ADVANCE PUBLICATION OF REPORTS

This publication gives five clear working days' notice of the decisions listed below.

These decisions are due to be signed by individual Cabinet Members
and operational key decision makers.

Once signed all decisions will be published on the Council's
Publication of Decisions List.

1. WORKING CAPITAL ARRANGEMENT FOR ENERGETIK (Pages 1 - 16)

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London Borough of Enfield

Report Title	**Working Capital Arrangement for Energetik**
Report to	**Cabinet Member for Finance & Procurement**
Date of Report	**14 August 2023**
Cabinet Member	**Cllr Tim Leaver**
Executive Director / Director	**Fay Hammond**
Report Author	Nadeem Akhtar Interim Finance Manager - Capital & Treasury Nadeem.Akhtar@enfield.gov.uk
Ward(s) affected	All
Key Decision Number	KD 5645
Classification	Part 1 & 2 (Para 3)
Reason for exemption	By virtue of paragraph(s) marked below with * of Part 1 of Schedule 12A of the Local Government Act 1972: 3 Information relating to the financial or business affairs of any particular person (including the authority holding that information).

Purpose of Report

1. To put in place a working capital facility for Energetik, one of the Council’s trading companies.

2. This paper sets out the reasons for providing the facility, the controls around accessing and using the facility, the business case for it and risks to the Council.

Recommendations

The Cabinet Member for Finance & Procurement is recommended to:

I. Approve a working capital facility for Energetik of £3.5m for a period of 3.5 years

II. Delegate authority to Executive Director Resources to extend the working capital facility up to March 2029 and increase the value up to £6m subject to a satisfactory conclusion of the external lender review of the 40 year business plan to be approved by Cabinet.

III. Delegate to Director of Finance (Capital) to sign the working capital agreement. Details of the proposed facility are included in Appendix 1.

IV. Note the monitoring conditions of the facility (as set out in para 23-34)

V. Note the accounting impact and recognition of an impairment charge at financial year end that will impact on the Council balances as set out in Appendix 1. This is effectively an accounting ‘cost’ which impacts the revenue position.

VI. Note that the Council cannot borrow in order to provide the working capital facility. The facility will be provided by using Council reserves, effectively assuming that the Council will not be spending £3.5m from the reserves until the facility is repaid. This will be partly financed by Money Market Fund income received on loans held for Energetik over and above the interest cost to the Council.

Reason for Proposal(s)

3. BEIS agreed for Energetik (via Enfield Council) a loan of £12m and grant of £12m in March 2021 and the Council entered into both a Grant Agreement and a Facility Agreement with HNIP/BEIS. As a condition of both the Grant Agreement and Facility Agreement, the Council had to provide a working capital facility. The Grant Agreement at Schedule 2, Part 3 (Conditions Subsequent) clause 1.9.4 states that by 31.7.2021, evidence must be provided to the Provider of "the funding arrangement (working capital facility) between the Recipient and Energetik". Similarly, the Facility Agreement at Schedule 2, Part 3 (Conditions Subsequent) clause 1.9 states that Conditions Subsequent 1.9-1.11 of the Grant Funding Agreement must be satisfied by their respective deadlines. This information was not included in the Council

report on 9th June 2021 (KD5304) explicitly and therefore now requires a specific authority report.

4. The proposal is to give Energetik the short term cashflow facility that its financial model shows it needs to meet its operating costs while it is building the heat network extension and before it starts to receive the connection fee income from Meridian Water and other developments, as was envisaged in 2021.

5. It is important to note that the business plan and the assumptions have changed since the Grant and Loan documentation was signed with BEIS. The financial model as presented to Council on 9th June 2021 (KD5304) is being refreshed with the most up to date information and assumptions for developments and connections. A review of the current Business Plan will be reported to Cabinet later in Autumn 2023.

Background

6. On 9th of June 2021 the Council approved a plan to extend Energetik's heat network along the east and south of the borough (KD5304). The funding for this plan came from a mix of loans (£37m) and a grant from HNIP of £12m. It is this grant agreement which contains the condition subsequent to provide Energetik with a working capital facility.

