REPORT FOR: Council

Date of Meeting:	4 July 2013
Subject:	West London Waste Authority – Infrastructure Loan
Responsible Officer:	Simon George, Director of Finance and Assurance
Exempt:	No.
Enclosures:	None.

Section 1 – Summary and Recommendations

Harrow is a participating borough in the West London Waste Authority, the latter having responsibility for Harrow's waste disposal. WLWA has commissioned a new energy from waste plant and is offering Harrow the opportunity to invest £15 million into the project.

Recommendations:

Council is asked to agree an addition to the capital programme of £15 million to be loaned to the WLWA and delegate authority for final approval to the Section 151 Officer after consultation with the Portfolio Holder after receiving assurance from Legal Officers on the terms.

Section 2 – Report

1. The Council has been invited to loan £15 million to the West London Waste Authority (WLWA) to part finance the cost of a new energy from waste facility. This expenditure will be treated as an addition to the capital programme and as it was not previously identified, requires Council consideration and approval to proceed. As terms are still being finalised it is proposed that final authority to proceed is delegated to the Section 151 Officer in consultation with the Portfolio Holder.

Background

2. WLWA is a statutory joint authority with six constituent boroughs (Brent, Ealing, Harrow, Hillingdon, Hounslow and Richmond). As a waste authority it is responsible for disposing of the waste collected by the six boroughs. WLWA is primarily financed by an annual levy on the boroughs. The levy includes fixed fees and a charge based on waste tonnage.

3. WLWA identified some years ago that it was in danger of failing to hit Government targets for diverting waste from landfill. It also identified that the rising cost of landfill, together with potential penalties for exceeding landfill targets, would mean that as well as the environmental impact of landfill, WLWA would be facing excessive costs if it did not take effective action.

4. Over past years, WLWA has let a number of contracts to manage the disposal of waste but now needs to secure a replacement for the landfill contracts. It has considered a wide number of options and worked through an OJEU process which has led to the current position where WLWA have agreed the preferred bidder for the development of a new energy from waste facility. This development will enable costs to be contained, 96.1% diversion from landfill and a reduced carbon impact from waste disposal. The proposal is also attractive to Harrow as it offers an almost fixed cost to waste disposal

5. The next phase of this proposal is to finalize the contract terms and move to financial close with the preferred bidder as quickly as practical to ensure there is no delay in the development of the new site.

Project Proposal

6. The proposal from the preferred bidder assumed funding from a combination of equity from the consortium and debt secured from commercial lenders. As part of the overall funding discussions the WLWA has raised the possibility of providing direct funding for the project (with WLWA effectively drawing the finance for this from loans from the constituent boroughs). The proposition is that the boroughs will be able to access finance at a lower rate than commercial lenders.

7. WLWA has also identified the possibility of making the investment either during the development of the plant (in effect contributing at the same

time as the commercial lenders) or at the completion of the plant. The relative risks and returns are discussed in more detail in the Finance and Risk sections below.

8. It should be stressed that the overall waste facility proposal and final contract is in no way dependent on this decision i.e. this is purely a decision on whether the Council chooses to invest directly in the project to achieve a better financial outcome.

9. The proposal is for Harrow and each of the other boroughs to invest £15m in this project via a loan to WLWA that they subsequently provide as funding for the project. WLWA will then repay this loan over the twenty five year life of the agreement together with an interest rate based on the savings achieved from removing part of the equity or commercial debt currently assumed.

Financial Returns

10. The accountants, PwC have reviewed the project cashflows and calculated that on a cost neutral basis, WLWA is able to provide a minimum return of 7.4% p.a. on the loans provided by each borough. As contractual negotiations continue, this return is subject to change.

11. The projected returns are far in excess of the average rate of return anticipated for treasury investments in 2013-14 (circa 1.5%) and also the rate of interest on a 25 year reducing balance loan (3.54% as of 19th June). The investment therefore almost certainly offers a significant gain regardless of whether it is funded from existing cash balances or by way of new funding. The working assumption is that existing cash balances will be used initially. Authority to borrow is given within the annual treasury strategy should that become advantageous.

12. The **net** benefit to Harrow (not the gross return) will be impacted by changes in prevailing interest rates, although the net return can be protected by taking out a matching loan.

13. The six boroughs have jointly appointed Sector, Harrow's treasury advisor, to review the PwC return analysis and to comment on the project risks. There are further comments on risk below, but in terms of returns, they confirmed the returns calculated by PwC.

