LONDON BOROUGH OF CROYDON

REPORT:		**OFFICER DELEGATED KEY DECISION**
DATE OF DECISION		**08th March 2023**
REPORT TITLE:		**Refinancing of Streetlighting PFI**
CORPORATE DIRECTOR / DIRECTOR:		**Jane West – Corporate Director of Resources and S151 Officer**
LEAD OFFICER:		**Nish Popat – Interim Head of Corporate Finance**
LEAD MEMBER:		**Cllr Jason Cummings – Lead Member of Finance**
DECISION TAKER:		**Officer Delegated Decision – Jane West Corporate Director of Resources and S151 Officer**
AUTHORITY TO TAKE DECISION:		**7th December 2022 Mayor in Cabinet Decision with delegations.**
KEY DECISION?		Yes
CONTAINS EXEMPT INFORMATION?		Yes Appendix A2 and A3
WARDS AFFECTED:		All

1 SUMMARY OF REPORT

1.1 Cabinet received a report on 7th December 2022 delegating to Corporate Director of Resources and Section 151 Officer in consultation with Monitoring Officer and Cabinet Member for Finance to accept or reject the final outcome of the refinancing offer subject to due diligence.

1.2 The December report, provided in Appendix A, explained that the Council can receive of a gain share from refinancing the senior debt at a lower interest rate. At the time of the December meeting the Council was still in the process of conducting due diligence however a new lender had been found and all necessary formalisation was being conducted.

1.3 This delegated report now seeks the final approval from Corporate Director of Resources and Section 151 Officer to accept the gain that will be due and finally confirmed on the day of Financial Close (FC). Latest advice from Council's financial advisors, Local Partnerships, indicates a potential gain of between £0.650m and £0.800m. The decision also seeks to accept the retention of the Department of Transport (DfT) gain, equivalent to the same amount for Croydon Council, in return for a reduced PFI credit in 5 years.

1.4 Latest dry run exercise, which took place on the 23rd of February and confirmed via email by Local Partnerships seems to indicate a gain for Croydon of £0.738m, however this is still subject to change and final figure will not be known until the day of the FC.

2 RECOMMENDATIONS

Corporate Director of Resources and Section 151 Officer, in consultation with the Monitoring Officer and Cabinet Member for Finance is recommended:

2.1 To note the due diligence undertaken since the December 2022 Cabinet report and approve the upfront refinancing gain, with the final figure being identified on the day of Financial Close as detailed within draft Protocol attached in Appendix D.

2.2 To approve the Local Government Contracts Act Certificate (provided in Appendix F) and to approve entering into the Direct Agreement (Appendix G).

2.3 To note the Senior Lender's Direct Agreement (provided in Appendix G) and note within Appendix B under paragraph 2.5 and section 10 that this agreement is a standard practice for replacing old lenders with new and does not materially impact on the Council.

2.4 To approve the Council taking an upfront gain through a cash receipt as opposed to a reduced Unitary Charge payment.

2.5 To delegate to Head of Finance – SCRER to enter into any agreements to give effect to the decisions in this report, including the Deed of Variation to the Project Agreement, at the Financial Close call or after so long as they are not materially different to the position provided within this report.

2.6 To approve that Head of Strategic Finance, Planning and Commercial at London Borough of Lewisham to speak on behalf of Croydon at Financial Close.

2.7 To approve that the Council retains the gain allocated to DfT in return for reduced PFI Credits from 2026/27.

2.8 Note the legal report, Appendix B, on variations made to the Project Agreement to reflect the outcome of the refinancing on the PFI.

3 REASONS FOR RECOMMENDATIONS

3.1 A follow on from the December 2022 Cabinet decision to delegate the final outcome of the PFI review to Corporate Director of Resources and Section 151.

4 BACKGROUND AND DETAILS

4.1 Cabinet received a report in December 2022 advising the details of the Streetlighting PFI including the background of the arrangement. This report has been provided within Appendix A and explains the commercial and financial implications.

