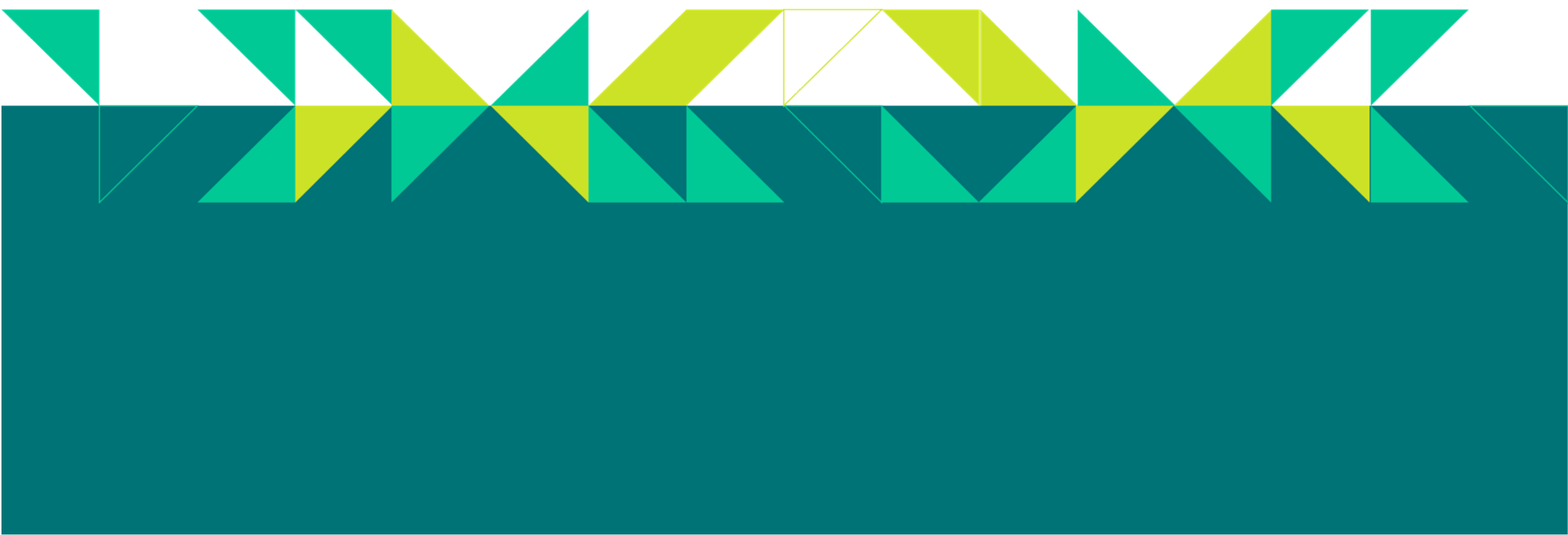
JOINTLY OWNED BY

CROYDON AND LEWISHAM STREET LIGHTING PFI PROJECT

Financial Report on the Planned Refinancing

Draft 2 – January 2023



Contents

1. Executive Summary **4**
1.1. Key Metrics 4
1.2. Background and introduction 4
1.3. Existing Funding arrangements 5
1.4. History of the Refinancing 5
1.5. Refinancing Funding Competition 5
1.6. Proposed Refinancing details 7
1.7. Overall Refinancing Gain and Sharing Arrangements 7
1.8. DfT Gainshare arrangements 8
1.9. Value for Money for the Authorities 9
1.10. Conclusion 10
2. Background and Project information **12**
2.1. The Project 12
2.2. Performance and demand 13
3. Refinancing Exercise **15**
3.1. History of the Refinancing 15
3.2. Other Project Agreement issues 15
3.3. Refinancing Funding Competition 15
3.4. Refinancing gain calculation 16
3.5. DfT Entitlement to Gainshare 17
4. Business Case assessment of the Refinancing – Introduction and Strategic Case 19
4.1. Introduction 19
4.2. Strategic Case: 19
5. Economic Case **20**
5.1. Introduction to the Options 20
5.2. ‘Do Nothing’ option 20
5.3. ‘No Gear Up’ option 20
5.4. Maximised Debt Refinancing Option 21
5.5. Comparison of the options 22
5.6. Upfront gain versus reduction in unitary charge 22
5.7. Introduction to the Value for Money Assessment 23
5.8. Council Default and Voluntary Termination 23
5.9. Force Majeure 25
5.10. Breaches of Prohibited Act Provisions 26

CONFIDENTIAL

5.11. Contractor Default 27
5.12. Robustness of the SPV 27
6. Commercial Case 29
6.1. Introduction 29
6.2. Project Documentation 29
6.3. Risk pre-financial close 29
7. Financial Case 32
7.1. Affordability 32
7.2. Risks to the refinancing and forecast level of refinancing gain 32
8. Management Case 34
8.1. Authorities team 34
8.2. Advisers 34
8.3. Timetable 35
Appendix 1 Details of the Funding Competition 37
Appendix 2: Refinancing Transaction Costs 38
Appendix 3: Refinancing Gain Calculation 39
Appendix 4: Pre and Post Refinancing Model Key Assumptions and Inputs 44

CONFIDENTIAL

1. Executive Summary

1.1. Key Metrics

The values are based on the financial model "Croydon Lewisham Refinancing v23.xls" and will be subject to updates up to the date of refinancing to primarily reflect movements in interest rates to that date.

Metric	Value	Comment
Overall Refinancing Gain	£4.97m	
Public Sector Refinancing Gain	£2.51m	Croydon £0.81m Lewisham £0.45m DfT £1.25m
Private Sector Refinancing Gain	£2.46m	
Amount of debt refinanced	£58.88m	
Amount of New debt	£66.15m	Refinancing benefits from release of £3.58m DSRA
Interest Rate	5.21%	SONIA Mid swap reference rate 3.46% Margin 1.75%
Swap Break Costs	£3.64m	
Contract start Date	April 2011	
Contract Expiry Date	July 2036	

CONFIDENTIAL

1.2. Background and introduction

This paper assesses the potential for a financial benefit to the London Borough of Croydon ("Croydon Council") and the London Borough of Lewisham ("Lewisham Council"), together "the Authorities" from the refinancing of the Croydon & Lewisham Street Lighting PFI Contract (the Project or the PFI Contract) which reached financial close in April 2011. The Project Agreement (Project Agreement or Contract) for the Project was signed with Croydon and Lewisham Lighting Services Limited ("CLLSL" or the SPV).

The Project included the refurbishment of 42,200 street and housing association lights, replacement of 8,400 illuminated traffic signs and bollards, re-lighting of 20 subways, and managing car park lighting and festive decorations. A Core Investment Programme Period ("CIPP") was completed in November 2016. The Project is now in the operational phase, with the day-to-day operations being delivered by Milestone Infrastructure Limited (the "OpCo") under a sub-contract from the SPV. Responsibility for delivery of the services was initially subcontracted to Skanska Construction UK Limited and was novated to Milestone Infrastructure Limited in 2021.

The contract is scheduled to expire in July 2036.

The Authorities jointly pay a unitary charge to the SPV to cover all the costs of the PFI scheme, including the costs of servicing the debt, as well as ongoing services and

maintenance of the street lighting in the Boroughs. The Project is one that the Authorities consider works effectively with few deductions and there are good working relationships between the Authorities, the SPV and with OpCo.

Originally, Skanska plc was the owner of the SPV. The SPV is now 100% owned by Equitix having purchased it through a mixture of vehicles being, the Equitix Fund V LP, the Equitix MA 8 LP, and Equitix MA 11 LP.

Equitix has been successful in both acquiring PFI schemes and then re-finance PFI debt in recent years. It currently has over 300 existing PFI /PPP contracts and infrastructure projects in to which it has committed over £7.5bn of equity capital.

1.3. Existing Funding arrangements

Following Equitix's acquisition of the Project, the Project continues to have a typical PFI project financing structure. Equitix's investment is through a combination of pure equity and shareholder loans with the following amounts:

Pure Equity £100

Shareholder loans £6.56m (estimate balance outstanding at date of refinancing)

Senior debt was provided by a group of 4 banks and who remain the funding group. These are:

Bank	Debt proportion	Swaps proportion
SEB (*)	33%	0%
SEK (*)	25%	0%
Lloyds	17%	50%
NIBC	25%	50%

(*) Swedish banks whose involvement related to Skanska's initial invollvement

The senior debt outstanding at the proposed date of refinancing is £58.9m. Some of the key metrics on the existing senior debt funding are as follows:

Swap Rate	4.76% (incl Credit Spread & MLAs)
Margins	2.00% until 30 Nov 2024 2.20% until 30 Nov 2031 2.40% until maturity
Tail	12 months (13 years remain)
Reserve Accounts	Debt Service Reserve Account – DSRA (£3.58m) current balance)

1.4. History of the Refinancing

As with most PFI projects of a similar age, the Project has standard refinancing clauses and Equitix initially embarked on exploring a refinancing in October 2020. However, the process did not fully progress until Spring 2022 when Equitix presented a worked up refinancing proposal. The Authorities appointed financial / commercial advisers (Local Partnerships) and legal advisers (Browne Jacobson) in early summer 2022 and a Memorandum of Understanding (MoU) was signed between the Authorities and Equitix in late summer 2022 at which point the refinancing process fully commenced.

1.5. Refinancing Funding Competition

CONFIDENTIAL

Operis received 17 responses from 18 funders issued the funding documents, albeit some responses were declines to bid. The street lighting refinancing funding market is well established in the UK albeit new entrants are continuing to join. Going to 18 prospective funders is at the higher end of market engagement and with a mix of the existing funders in the project, established refi funders, institutional and bank debt allowed for the best possible funding solution to be obtained.

The above resulted in 8 credible bids from a mix of banks and institutional funders. Of the existing funders only SEB put in a credible bid but only wanted a maximum of 33% of the new funding.

It appears that some overseas funders could not get comfortable with the Croydon financial situation. However, the main players in this lending space all bid.

Having a response from a good spectrum of the market was seen as positive and allows a good assessment of the pros and cons of different funders / combination of funders from which an informed decision can be made.

As shown in the summary of funder proposals in Appendix 1 there was a range of offers both in respect of terms offered and the proportion of the new debt that funders would be willing to take on. All of this meant that there was a significant follow up process conducted by Operis to try to get an optimal preferred funding package.

The successful funder was Aviva, who are proposing a SONIA based product, albeit with no swap (similar to their more familiar gilt based products but with a different pricing source). They were selected for the following main reasons:

- They offered the best overall terms;
- They were willing to take 100% of the funding;
- Aviva are a well-established funder in the Street Lighting project refinancing market, and have done refinancings with Equitix recently.
- They have precedent funding documents that they have agreed with Equitix previously which can be used.
- The pricing of the funding at financial close is more transparent than with bank debt.
- The due diligence process is likely to be more streamlined and less expensive – Aviva have already confirmed they do not need a full new technical assessment of the project but can rely on the original due diligence plus the ongoing technical adviser reports that have been produced.

