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Executive Member Decisions

Friday, 13th September, 2019

AGENDA

Date Published: 13th September 2019
Denise Park, Chief Executive

EXECUTIVE MEMBER DECISION

REPORT OF:	Executive Member for Finance and Governance Executive Member for Children, Young People and Education
LEAD OFFICERS:	Director of Finance & Customer Services Director of Children's Services and Education
DATE:	**13th September 2019**

PORTFOLIO/S AFFECTED:	Finance and Governance	Children, Young People and Education
WARD/S AFFECTED:	N/A	

SUBJECT: Refinancing of Building Schools for the Future – Private Finance Initiative Phase 2 – Blackburn Central High School with Crosshill and Witton Park High School

1. EXECUTIVE SUMMARY

Further to the Executive Board report in July 2017, this report requests approval to proceed with the refinancing of the second of the two Private Finance Initiative (PFI) schemes which the Council entered in to as part of the Building Schools for the Future (BSF) programme in 2010; that is the Phase 2 Scheme – Blackburn Central High School with Crosshill and Witton Park High School.

2. RECOMMENDATIONS

Under the delegated powers given to the Executive Member for Finance and Governance and the Executive Member for Children, Young People and Education, in consultation with the Director of Finance & Customer Services and the Director of Children's Services and Education, in the Executive Board report of July 2017, approval is sought to enter into a re-financing arrangement for the Council's PFI scheme covering Blackburn Central High School with Crosshill and Witton Park High School.

3. BACKGROUND

Building Schools for the Future Programme (BSF)

On the 21st September 2009, Balfour Beatty Education was appointed as the Council's selected partner to form the Blackburn with Darwen and Bolton Local Education Partnership (LEP) to deliver the BSF investment programme across the Borough. As part of the BSF Programme, three new schools were procured through two PFI Contracts. The schools were delivered in two phases and both achieved Financial Close in 2010:

Phase 1 - Pleckgate High School (Achieved Financial Close January 2010)
Phase 2 - Witton Park High School and Blackburn Central High School with Crosshill (Achieved Financial Close October 2010)

On the 12th July 2016, the LEP formally notified the Council of Balfour Beatty Investment's decision to sell its shares in both of the PFI Companies and in the LEP; their shareholding was subsequently sold to Amber Fund Management (AFM).

As such, the current shareholding in the 2 PFI companies comprises;

Holding Company – 81% AFM, 9% BwD BC, 10% Local Education Partnership (LEP)*
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Project Company - Blackburn with Darwen and Bolton Phase 1 Limited and Blackburn with Darwen and Bolton Phase 2 Limited

*(where the shareholding in the LEP comprises; 90% AFM, 5% BwD Borough Council, 5% Bolton Borough Council)

Financing Arrangements

The two phase 2 schools were completed in 2012 and the associated PFI contract runs until 2036.

During this time the Council pays a monthly fee to the contractor, currently £553,930.00 per month, known as the Unitary Charge. The Unitary Charge covers the financing and capital costs of the construction of the buildings, plus their maintenance costs until 2036, which includes the cost of future capital maintenance and 'soft' maintenance including caretaking and cleaning. The construction of the buildings was financed by borrowing from banks, and the majority of the costs covered by the charge relate to the repayment and servicing of this debt.

The Unitary Charge is currently funded by a PFI grant from government, contributions from schools and a further contribution from Schools which is provided to the school via the PFI Formula Factor within the Schools Budget Share Calculation within the Dedicated Schools Grant (DSG).

Re-financing

Following the sale of Balfour Beatty's investment to AFM, and following approval from the LEP Board, Amber Infrastructure Limited (which is the financial advisory arm of AFM) initiated a scoping exercise to consider refinancing of the Senior Debt within the Phase 1 PFI Contract relating to Pleckgate High School.

Most PFI contracts contain standard provisions whereby if the debt used to finance the initial construction phase of a project can be refinanced at a lower cost, then the benefit (after transaction costs, advisory fees and disbursements) is split between the Council and the PFI Contractor. In these arrangements, the debt to be refinanced is often referred to as Senior Debt and the providers of it are known as Senior Funders.

The interest rate charged to the PFI Contractor broadly comprises two elements:

- The underlying interest (swap) rate;
- A profit margin charged by the Senior Funder.

Refinancing opportunities generally exist where the market rate for the profit margin element falls below that currently charged by the incumbent Senior Funder. However, any refinancing exercise attracts significant early redemption penalties as well as legal and advisory fees. The reduction in margins must therefore be significant enough to offset these costs.