7. The financial model that supported the paper the Cabinet approved in June 2021 showed that Energetik would require a working capital facility to support its operating costs over the period it was building the network and before it received connection income from Meridian Water and other developments.

Revised Financial Model- June 2023

8. The financial model has been reviewed and updated by the Company and is currently undergoing sensitivity testing. The Council has commissioned an independent lending review of the business plan from an industry expert which is in progress.

9. The Council last reviewed this financial business model in June 2021 when it approved tranche 3 funding to extend the heat network over the "green" and "yellow" lines. Since then, there have been significant global challenges which has resulted in a combination of increases to energy prices, construction costs, interest rates, as well as some significant change and delays to forecast development build out, all of which cumulatively has had a significant impact on the financial business model. The Energetik financial business model has now been updated to reflect known changes as of June 2023 and compared to the financial model the Council reviewed when approving T3 funding in June 2021. In addition, a number of downside sensitivities have been analysed to show the impact on the financial model.

10. To mitigate rising construction costs Energetik has sought to procure as much of the project as possible on fixed cost contracts. Energetik has also saved significant increases in the cost of the pipe by pre-buying £6m worth in 2022. To mitigate the delays to developments Energetik has slowed delivery of the

build to match re-profiled development connection dates. This has limited expenditure and therefore reduced interest costs.

Authority To Grant a Working Capital Facility

11. A working capital facility falls under Treasury Management, as it is cashflow management. The approval for a working capital facility can be made by the Section 151 Officer or for significant values such as this by the Cabinet Member for Finance and Procurement in consultation in consultation with the Executive Director of Resources. The difference between working capital facility and capital loan arrangements is that the former represents the timing of payments and receipts whereas the latter represents an increase in the capital financing requirement of the authority. This will be reported in the six-monthly Treasury report to Council.

12. In agreeing a working capital facility, the Council needs to be satisfied that:
    - The loan facility can be repaid.
    - The purpose of the facility is for working capital only and to finance operational costs and not capital spend.
    - The value of the working capital facility is appropriate.

13. Energetik’s cashflow will be reviewed on a monthly basis to ensure that the working capital facility remains relevant and sufficient and is used in line with the conditions set out in the Facility Agreement. Officers regularly review Energetik’s financial and operational performance to ensure that Energetik will be able to repay its borrowing.

14. Any extension to the working capital facility beyond that in the recommendations will be approved by the Cabinet Member for Finance and Procurement in consultation with the Executive Director of Resources.

Size And Purpose of Facility

15. The purpose of the working capital facility is to fund operating costs until such time that connection receipts from the Meridian Water and other developments enable the company to become cash positive. The capital loans that Energetik have used to fund the heat network development works have conditions attached in terms of on how loan proceeds can be spent. These conditions do not allow the use of loan monies on operating expenses.

16. The need for a working capital facility to meet operating costs in the years before there are significant connection receipts from the new developments is shown in Energetik’s business plan and led to HNIP requesting the Council in providing such facility as a condition subsequent for both its grant funding and its loan. Energetik have identified a need for a facility of £6m covering deficit cashflow over a five-year term. This allows for headroom.

17. The current estimate is that a facility of up to £3.5m is required in the years 2023-27 increasing to £4m for 2028-33. This is based on assumptions of connections. If there are further delays, for example due to fire regulation changes, mitigating actions and/or a higher working capital facility would be required until the business is consistently cashflow positive.

18. In considering the request from Energetik, officers recommend approval of a working capital facility of £3.5m for an initial period of 3.5 years commencing from 15 August 2023 and with an initial end date of March 2027. This should be sufficient to cover the initial period of shortfall in operational cashflow.

19. Following a satisfactory conclusion of the external due diligence review of the 40-year business plan the working capital facility may be extended to a maximum of £6m and facility end date of March 2029.

Facility Access Process, Control and Restriction on Use

20. The facility would be accessed by a drawdown request from the company in the form set out in the facility agreement. The drawdown request would be approved by an officer in accordance with the Council’s Scheme of Delegation.

