
A separate report is submitted in the private part of the agenda in respect of this item, as it contains details of financial information required to be kept private in accordance with Schedule 12A of the Local Government Act 1972. The grounds for privacy are that it contains information relating to the financial and business affairs of any particular person (including the authority holding that information). The public interest in maintaining the exemption under Schedule 12A outweighs the public interest in disclosing the information.

Cabinet
Council

11th October 2022
18th October 2022

Name of Cabinet Member:

Cabinet Member for Strategic Finance and Resources - Councillor R Brown

Director approving submission of the report:

Joint report:

Managing Director for Coventry Municipal Holdings Limited (A Walster) and
Chief Operating Officer (B Hastie)

Ward(s) affected:

Foleshill

Title: Loan for Material Recycling Facility

Is this a key decision?

Yes - the proposals involve financial implications in excess of £1m per annum.

Executive summary:

The Business Plan for Tom White (TW) for 2022/23 was approved by the Shareholder Committee in March 2022 which supports Tom White business growth and ongoing development.

The business plan set out proposals to redevelop the Tom White recycling infrastructure at Longford Road site. Once completed, this redevelopment will improve the environmental performance of Tom White, dramatically increase the recycling rates for commercial waste and help to increase the financial dividend payable from Tom White back to the Shareholder (the Council).

Tom White growth generally, and the facility redevelopment specifically; focuses on **tackling climate change** and supporting the One Coventry Plan and Climate Change Strategy by

- Enhancing the recycling ability by reducing burden on raw materials and promoting circular economy;

- Achieving greater diversion of commercial waste from landfill; and
- Increasing energy production either directly or through a fuel manufacture.

The recycling facility redevelopment is core to these growth objectives, and the diagram at Appendix C shows how the new MRF sits in the context of overall waste management and recycling in Coventry and the sub-region.

The current recycling plant and equipment used by TW has historically suffered with little planned maintenance under previous ownership and as it reaches the end of its economic life is now experiencing significant breakdowns leading to poor plant availability, with plant availability reducing considerably. During April to December 2021, the facility experienced 72 days of plant downtime. The impact of this was an increased cost of maintenance (plant and vehicle repairs and spares) and increased plant hire in FY2021/22. There was also an increased cost of disposal due to more material going to landfill due to the plant not being available to sort material for an alternative, cheaper and environmentally sustainable disposal route as a fuel source for onward processing.

This existing plant performance is causing significant cost pressures in TW such that month to month the business is currently operating at about 'break even'. accordingly the new plant solution will remove the cost pressures that undermine profitability and allow the business to get back on track for profit and dividend availability.

In the short term the Tom White management team has hired new resilient mobile equipment to compensate for the poor performance of the plant. This means that the old unreliable plant does not need to be run, thereby cutting significantly the maintenance costs and subsequent impacts. However this is not a long term solution for the volume of waste processed through the facility, nor does it provide the opportunity to enhance recycling rates and improve financial returns to the shareholder.

The management team at TW have been working with its preferred supplier to design the new facility to move away from waste disposal but focus on treating commercial waste as commodity from which the maximum environmental and economic benefit should be extracted. Therefore the solution is focussed on creating zero waste to landfill.

The business plan increases economic stability with the business case for the recycling facility increasing financial of Tom White each year.

The approval of the business plan by the Coventry Shareholder Committee was subject to funding; this report puts forward the preferred options to finance the development of the material recycling facility by seeking funding to Tom White via a commercial loan for the sum as detailed in the Private Report to enable delivery of the recycling infrastructure.

Recommendations:

Cabinet is requested to recommend that Council:

- 1) Approve a Loan up to the value detailed in the Private Report on commercial market terms for the purposes of delivering the recycling infrastructure.
- 2) Approve the addition of up to the value detailed in the Private Report to the Councils approved capital programme for the purposes of entering into the Loan
- 3) Approve the increase in the Commercial Investment Strategy limit for 2022/23 for investment in service loans as detailed in the Private Report.