All of the above indicated that Aviva's proposition, as well as being competitive, had a good probability of being delivered in an efficient manner

Local Partnerships advised the Authorities that an appropriate funding competition had been conducted and that the overall terms and package offered by Aviva were 'on market'. The main terms being offered are as follows:

Funding Term	Aviva Terms
Underlying SONIA mid swap rate	3.46% – will be subject to change up to financial close
Funding Margin	1.75% flat
Tail	6 months
Swap credit spread	n/a
Senior facility Arrangement fee	1.0%

CONFIDENTIAL

ADSCR average & min	1.15
LLCR average & min	1.15

Aviva have proactively worked through the due diligence process and are aiming to obtain Credit Committee approval in early January 2022.

1.6. Proposed Refinancing details

Based on the above terms, and following discussions with existing funders and the swap providers, the following refinancing arrangement was proposed by Equitix to the Authorities:

- The existing debt providers exit;
- Maximise the new debt from Aviva within the constraints of cover ratios and the NPV of the Authorities' share of the gain exceeding the NPV of the Equitix share of the gain etc;
- Release the cash held in the DSRA of £3.58m and replace with facilities; and Maximise the amount of upfront gain payable at the refinancing date available to both parties and share based on an agreed approach

The table below shows the sources and uses of funds from the refinancing.

Sources	***£m***	***Uses***	***£m***
Refi debt facility drawn	66.15	Swap break cost	3.64
DSRA released	3.58	Legal and technical transaction costs	0.91
Opening cash balance	-	Funding arrangement fees	0.71
		Authorities share of refinancing gain	2.51
		Intercompany loan to MidCo	3.08
		Existing senior debt	58.88
Total	**69.73**		**69.73**

1.7. Overall Refinancing Gain and Sharing Arrangements

Based on the estimated swap breakage costs and underlying SONIA rates for the new debt at 31 January 2022 and reflecting the above terms, the estimated refinancing gains are as follows:

£m	**NPV of gain @ 14% Threshold Eq. IRR**	**Upfront gain**	**Comment**
Authorities share	2.515	2.515	All gain taken up front
SPV Share	2.458	3.082	Up front funds used to make shareholder loan which is then repaid and equity distributions made as normal. Hence higher up front but lower in overall NPV terms
Total	4.973	5.597	

The sharing arrangements include a commercial adjustment to the contractual sharing mechanism to allow the public sector to benefit from a higher level of refinancing than if the SPV had no gearing up of the level of debt. The commercial adjustment reflects:

CONFIDENTIAL

- that Equitix hold and value such assets as the this PFI Contract at around 6% in the current market. Evidence of this was provided to Local Partnerships;
- therefore if the additional refinancing gain arising from gearing up debt was purely shared on the basis of the contractual mechanism and applying a 14% discount rate there is very limited incentive for the Shareholders to gear up. As such the Shareholders require their share of the gain to be positive in NPV terms at that 6% discount rate; and
- the Authorities want all their gain up front;
- the public sector has to have the majority of the gain, thus requiring an adjustment to the contract provisions which would prevent the Authorities from receiving a larger share of upfront gain than the shareholders

As such there is a multistep process to derive the gain reflecting the above. Similar commercial adjustments following similar processes have been utilised on PFI refinancings previously both on transport / street lighting projects and in other sectors including Home Office projects. The benefit of gearing up (i.e. the SPV taking on more debt) is shown in the table below:

	Total Gain	Authorities share	Shareholder share	
	£m	£m	£m @14%	£m @6%
No Gear Up	3.46	2.02	1.44	0.52
Gear up – No adjustment	5.70	3.59	2.11	-0.20
Proposed gain with the adjustment	4.97	2.51	2.46	0.52

As well as allowing the Authorities to receive an upfront gain (not possible without a gear up), gearing up allows the Authorities to get a greater refinancing gain. However, without a commercial adjustment the shareholders are actually disincentivised at a 6% discount rate to take on more debt. Hence the commercial adjustment to put the shareholders back in the same position they are in the no gear up scenario.

Each Council's share of the gain reflects their share of the project and is as follows:

	%	£m
Croydon Share	64	1.610
Lewisham Share	36	0.905
Total	100	2.515

Local Partnerships has reviewed the financial models and confirm that the approach to calculating the refinancing gain, determining each party's share of the gain, and the approach to modelling the Authorities' payments reflects the Project Agreement terms as adjusted for the commercial adjustment.

The Authorities has the option to take the refinancing gain as an upfront amount (subject to the shareholders also opting for this approach), as a reduction in unitary charge, or a combination of both. The £2.51m upfront translates to a reduction in unitary charge of around £0.21m p.a. The Authorities considered the relative merits of these options reflecting their financial position and have both confirmed that taking all the gain upfront is the preferred choice.

1.8. DfT Gainshare arrangements

Under the terms of each Council's PFI funding support from the Department for Transport (DfT) the Council is obliged to pass on 50% of its share of the refinancing gain to DfT. It has

CONFIDENTIAL

been agreed with DfT that this can be done by way of a reduction in the ongoing annual PFI funding over the remaining term of the PFI Contract. It has also been agreed that each Council can separately determine whether they then choose to defer that PFI Credit reduction should there be a justifiable financial reason to.

Lewisham Council have selected to have no deferral. Croydon Council who have issued a new Section 114 notice since the refinancing process commenced are looking for a deferral in the PFI reduction up to 2026/27 to help manage their current financial situation. Further details of the rationale for this deferral are set out in section 3.5, but the Council confirm they understand the financial implications of such a deferral, and are factoring them into the medium term financial planning.

The table below sets out the financial consequences of the above approach.

	%	Gainshare £m	Amount owed to DfT £m	Reduction in annual PFI Credit £m	When PFI Credit reduction commences
Croydon	64	1.610	0.805	0.120	2026/27
Lewisham	36	0.905	0.452	0.048	2023/24
Total	100	2.515	1.257		

1.9. Value for Money for the Authorities

The Authorities, in agreeing to progress the refinancing process, have from the outset sought a refinancing solution that would:

- maximise the refinancing gain, should it be assessed as value for money to do so; and
- maximise the amount of lump sum gain it received should it be assessed as value for money to do so.

In maximising the debt and increasing the balance of senior debt outstanding, the Authorities understand that they need to carefully consider the trade-off between potentially higher termination liabilities and the benefit of optimising the refinancing gain they receive. This consideration also needs to reflect that the Authorities' share of the refinancing gain (of £2.515m) will be partially offset by the loss of an element of its annual PFI funding from DfT but retains the full impact of the increase in termination liabilities that arise due to the refinancing.

The detailed analysis that supports that assessment is set out in section 5.6 of this business case.

The greatest increase in termination liabilities comes in the case of a Council Default or Voluntary Termination. It is recognised that those termination liabilities decrease over time as the senior debt is paid off. The details of this are set out below.

Maximum Increase in Termination Liabilities	£8.5m	This occurs in the initial period to March 2023.
Estimated number of years before the increased termination liabilities fall below the value of the Authorites refinancing gain	8.5 years	

CONFIDENTIAL

Therefore the Authorities have to assess the likelihood of wanting to voluntarily terminate the Project Agreement in the next 8-9 years, and in particular in the earlier periods where the additional termination liabilities are greatest. The conclusion is that likelihood is small given:

- The Contract, which is beyond the initial asset replacement period and into steady state operations, is being delivered to a high standard by the contractor;
- The Service is one that will be required for the remainder of the contract period; and
- There is potential for the PFI credit funding provided by the Government to support payment for the contract services be withdrawn in the event of a voluntary termination

As such the likelihood of a voluntary termination by the Authorities is very unlikely and if the Authorities chose to explore a termination during this period then a higher termination liability for a period would be factored into that assessment at the time. Given the low probability of the Authorities voluntarily terminating or defaulting under the Project Agreement, the Authorities consider the low risk of increased liabilities as acceptable in return for their share of the refinancing gain.

The other events of termination where the Authorities would be obliged to pay a compensation sum based on senior debt are Force Majeure or Uninsurability, Prohibited Act and Breaches of Refinancing provisions. Whilst the termination liability increases are higher than for Council Voluntary Termination, being at around £11m above the current liabilities for the remainder of the Project term depending on the basis of termination and the timing, the probability of any of these compensation provisions applying are considered small.

1.10. Conclusion

This report shows that:

- The process to select the post refinancing funder is considered appropriate and robust;
- Based on the size, status and performance of the Project, the overall refinancing gain achieved is as good as likely to be achieved in the market at this current time;
- The refinancing gain sharing arrangements including the commercial adjustment are acceptable to the council and acknowledge that the Shareholders need to be incentivised to gear up and deliver a larger refinancing gain to the public sector than the Shareholders are obliged to offer;
- The various advisers engaged by all parties are considered appropriate and the process for selecting and engaging advisers was robust, giving confidence on their capabilities and the transaction costs;
- Transaction costs are largely committed at this stage albeit there is still a healthy contingency which if not used would boost the overall refinancing gain;
- Both the Authorities and the shareholders recognise that they are exposed to transaction costs in the event the refinancing does not proceed as set out in the MoU;
- The risks to reaching financial close on the refinancing are relatively low now given the new funder who has significant experience in refinancing PFI projects in this sector and with Equitix have largely concluded due diligence ahead of going to seek Credit approval in early January; and
- The consequences for the risk profile after the refinancing, including an increase in termination liabilities in certain circumstances, are considered acceptable in light of the financial benefit to be gained.

CONFIDENTIAL

Each Council has significantly progressed towards obtaining the relevant approvals to conclude a deal on the best terms available with the plan being for each Council to give delegated authority to a responsible officer to conclude the refinancing within agreed parameters. Croydon Council have issued a further S114 Notice since the selection of Aviva as preferred funder. This has not raised any concerns from either Aviva or Equitix.

All elements of the transaction are progressing, and the parties are working towards closing the refinancing by the end of the 2022/23 fiscal year at the latest.

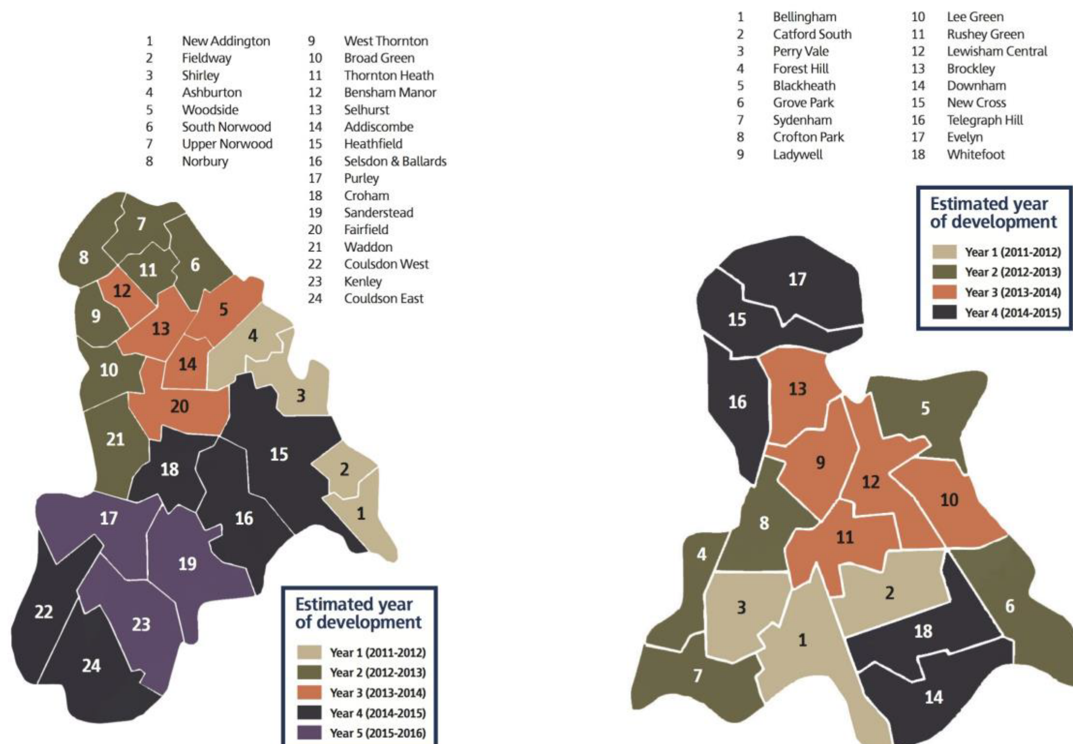
CONFIDENTIAL

2. Background and Project information

2.1. The Project

As set out in the Executive Summary, This paper assesses the potential for a financial benefit to the London Borough of Croydon ("Croydon Council") and the London Borough of Lewisham ("Lewisham Council"), together "the Authorities" from the refinancing of the Croydon & Lewisham Street Lighting PFI Contract (the Project or the PFI Contract) which reached financial close in April 2011. The Project Agreement (Project Agreement or Contract) for the Project was signed with Croydon and Lewisham Lighting Services Limited ("CLLSL" or the SPV).