21. The use of the facility is restricted to operational revenue expenditure and to bridging the cashflow gaps between timings of expenditures and the receipts of revenues over the short term (less than 20 years). The facility is not to be used for capital expenditure. The use of the facility will be monitored as part of the Council’s control process. Energetik will provide a 12-month detailed cashflow forecast and a high level 3-year cashflow forecast at each drawdown. The facility will be governed by a legal agreement.

Basis for Decision Making

22. As per Appendix D Para 15- point 3 of the Treasury Management Strategy Statement, approved at full Council on 23 February 2023 (KD5504), it notes that:

    “Working Capital Facilities: These are explicitly not capital expenditure because they exist to manage cashflows, nor intended to be of a long-term nature. The Council can loan on a commercial basis to other organisations and the approval process is via the Section 151 Officer, who depending on the size of the loan may choose to request additional approval from the relevant Cabinet member. However, regular reviews of cashflow are a requirement, taking place no less than on a quarterly basis. It is anticipated that majority of such facilities would take place in relation to wholly owned companies or JVs, and that they would be on a commercial basis. However, where they do not, additional approval from the relevant Cabinet member, depending on the size of the loan, should be sought. One key aspect that must be considered in relation to working capital is that the cashflow review is not just for the demonstration of the healthiness of the borrower and ability to repay (plus interest), but to ensure that the loan is not being used for capital purposes and is solely due to the timing of cashflows. The latter requires a different governance process as noted within the financial regulations.”

23. Appendix D (Investment Strategy) Para 15 (bullet point 4): New Local Council Companies: All borrowing to companies owned by the London Borough of Enfield will require a formal on-lending agreement.

24. The facility meets the definition of a Financial Instrument under IFRS 9 and is therefore required to undergo an expected credit loss (ECL) assessment to ascertain Energetik's ability to repay the loan and the value of impairment to charge the Council's Income and Expenditure account. ECL's related to financial instruments used for Revenue purposes are charged directly to the Council's revenue balances and subsequently reduce the Council's Reserves (unlike financial instruments used for Capital purposes that are transferred to the Capital Adjustment Account and Council revenue balances are protected). The nature of a working capital facility/ overdraft is that its use is volatile. If the full £3.5m was drawn down as at 31 March, there would be an estimated ECL impairment charge of £0.5m that will directly impact Council General Fund balances. In practice, Energetik currently estimate that the amount drawn down on 31 March will be around £900k (so the ECL charge to the Council would be around £130k). For clarity: this is a required accounting adjustment. The Council expects the entire face value of the facility to be repaid, which would offset the accounting charge by the time the working capital facility is repaid. This would be funded by interest received from Energetik and Money Market Fund income on capital loans currently held prior to passing them on to Energetik.

Financing of the Working Capital Facility (WCF)

25. Statutory legislation and regulations prohibit revenue expenditure to be financed from borrowing from the PWLB or any other external lender. The Council will therefore need to fund the WCF from cash held for its own General Fund Reserves.

26. The Council is receiving a financial benefit from Money Market Fund income on loans that have been drawn down but not yet on-lent to Energetik. This income (over and above interest payments made by the Council) will be used to create a new reserve which will be used to fund shareholder costs related to Energetik, offset the ECL charge and any remainder contribute to funding the working capital facility.

Any alternative options considered and rejected

27. The alternative would have been an either long term loan or equity injection. A long-term loan approach is not appropriate as borrowing for revenue purposes is prohibited under statutory law. An equity injection would give less direct control on the return to the Council as lender.

Main Considerations for the Council

28. Providing the working capital facility is a condition subsequent of the BEIS HNIP Grant Funding Agreement and Facility Agreement with the Council. The working capital facility is not classed as capital expenditure and does not increase the Council's capital finance requirement.

29. The Council considered and approved the proposal for two extensions to Energetik's heat network on 9th June 2021 under KD5304. The business

plan, financial model and assumptions that were considered in reaching that decision have now changed and a revised business plan will be reported to Council in the Autumn. The requirement for the working capital facility was not explicitly reported in the 9thJune Cabinet Report and this report is requesting that authority.

30. The merits of expanding the heat network are unchanged by the need for this working capital facility, which is to fund operating costs until connection receipts from Meridian Water and other developments enable the company to become cash positive.

