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.

This page is intentionally left blank

London Borough of Enfield

Report Title	**Tranche 3 – Energetik A1A2 Loan**
Report to	**Executive Director Resources**
Date of Report	18 October 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 5646*
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 release Government loan financing secured by the Council for one of its trading companies, Energetik.

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

Recommendations

The Executive Director Resources, in consultation with the Cabinet Member for Finance & Procurement and the Director of Law and Governance:

I. Approves the Council on-lending £11.86m to Energetik repayable by December 2048 (financed by the March 2021 HNIP loan). The loan will finance Tranche 3 capital works that are already in contract (A1 and A2 contracts). The contractors are on site installing the pipeline between the Meridian Water Energy Centre and Ponders End.

II. Each drawdown of the funds will be subject to due diligence outlined in the loan agreement, including but not limited to
   a. Latest cashflow forecasts
   b. Checks of progress costs vs budget
   c. Invoices received from contractors
   d. Continued implementation of any mitigations

III. Delegates authority to Director of Finance (Capital) to sign the A1A2 Loan Agreement. The main Heads of Terms of the loan agreement are set out in Appendix 2.

Background and Options

3. 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 amounting to £37m (£12m HNIP; £15m MEEF; and £10m PWLB) and a grant from HNIP of £12m and is referred to as Tranche 3 financing.

4. The Council has secured the following Tranche 3 repayable loan financing from Central Government Agencies to onward lend to Energetik for the delivery of the Tranche 3 works:

   i. Heat Networks Investment Programme (HNIP) loan - £11.86m (received March 2021) at a rate of 0.01%
   ii. Mayor of London’s Energy Efficiency Fund (MEEF) loan - £15.00m (received April 2023) at a weighted rate of 2.35% (the loan has a variable interest rate attached).

5. Energetik is currently delivering the Tranche 2 investment programme, which is the construction of the Energy Centre at Meridian Water. To date loans of £34.9m has been advanced Energetik to deliver Tranche 1 and Tranche 2 works. The Council has transferred the £12m HNIP grant as equity investment in return for £1 shares in the Company. No Tranche 3 loan financing have yet been advanced to Energetik.

6. This report is seeking approval for the transfer £11.86m to Energetik via a loan agreement ('A1A2 Loan Agreement'), funded by the HNIP loan. This will enable Energetik to meet its contractual obligations for the delivery of works by the appointed contractors. The works are valued at £15.5m. The difference between loan proceeds advanced and the value of the works has been financed by Tranche 3 grant (balance of the £12m equity grant advanced in 2021/22).

7. The remainder of the £37m Tranche 3 funding agreed by Cabinet in 2021 will be made available once Cabinet has reviewed and approved a refreshed business plan. It is envisaged that a second loan facility will be entered into for the remaining funds, but will also incorporate and supersede the A1A2 Loan Agreement so that the entirety of the Loan is provided for under one agreement ('the T3 On-Lending Agreement'). The signing of the T3 On-Lending Agreement is subject to the outcomes of the external business plan review that will be reported to Council later in the Autumn of 2023.

8. Contractors have been appointed and works have commenced on the Tranche 3 programme. Two contracts have been awarded by Energetik.

