

JOINT SCRUTINY COMMITTEE - PUBLIC MEETING

Date: Tuesday 23<sup>rd</sup> September 2008

Title: JOINT WASTE STRATEGY – PHASE 3 OUTLINE BUSINESS CASE  
SUBMISSION TO DEFRA FOR PFI FUNDING

<b>1. PURPOSE OF THE REPORT</b>
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To seek views of Joint Scrutiny Committee Members on the draft Outline Business Case and for them to note the procedural arrangements for it to be received and be approved by Bristol, South Gloucestershire and North Somerset Councils' Cabinets/Executives. Members are asked to note that each authority's Cabinet or Executive will invited to consider the following recommendations at their respective Cabinet/Executive meetings as follows:

South Gloucestershire	6 <sup>th</sup> October
North Somerset	28th October
Bristol	30 <sup>th</sup> October:

***That each UA Cabinet/Executive:***

- 1.1 Accepts the Outline Business Case and its Reference Project as evidence to secure PFI funding for the procurement of a shared waste treatment solution.
- 1.2 Approves the level of financial support required to meet the affordability gap for the Residual Waste Management PFI Project as outlined in Section 8.5 of the OBC, and as required by Defra.
- 1.3 Confirms that the Waste Portfolio Holders from Bristol City, North Somerset and South Gloucestershire Councils will complete the formalities prior to the submission of the OBC to Defra by the deadline of 31<sup>st</sup> October 2008.
- 1.4 Gives approval to proceed with the PFI procurement on the basis of financial information available and summarised in this report.
- 1.5 Explores all options and opportunities to fund the identified affordability gap and keeps this under regular review.
- 1.6 Notes, that the substance of the OBC, in particular the Costs (ie: the total cost of the reference project against business as usual; the underlying impact of the reference project on budgets; and the impact of the sensitivity analysis) will remain unchanged. However opportunities will be taken to refine the supporting text in order to improve its presentation for Defra up to the 31<sup>st</sup> October.