The Project included the refurbishment of 42,200 street and housing association lights, replacement of 8,400 illuminated traffic signs and bollards, re-lighting of 20 subways, and managing car park lighting and festive decorations. A Core Investment Programme Period ("CIPP") was completed in November 2016. The Project is now in the operational phase, with the day-to-day operations being delivered by Milestone Infrastructure Limited (the "OpCo") under a sub-contract from the SPV. Responsibility for delivery of the services was initially subcontracted to Skanska Construction UK Limited and was novated to Milestone Infrastructure Limited in 2021. Milestone Infrastructure Limited is a major supplier of specialist highway electrical services, managing over 100,000 assets.



The contract is scheduled to expire in July 2036.

The Authorities pay a joint unitary charge to the SPV to cover all the costs of the PFI scheme, including the costs of servicing the debt, as well as ongoing services and maintenance of the street lighting in the Borough. The Project is one that the Authorities consider works very effectively with few deductions and there are good working relationships between the Authorities, the SPV and with OpCo.

Originally, Skanska plc was the owner of the SPV. The SPV is now 100% owned by Equitix having purchased it through a mixture of vehicles being, the Equitix Fund V LP, the Equitix MA 8 LP, and Equitix MA 11 LP.

Following Equitix's acquisition of the Project, the Project continues to have a typical PFI project financing structure. Equitix's investment is through a combination of pure equity and shareholder loans with the following amounts:

Pure Equity £100

Shareholder loans £6.56m (estimate balance outstanding at date of refinancing)

Senior debt was provided by a group of 4 banks and who remain the funding group. These are:

Bank	Debt proportion	Swaps proportion
SEB (*)	33%	0%
SEK (*)	25%	0%
Lloyds	17%	50%
NIBC	25%	50%

(*) Swedish banks whose involvement related to Skanska's initial invollvement

The senior debt outstanding at the proposed date of refinancing is £58.9m. Some of the key metrics on the existing senior debt funding are as follows:

Swap Rate	4.76% (incl Credit Spread & MLAs)
Margins	2.00% until 30 Nov 2024 2.20% until 30 Nov 2031 2.40% until maturity
Tail	12 months (13 years remain)
Reserve Accounts	Debt Service Reserve Account – DSRA (£3.58m) current balance)

Equitix is seeking to take advantage of falling long term funding rates, the cash available in a Debt Service Reservice Account (DSRA) which can be removed, and the established operational history of the Project to realise a benefit thorough refinancing the senior debt portion of the financing. The Authorities are keen to share that benefit.

2.2. Performance and demand

The unitary charge is an availability based payment (fixed in real terms) which increases by an agreed inflation mechanism. There are also provisions to adjust the unitary charge for movement in electricity costs, and increases / decreases in the street lights, traffic signs and bollards etc. Other than for application of these adjustment provisions and inflation, the unitary charge has not changed.

Responsibility for delivery of the services was initially subcontracted to Skanska Construction UK Limited and was novated to Milestone Infrastructure Limited in 2021.

CONFIDENTIAL

Milestone Infrastructure Limited is a major supplier of specialist highway electrical services, managing over 100,000 assets. The Key Commercial Terms are

- Milestone Infrastructure Limited's Liability Cap is 100% of annual service fee and 150% of annual service fee in the event of termination of the Sub-Contract
- A Parent Company Guarantee is provided by M Group Services Limited for the performance of Milestone

The table below reports the level of performance deductions for the past 5 years. These amounts are c. 0.1% of annual unitary charge levels and have been fully passed down from the SPV to the contractor

	Aug 17- July 18	Aug 18- July 19	Aug 19- July 20	Aug 20- July 21	Aug 21- July 22
Total Deductions	£10,665.18	£6,517.29	£6,681.89	£12,226.32	£6,879.79

There are no operational issues which should be addressed before the Authorities agree to the refinancing. There are is an issue with the application of the Insurance Premium Risk Sharing provisions. This is being addressed but separately to the refinancings

The Authorities have confirmed that:

- the Project is performing well;
- that there remains a strong on-going requirement by each of the Councils for the services operated under the Project; and
- that there are no obvious alternate options for service delivery available at a significantly lower cost and which would more than offset the costs of terminating.

CONFIDENTIAL

3. Refinancing Exercise

3.1. History of the Refinancing

As with most PFI projects of a similar age, the Project has standard refinancing clauses and Equitix initially embarked on exploring a refinancing in 2021. The Project reached financial close at a time of relatively high funding costs for PFI projects post the banking crisis of 2008 as the details in Section 2.1 indicate. Equitix therefore want to explore taking advantage of more competitive funding terms in the current market to reduce the funding costs of the Project for the remaining term of the Project.

However, the process did not fully progress until Spring 2022 when Equitix presented a worked up refinancing proposal. The Authorities appointed financial / commercial advisers (Local Partnerships) and legal advisers (Browne Jacobson) in early summer 2022 and a Memorandum of Understanding (MoU) was signed between the Authorities and Equitix in late summer 2022 at which point the refinancing process fully commenced.

3.2. Other Project Agreement issues

The Authorities team confirmed there were no other contractual issues or risk sharing positions that are considered to have benefit in exploring as part of the refinancing.

3.3. Refinancing Funding Competition

Operis received 17 responses from 18 funders issued the funding documents, albeit some responses were declines to bid. The street lighting refinancing funding market is well established in the UK albeit new entrants are continuing to join. Going to 18 prospective funders is at the higher end of market engagement and with a mix of the existing funders in the project, established refi funders, institutional and bank debt allowed for the best possible funding solution to be obtained.

The above resulted in 8 credible bids from a mix of banks and institutional funders. Of the existing funders only SEB put in a credible bid but only wanted a maximum of 33% of the new funding.

It appears that some overseas funders could not get comfortable with the Croydon financial situation. However, the main players in this lending space all bid.

Having a response from a good spectrum of the market was seen as positive and allows a good assessment of the pros and cons of different funders / combination of funders from which an informed decision can be made.

As shown in the summary of funder proposals in Appendix 1 was a range of offers both in respect of terms offered and the proportion of the new debt that funders would be willing to take on. All of this meant that there was a significant follow up process conducted by Operis to try to get an optimal preferred funding package.

The successful funder was Aviva, who are proposing a SONIA based product, albeit with no swap (similar to their more familiar gilt based products but with a different pricing source). They were selected for the following main reasons:

- They offered the best overall terms;
- They were willing to take 100% of the funding;
- Aviva are a well-established funder in the Street Lighting project refinancing market, and have done refinancings with Equitix recently.

CONFIDENTIAL

- They have precedent funding documents that they have agreed with Equitix previously which can be used.
- The pricing of the funding at financial close is more transparent than with bank debt.
- The due diligence process is likely to be more streamlined and less expensive – Aviva have already confirmed they do not need a full new technical assessment of the project but can rely on the original due diligence plus the ongoing technical adviser reports that have been produced.

All of the above indicated that Aviva's proposition, as well as being competitive, had a good probability of being delivered in an efficient manner

Local Partnerships advised the Authorities that an appropriate funding competition had been conducted and that the overall terms and package offered by Aviva were 'on market'. The main terms being offered are as follows:

Funding Term	Aviva Terms
Underlying SONIA mid swap rate	3.46% – will be subject to change up to financial close
Funding Margin	1.75% flat
Tail	6 months
Swap credit spread	n/a
Senior facility Arrangement fee	0.50%
ADSCR average & min	1.15
LLCR average & min	1.15

Both parties therefore agreed to progress the refinancing to the stage of making final decisions, and signed a Memorandum of Understanding (MoU) to this effect, and in doing so have committed to their agreed share of any abortive costs should the refinancing not conclude.

3.4. Refinancing gain calculation

The refinancing gain is derived by comparison of the distributions projected to take place after the refinancing to those forecast to occur without the implementation of the refinancing. The difference in such distributions is discounted at the Threshold Equity IRR of 14%, (as defined in the Project Agreement) to give the refinancing gain figure. This is to be shared between the public and private sector, with the public sector receiving their share calculated on the basis of the contract sharing provisions as amended for an agreed commercial adjustment.

It should be noted that figures quoted in the following analysis are ***Croydon Lewisham Refinancing v23.xls***' prepared by the SPV's financial advisor, Operis.

Whilst the financial model is well developed, the refinancing gain (and consequent change in compensation on termination figures) will change up to the day of financial close, including for issues arising from the due diligence process, the confirmed refinancing date and any changes to underlying interest rates.

The mechanism for this commercial adjustment will be set out in the financial close protocol being developed by Operis so that there is a consistent approach to optimising the financial model and gain at financial close. The Local Partnerships team have reviewed the financial models and the methodology. They have confirmed that the approach to calculating the refinancing gain, determining each parties share of the gain, and the approach to modelling

CONFIDENTIAL

the Authorities payments reflects the contract terms as amended and is in line with the HM Treasury Refinancing guidance. The financial model is being optimised in terms of calculating the refinancing gain, based on agreed assumptions. Through the due diligence process, the Authorities' share of the refinancing gain will be continuously monitored right through to financial close to ensure that happens.

The model audit review, and separate tax and accounting reviews have yet to be completed, albeit there have been two iterations and no major issues are anticipated. The Model Audit Report will be shared with the Authorities and Local Partnerships as it develops.

3.5. DfT Entitlement to Gainshare

Under the terms of each of the Council's PFI funding support from the Department for Transport (DfT) both Councils are obliged to pass on 50% of its share of their refinancing gain to DfT. It has been agreed with DfT that this can be done by way of a reduction in the on going annual PFI funding over the remaining term of the PFI Contract.