4.2 The recommendation is to accept a gain upfront rather than a reduction in unitary charge as explained within the December 2022 report under Financial Implications. However, having the cash upfront allows the Council to utilise that cash for other means such as paying down debt or investing to generate further income.

4.3 The review and due diligence work has now largely been concluded and the Council is due to receive a gain somewhere between £0.650m and £0.800m as advised in email from Local Partnerships provided in Appendix E. The final gain will not be known until the day of Financial Close (FC) when all stakeholders and their legal representatives will conclude the position depending on the prevailing interest rate on the day of the FC. Latest dry run exercise for the Financial Close, which took place on the 23rd of February and confirmed via email by Local Partnerships indicates a gain for Croydon of c£0.738m, however this is still subject to change.

4.4 The range has been advised by Chatham, a financial advisory firm as the key advisor on interest rate projections. Whilst the projected gain has substantial expert assessment the final figure is still dependent on the boarder financial market position on the day of FC.

4.5 Recommendation 1 asks for accepting any gain as not accepting a gain on the day of FC would simply result in refinancing not progressing and would result in abortive costs. Croydon would need to pay up to £95k towards abortive costs as the pre-financing agreement. Therefore, in an event of refinancing not progressing the Council would be worse off by up to £95k and accepting a gain of any value of zero would leave the Council better off as the final gain figure will be net of all costs.

4.6 The likelihood of the refinancing generating a negative outcome are close to zero unless the national lending market drastically changes by the time FC takes place.

4.7 A decision is required prior to financial close so that approval is given to legal advisors, the PFI SPV and the new lenders to proceed with entering into formal agreements.

4.8 As further assurance that the delivery of the refinancing meets value for money (VfM) requirements, a DfT approved report on VfM has been appended at Appendix C. This report has been approved within DfT decision making processes.

4.9 The DfT is also a beneficiary of the gain share that would be achieved from the refinancing. DfT provides the Council with PFI Credits annually, which total £6.003m and these are split 64:36 (as per the PFI split) with Lewisham. These credits were awarded to the Councils as financial support for entering into PFI schemes and these were based on the final costs of the PFI. As the refinancing generates a gain it reduces the overall costs of the Agreement and, therefore, DfT as a counterparty are also entitled to share in the refinancing gain.

4.10 During the review and due diligence process the Council also had the option to retain DfT's gain in return for reduced PFI Credits. The gain for DfT equals the gain for the Council as the refinancing requires a 50:50 gain between Local and Central Government. The Council explored the retention option to support its short-term financial challenges where the Council faces an immediate need to support its debt balance. Retaining DfT's gain would provide the Council with upfront additional cash that will allow the Council to avoid potential borrowing, reducing future interest costs associated with taking on new debt. The retention of receipts can be placed into a reserve balance and can be drawn down when the PFI credits are reduced and so would not impact the revenue position in the future.

4.11 To ensure that the reduction in PFI credits did not result in an immediate revenue impact DfT have agreed to retain the same level of PFI credits for a period of 5 years from February 2023. This provides the Council with cash upfront without creating an immediate negative revenue impact. Table below indicates that the Council is better off retaining DfT refinancing gain and delaying the PFI credit reduction for 5 years.

	£650k	**£800k**
	£'000	£'000
Not taking DfT gain	£0.00	£0.00
Taking DfT Gain - Immediate Credits Reduction	£103.00	-£3.00
Taking DfT Gain - Reduction in PFI Credit in 4 years	-£131.00	-£163.00

4.12 The calculation factors a net projected 5% savings per annum from reduced interest costs.

5 CONSULTATION

5.1 The refinancing of the senior debt is allowable under the existing legal agreements and the Council is only required to agree to this proposal if there are gains.

5.2 The Council has been working, via its advisors, closely with Equitix to proceed with the refinancing. The costs of the refinancing are funded from the gains share and if the refinancing does not proceed due to the financial benefit not being sufficient to cover the costs of the transaction (i.e.no financial gain), then each party (Council, Lewisham and SPV) will bear their own abortive costs.

