

## Leeds City Council - Residual Waste Management PFI Project

| <b>VIABILITY</b>  |   |  |
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| <b>For PFI to be viable the investment objectives and desired outcomes need to be translatable into outputs that can form the basis of a contract and a sound payment mechanism; for example the quality and quantity of the outputs need to be ones that can be measured. Many service areas can be described in contractual terms, but some areas will be inherently 'non-contractible' as outputs.</b> |   |  |
| <b>Issue</b>  | <b>Questions</b>  | <b>Response</b>  |
| <b>Project level outputs</b>  | Is the project delivery team satisfied that a long term contract can be constructed for this project? Can the contractual outputs be framed so that they can be objectively measured? | Yes. The Authority envisages that only core disposal infrastructure facilities will be included in the PFI contract and that these services are sufficiently limited in scope for there to be clarity of roles in a long term client-contractor split. |
|   | Is the requirement deliverable as a service and as a long term arrangement? Can the contract describe the requirements in clear, objective, output-based terms?                       | Yes. The management of disposal infrastructure can be defined in objective KPIs and the targets for outputs are also definable and measurable, for example the tonnage of waste sent to landfill.  |
|   | Can the quality of the service be objectively and independently assessed?   | Yes. There are a defined number of key output measures that are straightforward to collect and this will allow for regular and accurate monitoring.  |
|   | Is there a good fit between needs and contractible outcomes?  | Yes. The OBC clearly expresses the need for long term improving recycling and limiting landfill, and these requirements are clearly translated into contractual outputs.   |
|   | Can the contract be drafted to avoid perverse incentives and to deliver quality services?   | Yes. The contract will be based on SoPC4, to provide a strong contractual basis. Any staff that transfer will become the full responsibility of the contractor and the contract will be based purely on quality outcomes.                              |
|   | Does the project require significant levels of investment in new capital assets?  | Yes. The project will require significant capital investment in a new waste disposal facility. The contract is likely to be a DBFO contract to transfer certain risks to the contractor such as cost of delay.   |

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|  | Are there fundamental issues relating to staff transfer? Would any transfer be free from causing any loss of core skills that have strategic and/or long term importance to the procuring authority? | The core facilities to be included in the PFI contract are all new facilities where no transfer will be applicable, namely transfer station and EFW. The only existing facilities for which staff transfer will be applicable are Household Waste sites and as such will not be relevant for the PFI contract. |
|  | Is service certification likely to be straightforward in terms of agreeing measurable criteria and satisfying the interests of stakeholders?   | Yes. Key criteria are defined in the output specification and performance measured against KPI's will impact on payments made through the payment mechanism.   |
|  | Does the project have clear boundaries (especially with respect to areas of procuring authority control)? If there are interfaces with other projects are they clear and manageable?                 | Yes. The project interfaces with both the collection services and the additional disposal services such as a MRF and composting facility. The project is being managed in conjunction with the additional disposal services.   |
|  | Can the service be provided without the essential involvement of Authority personnel? To what extent does any involvement negate the risk transfer that is needed for VfM?                           | Waste services are typically outsourced and the service is managed internally by the contractor with minimal Authority personnel involvement. Too much involvement from Authority personnel reduces VfM as certain risks are taken back that should have been passed to the contractor.                        |
|  | Is the contractor able or likely to have control/ownership of the intellectual property rights associated with the performance/design/development of the assets for the new service?                 | Yes. Waste services are generally technology based and the full service risk is taken by the contractor, thus intellectual property rights are common.   |
|  | Will existing or planned elements within the scope of the project - or interfacing vitally with it – be complete before the start of the new service?  | The PFI project involves end treatment of residual waste only and as such all other elements will be complete prior to commencement of the new service. The service is defined and has no dependent services.  |

