

Interface

Spring 2009

The newsletter of Manches Projects Group



Welcome to the Spring issue of Interface, we have included articles on PFI funding in the current market, the new planning process, Joint Waste Authorities and a round up of news.

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PFI FUNDING IN THE CURRENT MARKET

This article is based on a presentation given by Susie Hilton, a Manches Projects Group associate, at the Manches Projects Forum on 18 March 2009.

Like the rest of the economy, PFI has suffered as a consequence of the credit crunch. The bond market was one of the first markets to be affected: Monoline insurers, which had provided guarantees thereby raising bond investment grades, collapsed because of guarantees made on sub-prime mortgages. A significant proportion of PFI funding had been raised in the bond markets until this time. In tandem with this many of the traditional senior lenders have opted out of the PFI funding market altogether. Loan margins have steadily increased while swap rates have been in decline. There is now a funding gap that needs to be filled.

Those players that are still prepared to lend are more likely to participate as part of a syndicate in relation to existing credit arrangements, funders are enforcing their covenants, even terminating funding arrangements for minor breaches, and making it difficult to obtain additional borrowing. This will affect existing PFI projects looking to obtain variation funding.

On 3 March 2009, HM Treasury announced that it would step in to fill the gap. A new unit, the Infrastructure Finance Unit, has been set up at HM Treasury which will be run as a private limited company and will lend to projects at market rates. The Greater Manchester Waste Disposal Authority PFI reached financial close in April 2009; benefiting from a loan of £120 million from the Infrastructure Finance Unit. This is the first time the Infrastructure Finance Unit has lent to a PFI Scheme.

It has been suggested that this is at odds with the philosophy underlying PFI. But does this matter? The role of the senior lender has become one of the policemen of PFI, particularly before contract award and during the construction phase of a project. HM Treasury has hired members of the banking community to form part of the new unit and carry out due diligence on projects in the absence of an external senior lender. Although this is a possible solution further questions arise. Will the contractor be as concerned about project delivery when its relationship with the funder and the public sector authority is indistinguishable? How can the public sector continue to ensure risk transfer? While there is no one solution to these issues, possible approaches are outlined below.

- One approach to this problem is to ensure that the proportion of HM Treasury lending is not such as to remove the risk to private finance. This could be achieved either through a larger amount of equity funding or through other quasi public sector lenders (e.g. the European Investment Bank or the mooted Local Authority Mutual Fund). HM Treasury has said that it would be prepared to take on all the debt, but this may not be necessary (or desirable). The traditional lending community may be more prepared to lend where a larger proportion of the funding is being provided by the public sector (because its funds are less at risk).
- One HM Treasury funding model that was explored back in 2004 is the credit guarantee finance model. The Government provides a loan which is repaid after completion of the construction phase in accordance with a loan repayment schedule. The project is “wrapped” by a performance or

financing guarantee from a high quality bank. As terms of the loan must stay within the state aid rules this is not a cheaper form of finance. The risk here is shared with the private sector guarantor. This model could be used to create risk transfer in relation to the recently announced HM Treasury funding. Also, conversely, HM Treasury could underpin by way of guarantee funding to be provided by a conventional lender.

- Another type of funding arrangement that has been proposed by the banking community is the “mini-perm”. This is a shorter term finance arrangement, which is an easier credit decision for the banks. The debt is structured on a conventional basis but with an obligation to refinance at, say, year 7. If the Special Purpose Vehicle fails to refinance, this will result in either a default event termination or some form of cash sweep and margin increase. Equity providers will find this option less attractive because they may not get dividends after the refinancing date; however, deals are more likely to close and there is the possibility that they will benefit from the refinancing. The upside on a refinancing will depend on interest rate changes and margins. Project risk profiles improve at the end of construction, so improved financing terms should be available by year 7. HM Treasury guidance on refinancing as issued in October 2008 requires the first £1m of a refinancing gain to be shared on a 50:50 basis, then 60:40 to the public sector for the next £2m, then 70:30 to the public sector for any further amounts, the intention being for the Government to enjoy improvements in the financial markets when they occur.
- Another possible option in the event of funding shortfall is an increase in the capital contribution by the authority. This could be by way of prudential borrowing (pursuant to the Local Government Act 2003). Alternatively, the project sponsors could invest more in proportion to the senior debt, and look to private equity, sovereign funds or pension funds to fill the shortfall.
- Finally, there is the option of a Government guarantee (as referred to above). In this case the authority will make a compensation on termination payment of the underpinned amount. The reduction in risk to the private sector should result in a cost saving for financing but whether this offers better value overall remains to be seen.

