SSDC Opium Power Ltd - Request for Consent to distribution of 2022/23 half year profits

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Purpose of the Report

1. To consider a request from SSDC Opium Power Ltd under the Shareholders' Agreement to consent to the distribution of the half-yearly profits for 2022/23 of £900K, as a dividend.

Forward Plan

2. This report was recently added to the District Executive Forward Plan following receipt of the request after the SSDC Opium Power Ltd Board meeting on 21 November 2022.

Public Interest

3. Like many Councils, South Somerset District Council (SSDC) has over recent years developed and implemented a commercial strategy to generate additional income. The objectives were to replace the funding lost due to reductions in central government grant funding and to support the continued financing of key front-line services.

4. The Council invested in a renewables joint venture known as SSDC Opium Power Ltd and its two subsidiary companies. These investments have started to deliver an income stream and the Council has received a request from the directors of SSDC Opium Power Ltd to consent to the distribution of the half-yearly profits for 2022/23 as a dividend. The Council's express consent is required under the provisions of the Shareholders' Agreement.

Recommendation

5. That District Executive consents to the request from SSDC Opium Ltd to distribute the half-year profit generated in 2022/23 by FERL1 of £900k as a dividend payment to the two shareholders, SSDC and Opium Power Limited, in the agreed proportions: 65:35 respectively.

Background

6. As part of its commercial strategy SSDC invested £42m through a joint venture company, SSDC OPL, in the design, build, finance and operation of battery energy storage systems (BESS) at Taunton, Somerset and at Fareham, Hampshire.

7. The current structure of the joint venture comprises a parent company, SSDC Opium Power Ltd (SSDC OPL) and two subsidiary companies, Fareham Energy Reserve Ltd (FERL1) and Fareham Energy Reserve 2 Ltd (FERL2). There are 100 shares in SSDC OPL: the Council holds 50 and OPL holds 50. All the shares in FERL1 and FERL 2 are held by SSDC OPL.

8. The returns from these investments come by way of interest on the capital lent by SSDC to the joint venture and dividends from the profits. In addition, the loan repayments are used to fund the capital budget thus reducing the Council's overall borrowing needs.

9. To date, the loan repayments, including interest, have been made in accordance with the agreements. The overall loan balance at the end of March 2023 is forecast to be £39m.

10. As these projects needed to be constructed prior to trading, there was an initial period of investment without immediate return. Taunton started trading in 2020, Fareham 1 started trading in early 2022 and Fareham 2 reached completion in June 2022 and will shortly start trading.

Proposal from SSDC Opium Power Ltd.

11. Having made loan repayments in accordance with the minimum amounts set out in the loan agreement and leaving a small surplus in the company, the directors of FERL1 have declared a profit of £900k for the half-year 2022/23. This profit has been transferred to the parent company, SSDC OPL.

12. The Council received a request from the Board of SSDC OPL on 21 November 2021 for consent under the Shareholders' Agreement to use the profit to make a dividend payment to their shareholders, such dividend to be split 65% SSDC and 35% OPL in accordance with the provisions of the DSA.

13. An alternative option is for the profits to be used to repay the loan more quickly.

Financial Assessment and potential risks

14. This financial assessment analyses the two options the council has, namely:
    - Use the profits generated to make earlier repayments to the council of the loan debt outstanding, or
    - Use the profits to make a dividend payment to the two shareholders, SSDC and OPL.

15. The two options have been analysed and discounted back to directly comparable totals in today's prices using Discounted Cash Flow (DCN) modelling over the 25-year period of the loan to FERL1, as the company generating the profit in question.

16. The analysis assumes that the council's indebtedness arising from it having to borrow to lend to the company is financed by using loan finance from the Public Works Loan Board (PWLB) at an interest rate of 4.5%. This is the assumption being used in the 2023/24 budget reports being prepared for the new Somerset Council and given that the analysis is over a 25-year period it is appropriate to use the new council's financing assumptions.

17. It has also been assumed that DLUCH (Department for Levelling Up, Communities and Housing) will enact anticipated legislation in 2023/24 requiring local government to make Minimum Revenue Provision (MRP) costs in their revenue budget to cover the principal costs of borrowing the council undertakes for the purpose of lending to third parties. The annual MRP costs have been estimated at 2% of the loan total, again using the new council's financing assumptions.

