London Borough of Enfield

Report Title	**Tranche 3 – Energetik MEEF2 Loan**
Report to	**Executive Director Resources**
Date of Report	**4 Dec 2023**
Cabinet Member	**Cllr Tim Leaver**
Executive Director / Director	**Fay Hammond**
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Ward(s) affected	All
Key Decision Number	*KD5693*
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. This paper seeks approval to on-lend (and receive back from Energetik) £15m MEEF2 funding by 31 December, in line with loan conditions.

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 the MEEF2 Loan proceeds of £15m to Energetik by 31 December 2023 to meet a legal obligation that the Council has under the MEEF2 loan agreement. On-lending will be transacted via an on-lending agreement.

II. Approves the Council entering an On-Lending agreement between the Council (the Lender) and Energetik (the Borrower) (i.e., lending £15m to Energetik).

III. Approves the Council entering an On-Loan agreement between the Council (the Borrower) and Energetik (the Lender) (i.e., receiving the £15m back from Energetik)

IV. Delegates authority to the Director of Finance (Capital) to approve the final MEEF2 On-lending and On-Loan Agreement between the Council and Energetik.

V. Delegates authority to the Director of Finance (Capital) to agree any changes to the MEEF2 loan agreement to enable the proposals in this report, and to approve any documentation required to bring those changes into effect.

Background and Options

2. 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.

3. 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)

   ii. Mayor of London’s Energy Efficiency Fund (MEEF) loan - £15.00m (received April 2023) (‘MEEF 2 Loan’).

4. Energetik is currently delivering the Tranche 3 investment programme, which is connecting the Energy Centre at Meridian Water to the Ponders End Heat Network. As at 31 October 2023 loans of £34.9m have been advanced to 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. Advances of £1.3m from the working capital facility have been drawn by Energetik, which have been financed from the Council's own cash resources.

5. A Tranche 3 on-lending loan agreement was executed on 29/11/2023 for the delivery of contractually committed A1 and A2 works that transfers loans up to £11.9m to Energetik to fund the respective works.

6. A working capital facility has also been provided by the Council to allow Energetik to support its operational costs in the absence of connection fee income. A legal agreement was signed on 24th October 2023 to provide a facility of £3.5m and approved under KD5645.

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.

8. This report is seeking approval for the on-lending (to Energetik) and on-loaning (back from Energetik) of the £15.0m MEEF2 loan that the Council received in April 2023, which the Council is required to pass on the loan on to Energetik by 31 December 2023. (i.e. to loan it to Energetik who immediately loan it back to the Council and then draw it down as required in the future). There is precedent for this arrangement – the Council and Energetik entered into the same arrangement for LEEF/MEEF1.

9. The secured MEEF2 loan is below current PWLB rates and therefore it is in both Energetik and the Council's interest to comply with the lender's requirements and therefore keep this secured funding.

10. Any interest the Council receives from holding MEEF2 cash before it is required by Energetik will be used in the following order
(i) to cover the interest payments to MEEF and direct costs of holding the loan;
(ii) to cover Council costs relating to Energetik lender and shareholder activities (eg the legal costs to draw up the agreements) and then
(iii) separated in a reserve which can be held to mitigate financial risks related to Energetik and provide working capital to Energetik.

11. Options to consider:

- Onward lend the loan without Energetik lending it back to Enfield Council – this is not practical as Energetik does not require the loan proceeds until financial year 2024/25. Energetik is currently undertaking the A1 and A2 contractual works that are financed by the HNIP2 loan proceeds. These works are expected to continue into 2024/25 financial year. On-lending the loan also requires an on-lending agreement to be signed by the Council and Energetik.

- Return loan to lender – given the Council's and Energetik's contractual obligations, this would be poor value for money compared to using the MEEF2 loan. The Council would be required to finance the equivalent loan from the PWLB and capital markets when Energetik are ready to commence the specific works required (due to HNIP match funding requirements). Current PWLB loans for a similar size loan are priced at 5.49% (Standard Rate 30/10/2023 14.5 year annuity loan). PWLB rates are expected to remain at current levels therefore returning the loan does not offer any value and is not recommended.

Tranche 1 Approach

12. In 2015 the Council was in a similar situation as now whereby Tranche 1 funding had been secured in advance of works starting. Therefore the Council had entered into an on-lending agreement with Energetik to on-lend the loan proceeds that were transferred to Energetik. The funds were returned to the Council under an on-loaning agreement until the first loan drawdowns in 2017. During the period of the on-loaning agreement the Council was servicing the debt with its Lenders (European Investment Bank and LEEF).

MEEF2 Approach

13. It is proposed that the Council adopts a similar strategy as per the Tranche 1 loans and seeks to on-lend the MEEF2 loan proceeds (£15m) by 31 December 2023 to Energetik, and asks for the loan proceeds back via an on-loan agreement whereby the Council acts as a Borrower. The loan proceeds are held in immediately accessible Money Market Funds until such time the funds are required by Energetik. The Council uses the interest income to offset its own servicing loan costs to MEEF2. Council returns any surplus income (net of Council's loan costs) to Energetik.

