

**Haringey** Council  
Agenda item:

**Cabinet**

**14 October 2008**

Report Title: **NLWA Procurement – Affordability Envelope/Draft Statement of Principles (2)**

Forward Plan reference number:

Report of: **Director of Urban Environment and Chief Financial Officer**

Ward(s) affected: **All**

Report for: **Key Decision**

**1. Purpose**

- 1.1 As part of North London Waste Authority's procurement process they are required under the Private Finance Initiative (PFI) to model both the future waste treatment/disposal and waste collection costs over the proposed 30 year contract period from 2012 to 2042. This report informs Cabinet of the work carried out by the NLWA and their external technical and financial consultants whom have used their models to predict each constituent boroughs contribution to the overall base cost of the project. In order to help manage the risk of modelling cost over such a long period sensitivity analysis has been undertaken to produce an upper threshold cost. The range of increased cost between the base and upper threshold represents the Council's affordability envelope.
- 1.2 To seek agreement from the Cabinet to send a letter (attached as Appendix A) to Defra which will set out the Council's commitment to finance the project within the estimated affordability envelope.
- 1.3 To report the potential impact of these costs and the modelled scenarios should it be fully financed by council tax.
- 1.4 To note and seek agreement to the proposed draft Statement of Principles (2) as attached as Appendix D as a basis for further discussions with the NLWA.

## **2. Introduction of Cabinet Member for Environment and Conservation**

- 2.1. This report begins to highlight the scale of the waste treatment/disposal contract procurement and the impact that it will have in revenue terms on the Council in the next seven years. This could lead in the near future to an increase in Council Tax beyond the current 3% limit.
- 2.2 The PFI procurement process as preferred by NLWA is prescriptive in its approach with the first stage being the submission of the Outline Business Case (OBC). The selection of the PFI process is premised on its ability to deliver value for money. It is expected that NLWA and the constituent boroughs will receive an estimated £500 million in PFI revenue support over the 30 year contract period. Haringey's proportion of this is estimated at £64 million.
- 2.3 A key requirement of the OBC is for each constituent borough to send an 'affordability letter' to Defra. Whilst this letter is not legally binding it does indicate to Government that this Council is willing to make local financial decisions that are consistent with the scope and scale of this project. In order to meet the deadline for this round (4) of PFI credits the OBC must be submitted to Defra by 31<sup>st</sup> October. The Comprehensive Spending Review 2007 identified that the waste PFI 'Round 4' would be the last available round for the allocation of PFI credits of this type.
- 2.4 The urgency in agreeing to the affordability letter is self evident, however this does not mean that NLWA and the constituent boroughs are wedded to the OBC reference project solution, rather the signing of the affordability letter allows NLWA and the constituent boroughs the opportunity to fully understand the scale of PFI credits the Government is willing to award to support this project. Ultimately, it will be the private sector that will be providing outline technical solutions to meet NLWA's output specification requirements. It is envisaged that the evaluation of these outline solutions will be conducted in the summer of 2009. It is at this point that NLWA and the constituent boroughs will have better understanding of the proposed waste facilities that will actually meet the objectives of North London Joint Waste Strategy (NLJWS).
- 2.5 The proposals set out in this second draft Statement of Principles includes the concept of pooling recycling targets, the delivery of all recyclate materials to NLWA, transferring the responsibility for the provision of Household Waste Recycling Centres to NLWA and the development of a menu pricing mechanism. These outline principals provide a platform from which NLWA and constituent boroughs can work together in a fair and equitable manner to ensure that the overall procurement project delivers value for money and achieves the objectives set out in the NLJWS. All the Statement of Principles will ultimately form the basis from which a detailed Inter Authority Agreement will be produced in December 2010/January 2011.

### **3. Recommendations**

- 3.1 It is recommended that the Cabinet :
- 3.1.1 note the base and upper threshold modelled whole life net nominal cost of waste treatment/disposal and waste collection for Haringey of £299 million and £353 million over the proposed 30 year contract period;
  - 3.1.2 agree to the draft affordability letter (attached as Appendix A);
  - 3.1.3 agree that delegated authority be given to the Leader, Chief Financial Officer and Chief Executive to finalise and sign the affordability letter on behalf of the London Borough of Haringey;
  - 3.1.4 note and agree to the second Statement of Principles (2) (attached as Appendix D), and;
  - 3.1.5 agree that delegated authority be given to Leader of the Council to finalise and sign the Statement of Principles (2) on behalf of the London Borough of Haringey.

Report Authorised by: **Niall Bolger, Director of Urban Environment**

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### **4. Comments of the Chief Financial Officer**

4.1 Members are being asked to agree to the affordability of the NLWA procurement project, in so far as the modelled costs impact on Haringey, for the purposes of the PFI outline business case submission to DEFRA by the end of October deadline.

4.2 There are significant additional costs arising from the investment in the waste disposal infrastructure, which I had raised in previous financial planning reports to Cabinet. The NLWA have now been through an extensive options appraisal exercise to arrive at this reference project and preferred route. The technical solution has been modelled through a PFI project procurement route by the NLWA professional advisers and this has produced a financial outcome as set out in this report.