NATIONALLY SIGNIFICANT INFRASTRUCTURE - THE NEW PLANNING PROCESS

Under the Planning Act 2008 a new commission, the Infrastructure Planning Commission (IPC) has been created. Its role is to determine planning applications for nationally significant infrastructure projects.

Nationally Significant Infrastructure Projects – Example Areas

- Energy projects including renewable energy, fossil fuel projects and nuclear power;
- Infrastructure projects including rail and highways projects; and
- Waste and water projects.

Under the Planning Act 2008 a new form of planning permission, a Development Consent Order (DCO) has been created. At present there are a number of special statutory regimes for considering

whether development consent should be granted for certain types of projects such as the Transport and Works Act 1992, the Highways Act 1980 and the Harbours Act 1964. Under the new regime the application for a DCO precludes the need to obtain consent under any other statutory regimes. This one-stop planning application includes the compulsory purchase of land which, where appropriate, can be authorised under a DCO.

Decisions will be taken in accordance with National Policy Statements (NPSs). NPSs must state the reasons for the policy set out within it, the Secretary of State has wide discretion as to how prescriptive the NPS should be. Commissioners will be expected to adhere to the advice within the NPS as to the appropriateness or need for the development. The thinking behind the production of NPSs is to eradicate debate on the principle of the type of development concerned. Under the previous system a planning application could spark debate on the desirability and the safety of, for example, nuclear energy; this is no longer the case. Now, any debate will be in relation to other material considerations such as impact upon the landscape and human life – in other words issues of location rather than national issues. The Government is due to publish draft NPSs for ports and non-nuclear energy in Summer 2009 and the draft nuclear NPS in Summer/Autumn 2009.

Applicants must submit their DCO to the IPC not the Local Planning Authority. The process of applying for a DCO is detailed. Before an applicant proposes to make an application there is a statutory duty to consult widely and to take account of responses to consultation and publicity. The IPC must be notified of the pre-application consultation and the consultation report must accompany the application. The consultation process is crucial as it will affect the IPC's final decision. Draft guidance on this process was published on 30 March 2009¹ and the related consultation is open until 19 June 2009. However, transitional measures mean that a developer can carry out pre-application consultations and publicity that comply with the IPC requirements before 1 October 2009 and an application made before 1 October 2011 based on these consultations, publicity and notifying requirements will be deemed to be acceptable to the IPC.

Generally, decisions will be taken based on consideration of written evidence, round table discussions and open floor meetings. On certain occasions the commissioners may permit the giving of oral evidence and the ability to cross examine but this is intended to be the exception rather than the norm. It is hoped that this procedure will speed up the decision making process. However, feedback from the consultation exercise included fears that the democratic, local decision making process was being unjustifiably sacrificed. Again draft regulation on the application procedures was published on 30 March 2009 and the related consultation is open until 19 June 2009.



1. www.communities.gov.uk/publications/planningandbuilding/consultationpreapplication

Although the relevant provisions of the Planning Act 2008 are in force, regulations will need to be passed to set up the IPC. The timetable for setting up the IPC has now been published. Final revisions of the regulations are due to be in force on 1 October 2009, setting out the obligations on promoters to carry out extensive consultations, applications procedures, model provisions, Environmental Impact Assessments and the application of the Environmental Impact Assessment Directive required for nationally significant infrastructure projects by the Planning Act 2009. It is intended that the IPC will be up and running in 2010. It is to be hoped that this attempt to shorten the planning process for essential major projects will go far enough to be a success.

JOINT WASTE AUTHORITIES: CUTTING PROCUREMENT TIMES

Based on an article written by Frances Death-Lever, a Manches Projects Group associate, published in the April 2009 edition of the PPP Bulletin.

Reputations die hard, and that of waste PFI projects is no exception. Early experiences gave the sector a reputation for slow delivery but an objective assessment of the time from OJEU to financial close shows that waste is not a particularly poor performer. However, one major criticism of waste projects is that Authorities take too long to make decisions, particularly in two-tier authorities where responsibility for waste collection and disposal is split. They have been notoriously slow to act – and to decide whether to work together.

