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Annex 4

Resource Implications

Value for Money

1. Key considerations in delivering value for money (VfM) include:
    a. developing a competitive procurement process through which both quality and cost are used for evaluation purposes, which maintains competitive pressure;

    b. developing a robust business case; and

    c. determining an affordable contract price.

2. Securing competitive tension in any procurement process is fundamental in demonstrating and delivering VfM. Initially eight organisations submitted outline solutions, four organisations submitted detailed solutions, and this was reduced to two organisations that were asked to submit refined solutions. Urbaser Balfour Beatty (UBB) was selected as preferred bidder on the basis of them submitting the Most Economically Advantageous Tender (MEAT) as determined in accordance with the council's evaluation methodology. The contract which is being proposed closely follows Standardisation of PFI Contracts version 4 (SoPC4) and as such represents a reasonable allocation of risk between the council and the contractor. On this basis the procurement has been able to demonstrate that it has been carried out in a manner likely to deliver VfM.

3. In addition to the evaluation of final tenders submitted, for completeness, an assessment was also undertaken comparing the final tender submitted against the continuing cost to dispose of residual waste by way of landfill. This assessment included all costs associated with the treatment solution and continuing to landfill waste, including the cost of landfill, landfill tax, haulage and transfer.

4. In assessing the financial position, a number of key assumptions have been made:
    a. The new residual waste contract has been modelled by UBB based on the financial assumptions at final tender.

    b. It has also been modelled to show the impact of a £13 million contribution by the council.

    c. Debt funding terms have been updated to reflect the changes which have occurred since the final tender, in particular those affecting swap rates (positively) and margins (negatively).

    d. Income from electricity is based on published Ofgem forecasts (Green Transition).

5. Table 1 below provides a comparison between the continuing cost of landfill with the updated residual waste contract in circumstances where no contribution is made, and one with a contribution from the council of £13 million.

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Table 1: Comparison of continuing to landfill and project cost

£'000	Continuing to landfill	Project cost No contribution	Project cost £13m contribution
Unitary Charge	[redacted]	[redacted]	[redacted]
Non-PFI/landfill costs	[redacted]	[redacted]	[redacted]
Landfill costs	[redacted]	[redacted]	[redacted]
£13m contribution	[redacted]	[redacted]	[redacted]
Total costs (nominal)	[redacted]	[redacted]	[redacted]
Total costs (NPV)	[redacted]	[redacted]	[redacted]
Forecast saving (NPV)	[redacted]	[redacted]	[redacted]

6. In Net Present Value (NPV) terms the potential savings from the project compared with a scenario that seeks to rely on long term landfill as a disposal option is [redacted], based on a fully project financed solution. A contribution of £13 million by the council into the project at the service commencement date results in an estimated cost saving of [redacted], an additional saving of [redacted], in NPV terms, when comparing continuing to landfill and project cost.

7. There is an additional benefit to the council of using electricity generated by the project to supply its own infrastructure (rather than electricity being supplied to the electricity market under the 'base case' project assumptions). This is due to the saving achieved by the council by supplying its own electricity at cost, rather than buying it at a discounted market price. A further saving of £[redacted] in NPV terms is estimated resulting in a total cost saving between the continuing to landfill option and the project cost of £[redacted] (project financed solution) or [redacted] (with contribution) as outlined in table 2.

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Table 2: Comparison of continuing to landfill and project cost with council electricity saving

£'000	Continue to landfill	Project cost no contribution	Project cost £13m contribution
Total costs (NPV)	[redacted]	[redacted]	[redacted]
Projected council electricity cost saving (NPV)	[redacted]	[redacted]	[redacted]
Total costs net of the council's electricity cost saving (NPV)	[redacted]	[redacted]	[redacted]
Forecast saving (NPV)	[redacted]	[redacted]	[redacted]

Sensitivities

8. With any long term projection and despite careful consideration, a degree of uncertainty will remain. To help assess how changes in the council's assumptions might impact on the financial analysis a number of sensitivities were performed. Sensitivities were carried out on the 'base case' project assumptions (i.e. £13 million contribution and Ofgem Green Transition electricity prices). These were:

    a. Waste tonnages

    b. Electricity income

    c. Planning delay

Waste tonnages

9. Waste tonnages were modelled to provide a projection should waste flows vary significantly from the base case waste flows assumed. The sensitivities used were:

    a. High waste flow projection - 55% recycling achieved by 2020.

    b. Low waste flow projection - 60% to 70% recycling. The assumption that 60% recycling would be achieved by 2020 and 70% by 2030 and waste growth of 0.8% between 2029 and 2040.