- 4) Delegate authority to the Chief Operating Officer (S151 Officer) and the Chief Legal Officer , following consultation with the Cabinet Member for Strategic Finance and Resources, to finalise and agree the detailed terms of the transaction with Tom White. The authority under this delegation shall also include the power to enter into the necessary legal agreements and subsequently the power to negotiate and agree any such variations as is deemed necessary to the terms of the loan facility and ancillary documents.

Council is recommended to:

- 1) Approve a Loan up to the value detailed in the Private Report on commercial market terms for the purposes of delivering the recycling infrastructure
- 2) Approve the addition of up to the value detailed in the Private Report to the Councils approved capital programme for the purposes of entering into the Loan
- 3) Approve the increase in the Commercial Investment Strategy limit for 2022/23 for investment in service loans as detailed in the Private Report.
- 4) Delegate authority to the Chief Operating Officer (S151 Officer) and the Chief Legal Officer, following consultation with the Cabinet Member for Strategic Finance and Resources, to finalise and agree the detailed terms of the transaction with Tom White. The authority under this delegation shall also include the power to enter into the necessary legal agreements and subsequently the power to negotiate and agree any such variations as is deemed necessary to the terms of the loan facility and ancillary documents.

List of Appendices included:

Appendices are included in the Private Report

Background papers:

None

Other useful documents

None

Has it or will it be considered by scrutiny?

No

Has it or will it be considered by any other council committee, advisory panel or other body?

No

Will this report go to Council?

Yes

18th October 2022

Title of Report: Loan for Material Recycling Facility

1. Context (or background)

- 1.1. The business Plan for Tom White for 2022/23 was agreed by the Coventry Shareholder Committee in March 2022, and supports Tom White business growth and ongoing development. The business plan clearly set out proposals to redevelop the recycling infrastructure (MRF) at Longford Road to improve environmental performance, increase recycling rates for commercial waste and increase the financial dividend payable from Tom White back to the Shareholder (the Council).
- 1.2. The approval of the business plan by the Coventry Shareholder Committee was subject to funding; this report puts forward the preferred option available for funding the proposed infrastructure.
- 1.3. The approved Tom White business plan together with the approved business case for the MRF redevelopment are included in the Private report for information. It should be noted that the costs have increased since the business plan was approved to take into account global movements in construction costs and changes in the recycling market. The main points are summarised below:
 - **An improvement in the environmental performance** of Tom White taking the recovery of recyclable materials from c.7% of the waste delivered to Tom White, to over 70% meaning a significant enhancement of recycling performance and reduction in the cost of waste disposal. This contributes to the circular economy, with more material being recycled into new products with less reliance on the raw material in manufacture – a key aspect of tackling Climate Change.
 - Delivers **greater business resilience** for Tom White with far less reliance on third party providers to take the non-recyclable material received by Tom White from its customers. This provides greater market surety and more cost effective disposal routes that should completely avoid the use of Landfill or the export of material from the UK. This is also a key aspect of contributing to tackling Climate Change.
 - Delivers a **positive financial return** to Tom White that allows for greater dividend to be payable to the Shareholder in future years – this supports the ongoing financial sustainability of the Council and with 'profit for purpose' supports the funding of front line services in Coventry.
 - Provides an **enhanced recycling service** to businesses in communities across the city that previously may have been unaffordable – having the facility located in Coventry and achieving value from the materials recycled means a comprehensive recycling service will be affordable to all business communities in Coventry. We will **contribute to improving outcomes** for our communities in Coventry.
- 1.4. The proposed automated solution with mechanical sorting and recovery through utilising optical sorters and other equipment to sort material into individual product streams, improving the accuracy, pick rate and material quality. The proposed solution provides contingency as the equipment can be configured to adapt to changes in the commodity market and waste stream. It is assumed the new facility will be operational from Autumn 2023.