It has been agreed with DfT that this can be done by way of a reduction in the ongoing annual PFI funding over the remaining term of the PFI Contract. It has also been agreed that each Council can separately determine whether they then choose to defer that PFI Credit reduction should there be a justifiable financial reason to.

The methodology applied to determine the level of PFI Credit reduction has been agreed with DfT based on a precedent approach. This approach ensures that the DfT receives the same value of gain in NPV terms as would have been the case if received in a lump sum at the date of refinancing. The discount rate is the new senior debt rate, which in the current financial model is 5.21% but will change up to the date of the financial close. As such the annual PFI Credit reduction is an estimate, and is derived by goal seeking a value which delivers the required NPV gain. The current values are set out in the table below which also shows the period of deferral.

	%	Gainshare £m	Amount owed to DfT (50%) £m	Reduction in annual PFI Credit £m	When PFI Credit reduction commences
Croydon	64	1.610	0.805	0.120	2026/27
Lewisham	36	0.905	0.452	0.048	2023/24
Total	100	2.515	1.257		

Lewisham Council have elected to have no deferral.

Croydon Council have elected to seek a deferral until 2026/27 financial year. The Council issued a S114 notice in November 2022. This was the Council's third S114 notice in the last two years and currently is working through making the necessary financial improvements to reach financial sustainability. The Council is also suffering from significant borrowing over the past few years and currently hold £1.3bn in debt within its General Fund. The Council is

CONFIDENTIAL

currently in the midst of identifying a number of savings and efficiency gains so that the Council's budget remains balanced and removes itself from government support. As part of its options review the Council is seeking to retain cash to support Treasury cash management decisions so to reduce interest costs from refinancing existing debt and the Council has also identified that to resolve its financial challenge it will take significant time. As a result, the Council is requesting retention of the DfT gain and a grace period until 2026/27 before PFI credits reduce in return for retaining the DfT gain. The grace period will allow the Council the time it needs to reach financial sustainability and the upfront retention of DfT gain will assist with improved cash flow.

CONFIDENTIAL

4. Business Case assessment of the Refinancing – Introduction and Strategic Case

4.1. Introduction

The selected new funding partner for the Project, Aviva, proposed terms that provide good flexibility for the amount to be borrowed. As such both the SPV and the Authorities could assess options for maximising the refinancing gain and determine the balance between the upfront and long term gain, and the related value for money implications. The refinancing gainshare arrangements are on the basis of the Project Agreement provisions which in turn reflects HM Treasury guidance[1].

In assessing the available outcomes for the Authorities, Local Partnerships have used the Treasury Five Case structure to the extent it is relevant given the process and constraints dictated by this refinancing exercise.

4.2. Strategic Case:

The Project delivers the strategic objectives it was intended to.

Refinancing does not hinder or improve the delivery of the Project's strategic objectives or any of the wider objectives of the Authorities.

The refinancing exercise provides the Authorities with a choice to pursue a saving or not, balanced against the associated transaction costs and contingent liabilities.

CONFIDENTIAL

[1] HM Treasury Guidance Note: Calculation of the Authority's Share of a Refinancing Gain

5. Economic Case

5.1. Introduction to the Options

The principal choice facing the Authorities is whether to participate in the refinancing proposed by the shareholders or try to use its rights to prevent that refinancing.

On other projects, a 'no gear up' solution (ie not increasing the debt other than to meet any upfront transaction costs) has been considered where the parties just get the benefits in reduced funding margins plus any potential to release cash reserves (in Croydon & Lewisham's case this is the release of the £3.58m in the DSRA). This project is relatively small in value but with limited opportunity to reduce transaction costs. Owing to the high costs of exiting the existing funding arrangements if the debt is not maximised this leads to a sub optimal solution. It is not just the case that the upfront gains are lower, but that the overall gain and benefit to the Authorities are reduced.

Conversely, given the Project has the potential to absorb increased debt, the shareholders were willing to explore this option and soft market testing indicated that funders were willing to be flexible on the amounts borrowed, a solution which maximised the refinancing gain for all parties was considered the best option. As such a 'gear up' option was the preferred choice so long as the risk of taking on more debt was considered worthwhile to the shareholders. If the benefits for taking on increased debt did not meet investment criteria for Equitix they were willing to pursue a no gear up option.

Based on the above, three options compared are 'Do Nothing'', "No Gear Up" and 'Maximised Debt'

5.2. 'Do Nothing' option

The 'Do nothing' option is to continue with the Project as it stands, without the refinancing. The Authorities could veto any shareholders' refinancing proposal that increased its termination liabilities by any amount.

The Authorities are keen to realise a saving from the Project and so took the decision to invest time and resource to participate in the refinancing process.

5.3. 'No Gear Up' option

The 'No Gear Up' option replaces the existing debt with a similar amount of new debt (albeit with a small increase to cover transaction and other arrangement costs not met by the release of the DSRA. This equates to new funding of £60.5m compared to the refinanced debt outstanding of £58.9m.

Sources	*£m*	*Uses*	*£m*
Refi debt facility drawn	60.48	Swap break cost	3.64
DSRA released	3.58	Legal and technical transaction costs	0.91
Opening cash balance	-	Funding arrangement fees	0.63
		Authorities share of refinancing gain	0.00
		Intercompany loan to MidCo	0.00
		Existing senior debt	58.88
Total	**64.06**		**64.06**

CONFIDENTIAL

The refinancing benefit is shown in table below

	Total Gain	Authorities share	Shareholder share
	£m	£m	£m @14%
No Gear Up	3.46	2.02	1.44

5.4. Maximised Debt Refinancing Option

Maximising the new debt, within investment constraints and ensuring the Authority gain is greater than the equity gain, allows greater opportunity for both parties to receive an upfront gain.

The table below sets out the sources and uses for a maximised debt solution.

Sources	*£m*	*Uses*	*£m*
Refi debt facility drawn	66.15	Swap break cost	3.64
DSRA released	3.58	Legal and technical transaction costs	0.91
Opening cash balance	-	Funding arrangement fees	0.71
		Authorities share of refinancing gain	2.51
		Intercompany loan to MidCo	3.08
		Existing senior debt	58.88
Total	**69.73**		**69.73**

Based on the estimated swap breakage costs and underlying SONIA mid swap rates for the new debt at 17 January 2023 and reflecting the above terms, the estimated refinancing gains are as follows:

£m	NPV of gain @ 14% Threshold Eq. IRR	Upfront gain	Comment
Authorities share	2.515	2.515	All gain taken up front
SPV Share	2.458	3.082	Up front funds used to make shareholder loan which is then repaid and equity distributions made as normal. Hence higher up front but lower in overall NPV terms

The sharing arrangements include a commercial adjustment to the contractual sharing mechanism to allow the public sector to benefit from a higher level of refinancing than if the SPV had no gearing up of the level of debt. The commercial adjustment reflects:

- that Equitix hold and value such assets as the this PFI Contract at around 6% in the current market. Evidence of this was provided to Local Partnerships;
- therefore if the additional refinancing gain arising from gearing up debt was purely shared on the basis of the contractual mechanism and applying a 14% discount rate there is very limited incentive for the Shareholders to gear up. As such the Shareholders require their share of the gain to be positive in NPV terms at that 6% discount rate; and
- the Authorities want all their gain up front;
- the public sector has to have the majority of the gain, thus requiring an adjustment to the contract provisions which would prevent the Authorities from receiving a larger share of upfront gain than the shareholders

CONFIDENTIAL

As such there is a multistep process to derive the gain reflecting the above. Similar commercial adjustments following similar processes have been utilised on PFI refinancings previously both on transport / street lighting projects and in other sectors including Home Office projects. The benefit of gearing up (i.e. the SPV taking on more debt) is shown in the table below:

	Total Gain	Authorities share	Shareholder share	
	£m	£m	£m @14%	£m @6%
No Gear Up	3.46	2.02	1.44	0.52
Gear up – No adjustment	5.70	3.59	2.11	-0.20
Proposed gain with the adjustment	4.97	2.51	2.46	0.52

As well as allowing the Authorities to receive an upfront gain (not possible without a gear up), gearing up allows the Authorities to get a greater refinancing gain. However, without a commercial adjustment the shareholders are actually disincentivised at a 6% discount rate to take on more debt. Hence the commercial adjustment to put the shareholders back in the same position they are in the no gear up scenario.

The refinancing gain has been calculated in a refinancing model created by Operis for the Shareholders and which uses the SPV operating model as the basis. An approach that is typical in such refinancing processes. The key inputs and differences between the pre and post refinancing models are included at Appendix 4.

5.5. Comparison of the options

Therefore, given the Authorities appetites to generate a refinancing gain, subject to the value for money assessment below relating to the additional risks and liabilities associated with the Maximised Debt option, the Authorities preference is to agree to the option which maximises the benefit to them within the constraints of the shareholders investment requirements and the need to ensure the public sector receives the greatest proportion of the refinancing gain.

Having confirmed that position to the SPV and following discussions with existing funder the following refinancing arrangement was proposed by Equitix to the Authorities:

- The existing debt providers exit;
- Maximise the new debt from Aviva within the constraints of cover ratios etc; and
- Release the cash held in the DSRA of £3.58m and replace with facilities;

5.6. Upfront gain versus reduction in unitary charge

The Authorities has the option to take the refinancing gain as an upfront amount (subject to the shareholders also opting for this approach), as a reduction in unitary charge, or a combination of both. The £2.51m upfront translates to a reduction in unitary charge of around £0.21m p.a. The Authorities considered the relative merits of these options reflecting their financial position and have both confirmed that taking all the gain upfront is the preferred choice.

5.7. Introduction to the Value for Money Assessment

A key area to be considered when refinancing is the impact on the Authorities exposure in termination scenarios, specifically Voluntary Termination by the Council (clause 41 of the Project Agreement), Council Default (clause 43), Force Majeure (clause 44), Corrupt Gifts or

CONFIDENTIAL

Fraud (clause 42) and Refinancing Breaches (clause 41.9), and Contractor Default (clause 41.2).

Under each of these scenarios the Authorities are required to pay compensation to the SPV, where potentially such compensation is increased as a result of the higher debt levels that result from the proposed refinancing. The level of any increase and the likelihood of occurrence must therefore be balanced against the size of the Refinancing Gain when judging the value for money of the proposal. This consideration also needs to reflect that the Council loses 50% of its share of the refinancing gain to DfT but retains the full impact of the increase in termination liabilities.

5.8. Council Default and Voluntary Termination

The compensation payable by the Authorities under Council Default and Voluntary Termination scenarios is made up of the following categories:

Service Provider redundancy payments	The level of Service Provider redundancy payments will remain unchanged as a result of the refinancing, and for the purposes of this analysis throughout this section have been assumed to be zero.
Base Senior Debt Termination Amount	The value of outstanding senior debt, accrued interest, the cost/gain from breaking the interest rate swaps or penalties for pre-paying the debt less any credit balances on bank accounts held. The basis of calculation also changes as Aviva, reflecting that they do not have swap arrangements in place replace these with 'make whole' provisions
The aggregate amount for which the share capital of the Service Provider and the amounts outstanding under the Subordinated Financing Agreements could have been sold on an open market basis based on the Relevant Assumptions.	As a proxy for this value for future modelled equity payments which is the value of distributions (relating to shareholder loans and equity) discounted at the Base Case Equity IRR being 14% pre-tax blended.