5.3 During the refinancing process the Councils have been engaging and updating DfT on the progress of the process and DfT have been supportive.

6 IMPLICATIONS

6.1 FINANCIAL IMPLICATIONS

6.1.1 The costs, which include financial and legal advisory, are covered by the refinancing project with the gross gains generated by the refinancing review.

6.1.2 The Council will benefit from a one-off upfront cash injection which can be used to support corporate services and generate additional cash flow which will help with Treasury services.

6.1.3 The refinancing proposal can generate a gain through a reduction in unitary charge or an upfront capital receipt. Both generate the same net present value (NPV) and therefore, over time, the Council will receive an equal benefit under each option. Having a capital receipt upfront gives the Council greater flexibility as to how it uses the funds. For example, to pay down debt and reduce minimum revenue provision, or use the capital receipts to fund capital expenditure. The additional cash will also support the need for less cash flow borrowing.

6.1.4 Key risk with accepting an upfront gain is it increases the costs of terminating the PFI. However, the additional debt means increased costs if the PFI were to be terminated as more would need to be paid back to the lenders. However, it is important to note that the ability voluntarily to terminate a PFI arrangement is limited as this would not usually be value for money and requires approval from Central Government.

6.1.5 In the event that the refinancing does not proceed due to the financial benefit not being sufficient to cover the costs of the transaction, then each party (Authority and SPV) will bear their own abortive costs. For Lewisham and Croydon these will be our joint legal and financial due diligence costs associated with the transaction. These have been estimated to be circa £150k jointly, with the expectation that if the re-financing did not occur at this point, that all of these would be abortive costs, meaning these costs will be shared between Lewisham and Croydon in proportion with the Croydon's exposure estimated to be up to £95k.

7.1 LEGAL IMPLICATIONS

7.1.1 These legal implications should be read in conjunction with the legal implications set out in the Cabinet report at Appendix A. The powers set out in the Cabinet report remain relevant and the Executive Mayor has delegated authority as set out in the

Cabinet report. A detailed legal advice note from external solicitors is appended at Appendix B.

7.1.2 The Project Agreement is based upon on Standardisation of PFI Contracts (SOPC) 4, being (A) the fourth iteration of the Standard form of Project Contract issued by HM Treasury and (B) the basis of which PFI arrangements were entered into at the relevant time). Consequently, the Project Agreement contains provisions dealing with a refinancing of the senior debt. Such provisions are set out in Clause 60 and Schedule 12 of the Agreement.

7.1.3 Given the refinancing exercise is envisaged to result in a Refinancing Gain (defined below), the refinancing will constitute a “Qualifying Refinancing” under the Project Agreement. This means that (A) the Authority’s consent is required to implement the refinancing (and the Authority is required to act in good faith in this regard) and (B) entitles the Authority to receive a share of any gain generated by the refinancing (acknowledging that the refinancing will achieve improved economics) (**Refinancing Gain**).

7.1.4 The Project Agreement prescribes that:

i. The share of the Refinancing Gain to which the Councils are entitled is:
   - 50% of the refinancing gain which arises up to £1m.
   - 60% of any refinancing gain up to £3m.
   - 70% of any refinancing gain above £3m,

   and the Authority is not permitted to withhold or delay its consent to a Qualifying Refinancing for the purposes of obtaining a greater share than that prescribed;

ii. the Authority is entitled to take its share of the Refinancing Gain either as a single upfront payment (which should not be in excess of the day 1 gain paid to the project company’s shareholders), a reduction of the Unitary Charge over the life of the Project Agreement or a combination of the foregoing; and

iii. the Authority and the project company must negotiate in good faith to agree the basis and method of the Refinancing Gain.

