REPORT TO: Cabinet

DATE: 7 August 2008

SUBJECT: Merseyside Waste PFI Procurement Programme

WARDS AFFECTED: All

REPORT OF: W. T. Milburn
Environmental Protection Director

CONTACT OFFICER: Carl Beer, Director, Merseyside Waste Disposal Authority
0151 255 1444

EXEMPT/CONFIDENTIAL: No

PURPOSE/SUMMARY:
To inform Elected Members, at the specific request of Merseyside Waste Disposal Authority, of the outcome of the 4Ps Strategic Gateway Review of the Waste PFI Procurement Process; the risks and costs associated with delay to the site acquisition and planning timetable; and to introduce the Economic Impact Study of the Waste PFI Project commissioned by the North West Development Agency.

REASON WHY DECISION REQUIRED:
Significant financial cost and environmental harm will arise and potential economic development benefits missed from the increasing risk of delay in the procurement of sites for essential new municipal waste management facilities.

RECOMMENDATION(S):
That Cabinet:

1. Notes the significant risk and costs that attach to the potential failure to progress site acquisitions and planning consents for the Merseyside and Halton Waste PFI Procurement Programme.

2. Notes the wider positive economic impact that will result from the waste infrastructure when delivered.

KEY DECISION: No

FORWARD PLAN: Not appropriate

IMPLEMENTATION DATE: Not Appropriate
ALTERNATIVE OPTIONS:

As landfill is increasingly banned, an alternative waste disposal route for unrecycled municipal waste must be found. There is the potential of using private sector merchant facilities if available in the future, however the uncertainty in securing sufficient future merchant capacity (that does not currently exist) at an affordable cost is an unmanageable and significant financial risk.

IMPLICATIONS:

Budget/Policy Framework: Delivery of Merseyside Joint Municipal Waste Management Strategy

Financial: The combined costs to the Merseyside and Halton Waste Partnership PFI Contract Procurement Programme of a potential delay of 3 years are estimated to be between £192 and £405 Million over the 25 yr life of the project. Sefton Council would be liable to between £34 million and £72 million of these additional costs.

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<tr>
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<tbody>
<tr>
<td>Gross Increase in Capital Expenditure</td>
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<td>Funded by:</td>
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<td>Sefton Capital Resources</td>
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<td>Specific Capital Resources</td>
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<td>Gross Increase in Revenue Expenditure</td>
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<td>Funded by:</td>
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<td>Sefton funded Resources</td>
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<tr>
<td>Does the External Funding have an expiry date? Y/N</td>
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<td>How will the service be funded post expiry?</td>
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Legal: Merseyside and Halton Authorities have agreed to enter into an Inter authority agreement to facilitate the delivery of the JMWMS.

Risk Assessment: This Item has been placed on the MWDA High Level Risk Register

Asset Management: Not Relevant to Sefton at this time.

CONSULTATION UNDERTAKEN/VIEWS

All Merseyside and Halton Council Chief Executives and Chief Officers responsible for Waste Management or their representatives took part in the Gateway Review.
Corporation objective monitoring:

<table>
<thead>
<tr>
<th>Corporate Objective</th>
<th>Positive Impact</th>
<th>Neutral Impact</th>
<th>Negative Impact</th>
</tr>
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<tbody>
<tr>
<td>1 Creating a Learning Community</td>
<td>✔️</td>
<td></td>
<td>✔️</td>
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<tr>
<td>2 Creating Safe Communities</td>
<td>✔️</td>
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<td>3 Jobs and Prosperity</td>
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<td>4 Improving Health and Well-Being</td>
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<td>5 Environmental Sustainability</td>
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<tr>
<td>6 Creating Inclusive Communities</td>
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<tr>
<td>7 Improving the Quality of Council Services and Strengthening local Democracy</td>
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<td>✔️</td>
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<tr>
<td>8 Children and Young People</td>
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List of background papers relied upon in the preparation of this report:

Background

1. Merseyside Waste Disposal Authority (MWDA) is conducting a Waste PFI Procurement Programme on behalf of all the Merseyside District Councils and Halton Council for the long-term treatment and disposal of residual waste. This is essentially waste that has not been recycled through kerbside or other schemes.