More details of the calculations and the approach to calulation is included at Appendix 3

The table below sets out an estimate of the compensation on termination from Council Default or Voluntary Termination that would have been due in February 2023 (shortly after the modelled date of Financial Close) under the current financing structure and how this increases as a result of the refinancing transaction, with the individual components of the increase identified:

CONFIDENTIAL

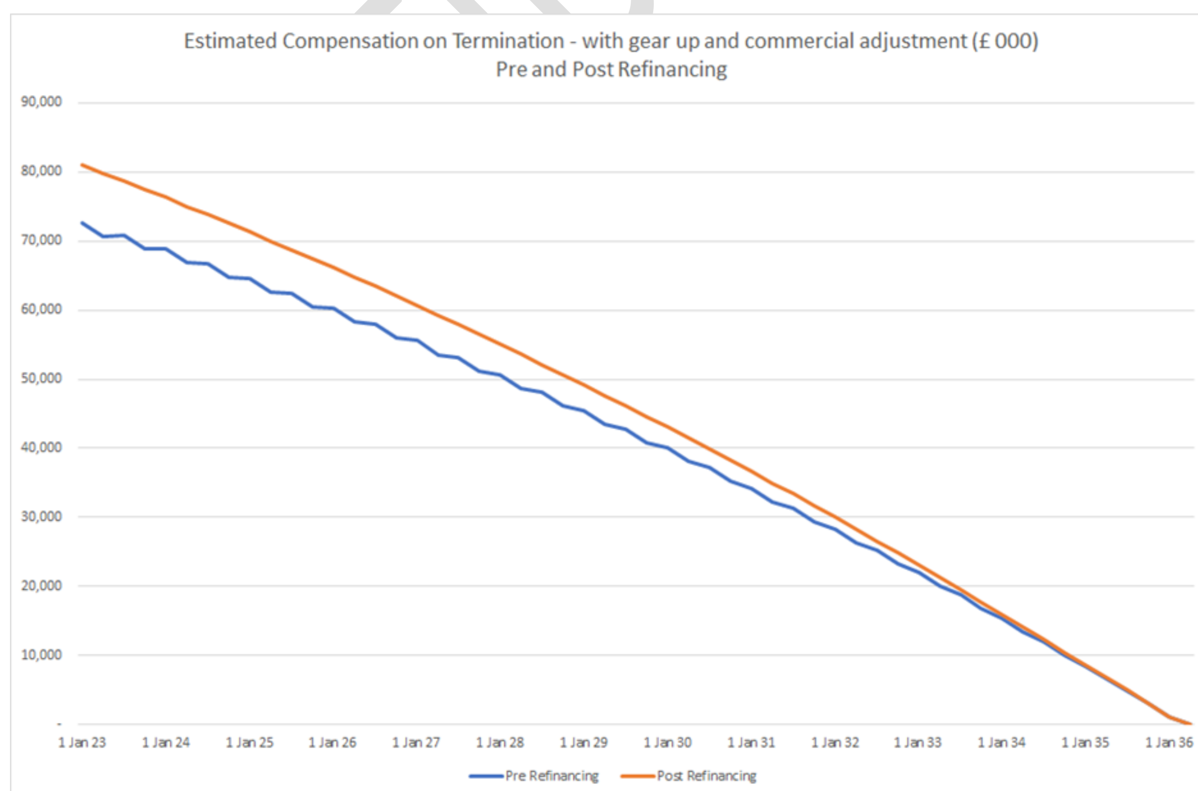
Compensation on Termination for Council default or voluntary termination @ Feb 23	Without Refinancing £m	With Refinancing £m
Senior debt	57.31	65.39
Less cash balances	(4.15)	(1.42)
Swap break costs	3.64	3.92
Total senior debt compensation	**56.80**	**67.89**
Equity Payment	15.79	13.20
Total compensation on termination	**72.59**	**81.09**
Increase in termination liability with refinancing		**8.50**

Under our assumptions, the compensation due under Council Default termination scenarios therefore increases by £8.5m against the position without the refinancing. Senior debt outstanding increases significantly, and the DSRA cash balances no longer exist post refinancing to reduce the liability. This is partially offset by lower equity payments.

Impact of time and the reducing senior debt balance

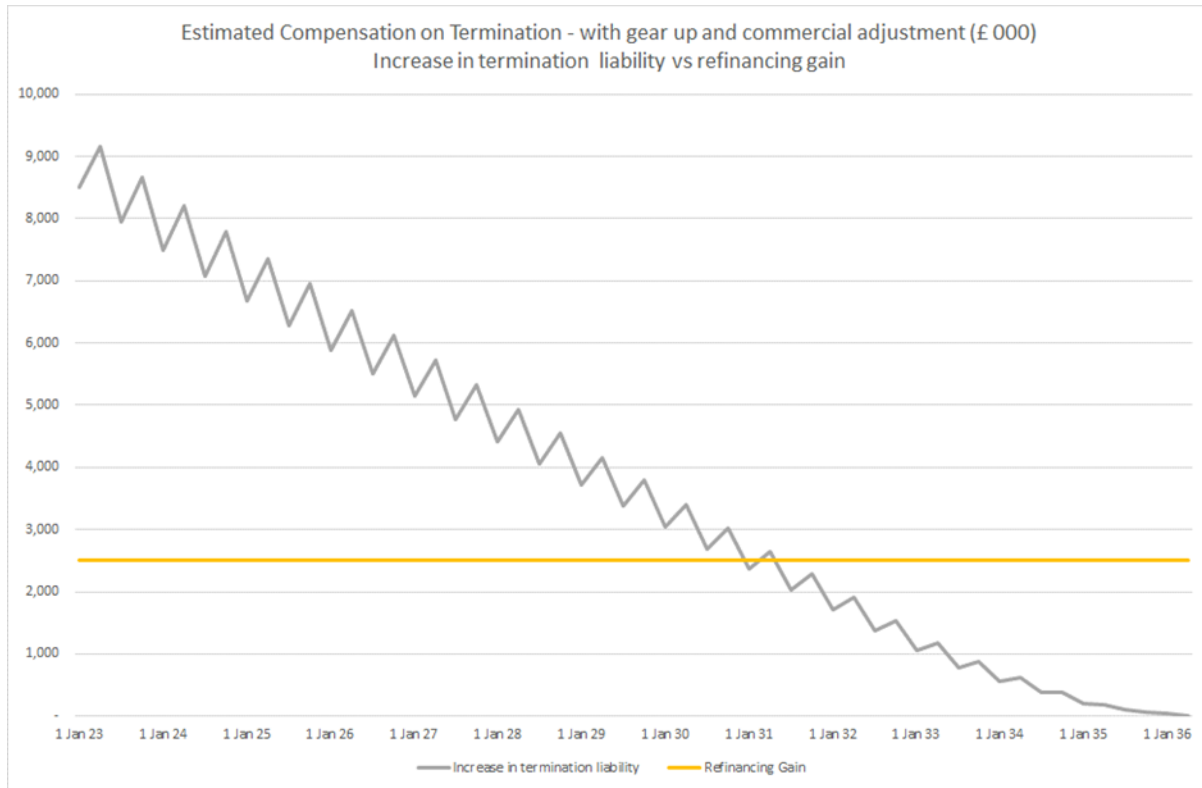
The passing of time will impact on termination liabilities through the reduction in debt outstanding, swap liabilities and value of equity. It is expected that the difference between the calculated termination liabilities after a refinancing compared to the termination liabilities without a refinancing will reduce through time.

The chart below shows the values for pre- and post-refinancing termination liabilities (in £m) in the event of Council Default converging over time.



CONFIDENTIAL

When comparing the increase in termination liability to the forecast public sector refinancing gain of £2.515m, the time before the increased termination liabilities drops to the value of the refinancing gain is circa 8.5 years, with a remaining contract term of 13 years. This is shown graphically below.



To reflect both potential scenarios, the Authorities have to assess the likelihood of wanting to voluntarily terminate the PFI Contract in the next 8-9 years, and in particular in the earlier periods where the additional termination liabilities are greatest. The conclusion is that likelihood is small given:

- The contract, which is beyond the initial asset replacement period and into steady state operations, is being delivered to a good standard by the contractor;
- The Service is one that will be required for the remainder of the contract period; and
- There is potential for the PFI credit funding provided by the Government to support payment for the contract services be withdrawn in the event of a voluntary termination

As such the likelihood of a voluntary termination by the Authorities is unlikely and if the Authorities chose to explore a termination during this period then a higher termination liability for a period would be factored into that assessment at the time. Given the low probability of the Council voluntarily terminating or defaulting under the Project Agreement, the Authorities consider the low risk of increased liabilities as acceptable in return for their share of the Refinancing Gain.

5.9. Force Majeure

Compensation payable under an event of Force Majeure differs from Council Default or Voluntary Termination due to a lower equity component. Rather than receiving the market

value of outstanding share capital and subordinated debt, compensation due to equity is equal to:

- the amount of equity subscribed less distributions to date (subject to a limit of zero); plus
- the subordinated debt balance less interest payments made to date (subject to a limit of zero).

No increase in equity or sub-debt subscribed is planned in the refinancing and historic distributions and interest payments remain the same, therefore the equity component of compensation would only change due to the payments made at the time closing the refinancing.

Compensation on Termination for Force Majeure termination @ March 2023	Without Refinancing (£m)	With Refinancing (£m)
Sub-debt Equity	1.12 0.00	0.78 0.00
Total Equity Compensation	**1.12**	**0.79**
Senior debt compensation (see Authority Default)	**56.80**	**67.89**
Total compensation on termination	**57.92**	**68.68**
Increase in termination liability with refinancing	**10.76**	

The compensation due under Force Majeure termination scenarios therefore has increased by £10.8m against the position without the refinancing. The increase in the termination liabilities associated with the senior debt is balanced to a lesser degree by the reduction in the compensation due to the shareholders on termination. The increase in liability should a Force Majeure termination occur in March 2023 is £8.3m higher than the overall refinancing benefit that the Authorities would have received at the date of termination.

However, Force Majeure termination once in the operational phase is considered extremely unlikely. Consequently, the benefit of receiving the refinancing gain is considered worth this very low risk from Force Majeure termination.

5.10. Breaches of Prohibited Act Provisions

Where termination occurs due to Prohibited Act including Breaches of Refinancing provisions, no compensation is due to equity.

The Revised Senior Debt Termination Amount will be payable. This is substantially the same as the Base Senior Debt Termination Amount, with the main difference being where the senior debt balance is in excess of the original scheduled amount ("Additional Permitted Borrowing"). In such circumstances, distributions made to equity during the period of additional borrowing will be excluded from the compensation payable.

As no Additional Permitted Borrowing exists prior to the refinancing, and the refinancing itself will not affect this, compensation payable under such a scenario will be similar to that set out above – particularly as in this case there will be no change to the equity component of compensation, being set at zero.

Compensation on Termination for Prohibited Act and Breaches of Refinancing termination @ March 2023	Without Refinancing (£m)	With Refinancing (£m)
Total senior debt compensation on termination	56.80	67.89
Increase in termination liability with refinancing	11.09	

CONFIDENTIAL

The compensation due under breaches of Prohibited Act and Refinancing Provisions termination scenarios has increased by £11.1m against the position without the refinancing. The increase in the termination liabilities associated with the senior debt is no longer balanced by any reduction in the compensation due to the shareholders on termination.