It is common for this debt to be refinanced sometime after the completion of construction because the risks involved in the project generally reduce at this point which means that the initial loans can be replaced by loans at a lower rate of interest. The approach from AFM has been made at this time because of the historically low level of interest rates available at present.

Implications for Schools

Under the Governing Body Agreements the schools have agreed to pay the Council an element of the Unitary Charge. The schools contribution to the Unitary Charge was set and agreed at the project outset and covers the management of the schools facilities, such as maintenance and cleaning, together with insurance cost and elements of project operating costs. The Council is responsible for the repayment of the capital / interest sum. It is this capital/interest sum that is the subject of the refinancing exercise and as such the re-financing will not impact on the Facilities Management aspect of the Unitary charge and therefore has no direct implications for the school.

Refinancing of Phase 1 Scheme
Following on from the initial scoping exercise the Council and AFM conducted a refinancing exercise of the Phase 1 PFI contract earlier this year, which resulted in more beneficial interest rates and a resultant financial benefit to the Council.

4. KEY ISSUES & RISKS

Current Position

Following the success of the Phase 1 refinancing exercise the Council wish to proceed with the refinancing of the Phase 2 contract. The original Senior Debt on the Phase 2 scheme was approximately £50 million, of which approximately £41 million remains outstanding. The current Senior Debt Lenders are Nord/LB, Dexia and KFW.

The PFI contract includes provisions for payments to be made upon termination. If the contract is terminated by the choice of, or through default by the Council, then the Council would have to make a termination payment, i.e. the cost for prematurely ending the existing funding arrangement between the Project Company and the Senior Debt Provider. It is estimated that the cost of these early redemption payments would increase by approximately £2.6 million as a result of the refinancing exercise, in the main due to the increase in value of the new Senior Debt that is required to fund the current swap breakage costs.

Although there would be an increase in the outstanding debt on the scheme, it is expected that the total value of the remaining repayments will be lower than those currently planned, due to the expected reduction in the interest rate charged on the new loan debt.

At this stage AFM have approached the market to seek terms. Based upon their work, AFM have advised the Council that the terms being offered by prospective funders will result in a net gain which would provide the Council with the following benefits;

- A share of the gain attributed to the Council as granting authority, as defined by sharing provisions in the initial Project Agreement in 2010, with any benefit from the refinancing to be split between the Council and the Project Company as follows:
  - Up to £1million - benefit of 50% (with 50% payable to the Project Company)
  - Between £1million and £3million - benefit of 60% BwD (with 40% payable to the Project Company)
  - Over £3m - benefit of 70% (with 30% payable to the Project Company)

- As the Council is also a shareholder in the Project Company (directly owning 9% of the shares in the Holding Company, and also 5% in the LEP who in turn owns 10% of the shares in the Holding Company), the Council will receive 9.5% of the benefit identified above as going to the Project Company.

The financial and legal arrangements in PFI deals are extremely complex. With this in mind Asteros Advisers Ltd (Finance Advisors – this is a new company formed by advisors who worked for BDO during the phase 1 refinancing) and DAC Beachcroft LLP (Legal Advisors) have been appointed to provide advice to the Council to ensure the Council achieves optimum value for money from any refinancing but to also protect the Council's interests throughout the negotiations. Both sets of advisers were involved in the refinancing of the Phase 1 scheme and are therefore have a comprehensive understanding of the Councils PFI contracts.

It is not clear at which precise point and on what date the Council will be required to enter into contractual arrangements to finalise any refinancing arrangement, however, it is hoped and expected that the refinancing transaction will be executed in mid-October, prior to Brexit.

RISKS
Options/Alternatives

As a minority shareholder, there are two options in the Council’s approach to the re-financing:

- Option 1 – Proceed with the proposed refinancing; implications are:
    - the Council would receive a financial benefit from the re-financing gain
    - the Council accepts the risk of higher termination liabilities in the unlikely event that the Council were to terminate the PFI contract by choice or through default
    - all costs incurred by the council in relation to the re-financing process are fully paid for as part of the calculation of the net re-financing gain

- Option 2 – Do not proceed with the proposed refinancing;
    - the Project Company is not able to proceed with the re-financing without the Council's approval.
    - the Council would lose the financial benefit from the re-financing opportunity
    - the costs incurred in respect of financial and legal advice in exploring the option of re-financing to this point would be borne by the Council

The Preferred Option is Option 1 as this will give rise to a financial benefit for the Council.