9. Contract A1 involves installing pipeline from Meridian Water Energy Centre to Edmonton Green along Southbury Road:

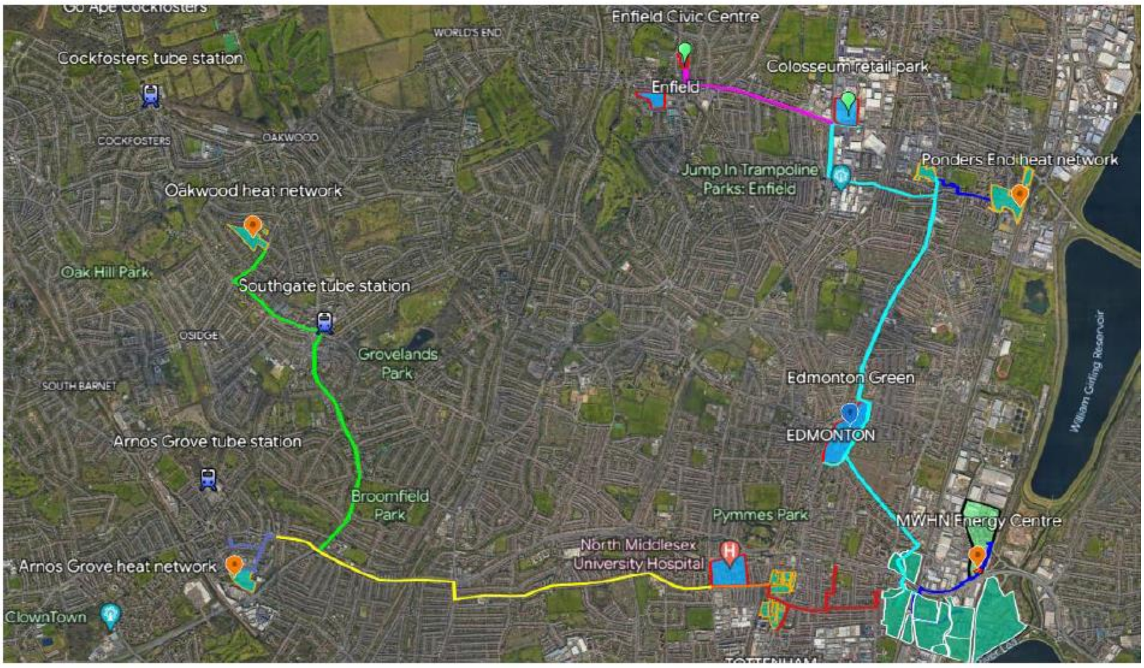
   - Supply Edmonton Green (Crosstree development)
   - Facilitate connection to Ponders End Heat Network
   - Facilitate connection to Colosseum Retail Park
   - Facilitate connection to Civic Centre & Palace Gardens

10. Contract A2 involves working from Edmonton Green to Ponders End (North of the Meridian Water Energy Centre along Southbury Road):

    - Connect to Ponders End Heat Network
    - Facilitate connection to Colosseum Retail Park
    - Facilitate connection to Civic Centre & Palace Gardens

11. Both contractual works are taking place on the pipe line between the Meridian Water Energy Centre and Ponders End along Southbury Road.

12. The map below shows the current and planned routes of development of the heat network.



13. **Revised Financial Model- June 2023:** The financial model has been reviewed and updated by the Company and is currently undergoing sensitivity testing and finalisation for Member reporting later in the calendar year.

14. The Cabinet last reviewed Energetik's 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.

15. 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 and maintenance costs.

16. The Council is currently reviewing Energetik's updated business plan, which will be reported to Cabinet later in the year.

HNIP Grant and Loan Agreement

17. Both the BEIS/HNIP Grant Agreement (HNIP Grant) and the BEIS/HNIP Loan agreement (HNIP Loan) were executed on the 19th March 2021.

Authority to Advance Loan

18. Energetik's capital programme and subsequent loan drawdowns have been incorporated into the Council's ten-year capital programme that was approved by Council on 23 February 2023 in KD5502.

19. The Council's borrowing Strategy was also approved by Council on 23 February 2023 in KD5504 as part of the Council's Treasury Management Strategy.

20. Annex 1 Appendix D (Investment Strategy) of the Treasury Management Strategy Para 15 (bullet point 4) states: All borrowing to companies owned by the London Borough of Enfield will require a formal on-lending agreement.

Interim Loan Terms

21. See Part 2 Appendix 2.

Use of Loan and Controls

22. The A1A2 Loan Agreement explicitly states that the loan proceeds can only be used for Eligible capital expenditure that will deliver the A1 and A2 contractual works as defined in paragraphs 9 and 10 and Appendix 2 (Purpose).