However, given the controls underpinning the PFI Contract and the strong reputation of the contracting parties, in addition to the fact the Authorities are not obliged to terminate, a termination where this compensation provision applies is considered highly unlikely.

5.11. Contractor Default

Where termination occurs as a result of Contractor Default, the Authorities are required to elect to follow either the Retendering Procedure or the No Retendering Procedure.

Under the Retendering Procedure, the Authorities receive and subsequently pays to the defaulting Contractor the Highest Compliant Tender Price from a replacement Contractor following a market competition.

Under the No Retendering Procedure an expert determines an estimate equivalent to that Highest Compliant Tender Price referred to as the Estimated Fair Value of the Contract.

In both cases the relevant references are the Project's unitary charge and the estimated costs of delivering the required services under the Project Agreement, neither of which are affected by the refinancing. Senior debt principal amounts and breakage costs, and equity investments and returns are not referred to in either case. Under the Credit Agreement with the Lender, the Contractor does still have equivalent senior debt obligations, but in this instance they are not matched by obligations for the Authorities under the Project Agreement. Notably, this is the only default scenario where the senior lenders are at risk of not receiving the full value of their loans back through the Compensation on Termination calculations.

As such, the refinancing has no impact on the termination liabilities for the Authorities in this scenario.

5.12. Robustness of the SPV

The other area of substance for risk after the refinancing relates to any reduction in the ability of the SPV to withstand operational risks due to the new financing structure.

Although the total debt amount increases, the senior debt interest costs decrease due to the lower interest rate and extension of the debt term. This contributes to the fact that Annual Debt Service Cover Ratios (ADSCR) remain the same as the existing financing. This is a key measure to funders that the project economics and cashflows are robust. The funder requirements both pre and post refinancing are for average and minimum ADSCRs of 1.15x, and the post refinancing model actually exceeds this position due to the constraints of the requirement that the public sector takes a higher proportion of the gain which prevents the model being fully optimised against the ADSCR constraint.

The new funder has not amended the lifecycle maintenance provision requirements. The level of lifecycle spend modelled will be the subject of technical due diligence on behalf of the new funder. Any concerns by the new funder about the adequacy of the lifecycle pot will be flagged ahead of final credit approvals. This process is aided by the fact that the risks relating to the original investment programme have now passed, the existing assets adopted have now had critical intervention work and are well-understood, and an operational track record for the assets now exists.

CONFIDENTIAL

This provides the Authorities with confidence that the overall robustness of the SPV once the new financing structure has been implemented still compares well to the position at financial close.

CONFIDENTIAL

6. Commercial Case

6.1. Introduction

The full Project Agreement provisions relating to refinancing are not included in this report as they follow SOPC guidance (SOPC4, as extant at the time of financial close). The methodology for calculating the Refinancing Gain is addressed in section 3.6. The Authorities do not have significant commercial control over a process which the Project Agreement and all related guidance provides for the SPV and the Shareholders to run independently.

The most important aspect to highlight is that the Authorities have not issued a Refinancing Notice, as doing so would leave the PFI Service Provider with a contractual route for recovery of costs such as adviser fees in the event that the refinancing was abandoned.

6.2. Project Documentation

The outcome of the refinancing and any implications for the Project Agreement have been captured in a Deed of Variation ("DoV"). This is a fairly vanilla transaction and so there are no material implications for the Project going forward. Points to note are as follows:

- It is confirmed the refinancing is a Qualifying Refinancing pursuant to the terms of the Project Agreement.
- The Authorities and shareholders (the "Parties") have agreed to the sale by HoldCo of all its shares in the Service Provider to MidCo. Creating a 'MidCo' is a recognised approach, reflecting HMRC guidance, to allow the shareholders to receive an upfront lump sum.
- The refinancing gain has been calculated using the operational model as the basis for the pre refinancing model. As the Parties have agreed that an update to the Base Case model is not required at this time, but that there are consequences of the refinancing which would impact the Base Case, the Parties have agreed drafting that seeks to ensure that in certain scenarios, including on a termination, the Base Case will be updated and that the impact of this refinancing will be included in that update.
- The Parties agree that the revenue sharing provisions in the Project Agreement will be updated to take account of the refinancing.
- The Project Agreement is being updated to reflect that a bank based funding solution is being replaced with institutional debt. Therefore, the impact of this on funding clauses including the impact of the 'make whole' requirements in the event of termination are included in the DoV.

6.3. Risk pre-financial close

Abort

In the event the refinancing transaction fails to reach financial close then abortive costs will become due. Given the refinancing exercise is progressing apace, the fees incurred by advisers so far is likely to be at least 75% of the estimated full value of £787k (excluding contingency).

The Authorities have minimised their risk related to abortive costs by avoiding issuing a Refinancing Notice; therefore in contractual terms, the Authorities have not triggered the refinancing exercise. Issuing a Refinancing Notice would leave the PFI Service Provider with a contractual route for recovery of costs such as adviser fees in the event that the refinancing was abandoned.

CONFIDENTIAL

However, it is expected that, in the event the refinancing exercise is abandoned, each party would have to bear its own costs. In relation to the Authorities, this would amount to around £50-90k depending when it happened and encompass the Authorities' legal adviser, Browne Jacobson, and financial and commercial adviser, Local Partnerships. The position will be monitored up to close. Notwithstanding that position, if the Authorities abandoned the refinancing at this stage without good reason, it may be anticipated that the Shareholders would attempt to procure compensation for its other costs from the Authorities on the basis of 'good faith'.

The officers at each of the Councils have actively addressed the risk of failing to achieve the refinancing on the Authorities part by ensuring senior officer engagement and support and progressing to obtaining relevant approval to proceed with the refinancing transaction (including delegated powers to execute all related documents).

The risk of abort due to a decision by the Authorities or the shareholders is considered to be very low given resource and cost commitment to the exercise already expended and the financing benefit to be shared by the public and private sector.

Increase in underlying financing costs and margins
A key determinant of the quantum of Refinancing Gain is the overall cost of funding. This can be split into two areas:

- Funding margin, and
- Underlying cost of funds (i.e. SONIA Mid swap rate); and

The debt margin of 175 bps has been agreed with Aviva who are progressing towards obtaining Credit Approval to lend on those terms.

It is accepted however that the underlying cost of funds remains a risk to the Authorities Share of the Refinancing Gain until the point of financial close, as the Refinancing Gain will vary dependent on the final pricing of rates. The impact of a 1% increase in the swap rates would be a reduction of circa £160k in the Authorities Share of the Refinancing Gain. Swap rates have increased by at least that level over the last 6 months but increases have halted and there has been some recent reversal in rates. However, the refinancing is scheduled to reach financial close in the next two months and given a 1% move creates only around a 6% reduction the implications of such levels of movements will not alter either Council's decision to complete the refinancing. The position will continue to be monitored. Additional comfort can be gained by the fact that a movement one way in the gilt rates for the new funding is likely to have an opposite impact on the costs of breaking the interest rate swaps on the existing funding and therefore to some extent offsets the impact.

Delay of the deal
There is a good level of contingency, in the form of c. £120k of additional transaction costs built into the current financial model to mitigate negative movements; to the extent it is not used, it will be released at financial close to improve the Refinancing Gain.

Contract breach
The risk associated with failing to follow the processes laid out in the Project Agreement should not impact on the Authorities. The Authorities' advisers will ensure that the shareholders cannot gain undue advantage by avoiding the correct processes, but no opportunity has been identified to do so.

CONFIDENTIAL

The consequences for contractual breach associated with refinancing are severe, the Authorities would have the right to terminate the PFI contract with only senior debt paid out in line with the provisions around corrupt gifts and fraud.

Largely, the interests of the Authorities and the shareholders are aligned in maximising the value achievable through improved funding terms.

Incorrect calculation of Refinancing Gain

As above, if a deliberate attempt to reduce the Authorities' benefit from the refinancing was discovered, the consequences would be severe.

The most significant area of the refinancing exercise where the interests of the Authorities and the shareholders are not aligned lies in the optimisation of the post-refinancing financial model, as money not identified as Refinancing Gain will remain in the Project to the benefit of the shareholders. The protocols for generating and solving the financial models at financial close are understood and will be tightly defined in advance.

The Authorities' advisers have been fully involved in the process from start to finish, have performed assurance work and reconciliation testing on the financial models and the Refinancing Gain calculations and will continue to do so through to financial close and finalisation.

CONFIDENTIAL

7. Financial Case

7.1. Affordability

The refinancing exercise is considered to be affordable for each of the Councils.

Internal resource from the Authorities are being used. This is being supplemented by specialist external advice from the Authorities commercial and financial adviser, Local Partnerships, and legal adviser Browne Jacobson. The Authorities advisers are engaged on a fixed price basis for an agreed scope of work.

If the refinancing was not completed, the Authorities would be liable for fees for its advisers on a day rate basis for the time worked up to the point of termination.

However, provided the refinancing is completed, the costs of the Authorities advisers, as well as the advisers to the SPV, the Shareholders and the lenders, will all be paid from the proceeds of the refinancing before the Refinancing Gain to be shared between the Authorities and the shareholders is calculated. As such, the costs of the exercise should have no impact on each of the Council's budgets.

The receipt of the estimated £2.515m upfront payment of the Refinancing Gain will provide an uplift for each of the Council's funds in year. However, the Councils each have to share 50% of this gain with DfT. It has been agreed in principle that this will be through a reduction in the ongoing DfT funding over the remaining life of the Contract. As such there will be reductions to each of the Council's on-going annual budgets. However, this is understood and will be factored into medium term financial planning.

7.2. Risks to the refinancing and forecast level of refinancing gain

The commentary on the risk below reflects that there is around one month from the date of this business case to the planned refinancing date.

Risks to the Refinancing Gain amount being lower

Risk	Probability	Impact
Interest rates move adversely	• High risk of small adverse movements • Medium risk of large movements (50-100bps)	Likely to be under £100k reduction in Authorities gain received (c.6% of the forecast gain)
Additional delay interest on existing loan due to timetable delays	• Medium – high risk of a small (1 month delay) • Medium risk of a 2-3 month delay • Low risk of extended delay	Costs of a mid period swap break are factored into the financial model given the assumed refinancing date is 22 Feb. There is a £120k cost contingency included in the current financial model
Funding terms change due to Croydon financial situation	• Very Low (Aviva are aware of the recently issued S114 Notice and have raised no concerns)	If they adjusted the risk margin, the impact would apply in the same way as a change in underlying interest rates. It is very unlikely other changes to terms (e.g DSCR) would change as the SPV is the borrower not Croydon Council and the project is performing well.
Transaction Costs increase	• Low risk	The current financial model has a £120k contingency built in

CONFIDENTIAL

The identified risks are considered to have a low impact. The greatest risk is for a short to medium (1-3 months) delay beyond the end of the March 2022. These delays could be caused by general delays caused by availability of key personnel or as has been seen on other projects by difficulty getting the OpCo approvals given there is no financial incentive for them. However, as the sensitivity analysis shows, whilst delays can increase the potential for unforeseen movements in the market to happen the impact is relatively small and there are likely to be compensating movements between the costs of new funds and the costs of breaking the existing swaps.

