec-16	0.7	131.0
Jan-17	8.2	139.2
Feb-17	1.2	140.4
Mar-17	21.4	161.8

Graphical representation of SPV Drawdown Profile for Construction



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Mr Alistair Neill
Chief Executive
Herefordshire Council
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35 Hafod Road
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HR1 1SH

Your ref:
Our ref:
Date: 20 December 2013

Dear Ms Haines and Mr Neill,

Herefordshire Council and Worcestershire County Council Waste Infrastructure Project (the "Project"): Waste Infrastructure Credit Letter[1]

1. I refer to your draft Variation Business Case (VBC) in relation to the Project submitted on 31 July 2013 and subsequently updated in September 2013.

2. We have had various discussions with your Authorities concerning the VBC's implications for continuing Waste Infrastructure Grant support for the Project. I am writing to confirm these implications and to set out future arrangements for Waste Infrastructure Grant support for the Project.

3. As you know, by a letter dated 23 October 1998, Defra's predecessor department, the Department for Environment, Transport and Regions ("**DETR**") issued a promissory note to Worcestershire County Council ("**WCC**") in respect of PFI (now Waste Infrastructure) Credits of £57.361m in support of the Project. That was the second of two promissory notes issued in support of your Project: the first was issued in the form of a letter from DETR to WCC dated 17 March 1998 (together, the "**Promissory Notes**").

4. When the PFI Credits were allocated in 1998/1999, it was on the basis of eligible expenditure, including for recycling and Energy from Waste (EfW) facilities. We understand from your letter dated 10 December 2013 that the capital expenditures

[1] The former PFI credits are now referred to as Waste Infrastructure Credits. Likewise the former PFI Grant is now referred to as Waste Infrastructure Grant.

envisaged in 1998 other than those related to the EfW facility have been invested. However the main residual waste treatment infrastructure – the Energy from Waste facility - is still to be delivered.

5. Your Authorities propose to deliver the EfW facility with the Authorities providing debt finance to the contractor. My letter dated 13 November 2013 outlines our main concerns with the proposal. Therefore, from the first quarter of 2014/15, the Authorities will not receive any Waste Infrastructure Grant payments from Defra to contribute to the running costs of the proposed EfW facility.

6. Pursuant to recent discussions at officer level and with the agreement of both Authorities on 12 December 2013, as notified in the joint letter of 13 December 2013 from your Section 151 Officers, we are writing in the following terms. The terms under which PFI Credits were allocated to the Project in 1998/1999 are varied and superseded by this letter. Defra, by this Waste Infrastructure Credit Letter, now confirms the continuation of payment of the Waste Infrastructure Grant for the Project to your Authorities solely to support the service payment of the facilities already delivered. Subject to the remaining provisions of this letter, the Waste Infrastructure Grant payable with effect from the first quarter of 2014/15 will be £2,416,044 per annum until 2022/23 followed by £1,710,559 for the final year of the contract (2023/24). The maximum WIG from the first quarter of 2014/15 until contract expiry in December 2023 is £23,454,955.

7. This Waste Infrastructure Credit letter is subject to:

   i. The following project specific conditions:

      a. The Authorities will develop and provide Defra at the beginning of each financial year with an annual recycling and composting plan which details how the Authorities will make year on year progress to achieve the 50% recycling and composting target by 2020;

      b. The Secretary of State may require your Authorities to make payments in respect of any EU financial sanctions resulting from an infraction of EU law where any acts of your Authorities were found to have caused or contributed to that infraction.

   ii. your Authorities continuing to comply with any relevant terms of the Promissory Notes dated 17 March 1998 and 23 October 1998.

   iii. your Authorities' agreement to and compliance with the general terms and conditions set out below:

      a. Your Authorities are required to send a copy of the signed variation agreement and any related contract documentation (including financing) directly to the WIDP team in Defra. This will be used for compliance monitoring purposes. Please send this on CD (or any other appropriate medium) marked for the attention of

The WIDP Scrutiny Team (area 2B), Defra, Nobel House, 17 Smith Square, London SW1P 3JR or submit via your Transactor.

b. If you have not already done so, you should also publish your VBC (once approved by the Authorities' respective members) on at least one of your Authorities' websites within one month of completion of the variation agreement, although you may remove any information which falls within the exceptions to the Environmental Information Regulations 2004 or the Freedom of Information Act 2000.

c. Your Authorities must provide to Defra all information that Defra requests in relation to the Project and, furthermore, must act proactively and in good faith in providing information relevant to Defra's involvement with the Project and the Authorities' involvement.

d. Your Authorities must not, without Defra's prior written approval, agree or make any material changes to the terms of the Contract that relate to the recycling and composting services. Any plan for any such changes must be reported to Defra and approved by Defra before the changes are agreed with the Contractor or implemented. Approval to such changes, if given, would be confirmed by way of a further Waste Infrastructure Credit Letter.