Financing of the A1A2 Loan

23. The Council received £11.86m HNIP loan on 31 March 2021 and £15m MEEF loan on 17 April 2023.

24. The HNIP loan will be used to finance this loan. There is a requirement for match funding from the HNIP loan. The loan agreement will include a clause that allows the Council to change the terms of the loan if the source of the funding were to change in the future for any reason.

Subsidy Control

25. The Council has obtained advice from financial and legal advisers to ensure that the proposed arrangements are lawful under the new Subsidy Control regime which came into effect in the UK pursuant to the Subsidy Control Act 2022. The subsidy control analysis carried out by Council officers has been documented and appended to this Report (see Background Papers).

Any alternative options considered and rejected

26. There is no alternative option to this funding. The Council has secured a very low fixed rate loan financing from Central Government in March 2021 that matures in December 2048. The equivalent 25-year PWLB loan will cost the cost the Council 5.23% (Certain Rate for Annuity loan on 27/07/2023).

Furthermore, if the loan financing is not on-lent to Energetik then the Council is obliged to return it to HNIP.

Main Considerations for the Council

27. In reaching a decision on this matter, the Council must consider the possible reputational damage and financial loss through breaching the HNIP Loan and being required to repay the £12m HNIP loan if it decides not to on-lend the loan proceeds.

28. 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. However since the contracts for works to be delivered on Meridian Water to Ponders End line have already been signed, and contractors are on site, refusal to pass on the loan financing to Energetik would result in Energetik not being able to pay the contractors in a timely manner.

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

29. Energetik’s financial model identifies the need for this loan financing to fund the development of the heat network. Without the loan it is not clear how Energetik would be able to continue to operate and deliver the approved expansion of the heat network.

30. Energetik has signed contractual agreements with contractors, who are now on site undertaking the works. Refusal to give the loan would result in a breach in the contracts and damages being sought by the contractors.

31. 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 loan financing supports, would lose the opportunity to reduce this potential risk of company failure and therefore financial loss for the Council.

32. Not continuing with the heat network expansion that this loan financing 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

33. The main risk in providing the A1A2 loan is the risk that Energetik would be unable to meet the interest and capital payments for the loan as they fall due. The mitigations for this risk are:

    i. Close working with Energetik to understand the business' up to date financial position and agree any mitigations required

    ii. 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 (2021).

    iii. 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.

    iv. Energetik will be required to provide a periodic rolling cashflow forecast.

34. There is also the risk of loan proceeds not being used for capital purposes. The loan agreement will stipulate that the proceeds are used to fund the A1 and A2 contracts for capital works procured. Checks at drawdown stage will take place and invoices will be requested from Energetik.

Preferred Option and Reasons For Preferred Option

35. The Executive Director of Resources, in consultation with the Cabinet Member for Finance & Procurement and Director of Law and Governance approves the on-lending of £11.86m funded by the HNIP loan via periodic loan drawdowns managed via an on lending agreement. The loan will be used to fund A1 and A2 contractual works.

Relevance to Council Plans and Strategies

36. The A1A2 Loan supports delivery of the extension to Energetik's heat network that was approved by the Council on 9th June 2021 (KD5304).

37. 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.

38. 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

39. The Council has lent Energetik £34.9m to date (financed by low interest loans obtained from Government). Loans lent to date relate to the Tranche 1 and Tranche 2 works. A HNIP loan of £11.86m was received by the Council on 31 March 2021 and relates to Tranche 3 works, which involves, in part, taking the line north of the Meridian Water Energy Centre. In addition, the Council received a £15m MEEF loan.

40. The accounting for the A1A2 loan relates to two parts. Firstly, interest and capital repaid to the Council's Lender, HNIP. To date the council has paid £2k in interest on the loan, and over the life of the loan the Council will pay £18k. Capital payments are expected to commence from 30 June 2024. Final loan instalment is 31 December 2048 when the loan is expected to be paid back in full (the maturity date). Interest is the charged to the Corporate Debt Management Budget.

