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Report of: Executive Director, Place
Report to: Co-operative Executive
Date of Decision: 15th December 2021
Subject: Streets Ahead PFI Contract– Refinance

Is this a Key Decision? If Yes, reason Key Decision:-	Yes	<input checked="" type="checkbox"/>	No	<input type="checkbox"/>
- Expenditure and/or savings over £500,000		<input checked="" type="checkbox"/>		
- Affects 2 or more Wards		<input type="checkbox"/>		
Which Cabinet Member Portfolio does this relate to? Cllr Paul Wood , Executive Member for Housing, Roads and Waste Management Which Scrutiny and Policy Development Committee does this relate to? The Overview and Scrutiny Management Committee				
Has an Equality Impact Assessment (EIA) been undertaken? Yes <input type="checkbox"/> No <input checked="" type="checkbox"/> If YES, what EIA reference number has it been given? <i>(Insert reference number)</i>				
Does the report contain confidential or exempt information? Yes <input type="checkbox"/> No <input checked="" type="checkbox"/>				

Purpose of Report:

The Streets Ahead PFI contract ('the Contract') has been set a significant savings target in order to contribute to the Council achieving its challenging budget position in the future.

This report seeks approval to the Council pursuing a contract Refinance to replace the current funders of the Streets Ahead contract with potential new funders, on more favourable terms in order to reduce the cost to the Council and to progress any necessary changes to the contract.

Recommendations:

It is recommended that the Co-Operative Executive:

1. Approve the continuation of the Refinance process and dialogue with existing and potential new funders in order to determine the optimal route in terms of maximising savings and mitigating risks and subsequently take forward the preferred option.
2. Approve the ongoing dialogue with the DfT throughout the refinance process and to submit a business case seeking DfT/HMT approval to complete the refinance, which includes agreeing the optimal process for funding the DfT's share of the refinance savings.
3. Approve the funding of any abortive project costs of the Refinance from the Streets Ahead contingency.
4. Delegates authority to the Executive Director of Resources to:
 - i. monitor the progress made by Council officers in determining the optimal refinancing option and approve (if appropriate) the recommended option; and
 - ii. review and authorise the submission of a business case to the DfT/ HMT including the methodology for funding the DfT's share of the refinancing savings; and
 - iii. complete the refinance of the Contract subject to the approval of commercially acceptable terms by the Director of Legal and Governance
5. Delegates authority to the Director of Legal and Governance to process the High Value Changes under a Deed of Variation.
6. Where no existing authority exists, delegates authority to the Executive Director of Resources, in consultation with the Director of Legal and Governance to take such steps to meet the aims and objectives of the report.

Background Papers:

Cabinet Report: Proposed Changes Towards a Sustainable Streets Ahead Contract February 2021

Lead Officer to complete:-		
1	I have consulted the relevant departments in respect of any relevant implications indicated on the Statutory and Council Policy Checklist, and comments have been incorporated / additional forms	Finance: <i>Tim Hardie</i>
		Legal: <i>Nadine Sime</i>

	completed / EIA completed, where required.	Equalities: <i>Louise Nunn</i>
	<i>Legal, financial/commercial and equalities implications must be included within the report and the name of the officer consulted must be included above.</i>	
2	EMT member who approved submission:	Michael Crofts
3	Cabinet Member consulted:	Cllr Paul Wood, Executive member for Housing, Roads and Waste Management
4	I confirm that all necessary approval has been obtained in respect of the implications indicated on the Statutory and Council Policy Checklist and that the report has been approved for submission to the Decision Maker by the EMT member indicated at 2. In addition, any additional forms have been completed and signed off as required at 1.	
	Lead Officer Name: Jayne Clarke	Job Title: Finance Business Partner
	Date: November 2021	

1. PROPOSAL

- 1.1 The Streets Ahead contract ('the Contract') has been set a significant savings target in order to contribute to the Council achieving its reduced budget in the future.
- 1.2 Savings can be achieved through refinancing the bank debt owing to the more favourable interest rates being offered by the financial markets than those available when the Contract was last refinanced in December 2016. This has also been made possible by the contract moving into a more stable state, as a result of a significant proportion of the improvement works now being complete and agreed changes to the performance mechanism now in place.
- 1.3 Following the successful conclusion of an exercise to test the appetite of the existing funding group and a range of potential new funders, this report seeks approval for the refinance to be completed. It is estimated that the refinance will secure savings of circa £0.4m to £0.7m per annum over the remaining 16 years of the Contract Term giving a total saving of between £6m and £10m.

2. HOW DOES THIS DECISION CONTRIBUTE ?

- 2.1 There is no impact on the services received by the people of Sheffield.
- 2.2 The savings realised will contribute to the Council achieving its budget, thereby reducing the risk of additional budgetary pressures being placed on other services delivered to Sheffield people.
- 2.3 This will be an enabler to the Council's delivery of the One Year Plan and subsequent Corporate plans.