Financing options

14. Two different funding options have been offered to the six boroughs. One is to fund the project in stages during the construction phase (2013 to 2016). The second is to fund at the service commencement (broadly end of construction) in 2016. The return for the second option, service commencement, is a little lower at 7.4% compared with 7.9% for stage funded. There is a preference, subject to agreement with the other funding boroughs, that we opt for service completion to minimize risk. This also avoids negative cash flows from loan interest payable during the construction phase impacting on already agreed council budgets.

Approval Process

15. Should the investment proceed it will require an increase in the capital programme, which requires the approval of full Council. The loan will be treated as capital expenditure for accounting purposes.

16. It is understood that for the financing option to proceed that collectively the six boroughs need to commit £75 million and agree a common funding timetable (stages or service commencement).

17. At the time of writing this note, none of the other five boroughs have yet formally considered their position on this issue. We are aware of two positive recommendations, with no information from the other three boroughs. We are seeking authority to proceed with the £15 million investment subject to:

    a) confirmation that the returns are as projected once the contract terms are finalized,
    b) Sufficient funds are pledged by the six boroughs to achieve the £75 million aggregate target, and
    c) Legal advice is received that the loan and other project documentation offers sufficient protection to the Council.

Financial Implications

18. Paragraph 15 above comments on the project investment return. PwC has calculated a **net interest** cash flow over 25 years after allowing for debt interest at 3.5% of £11.9 million for a £15 million investment at service commencement. In net present value terms this is £4.0 million, an appealing return. The cashflows and NPV are higher if funded in stages during construction or if existing cash balances are used. The capital value of the loan will also be repaid over 25 years.

19. If interest and the discount rates are increased to 5%, the net interest cashflow is reduced to £9.0 million and the NPV to £1.5 million. Should interest rates start to increase above current levels, Harrow's expected surplus can be protected by taking out fixed rate PWLB borrowing.

20. At all prevailing funding rates below 7.4%, the project will be financially beneficial to Harrow.

Risk Management Implications

21. Risk included on Directorate risk register? No

22. Separate risk register in place? No

23. Clearly in making this (or any) investment there is a risk. However, the risk has both been reviewed by the WLWA advisors (PwC) and independently on behalf of all the boroughs by our Treasury Advisors

(Sector). The view from both is that the major risk to WLWA (and therefore the Boroughs) is contained in the commitment to the overall procurement deal and is only marginally increased by the decision to provide direct investment (such risk being largely associated with the potential delay in realizing the benefits if the contractor were to fail in its obligations). The advisors have stressed the importance of ensuring that the WLWA contract with SITA contains appropriate conditions to maintain this position. A joint legal review has been proposed to ensure that the contract contains appropriate conditions and safeguards.

24. The recommendation to the other boroughs to fund at completion rather than during construction is aimed at avoiding unnecessary risk. All the participating boroughs must agree the timing of the contribution. The advice from Sector is that funding during construction does not add to project risk. However, caution suggests that funding at service commencement must put Harrow at least in a no worse position when considering the impact of project delays and cost overruns.

Equalities Implications

25. Was an Equality Impact Assessment carried out? A preliminary impact assessment indicates that there are no direct equalities implications arising from extending a loan to WLWA.

Corporate Priorities

26. The overall project, although not the funding options, will contribute to the priority “Keeping neighbourhoods clean, green and safe” through the environmentally friendly recycling and disposal of waste.

Legal Implications

27. The Council owes a fiduciary duty to its council tax payers to conduct its administration in a business manner with reasonable care and skill. The Council must carefully weigh up the risks and benefits of lending this money.

The Localism Act 2011 gives the council the power to do anything that individuals generally may do except where it is unable to do it because of a statutory limitation. An individual could do what is proposed and whether the loan is classed as capital expenditure or as a loan or “investment”.

Also section 12 of the Local Government Act 2003 empowers the council to “invest (a) for any purpose relevant to its functions under any enactment, or (b) for the purposes of the prudent management of its financial affairs.”

Section 3 - Statutory Officer Clearance

Name: Simon George Date: 25 June 2013	x	Chief Financial Officer
Name: Jessica Farmer Date: 25 June 2013	x	on behalf of the* Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: George Bruce, Treasury and Pension Fund Manager, 020 8424 1170

Background Papers: None

If appropriate, does the report include the following considerations?

1.	Consultation	NO
2.	Corporate Priorities	YES