NOTIFICATION OF OPERATIONAL DECISION TAKEN – NOT FOR PUBLICATION

Decision taken by: Executive Director of Finance, Resources and Customer Services

Summary of Decision Taken including reasons

Title: Facility Agreement for On-Loan of Tranche 1 Ineligible Expenditure for Energetik

The proposals in the report have been made in order that a mechanism exists to advance funding to energetik for expenditure that is not eligible for state aid exemption under GBER, in order to progress the Lee Valley Heat Network project. It is recommended that the Executive Director of Finance Resources and Customer Services gives approval to the following:

1. The authorisation of a Facility Agreement between London Borough of Enfield and energetik for the on-lending of loans totalling £4.627m, which will be used by the company solely for the purpose of the project, and for expenditure in Tranche 1 of the project deemed "ineligible" for state aid.
2. That any proposed changes to this Facility amount should be referred back to the Executive Director of Finance, Resources and Customer Services for approval to ensure that the total approved Tranche 1 investment of £15m is not exceeded
3. That applications to draw down amounts against this facility must be approved by the Executive Director of Finance Resources and Customer Services and are subject to the company meeting the evidence requirements detailed in the agreement.
4. The interest rate in this agreement should be reviewed on an annual basis to ensure continued compliance with state aid regulations.

PLEASE SPECIFY CATEGORY OF DECISION: Key

If Key, please quote the Forward Plan reference number: 4036

Any alternative options considered and rejected:
None

Was the decision made in Part 1 or Part 2? Part 1

Interests Declared in Respect of the Decision (and by who):
N/A

NOTE: This form must be signed and dated by the decision taker(s) – see below:
The date specified will be taken as the date that the decision was made.

Signed ______________

Director – Finance, Resources and Customer Services

Date 10 / 3 / 2017

JAMES ROLFE
PLEASE PRINT NAME

MUNICIPAL YEAR 2016/2017 REPORT NO.

ACTION TO BE TAKEN UNDER DELEGATED AUTHORITY

Agenda – Part: 1	KD Num: 4036
Subject: Facility Agreement for On-Lending of Tranche 1 Ineligible Expenditure for energetik	

Wards: Cockfosters, Southgate Green, Upper Edmonton, Edmonton Green and Ponders End

OPERATIONAL DECISION OF:
Executive Director – Finance, Resources and Customer Services

Contact officer and telephone number:

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1. EXECUTIVE SUMMARY

1.1 Council 25th January 2017 approved the first Tranche of funding totalling £15m for the Lee Valley Heat Network (LVHN) scheme.

1.2 This report seeks approval to the signing of an on-lending agreement with Lee Valley Heat Network's subsidiary company "energetik" for £4.627m of this approved investment in order to fund the project expenditure deemed "ineligible" for state aid. The agreement is appended to the Part 2 report.

1.3 The loan is to be used solely for the purpose of the project, as detailed in the Council report 25th January 2017, and for expenditure deemed "ineligible" for state aid as further defined in the on-lending agreement.

1.4 A "commercial" interest rate has been advised as at the date of the agreement but will be subject to annual review basis to ensure continued compliance with state aid regulations. Details of the interest rate are included in the Part 2 report.

2. RECOMMENDATIONS

2.1 Approval is sought to the authorisation of a Facility Agreement between London Borough of Enfield and energetik for the on-lending of loans totalling £4.627m, which will be used by the company solely for the purpose of the project, and for expenditure in Tranche 1 of the project deemed "ineligible" for state aid.

2.2 It is recommended that any proposed changes to this Facility amount should be referred back to the Executive Director of Finance, Resources and Customer Services for approval to ensure that the total approved Tranche 1 investment of £15m is not exceeded.

2.3 It is recommended that applications to draw down amounts against this facility must be approved by the Executive Director of Finance, Resources and Customer Services and are subject to the company meeting the evidence requirements detailed in the agreement.

2.4 The interest rate in this agreement should be reviewed on an annual basis to ensure continued compliance with state aid regulations.

3. BACKGROUND

3.1 Council 25th January 2017 approved the first Tranche of funding totalling £15m for the Lee Valley Heat Network (LVHN) scheme. The investment will be made in LVHN's subsidiary company trading as "energetik"

3.2 Recommendation 2.6 of the Council Report delegated authority to the Executive Director of Finance, Resources and Customer Services to "agree an On-Lending Agreement between the Council and energetik for the outstanding balance from the £15 million Tranche 1 funding, noting that £12 million has already been successfully secured under a match funding arrangement with the European Investment Bank (EIB) (£6 million) and the London Energy Efficiency Fund (LEEF) (£6 million)."