- 1.5. It is on the basis as described above that the approval to redevelop the Material Recycling Facility (MRF) at Tom White was approved by the Coventry Shareholder Committee, subject to securing funding. The costs for the recycling facility are detailed in the Private report.

2. Options considered and recommended proposal

- 2.1. Three options have been considered for delivering funding for the redevelopment of the MRF at Tom White which are set out as follows:

Option 1 - Do Nothing

- 2.2. Doing nothing would result in the MRF not being redeveloped. The existing MRF is now beyond its useful life, with the costs of ongoing maintenance being prohibitive to Tom White's financial performance, impacting on dividend potential to the Shareholder. Furthermore the MRF is no longer able to keep up with current best environmental practices, with only 7% of input materials being recovered for recycling. The remainder being either sent to landfill or incinerated to extract energy which is contrary to the recognised waste hierarchy, whilst also presenting more costly routes for the disposal of waste.
- 2.3. This option would result in the environmental benefits of the MRF not being realised, and the company would not be in a position to declare any further dividend based on the expected higher costs of operation.
- 2.4. The mobile equipment that has been acquired could continue to be utilised, but this is not a long term solution as the equipment is not designed for the volumes of waste that we would expect the flow through the facility.
- 2.5. This is not the recommended option.

Option 2 - Third Party Asset Backed Debt Funding

- 2.6. The Tom White team has explored third party funding through a number of routes. Heads of terms have been presented by a third party funder for the MRF project. They have undertaken commercial and technical due diligence on the redevelopment proposals and are keen to fund the development.
- 2.7. The third party has provided Tom White with a commercial term sheet, with details of the terms of the loan with a payment company guarantee from the Council. This was based on the expected costs of the facility, which have now increased due to agreement of final design and movements in the price of materials within the market.
- 2.8. If the Council was to offer a Parent company guarantee it would mean that if Tom White was not in a position to meet the debt servicing costs, the Council would have to step in and meet the liabilities of repaying back the Loan. If the Council provided the parent company guarantee the value would be required to be noted on in the Council's accounts as a contingent liability without receipt of any of the interest benefits.
- 2.9. Whilst this option avoids the need for the Council to provide a Loan on market terms into Tom White for the MRF redevelopment, the Shareholder (Council) would retain the payment risk associated with the funding without the benefit of the interest payment.
- 2.10. This is not the recommended option.

Option 3 - Shareholder Loan

- 2.11. Coventry Shareholder Committee approved the investment in principle for TWW as part of the business plan approvals in March 2022. This was subject to securing suitable finance to take the project forward.
- 2.12. The Council could provide a shareholder loan for the value detailed in the Private report to Tom White using the offer from the third party funder as a market comparator and the specific commercial market terms. The Council have used the EU Reference Rates to help determine the interest rate which is to be charged under a Loan on market terms. In line with the CIPFA Prudential Borrowing Code the Council can justify financing the project on the basis of the primary environmental and social benefits achieved as a direct result of the investment. The development of the MRF supports the Council's Climate Change Strategy, in particular the aspirations in relation to the Circular Economy as detailed within the plan and depicted in the Appendices, rather than the primary driver being to generate income.
- 2.13. The Council's cost of borrowing is lower than the rate of interest that the Council will charge to TWW. This means that the Council will generate a financial benefit from a loan arrangement. The risk of providing a loan is no greater in effect than the financial guarantee considered in option 2.
- 2.14. The project supports the Council in meeting its Climate Change Strategy and enables the Council to provide finance for the project without any greater perceived risk than under option 2, but with the ability to receive a revenue stream as loan interest, which is a by-product of the financing agreements. This is the recommended option.

3. Results of consultation undertaken

- 3.1. No formal consultation has been or is planned to be undertaken in respect of this paper. However the business plan for Tom White for 2022/23 and the business case for the MRF redevelopment has been shared and approved previously by the Shareholder Committee.

