

Waste Credit Governance Committee

Wednesday, 28 October 2015, County Hall, Worcester - 2.00 pm

Present:

Minutes

Mr W P Gretton (Chairman), Mr L C R Mallett (Vice Chairman), Mr R C Adams, Mrs S Askin, Mr R W Banks, Mr M H Broomfield, Mr P M McDonald and Mr P A Tuthill

Available papers

The Members had before them:

- A. The Agenda papers (previously circulated); and
- B. The Minutes of the meeting held on 17 July 2015 (previously circulated).

A copy of document A will be attached to the signed Minutes.

The Chairman informed the Committee that Jim Parish had sadly passed away. A Minute's silence was held in his memory.

33 Named Substitutes (Agenda item 1)

Mr P McDonald substituted for Mr P Denham.

34 Apologies/ Declarations of Interest (Agenda item 2)

An apology was received from Mr P Denham.

35 Public Participation (Agenda item 3)

Mr Rob Wilden addressed the Committee. He asked questions in relation to Agenda item 6 – Progress report from technical advisors. The Chairman thanked Mr Wilden for his questions and promised that he would receive a written response in due course.

Mr Sheridan Tranter addressed the Committee. He asked questions in relation to Agenda item 6 – Progress report from technical advisors. The Chairman thanked Mr Tranter for his questions and promised that he would receive a written response in due course.

Mrs Eve Jones addressed the Committee. She asked questions in relation to Agenda item 6 – Progress report

from technical advisors. The Chairman thanked Mrs Jones for his questions and promised that he would receive a written response in due course.

36 Confirmation of Minutes (Agenda item 4)

RESOLVED that the Minutes of the meeting held on 17 July 2015 be confirmed as a correct record and signed by the Chairman.

37 Actual construction period cash flow test (Agenda item 5)

The Committee considered the result of the Actual Construction Period Cash Flow Test.

The report set out details of the review performed by Deloitte and a summary of the results.

The Chief Financial Officer introduced the report and commented that the result of the ACPCFT performed by Mercia for the period under review was an Excess Cash Flow amount as at 30 June 2015 of £1,087k. The result showed that in the period from 1 May 2014 to 30 June 2015, the operations had produced £1,087k more than was forecast for this period in the Base Case Financial Model. The test was therefore satisfied.

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

- In response to a query, the Chief Financial Officer explained that Mercia was able to use its existing business as equity for cash flow purposes. A higher cash flow offset the need for Mercia to borrow early. The Council had the ability to lock up Mercia's equity if Mercia failed to achieve an adequate level of excess cash. However at present Mercia had the right level of equity to satisfy the tests
- The technical report indicated that there had been delays in the work on site, how was it possible therefore for Mercia to achieve an excess cash flow of £1m? The Chief Financial Officer explained whist the takeover date had moved backwards the repayment of the loan would commence on the Planned Takeover Date through the payment of Liquidated Damages. Excess cash flow within Mercia's existing business was primarily a matter for the Council in its capacity as purchaser of the waste disposal authority. The relevance to this Committee was that the test result provided comfort that Mercia had sufficient cash flows that define Mercia's equity contribution to the Energy from Waste Plant

38 Progress summary from technical advisors (Agenda item 6)

- How could delays in the programme of works impact on cash levels. The Chief Financial Officer responded that he had received written confirmation from Mercia that the delays to the work on site had not impacted on its core business
- In response to a query, the Chief Financial Officer explained that the operating costs generated by other activities related to tests on the ability of Mercia's existing business to generate cash
- Was the upturn in the economy a major reason for the amount of cash generated by Mercia? The Chief Financial Officer commented that the amount of waste going to land fill was increasing as the economy improved which meant that Mercia was able to charge the Council for additional tonnage that was handled. However this was only one of a number of factors which explained the cash flow surplus
- The Chief Financial Officer indicated that the next cash flow test was currently being undertaken.

RESOLVED that the result of the Actual Construction Period Cash Flow Test be accepted.

The Committee considered the summary report from Fichtner Consulting Engineers – Technical Advisors.

The Chief Financial Officer introduced the report and commented that:

- Prior to the termination of its contract with Interserve, HZI had appointed Dawnus to undertake the civil engineering work on the turbine hall which had allowed this aspect of the project to remain on track
- Since the termination of the Interserve contract, he had visited the site in person each month and received detailed appraisals of the project from representatives of Mercia. These appraisals had been confirmed in writing
- Written confirmation had been received from the Sponsors that they did not consider that there were any financial risks associated with the project at this stage that impacted on them as Sponsors. The Council in its role as Funder would only be exposed to risk after the Sponsors. The positive response from the Sponsors should provide comfort and assurance to the Council as Funder about the financial risks of the project

- Fichtner had highlighted that it had not been made aware of any issues during the month of September which needed to be drawn to the Council's attention
- The predicted take over date had slipped to 31 March 2017 although there was still a possibility that this could be brought forward. However this would not impact on the loan as it would be repaid irrespective of this delay
- There were a number of activities on the critical path. However it should be noted that activities moved on and off the critical path at different stages of the project
- It was anticipated that the building services contract would be let in November 2015
- The fire detection/suppression contracts were on the critical path as it was important that the relevant equipment was on site at the right time and that the contractors were available on site to commence work
- Fichtner had indicated that HZI had a good health and safety record on site and had concluded that it was a well-run site with good control processes.