3.3 As the On-Lending Agreement involves the provision of state resources to energetik, the Council must take steps to minimise or eliminate the risk of the On-Lending Agreement involving the provision of illegal state aid. The Council has taken external legal and financial advice to ensure that such steps are taken. The latest advice obtained recommends the use of a "commercial" interest rate for expenditure that is not deemed eligible for state aid under the General Block Exemption Regulation 2014 (GBER). It has been advised that this interest rate should be kept under review, to ensure that it continues to be relevant, and it is recommended that this is done on an annual basis. The initial interest rate proposed is set out in the Part 2 report.

3.4 Energetik's financial model had assumed an interest rate that was lower than the commercial rate now advised (Detail is in Part 2 report) In order to achieve this rate on average across all loan repayments energetik have therefore proposed to split the on-lending of the £15m into two agreements, one to cover expenditure that is "eligible" for state aid and a second agreement to cover expenditure that is "ineligible". This will allow a lower rate of interest to be applied to the "eligible" expenditure in order to achieve the required overall average in the company's financial model.

3.5 The initial split of the approved £15m investment across the two agreements has been estimated as £10.373m eligible and £4.627m ineligible. The facility amount in the "ineligible" agreement appended to the Part 2 report has therefore been set at £4.627m. The on-lending agreement for "eligible" expenditure has an initial facility amount of £10.373m and will be funded from the LEEF and EIB loans referenced above. An existing on-lending agreement with LVHN is being novated to energetik and updated to this new facility amount to cover the eligible expenditure. The balance of the £12m LEEF and EIB loans, which have been earmarked for eligible expenditure, will be applied to Tranche 2 expenditure subject to further approval by Council.

3.6 A provision has been made in both agreements to vary the facility amounts to provide for the event that the eligible and ineligible split of funding in Tranche 1 is not exactly as planned. This will require the approval of the Executive Director of Finance Resources and Customer Services and is subject to the total of the two Facility amounts not at any time exceeding £15m.

3.7 Drawdown of the facility will be made in accordance with the schedule to the agreement and is subject to the agreement of the Executive Director of Finance Resources and Customer Services and to the provision of information as set out in the agreement. Interest will be chargeable on drawdown amounts from the date of the loan advance.

Principle repayments will be as set out in the schedule of repayments included in the agreement (see Part 2 report)

3.8 Loans will be selected by LBE for on-lending to provide the best fit to energetik's planned repayment profile and to achieve the best available rate, while according with the Council's approved Treasury Management strategy.

4. ALTERNATIVE OPTIONS CONSIDERED

None in the context of this report

5. REASONS FOR RECOMMENDATIONS

5.1 The above recommendations will ensure that a mechanism exists to advance funding to energetik for expenditure that is not eligible for state aid exemption under GBER, in order to progress the LVHN project.

5.2 The recommendations also aim to ensure that approved funding cannot be exceeded and that appropriate governance is in place to monitor expenditure prior to the drawdown of loans.

6. COMMENTS OF THE DIRECTOR OF FINANCE, RESOURCES AND CUSTOMER SERVICES, AND OTHER DEPARTMENTS

6.1 Financial Implications

6.1.1 On the 25th January Council approved an addition of £10.63m to the Capital programme to fund Tranche 1 of the project. This was in addition of the £4.37m, already approved in the Capital programme, bringing the total investment to £15m

6.1.2 As per recommendation 2.6, this report is setting up the on lending agreement for the balance of Tranche 1. As detailed above due to the requirement to split expenditure incurred into eligible and ineligible this on-lending agreement is for an estimated £4.627M, as opposed to £3M (i.e. the difference between the LEEF/EIB Loans and the total tranche 1 funding required)

6.1.3 See Part 2

6.1.4 Any changes to the schedule of loan repayments and the associated milestones are subject to approval by the Executive Director of Finance, Resources and Customer Services. It should be noted that £4.37m of the facility amount is in respect of expenditure already incurred by LBE in respect of this project. In relation to this sum it is proposed that there will be no transfer of cash between energetik and LBE but the liability will be passed to energetik by accounting adjustments in both parties' accounts so that the debt transfers to energetik. This will be subject to compliance with VAT regulations and ensuring that it does not have any negative impact on LBE's VAT position.

6.2 Legal Implications

6.2.1 The Council has 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. There is no express prohibition, restriction or limitation contained in a statute against use of the power to undertake the LVHN scheme in the manner envisaged by the recommendations in this Report. In addition, section 111 of the Local Government Act 1972 gives a local authority power to do anything which is calculated to facilitate, or is conducive or incidental to, the discharge of any of its functions (such functions including its housing and related economic development functions) and section 111 of the Local Government Act 1976 gives local authorities the power to sell heat and electricity generated in association with heat. In addition to the Localism Act 2011, the Council has power under section 95 of the Local Government Act 2003 to trade in function related activities through a company. Section 1 of the Local Government Act 2003 permits the Council to borrow and to comply with the Prudential Code for Finance in Local Authorities. The recommendations detailed in this report are in accordance with these powers.