14. This approach does not breach the borrow to invest regulations. Borrowing to invest is prohibited under capital finance regulations. The Council secured the funding with the intention of funding the expansion of the heat network as approved by Council in June 2021 via an on-lending of the MEEF2 loan. The delay in developments due to the ongoing economic conditions (high inflation, high interest rates) has had an impact on Energetik's ability to progress with the works. Therefore, as the Council is incurring loan costs it needs to retain the funding (as it was secured on favourable terms in light current interest rates) and manage the loan proceeds that the Council has secured in advance to support the construction of Energetik's heat network.

Legal Agreements

The legal agreements (on-lending and on-loaning) should be prepared by an external legal organisation with specialism in this area to ensure that the Council has a commercially sound legal agreement in operation.

Any alternative options considered and rejected

15. The alternative options for the MEEF2 have been discussed in the report. The Council has secured a low fixed rate loan financing from a Central Government Agency in April 2023 that matures in May 2038. The equivalent 14.5-year PWLB loan will cost the cost the Council circa 5.49% (Standard Rate 30/10/2023 14.5 year annuity loan).

Main Considerations for the Council

16. In reaching a decision on this matter, the Council must consider the possible reputational damage and financial loss through breaching the MEEF2 Loan Agreement and potentially being required to repay the £15.0m loan if the loan agreement is not adhered to.

17. 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 due to wider economic conditions and a revised business plan will be reported to Council in the Spring of 2024.

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

18. 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.

19. The MEEF2 loan was obtained with the intention of financing the expansion works. As the works are delayed, and pending the outcome of the business plan update, the Council is not in the position to on-lend the loan proceeds or related match funding in accordance with the loan agreement clause 15.3.a.(i). The clause stipulates an on-lending agreement to be in place by mid December 2023 and the funds to be lent by 31 December 2023. Neither of these events have taken place and therefore the Council needs the lending deadline to be revised and proactively manage the loan funds until such time the funds are needed. This requires permission of the Funder and Energetik.

20. The risks that may arise if the related work is not undertaken is the potential repayment of a low cost loan; future funding jeopardy of the project; and reputational damage to the Council for future funding opportunities from the Mayor of London's Office, and Amber Infrastructure.

21. If the on-loaning agreement is not enacted then there is a risk that the funds could be used by Energetik to fund operational costs in the absence of reduced connection fee income; and or be used for non-approved purposes.

Preferred Option and Reasons For Preferred Option

22. 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 £15m to Energetik by 31 December 2023 to meet the MEEF2 loan agreement obligation; investing the Energetik loan proceeds in accordance with the approved Treasury Management Strategy via an on-loaning agreement between Energetik (the Lender) and the Council (the Borrower); and utilisation of interest earned on investing £15m to net off the Council's costs associated with servicing the MEEF2 loan.

Relevance to Council Plans and Strategies

23. The MEEF2 Loan supports delivery of the extension to Energetik's heat network that was approved by the Council on 9th June 2021 (KD5304).

24. 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.

25. 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

26. The Council has lent Energetik £34.9m as at 30 November 2023 (financed by low interest loans obtained from Government) as well as £1.5m from the working capital facility. Loans lent to date relate to the Tranche 1 and Tranche 2 works, whilst the working capital facility as been financed from the Council's own cash resources.

27. A MEEF2 loan of £15.0m was received by the Council on 17 April 2023 and relates to the expansion of the heat network Tranche 3 .

28. The accounting for the MEEF2 loan relates to two parts. Firstly, interest and capital repaid to the Council's Lender, Amber Infrastructure. To date the council has paid £0.08m in interest on the loan, and over the life of the loan the Council will pay £3.49m. Capital payments are expected to commence from 31 December 2026. Final loan instalment is 31 May 2038 when the loan is expected to be paid back in full (the maturity date). Interest is the charged to the Corporate Debt Management Budget.

29. 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.

30. 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.

31. The Council will collect total interest from Energetik once an On-Lending Agreement is in place and Energetik has drawn down the MEEF2 loan. The interest collected from Energetik will be used to finance the interest costs to the Council.

Legal Implications

32. 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.

33. The Council must be satisfied that the on-lending arrangements do not constitute an unlawful subsidy under the Subsidy Control Act 2022 or – in the case of the MEEF funding (as it derives from legacy European Regional Development Funding)- the EU state aid regime. External legal and financial advice is being sought on a continuous basis in relation to the project as a whole and having taken advice on the on-lending arrangements proposed in this Report, Council officers are satisfied that such arrangements fall within an exemption (‘GBER’) under EU state aid law.

34. The On-Lending and On-Loan documentation is being prepared by an external legal firm with specialism in this area. As the Council is the signatory to the MEEF 2 Loan, it will be responsible for ensuring compliance with the terms and conditions attached to the MEEF funding. Accordingly, the obligations and requirements imposed on the Council should be mirrored and passed down via the on-lending documentation.

35. As detailed elsewhere in this Report, the Council must comply with its obligations under the MEEF2 Loan to sign an on-lending agreement with Energetik and pass on the funding by 31 December 2023, or it will be in breach of the MEEF 2 Loan Agreement. Where Council officers are required seek the agreement of MEEF as Funder, any subsequent variations to the MEEF 2 Loan must be in a form approved by Legal Services on behalf of the Director of Law and Governance.

Equalities Implications

36. 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

37. 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

There are no direct environmental and climate change implications as the matter is primarily about funding

Public Health Implications

There are no direct public health implications as the matter is primarily about funding.

Property Implications

38. 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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