41. And secondly, interest collected from Energetik is recorded as interest income, which is used to offset the Council's costs relating to Energetik shareholder activities and part-finance a working capital loan. Capital payments received will be regarded as the equivalent Minimum Revenue Provision (MRP) charge payment in accordance with current capital finance regulations.

42. Current MRP Regulations allow for loan repayments received from Council companies to be treated as the equivalent MRP charge for the respective year. Therefore, the Council is not required to set aside any MRP to cover the loan.

43. It is proposed that the interest and capital repayments from Energetik will need to mirror the Council's own payments to HNIP and MEEF repayments and includes matching loan durations. This mitigates the Council's refinancing risk that arises on timing differences between when the Council makes its repayments to HNIP and when the Council receives loan instalments from Energetik.

44. The Council will collect total interest from Energetik over the duration of the loan which will be used to finance the interest costs to the Council.

45. All loan drawdowns to finance the A1 and A2 contractual loan will be governed by a loan agreement. Loans that are to be drawn down from the loan facility (£11.86m) will be subject to Energetik satisfying the requirements of the loan agreement and providing the necessary evidence to support the loan request.

46. The ten-year capital programme that was approved by Council on 23rd February 2023 (KD5502) anticipated Energetik's 2023/24 Tranche 3 drawdown being £12.4m. However, Energetik have revised the expected drawdown for 2023/24 Tranche 3 loan financing (revision at August 2023) and it is likely to be £6.2m and £5.6m for 2024/25. Some Tranche 3 pipe installation cost has been financed from the residual Tranche 3 grant that was passed to Energetik as equity in October 2021.

47. In accordance with condition 17.4.3.(f) of the loan agreement signed between the Council and its Lender (BEIS/HNIP), the loan for A1 and A2 contractual works will be on-lent to Energetik at cost. Subsequently the Council will only recover the interest cost it pays HNIP. The Interim loan agreement will ensure that the loan payments (capital and interest) from Energetik mirror those of the Council’s payment arrangements with its Lender, thus minimising the Council’s refinancing; liquidity; and cashflow risks. Subsequently there is no financial gain in the form of an interest premium for the Council on this interim loan.

48. Over the life of the interim loan, the Council will pay HNIP total interest of £0.02m. The loan matures in December 2048. The Council’s first capital repayment will be in June 2024 (unless HNIP agrees to defer the payment on the grounds that the works are incomplete). The interim loan agreement will require Energetik to pay interest of £0.02m over the same period and mirror the Council’s capital and interest payments.

Legal Implications

49. 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.

50. The Council must be satisfied that the on-lending 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 having taken external advice on the on-lending arrangements proposed in this Report, Council officers are satisfied that passing on the HNIP funding by way of the Interim Loan is permissible under the subsidy control regime. The Director of Finance (Capital) will review the subsidy control position prior to signing the loan agreement.

51. The Interim Loan Agreement must be in a form approved by Legal Services on behalf of the Director of Law and Governance. Such Agreement will need to include provisions to reflect the conditions attached to the original HNIP funding and to help ensure compliance with Subsidy Control rules.

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

53. See Confidential Appendix

Equalities Implications

54. 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

55. 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

56. This Interim Loan 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

57. The heat network Energetik is building, which requires this loan, 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

58. 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.

Report Author: Nadeem Akhtar
Interim Finance Manager- Capital & Treasury
Nadeem.Akhtar@enfield.gov.uk
0208 148 4948

Appendices
Appendix 1: Part 2- Further information

Appendix 2: Part 2 – Heads of Terms

Background Papers
BEIS HNIP Grant Agreement- Executed March 2021
BEIS HNIP Loan Agreement- Executed March 2021
June 2023 Energetik Financial Model

This page is intentionally left blank

This page is intentionally left blank