10. The sensitivity analysis as outlined in table 3 indicates that the project still demonstrates VfM under the high and low waste flow projections with the project having a lower estimated NPV when compared to a landfill based solution. The increase in the NPV benefit as the tonnage gets higher is due to the average disposal cost per tonne reducing under the project whereas it remains the same under the continue to landfill option.

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Table 3: Waste flow sensitivities

£'000	Base case	High waste flow projection	Low waste flow projection
Continue to landfill	[redacted]	[redacted]	[redacted]
Project cost (£13m contribution) (NPV)	[redacted]	[redacted]	[redacted]
Forecast saving (NPV)	[redacted]	[redacted]	[redacted]

Electricity

11. Electricity income was tested using the following price sensitivities compared to the base case assumption based on the Ofgem Green Transition price curve. The Ofgem price curves are based on scenarios projecting differing prospects for the energy market scenarios over a fifteen year period. More detail can be found on the Ofgem website[1]. The options used were:

    a. Ofgem Green Stimulus - There is a slow recovery from the recession and restricted availability of finance. Governments around the world implement green stimulus packages to achieve environmental goals and boost economic activities. High carbon prices and government policies support investment in renewables, nuclear and carbon capture and storage. The effect on domestic consumer bills is an increase of 14% by 2020.

    b. Ofgem Dash for Energy - Global economies bounce back strongly but security of supply concerns prevail over meeting environmental targets. As a result GB renewables targets and the government's carbon budgets are missed. Competition between countries for energy resources results in tight gas supplies and high fuel prices. Planning and supply chain constraints prevent new nuclear plant from becoming operational before 2020. The effect on domestic consumer bills is an increase of more than 60% by 2016 before falling back.

    c. £40/MWh in real terms i.e. no increase in electricity prices.

[1] http://www.ofgem.gov.uk/Media/PressRel/Documents1/Ofgem%20-%20Discovery%20-%20PR8%20(2).pdf

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Table 4: Electricity price sensitivities

£'000	Base case - Ofgem Green Transition	Ofgem Green Stimulus	Ofgem Dash for Energy	£40/MWh
Continue to landfill	[redacted]	[redacted]	[redacted]	[redacted]
Project cost (£13m contribution) (NPV)	[redacted]	[redacted]	[redacted]	[redacted]
Forecast saving (NPV)	[redacted]	[redacted]	[redacted]	[redacted]

12. The sensitivity analysis indicates that the project still demonstrates VfM under the high and low Ofgem electricity projections as well as the downside scenario of electricity prices remaining at £40/MWh (subject to inflation).

Planning delay

13. A planning delay scenario has been undertaken where there is an assumed 12 month delay in planning determination and as a result a 2% increase in the capital cost. The estimated impact on the project NPV is an increase of £[redacted], however despite this increase the project remains VfM when compared with the continue to landfill option, as shown in Table 5.

Table 5 Planning delay

£'000	Base case	1 year planning delay
Continue to landfill	[redacted]	[redacted]
Project cost (£13m contribution) (NPV)	[redacted]	[redacted]
Forecast saving (NPV)	[redacted]	[redacted]

14. The sensitivity assessment demonstrates that taking into account the potential downside risks associated with each scenario, the contract with UBB still demonstrates the potential to deliver VfM.

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15. It is currently planned that the contract prices will be fixed in sterling at the time of close. This is however, based on achieving planning permission towards the end of this year. Given the uncertainties over the timing of planning approval, however, this will be reviewed closer to the time of financial close and advice will be sought from the project's financial advisers, Ernst and Young LLP, as to the foreign exchange management strategy that provides least risk to the council. Consequently this may require the foreign exchange contracts to be committed to by UBB on a date following financial close.

16. In the event of planning refusal the bidder would appeal. The contract identifies that the cost of appeal is a shared risk with the bidder funding the first £[redacted] and the council liable for [redacted]% of the costs above this sum. Given experiences elsewhere, these are estimated at £[redacted]k.

Other commercial and financial issues

Consequences of termination due to inability to obtain planning

17. If planning is ultimately unsuccessful and the contract is terminated, the council would be liable to pay a capped sum in compensation as outlined in table 6 below. However for contract termination to occur UBB and the council would both have to conclude that there was no reasonable prospect of success in obtaining planning permission. UBB would also be required to demonstrate that it has used all reasonable endeavours (a defined legal concept) to obtain planning permission. This does not take into account the breaking of interest rate swaps or foreign exchange contracts, the result of which could either increase or decrease the liability depending on economic conditions at the time.