18. **Option One**: Use the profits generated to make earlier repayments to SSDC of the debt outstanding. The financial implications of this option are:

    - All the half year profit (of £900k) is used to repay FERL1 outstanding debt.
    - The outstanding debt at beginning of 2022/23 was £18.691m.
    - Scheduled loan payments during this year are £0.444m, so along with the additional repayment of £900k, the debt outstanding at beginning of 2023/24 would be £17.347m – meaning that 7.2% of the total loan outstanding would be repaid during the 2022/23 financial year.
    - The net financial impact on the Council's revenue budget over a 25-year period, and discounted and totalled to a present-day value, is a beneficial impact of £516k comprising:
        - Annual loss of interest income received by the council as the debt is repaid quicker than anticipated in the agreed loan repayment schedule.
        - Annual savings in financing charges (interest costs) arising from the Councils overall indebtedness being reduced by the loan repayment of £900k.
        - Annual savings in MRP costs (assuming the new legislation is introduced).

19. **Option Two**: Use the profits generated to make dividend payments to the two shareholders. The financial implications of this option are:

    - 65% of the half year profit is distributed to SSDC – our share being £585k.
    - 35% (or £315k) is received by the other shareholder (OPL).
    - There will be no loss of interest income received by the Council as interest payments will remain in line with the agreed loan repayment schedule.
    - Local government is not taxed on dividend income so there are no additional costs.
    - The result is a one-off beneficial impact on the revenue budget of £585k.

20. In summary therefore:
    - The Net Present Value of using the profit to repay outstanding debt is an income of **£516k** realised over the next 25 years.

- The Net Present Value of distributing the profit as a dividend is a one-off income of **£585k** in this financial year.

21. This analysis has just been undertaken for the half year profits realised in 2022/23. The company however is forecasting further profit for this year and for future years.

22. There are two main financial risks that need to be considered as follows:

    - The bank base rate (currently 3.5%) is likely to rise to 3.75% by the end of this financial year. The long-term borrowing rate from PWLB is currently 4.5% and could increase further. The loans to FERL1 however charge 4% per annum over 25 years – so there is a risk that if interest rates continue to rise, and do not decline as economists predict in the medium term, that the Council is making a loss on its lending and is effectively subsidising the company in terms of the latter's costs of borrowing.

    - Elected Members also need to consider whether there is also the potential risk of the company not continuing to trade profitably over 25 years and therefore not being able to repay the total amount of debt outstanding to the Council. Option One, i.e. reducing the loan more quickly, decreases this risk.

23. In mitigation of these risks, it should be noted that every request to declare a dividend will require consent under the Shareholders' Agreement, which will allow the new Somerset Council to consider the development and likely impact of these risks over time.

Financial Implications

24. Any dividend income from the companies has not, for prudential reasons, been included by the S151 Officer in the base revenue budget position. Nor have the financial implications of any loan repayments above the agreed loan schedule been included in the revenue budget.

25. Option One: given that the additional loan repayment of £900k would not be received until February, very late in the financial year, this would have minimal impact on the 2022/23 revenue budget in terms of interest income lost net of the savings arising in financing costs. It would however give a £900k reduction in the Council's Capital Financing Requirement figure (the council's indebtedness position) presented in the 2022/23 Statement of Accounts.

26. Option Two: this would result in new unbudgeted income of £585k being received in 2022/23 which would be reported in the Quarter Three revenue budget report to District Executive in March 2023.

Officer assessment and recommendations

27. Given that the new Somerset Council will have ongoing pressures on its revenue budget position, the Chief Finance Officer, on balance, recommends that District Executive

agrees to the profit being distributed by means of a dividend payment to the shareholders on this occasion and it is therefore recommended that SSDC grants shareholder consent to the declaration of this dividend (option 2). This will not fetter the flexibility of the new Somerset Council in future decisions.

Legal implications and details of Statutory Powers

28. The Council's position is covered by the terms of the various agreements with SSDC OPL and its subsidiary companies. There is a requirement in the Shareholders' Agreement that any dividend requires express consent from the Council.

Council Plan Implications

29. Environment: Deliver schemes to enhance the quality of our local environment and its resilience to adapt to climate change

Carbon Emissions and Climate Change Implications

30. Battery storage as a business compliments our carbon emission and climate change aspirations.

Equality and Diversity Implications

31. An equality relevance check has not been undertaken on this proposal as there are no adverse implications.

Privacy Impact Assessment

32. There are no adverse personal data implications to this report.

Background Papers

None