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| <b>Operational flexibility</b>               | Is there a practical balance between the degree of operational flexibility that is desired and long term contracting based on up-front capital investment?                    | While it may be necessary to guarantee a minimum tonnage to be processed, this is expected to be far below the projected household and waste growth assumptions in Leeds, and there will still be flexibility of varying the demand. It is also considered that the contractor will be able to sell spare capacity not taken up by the Authority and that this will even provide a profit share.                                   |
|  | What is the likelihood of large contract variations being necessary during the life of the contract?  | Contract variations are not expected during the life of the contract. However, due to the length of the contract and the potential for future changes including legislative change, the mechanism for contract variations has been included within the contract.   |
|  | Can the service be implemented without constraining the delivery of future operational objectives?  | The facility will be sized in line with targets and objectives. Treatment is required as part of the waste strategy's objectives and operates independently from other aspects of waste services, it does not constrain competing strategy objectives such as increased recycling.   |
|  | Is there confidence that operational flexibility is likely to be maintained over the lifetime of the contract, at an acceptable cost?   | Yes. The contract payment is expected to be made on a variable basis according to volume of waste processed. This provides flexibility for the Authority in terms of future waste growth scenarios. Although the Authority is tying itself to a long term EfW solution, this is a tried and tested technology which will deliver the required outputs and therefore cannot become obsolete in relation to its contractual purpose. |
| <b>Equity, efficiency and accountability</b> | Are there public equity, efficiency or accountability reasons for providing the service directly, rather than through a PFI contract?   | No. The design, build, operate and finance of waste disposal infrastructure by a private operator is in line with national policy and practice on the operation of waste facilities which allows for ownership and management of facilities by the private sector.   |
|  | Does the scope of the service lend itself to providing the contractor with "end-to-end" control of the relevant functional processes? Does the service have clear boundaries? | The scope of the service has clear boundaries and is operated from the point of handover of the waste to the facility, to the disposal of residues once processed.   |
|  | Are there regulatory or legal restrictions that require services to be provided directly?   | There are no such restrictions and the proposed solution is in line with national policy and practice for the provision of this statutory service.   |

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|                          | Is the private sector able to exploit economies of scale through the provision, operation or maintenance of other similar services to other customers (not necessarily utilising the same assets)? | Yes. The private sector can provide a revenue stream through sale of third party capacity to other users. Increased recycling rates will provide greater capacity for sale.  |
|                          | Does the private sector have greater experience/expertise than the procuring authority in the delivery of this service?<br>Are the services non-core to the procuring authority?                   | Yes. The private sector has significant experience in the delivery of the services. The level of capital expenditure and complexity of design, build and operation of the facilities means that the procuring authority would not have the experience of expertise to deliver. The services will impact on the delivery of targets for the authority and thus are core to the authority's future objectives. |
|                          | Is a PFI procurement for this project likely to deliver improved value for money to the department as a whole, considering its impact on other projects?   | Yes. It is part of the national strategy to build capacity across the country and is supported by Defra through the acceptance of the Expression of Interest.  |
| <b>OVERALL VIABILITY</b> | Overall, in considering PFI, is the department satisfied that suitable long term contracts can be constructed, and that strategic and regulatory issues can be overcome?                           | Overall the Authority believes that the PFI project is viable as a value for money option which is in line with its strategic requirements, offering the right balance of flexibility with risk transfer and no regulatory issues to PFI.  |

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| <b>DESIRABILITY</b>   |   |   |
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| <b>PFI can provide better risk management and produce incentives to develop innovative approaches to output delivery. Consistent high quality services can be incentivised through performance and payment mechanisms. However, risk transfer is priced into the contract. The purpose of these questions is to consider whether the benefits of PFI are likely to outweigh any additional costs and disadvantages.</b> |   |   |
| <b>Issue</b>  | <b>Questions</b>  | <b>Response</b>   |
| <b>Risk management</b>  | Bearing in mind the relevant risks that need to be managed for the programme what is the ability of the private sector to price and manage these risks?   | The risks are a key reason for utilising a PFI contract. The EfW plant itself is likely to cost over £100m and is likely to take four years to build. There is a high risk of overrun which the Authority would like to pass to a private contractor.<br><br>The operating costs of the EFW alone are around £10m per annum. The control of capex and operating costs are inextricably linked and are best managed in an integrated waste contract. |
|   | Can the payment mechanism and contract terms incentivise good risk management?  | Yes. Deductions within the payment mechanism as detailed in Section 5 incentivise good risk management and operational efficiency, allowing the contractor to gain financially if waste is disposed of at a lower cost.   |
| <b>Innovation</b>   | Is there scope for innovation in either the design of the solution or in the provision of the services?   | Yes. The authority is hoping for a design which is tailored to the authority's needs to provide innovation for the region.  |
|   | Does some degree of flexibility remain in the nature of the technical solution/service and/or the scope of the project? Is the solution sufficiently free from the constraints imposed by the Authority, legal requirements and/or technical standards? | Yes. A degree of flexibility is required within the scope of the project to ensure value for money is obtained from the private sector. The specification for the services will be output based and as such, the nature of the technical solution can be flexed to meet these outputs.  |