7.1.5 As set out in the note prepared by Local Partnerships at Appendix C (the **LP Note**), Equitix have proposed a ‘commercial adjustment’ (the **Commercial Adjustment**) to the contractual position contained in the Project Agreement regarding the Authority’s share of the Refinancing Gain. The mechanic enabling this Commercial Adjustment to be implemented also results in the shares in the project company being sold by Croydon and Lewisham Lighting Services (Holdings) Limited (**HoldCo**) to Croydon and Lewisham Lighting Services (MidCo) Limited (**MidCo**) (being a further SPV company set up within the structure). More detail can be found in the legal memorandum found at Appendix B (the **Legal Memorandum**) and the LP Note but in summary this adjustment is necessary to incentivise Equitix to implement the refinancing and results in an improved refinancing gain position for the Authority.

7.1.6 Given the context outlined in paragraphs [7.1.4] and [7.1.5] above, a deed of variation to the Project Agreement will be entered into in connection with the refinancing which will, *inter alia*:

i. contain a consent from the Authority to (A) the refinancing; and (B) the entry into the new finance documents with Aviva; (C) the sale of the shares from HoldCo to MidCo; and (D) the distribution of the project company's share of the Refinancing Gain to MidCo;
ii. reflect the Commercial Adjustment;
iii. confirm the Authority's election to receive its share of the Refinancing Gain as a single upfront payment;
iv. reflect the replacement of the existing financing documents with the refinancing financing documentation; and
v. otherwise deal with certain of the contractual implications set out in the LP Note.

7.1.7 By its very nature, a refinancing will entail the replacement of the existing senior debt documentation with new debt documentation. A high level summary of these arrangements can be found in the Legal Memorandum but we would make particular note to the following:

i. Aviva is a fixed rate funder and as such (A) no new swap arrangements will be entered into; (B) the new finance documentation will include 'make whole' protection for Aviva which aims to compensate them for early receipt of any monies given the fixed nature of their debt pricing; and (C) the pricing of the new finance documentation will not be set until shortly before close given the reference point for such pricing will be the then prevailing SONIA mid-swap rate;

ii. The total amount of debt being incurred as a result of the refinancing is more than that currently outstanding under the existing finance arrangement. As such, coupled with the 'make-whole' protection mention in paragraph [7.1.7 i], the refinancing could give rise to an increase in termination liabilities in the event of a termination of the Project Agreement where such termination results in compensation being calculable under the Project Agreement by reference to, *inter alia*, the outstanding senior debt amount; and

iii. The implementation of the refinancing will require the existing hedging arrangements to be terminated. Such termination will occur on the day of the refinancing. The price of breaking the Existing Hedging and the final Aviva debt pricing each depends on the market at the time of refinancing. As such the amount of the Refinancing Gain will not be definitively known until close to completion of the refinancing though a Closing Protocol has been agreed which, together with the role of Local Partnerships and 'dry runs' in the lead up to completion of the refinancing, will result in visibility as to the likely outcome of this process and as such the Refinancing Gain achieved.

Comments approved by the Head of Commercial & Property Law on behalf of the Director of Legal Services and Monitoring Officer. (Date 08/03/2023)

7.2 HR IMPLICATIONS

7.2.1 There are no immediate HR implications arising from this report for Croydon Council employees or staff.

Approved by: Gillian Bevan, Head of HR, Resources and Assistant Chief Executives on behalf of the Chief People Officer

7.3 EQUALITIES IMPLICATIONS

7.3.1 There are no equality implications, arising from this report.

Approved by: Denise McCausland- Equalities Programme Manager

8. APPENDICES

Appendix A - December 2022 – Cabinet Report on Refinancing of Streetlighting PFI

Confidential Appendix A2 – Equitix refinancing model

Confidential Appendix A3 – Local Partnerships Quote

Appendix B - BrowneJacobson – Legal Report on variations and updates made to Project Agreement

Appendix C - Value for Money Report and DfT approval

Appendix D – Financial Close Protocol

Appendix E – Email from Local Partnerships confirming gain range

Appendix F - Local Government Contracts Act Certificate

Appendix G - Senior Lender's Direct Agreement

9. BACKGROUND DOCUMENTS

December 2022 – Cabinet Report on Refinancing of Streetlighting PFI including Appendices