

Cabinet

19 October 2016



Schools PFI Refinancing

Report of Corporate Management Team

John Hewitt, Corporate Director Resources

Councillor Alan Napier, Portfolio Holder Finance

Purpose of report

- 1 To seek approval for delegated powers to be utilised to enter into a debt refinancing arrangement for the Council's Public Finance Initiative (PFI) covering Schools.

Background

- 2 As part of the Building Schools for the Future programme, three new schools were procured through a PFI contract with Inspiredspaces Durham (ProjectCo1) Ltd. The schools are:
 - (i) Shotton Hall Academy
 - (ii) Shotton Hall Primary
 - (iii) Sedgefield Community College
- 3 The schools were completed between September 2010 and January 2011 and the associated PFI contract runs until January 2036. During this time, the Council pays a monthly amount to the contractor, currently £608,000 per month, which is currently funded by a PFI grant, contributions from the schools, and a contribution from the Dedicated Schools Grant.
- 4 The monthly payment is known as a Unitary Charge (UC), and covers the financing costs of the construction of the buildings, plus their maintenance until January 2036, including 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 in practice much of the cost covered by the UC consists of the repayment and servicing of the debt.
- 5 The Council has been approached by Amber Fund Management Limited (AFM), our partner in the PFI Project Company to consider the refinancing of the senior debt within the PFI deal. Senior debt is the most secure form of lending within a PFI contract, and carries the lowest risk and hence the lowest cost; 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. This approach has been made at this time because of the historically low level of interest rates available at present.

Current Position

- 6 In total the original senior debt was circa £49million with circa £43million still outstanding. The senior debt lenders were Barclays and Nationwide, with the debt being split equally between them. AFM have approached the Council along with five other local authorities to bring together a larger portfolio to take to the market to seek a refinancing deal. In total the outstanding debt for all of the authorities is £390million. It is expected that a more competitive deal can be secured by going to the market for £390million rather than just the Councils £43million. Notwithstanding this expectation, terms will be sought for individual authorities as well as for the full £390million. This will enable each local authority to be able to compare and assess options individually and collectively.
- 7 Each of the PFI contracts includes a requirement for early redemption penalties to be paid as part of any refinancing deal. It is estimated that the cost of these early redemption payments for the six local authorities could be circa £110million. This would require a total refinance package of circa £500million. Although this would result in an increase in the outstanding debt, it is still expected that the total repayments over the remaining term of the arrangement (circa 20 – 22 years) will be lower due to the expected reduction in interest rate charged on the new loan debt.
- 8 At this stage AFM have approached the market to seek terms. AFM have advised the Council that ten funders have indicated a firm interest in the refinancing deal. Over the coming weeks the ten potential funders will be narrowed down to three or four. Additional due diligence will then be carried out with this short list before a preferred funder is agreed.
- 9 In terms of timing, it is expected that the short list will be agreed by the end of October and a final deal being finalised by the end of March 2017. Based upon initial indications AFM have advised the Council that the terms being offered by prospective funders will result in a net gain for the six local authorities. Any benefit from the refinancing will be split between the Council and AFM as follows:

Up to £1million benefit	50% DCC – 50% AFM
Between £1million and £3million benefit	60% DCC – 40% AFM
Over £3m benefit	70% DCC – 30% AFM

- 10 The financial and legal arrangements in PFI deals are extremely complex. With this in mind Ernst and Young (Finance) and Bond Dickinson (Legal) have been appointed to provide the Council with advice over the coming months to ensure the Council achieves optimum value for money from any refinancing but to also protect the Council's interests throughout the negotiations.

- 11 It is not clear at this point when the Council will be required to enter into contractual arrangements to finalise any refinancing arrangement, however, there may be a need to move at pace in this regard. With this in mind this report seeks approval for delegated approval to be given to enable any such arrangement to be entered into on the basis that any arrangement generates a financial benefit, balances risk and protects the interests of the Council.

Recommendations and Reasons

- 12 It is recommended that Cabinet :
- (i) Note the option to refinance the debt outstanding in the Council's Schools PFI;
 - (ii) Note the total sums outstanding and the option to aggregate the Council's outstanding debt with that of five other local authorities to maximize financial benefit;
 - (iii) Note the expectation of a financial benefit being generated from the refinancing;
 - (iv) Agree to authorise the Corporate Director Resources in consultation with the Portfolio Holder for Finance to agree a refinancing deal beneficial to the Council.

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Appendix 1: Implications

Finance – The Council has the option of refinancing the outstanding senior debt on the Schools PFI of circa £43million on the expectation of the realisation of a financial benefit.

Staffing – none

Risk – The Council will need to ensure that any arrangement entered into will protect the interests of the Council.

Equality and Diversity / Public Sector Equality Duty – none

Accommodation – none

Crime and Disorder – none

Human Rights – none

Consultation – none

Procurement – none

Disability Issues – none

Legal Implications – The Council will be required to enter into a new contractual arrangement with new funders. Legal Services will advise in this regard as well as receiving additional support from Bond Dickinson.