4.3 The reference project models an affordability gap for Haringey at £299m over the 30 year contract life, including assumptions for inflation. In revenue budget terms this is an increase cost of £5.3m per annum by 2016/17. The potential impact on council tax is set out in the report although clearly members may wish to seek to minimise the impact on the local taxpayer by looking for efficiencies in the relevant financial planning periods.

4.4 The financial model includes assumptions on the planning variables including inflation, risk, income, waste growth and recycling. The model also looks at various sensitivities of these variables and has produced an upper affordability envelope of £353m for Haringey. The potential impact of this on council tax is also set out in the report as this is the upper limit of affordability that Members are being asked to agree.

4.5 The work done by the NLWA shows that the PFI approach offers a value for money solution in comparison to the 'do minimum' option by £400m. A further £500m saving could be achieved with the granting of the PFI grant. Options for using prudential borrowing have also been explored, but are not likely to deliver the same level of saving as the PFI grant.

## **5. Head of Legal Services Comments**

5.1 The Head of Legal Services notes the contents of the report, following on from the earlier report to the Cabinet on 17 June 2008 recommending which secured approval of the Memorandum of Understanding between the NLWA and its constituent boroughs.

5.2 The NLWA is a statutory waste disposal authority with responsibility for disposal of waste for the seven constituent boroughs.

5.3 Under the Council's Constitution (Part 3, Section D 1, (1) (1.1)) the Cabinet has power to approve the recommendations in this report.

5.4 The Cabinet also has power under Part 3, Section D 1 (2.4) of the Constitution to determine that a decision shall be delegated to an individual Cabinet Member for decision.

5.5 The Cabinet has power under Section 15 of the Local Government Act 2000 to delegate matters to officers.

5.6 The proposed procurement is a key decision and as such needs to be included in the Forward Plan. The client department has confirmed that this has been done.

5.7 The Head of Legal Services notes that prudential borrowing has been considered as a possible future solution. In this event, compliance with the Prudential Code produced by CIPFA will be required.

5.8 NLWA will be conducting the procurement strategy and will be required to comply with the Public Contracts Regulations 2006 and other relevant legislation.

5.9 The NLWA has liaised with the Legal Services departments of all the constituent

boroughs in the proposed procurement process. In respect of the future Inter Authority Arrangement between the participating Councils and the NLWA, which will be contractually binding, further legal advice will need to be sought .

5.10 The Head of Legal Services confirms that there is no legal reason preventing Members from approving the recommendations in this report.

## **6. Local Government (Access to Information) Act, 1985**

### **Background Documents**

North London Joint Waste Strategy, SEA draft May 2008.

Cabinet Report, Memorandum of Understanding, 17<sup>th</sup> June 2008.

Cabinet Report, North London Joint Waste Strategy and SEA Public Consultation.

North London Waste Authority, Waste Services Procurement: Affordability, 26<sup>th</sup> September 2008.

This report contains exempt information and is not for publication.

The exempt information is under the following category (identified in the amended Schedule 12A of the Local Government Act 1972)

(3) information relating to the financial or business affairs of any person (including the authority holding that information).

## **7. Strategic Implications**

### **Affordability Envelope**

- 7.1 At its meeting on 15<sup>th</sup> July 2008 the Cabinet agreed the adoption of the North London Joint Waste Strategy (NLJWS). The strategy which is in the process of being adopted by NLWA and the seven constituent boroughs sets out a framework of how collectively these authorities will meet European and National statutory performance standards. In order to achieve these standards the constituent authorities have within the NLJWS committed themselves to meet the following recycling targets: 35% by 2010; 45% by 2015; 50% by 2020. At present the 7 North London Boroughs achieve between 25% and 30% recycling, with an average of 27% across the sub-region.
- 7.2 In order to provide a technical solution to meet these new recycling targets and reduce the amount of waste that is sent to landfill, NLWA initially completed, within the development of the NLJWS, a Strategic Environmental Assessment (SEA) of five possible technical solutions. Based on the results of this assessment further detailed in depth analysis was undertaken by technical advisors to identify a complete treatment and disposal solution that would act as a reference project.
- 7.3 NLWA's current waste disposal contract will end in 2014; therefore the procurement of the new 30 year (2012 – 2042) waste treatment and disposal contract will be key in order to deliver NLJWS objectives. NLWA has examined the possible ways forward and concluded that it should procure a contract solution involving new build

and risk transfer to the private sector on key Design, Build, Finance and Operate issues. On value for money and affordability grounds the NLWA is currently anticipating pursuing the long term contract utilising the Private Finance Initiative (PFI). For further details refer to NLWA's procurement strategy attached as Appendix B.