4. Timetable for implementing this decision

- 4.1. It is intended that the construction contract for the MRF development will be entered into within 4 weeks of this decision, with the MRF fully operational within 12 months. The Business Plan contemplated that Tom White's would start operating the new facility from February 2023. This date has now slipped to further design development, engagement with funders, and concluding the contracts for the construction. Global supply chain pressures have also extended lead times, resulting in a c.12 month lead time for completion of the facility. It is anticipated that the plant will be operational by Autumn 2023 assuming all contracts concluded, and prices fixed in October 2022.

5. Comments from Chief Operating Officer (Section 151 Officer) and Director of Law and Governance

5.1. Financial Implications

The investment in the Material Recycling Facility (MRF) was approved in principle, subject to funding by Shareholder Committee in March 2022. TW management team have secured an offer for finance from a third party which provides a market comparator to the Shareholder loan terms. The proposal from the third party funder required a payment guarantee from the Council to move ahead with the loan. This would in effect mean that the Council would have

to account for the perceived risk of the payment guarantee being called on. The payment guarantee would be appraised annually for the risk of the guarantee being called in with the resulting sum being referenced within the Council's accounts as an impairment provision.

The Shareholder loan has been set to a longer term based on the life of the asset. The Council will finance the loan using prudential borrowing, which will be repaid from the loan repayments for capital and interest from Tom White's, over the life of the loan.

The investment by the Council is in line with the CIPFA Prudential Borrowing regulations due to the project supporting the Councils Climate Change Strategy and the strong strategic climate change aspirations in the One Coventry Council Plan. Investing in this facility will improve the recycling ability of the plant from 7% to 70%. The facility will ensure that there is zero or very little waste sent to landfill and increase business resilience through having access to more markets for the offtake material and recyclates extracted from the waste stream.

As part of the Commercial Investment Strategy the Council set limits for investing in shares and service loans, with a total limit of £123m for 2022/23. These were reported on the Q1 Monitoring Report in August 2022. The proposed loan would increase the total level of investments through service loans, including planned and committed, to take account of the additional loan finance. Whilst this is a significant further investment within the waste sector, it provides a significant opportunity to develop facilities in line with the Council's Climate Change Strategy and One Coventry principles, with the risks associated with the development being managed as described in this report. It is proposed that the limit for loans provided to external organisations be increased to include the value of the loan as detailed in the Private report to facilitate the development, whilst maintaining a small element of headroom within the limit.

The payment terms for the Shareholder loan would be on market terms and conditions, with the capital repayment spread evenly over the term of the loan, and interest calculated on a reducing balance basis (equal instalment payment basis). The investment in the new equipment should derive a return greater than the cost of capital financing each year leaving resource within the company to declare a dividend back to the Council.

The forecast position indicates that Tom White's underlying business and the MRF investment will generate sufficient cash to enable the business to declare a dividend once the facility is operational.

The proposal in this report represents a major investment, the risk for which rests with the Council ultimately, given its role as 100% shareholder. Repayment of the loan and delivery of financial returns in the form of additional dividends will rely upon the trading performance of Tom White over the lifetime of the MRF infrastructure. The proposals have been subject to significant due diligence and external advice which provide a high degree of confidence that these proposals are financially sound. Like all such proposals however, it is important to recognise the commercial risk involved. The Council has taken care to extend its overall commercial investments over a broad range of activities to provide protection against financial shocks that might affect specific sectors. Given the financial backdrop to local government funding and the approaching financial headwinds of inflation and financial recession, the greatest risk to the Council is to do nothing. The proposal contained here demonstrates a continued commitment by the Council to protect its financial position through well researched investments supported by robust business cases.