Table 6: Costs in the event of planning failure

Cost element	£ million
Base senior debt termination amount	[redacted]
Sub-contractor breakage costs & redundancy	[redacted]
Total	[redacted]

Site access road

[redacted] The council is opposing the inclusion of such a compensation event in the contract but in the event that it has to concede on this point, it is felt that the risk of [redacted]

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[redacted]

Affordability

19. When considering the affordability of the project the council compared the existing forecast budget position as represented in the Medium Term Financial Strategy (MTFS) with the forecast cost of the new contract and associated disposal services, in particular looking at the transition between the two contracts.

20. [redacted]

21. The affordability of the project in the first four years from 1 April 2015 compared with the MTFS (adjusted for non-project and non-landfill costs) is set out in table 7 below.

Table 7: Affordability

Nominal £'000s	13/14	14/15	15/16	16/17	17/18	18/19
Project cost (£13m contribution)	[redacted]					
Adjusted MTFS						
Continue to landfill (proxy for MTFS post 2015/16)						
Forecast saving						

22. The affordability analysis indicates that the project cost in the first year compared with the current MTFS for that year (2015/16), based on the assumptions modelled, is affordable. By using the 'continue to landfill' cost as a proxy for the MTFS beyond 2015/16, the analysis indicates that the project will remain affordable in the early years of the project. The degree of cost reduction projected under the project is however subject to electricity price movements and a significant reduction in the price could make the project less affordable. As previously outlined a planning delay increases project cost, which would also have an impact on affordability in the early years however over the life of the project the analysis in table 5 demonstrates VfM.

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23. There is a further financial benefit to the council of using some of the electricity from the project for its own consumption using a 'netting off arrangement'. We have modelled a scenario which assumes that [redacted]% of the total electricity produced is consumed by the council. This represents approximately half of the current consumption of electricity by the council, i.e. excluding schools who have delegated budgets. On this basis it has been estimated that such an arrangement could bring the council an additional income of £[redacted] million (nominal) over the life of the contract. That said because such a construct is relatively novel we have futher discounted it by [redacted]% to account for uncertainty giving a prudent expected value of this additional income of £[redacted] million (nominal), which gives even greater affordability against the MTFS.

24. The project will be funded by a consortium of banks; each bank will make an equal contribution to the funding requirement. The length of debt will be around twenty three years leaving a debt free (or tail) period of two years at the end of the service concession. UBB have demonstrated that funding is available for this project.

25. The overall cost of funding has increased since selection of preferred bidder in December 2011. This is as a consequence not of interest rate rises but of increases in the bank's lending margin. The contract has included provisions such that if and when the banks margins return to more normal rates then [redacted] of the reduction will pass to the council.

26. Given the current uncertainty in financial markets which has increased the cost of borrowing, officers have explored the opportunity to make a contribution. The benefit of this contribution would be to reduce the amount funded by the banks resulting in an additional saving on the overall project cost and the annual cost, as outlined in paragraph 6 above.

27. A Strategic Waste Reserve was established to allow for the purchase of Landfill Allowance Trading Scheme (LATS) certificates in the period before the facility was in service. In 2011 the government's 'Waste Policy Review in England' announced the end of LATS after the 2012/2013 scheme year. This legislation change is still to be enacted; however, officers have contacted Defra who have advised that this is due to happen in late 2012. A review of any remaining liability estimates that this will be in the region of £0.5 million, leaving £13 million available to contribute towards the residual waste project. The reserve currently stands at £[redacted] million and has an approved base budget contribution on an annual basis. It would seem appropriate, given that increasing landfill tax has now been used as the primary economic driver towards a move away from landfill that this reserve should be used as the primary source of funding for a contribution.

28. It is therefore proposed that the council will make a lump-sum payment to the contractor which is applied to pay-off a matching amount of private sector senior loan capital in respect of the lump sum payment, the subsequent gate fees payable by the council will be reduced pro rata. By making the lump-sum payment this will lower the cost of borrowing, and reduce the cost of the project to the council. [redacted] The s.151 officer believes that this would be a prudent use of funds by making use of the reserve rather than requiring the contractor to borrow from the banks which would increase the cost of the project.

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29. [redacted]

Conclusion

30. The contract is affordable within the MTFS as shown, and within the affordability limit originally set by the Cabinet on 23 April 2008, which has been adjusted to reflect the latest tonnage forecast. It provides a VfM solution to the council with certainty over service costs in the long-term. It also provides the council with opportunities for additional cost savings from self-supply of electricity. The figures outlined in this annex are commercially sensitive and therefore the benefit expressed publicly is shown as up to £190m, which is effectively the base case saving plus an estimated saving associated with electricity benefits.