- 7.4 It is estimated that pursuing a Private Finance Initiative (PFI) approach will result in a 9% reduction in risk adjusted Net Present Cost when compared to a traditional public sector procurement. However, in coming to this decision NLWA did analyse the potential benefits of financing the project through the prudential borrowing route. NLWA's external financial advisors concluded that the potential saving on interest rates that might be made from prudential borrowing would be more than offset by the likely additional revenue support that would flow to the Authority from a PFI credit award. If NLWA is successful the award is likely to be worth between £500 million and £600 million in nominal terms over the life of the contract, funding 50% of the eligible capital expenditure.
- 7.5 However, if the market response does not match the value for money analysis that has been modelled, other options including the use of prudential borrowing would inevitably need to be considered.
- 7.6 Within the PFI process one of the first key tasks is the submission of an Outline Business Case (OBC) to Defra. In order to potentially benefit from £500 million - £600 million PFI credits NLWA will need to submit its OBC by 31<sup>st</sup> October 2008. As part of the OBC submission NLWA is required to:
- compare the costs of the 'do minimum' scenario with the 'reference project' solution;
  - calculate the affordability gap for both waste treatment/disposal and collection costs for NLWA and the constituent boroughs;
  - complete cost sensitivity analysis on the reference project which will provide an upper limit project cost; and
  - present an affordability letter from NLWA and the seven constituent authorities which sets out the base and upper limit costs (affordability envelope). This letter will give reassurance to the Government that NLWA and the constituent boroughs are prepared to make local financing decisions that are consistent with the scope and scale of the project.
- 7.7 NLWA formally agreed, at its meeting on 26<sup>th</sup> September 2008, for their Chair, Clerk and Finance Advisor to sign their affordability letter, which encompasses the total affordability gap for both waste treatment/disposal and waste collection costs across the seven constituent boroughs. The affordability gap ranges from a base cost of £2,487 million to an upper threshold cost of £2,889 million.

### **Draft Statement of Principles (2)**

- 7.8 At its meeting of meeting of 17<sup>th</sup> June 2008, the Cabinet agreed to delegate authority to the Leader of the Council to sign a Memorandum of Understanding (MOU) on behalf of the London Borough of Haringey. This was duly signed by the Leader on 30<sup>th</sup> July 2008 and sent to the North London Waste Authority (NLWA). As required all seven constituent boroughs and the NLWA agreed and signed the MOU

and the first statement of principle the intention to enter a Deed of Confidentiality. For information the MOU is attached to this report as Appendix E.

- 7.9 The purpose of the MOU is to set a framework of high level principles (not legally binding) to provide a strategic platform on how the seven constituent boroughs and NLWA will work together to procure a future waste treatment and disposal contract that will achieve the common goals as set out in North London Joint Waste Strategy. The MOU and the subsequent draft Statements of principle will lead to the development of an Inter Authority Agreement (IAA) which will be legally binding. It is expected that the IAA will be presented to the Cabinet in December 2010/January 2011 for consideration, following NLWA finalising contract documents and completing financial closure.
- 7.10 The MOU will evolve over time as it leads to the development of an IAA and such changes will be recorded as a Statement of Principle. The process is set out in section 5 of the MOU. This report considers the adoption of the second draft Statement of Principle (attached as Appendix D) whereby 19 overarching principles are specified. The majority of draft Statements refer to the boroughs and NLWA working together in a fair, equitable and transparent manner; however Members are directed to the following four areas of principle that may result, if agreed at a later date via the IAA, to changes in how the Council currently operates. The proposed principles are :
- To transfer the duty to provide Household Reuse and Recycling Centres from the Council to NLWA.
  - To consider the potential impact of pooling recycling targets.
  - To consider providing to NLWA all recyclate materials collected and for NLWA to arrange for the sale of these materials; and
  - To review how the Council operates its waste collection services. This review waste collection services will be undertaken as part of the development and procurement of the new integrated waste management contract, which is due to commence in April 2011.

## **8.0 Financial Implications**

- 8.1 The financial implications will address all the OBC requirements as set out in paragraph 7.5.
- 8.2 'Do minimum' versus 'Reference Project' solution
- 8.3 NLWA is required to undertake a cost comparison between a 'do minimum' scenario and 'reference project' solution. The 'do minimum' scenario would assume that the constituent councils would meet their respective recycling targets as set out in the NLJWS but all residual waste would be landfilled. The 'reference project' anticipates a residual waste solution that includes Mechanical Biological Treatment (MBT) which will produce a Solid Recovered Fuel (SRF) and a biological solution utilising Anaerobic Digestion (AD).
- 8.4 A comparison of the costs associated with each model was established and is outlined in Table 1 below:

Table 1 - Comparison of 'Do Minimum' and 'Reference Project' Modelled Costs

	'Do Minimum' £m	'Reference Project' £m	Difference £m
PFI Project Costs	0	2,739	(2,739)
Additional System Costs	1,455	560	895
Landfill Costs (gate fee and tax)	2,079	373	1,706
Collection Costs	4,284	4,152	132
LATS (permits)	409	0	409
<b>Total Nominal Costs</b>	<b>8,227</b>	<b>7,824</b>	<b>403</b>
Less PFI Credit	0	(501)	501
<b>Total Net Nominal Costs</b>	<b>8,227</b>	<b>7,323</b>	<b>904</b>

- 8.5 The reference project total costs are £403 million pounds cheaper than a 'do minimum' even if the conservative position is adopted with the sale of surplus Landfill Allowance Trading Scheme (LATs) permits assumed to have nil value. This figure is further increased to £904 million cheaper than 'do minimum' after the taking into account the benefit to the constituent boroughs of the PFI Revenue Support Grant. The total cost for Haringey of the reference project is £1,022m before taking into account existing budgets.
- 8.6 Affordability Gap Analysis
- 8.7 The inevitable conclusion is that the NLWA should 'do something' rather than to 'do the minimum'. Therefore using the modelled reference project costs NLWA Technical (AEA Technology Limited) and Financial (Ernst & Young) advisors calculated the affordability gap profile for each constituent borough over the 30 year contract period (2012 – 2042). As part of the PFI requirements, Defra when considering OBC submissions, want the total waste affordability gap to include the cost of waste collection.
- 8.8 Table 2 below identifies the affordability gap for each the constituent boroughs when considering both waste treatment/disposal and waste collection costs.