## **2. Summary**

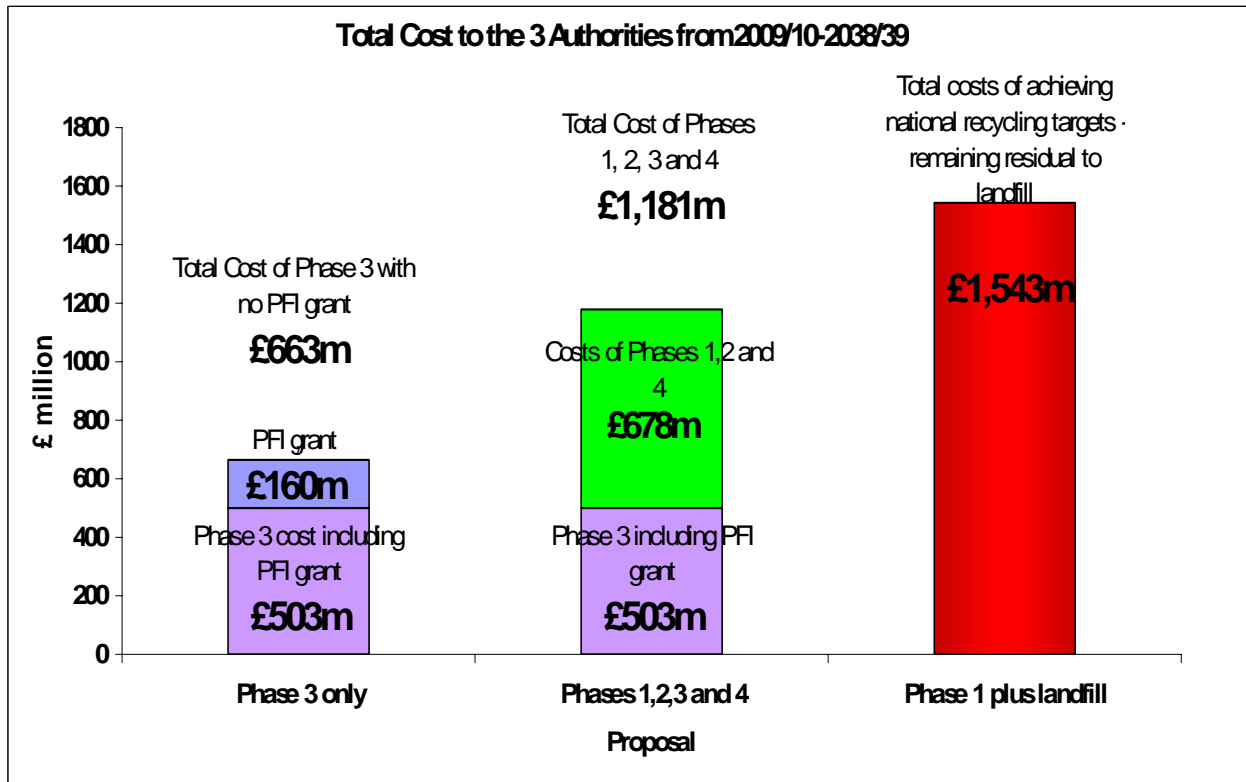
- 2.1 In March 2008 the three authorities of Bristol, North Somerset, South Gloucestershire together submitted an Expression of Interest (Eoi) to Defra for Private Finance Initiative (PFI) funding support to help procure waste treatment facilities to deal with municipal waste arising in their areas.
- 2.2 In May 2008 Defra confirmed that the Eoi had met the Government's eligibility criteria for PFI support and invited the three Authorities to submit an Outline Business Case from which it will determine the level of funding support that can be granted.
- 2.3 The report to each UA Cabinet/Executive in October 2008 will seek approval and authorisation to submit the Outline Business Case for the joint procurement of waste treatment capacity under Phase 3 of the Joint Waste Strategy.
- 2.4 The report will also explain:
  - The additional waste minimisation, recycling and composting initiatives to be undertaken by each of the partnering Authorities so that each Authority can at least achieve the Government's national recycling target of 50% by 2020. These are embodied within the OBC. Each Authority will be required to confirm its commitment to deliver these initiatives in addition to the residual waste treatment infrastructure.
  - The provision of a legally binding Joint Working Agreement (JWA) that formally records the commitment of each Authority to work in partnership. It refers to the financial consequences should any of the Authorities withdraw from the partnership either during the procurement process or the operational life of the facility.
  - The nature and extent of each Authority's commitment, in terms of finance, future expenditure and other resources that it must make to implement the proposed residual waste treatment solution. The required financial commitment represents the most economically advantageous solution for the Authorities over the life the life of the contract.

## **3. The significant issues in the OBC are:**

- 3.1 Without a firm commitment from the Councils that an appropriate level of funding will be made available, the envisaged solution will not be deliverable and Defra will not support the Partnership proposals with the required level of PFI funding support.
- 3.2 The costs and affordability have been calculated by the appointed Financial Advisors, PricewaterhouseCoopers, in close liaison with each authority's Finance Officers who have provided future budget forecasts and have agreed key assumptions used. Section 8 of the OBC contains more detail of the Costs, Budgets and Finance.

3.3 This Chart 1 below shows the costs of Phase 3 with and without the PFI grant in the first column. It should be noted that PFI grant would not be available under the prudential borrowing method of funding. The second column shows the total indicative cost of the Joint Waste Strategy compared with the third column of achieving national recycling targets and sending the remaining residual waste to landfill.