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

- In response to a query, the Chief Financial Officer confirmed that at the takeover date, the Council would be in receipt of a fully operational facility that had passed all the relevant tests. Operating tests would be undertaken for an approximate six month period in advance of the takeover date to ensure that it was in full working order. Waste would be treated during this period without any cost to the Council
- Should the Council be concerned that the takeover date had slipped by four months from the original forecast date? The Chief Financial Officer stated that he had received an assurance from Mercia that the present forecast actual takeover date was accurate. Although the loan would be repaid in any respect from the Planned Takeover Date, it was in the Council's best interests to ensure that the plant was up and running as soon as possible. It had been anticipated that the contracts would be let out more quickly. HZI had had to take over and let the contracts following the termination of the Interserve contract. Civil Engineering works totalled approximately £40m of which £13m remained to be let. Of the £13m,

approximately £10m related to Building Services work which was particularly complex in nature but he anticipated that these contracts would be let in November 2015

- What was the reason for the termination of the Interserve contract and was it a clean break or had it impacted on the work on site? The Chief Financial Officer explained that HZI had been concerned about the time taken on the civil engineering works and they believed that to ensure that the contract remained on time and to budget, Interserve should be replaced. This had been agreed in consultation with Mercia. It was a clean break in the contract however it must be emphasised that it was an issue between HZI and Interserve. HZI had acted quickly and undertaken some of the work itself. HZI had provided Mercia with evidence that there was a separation of duties within its organisation between the teams undertaking the work on site and the on-going discussions with Interserve with regard to the termination. The Council's relationship was with Mercia and an assurance in this respect had been received from them
- In response to a query, the Chief Financial Officer stated that the only major (Schedule 7) contract not yet signed off was for building services which represented a total of £10m
- In response to a query, the Chief Financial Officer commented that the variation orders would not impact on the financial package but their significance to service provision would be considered by the Council's Waste Disposal Authority Team
- Was the decision not to provide a concrete lining wall to the perimeter secant piles of any significance? The Chief Financial Officer stated that there was a process of checks and balances to ensure that HZI were delivering the construction of the Plant within the required specifications. This was a matter for the Council as the purchaser. However he confirmed that a quality test had been signed off by the Council and the matter would be referred to that team
- Was the decision not to provide the concrete wall lining a cost-driven decision? The Chief Financial Officer commented that this was a matter for the Council's waste management team and he would facilitate a response from them.

RESOLVED that the summary report from Fichtner

**39 Risk Register
(Agenda item 7)**

Consulting Engineers – Technical Advisors be noted.

The Committee considered the mitigated and unmitigated risks set out in the Risk Register.

The Chief Financial Officer introduced the report and commented that:

- Although the expected takeover date had been deferred until 31 March 2017, the repayment of the loan on 28 February 2017 was not at risk
- The Due Diligence test had been undertaken to establish the financial strength of HZI to continue with the contract. No concerns had been raised as a result and therefore there was no change to the residual risk RAG rating of six
- The Council was not facing any more risks as a result of the contract therefore it was considered that the security packages were working effectively
- In response to comments made at the last Committee, he had provided a letter from Fichtner which confirmed that there were no concerns about the quality of the work as a result of the termination of the Interserve contract.

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

- At what stage would the risk associated with the repayment of the loan turn to a RAG rating of Amber? The Chief Financial Officer explained that the Council as lender had the right to call the loan into default if construction was not completed by a long stop date approximately 18 months after the loan repayment date and at some point prior to this point the rating would change to Amber
- In response to a query, the Chief Financial Officer stated that contracts below £10m would be signed off by HZI. The Council had the ability to sign off contracts over £10m as part of Schedule 7 of the Loan Agreement
- Did the daily inspections by Fichtner give the Council further assurance about the quality of the work carried out? The Chief Financial Officer commented that there was a range of control mechanisms that were in place to ensure that the lender and purchaser were satisfied with quality of the work undertaken. He summarised that the letter from Fichtners provided a summary of the Technical Consultants work for Mercia and their

views on the overall quality of the project that was a focus of the discussions at the last Committee.

RESOLVED that the unmitigated and mitigated risks set out in the Risk Register be accepted.

**40 Waivers/
consents
(Agenda item 8)**

The Chief Financial Officer confirmed that for the period under review the following waivers/consents were requested by the Sponsors and approved by the Councils:

- The Councils provided a waiver/consent for the re-appointment of ARUP and Royal Haskoning as new Major Subcontractors for the plant design following the HZI termination of Interserve
- The Councils provided a waiver/consent under clause 18.4(b)(ii)(G) of the Senior Term Loan Facility Agreement in relation to the appointment of either Compco or Argus as new Major Subcontractors to replace a number of the subcontracts that needed to be re-procured following the HZI termination of Interserve
- The Councils provided a waiver/consent for the appointment of Orona Elevators for the lift contract following the HZI termination of Interserve.

The Councils' officers and advisors conducted the required Due Diligence prior to these approvals.

Sponsors had now confirmed that the remaining civil packages to be let by HZI, following the termination of Interserve, was £13.7M compared to £19M at the start of August. Of the £13.7M that is outstanding c. 70% related to building services.

RESOLVED that the waivers/consents granted during the period under review be noted.

The meeting ended at 3.00pm

Chairman