2. MWDA was awarded £90 Million in PFI credits from Government in July 2007 based on its Outline Business Case originally submitted in 2005 and the demonstration of sufficient progress in accordance with the submitted project, which currently targets financial close occurring before 30th September 2010.

3. MWDA has not ruled in or out any specific technology for the treatment of residual waste, however, the reference case for planning purposes is based on Mechanical Biological Treatment (MBT), the production of a Refuse-derived Fuel (Rdf) and Energy Recovery of that fuel (in the form of electricity, heat or both).

4. MWDA has embarked on a strategy of seeking to acquire an interest in two large (8 hectares plus) sites and is seeking planning permission on those sites for two facilities treating 325,000 tonnes/year each, given its assessment that a failure to deliver sites represents the biggest single risk to the project.

5. As part of the PFI process, MWDA invited 4Ps (Government Procurement Advisors to Local Authorities) to conduct an independent strategic Gateway Review of the process. This report informs of the outcome of that Gateway Review, the actions taken as a result and the remaining timetable risks and costs associated with the principle risk of a failure to deliver sites and planning consents.

4Ps Gateway Review

6. 4Ps conducted a Strategic Gateway Review of the Waste Procurement Programme in January 2008. The primary purpose of the Gateway Review is to review the outcomes and objectives of the Programme (and the way they fit together) and to confirm that they make the necessary contribution to the Authority’s overall strategy. The key findings and recommendations of the Gateway Review are attached at Appendix A.

7. The Gateway Review identified positive feedback from stakeholders about the conduct of the Waste PFI Procurement, in particular highlighting that ‘MWDA business processes are professionally well managed and that the outline Business Case (OBC) produced for the end treatment / recovery project is comprehensive and robust’.
8. The Gateway Review highlighted as a ‘Red’ (take action immediately), for the re-examination of the Waste Procurement Strategy in respect of Sites and Planning, given the **impasse in achieving progress** on this issue.

9. MWDA was recommended to revisit its sites and planning strategy, which it did in February 2008. In particular, MWDA Members considered the alternative options of waiting for the Waste Development Plan Document (WDPD) Process to conclude, using this as the method of site selection), and the alternative of awaiting the result of the competitive tenders submitted under the PFI procurement (i.e. leaving it to the preferred bidder to make the planning application for their own, or the MWDA selected sites).

10. MWDA determined at that meeting that the risks of these two alternative options outweighed the benefits, and concluded that it should continue to pursue its current strategy of moving ahead with the **acquisition of sites**.

11. MWDA also determined, at the March 2008 meeting of the Authority, to proceed with its sites and planning strategy, including the development of a **CPO strategy** and to **use its powers** in this regard if necessary.

12. The Officers of MWDA have also revisited the strategy of seeking sites and planning permissions for the facilities necessary to deliver its PFI procurement contract with the bidders engaged in the procurement process during the current Competitive Dialogue meetings. All bidders have endorsed the approach of the Authority, and have also indicated that their detailed proposals are based on utilising the sites proposed by the MWDA.

13. The Gateway Review identified some weakness in the integrated management of communications with key stakeholders. In particular, the Review identified that there was a political will to resolve the difficulties through negotiations, and that this would be facilitated if all Merseyside and Halton Waste Partnership Authorities had access to full information.

14. Acting on the recommendations of the Gateway Review findings, the Director of Waste Disposal has conducted a further round of confidential informal meetings with all Leaders/Chief Executives to inform them of the site selection process and outcomes, and to bring to their attention the desire to work with all Authorities to find a solution to the sites impasse, given the magnitude of the risks.

15. This report also seeks to address two further matters addressed by the Gateway Review report, namely communications, and engaging the wider membership of the Waste Partnership across Merseyside and Halton in considering and responding to the high-level risk register of the MWDA in delivering the Waste Management Strategy. On the latter matter, the high level risk register is reported
to the Procurement Group (which includes Members of the MWDA and Senior District Officers), as well as the Joint Municipal Waste Management Strategy (JMWMS) Senior Officer Working Group.

16. This report seeks to articulate and quantify in summary the risks, costs and the wider economic benefits of the Waste PFI project, so that Members can be advised as to exactly what is at stake, should the Waste Partnership fail to find a solution to the ‘sites’ issue.

