Report to:	**EXECUTIVE**
Relevant Officer:	Steve Thompson, Director of Resources
Relevant Cabinet Member:	Councillor Simon Blackburn, Leader of the Council
Date of Meeting:	2nd November 2015

STREET LIGHTING AND TRAFFIC SIGNAL PRIVATE FINANCE INITIATIVE REFINANCING 2015

1.0 Purpose of the report:

1.1 To consider the refinancing of the Blackpool Street Lighting and Traffic Signals Private Finance Initiative (PFI) contract.

2.0 Recommendation(s):

2.1 To approve the refinancing of the Blackpool Street Lighting and Traffic Signals Private Finance Initiative contract. A refinancing gain of £2.88m is estimated at financial close which is anticipated to take place in November/December 2015.

2.2 To agree that the refinancing gain is taken as a reduction in the monthly Unitary Charge (UC) payment to Community Lighting Partnership (CLP). The reduction is in the region of £170,000 for each remaining year of the contract.

3.0 Reasons for recommendation(s):

3.1 In March 2015, Equitix Investment Management Limited (Equitix), a 50% investment partner in Community Lighting Partnership, approached Blackpool Council to gain its support for the refinancing of the Blackpool Street Lighting and Traffic Signals Private Finance Initiative project. At this point in time a Council share of the Refinancing Gain of £2.5m was estimated.

The scheme was originally procured during the period of economic instability caused by the credit crunch, with the preferred senior debt funder withdrawing shortly before financial close. Debt margins are now significantly lower than their credit-crunch highs and whilst current funders Barclays and National Australia Bank (NAB) are no longer operating in this market Nord LB (Nord) and Sumitomo Mitsui Banking Corporation (SMBC) have been identified as replacement funders. The long term cost of funds within the Special Purpose Vehicle (SPV) can therefore be reduced with a consequential improvement in shareholder returns.

In exchange for granting consent to the refinancing, the Council will receive £2.88m as its share of the Refinancing Gain, whilst also being required to underwrite increased levels of compensation to the Special Purpose Vehicle under certain events of default.

Equitix has also approached five other Councils on the same basis and is seeking to achieve optimum terms through refinancing the portfolio of six Private Finance Initiative /PPP transactions on similar timescales.

3.2a	Is the recommendation contrary to a plan or strategy adopted or approved by the Council?	No
3.2b	Is the recommendation in accordance with the Council's approved budget?	Yes

3.3 Other alternative options to be considered:

Do nothing – the contract would continue to be delivered under the current financial arrangements with the existing funders Barclays and National Australia Bank (NAB). This would prevent the Council from accessing the more favourable financial terms available on the market presently and not realise the savings detailed earlier in the report but would mean no increase in the compensation payable by the Council in the event of Default, Voluntary Termination or Force Majeure.

4.0 Council Priority:

4.1 The relevant Council Priority is;

'Create safer communities and reduce crime and anti-social behaviour'

5.0 Background Information

5.1 In July 2009 Blackpool Council awarded preferred bidder status for the delivery of the Street Lighting and Traffic Signals Private Finance Initiative contract to Community Lighting Partnership, a 50:50 consortium of Telereal Trillium and Pell Frischmann.

5.2 The project reached financial close in December 2009 during a period of economic instability caused by the credit crunch. A term loan facility was secured with Barclays and NAB, featuring an interest margin of 2.30% stepping to 2.80% - typical for Private Finance Initiative projects during this period of time.

5.3 Equitix purchased their 50% share from Telereal Trillium in 2010 shortly after contract start with full consent from the Council.

5.4 The £153m contract was procured under competitive dialogue and was supported by a £33.9m Private Finance Initiative grant from the Department for Transport (DfT) to fund the capital works and maintenance programme over a 25year period. The business case for the Project included a number of high level and detailed objectives but is in essence focused on:

- The replacement of failing lighting and traffic signal infrastructure to bring lighting and signal levels to appropriate British and European standards;
- Investment in new lighting in back alleys and associated areas with high crime statistics;
- Improving safety of the existing highways infrastructure and reducing road traffic accidents across the borough; and
- The modernisation and future proofing of the lighting and traffic signals infrastructure, resulting in reduced maintenance and energy consumption.