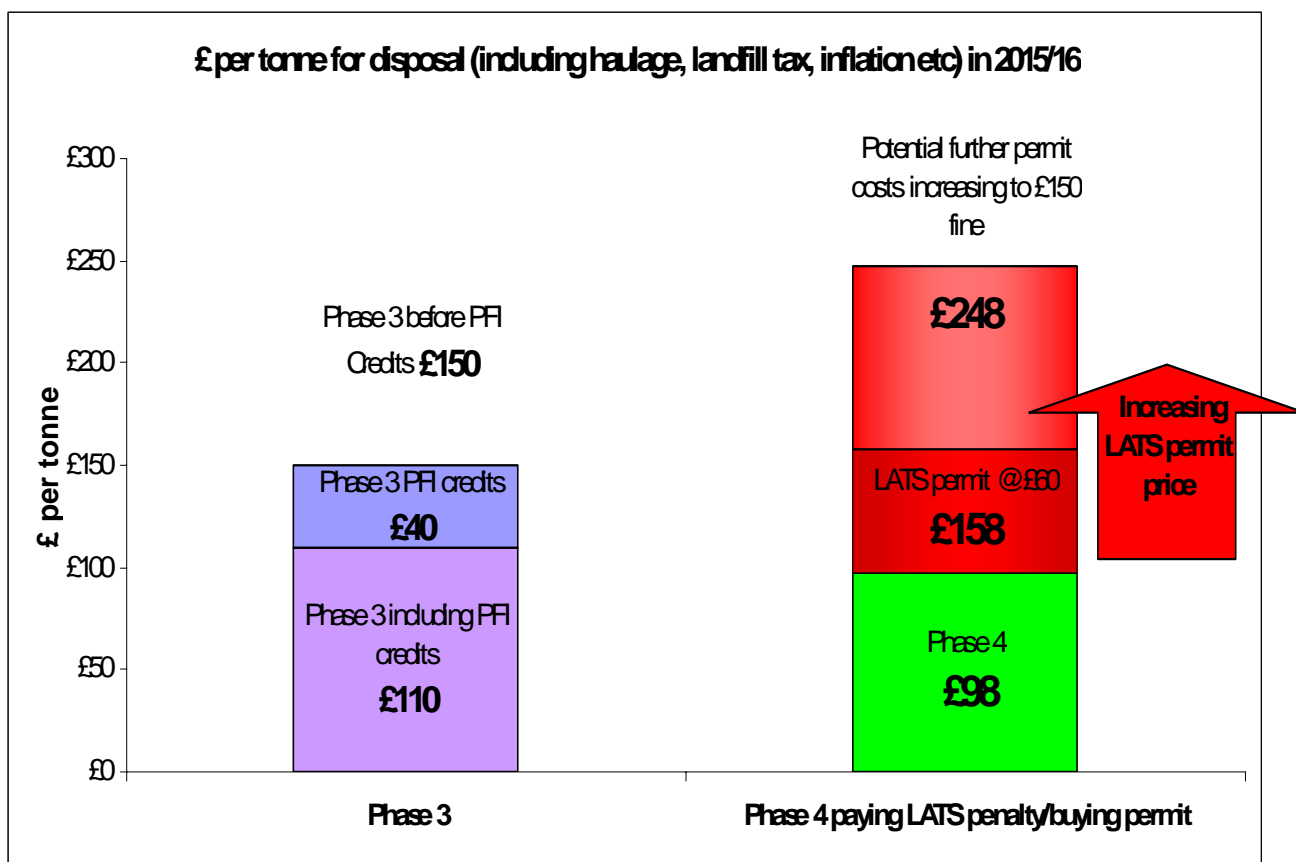
Chart 1: Headline costs comparison



3.4 A similar comparison of the forecast costs per tonne in one year 2015/16 is given in Chart 2 below, also showing clearly the potential impact of buying LATS permits (at an estimated future cost) or the scenario of having to pay the £150 per tonne fines for failing to meet LATS targets.

3.5 By pursuing this phased approach, PFI credits significantly reduce the cost per tonne of dealing with the residual waste. The level of uncertainty in landfill and LATS assumptions creates a far riskier and potentially significantly more expensive option if 'business as usual' is pursued as an option.

Chart 2: Comparison of costs per tonne in 2015/16



- 3.6 Table 1 below summarises the key assumptions that have been included in the shadow bid model calculations, as agreed with the authorities' Finance Officers.
- 3.7 It is important to understand that these assumptions are based on robust and current data, but may not be fully reflected when prices are submitted by the market in 2+ years time.