This may change, however. The Joint Waste Authorities (Proposals) Regulations 2009 came into force in February and implement new powers allowing the Secretary of State to create Joint Waste Authorities (JWAs), enabling Authorities who wish to put their partnership working on a statutory footing to apply to create a JWA. Authorities will first have to consider important issues such as the nature of the waste function to be transferred, internal governance arrangements, funding and stakeholder consultation. Negotiations over how the JWA should be managed will be slow: Defra has suggested it is likely to take 12 months before a JWA can be established.

They will not have an immediate impact. However, once one is established, it will be able to enter into contracts in its own right, and this single layer decision-making process should cut the procurement period.

Of course, Authorities can already use local waste partnerships and section 101 transfers to formalise joint working in the waste sector. The JWA may muddy the waters by giving councils more choice, but it may also provide the most robust mechanism in the long term. Whatever the case, Authorities need to decide promptly on the extent and mechanism for their partnering, and then commit to streamlined and well-directed procurements using that mechanism.

Key points for successful use of a JWA

- Be realistic about the inability of large groups to make decisions; keep any JWA or partnership board as small and manageable as possible; and use a voting system that gives results;
- Make sure that all participating Authorities understand the need for board members to be able to make decisions without constant reference back to their appointing Authority;
- Appoint a strong and experienced management team, and do not be afraid to delegate decision-making power to them;
- Do not defer decisions on difficult questions, as they will rarely get any easier with time; if need be, don't partner with those you don't agree with.

INTERFACE NEWS ROUNDUP

Housing

The Sixth Housing PFI Bidding Round was launched in July 2008 with a closing date for Local Authorities' Expressions of Interest of 31 October 2008. 24 Expressions of Interest were received and a total of over £4 billion worth of PFI credits was applied for. The Expressions of Interest are currently being assessed by the new Homes and Communities Agency (HCA). Initially the Department of Communities and Local Government (DCLG) had published February 2009 as the date by which Round 6 would be announced. This timing has slipped and it is likely that the announcement will now not be made until April/May 2009. DCLG had also stated that it would issue new guidance addressing issues that have caused difficulties in previous rounds at the end of March 2009 to accompany Round 6. It is still to be decided whether this new guidance will be published.

£1.87 billion worth of PFI credits is available for Round 6. This is the total amount made available to housing in the 2007 Comprehensive Spending Review. There are, therefore, no plans for further bidding rounds in 2009 and 2010. It is the Government's aim that around 15 projects will be included in Round 6. The selected projects will be of a significant scale (capital value in excess of £100 million).

The HCA was launched on 1 December 2008 and is responsible for delivering the Housing PFI Programme; supporting Local Authorities running PFI projects and making recommendations to DCLG on the allocation of PFI credits (DCLG still retains ultimate sign-off responsibility).

BSF

An indicative prioritisation of the revised national programme for Building Schools for the Future (BSF) was issued on 2 March 2009². This was based on the revised Expressions of Interest of Authorities with projects in waves 7 to 15 and only shows preliminary prioritisation; the actual order in which the BSF projects will be undertaken will be dependent on project management and the momentum of the delivery of projects. It is expected that all projects on the "first follow-on projects" list will, however, be given the opportunity to start before those on the "second follow-on projects" list.

Waste

The deadline for applying to Defra for the last confirmed award round of PFI credits (which utilises funds made available to Defra in the 2007 Comprehensive Spending Review), passed in October 2008. Defra reported that 9 Authorities submitted Outline Business Cases which are progressing through the approval process. Announcements as to whether PFI credits have been granted will be made on specific projects as and when they secure approval from the Treasury led Project Review Group. On 27 March 2009 it was announced that 3 projects were collectively awarded a total of £319 million worth of PFI credits - £115.3 million to Hertfordshire County Council, £91 million to Norfolk County Council and £112.9 million to the South London Waste Partnership. Hertfordshire County Council have already issued an OJEU notice while Norfolk County Council have published a prior information notice. A list of all approved schemes and pipeline projects can be found on Defra's website³.

2. www.teachernet.gov.uk/management/resourcesfinanceandbuilding/bsf/rmp/
3. www.defra.gov.uk/environment/waste/localauth/funding/pfi/projects.htm

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This newsletter is intended merely to provide a summary of the law in this area. It is not intended to provide legal advice for specific cases.

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