



National Audit Office

DEPARTMENT FOR ENVIRONMENT, FOOD AND RURAL AFFAIRS
Managing the waste PFI programme

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SUMMARY

1 The European Union (EU) introduced a Directive in 1999 (“the EU Directive”) requiring all Member States to reduce the amount of biodegradable municipal waste (BMW) sent to landfill. BMW, which accounts for 70 per cent of municipal waste, is waste, such as food, vegetation and paper, that can be broken down by other living organisms.

2 The EU has set targets for the reduction of BMW sent to landfill because:

- biodegradable material sent to landfill prevents the recycling of waste and the recovery of energy from waste materials; and
- it can also release emissions: to the air, which may be harmful to the environment and contribute to climate change; and to soil and water, which can be harmful to health.

3 EU Member States will be subject to financial penalties if they fail to meet the landfill reduction targets for BMW. The targets for reduction in England are:

- by 2010 to reduce the weight of BMW landfilled to 11.25 million tonnes per annum (75 per cent of BMW landfilled in 1995);
- by 2013 to reduce the weight of BMW landfilled to 7.5 million tonnes per annum (50 per cent of BMW landfilled in 1995); and
- by 2020 to reduce the weight of BMW landfilled to 5.25 million tonnes per annum (35 per cent of BMW landfilled in 1995).

4 The Department for the Environment, Food and Rural Affairs (The Department) has a national strategy for waste disposal, which includes plans for meeting the EU Landfill Directive targets in England. Local authorities have statutory responsibility for municipal waste disposal. The Department decided that, to meet the targets, local authorities needed to invest in new waste infrastructure.

5 Local authorities decide the form of procurement for their waste infrastructure projects. Where authorities procure projects under the Private Finance Initiative (PFI), central government financial support, known as PFI credits, is available for approved projects. The PFI credit is an undertaking that central government will give annual grants to the value of the PFI credit to help local authorities service the cost of the projects.

6 So far, 18 local authorities have signed PFI contracts with a combined capital value of £1.6 billion. The Department has allocated around £750 million of PFI credits and in the Comprehensive Spending Review 2007 it received a further provisional allocation of £2 billion for waste projects.

7 PFI contracts are expected to cover around 80 per cent of the waste processed by new infrastructure coming into operation by 2013. Some local authorities, however, use other types of procurement for these projects. These other procurements account for most of the deals expected to close in 2008-09 and 2009-10. The non-PFI procurements are mainly small capacity projects but PFI continues to be used for the larger projects.

8 A previous National Audit Office report *Reducing the Reliance on Landfill in England (HC1177 2005-06)* examined the Department's initial response to the EU Directive. In this report we have examined the Department's management of its PFI waste infrastructure programme. We focus on three criteria:

- i whether a suitable programme of projects with a thriving, competitive supply market has been established;
- ii whether the projects have been delivered in a timely fashion; and
- iii whether the Department has applied appropriate oversight to the projects for which it is providing financial support.

9 This report focuses on PFI projects for which the Department has responsibility through granting PFI credits to local authorities. Many of the issues set out in the report will also be relevant to local authorities taking forward other forms of waste infrastructure procurement. Local Authorities are subject to inspection by the Audit Commission which published in September 2008 *Well disposed: Responding to the waste challenge*. The Audit Commission's report focussed on the local authorities' approach to the problem of BMW being sent to landfill.

Findings

Managing the programme

10 The risks faced by waste infrastructure projects are different from those found in other PFI infrastructure projects. They include: uncertainty over the volume of future waste throughput; planning permission difficulties due to concern by residents about the nature of the facilities being proposed; the risks of different types of waste treatment technology; and finding markets to sell products from waste treatment. PFI projects require interfaces between central and local government and sometimes between neighbouring local authorities. The supply side of the market was relatively undeveloped until recently and mainly focussed on waste collection and landfill.

11 The Department initially responded too slowly to these challenges. The EU Directive in 1999 created a need for a strategy for significantly increasing diversion of waste away from landfill. Before 2003 the Department's strategies lacked practical plans for reducing reliance on landfill. Only then did the Department start to address the complex issues involved in building new waste treatment infrastructure. As a result, the market for waste infrastructure projects developed slowly. Only two of the new waste infrastructure projects developed since the EU Directive (1999) have completed construction of all planned assets.