Table 1: Key assumptions for Costs and Affordability modelling

<b>Recycling</b>		<b>2019/20</b>
Assumed recycling rate achieved		50%
Total Available Residual Waste (tonnes)		231,677
Capacity of plant (tonnes)		160,000
Recycling that could still occur (tonnes)		71,677
Recycling target that could still be achieved by 2020		65%
Average annual cost of Ph 1 initiatives across 3 Authorities		£6.7m
<b>Combined Heat and Power costs additional to EfW costs</b>		
Capital (Total)		£23m
Operating costs (per annum)		£1m
ROCS (per tonne)		£3.09
Electricity (per tonne)		£31.62
Heat (per tonne)		£13.83
<b>Economic Assumptions</b>		
Annual cost of bank borrowing		7.04%
Inflation		2.50%
Capital Inflation		5.00%
<b>Landfill Assumptions</b>		
LATS price		£150
Landfill tax (from 2010/11)		£48
Landfill tax inflation from (2010/11)		3.50%
Landfill gate fee		£25

- 3.8 An additional Defra requirement is for the authorities to demonstrate Value for Money (VfM) by comparing PFI funded (private sector) against traditional in-house procurement and risk transfer analysis is the key component in this.
- 3.9 The results show that the project does offer better value for money by using PFI by a margin of 11.91% which is slightly higher than Defra's target window of 5-10% and will give confidence that a PFI route is appropriate.
- 3.10 Furthermore, the results demonstrate that capital costs would have to decrease by 20% before value for money would not be evident or annual costs would have to increase by 14%. Overall, this demonstrates that the private sector are the best people to manage the risks involved in the design, build, financing and operation of this Phase 3 project.
- 3.11 PFI support is revenue support grant provided by the Government, not the actual funding that pays for the capital element of the project. Work carried out by previous advisors in 2007 indicated that the PFI procurement route with private sector funding would provide better value for money than using prudential borrowing (in essence a loan from the Public Works Loan Board).
- 3.12 This comparison is not required to be re-confirmed for the OBC but Table 2 below does show a summary of key factors between the two methods.

Table 2: Summary of Key Factors between PFI and Prudential Borrowing

PFI (Private Finance)	Prudential Borrowing
£160m revenue support grant <b>receivable</b> to help you meet your monthly payments to the contractor	<b>No £160m</b> of revenue support grant to help you pay back the PWLB (Public Works Loan Board) loan
Commercial lender will perform extensive assessment of project and its potential performance to ensure they will get the required return on their loan	PWLB do not perform an assessment of your project and therefore will not take any risk on the performance of the project – you should perform your own assessment
Risk transfer - £ per tonne would not go up if risks managed by contractor crystallise	Limited risk transfer – £ per tonne would go up if risks that you manage crystallise

3.13 Each authority's own Cabinet or Executive report will include further detail of relevant individual financial implications and detail.

#### 4. Policy

- 4.1 Bristol, North Somerset, South Gloucestershire and Bath & North East Somerset Councils, as the West of England Partnership, have adopted a Joint Residual Municipal Waste Management Strategy (Joint Waste Strategy) in 2008.
- 4.2 Phase 3 of the Joint Waste Strategy is the joint procurement of waste treatment capacity to handle 160,000 tonnes per annum of residual municipal waste from the three authorities of Bristol, North Somerset and South Gloucestershire, for at least 25 years.
- 4.3 Each authority's own Cabinet/Executive report will include detail of relevant individual corporate policy and waste strategy information.