3. HAS THERE BEEN ANY CONSULTATION?

- 3.1 There has not been any consultation, as this is a financing opportunity which will not directly impact the people of Sheffield.

4. RISK ANALYSIS AND IMPLICATIONS OF THE DECISION

4.1 Equality of Opportunity Implications

- 4.1.1 As this refinance proposal is purely related to financial restructuring of the Contract and has no material effect upon the services received by the people of Sheffield then there are no equality impacts. The proposal is equality neutral affecting all people the same regardless of age, race, faith, disability, gender, sexuality and so forth.

4.2 Financial and Commercial Implications

Background

- 4.2.1 The Contract was previously Refinanced and revised terms were agreed with a group of new funders. Those terms were reflected in a change to the contract and reduced the contract payments with effect from December 2016. However, it was acknowledged that

as the project was still in the riskier Core Investment Phase then it had not been possible to achieve the most competitive funding terms at that time.

- 4.2.2 Following on from December 2016 the Council continued to explore a number of options with Amey Hallam Highways (Amey) to deliver savings and make the contract more affordable and stable. This resulted in a number of changes to the specifications of services and finally to a change to the operation of the performance mechanism within the contract, which was approved by Cabinet in February 2021.
- 4.2.3 In addition to the contract changes, the programme of works has advanced, and the contract is now in the steadier operational phase with debt reducing over time.
- 4.2.4 These changes have now culminated in a contract that is much more attractive to prospective funders meaning a wider pool of funders offering competitive terms.
- 4.2.5 Additionally, although the funding market stopped lending to new schemes in the initial stages of the Covid-19 lockdown, it soon returned to more normal levels of activity. PFI projects have performed well during the pandemic and therefore funders are now keen to remain with them and/or invest in new projects.
- 4.2.6 These factors have created a perfect opportunity of more attractive contract with very competitive markets that should secure the best level of savings.

Refinance Process

- 4.2.7 Under the Contract the Refinance process is managed by Amey and its advisors and the Council has an oversight and approval role.
- 4.2.8 The Council has appointed Financial Advisors, Local Partnerships and Legal Advisors, Bevan Brittan to carry out the necessary due diligence and provide market expertise.
- 4.2.9 The Council will incur direct costs to carry out the Refinance. Providing the Refinance is complete, those costs will be reimbursed by Amey and set-off against the Refinance gain. However, if the transaction doesn't complete then it will have to bear those abortive costs.
- 4.2.10 As a result of a Refinance the level of debt will increase because it will include funding for any break costs associated with ending the current funding and the transaction cost of the Refinance. However, this debt will be at cheaper rates creating a reduction in cost overall (the Refinance Gain).
- 4.2.11 This increased debt will increase the compensation payable if the contracted were Terminated in the early years following the Refinance.
- 4.2.12 The Refinancing will be subject to Department for Transport (DfT) approval following submission of a Final Business Case (FBC) at the appropriate time. The FBC will need to demonstrate that the Refinance is on market terms and that it represents Value for Money taking into account the increase in termination Liabilities.
- 4.2.13 The Refinancing Gain realised is subject to a sharing mechanism firstly with Amey as set out in the Contract and secondly, with the DfT under their PFI grant funding terms.

Progress To Date

- 4.2.14 Amey have started the market engagement and have sought revised terms from a number of funders. This includes a mix of existing and new funders and both banks and institutional lenders (Insurance/Pension Funds).

- 4.2.15 Publicly available evidence of ethical, sustainability and social responsibility policy commitment was a pre-requisite for inclusion within an original long list of potential lenders.
- 4.2.16 Responses were sought with terms that offered a reduced interest rate on the £230m borrowing and other changes to the structuring of the debt that would make the contract funding more efficient.
- 4.2.17 16 responses were received which is positive given the level of borrowing and complexity of the contract. The responses were from a good spectrum of the market and allows a good assessment of the pros and cons of different funders / combination of funders from which an informed decision can be made.
- 4.2.18 The indicative level of financial savings achievable from the responses mean that the Council could realise savings of between **£0.4m** and **£0.7m pa**. This equates to a total saving of between **£6m** and **£10m** over the contract term.
- 4.2.19 Its is expected that the Refinance can be completed before the end of the 2021/22 financial year.
- 4.2.20 The Council has engaged with DfT and they are comfortable with the approach to the refinancing and we have opened up discussions around their share of the Gain.
- 4.2.21 Given that this would be the second refinance of the contract with the resultant additional debt and termination costs, it is unlikely that a further Refinance would be possible for the foreseeable future and so it is imperative to ensure that the most competitive market terms are secured.