This sensitivity analysis will inform the range of each of the Council's delegated authorities to conclude the refinancing. The potential for movements in swap rates may also bring the potential for similar levels of increase in refinancing gain, as would the potential to improve any of the terms with existing or new funders.

Risks to the refinancing occurring

Risk	Probability	Comment
Authorities will not accept	Low	See comments in above table
Shareholders walk away	Very low	Equitix have a strong track record of completing refinancings of their PFI portfolio
Funding market closes or material adverse changes to terms	Very low	After the initial shock to the market during the very initial lockdown, the funding market remained active and stable during the bulk of the COVID lockdown period. Therefore, a material worsening or effective closing of the funding markets is not currently anticipated.
Aviva back away from the deal	Very Low	Credit approval is close to being obtained. Aviva are very experienced in refinancing street lighting projects. They are using precedent funding documentation for the refinancing of a project that is performing well. The issue of Croydon Council issuing a S114 notice has not raised any concerns.

CONFIDENTIAL

8. Management Case

Having the right people in place to deliver the refinancing exercise is principally considered to be focussed on the quality of the advisory team involved.

8.1. Authorities team

Each Council has representatives on a project team who have been managing the relationship with Equitix, DfT and with the internal processes. The core representatives are:

- Nish Popat, Interim Head of Corporate Finance, Croydon Council
- Katharine Nidd, Head of Strategic Finance, Planning and Commercial Finance, Lewisham Council
- John Agar, Street Lighting PFI Project Manager
- Kiri Bailey, Head of Commercial & Property Law, Croydon Council

Other officers from both Councils have been involved in the process as required. Katharine and Nish have been liaising with their respective S151 officers who will be given the delegated authorities to execute the refinancings on behalf of the Councils.

8.2. Advisers

The advisers appointed by the shareholders and the Authorities are considered to have the appropriate capability and expertise.

A breakdown of budgeted transaction costs is included at Appendix 2. This remains an estimate based on original quotes and scopes and is subject to potential change should the scopes and timelines alter, given there is an estimated 2 months remaining until the planned refinancing date. The total budget of £908k includes a contingency of £120k which is considered appropriate at this stage in the process.

The budgets allocated for each role are considered appropriate.

Authorities' commercial and financial adviser

The Authorities engaged Local Partnerships as their commercial and financial adviser for this refinancing exercise. Fees are fixed (against a defined scope and with longstop dates). The Authorities were able to benefit from the ease of engagement with Local Partnerships as it is owned by HM Treasury, the Local Government Association and the Welsh Government, and also the competitive billing rates compared to commercial market terms. Local Partnerships has already supported refinancing exercises on a large number of PFI projects since 2016, including street lighting projects involving DfT, Equitix and Aviva. It is therefore well positioned to provide up-to-date market intelligence and commercial challenge on behalf of the Authorities.

Authorities legal adviser

Browne Jacobson, were appointed as having an existing call off contract with Croydon Council. They have experience of both working for on project work and providing legal advisory services on other PFI refinancings including advising funders.

Browne Jacobson are considered to have the capability and expertise required. Fees are being capped against a defined scope, albeit with an element of contingency.

CONFIDENTIAL

Shareholders' financial adviser
The shareholders appointed Operis as financial adviser to the SPV and the Shareholders.

The Authorities have no right of veto over the shareholders' choice of advisers. However, the team at Operis have significant experience in the PPP refinancing markets and are considered to have the appropriate capability and expertise. They advised the Shareholders (which included Equitix) in the refinancing of a very large and complex street maintenance PFI contract with Sheffield City Council earlier in 2022, and have advised on other street lighting PFI refinancings.

Shareholders's legal adviser
The shareholders appointed Freeths as legal adviser to the SPV and the shareholders. The individuals in the team at Freeths have many years of experience in the PPP and funding markets and are considered to have the appropriate capability and expertise. The same team advised Equitix on the refinancing of two street lighting PFI projects with Aviva earlier in 2022.

Lender's legal adviser
After discussion with Aviva as preferred lenders, the Shareholders appointed CMS as legal adviser to the Lenders. The CMS team have many years of experience in the PPP and funding markets and are considered to have the appropriate capability and expertise. They have advised Aviva on previous transactions.

A separate team at CMS is advising the exiting lenders.

Model audit
The Lenders require a model audit, and the shareholders have appointed a separate team at Operis. The Authorities will also have access to the Model Audit report. Operis are well known in the market and having audited other street lighting refinancing financial models.

Tax and Accounting
The shareholders appointed a separate team at Operis as tax and accounting adviser to the SPV and the shareholders. They have advised in a similar role on recent street lighting refinancings.

Swap Benchmarking
The shareholders appointed Chatham Financial as swap benchmarking adviser. Chtham have been appointed by the shareholders but have a duty of care to the Authorities, as the requirements and objectives from the Chatham work are the same for both parties. They are considered to have the skills and experience appropriate to this role and have provided a similar role on other street lighting PFI refinancings with both Equitix and Aviva.

Technical Adviser
Mott Macdonald, the technical adviser during the investment phase, has been retained as technical adviser for the new Lender.

Other advisers have been appointed including Willis (Insurance) and the MSA to the SPV have roles in the refinancing including in updating operational models.

8.3. Timetable

Aviva, the new funder, have largely concluded due diligence and the funding documents are largely agreed (having used a precedent suite of documents as the basis). They are due to seek credit approval in early January 2023.

CONFIDENTIAL

Equitix have a streamlined process for finalising approvals so whilst final approval is yet to be confirmed it is unlikely to be on the critical path given Aviva has completed its due diligence and all material commercial matters between the Authorities and shareholders have been agreed.

Each of the Councils will finalise their approval for the refinancing within agreed parameters early in January 2023 using this report as key supporting evidence. Arrangements for delegated authority to enter the contract are being finalised. The approvals are likely to be on the basis that the relevant Executive Director of Resources could agree the final proposal, make related decisions and conclude the DOV/contract changes and for the Head of Legal Services to enact documentation.

DfT will use this report as a basis for seeking approval through their RIC Committee, which is the standard route for such approvals. The process could take up to 4 weeks.,

As a consequence of the above, all parties are committed to reaching financial close as rapidly as possible . Although currently modelled as 18 January, financial close is likely to be the end of January or early February. All parties are focussed on ensuring the close happens before 31 March 2023.

CONFIDENTIAL

Appendix 1 Details of the Funding Competition

1. Funding Term comparison

The table shows a comparison of the key funding terms.

Funding Term	Aviva	Range	Comment
Senior debt Margins	175bp flat	135bp flat – 190bp flat	All priced over SONIA mid swaps
Tail	6 mths	6 mths	All 6 months
Senior debt funder ticket size (based on new debt requirement of £68m plus contingency	100%	33%-100%	Those with better margins would only do 50% or less / want to syndicate / bring in one other bank pre FC. Given the mix of funders none of these positions were considered to be workable. The only funders willing to provide 100% were Aviva, MIDIS, MUFG and Nord LB
Swap credit spread	0bps	13 – 17 bps	Not applicable to all as some do not require swaps. Based on SONIA underlying rate where applicable
Upfront fees	50bps	75- 130 bps	Applies to senior facility, DSRF and CiLF as applicable
Other account bank & agency fees p.a.	£10k	£0-£47k	
ADSCR min	1.15x	1.15-1.18x	Most @ 1.15x
LLCR min	1.15	1.15	

A number of funders requiring to be part of a club of funders or to be able to syndicate debt. Unfortunately, despite attempts by Operis to bring funders together club or syndicated arrangements could not work. This left three deliverable funding options:

- 100% MUFG - bank debt priced over SONIA swaps
- 100% MIDIS (Macquarie Infra Debt) – infra debt priced over gilts
- 100% Aviva – institutional debt priced over SONIA mid swaps

The overall best solution being the 100% Aviva.

CONFIDENTIAL

Appendix 2: Refinancing Transaction Costs

The table below shows the budgets that have been set for each of the transaction advisers. This total budget is included in the financial model. The fees and contingency will be monitored and a final agreed cost included in the final financial model.

Category	Entity	Cost £k (ex VAT)	Comments
Funder legal advice	CMS	99	Appointed
Funder technical advice	Mott Macdonald	24	Appointed
Funder insurance advice	Willis	12	Appointed
Model audits	Operis	61	Appointed £43k Refi Model and £18k Op model
SPV financial advice	Operis	204	Appointed
SPV legal advice	Freeths	72	Appointed
SPV tax and accounting	Operis	32	Appointed
SPV operating model update	Equitix Management Services Ltd	15	Part of ongoing appointment
SPV MSA fee	Equitix Management Services Ltd	24	Part of ongoing appointment
Swap benchmarking	Chatham Financial	25	Appointed
Tax and audit fee	TBC	15	Estimate of additional year 1 tax/audit fee for new structure
Authorities financial adviser	Local Partnerships	63	Appointed
Authorities legal advice	Browne Jacobson	90	Appointed
Existing lender legal advice	CMS	36	Appointed
Subcontractor legal advice	TBC	18	Appointed
Sub-total		**788**	
Contingency		120	Balancing figure
Transaction costs per current financial model		**908**	

CONFIDENTIAL

Appendix 3: Refinancing Gain Calculation

Project Agreement Terms

The terms may be summarised as set out below.

> "Refinancing Gain" means an amount equal to the greater of zero and **((A - B) - C)**, where:
>
> **A =** the Net Present Value of the Distributions taking into account the effect of the Refinancing
>
> **B =** the Net Present Value of the Distributions without taking into account the effect of the Refinancing
>
> **C =** any adjustment required to raise the Pre-Refinancing Equity IRR to the Threshold Equity IRR

The Authority share of this gain is to be calculated as follows:

a) 50% of the first £1m

b) 60% of the next £2m

c) 70% of any further gain

The Authority can take its share of the gain as either a single payment (less than or equal to any Distribution to shareholders), a reduction in the future Unitary Charge, or a combination of the above.

The Authority has elected to receive its share of any Refinancing Gain as a single payment at the date of the Refinancing, rather than as a reduction in the Unitary Charge over the remainder of the Contract Period.

Project Agreement Terms – Implications for Financial Model

The financial model ("Model") calculations are inherently circular. In particular, regarding the calculation of Refinancing Gain:

- The definition of Refinancing Gain as set out in Schedule 1 is based solely upon distributions to shareholders (i.e. it excludes any share of the gain allocated to the Authority)
- However, as set out in Schedule 12, the Authority is entitled to receive a share of this Refinancing Gain (as either an upfront payment or a reduction in Unitary Charge)
- Once the Authority's share of the Refinancing Gain has been allocated to it, distributions to shareholders will change, thereby also changing the both the Refinancing Gain, and the share of the gain allocated to shareholders and to the Authority

This presents three separate but related issues:

1. The cash flows required to calculate the Refinancing Gain (and the shares of this gain allocated to shareholders and to the Authority) depend upon the results of the Refinancing Gain calculation.
2. Conceptually, there are two scenarios involved in calculating the Refinancing Gain, and how it is to be allocated: an initial scenario, in which a gain that would be received only by shareholders is calculated, and then a subsequent scenario, in

CONFIDENTIAL

which that gain would be allocated between shareholders and the Authority. But the Model can only show a single scenario, at any one time.