12 The Department has improved its approach to building a market for new waste infrastructure projects. In July 2006, the Department established a delivery unit, the Waste Infrastructure Delivery Programme (WIDP), to accelerate the delivery of waste infrastructure and to provide greater support to local authorities undertaking the projects. WIDP comprises staff from Defra, Partnerships UK and 4ps, who are managed as a single unified team led by the Defra Programme Director. WIDP currently has around 30 staff. The WIDP team has made considerable progress since 2006 in developing the market, including an increasing focus on energy from waste solutions. It has also sought to achieve value for money through agreeing with the market PFI contract terms relevant to waste projects and by improving oversight of the projects.

13 The actions implemented by WIDP have accelerated the rollout of new, larger projects with more contractors interested in bidding for these projects. Nine new contracts were signed in the two years to March 2008. At the time of our audit, June 2008, the Department had a pipeline of 19 other projects to be advertised in the next three years. The Department has been focusing on larger projects. Projects currently in procurement will, on average, process over twice as much waste as past contracts. The Department has also encouraged local authorities to secure economies of scale by promoting joint projects between neighbouring authorities. There was initially a small number of bidders but the Department's actions have helped stimulate bids from companies not previously involved, including overseas companies.

14 The cost of finance reflects the risks of waste projects and, in recent times, uncertainties in the financing markets. The risk margin for debt finance is higher for waste PFI projects than other PFI projects such as hospitals or schools. This margin reflects the complex risks of the waste projects. Also, lenders are not yet able to draw confidence from a flow of successful operational projects. In addition, all PFI projects have been facing higher financing costs in 2008 because of the uncertainties in the financial markets. In the longer term, there may be opportunities for the private sector to secure refinancing gains if these risks reduce. The Treasury has introduced a sliding scale whereby the public sector is now entitled to up to 70 per cent of refinancing gains on all PFI contracts signed during the current disruption to the credit markets compared with the previous normal arrangement of 50 per cent.

Delivering projects

15 There are long lead times for developing projects and bringing the assets into operation. It takes five to nine years to develop projects and bring assets into operation. Delays can occur prior to contract award and in bringing the new facilities into operation. Prior to contract award, PFI projects have been delayed by an average of 19 months compared to the original timetables. Some delays occur because projects need to improve their business cases to gain central government approval. The current difficulties in the financing markets are also delaying large deals. Some projects have, however, been funded by contractors out of existing financial resources giving the prospect of faster deal closure. After contract award, delays have occurred because some projects have encountered difficulty in obtaining planning permission.

Oversight of projects to ensure value for money

16 The Department has improved the oversight and support available to local authorities. The Department, through WIDP, has strengthened its oversight of projects. This action is aimed at reducing delays and achieving better deals. The Department has developed a range of guidance. WIDP is providing practical support by placing experienced commercial staff (known as Transactors) in procurement teams. The Department has also strengthened its quality assurance processes for scrutinising and challenging authorities' projects.

Achieving landfill targets

17 There is now pressure on the fulfilment of the EU landfill targets. The Department's slow start to programme management and the long timescales needed for bringing these complex projects into operation has created pressure on the EU landfill diversion targets. Based on current data:

- a** it is likely that the 2010 target for landfill reduction will be met.
- b** the 2013 target is challenging. It will not be met if there continue to be programme delays or the infrastructure built does not work as efficiently as expected. If the 2013 target is missed the EU is expected to levy fines on the UK, although the EU has yet to announce the rate of such fines. Central government has said that it will levy a fine of £150 per tonne if local authorities fail to meet their 2013 landfill targets.
- c** It is harder to assess whether the 2020 target will be met. The likelihood of meeting the target will depend on two factors: success of the PFI investment programme; and efforts by local authorities and consumers to produce less waste and recycle more.
- d** Achievement of the landfill targets is also dependent on bringing into operation the increasing proportion of projects which local authorities are carrying out under non-PFI procurements. As central government

funding support is not given to these projects there is at present no requirement for local authorities to submit information about these to the Department. Without this information the Department's ability to monitor progress is limited.

Value for money conclusion

18 The Department has allocated around £750 million worth of PFI credits to local authorities undertaking PFI waste infrastructure projects and in the Comprehensive Spending Review 2007 it received a further provisional allocation of £2 billion. Achieving value for money from this commitment depends on whether: enough PFI facilities are delivered to meet EU landfill targets; the deals give the prospect of value for money; and the projects are subsequently managed well in operation. The Department was initially slow to address these issues and prior to 2006 few new PFI facilities were delivered. Since 2006, the Department has adopted a programme management approach which has developed the market and achieved a more rapid flow of new and larger PFI contracts. It has strengthened its arrangements for oversight of, and support to, local authorities who enter into waste PFI contracts. England is likely to meet its 2010 landfill reduction targets but to meet the 2013 target the Department will need to reduce substantially the time taken to procure projects and bring them into operation.