31. Energetik's financial model, that underpinned the Council's decision to approve the expansion of the heat network, shows a requirement for this working capital facility. Not providing the facility would put in doubt Energetik's ability to deliver the approved programme and have significant consequences for the company.

Risks that may arise if the proposed decision and related work is not taken

32. Not providing the working capital facility would put the Council in breach of a condition in the BEIS HNIP Grant Funding Agreement and Facility Agreement of March 2021, as detailed at the start of this report. Failing to meet this condition may cause reputational damage to the Council and could require the grant and loan to be repaid.

33. Energetik's financial model identifies the need for this working capital facility for a period of up to 10 years to fund operating costs in advance of connection receipts from Meridian Water and other developments. Without the facility it is not clear how Energetik would be able to continue to operate and deliver the approved expansion of the heat network.

34. Energetik's current business plan relies substantially on development at Meridian Water and Joyce and Snells. The business plan acknowledges this by requiring the company to investigate opportunities to expand. Through expanding, Energetik would reduce the risk to the company's viability that comes from depending so heavily on just two developments for connection income. Not continuing with the heat network expansion, that this working capital facility and related grant funding support, would lose the opportunity to reduce this potential risk of company failure and therefore financial loss for the Council.

35. Not continuing with the heat network expansion that this working capital facility supports, may result in reputational damage for the company and by extension the Council, as developers at key developments have submitted their planning applications on the basis that they would be connecting to the heat network.

Risks that may arise if the proposed decision is taken and actions that will be taken to manage these risks

36. The main risk in providing the working capital facility is that Energetik would be unable to meet the interest payments for the facility as they fall due, and in the end repay the facility. The mitigations for this risk are:

    i. The financial model that underpinned the proposal to extend the heat network was reviewed and stress tested by EY giving confidence that business plan will be able to generate the cash inflows required to repay the principal and interest due for this facility.
    ii. The Interdependency Board will continue to monitor connections and Energetik will be required to submit quarterly monitoring on the connection pipeline to inform the funding profile.
    iii. Energetik will be required to provide a quarterly 5-year rolling cashflow forecast to access the facility and throughout the life of the facility, with Enfield's finance team reviewing how the facility is used, the drawdown profile and how it will be repaid.

Preferred Option and Reasons for Preferred Option

37. The Cabinet Member for Finance & Procurement in consultation with the Executive Director of Resources approves a Working Capital Facility to Energetik of £3.5m for 3.5 years. This is to:

    i. Prevent the Council breaking the grant covenants with HNIP.
    ii. Provide Energetik with the working capital its financial plan shows is needed in the short term.

38. The Cabinet Member for Finance & Procurement in consultation with the Executive Director of Resources to approve extension of the working capital facility to a maximum of £6m and facility end date of March 2029 subject to a satisfactory conclusion of the external due diligence review of the 40-year business plan.

39. The Executive Director of Resources receive a quarterly assurance report that the facility is being used appropriately and a forecast of usage and when it would be no longer necessary.

40. To fund the working capital loan facility from cash held for existing General Fund Reserves in order to remain compliant with Statutory Law, which prohibits the use of loan financing (which is deemed as capital financing) as a means to finance revenue expenditure.

41. To note a forecasted accounting impairment at year-end in compliance with IFRS 9 and the recognition of risk associated with lending. As the lending is non-capitalisable the impairment charge will be made against General Fund balances as part of the year-end processes.

Relevance to Council Plans and Strategies

42. The working capital facility supports delivery of the extension to Energetik's heat network that was approved by the Council on 9th June 2021 (KD5304).

43. In line with Enfield Council's Vision to make Enfield a better place to live and work, delivering fairness to all, growth, sustainability, and strong communities, Energetik provides the Council with the opportunity to reduce carbon emissions as properties and businesses connect over time.

44. Energetik shares the Council's values and principles and is working to improve Enfield for the long term. The company's activities play a key role in creating good homes in well-connected neighbourhoods and supports the borough's ambitious regeneration and housebuilding programme through its provision of an environmentally friendly heat source.