Site Acquisition and Planning Timetable Risks

17. The Planning Consultants engaged by the Authority are Mouchel. They have reported on the risk of delays to the sites acquisition and planning programme timetable.¹

18. In particular Mouchel identify the principle risks of slippage in the sites programme to be: -

   i. Failure to gain timely access to sites to conduct Environmental Surveys

   ii. Delay to the acquisition of sites due to unduly protracted negotiations with landowners, or as a last resort the use of Compulsory Purchase Order (CPO) Powers.

   iii. A prolonged planning determination period (greater than 2 years).

   iv. A prolonged CPO process should planning issues not be resolved (greater than 18 months).

19. Taking account of the current difficulties in accessing sites and entering into negotiations with the landowners, Mouchel identify a likelihood of significant delay on the sites issue compared to the current timetable. If the process is subject to prolonged planning and CPO determination periods, this delay could be as long as three years.

Bidder engagement.

20. MWDA has invested considerable resources in engaging with the bidding community and has now ensured that a fully competitive procurement process, involving the leading waste management contractors, is being undertaken. Recent rounds of additional PFI funding support from DEFRA, has now brought a number of other local authority procurements to the market, at the same time as

the MWDA and is placing a competitive pressure on bidders to deploy their resources to tender for contracts judiciously. Should delays and hence additional costs to bidders arise, or the prospect of sites not being available on which to deliver bidders solutions, then the MWDA runs the risk of withdrawal of bidders from the procurement process, and turning their resources to procurements that they consider ‘more deliverable’.

Financial Risks

21. The Authority employs Ernst & Young LLP as financial advisors to the Procurement. They have recently concluded a piece of work to identify the financial risks and associated additional costs which could accrue in the event delays to the current sites programme were to increase, compared to the current timescale.²

22. Ernst & Young identify the main financial risks of delay as follows:

- Loss of PFI credit support;
- Construction Cost Inflation;
- Purchase of Additional Landfill Permits; and
- Additional Landfill and Landfill Tax Costs.

23. The estimated additional costs of the above financial risks are summarised below based on a delay to the commencement of Waste Treatment Facilities of 3 years as set out in paragraph 4.3.

Loss of PFI Credit Support

24. The £90 Million of PFI Credits awarded to Merseyside and Halton equates to approximately £175 Million of revenue support over the life of the project.

25. Should sites not be secured, the procurement will be unable to achieve financial close by the 2010 target date

26. In this case there is a significant risk that the Waste Partnership will lose the allocation of PFI credits on the basis that DEFRA is obliged to allocate resources to those projects that are able to achieve landfill diversion via a deliverable project.

27. PFI credit funding for waste projects is currently very much in demand. There is at present no further known funding available beyond the round that requires

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² Ernst & Young Report Financial Impact of meeting to Waste PFI May 2008.
Outline Business Cases to be submitted to DEFRA in September of this year. As a minimum there is a significant risk that the PFI Credit award will be reduced as a result of any continuing delay. The Director of MWDA is given to understand that such a reduction has occurred on another recent Waste PFI project. The anticipated cost impact of the reduction or loss of PFI credit support is assessed at between £87 Million (assuming a halving of credit allocation) and £175 Million (total loss of credit).

**Construction Cost Inflation**

28. The original modelling work undertaken in relation to the reference project assumed construction inflation of 4.5% per annum. Based on an estimated construction cost of circa £300 Million, a three-year delay would result in additional construction and finance related costs of approximately £4 Million per annum equating to an estimated £99 Million over the project life. Using recent data from the Statistics Office which indicates that RPI inflation for the period April 2007 to April 2008 was around 4.2%, the construction escalation could be as much as 6.2% with an annual cost of £5.5 Million totalling £139 Million over a period of 25 years.

29. The anticipated cost impact of construction cost inflation is between £99 Million and £139 Million.

**Landfill Permits**

30. In the event of a three-year delay to the Waste PFI facilities coming on-stream, Merseyside Waste Disposal Authority would have to purchase additional landfill permits to allow the continued landfilling of residual waste above its allowance.

31. During the 3-year period, an additional 500,000 tonnes of landfill permits will need to be purchased. At an estimated cost of £50 per tonne trading price, assuming that they are available in the market, this would result in additional costs of £25 Million; rising to nearer £75 Million in the event that there are no allowances available for purchase and MWDA has to pay fines at £150 per tonne.