1 Projected performance against EU landfill targets and potential fines if 2013 landfill target exceeded

		A	B	C = (A-B)	D	E = (C x D)
		Projected Biodegradable Municipal Waste to Landfill 000's of tonnes	Total allowance 000's of tonnes	Total excess over allowance 000's of tonnes	Fine per tonne of excess £	Total estimated fine for 2013 £m
Scenario 1	High Delivery	7,512	7,460	52	150	8
The Department's Base case						
Scenario 2	Medium Delivery	8,853	7,460	1,393	150	209
Scenario 3	Low Delivery	9,898	7,460	2,438	150	366

Source: Defra

NOTE

The fines are based on £150 per tonne sent to landfill in 2013 in excess of the 2013 EU landfill target. This is the rate that central government will fine local authorities for missing the 2013 targets.

Recommendations

We make the following recommendations to help the Department accelerate the successful delivery of waste management PFI projects.

I The Department is engaged in taking forward a challenging programme of procurements of projects which have complex risks. To help evaluation of the programme and the identification of areas for improvement, the Department should build on its existing management information and develop Key Performance Indicators. The Department should then publish annual performance statistics for the projects which it approves. These statistics should include:

- a** project delivery timescales, including separate monitoring of project approval, procurement and construction periods;
- b** the number and range of bidders for local authority waste PFI projects;
- c** the extent of price changes after selection of preferred bidder;
- d** authority satisfaction with support received from WIDP; and
- e** whether the services in operational projects are being delivered in line with the contract.

II Local authorities would value greater access to benchmarking information and data that could help them plan procurements effectively. The Department should complete its current work in compiling benchmarked costs of infrastructure for different types of waste project. This information will help local authorities to plan projects and to evaluate bids. The Department should also supplement its existing guidance by collating the following information and making it available to authorities to assist in the development of projects:

- a** Internal and external resource requirements for different types and size of project including appropriate budgets for the use of external advisers.
- b** A standard set of assumptions for authorities to use in project plans on key variables such as waste growth. Local authorities may still wish to carry out sensitivity analysis based on alternative assumptions.
- c** Information on how to handle the interfaces within the waste management system where waste collection is excluded from the PFI contract.

III The financing costs for waste PFI projects are higher than many other types of PFI projects and, like other PFI projects, are affected by the current uncertainties in the financing markets. The Department should:

- a** check that the cost of finance for waste PFI projects can be shown to be reasonable for the risks borne either through a funding competition or benchmarking;
- b** analyse trends in the differential between the cost of finance for PFI waste projects and other types of PFI project to establish the scale of, and reasons for, the difference; and
- c** set out the assessment local authorities should undertake where a contractor proposes to finance construction through its own resources. This form of financing may avoid delays or price uncertainties in raising project finance in the current financing markets. Authorities should, however, not see faster deal closure as the main reason for choosing a contractor but should weigh this alongside other value for money considerations.

IV To date the Department's support to local authorities has mainly focused on project development and procurement. It is now beginning to consider contract management. The Department should increase its oversight of projects after contract award and particularly during the construction phase by:

- a** building on its existing model of providing experienced individuals to assist with project development and procurement and making sure input is available after contract award if required;
- b** establishing minimum standards for resourcing contract management and encouraging local authorities to plan for the handover from procurement to operational contract management; and
- c** increasing the frequency of monitoring returns from local authorities during the construction phase to at least quarterly, rather than six monthly, from contract award until asset construction is complete and all facilities are operational.

V Gaining planning permission for new waste treatment facilities is a challenge for local authorities. There is often concern by residents about the nature of the facilities being proposed, resulting in objections which can cause substantial delays to the Department's programme. The Department should encourage local authorities to consult early with residents to identify issues which residents are likely to raise about different types of technical solution. The Department should complete its planned communications toolkit to assist authorities.

VI The achievement of the EU landfill targets will be dependent on local authority projects using forms of procurement other than PFI. The Department should obtain sufficient information from local authorities in the form of business cases and progress reports to enable the Department to assess the deliverability of these projects within the forecast timetables. The Department's oversight disciplines for PFI projects, for example its review of business cases and the involvement of Transactors as a support to project teams, may also be helpful to local authorities using other forms of procurement.