Financial Implications

Prepared by Nadeem Akhtar 20/07/2023

45. The Council has lent Energetik £34.9m to date (financed by low interest loans from Government). A working capital facility is necessary in order to ensure that the company remains solvent, as was foreseen in 2021.

46. The working capital facility will be financed from General Fund Revenue Reserves as the WCF proceeds will be used for non-capital purposes. This means that £3.5m of the Council's reserves cannot be used for 3.5 years and must be held unspent (so that the cash can be used to lend to Energetik).

47. This will initially be the interest and Minimum Revenue Provision smoothing reserve and will be replaced by a specific risk reserve created from any margins and Money Market Fund receipts related to Energetik financing.

48. In addition, there will be an immediate revenue accounting cost to the Council of circa £0.5m. This is required by IFRS 9 using an 'expected credit loss' calculation. For clarity, the calculation is theoretical, and the Council expects the entire £3.5m to be repaid. The £0.5m will be financed from the return on overnight investing of low interest loans that the Council is holding prior to passing on to Energetik.

49. Interest generated from the working capital facility will be reported in Corporate Budgets and the Treasury Management reports. The income should generate a small surplus over the equivalent balance being invested in a money market fund at the current rate of 4.75% (assuming the rate remains static for the next three years and follows the same cashflow profile as per Energetik use). Up until this point the premiums made on Energetik capital loans have reduced the overall Council interest paid on its debt.

Legal Implications

Prepared by CP based on version of report circulated on 20 July 2023)

50. The Council has the power under Section 1(1) of the Localism Act 2011 to do anything which individuals generally may do provided it is not prohibited by legislation and subject to public law principles (the 'general power of competence'). Further statutory powers exist to establish and invest in Energetik, and Section 1 of the Local Government Act 2003 permits the Council to borrow and lend (subject to complying with the Prudential Code for Finance in Local Authorities). The recommendations detailed in this report are in accordance with legal justifications previously reported to Cabinet and/or Full Council (June 2015, September 2019, and May/June 2021) for establishing and implementing the business.

51. The Council must be satisfied that the working facility arrangements do not constitute an unlawful subsidy under the Subsidy Control Act 2022. External legal and financial advice is being sought on a continuous basis in relation to the project as a whole, and external advice is currently being sought on the working capital facility to confirm that any subsidy incurred under the proposed working capital facility is within permissible limits.

52. In taking the decision to provide a working capital facility to Energetik, the Council must also have proper regard to its fiduciary duty to act prudently with public monies.

53. The Working Capital Facility Agreement must be in a form approved by Legal Services on behalf of the Director of Law and Governance.

54. As this constitutes a 'Key Decision' as defined in the Council's Constitution, the Key Decision process must be followed.

Equalities Implications

55. An Equalities assessment identified one potential effect under disabilities: indirectly, customers with any disability (either physical or mental) could be at greater risk of falling below their credit threshold into debt and losing heat supply

56. This is already an existing risk for the company's current connections. Energetik manages this risk by maintaining a register of vulnerable customers and having separate debt protocols for liaising with these customers, including restrictions on withdrawing supply.

Environmental and Climate Change Implications

57. This working capital facility supports the expansion of Energetik's heat network. Based on known and identified connections the expansion of the network is projected to provide over a 35-year period a 45% reduction in Carbon emissions (equivalent to planting 236,000 trees) and a 59% reduction in Nitrous Oxide emissions (equivalent to removing 24,000 cars from the road).

Public Health Implications

58. The heat network Energetik is building, which requires this working capital facility, would result in a significant reduction in Nitrous Oxide emissions compared to supplying developments with traditional energy. This could be as much as 32,000kg for the number of connections assumed in the business plan over 35 years and more than 150,000kg if the network had connections to match its full capacity. At high concentrations Nitrous Oxides have an adverse impact on respiratory conditions and long-term exposure can lead to decreased lung capacity. Reducing these emissions improves local air quality and positive health benefits for local residents.

Property Implications

59. There are no direct property implications as the matter is primarily about funding. However, the purpose of the funding is to provide heat network infrastructure on/under/within Council properties and land assets. As and when detailed proposals come forward for these works' property implications will arise as part of the implementation and these should be addressed then.

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