

APPENDIX 2-

Waste options financial assessment April 2015

Background & Summary

1. Officers have worked with the council’s financial advisor Deloitte, and technical advisor Mott MacDonald, to review and update the value for money (VfM) assessment reported to Cabinet on 30 October 2013.
2. The value for money analysis within the 30 October 2013 Cabinet report considered both quantitative and qualitative aspects of proceeding with the contract variation to deliver the council’s Waste Strategy. Based on financial analysis alone, there was no material difference between proceeding with the contract variation or delivering the council’s Waste Strategy through alternative third party arrangements. However, when taking into account other significant legislative, strategic, contractual and economic qualitative factors, it was considered that the delivery of the council’s Waste Strategy through a contract variation represented the best overall value to the public. When taking into account future Waste Infrastructure Grant due to the council, the contract variation was also the most affordable option.
3. Subsequent delays due to regulatory approvals have resulted in changes to costs, requiring the value for money assessment to be updated. Officers have continued to work with specialist advisors, and have followed Deloitte’s advice and applied a methodology which is consistent with previous assessments. Deloitte’s final report confirms that the position remains broadly unchanged – i.e. that there remains no material difference between options in financial terms. The qualitative analysis set out in previous reports remains up to date and valid. Therefore, proceeding with the delivery of the council’s Waste Strategy through the contract variation with SITA, including development of the Eco Park, continues to represent best overall value for money to the public sector and is the most affordable option for the council.

Updated VfM position

4. The value for money assessment considers the overall impact on the public purse, and therefore excludes Waste Infrastructure Grant which is a transfer from one arm of government to another and does not affect the overall cost to the UK taxpayer.
5. The updated financial assessment has confirmed the position reported to Cabinet in October 2013 remains unchanged, i.e. that with a difference of 0.17%, there remains no material difference between options when excluding the benefit of Waste Infrastructure Grant. The table below shows the estimated net present value (NPV - i.e. value at today’s equivalent cost, discounted in line with HM Treasury guidance) of each option over the 25 year assessment period.

Value for money summary	NPV excluding Waste Infrastructure Grant £m
Option 1 - Amend the Waste Contract to deliver the Waste Strategy, including the Eco Park	1,120
Option 2 - Terminate Waste Contract, achieve recycling and landfill diversion improvements without building new infrastructure (i.e. secure other processing arrangements)	1,118
Difference	2

Costs include a quantified risk adjustment

Updated affordability position

6. The affordability assessment considers the effect on the council's finances and as such does take account of Waste Infrastructure Grant. Grant of £78.6m (NPV £56m) is expected between 2015/16 and 2023/24. In option 1 this grant is expected to continue, whereas in option 2 it can be expected to stop.
7. When taking into account the benefit of future Waste Infrastructure Grant, option 1 is clearly the most affordable to the council.

Affordability summary	NPV including loss of future Waste Infrastructure Grant £m
Option 1 - Amend the Waste Contract to deliver the Waste Strategy including the Eco Park	1,064
Option 2 - Terminate Waste Contract, achieve recycling and landfill diversion improvements without building new infrastructure (i.e. secure other processing arrangements)	1,118
Difference	-54

Costs include a quantified risk adjustment

8. The annual budget impact of proceeding with option 1 will be influenced by a number of factors, including the council's plans and ability to make future savings and the potential to reconsider the mechanism for financing a proportion of the capital investment. The updated budget impact will be reported to Cabinet as part of the Medium Term Financial Plan refresh in July 2015.

Movements in cost since October 2013

9. Costs and risks have changed in a number of areas since the last financial assessment was reported to Cabinet in October 2013. These include changes to capital costs, waste treatment site operating costs, expected termination costs of the SITA contract, and changes in the wider waste market. Overall, the value for money margin between the two options has changed from option 1 having the lowest NPV by £6.5m in 2013, to option 2 having the lowest NPV by £1.9m in 2015. Both amounts are considered immaterial in the context of the size of the project.

Total movement in VfM margin since October 2013	NPV £m
Value for money margin at 30 October 2013	-6.5
Waste treatment site operating and capital costs	21.1
SITA contract termination costs (allowing for capital development to date and other costs)	-13.3
Other changes including updated assumptions	2.5
Merchant EfW and AD site costs	-1.9
Value for money margin at 28 April 2015	1.9

10. As a consequence of delays to the regulatory process since October 2013, the capital cost of the Eco Park has increased by £16.7 million, from £74.6 million to £91.3 million. As this is a certain cost it has been used as the basis for financial assessment, however officers are working to mitigate the increase via wider contractual discussions. The cost increase includes £0.35 million for environmental enhancements relating to drainage and landscaping. The development of the Eco Park is one aspect of the council's 25 year contract with SITA, which commenced in 1999. Other costs associated with the provision of an integrated waste management service have also changed since October 2013.
11. The overall effect of changes to costs have been taken into account in the value for money and affordability assessment reported in this annex and, therefore, do not change the assessment of the option to deliver the Waste Strategy, including the Eco Park.
12. The impact of changes in cost on the county council's corporate revenue budget will be incorporated into the budget refresh of the Medium Term Financial Plan, which will be reported to Cabinet in July 2015.