32. The anticipated cost impact of the need to purchase additional landfill permits is between £25 Million and £75 Million.

Table 1 below summarises the combined risk/cost impact based on a 3-year delay.

**Table 1: Combined Risk/Cost Impact**
<table>
<thead>
<tr>
<th>Risk</th>
<th>Base Case 2013 Costs (£ Millions)</th>
<th>Delay Case 2016 Costs (£ Millions) Lower threshold</th>
<th>Delay Case 2016 Costs (£ Millions) Upper threshold</th>
</tr>
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<tbody>
<tr>
<td>Loss of PFI funding</td>
<td>-</td>
<td>87</td>
<td>175</td>
</tr>
<tr>
<td>Construction Cost Inflation</td>
<td>-</td>
<td>99</td>
<td>139</td>
</tr>
<tr>
<td>Landfill Gate Fee</td>
<td>-</td>
<td>34</td>
<td>34</td>
</tr>
<tr>
<td>Landfill Permits</td>
<td>-</td>
<td>25</td>
<td>75</td>
</tr>
<tr>
<td>Landfill Tax</td>
<td>-</td>
<td>72</td>
<td>107</td>
</tr>
<tr>
<td>Sub Total Additional costs</td>
<td>0</td>
<td>317</td>
<td>530</td>
</tr>
<tr>
<td>Reduction in Resource Recovery Contract Payment&lt;sup&gt;3&lt;/sup&gt;</td>
<td>-125</td>
<td>-125</td>
<td></td>
</tr>
<tr>
<td>Net Effect</td>
<td></td>
<td>192</td>
<td>405</td>
</tr>
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</table>

**Effect on Affordability, Disposal Authority Levy and Council Tax**

33. The Authority’s Advisors have created waste flow and financial models, the results of which have been discussed with Leaders, Chief Executives and Treasurers of the participating District Councils. The above impacts identify increased costs to be built into the financial model with consequent effect on Affordability, Levy and Council Tax. The apportioned impact on each district Council of the waste partnership is outlined in table 2 below:

Table 2: Apportioned additional costs to each Local Authority partner

<sup>3</sup> This reduction is the direct result of a shorter concession under the RRC contract in the Delay Case.
<table>
<thead>
<tr>
<th></th>
<th>%</th>
<th>£m</th>
<th>£m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knowsley</td>
<td>10.5</td>
<td>20</td>
<td>43</td>
</tr>
<tr>
<td>Liverpool</td>
<td>30.5</td>
<td>59</td>
<td>124</td>
</tr>
<tr>
<td>St. Helens</td>
<td>12.4</td>
<td>24</td>
<td>50</td>
</tr>
<tr>
<td>Sefton</td>
<td>17.8</td>
<td>34</td>
<td>72</td>
</tr>
<tr>
<td>Wirral</td>
<td>20.8</td>
<td>40</td>
<td>84</td>
</tr>
<tr>
<td>Halton</td>
<td>8.0</td>
<td>15</td>
<td>32</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
<td><strong>192</strong></td>
<td><strong>405</strong></td>
</tr>
</tbody>
</table>

**Wider Economic and Sustainability Impact**

34. The cumulative impact of significant delay to the Waste PFI programme goes beyond the timetable delay and the direct cost increases which would result. In particular there is the ‘opportunity cost’ of delay in bringing the capital investment into the local economy and changing the carbon impacts and wider sustainability impacts of a different infrastructure to handle residual waste.

**Economic Impact Study**

35. The ‘upside’ benefits of the investment by the MWDA in large waste treatment facilities of some £300 million has been examined through an independent study by Deloitte commissioned by the North West Development Agency.  

36. The Deloitte Economic Impact Study (draft report) concluded that the following effects would result:

- 1,100 jobs in total during the total course of the construction project within the authorities where the sites are located;

- A further 100 jobs in the rest of Merseyside and another 300 jobs in the rest of the North West;

- As many as 150 jobs on-site

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4 North West Development Agency
Around £12 Million from electricity generation.