8. The Waste Infrastructure Grant is not intended to match or correlate directly to the payments that arise under the Contract between your Authorities and their Contractor. The level of Waste Infrastructure Grant payable in the remaining funding period will not therefore be affected by any decision of your Authorities in respect of the planned Energy from Waste facility and/or by any other new facilities and/or by any increase in the costs of the project for any other reason.

9. Existing or future central government guidance, including the CLG Local Government PFI Project Support Guide (or as it may be amended), is guidance only and may be updated from time to time. Your Authorities are bound by any relevant terms of its Promissory Notes and this Waste Infrastructure Credit Letter. In the case of any discrepancy or overlap between the terms of this Waste Infrastructure Credit Letter, your Authorities' Promissory Notes and any central government Guidance, they shall have priority in the order in which they appear in this sentence.

10. Any departure from the terms and conditions of this Waste Infrastructure Credit Letter or the Promissory Notes, or a termination of the Contract, may affect your Authorities' continuing entitlement to the Waste Infrastructure Credits and therefore Waste Infrastructure Grant.

Yours sincerely,

Nigel Atkinson
Programme Director
Waste Infrastructure Delivery Programme (WIDP)
Email: widp.programmeoffice@defra.gsi.gov.uk

cc:
Patrick Birch – Director of Resources (S151 Officer), Worcestershire County Council
Peter Robinson – Chief Financial Officer (S151 Officer), Herefordshire Council
John Hobbs – Director of Business, Environment and Community, Worcestershire County Council
Sean Pearce – Head of Corporate Financial Strategy, Worcestershire County Council
Rachel Hill – Programme Director, Waste
Teresa Oliviere – WIDP Project Transactor
Wijanty Tijono – Head of WIDP Commercial Team and Contracts
David Watts – WIDP Programme Manager

Appendix E: Draft Waste Credit Control Committee Terms of Reference

(a) To act on behalf of the Council as lender to the waste project

(b) To review, in conjunction with external advisers advising the Council as lender, the risks being borne by Mercia Waste Management and its supply chain and determine 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

(c) 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 may be required or are desirable

(d) To take steps to protect the interests of the Council as lender in the event of a default or breach of covenant, including enforcement of security and litigation

(e) To consider and protect the position of the Council as lender to the waste project

(f) To make recommendations as appropriate to Council with regard to its Budget and Policy framework and the loan to the waste project

(g) Generally to take such other steps in relation to the loan as the Contract credit Committee considers this to be appropriate

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- The Committee will be cross-party established in accordance with the legal requirements of political balance
- The Committee will not contain any current members from time to time of the Cabinet
- The Committee will be chaired by a Councillor appointed by full Council. [The Vice-Chairman will be from a Group other than that forming the present administration]
- The Committee will be advised by external financial and legal advisers on behalf of the Council's s151 officer
- The Committee will meet in public (unless the grounds for exemption are met under the Access to Information legislation) and upon at least 5 working days notice (unless called sooner as a matter of urgency)
- The Committee will not be responsible for the operation of the waste contract or any waste disposal authority executive functions
- The Committee will not be accountable or report to the Cabinet
- The Committee may decide matters within its terms of reference or refer them to full Council for determination in accordance with the usual rules of delegation.

As the Committee regulates or controls the finance of the Council (in relation to the funding provided to the Waste Contractor) the law does not permit co-optees to sit as members of the committee by virtue of s102(3) LGA 1972.

However, in order to benefit from a clearer separation of roles, the Committee may be advised by an external financial expert who will report to the Committee, attend its meetings and provide expert advice to it. As necessary, the Committee may also receive legal advice from an external firm of solicitors with expertise in banking law. The Council's s151 officer and Monitoring Officer will retain their overarching statutory roles in respect of the Committee.

The Cabinet will continue to be responsible for exercising the role of the Council's executive, acting as a waste disposal authority within the overall Budget and Policy framework set by the Council. The Cabinet will have no supervisory or other responsibility for the Waste Contract Credit Committee.

In addition to the Committee, suitably qualified and experienced council employees need to be designated to support the Council so that the Committee is presented with detailed reports which benefit from input from the external advisers.

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Waste Credit Governance Committee
20 October 2014

7. PROGRESS SUMMARY FROM TECHNICAL ADVISORS

Recommendation

1. **The Chief Financial Officer recommends that the summary report from Fichtner Consulting Engineers – Technical Advisors be noted.**

Introduction

2. As set out in its Terms of Reference, the Committee will be advised by external financial and legal advisers on behalf of the Council's s151 officer.

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

Supporting information

- Appendix – Summary report from Fichtner Consulting Engineers

Contact Points

County Council Contact Points
Worcester (01905) 763763, Kidderminster (01562) 822511 or Minicom: Worcester (01905) 766399

Specific Contact Points for this Report
Sean Pearce – Chief Financial Officer
01905 766268. 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 this report.