6.2.2 The proposed on-lending agreement is a vehicle for directing funding to energetik for expenditure that is not eligible for state aid exemption under GBER. As such, it is important that the on-lending agreement should be on 'commercial terms'. This includes a commercial rate of interest. Advice sought from financial advisors, ASM, confirmed an appropriate rate of interest to charge for a project of this type and at this stage in its development as detailed in the Part 2 report. This rate is charged under the on-lending agreement but should be kept under review to ensure continuing compliance with state aid rules.

6.2.3 The agreement contains a number of conditions to draw down. These include conditions to ensure that the Facility Amount is not exceeded, although a request may be made to increase the Facility Amount if the split between expenditure which is eligible and that which is ineligible is such that more than anticipated expenditure is ineligible. That would require more funding to flow through this agreement. The conditions to draw down also include conditions that ensure that the total amount drawn down under the Tranche 1 approval never exceeds £15m, however it splits between eligible and ineligible. These provisions will need to be carefully monitored.

6.2.4 An indicative drawn down and repayment schedule is included in the agreement (see Part 2 report). This will need to be updated from time to time by agreement between the Council and energetik. Setting the schedule requires Council approval (as lender) as does disbursing any funds requested by energetik under a draw down request.

6.2.4 The risk to the Council of energetik defaulting on repayments because it does not have sufficient revenue is a commercial risk associated with the LVHN scheme. However, we understand that the repayment profile has been modelled to defer substantial capital repayments until the scheme is expected to be generating revenue.

6.3 Property Implications

None

7. KEY RISKS

7.1 There is a risk that a failure to monitor the drawdowns made against this on-lending agreement and/or a failure to do this in conjunction with the eligible expenditure on-lending agreement could result in expenditure exceeding the £15m approved investment. Provisions have been made in the agreement (as set out in the body of this report and summarised in the recommendations) in order to minimise this risk.

7.2 **Lender risk:** the Council, as lender under these agreements, is exposed to the potential failure of energetik, as borrower, and energetik's inability to repay the money it owes to the Council. This is mitigated to a large degree by the terms of the loan agreements, the oversight the Council has over the running of the business as sole shareholder, and the governance measures implemented through the Delegations Matrix.

7.3 As ultimate shareholder in the borrower, through requirements imposed on energetik to report to its Holding Company Board (which includes Council representation), and through Board and shareholder approval requirements, the Council will have substantially greater visibility of the ongoing financial and technical performance of the business. This will give the Council advanced warning of any issues arising, the ability to probe and seek guidance, and the opportunity to remedy such issues. This additional level of oversight, control and influence is significantly greater (in both a legal and practical sense) than a normal lender would have in a pure lender-borrower relationship (where security rights would be purely contractual).

8. IMPACT ON COUNCIL PRIORITIES

8.1 Fairness for All

The heat networks will help tackle inequalities in the borough as set out in detail in the Cabinet report

8.2 Growth and Sustainability

Providing funding to energetik will support the Council's ambitious plans for regeneration of deprived areas and sustainable economic growth, supporting the following priorities

- Maintaining a clean, green, sustainable environment
- Bringing growth, jobs and opportunities to the Borough

8.3 **Strong Communities**

- Community engagement and enabling is a cornerstone of the business' delivery model. This in turn promotes stronger, more cohesive communities and active citizenship
- The Council-owned energy company will provide local benefits through jobs and employment opportunities as well as supporting a major boost to the local economy

9. EQUALITY IMPACT IMPLICATIONS

An EQI Assessment was been undertaken for the Cabinet Report. It identified that the recommendations were unlikely to have a significant impact on the protected characteristic groups or the way that individuals access information or services. An EQIA Action Plan has been created and will be regularly reviewed and updated.

10. PERFORMANCE MANAGEMENT IMPLICATIONS

10.1 Lee Valley Heat Network Ltd and its 'energetik' subsidiary have been trading since September 2015 in accordance with its Articles of Association. The performance of energetik is managed through one-to-ones; team meetings; the monthly OpCo Board meeting; and regular HoldCo Board meetings.

10.2 Regular reports are prepared on the programme, budgets, the business' Risk Register and energetik's overall performance, including Highlight Reports. An independent Audit Committee has also been established.

11. PUBLIC HEALTH IMPLICATIONS

11.1 14.1 energetik will deliver significant economic, environmental and social benefits.

11.2 Climate change is a major threat to public health. energetik will help to reduce its impact. The carbon footprint of a home due to heating will be reduced at least 50% compared to conventional fuel. The business is hugely important for meeting London's carbon reduction targets.

14.3 energetik will deliver better value heat to new homes, and possibly, at a later stage of development to existing homes. Well heated homes help to promote the general health of the people who live in them, through reductions in vascular and respiratory disease and by reducing social isolation.

Background Papers

Cabinet and Council Report January 2017 "The Council's Main Investment Decision in energetik"