The total net longer-term benefits of ongoing operations can be summarised as:

- Approximately 59 jobs within the authorities where the sites are located;
- A further 6 jobs in the rest of Merseyside; and
- A further 11 jobs in the rest of the North West

After accounting for the residual economic value in the waste-stream, it is estimated that the increase in GVA associated with the Waste PFI would be of the order of:

- £7.1 Million in the authorities where the sites are located;
- A further £0.2 Million in the rest of Merseyside (0.04 per cent annual GVA); and
- A further £0.4 Million in the rest of the North West (0.01 per cent annual GVA);

Additionally there are other effects that are not easily quantifiable and are excluded from the above estimates. These include:

- House price externalities;
- Agglomeration and clustering effects;
- Induced trade in waste and recyclates; and
- The environmental benefits of Waste PFI activities

The exclusion of the above factors from the analysis is likely to result in an underestimate of the monetary benefits of the scheme.

37. Clearly, any delay in the sites and planning issue has a knock-on effect on the ability to let the contract and therefore, also has the knock-on effect of delaying the realisation of these economic and employment benefits.
Sustainability Benefits

38. Enviros has undertaken a scoping assessment to assess the implications of delay for the Carbon burdens associated with the management of Merseyside and Halton’s waste. The assessment was undertaken using the Environment Agency’s WRATE Life Cycle Assessment (LCA) tool, and has been ‘sense checked’ by comparing both the Authority’s Reference Project and Participant’s Solutions received through the procurement process. The results were found to be consistent.

39. The WRATE analysis indicates that implementation of the Authority’s WMRC Contract alone will produce a position whereby the management of Municipal Waste produces at best a slight Carbon benefit as a result of improved recycling rates in the future. In all cases the Carbon benefits of recycling are substantially lost through the significant Carbon emissions associated with the continued landfilling of the Residual Waste.

40. Implementation of the Authority’s Waste Strategy through delivery of the RRC facilities will deliver significant Carbon benefits. On the basis that the Reference Project is delivered adopting typical MBT and EfW technology (not including heat use through CHP) Enviros estimate that the consequent reduction in Carbon burdens would be of the order of 95,000,000 kg of CO2 per year. Therefore, a three-year delay in the delivery of the RRC facilities would be responsible for an additional Carbon burden equivalent to the emission of around 285,000,000 kg of CO2.

41. Data for the Carbon burden of a single reference year with and without RRC facilities are shown below:

<table>
<thead>
<tr>
<th>Kg.CO2 e.g.</th>
<th>Baseline, residual to landfill</th>
<th>Including RRC, residual to MBT/EfW</th>
</tr>
</thead>
<tbody>
<tr>
<td>Collection</td>
<td>2,081,592</td>
<td>2,081,592</td>
</tr>
<tr>
<td>Transport</td>
<td>4,651,058</td>
<td>4,651,058</td>
</tr>
<tr>
<td>Intermediate Facilities (MRF and transfer stations)</td>
<td>3,096,818</td>
<td>3,096,818</td>
</tr>
<tr>
<td>Recycling</td>
<td>-100,811,890</td>
<td>-168,281,331</td>
</tr>
<tr>
<td>Treatment and Recovery (Composting/AD/MBT/EfW)</td>
<td>-8,668,496</td>
<td>55,948,463</td>
</tr>
<tr>
<td>Landfill</td>
<td>96,550,758</td>
<td>3,571,307</td>
</tr>
<tr>
<td>Total Carbon Burden</td>
<td>-3,100,160</td>
<td>-98,932,091</td>
</tr>
</tbody>
</table>
42. The combined contribution of both higher recycling rates along with residual waste treatment (including a further contribution to recycling by the RRC facilities and an overall reduction in landfill) are required before the WRATE assessment indicates that the Authority’s Contracts will deliver a substantial overall benefit with respect to Carbon emissions.

43. The above data are based on the Environment Agency’s data arising from already operational waste facilities in Europe, and do not include for the potential adoption of CHP. It may therefore be possible through implementation of the RRC facilities to significantly improve on the efficiencies of these technologies through the adoption of CHP, and thereby further reduce the Carbon burden associated with the management of Waste by Merseyside and Halton.

Conclusion

44. The Combined costs to the Merseyside and Halton Waste Partnership PFI Contract Procurement Programme of a potential delay of 3 years are estimated to be between £192 and £405 Million.

45. The beneficial economic impact of the infrastructure investment through the Waste PFI Contract is estimated at £7.6 Million GVA.

46. There are wider potential sustainability and carbon reduction benefits that could be realised.