5.5 The 25year contract term is based upon an initial 5year investment programme Core Investment Period to replace the street lighting and traffic signals infrastructure along with a comprehensive maintenance regime over the full term of the contract. The Core Investment Period was completed in full earlier in 2015, and in essence the contract is now focused upon a highways contract with specified performance standards to manage the planned and reactive maintenance.

5.6 The refinancing exercise will not impact upon the operational requirements of the contract. In this respect the refinancing of the project is essentially an isolated process to enable the Council and the service provider to take advantage of the improved lending rates available in the marketplace.

5.7 Does the information submitted include any exempt information? No

5.7 **List of Appendices:**

None

6.0 Legal considerations:

6.1 The Council has appointed external Legal Advisers to support the refinancing process. There would be a requirement to amend a range of legal documents appertaining to the contract which would be completed as part of the financial close process. The Council's internal Legal Services team would instruct the advisors accordingly.

7.0 Human Resources considerations:

7.1 Not applicable

8.0 Equalities considerations:

8.1 Not applicable

9.0 Financial considerations:

9.1 The refinancing gain of £2.88m is derived by comparison of the distributions projected to take place after the refinancing, less those forecast to occur prior to implementing the refinancing. The difference is discounted at 12.75%, (a rate set in the original contract) resulting in the Refinancing Gain figure. This is shared between the Public and Private sector on the following basis :-

- 50% of first £1m generated to the Public sector;
- 60% of any balance between £1m and £3m; and
- 70% thereafter

The gain can be taken as a one-off upfront payment, or alternatively over time through a reduction in the annual Unitary Charge. The annual Unitary Charge reduction would be in the region of £0.17m per year.

The Director of Resources has elected to take the Gain as a reduction in the Unitary Charge, spreading the benefit in line with the period of the remaining contract.

9.2 In reaching its decision to seek to refinance the Council has assessed the potential financial exposure we face from termination liability scenarios, specifically Voluntary Termination (the Council terminating the Contract), Authority Default (the Council defaulting on payment) or Force Majeure (Act of God). Under these scenarios the Council is required to pay compensation to the Contractor.

The level of compensation increases at the point of refinancing under both Voluntary Termination/Authority Default and Force Majeure scenarios by £2.38m and £1.84m respectively as a result of the higher debt levels from the proposed refinancing. In addition, the increases in potential compensation payments change over the life of the project with the additional exposure increasing significantly under the Force Majeure scenario to circa £6.0m near the end of the contract. Given the fact that approximately 19 years of the Project remain, the profile of increased compensation payment over the term has also been considered.

Figure 1 below outlines the estimated compensation due over time both before and after refinancing occurs.

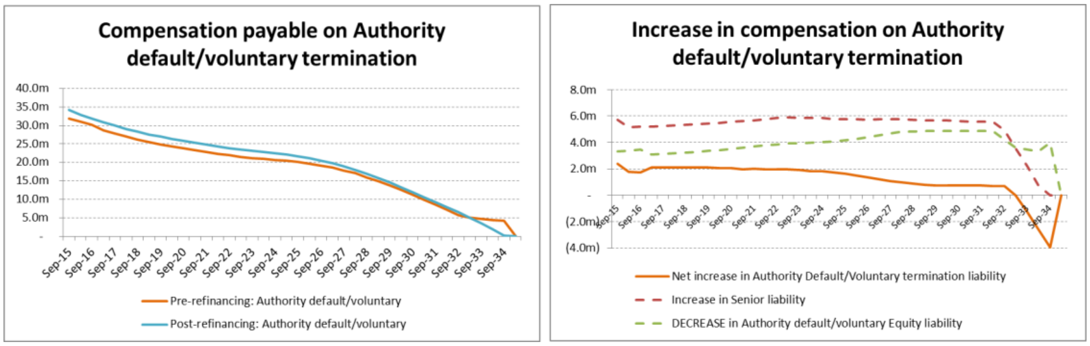

Figure 1: Voluntary termination/Authority default liability over time

Whilst the Refinancing Gain payment is lower than the increase in compensation payments that become liable, the value for money (VfM) of the proposal can only be judged by consideration of the probability of such compensation actually being required. The likelihood of the Council voluntarily terminating the Project given the statutory nature of the service, the performance of the contractor or defaulting on payment to the contractor is considered to be very low. Force Majeure, by its very definition, is considered to be extremely unlikely.