5. POLICY IMPLICATIONS
There are no specific policy implications associated with this report.

6. FINANCIAL IMPLICATIONS
Proceeding with the proposed refinancing will give rise to a financial benefit for the Council. The precise value of this benefit will not be known until completion of the re-financing deal which is expected to be in mid-October, as this will be dependent on the financial markets at the precise time that the re-financing transaction is undertaken.

Financial and legal advisers have been engaged to support the Council in its efforts to pursue refinancing opportunities.

7. LEGAL IMPLICATIONS
The Council’s Financial Procedure Rules have been complied with in the progression of the re-financing arrangement and the Council has procured expert, external legal and financial advice to support this project. The Council’s legal advisors will review all necessary documentation and advise the Council on its contents and highlight any associated risks.

8. RESOURCE IMPLICATIONS
There will be some impact on finance, procurement and contracting staffing resources for the finalisation of the re-financing arrangements.
The ongoing input and management of the PFI contract will not materially impact on the current staffing resources.

9. EQUALITY AND HEALTH IMPLICATIONS
Please select one of the options below. Where appropriate please include the hyperlink to the EIA.

Option 1 ☒ Equality Impact Assessment (EIA) not required – the EIA checklist has been completed.

Option 2 ☐ In determining this matter the Executive Member needs to consider the EIA associated with this item in advance of making the decision. *(insert EIA link here)*

Option 3 ☐ In determining this matter the Executive Board Members need to consider the EIA associated with this item in advance of making the decision. *(insert EIA attachment)*

10. CONSULTATIONS
None.

11. STATEMENT OF COMPLIANCE
The recommendations are made further to advice from the Monitoring Officer and the Section 151 Officer has confirmed that they do not incur unlawful expenditure. They are also compliant with equality legislation and an equality analysis and impact assessment has been considered. The recommendations reflect the core principles of good governance set out in the Council's Code of Corporate Governance.

12. DECLARATION OF INTEREST
All Declarations of Interest of any Executive Member consulted and note of any dispensation granted by the Chief Executive will be recorded and published if applicable.

VERSION:	**1**

CONTACT OFFICER:	Chris Bradley – Service Lead, Contracting and Procurement Team Zoe Evans – Head of Service, Finance
DATE:	10th September 2019
BACKGROUND PAPER:	Executive Board Decision - Refinancing of the Building Schools for the Future (BSF) Private Finance Initiative (PFI) contract – July 2017

EQUALITY IMPACT ASSESSMENT CHECKLIST

This checklist is to be used when you are uncertain if your activity requires an EIA or not.

An Equality Impact Assessment (EIA) is a tool for identifying the potential impact of the organisation's policies, services and functions on its residents and staff. EIAs should be actively looking for negative or adverse impacts of policies, services and functions on any of the nine protected characteristics.

The checklist below contains a number of questions/prompts to assist officers and service managers to assess whether or not the activity proposed requires an EIA. Supporting literature and useful questions are supplied within the EIA Guidance to assist managers and team leaders to complete all EIAs.

Service area & dept.	Resources, Schools and Education		**Date the activity will be implemented**	01/09/2017

Brief description of activity	Refinancing of the BSF PFI Contract.

Answers favouring doing an EIA	Checklist question	Answers favouring not doing an EIA
☐ Yes	Does this activity involve any of the following: - Commissioning / decommissioning a service - Budget changes - Change to existing Council policy/strategy	☒ No
☐ Yes	Does the activity impact negatively on any of the protected characteristics as stated within the Equality Act (2010)?	☒ No
☐ No ☐ Not sure	Is there a sufficient information / intelligence with regards to service uptake and customer profiles to understand the activity's implications?	☒ Yes
☐ No ☐ Not sure	**Does this activity contribute towards meeting the Equality Act's General Public Sector Equality Duty? Does it:** Eliminate unlawful discrimination, harassment and victimisation and other conduct prohibited by the Act *(i.e. the activity removes or minimises disadvantages suffered by people due to their protected characteristic)*	☒ Yes
☐ No ☒ Not sure	Advance equality of opportunity between those who share a protected characteristic and those who do not *(i.e. the activity takes steps to meet the needs of people from protected groups where these are different from the needs of other people)*	☐ Yes
☐ No ☒ Not sure	Foster good relations between people who share a protected characteristic and those who do not *(i.e. the function encourages people from protected groups to participate in public life or in other activities where their participation is disproportionately low)*	☐ Yes
FOR =2	**TOTAL**	**AGAINST =4**

Will you now be completing an EIA? ☐ Yes ☒ No

The EIA toolkit can be found here

Signature	Rizwana Karim

Date	29/06/2017