3. The definition of Refinancing Gain within Schedule 12 only considers the part of the gain that accrues to shareholders (i.e. it does *not* also include any share of the gain allocated to the Authority). It seems to be implicit that this calculation should be done before any such allocation is made (possibly to avoid any circularity within the legal documents), but this has not been made clear, and different interpretations are also possible (e.g. that this calculation should be done using the distributions to shareholders *after* the allocation of any gain to the Authority).

Within the Model, these three issues have been dealt with as follows:

1. Th Model contains a 'Copy and Paste' macro, which iterates the Model inputs and outputs to a solution in which the cash flows used in the Refinancing Gain calculation are consistent with the results of that calculation.
2. The 'Copy and Paste' macro iterates the Model to a position where only the second scenario, representing the final allocation of the gain, is shown. The Model therefore does not contain calculations which show the total gain that would accrue to shareholders in the event of no share being allocated to the Authority, and then allocate that gain between the two parties; it only shows a final position, once these allocations have been made in a manner that ensures the Model inputs are consistent with its outputs.
3. Schedule 1 has been taken to mean that the Refinancing Gain represents the total gain *before* any allocation to the Authority, and – in the absence of any calculation in the Model that works out this amount (see previous bullet above) – the total gain after all allocations (i.e. the gain to shareholders plus the gain to the Authority) has been used in its place.

Commercial Adjustment

The Model includes a Commercial Adjustment. This takes the form of a reduction in the share of the Refinancing Gain allocated to the Authority and an increase in the share allocated to the shareholders (via shareholder distributions) such that the NPV of these shareholder distributions discounted at 6.0% achieves a given target level (being the NPV of shareholder distributions under a refinancing without any gearing up, discounted at 6.0%).

The Commercial Adjustment is not part of the Project Agreement Terms, but is an 'out of contract' mechanism that has been agreed between the shareholders and the Authority.

Financial Model Scenarios

The Model includes eight scenarios:

1. A 'no refinancing' scenario based upon the existing operating model
2. A 'no refinancing' scenario based upon the existing operating model, with adjustments
3. A 'refinance with no gear up' scenario
4. A 'refinance and gear up with Commercial Adjustment' scenario, which is the base case
5. Base rate parallel shift -1%, for the 'refinance and no-gear up' scenario
6. Base rate parallel shift -1%, for the base case scenario
7. Base rate parallel shift +1%, for the 'refinance and no-gear up' scenario

CONFIDENTIAL

8. Base rate parallel shift +1%, for the base case scenario

It is the fourth of these scenarios which represents the final funding solution which is the subject of this file note.

8.4. Financial Model Results

This analysis is based on the “Croydon & Lewisham Refinancing v23” Model. The refinancing gains in the Model (after the ‘Copy and Paste’ macro has been run) are as follows:

	£000
Equity share: Discounted change in shareholder distributions	2,458
Authority share: upfront payment	2,515
Total refinancing gain	**4,973**

The change in shareholder distribution cash flows across all post-refinancing periods is as set out below, and these result in the net gain of £2,458k when discounted using the threshold IRR of 14.0%. These calculations are consistent with the terms of Schedule 1 as set out within the Project Agreement Terms section above.

	£000	**Checked to Model**
A: Post refinancing:		
Sub-debt interest and capital repayments	[12,465]	Ratios & Returns rows [265-7]
Spens premium	[2,704]	Ratios & Returns row [269]
Net payments on upstream loan	[(1,404)]	Ratios & Returns rows [270-2]
Dividend payments and equity redemption	[8,811]	Ratios & Returns rows [274-5]
B: Less:		
Pre-refinancing shareholder distributions	[(26,854)]	Financing row [802]
C: Plus:		
Adjustment required to raise the Pre-Refinancing Equity IRR to the Threshold Equity IRR	[-]	Financing [E806]
Discounted Change in shareholder distribution at [14.0]%	**[2,458]**	Financing [E811]

The Authority share of the refinancing gain is the upfront payment of £2,515k. As set out within the Project Agreement Terms section above, instead of being calculated based upon the final change in shareholder distributions (of £2,458k, per the two tables above), this has instead been calculated as set out in the table below based upon the total refinancing gain (of £4,973k), which appears to have been taken to represent the Refinancing Gain that would have arisen for shareholders in the absence of any allocation to the Authority. Except for this, these calculations are consistent with the terms of Schedule 12 as set out within the Project Agreement Terms section above.

CONFIDENTIAL

	Total gain £000	Authority share £000	Checked to Model
50% of any gain up to £1m	1,000	500	Financing row [884]
60% of any gain between £1m and £3m	2,000	1,200	Financing row [885]
70% of any gain over £3m	1,973	1,381	Financing row [886]
Less: Commercial Adjustment		(566)	Financing [E879]
Total	**4,973**	**2,515**	Financing [E901]

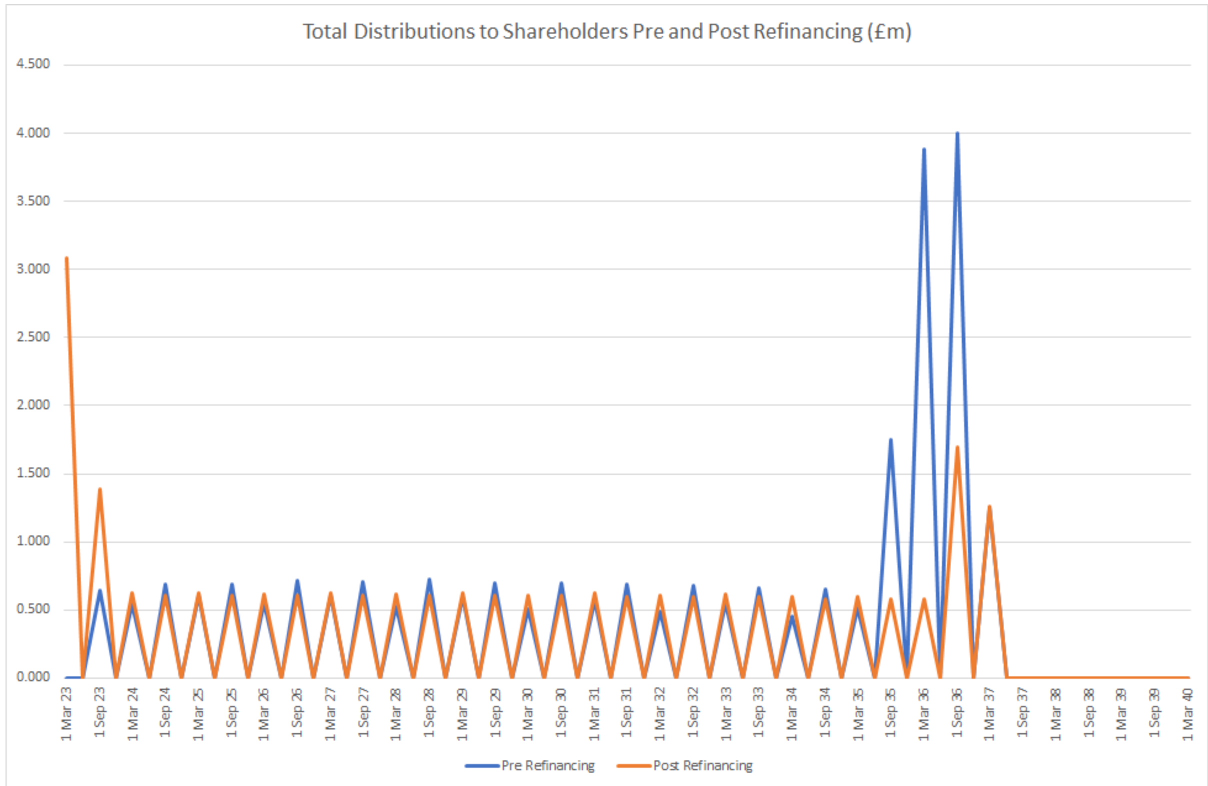
As set out in the sections above, it should be noted that the Commercial Adjustment reduces the share of the Refinancing Gain allocated to the Authority and increases the share allocated to the shareholders such that the NPV of these shareholder distributions discounted at 6.0% achieves the same NPV as shareholder distributions under a refinancing without any gearing up, discounted at 6.0%.

Shareholder Distributions

The graph below compares the pre and post refinancing total shareholder distributions. This includes:

- Subordinated debt capital repayment
- Subordinated debt interest
- Spens premium
- Upstream loan drawdown
- Upstream loan repayments, including interest
- Dividend payments
- Equity redemption

CONFIDENTIAL



The graph shows that effectively distributions to shareholders are pulled forwards due to the extraction of the refinancing gain through the upstream loan.

CONFIDENTIAL

Appendix 4: Pre and Post Refinancing Model Key Assumptions and Inputs

Input	Post Refinancing	Pre Refinancing	Comment
Percentage of swap being broken	100%	n/a	The swap is broken in its entirety.
New margin	1.75%	2.00%-2.40%	Applies to Senior Debt, DSRF and CiLF (although no Model inputs for DSRF and CILF, since assumed these are not drawn). Existing senior debt funding is split: SEB 33%, SEK 25%, Lloyds 17%, NIBC 25%
Underlying finding rate	3.46%	4.76%	Aviva offer fixed rate loans priced over SONIA Mid Swaps, with the rate selected based on the term and structure. This rate will move (and will be set and benchmarked at Financial Close. No buffer has been included.
Arrangement fee	1.00%	-	To be checked to Financing docs
Agency fee	£10,000	£15,000	To be checked to Financing docs
Tenor	6 months tail	12 months tail	To be checked to Financing docs
Refinancing Date	17/1/2022	-	This date will need to be updated depending on the eventual timing for the refinancing.
Transaction cost £000	908	-	Refer to table below for the transaction cost assumptions.
Swap break cost £000	3,638	-	The swap break cost was priced by Chatham Financial on [30 Nov 2022]. This will be benchmarked at Financial Close (and dry runs).
Is the Debt Service Reserve Account (DSRA) swapped for Debt Service Reserve Facility (DSRF)?	Yes	-	The DSRA is repaid as part of the refinancing and replaced with an uncommitted DSRF.
DSRF commitment fee	-	n/a	Aviva offer a DSRF without commitment fees. This technically means it is uncommitted, but available to be drawn.
DSRF arrangement fee (when drawn)	0.50%	n/a	
DSRF Interest Rate	TBD when drawn	-	
DSRF size £000	-		
Period	6 months shorter than main facility		
ADSCR	Model 1.172 Min 1.15	TBC	ADSCR cannot be fully optimised due to constraint of Authorities having to take majority of gain
Change in Law	£1.483m	£1.483m	Requirements remain unchanged
LCMRA required	No	No	Requirements remain unchanged

Disclaimer

This report has been produced and published in good faith by Local Partnerships and Local Partnerships shall not incur any liability for any action or omission arising out of any reliance being placed on the report (including any information it contains) by any organisation or other person. Any organisation or other person in receipt of this report should take their own legal, financial and/or other relevant professional advice when considering what action (if any) to take in respect of any associated initiative, proposal or other arrangement, or before placing any reliance on the report (including any information it contains).

Copyright © Local Partnerships LLP 2022

CONFIDENTIAL