On this basis it appears prudent for the Council to proceed with the refinancing proposal given the very low likelihood of the termination liabilities occurring.

10.0 Risk management considerations:

10.1 Abort Costs

In the event the refinancing transaction fails to reach financial close then abort costs will become due. In such a circumstance the Council would only be liable for costs incurred in respect of its own advisers (financial and legal) limited by agreed fee caps totalling £160,000. The risk of abort is considered to be very low however given the size of the financing benefit to be shared by the public and private sector, as well as the current liquidity in the funding market.

To the extent one of Nord LB or SMBC withdrew from the refinancing process negotiations would commence with the remaining funder to explore the possibility of increasing participation to 100% of the debt requirement. A number of other financing options also exist, as identified through the funding competition - whilst terms would not prove as attractive the overall transaction should still remain viable.

10.2 **Increase in underlying financing costs and margins**

It is accepted that the underlying cost of funds remains a Council risk to the point of financial close, and the Refinancing Gain will therefore vary dependent on final pricing. Unlike a primary Private Finance Initiative transaction however, the majority of risk with regard to the underlying swap rate is already hedged through the existing interest rate swap. In the event swap rates increase from the 1.98% assumption included in the latest financial model the ongoing cost of funds will increase, thereby depressing the amount of additional debt that can be raised. The cost of breaking the existing interest rate swap will however decrease, offsetting much of the impact of the higher underlying rate. This is demonstrated by the following sensitivity – a 10 basis point increase in the swap rate reduces the Refinancing Gain by just £100,000

10.3 **Potential for Reduction in Blackpool Refinance Gain**

Department of Transport's Promissory Note for Blackpool relating to the initial Private Finance Initiative grant of £33.9m contains no provision for any future share of the refinance gain to pass back to Department for Transport.

10.4 **Robustness of Community Lighting Partnership**

Risks relating to the original construction programme have now passed, and an operational track record for the asset (albeit relatively short) now exists. Importantly the senior lenders have performed significant due diligence on the assets in order to provide them with the confidence to lend, including both qualitative analysis from a technical adviser along with quantitative assessment of numerous sensitivities through the Financial Model.

This should provide the Council with confidence on the overall robustness of the Special Purpose Vehicle once the new financing structure has been implemented.

11.0 Ethical considerations:

11.1 None known

12.0 Internal/ External Consultation undertaken:

12.1 Department for Transport is the sponsoring government department for the project. The Council has engaged fully with Department for Transport regarding the refinancing process and is awaiting confirmation and ministerial approval to proceed with the project refinancing. A comprehensive value for money exercise formed part of the external approval process. HM Treasury has also confirmed their support as part of the group refinancing package with a number of Other Local Authorities as mentioned earlier.

13.0 Background papers:

None

14.0 Key decision information:

14.1	Is this a key decision?	Yes
14.2	If so, Forward Plan reference number:	18/2015
14.3	If a key decision, is the decision required in less than five days?	No
14.4	If **yes**, please describe the reason for urgency:	

15.0 Call-in information:

15.1	Are there any grounds for urgency, which would cause this decision to be exempt from the call-in process?	No
15.2	If **yes**, please give reason:	

TO BE COMPLETED BY THE HEAD OF DEMOCRATIC GOVERNANCE

16.0 Scrutiny Committee Chairman (where appropriate):

Date informed: 23rd October 2015 Date approved: N/A

17.0 Declarations of interest (if applicable):

17.1

18.0 Executive decision:

18.1

18.2 **Date of Decision:**

19.0 Reason(s) for decision:

19.1 **Date Decision published:**

20.0 Executive Members in attendance:

20.1

21.0 Call-in:

21.1

22.0 Notes:

22.1