Table 2 – Affordability Gap Analysis

Cost (Nominal)	Barnet £m	Camden £m	Enfield £m	Hackney £m	<b>Haringey £m</b>	Islington £m	Waltham Forest £m	Total £m
<b>NLWA Disposal</b>								
PFI Contract	560	274	495	342	<b>369</b>	289	410	2,739
Additional Systems	181	116	156	123	<b>121</b>	106	130	933
PFI Revenue Support	(93)	(72)	(77)	(65)	<b>(64)</b>	(62)	(68)	(501)
Net Costs	647	318	574	400	<b>426</b>	333	473	3,171
(Disposal Budgets)	(374)	(246)	(300)	(261)	<b>(263)</b>	(265)	(235)	(1,944)
Affordability Gap	274	72	274	139	<b>163</b>	68	237	1,227
<b>Borough Collection</b>								
Collection Costs	744	593	472	653	<b>596</b>	651	443	4,152
(Collection Budgets)	(463)	(389)	(325)	(467)	<b>(460)</b>	(438)	(350)	(2,892)
Collection Affordability Gap	281	204	147	186	<b>136</b>	213	93	1,260
<b>Total Affordability Gap</b>								
	555	276	421	325	<b>299</b>	281	330	2,487

8.9 In summary the model has identified a £2.487 billion affordability gap (from 2012 to 2042) by taking into account the existing borough budgets and the potential benefit of PFI credit support. These costs have been allocated to constituent boroughs on an apportionment basis linked to total municipal waste arisings. The modelling process does not take into account any menu pricing system or other recharge methods that might be developed under an Inter Authority Agreement.

8.10 The model estimates an affordability gap for Haringey Council, over the 30 years of the contract (from 2012 to 2042) of £299 million. This gap is made up of two parts the estimated additional funding of £136 million for collection of waste and £163 million for treatment and disposal. Further detailed analysis on the profile of additional costs for disposal/treatment and waste collection is set out in paragraph 12.7.

#### 8.11 Sensitivity Analysis

8.12 In order to begin to quantify potential risks to the affordability gap modelling results, sensitivity analysis has been undertaken on the future disposal/treatment costs. It is considered that the affordability gap associated with waste collection costs should remain the risk of constituent councils to manage. The details of the sensitivities identified are outlined in paragraph 12.9. The results of the sensitivity analysis are shown in whole life nominal terms in Table 3 below.

Table 3 - Sensitivity Analysis Costs

Cost (Nominal)	Barnet £m	Camden £m	Enfield £m	Hackney £m	<b>Haringey £m</b>	Islington £m	Waltham Forest £m	Total £m
<b>NLWA Disposal</b>								
PFI Contract	642	315	568	392	<b>423</b>	331	470	3,141
Additional Systems	181	116	156	123	<b>121</b>	106	130	933
PFI Revenue Support	(93)	(72)	(77)	(65)	<b>(64)</b>	(62)	(68)	(501)
Net Costs	730	359	647	450	<b>480</b>	375	532	3,573
(Disposal Budgets)	(374)	(246)	(300)	(261)	<b>(263)</b>	(265)	(235)	(1,944)
Affordability Gap	356	113	347	189	<b>217</b>	110	297	1,629
<b>Borough Collection</b>								
Collection Costs	744	593	472	653	<b>596</b>	651	443	4,152
(Collection Budgets)	(463)	(389)	(325)	(467)	<b>(460)</b>	(438)	(350)	(2,892)
Collection Affordability Gap	281	204	147	186	<b>136</b>	213	93	1,260
<b>Total Affordability Gap</b>								
	637	317	494	375	<b>353</b>	323	390	2,889

8.13 The total cost for Haringey before existing budgets of this upper limit is £1,076m. The final cost envelope that affordability letter for Haringey Council supports is shown in bold in Table 4 below:

Table 4 – Affordability Envelope

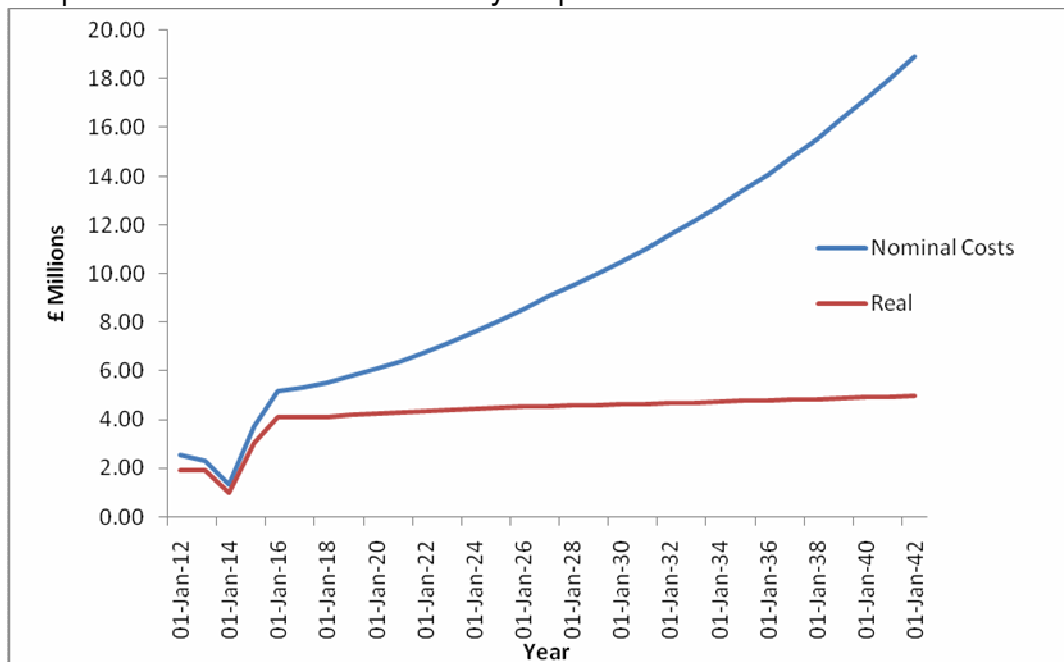
Borough	Nominal Cost	
	Base Case £m	Upper Threshold £m
Barnet	555	637
Camden	276	317
Enfield	421	494
Hackney	325	375
<b>Haringey</b>	<b>299</b>	<b>353</b>
Islington	281	323
Waltham Forest	330	390
<b>Total</b>	<b>2,487</b>	<b>2,889</b>

8.14 The Cabinet is recommended to approve the level of financial support required to meet the affordability implications of the project within the envelope shown in Table 5. The affordability gap cost start from the estimated base total of £299 million and rising to £353 million after applying sensitivity analysis. It is this envelope of cost that the affordability letter attached as Appendix A supports.

8.15 Impact on revenue budget/council tax

8.16 The profile of the total affordability gap over the 30 year period of the contract is shown in Graph 1 below:

Graph 1 – Total Waste Affordability Gap



8.17 In real terms the overall annual increase in the modelled total net affordability gap from 2012 (£1.91 million) to 2042 (£4.97 million) is £3.06 million. When taking into account the modelled inflation rates as applied to the waste treatment/disposal and waste collection costs this gap increases from £2.55 million (2012) to £18.93 million (2042). The reasons for the increase in real term costs are detailed in paragraph 12.7.

8.18 In terms of impact on the Council’s revenue budget, the full year affordability gap will be broadly reached in 2016/17. The impact of this is estimated by the model to be £5.33m per annum additional net cost (after allowing for a share of the PFI grant of £2.35m).

8.19 For the reference project modelled at an affordability gap of £299m for Haringey, the impact of the full year cost of £5.33m pa would be a 5.4% increase in the council tax if funded this way. This can be analysed as follows:

Affordability gap	Net revenue cost p.a.	Council tax increase
Disposal (NLWA levy)	£4.357	4.4%
Collection (council direct)	£0.96m	1.0%
<b>Sub-total reference project</b>	<b>£5.33m</b>	<b>5.4%</b>
Upper limit sensitivity (£353m)	£0.99m	1.0%
<b>Total upper limit</b>	<b>£6.32m</b>	<b>6.4%</b>

- 8.20 A number of assumptions have been made in the model produced by Ernst and Young on the disposal and collection costs. The risks and sensitivities around these assumptions are outlined in paragraph 12.9. The sensitivity with the highest impact would be long term inflation 1% higher than modelled (2.5%). This would add around £400m to the cost in total and £54m to the Haringey contribution making an upper limit of £353m, approximately another **1.0%** on the council tax. The maximum impact is therefore a council tax increase of **6.4%**. Authorities are being asked to sign up to this level of affordability. It should be noted, however, that inflation would be a risk even if the NLWA went for the 'do minimum' option.
- 8.21 The OBC also includes projected collection costs, as per the DEFRA guidelines, however, these costs will be totally within each borough's control and will not form part of the PFI contract or the NLWA levy. Therefore if collection costs were maintained at the same level by Haringey this would save **1.0%** on the council tax as per the table above.
- 8.22 Members will have the flexibility to decide how the council tax increases could be implemented if necessary, including increasing them earlier than 2016 and paying sums into a sinking fund. This will also allow increases to be phased in smaller stepped increases or balances to be used to fund the longer term smaller increase once the capital investment is complete. Examples of the different phasing are shown in Appendix F. A front loaded smoothing from 2011/12 would generate spare one-off funds, whereas back loaded increases would require use of reserves to fund expenditure shortfalls in year. Assuming the current council tax strategy of a 3% increase then it would be recommended to increase no more than a further 2% in any one year in order to stay below current capping levels.
- 8.23 NLWA will be looking to reduce the affordability gap by ensuring the procurement of the treatment and disposal contract attracts a level of competition which will result in competitive bids. NLWA has agreed at its meeting on 26<sup>th</sup> September to undertake a programme of work that would be carried out in parallel to the procurement process which is designed to identify 18 areas where the NLWA can over-achieve against currently modelled costs or income. The 18 possible work streams are attached as Appendix C.