5.2. Legal Implications

- 5.2.1. Under Section 12 of the Local Government Act 2003, the Council has a specific power to invest (or provide a loan). The power states "a local authority may invest for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". This provides the Council with a power to invest in Tom White, for any purpose relevant to its functions (this function would have to be identified) or if the Council can show it is for the prudent management of its financial affairs.
- 5.2.2. Furthermore, under section 1 of the Localism Act 2011, the Council also has a power "to do anything that individuals generally may do" (the "General Power of Competence"). "Individual" means an individual with full capacity. The General Power of Competence gives the Council:
- Power to do a thing anywhere in the United Kingdom or elsewhere;
 - Power to do it for a commercial purpose or otherwise for a charge, or without charge, and
 - Power to do it for, or otherwise than for, the benefit of the authority, its area or persons resident or present in its area.
- 5.2.3. The Council will be compliant with the requirements of both the General Power of Competence and the Power to Invest. This report serves as the case for the proposal and the basis on which the investment powers can be utilised.

Subsidy Control

- 5.2.4. Following the withdrawal of the United Kingdom from the European Union which came to an end at 11pm on 31 December 2020. EU State aid law no longer applies to financial assistance provided by UK public authorities.
- 5.2.5. However, under Chapter 3 of Title XI of Part 2 (the "Subsidy Control Chapter") of the Trade and Co-operation Agreement between the European Union and the United Kingdom (the "TCA"), both the EU and the UK have undertaken to implement an effective subsidy control regime in their respective territories.
- 5.2.6. It should be noted that the Subsidy Control Chapter is only relevant where a particular public intervention meets the definition of a "subsidy" in the TCA. The Subsidy Control Act 2022 gained royal assent in April 2022 and comes into force in the autumn.
- 5.2.7. Market Economy Investor Principle ("MEIP") is a well established exemption to the previous EU State Aid legislation. Such as exemption is still applicable to the Subsidy Control Regime (which replaces the previous EU State Aid Legislation). A Loan does not automatically constitute a subsidy if the Council carries out prior due diligence that demonstrates that investments are likely to generate sufficient returns that a private prudent investor would have made the same investment. i.e. the Council can invest in the proposal in return for an appropriate commercial return which would satisfy the expectations of a private prudent investor.
- 5.2.8. The risk of Subsidy is not dependent upon whether the financial return is actually ever achieved by the Council, as whether the Subsidy exists or not is assessed at the time of the funding advanced, but there must be a realistic prospect of the financial return being achieved by the Council.
- 5.2.9. We have undertaken analysis of interest rate based on the EU Reference Rates which show that the rate of interest charged is an appropriate rate of interest to charge on market terms

based on the rates issued by the EU. Therefore the investment by the Council would not be conveying an economic advantage and also demonstrates the MEIP test.

5.2.10. In practice the Council would need to rely on the MEIP analysis as a justification for any subsidy in the event of a complaint, challenge or investigation. The risk of Subsidy Control is not dependent upon whether the financial return is actually ever achieved by the Council, as whether subsidy exists or not is assessed at the time of the funding advanced, but there must be a realistic prospect of the financial return being achieved by the Council.

5.2.11. The Council is complying with Subsidy Control Regime as the transaction is being undertaken upon arms' length terms and will comply with the MEIP principle, meaning that no benefit is conferred on the recipient and therefore there is no distortion to competition.

6. Other implications

6.1. How will this contribute to the Council Plan (www.coventry.gov.uk/councilplan/)?

The proposal complements the One Coventry Plan as below:

Improves the environmental performance of Tom White taking the recovery of recyclable materials from c.7% of the waste delivered to Tom White, to over 70% meaning a significant enhancement of recycling performance. This contributes to the circular economy, with more material being recycled into new products with less reliance on the raw material in manufacture – a key aspect of **tackling Climate Change**.

Delivers greater business resilience for Tom White with far less reliance on third party providers to take the non-recyclable material received by Tom White from its customers. This provides greater market surety and more cost effective disposal routes that avoids completely the use of Landfill or the export of material from the UK. This is also a key aspect of contributing to **tackling Climate Change**.