#### 5. Consultation

- 5.1 The Joint Scrutiny Committee which was set up in July 2008 to cover all areas of work being undertaken by the West of England Partnership has received briefings and information on the OBC and particularly the emerging Section 8 on Costs, Budgets and Finance at its meetings on:
  - ◆ July 11<sup>th</sup>
  - ◆ July 25<sup>th</sup>

- ◆ September 5th
- ◆ September 12<sup>th</sup>

## **6. Context**

### **6.1 Procurement Strategy and Approach**

6.1.1 The Partnership has established the Reference Project for the OBC through a robust Technology Options Appraisal process, assisted by a stakeholder group which participated in the determination of evaluation criteria and weighting. The Authorities have adopted as its reference technology energy from waste by incineration with combined heat and power to meet its 2020 landfill allowances. This Reference Project will be used as a yardstick against which tenders will be evaluated. The requisite capacity is 160,000 tonnes per annum, which is deliberately sized so as not to present a barrier to future improvements in waste reduction, reuse, recycling and composting.

6.1.2 A comparison of the various procurement and funding options has shown the financial benefits of procuring facilities jointly with the addition of Private Finance Initiative (PFI) credit support from Central Government. The OBC has subsequently confirmed that the PFI route provides better value for money over conventional procurement. It should be noted however that this OBC is being submitted under Round 4 of the PFI applications, which is the last round of bidding, and must be submitted by 31<sup>st</sup> October 2008. The availability of PFI funding support is not certain thereafter, and remains competitive in this last Round.

### **6.2 Waste-flow modelling**

6.2.1 Jacobs has worked in conjunction with waste officers to model future trends in waste arisings and capture rates. This process was first undertaken in 2006 as part of the Technical Options Appraisal. In late 2007 this was updated to include 2006/7 actual arisings data, assumptions and projections on waste arisings and capture rate were re-agreed with officers. This data was subsequently updated in early 2008 to ensure that all partnering authorities met the Waste Strategy 2007 targets.

6.2.2 All waste arisings and Phase 1 capture rate assumptions have now been updated allowing the inclusion of 2007/8 waste tonnage data and to include the most recent Regional Spatial Strategy housing allocations. Further waste-flow modelling and composition analysis will be undertaken in 2009 to ensure that the tonnage information for the procurement and contract is as up-to-date and accurate as possible.

6.2.3 Total MSW arisings in BCC, NS and SG are predominantly affected by growth in household numbers. The Authorities all expect household numbers to increase considerably each year up to at least 2026.

### 6.3 Outline Business Case

- 6.3.1 The Outline Business Case (OBC) must be finalised and submitted to Defra by 31st October 2008. This concludes Round 4 of the bidding process for waste PFI funding support. Defra has made it clear that there are no plans to promote any future rounds beyond Round 4.
- 6.3.2 This report summarises key information from the OBC and seeks to have confirmed that the Waste Portfolio Holders from Bristol City, North Somerset and South Gloucestershire Councils complete the formalities prior to the submission of the OBC to Defra by the deadline of 31<sup>st</sup> October 2008.

The OBC follows a detailed template format issued by Defra and is formatted under the following headings.

1. Executive Summary
2. Background
3. Strategic Waste Management Objectives
4. Procurement Strategy and Reference Project
5. Risk Management, Risk Allocation and Contractual Structures
6. Project Team and Governance
7. Sites, Planning and Design
8. Costs, Budgets and Finance
9. Stakeholder Communications
10. Timetable

- 6.3.3 The OBC will be reviewed by Defra after its submission at the end of October 2008. It is understood that final adjustments may be called for before a further review is carried out by Partnerships (UK) before submission to the Treasury's Project Review Group.
- 6.3.4 The OBC document is a large and complex document that is being prepared to tight timescales. **Appendix A** contains the current version which includes all the main sections completed. There will be a further version available for the first Cabinet papers' deadline. Following this any further changes will be in accordance with paragraph 1.6. A completed OBC will be ready for submission by the deadline date of 31<sup>st</sup> October 2008. This report summarises the key OBC information for approval.