## **9. Legal Implications**

- 9.1 The legal implications are outlined in section 5 above.

## **10 Equalities**

- 10.1 There are no specific equalities issues arising from this report.

## **11. Consultation**

- 11.1 The affordability letter was circulated to the constituent boroughs' Directors of Finance (DoFs). The final draft of the letter has been agreed by NLWA and the seven constituent authorities' DoFs.

## 12. Background

12.1 The background information is set out to support the financial implication comments in the same order that it appears within Section 8; 'do minimum' versus 'reference project', affordability gap analysis (waste treatment/disposal and waste collection) and waste treatment/disposal sensitivity analysis.

12.2 'Do Minimum' versus 'Reference Project'

12.3 As noted in paragraph 7.2, NLWA has undertaken detailed analysis of possible technical solutions to develop a reference project. This is required by Defra as part of the PFI process. The facilities that form part of this reference project are:

- 5 new/replacement Household Waste Recycling Centres & works at others (£31.0m incl. £10.3m land)
- 2 X 70k/t/pa Materials Recycling Facilities (£36.7m incl. £11.7m land)
- 30k/t/pa Green Waste composting capacity (nil capex cost)
- 1 X 145k/t/pa Anaerobic Digestion (AD) plant (£50.5m incl. £19.4m land)
- 2 X Mechanical Biological Treatment (MBT)/AD plants – 250k & 350k (£244.5m incl. £33m land)
- 1 X 300k Fuel Use facility (215.1m incl. £8.8m land)
- Rail Transfer Station (£18.7m, no land)
- Total capex £596.5m of which £83.2m is land

12.4 In identifying this reference project NLWA undertook a wide ranging review of possible technical solutions and their potential costs. There was one possible approach that was cheaper than that which is proposed, involving building traditional incineration capacity to receive untreated residual waste as opposed to MBT/ AD creating a stabilised fuel and building a fuel use facility for that fuel. In theory the incineration solution would be cheaper if the facilities were to receive planning permission and be built in a relatively short period of time. If delivery was delayed by a further 3 years, the traditional incineration solution was no longer cheaper and if it was delayed still further it would be more expensive. The NLWA considered that the incineration solution was a poor reference project because it had poor delivery prospects. There has been no subsequent indication that any North London Borough believes that it has a site where such a facility could be located with good prospects of receiving a prompt planning permission.

12.5 However, the reference project does not preclude prospective bidders using the traditional incineration route and it is estimated this could reduce costs by £300m when compared to the reference project.

12.6 Aside from being cheaper, the NLWA's reference project has other benefits over the 'do minimum' option. It provides:

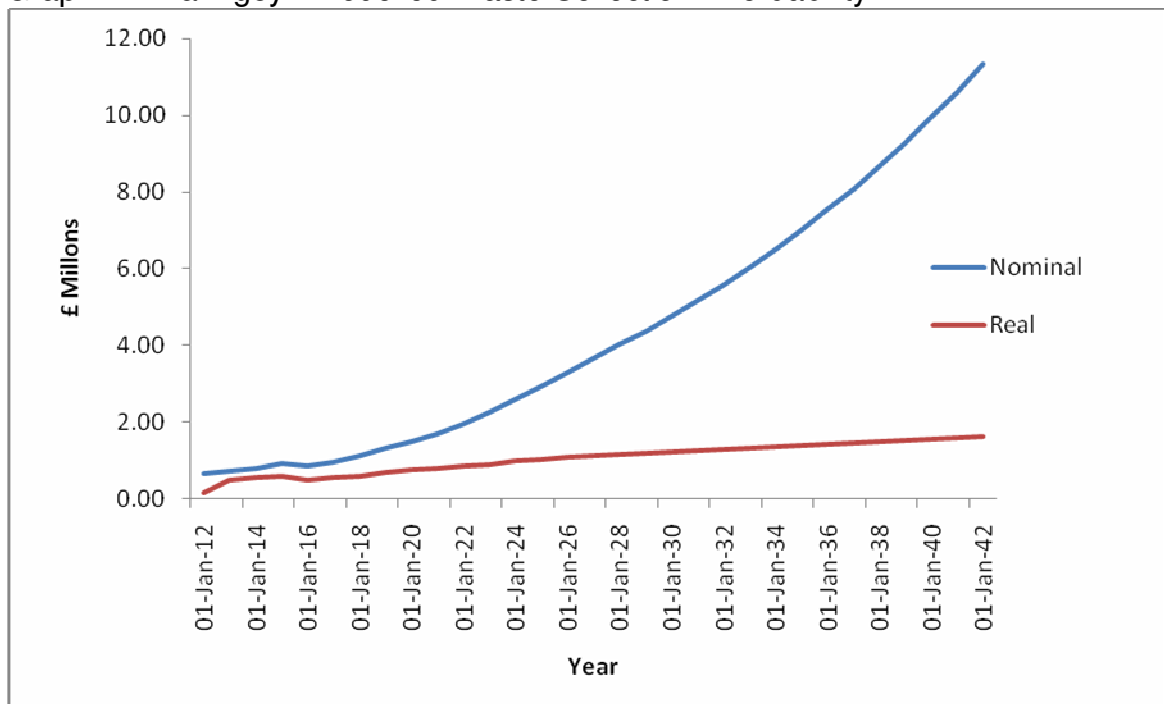
- opportunities to over-achieve against the prudent estimates that have been used. For example, the heat that would be provided to the energy user is assumed to have nil value. However, in reality providing heat should have a commercial value which should provide a beneficial income stream to the NLWA;
- a legacy in the form of assets that has been funded under the procurement and which will generally return to the NLWA at the end of the contract period. This will include sites and some facilities that will have been well maintained and which have a life well beyond the contract period;
- better services, including a much better environmental performance, rather than in payments for landfill services, landfill tax and in buying surplus LATs allowances from other local authorities; and
- a transfer of key risks associated with performance to the private sector, which will result in North London authorities being less exposed to market and supply risks.