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MEMORANDUM

To:	Mark Forrester	**Organisation:**	Worcestershire County Council
cc:		**Organisation:**	
From:	Lekan Omoniwa	**Our Ref:**	S1291-0010-0158LO
Date:	06/10/2014	**No. of Pages:**	2
Subject:	Mercia Lta Progress Summary August 2014		

Dear Mark

1 INTRODUCTION

Mercia Waste Management Limited ("Mercia") is constructing the 200,000 tonnes/year Mercia EnviRecover EfW Plant in Kidderminster, 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 (up to August 2014) from the EPC Contractor (HZI), Mercia and the Owner's Engineer, and discussions during the monthly progress meeting held at the site on 11th September 2014.

2 PROJECT PROGRESS

The site has been cleared and vehicle routes have been established across the site. A legal agreement permitting access across the sewage works which will enable excavated clay to be supplied to the adjacent brick works is anticipated in September 2014. In the interim, excavated material is being disposed of at Hill and Moor Landfill site.

The two contractors appointed for the piling works are expected to mobilise and commence piling by late September 2014. The piling work is slightly delayed as it was scheduled to commence in early August 2014. Mercia has advised that HZI is seeking a mitigation plan from the civils sub-contractor (Interserve) for the civil works.

HZI has been submitting civil and process design documents to the Owner's Engineer for review.

At present the plant is due for Take Over on 28th February 2017. However, HZI is targeting early completion by November 2016.

3 KEY PROJECT RISKS AND OBSERVATIONS

An Approved Programme is still not yet in place. HZI has submitted up to five revisions to the programme which were rejected by Mercia as they did not comply with the contract specification. Mercia has advised that the Owner's Engineer will comment on the robustness of HZI's programme once it has been approved.

There are ongoing delays to the piling and civil works which could potentially delay the entire programme if suitable mitigation plans are not put in place. Interserve has been asked by HZI to produce a mitigation plan which is expected to incorporate parallel piling works by two appointed piling contractors in order to recover this delay. As a result, whilst the target completion date for this task may slip, the target take over date still remains achievable.

A number of changes have been made to the permitted planning drawings, which will require the approval of the Local Planning Authority (LPA). Mercia indicated that it expects these changes to be approved as non-material amendments (section 96A) to the planning consent. However, our view is that three of the proposed changes, specifically:

(1) inclusion of the continuous emissions monitoring system (CEMS) access platform on the chimney stack;

(2) modification of the tipping hall geometry; and

(3) slight geometric changes to the building envelope resulting from setting out of the building,

are subject to interpretation on whether they can definitively be considered to be non-material changes. It is possible that the LPA may consider them to be significant/material changes due to their visual impact.

Mercia stated that once the updated drawings are available, a meeting will be scheduled with the LPA to discuss the proposals in advance of any submission seeking to change the planning consent. Mercia believes that this approach will ensure submissions are made with appropriate sensitivity to the LPA's requirements, avoiding submission of unsatisfactory changes and thereby minimising any potential delays.

4 Financial and Commercial

Mercia is in discussions with HZI concerning payment for milestone 3 – Enabling Works Complete. The welfare and office facilities are now in place, albeit in a temporary location. HZI has confirmed that these facilities will be relocated to their contractual locations. As a result, Mercia is exploring the option of making a part payment to HZI, which it proposes to fund directly without recourse to making a drawdown request to the lenders.

Due to various delays, milestones 2 and 4 which were due in month 1 and 3 respectively, will be achieved by October 2014 (month 5) at the earliest.

Four Variation orders have been issued to date against Technical Queries which led to changes to the Specification. Only one of these Variation Orders – removal of the requirement for an aircraft warning light – resulted in an adjustment to the contract price.

5 Planned Activities Next Period

At present the following activities are planned for September 2014:

- completion of the storm & foul water drainage;
- advancement of the basement area excavation works;
- mobilization for piling works;
- commencement of clay deliveries to the adjacent brick works; and
- connection of drainage ditches for temporary drainage scheme.

Yours sincerely
FICHTNER Consulting Engineers Limited

Lekan Omoniwa
Consultant

Phin Eddy
Commercial Director

worcestershire
countycouncil

Waste Credit Governance Committee
20 October 2014

8. WAIVERS GRANTED

Recommendation

1. **The Chief Financial Officer recommends that his decision to grant a waiver for the extension of time to lodge the financial close financial model with the custodian be endorsed.**

Introduction

2. Part of the Committee's Terms of Reference is 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 may 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.

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

Contact Points

County Council Contact Points
Worcester (01905) 763763, Kidderminster (01562) 822511 or Minicom: Worcester (01905) 766399

Specific Contact Points for this Report
Sean Pearce – Chief Financial Officer
01905 766268. 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 this report.

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