### 6.4 Appraisal of Waste Treatment Options

- 6.4.1 During 2006 the Partnership's Project Board considered a range of technology options along with the Status Quo option in a formal Technology Options Appraisal process. The options were compared to one another by scoring them against a series of decision-making evaluation criteria. These criteria evaluated the environmental, socio-economic, technical and financial factors affecting each technology option. The application of decision-making evaluation criteria enabled the Partnership to engage with and involve

stakeholders in the decision-making process. To provide a process which was transparent, accountable and robust, the selection of the evaluation criteria involved a wide range of stakeholders through consultation.

- 6.4.2 The Member Project Board subsequently reviewed and considered the outcomes from a Criteria Consultation Day recommending the short-listed criteria and determining the relative weightings. The weighting for each criterion being assessed was then used within the decision-making process as a means of determining which waste management option performed best. This then became the reference technology within the Reference Project which when costed becomes a key component of the OBC.
- 6.4.3 The Technology Options Appraisal determined the technology for the Reference Project to be Energy from Waste (EfW) by conventional incineration with a preference for combined heat and power (CHP). It is emphasised that whilst conventional incineration will be the Reference Project, this will not preclude interested parties coming forward with other forms of treatment which will achieve the requisite outcomes. The outcomes will be determined by the evaluation criteria by which tenders will be assessed. The evaluation criteria will be established through further stakeholder engagement. Defra recommends that an open output specification be used so as to attract a wide range of potential solutions. This could include solutions/technologies other than the one identified in the Reference Project.

## **6.5 Reference Project Details**

- 6.5.1 Defra requires that the Partnership presents and demonstrates a solution that is bankable, affordable and deliverable at the scale required by the Partnership. Defra stresses that, in presenting the Reference Project, authorities are not committed to the specified treatment technology (or site) within the Reference Project, as this will be determined as part of the procurement process. An Output specification will be used allowing bidders to determine the best way to deliver the outputs specified by the Partnership. A review and refresh of the evaluation criteria used in the Technical Options Appraisal (see 6.3.3 above) is programmed for November / December and will again engage with a range of stakeholders in the process. The evaluation criteria will allow the Partnership to specify its requirements and the relative importance of each one.
- 6.5.2 The Reference Project solution has been used as a basis for determining high-level cost estimates (the Affordability Envelope), evaluating project risks and will also be used to inform the development of the procurement documentation and process. It assumes an energy from waste treatment facility with CHP dealing with 160,000 tonnes per annum of residual waste. Work continues on securing a site in the control of one of the Authorities which could be made available. Such a site will offer an alternative to bidding contractors having to find their own site. By doing so it will increase competition and speed up the procurement process.
- 6.5.3 In addition to the energy from waste treatment facility, the Reference Project also identifies the waste transfer arrangements whereby each Authority will

deliver its waste to the facility, together with a range of recycling, composting and waste minimisation initiatives [ie: the Programmed Service Improvements (PSIs)]. The costs associated with delivering these initiatives and their performance have been included in the Reference Project costings. These additional costs must be recognised and accepted by each Authority as forming part of the overall project delivery and Affordability Assessment.

6.5.4 The Reference Project offers the most advantageous option for the future waste treatment of municipal waste arising in the area of the three partnering Authorities when evaluated against a range of environmental, economic, technical and planning delivery criteria.

## 6.6 Procurement Programme

6.6.1 An outline programme for the procurement of the residual waste treatment solution, based on the Councils' output specification and not the reference project, is included in the OBC. Key dates are summarised below:

Outline Business Case submission deadline	31 <sup>st</sup> October 2008
Refine and improve evaluation criteria with Joint Waste Committee and Joint Scrutiny Committee involvement	Nov/Dec 2008
Receive response from Defra re OBC	February 2009
Receive response from HM Treasury Project Review Group	March 2009
Approve Output specification and Evaluation Criteria	March 2009
Advertise in Official Journal of the European Union (OJEU)	April/May 2009
Decision to invite bidders to participate in Phase 3	Late 2009
Approval to submit Outline submissions	Early 2010
Approved Preferred Bidder	Late 2010
Approve Final Business Case	Mid 2011
Award Contract	Late 2011
Residual treatment facility operational	2015/16

## 7. Other Options Considered

### 7.1 *Not to pursue potential PFI funding support for future residual treatment*

A financial evaluation of the different funding options has been undertaken as part of the EoI and OBC preparation and this indicates that a PFI supported joint procurement provides better value for money than a non-PFI funded solution.