## 12.7 Affordability Gap Analysis

### 12.7.1 Projected Waste Collection Costs

12.7.2 The modelled projected affordability gap for waste collection over the 30 year contract period is depicted in Graph 2 below.

Graph 2 – Haringey - Modelled Waste Collection Affordability



12.7.3 The real cost of waste collection remains relatively stable increasing by an estimated £1.5 million over the 30 year contract period. This additional cost within the model can be attributed to a number of factors, including:

- the estimated increase in the number of households within the Borough (using GLA data);
- the model assumes that the Borough will increase its recycling rate from the base position in 2011/12 of 35% to a 50% recycling rate by 2020. The model then estimates the costs of collecting this additional tonnage and profiles the cost over the 30 year contract period;
- the additional tonnage associated with the assumed waste growth of 1% up to 2015, which is reduced to 0.5% thereafter to the end of the contract in 2042; and
- the introduction of a education/enforcement/incentive budget to ensure high levels of recycling participation and capture.

12.7.4 The collection cost model also makes a number of assumptions which include:

- That the collection and disposal costs of trade waste are passed onto customers with no net benefit to the collection authority.
- That high participation and capture rates will be achieved to meet the 45% and 50% recycling targets in 2015 and 2020 respectively.
- That the current waste collection systems remain as the status quo. It therefore does not account for any potential savings that may be achieved in the future procurement of waste collection costs following the integration of residual and recycling operations. The new contract is planned to commence from April 2011.
- That those collection authorities that have decided to focus on providing incentives to increase recycling participation do not introduce compulsory recycling.
- That no additional cost benefits relating to the possible introduction of a ban on the collection of side waste and or the introduction of an alternate weekly collection service have been modelled.
- That the housing mix within the borough remains constant throughout the 30 year contract period.
- That there is no rationalisation of collection services across the constituent boroughs resulting in savings through economies of scale.

12.7.5 In terms of nominal cost the waste collection affordability gap will increase from £0.65 million (2012) per annum to £11.33 million per annum, producing an estimated overall affordability gap of £10.68 million. This increase is mainly due to the impact of inflation with rates of 2.5% for non labour and 4.25% for labour being assumed. The model further weights these inflation rates with a 46% labour and 54% non labour split.

12.7.6 NLWA will be refining the waste collection costs for each of the constituent boroughs prior to the final OBC submission. It is expected that final modelled costs with its overall impact on affordability will be made available by 20<sup>th</sup> October 2008. However, the significance of any reduction or increase in real terms will be relatively

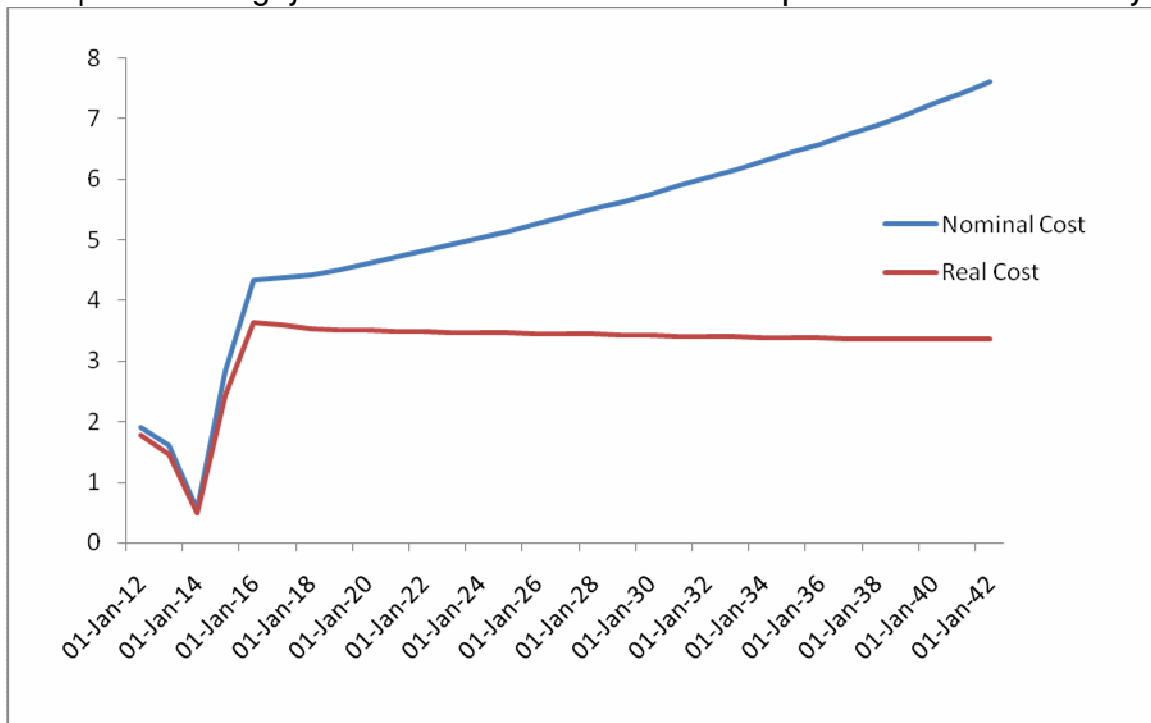
small and the overall nominal affordability gap for the project is likely to remain within the upper threshold (£359 million) limits.