Methodology & key assumptions

13. In order to reassess the financial case for proceeding with the Eco Park, the council has followed the advice of its financial advisor, Deloitte, and its technical advisor, Mott MacDonald. The methodology applied is consistent with previous assessments.
14. Previous assessments included additional options (to terminate the waste contract and re-procure a contract to develop infrastructure, and to terminate and dispose of waste through landfill). These earlier assessments showed that these two options did not represent value for money. The current assessment has therefore focussed on the two lowest cost options available to the council which are:
 - Option 1 - Amend the Waste Contract to deliver the Waste Strategy, including the Eco Park.
 - Option 2 - Terminate Waste Contract, achieve recycling and landfill diversion improvements without building new infrastructure (i.e. secure other processing arrangements).
15. A number of assumptions have been made, including:
 - General inflation of 2.5% per annum.
 - Waste tonnages of 575,000 tonnes in 2015/16, based on the average tonnage across 2013/14 and 2014/15, which then varies in future years in line with industry expectations (as forecast by WRAP, a waste industry advisor).
 - Both options have been considered over a 25 year term, in line with the expected economic life of the Eco Park.
 - Costs are taken from the existing SITA contract, other SCC contracts, or have been estimated in line with market data and in accordance with advice from Mott MacDonald.
 - Costs include a quantified risk assessment (explained below).
 - Costs are presented in net present value (NPV) terms, i.e. at today's equivalent cost, discounted in line with HM Treasury guidance.
16. An independent audit of SITA's financial model has been undertaken by Operis, a company specialising in financial modelling and advice. Operis' final report confirms that "the logic and integrity of SITA's model are correct", that the model complies with accounting regulations and UK tax legislation, and no material errors have been identified.

Quantified risk assessment

17. The council has worked with its financial and technical advisors, Deloitte and Mott MacDonald, to understand and quantify key risks, applying HM Treasury “Green Book” guidance, including 3-point estimates (lower, most likely and upper limit).
18. Risk reduces as a project becomes more certain. Option 1 benefits from the SITA contract, where costs are largely known, for the next 11 years. Option 2 involves terminating the SITA contract and procuring new contracts for managing facilities and disposing of waste and, therefore, contains more uncertainty and risk.
19. Key areas of uncertainty include:
- Cost of waste disposal outside of the SITA contract – including transport & gate fees at 3rd party facilities and landfill sites (including landfill tax).
 - Cost of operating waste treatment sites outside of the SITA contract.

Quantified risk adjustment (included in overall value for money assessment)	NPV £m
Amend the Waste Contract to deliver the Waste Strategy including the Eco Park	46
Terminate Waste Contract, achieve recycling and landfill diversion improvements without building new infrastructure (i.e. secure other processing arrangements)	99

Sensitivity analysis

20. The outcome of the financial assessment is dependent on a number of assumptions, and as such there remains the potential for a range of outcomes depending on changes to those assumptions. This is reflected in the following sensitivity analysis.
21. **Energy income** – income is derived from the sale of energy produced by the Eco Park. SITA has assumed an energy price of £56 / Megawatt Hour (MwH), plus inflation, however this is not guaranteed. A lower rate of £44/MwH has been modelled to illustrate the impact of a variation in prices. This would increase the NPV of option 1 by £3.1m.
22. **Renewable Obligation Certificates (ROCs)** – ROCs are tradable certificates issued by OFGEM for production of renewable energy. The ROCs framework is due to change on 1 April 2017, and details of its successor (Contracts for Difference) remain unclear. SITA has started the process of applying for ROCs accreditation and do not expect the current delay to impact on this. However if no ROCs accreditation/income were received this would increase the NPV of option 1 by £8.5m.
23. **Capital financing terms** – any movement in underlying interest/swap rates and foreign exchange rates will impact the cost of option 1. Total debt charges are estimated at 6.245% made up of a 2.15% swap rate (1.72% indicative swap rate provided by SITA plus a standard 0.43% buffer to allow for movement in rates prior to financial close), 3.75% margin, 0.325% credit charge and other costs. The actual swap rate will be fixed when the loan is entered into, and may therefore change. The following sensitivities have been considered:
- If the swap rate remained at the estimated level and the 0.43% buffer was not required the cost of option 1 would reduce by £1.6m NPV.
 - As above, and with a further swap rate reduction of 0.25%, the cost of option 1 would reduce by £2.6m NPV.
 - An increase in the swap rate of 0.25% above the buffer would increase the cost of option 1 by £1m NPV.

Company credit checks

24. Company credit checks have been undertaken for the main contractors, including SITA Surrey's sub-contractors. The results are summarised below.

Company	Function	Credit rating	Turnover £m
SITA Holdings UK Ltd	Parent company of SITA Surrey Ltd	Good	£633m
SITA Surrey Ltd	Main contractor	Very good	£61m
MW High Tech Projects UK Ltd	EPC (engineer, procure & construct) contractor	Very good	£330m
Outotec OYJ (Finland)	Parent company of Outotec UK Ltd – gasification technology	No concerns identified	£1,104m
Monsal Ltd	Anaerobic digester technology	Good	£13m

This page is intentionally left blank