Next Steps

- 4.2.22 The key next step will be to determine the preferred funding model. This could be a single funder or more likely a group of banks to be able to cover the full level of debt. The consideration will be based on the most competitive terms and acceptable termination liability.
- 4.2.23 The shortlisted funder(s) will then go through their own due diligence process relying on Legal and Technical Advisors reports of the performance and risk of the contract. If they are happy with this process, they will then seek formal approval of the terms from their credit committees.
- 4.2.24 At the same time the Council will develop the FBC to submit to DfT for approval.
- 4.2.25 Once credit committee and DfT approval is received the Refinance can be executed.
- 4.2.26 The credit committee approval will be based on an interest rate margin which will be applied to the prevailing underlying base rate on the day that the Refinance is complete. Therefore, the exact cost of finance and relevant break costs can only be determined at that time. Interest rate movements will be monitored in the run-up to the Refinance and a range of acceptable rates determined to ensure the refinance remains viable.

4.2.27 Risks

Risks	Impact	Mitigation
Refinance fails to reach	Abortive transaction costs and budgeted	Proven strong market interest and likley inclusion of some of current funders should

Financial Close	saving not achieved	ensure a successful outcome can be achieved.
Actual Bank Margin higher than assumed	Lower saving (an increase of 0.25% reduces saving by £100k p.a.	Stabilisation of contract through Pay Mech. Changes helps contract risk rating and but Highway Maintenance still a more difficult sector for investors to understand. However, range of margins submitted from all funders are competitive.
Transaction costs higher than assumed	Marginally lower saving	Above savings based on very prudent cost assumptions. Competitive terms secured from SCC advisors. As transaction costs set-off against gain share will have minimal impact on SCC share.
Process takes longer than expected	Lower saving	Delay has more material impact through reduced debt saving but transaction already well progressed.
DfT reject Refi. Business Case	Abortive transaction costs and budgeted saving not achieved.	Concern will be increase in termination costs. Impact which will be quantified and modelled as proposed terms are firmed up.

4.2.28 Proposals:

To continue with the Refinancing with existing and potential new funders in order to determine the optimal route in terms of maximising savings and mitigating risks and subsequently take forward the preferred option; and

4.2.29 Continue the ongoing dialogue with the DfT throughout the refinance process and to submit a business case seeking DfT/HMT approval to complete the refinance which includes agreeing the optimal process for funding the DfT's share of the refinance savings; and

4.2.30 Fund any abortive project costs from the Refinance from the Streets Ahead contingency; should the refinance not be possible to complete; and

4.2.31 In order to progress the refinance within the time constraints described in this report, the Co-operative Executive is requested to delegate its authority for some of the process to the Executive Director of Resources, as detailed within the recommendations.

4.3 Legal Implications

4.3.1 The Streets Ahead contract provides for a refinance and therefore the refinance itself carries no legal implications.

4.3.2 In terms of the other changes proposed, the Contract contains a High Value Change mechanism that allows the proposed changes to be made. In addition, the Council has a general power under section 1 of the Localism Act 2011 to do things an individual may generally do (including vary a contract in accordance with its terms) provided, it is not prohibited by other legislation and the power is exercised in accordance with the limitations specified in the Act e.g. around charging for the provision of a service.

4.3.3 When it was procured this Contract was above the public procurement financial thresholds and consequently was procured under a regulated procurement procedure. If the Contract is changed to a material degree, it may be held that there is, in fact, a new

contract, which should have been re-tendered in accordance with the Procurement Regulations and the resultant contract could be held ineffective.

4.3.4 The proposed changes are not considered to be material changes to the existing contract because there will be no variation to the services to be provided. Although Amey will make additional profit as a result of the changes, this is a usual consequence of a standard PFI Contract where Refinance clauses and Gainshare mechanisms exist and are commonly executed.

4.4 Other Implications

4.4.1 *n/a*

5. **ALTERNATIVE OPTIONS CONSIDERED**

5.1 Do Nothing

5.1.1 Under this option no further action would be taken now in relation to a Refinance and all activities would be stopped.

5.1.2 In this scenario the Council would have to bear the abortive transaction costs and would not generate the expected ongoing contract savings.

5.1.3 This would have the advantage of being able to carry out a Refinance in future years should the finance market be deemed to be more competitive.

5.1.4 However, there is no certainty that there would be an improvement on the current market conditions and the benefits of a refinance reduce with time as more of the debt is paid off at the current higher rates.

6. **REASONS FOR RECOMMENDATIONS**

6.1 The Streets Ahead PFI contract ('the Contract') has been set a significant savings target in order to contribute to the Council achieving its challenging budget position in the future.

6.2 The current stage of the contract makes it more attractive to the funding market and there are a limited number of competing relatively safe investments for funders in the current economic environment. These combine to give the Council a high chance of success in achieving a Refinance of the contract on the most favourable terms.

6.3 The Do-Nothing option will result in more pressure on achieving the Council's current and future budget and may result in more drastic cuts to front line services.

6.4 Failure to carry out the Refinance will result in more pressure on achieving the Council's current and future budget and may result in more drastic cuts to front line services. There is no evidence that deferring the Refinance will result in a more viable outcome in the future.