12.7.7 The risks associated with the funding of the waste collection costs will remain and be managed by the individual constituent boroughs. This risk will be assessed further as more accurate estimates of waste collection costs will be forthcoming with the advent of further more complex modelling. In reality any additional cost will be accounted for within the budget setting process.

12.7.8 Projected Waste Treatment & Disposal Cost

12.7.9 The modelled projected affordability gap cost of waste treatment and disposal over the 30 year contract period is depicted in Graph 3 below.

Graph 3 – Haringey Modelled Waste Treatment & Disposal Costs - Affordability Gap



12.7.10 In real terms the major increase in costs occurs from the start of the new contract in 2014 culminating in the maximum net affordability gap of £3.64 in 2016. There after the gap flat lines, remaining relatively constant at the same value until the end of the contract in 2042. In nominal terms the affordability gap increases from £1.9 million in 2012 to £7.6 million in 2042.

12.7.11 The waste disposal costs have been calculated in accordance with Government guidance. This includes highly prudent assumptions including a nil value assumption on surplus LATS allowances and a nil value for heat used in a Combined Heat & Power solution. NLWA suggest that a high level of confidence can be applied to these treatment/disposal cost due to their knowledge of recent similar procurements within the industry.



12.7.12 A number of assumptions have been made with respect to the waste treatment/disposal model, these include:

- Waste growth is reduced from 2016 from 1% per annum to 0.5% per annum.
- The cost of processing commercial waste tonnage has been made cost neutral with the assumption that the full cost of treating and disposing of commercial waste is recovered by boroughs from commercial waste customers.
- A cash receipt is assumed to arise from the sale of the Authority's shareholding in LondonWaste Limited. This revenue is offset against prudential borrowing costs associated with land acquisition for the project.
- It assumed that Materials Recycling Facilities, Anaerobic Digestion and rail transport infrastructure will qualify for PFI revenue support.

## 12.8 Sensitivity Analysis

12.9 In order to begin to address possible risk to the assumptions made within the model, sensitivity analysis has been completed on the treatment and disposal costs. The following sensitivities were identified and applied to the model to determine an upper limit for the cost of delivering the reference project:

- Construction cost risk: Construction cost inflation is assumed to be 10% per annum, 5% per annum higher than that assumed in the base case.
- Operating cost risk: The annual operating costs underpinning the PFI contract are assumed to be 5% higher than that assumed in the base case.
- Third party income risk: Third party income is assumed to be 10% lower than that assumed in the base case.
- Cost of delay: A one year delay in the PFI facilities becoming operational has been modelled.
- Waste growth risk: Waste growth of 1% per annum has been assumed throughout the contract period.
- Recycling rate risk: Recycling rates achieved in each contract year are assumed to be 5 percentage points below that assumed in the base case, resulting in higher residual treatment costs.
- Risks surrounding PFI support: This sensitivity examines the cost to the Authority in the event that the 'front end' MRF, AD and transport infrastructure fails to secure PFI support.
- Inflation risks: This sensitivity assumes that long term general inflation of 3.5% per annum applies to the Authority's costs and PFI contract payment obligations, rather than the 2.5% per annum assumed in the base case.

## 13. Conclusion

13.1 The affordability envelope of £299 million and £359 million represents the best estimate, with the information available to date, of Haringey's total modelled nominal whole life affordability gap for both waste treatment/disposal and waste collection costs. However, a number of prudent assumptions have been made within the model and these costs will be subject to continuing review. It is anticipated that the actual costs will become evident following the final evaluation of detailed solution bids in the August/September 2010. On this basis and given the

opportunity to secure substantial revenue support through PFI credits it is recommended that the Cabinet agree to send the draft affordability letter attached as Appendix A.

**14. Use of Appendices**

Appendix A - Affordability Envelope

Appendix B - Procurement Strategy

Appendix C – NLWA Work Programme

Appendix D – Draft Statement of Principles (2)

Appendix E – Memorandum of Understanding

Appendix F - Financing Affordability Gap – indicative council tax modelling