### 7.2 *To continue with landfill disposal as the preferred method for dealing with waste that is not recycled or composted.*

The option of continuing to dispose of the Authorities' residual waste to landfill (the

Status Quo) was modelled at the EoI stage and re-appraised as part of the OBC evaluation. Whilst continuing with landfill is financially economic in the very short term, results from the options appraisal has indicated that continuing to landfill beyond the short term is the least preferable environment and financial option.

### **7.3 For each authority to progress its own individual residual waste treatment solution via separate facilities**

Work done at the EoI stage and re-appraised at OBC indicates that there is very little environmental benefit in developing individual solutions and that individual waste treatment solutions would be more expensive than procuring a joint facility, through loss of economies of scale and duplication of procurement resources.

## **8. Other Issues and Support Information**

- 8.1 The Joint Waste Strategy also includes Phase 1 and Phase 2 which are in progress and development at the moment.
- 8.2 Under Phase 1 each authority is committed to continuing to implement its own energetic programme of waste reduction and recycling activities, according to its own waste strategy. The Strategy expects minimum recycling levels of 50% by 2020 to be achieved. In addition, the Partnership intends to look for ways in which we can work together with our residents to reduce waste and boost levels of material reuse and recycling.
- 8.3 Phase 2 is intended to meet the Partnership's interim need to achieve diversion from landfill to meet the immediate LATS penalties prior to Phase 3 becoming operational. Work to prepare tender and contract documentation is nearing completion with the intentiojn to commence the formal process in October. This process will invite industry to present the most suitable technical options for dealing with waste for at least a 5 year contract period
- 8.4 The Phase 2 procurement and contract packaging has been the subject of separate reports to Executive Members and to the Joint Scrutiny Committee.

## **9. Legal and Resource Implications**

### **Legal - Joint Working Agreement and Project Governance**

- 9.1 Section 6 of the OBC sets out the arrangements for the Joint Waste Management Committee which develops and recommends the Policy and Budget framework for Waste Management to Cabinets, and then takes responsibility for key decisions necessary in implementing the Joint Waste Strategy. The Joint Committee will meet in public and be convened, administered and conducted on the same basis as individual Council Executives.

- 9.2 The Joint Working Agreement underpins the operation of the Joint Waste Management Committee, in particular the obligation of the partners to each other, including duties, responsibilities, cost allocations and legal indemnities.
- 9.3 The cross-party Joint Scrutiny of the Joint Waste Management Committee comprises 4 Scrutiny Committees, each of 3 Councillors nominated by their Councils, working together with the assistance of expert witnesses and advisors.

## **Financial**

- 9.4 Procurement project budgets have been updated up to contract award in 2011/12 and are included in the OBC Section 8. These are in the process of being incorporated into each authority's Medium Term Financial Plans via Finance and Waste Officers.

## **Land**

- 9.5 The Partnership is also in the process of developing a Joint Waste Core Strategy which will establish the spatial strategy for the distribution of strategic waste facilities for municipal, industrial and commercial waste within the West of England. The Preferred Options of the Joint Waste Core Strategy has identified a number of sites that could be capable of accommodating waste treatment facilities to deliver Phase 3 of the Joint Waste Management Strategy (the subject of the OBC). These sites have been the subject of a Sites and Planning Appraisal Study. The Partnership is in the process of securing a preferred site in the ownership of one of the Authorities. It is proposed that such a site brought forward from this work would be leased to the successful contracting organisation for the term of the contract.

## **ACCESS TO INFORMATION**

**Background Papers – available as downloads from [www.rubbishorresource.co.uk](http://www.rubbishorresource.co.uk)**

WoE Joint Waste Strategy – Full and Summary versions – June 2008

Expression of Interest to Defra – March 2008

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