Delivers a positive financial return to Tom White that allows for greater dividend to be payable to the Shareholder in future years – this supports the **ongoing financial sustainability** of the Council and with 'profit for purpose' supports the funding of front line services in Coventry. This is discussed further in the financial section of this report.

Provides an enhanced recycling service to businesses in communities across the city that previously may have been unaffordable – having the facility located in Coventry and achieving value from the materials recycled means a comprehensive recycling service will be affordable to all business communities in Coventry. We will contribute to **improving outcomes for our communities** in Coventry.

6.2. How is risk being managed?

A project risk assessment and mitigation plan is being developed and incorporated within the construction planning process. A professional Owners Engineer / Project Manager is being employed to oversee the detailed design and construction process post contract award to ensure construction and interface risks are suitably managed and mitigated.

This business case for the investment was approved by Shareholder Committee in March 2022 and will be incorporated into the budget for Tom White for FY24 onwards which will be subject to approval by Shareholder Committee. Regular updates will be provided by the management team to the Board of Directors to ensure the investment is progressing as expected. The Loan Facility agreement will also contain market terms and clauses such a

requirement for regular financial updates from TW to the Council to ensure they are able to meet the terms of the loan agreement

A number of sensitivity scenarios have been considered to test and support the financial case for the investment.

6.3. What is the impact on the organisation?

The proposal in this report represents a major investment, the risk for which rests with the Council ultimately, given its role as 100% shareholder. The repayment of the loan and delivery of any dividends will rely upon the trading performance of Tom White over the lifetime of the MRF infrastructure. The proposals have been subject to significant due diligence and external advice which provide a high degree of confidence that these proposals are financially sound. Like all such proposals however, it is important to recognise the commercial risk involved.

The Council's Commercial Investment Strategy is designed to ensure that the Council's management arrangements and level of commercial investments in the form of shares, commercial property and loans to external organisations is proportionate to the size of the Council. The proposed Shareholder loan requires the existing limits for loans to be increased as recommended in this report. The Council has taken care to extend its overall commercial investments over a broad range of activities to provide protection against financial shocks that might affect specific sectors.

Given the financial backdrop to local government funding and the approaching financial headwinds of inflation and financial recession, the greatest risk to the Council is to do nothing. The proposal contained here demonstrates a continued commitment by the Council to protect its financial position through well researched investments supported by robust business cases. The risks and mitigating actions are covered in the section above to reduce the impact on the Council and ensure oversight of the loan investment.

6.4. Equalities / EIA?

No equality impact assessment has been carried out as the recommendations do not constitute a change in service or policy.

6.5. Implications for (or impact on) climate change and the environment?

This proposal has a material positive impact on climate change and the environment. The MRF redevelopment will significantly increase the recycling of commercial waste in Coventry that is received by Tom White from 7% to over 70%, contributing to the circular economy, reducing the burden on raw materials. Currently 46% of material is sent to landfill at a cost of £1.8m pa which should be reduced to close to zero.

The quality of the outputs will ensure that UK based processors will be sourced for the separated materials, and there will be increased opportunities to access emerging UK markets materials such as plastic film.

Having the development situated in Coventry will result in less transport miles for recyclable material to be processed by a state-of-the-art facility.

6.6. Implications for partner organisations?

The report has implications for TW in which the Council has a shareholder interest through Coventry Municipal Holdings Limited, who have 100% of shares in TW. The investment will

have a significant environmental impact on the operation of Tom White with a dramatic improvement to the material recovery rates and a reduction in the cost of waste disposal, including a reduction in the headcount currently used to pick the waste for separation. The 4 affected posts will be re-trained and redeployed within the organisation.

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Director: Andrew Walster	Managing Director	Coventry Municipal Holdings	6 th August 22	6 th August 22
Members: Councillor Richard Brown	Cabinet Member for Strategic Finance and Resources	-	8 th August 22	26 th Sept 22

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