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|   | Does a preliminary assessment indicate that there is likely to be scope for innovation in the programme?  | While ensuring that the PFI scope is narrow enough to be deliverable, i.e. currently considered to exclude collection and landfill, the Authority believes that there are a sufficiently wide range of facilities and scope of processes to offer considerable scope for innovation and efficiency. The technologies used in waste processing are developing and the Authority will use the procurement to optimise the latest technology offerings. |
|   | Could the private sector improve the level of utilisation of the assets underpinning the project (e.g. through selling, licensing, commercially developing for third party usage etc)?  | Yes. The authority is keen to maximise the revenue received in this project and the private sector have the network and contacts to obtain the best prices from third parties for sale of outputs.   |
| <b>Contract Duration and residual value</b> | How far into the future can service demand be reasonably predicted? What is the expected life of the assets? What are the disadvantages of a long contract length?  | Contract length could be up to 28 years to take account of a 4 year build and 24 year operating period. This will allow the project to be affordable as the finance charges will be spread. The Authority believes that a long term contract is suitable because EFW offers a long term stable solution to waste disposal and any spare capacity is certain to be taken up.  |
|   | Are there constraints on the status of the assets after the contracts end?  | Assets may revert back to the authority with a residual value which allows the authority to utilise the assets further and potentially to re-let the contract. The land will also have planning permissions.   |
|   | Given the possibility of changes to the requirement, the assets and the operating environment, is it possible to sustain value for money over the life of the contract utilising as appropriate, mechanisms such as benchmarking and technology re-fresh? | Yes. It is possible to sustain value for money over the life of the contract and the refreshment and maintenance of assets will be built into the contractual terms.   |
| <b>Incentive and monitoring</b>             | Can the outcomes or outputs of the investment programme be described in contractual terms which would be objective and measurable?  | Yes. The outputs and performance measures for waste processing are based around key recycling targets and landfill disposal tonnages.  |
|   | Can the service be assessed independently against an agreed standard?   | Yes. The standards and targets are well understood nationally by government, industry and the wider community.   |

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|  | Would incentives for service delivery be enhanced through a PFI payment mechanism?   | The Authority believes that a payment mechanism where outputs are linked directly to payment and deductions is a logical step from having clear targets and risk transfer. Work by the 4Ps has shown that a suitable waste payment mechanism can be made to work.  |
| <b>Lifecycle costs and residual value?</b> | Is it possible to integrate the design, build and operation elements of the project?   | Yes. This is a key reason selecting the PFI route.   |
|  | Is a lengthy contract envisaged? Will a long-term contractual relationship be suitable (or advantageous) for the service?  | The contract is expected to be 28 years with a 4 year build period to include 1 year commissioning.  |
|  | Are there significant ongoing operating costs and maintenance requirements? Are these likely to be sensitive to the type of construction?                                  | Yes. In waste schemes, the operating costs are a more significant component than accommodation schemes. There is a direct link between design and operating costs as one determines and the other is the result of waste processing.   |
| <b>OVERALL DESIRABILITY</b>                | Overall, is the accounting officer satisfied that PFI would bring sufficient benefits that would outweigh the expected higher cost of capital and any other disadvantages? | Yes. The Authority believes that PFI offers the best way to manage risk and, far from leading to a higher capital cost, believes that an integrated capex and operating contract will mean private sector efficiencies which will be passed on as a price reduction from operating separate conventionally procured contracts. |

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| <b>ACHIEVABILITY</b>   |  |  |
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| <p>While PFI may allow a more efficient and effective combination of public and private sector skills, determining the rules that will govern the relationship between the two sectors does involve significant transaction costs. In particular, the procurement process can be complex and involve significant resources, including senior management time which may be required for project development and the ongoing monitoring of service delivery. Authority capacity and capability, together with private sector deliverability will have direct consequences for procurement times and the level and quality of market interest. PFI needs a robust competitive process to deliver fully its benefits and so the choice of procurement route should be informed by an assessment of the likely market appetite.</p> |  |  |
| Issue  | Questions  | Response   |
| <b>Market Interest</b>   | Is there evidence that the private sector is capable of delivering the required outcome?   | Yes. There are already a number of waste PFI schemes in operation and even more schemes based around the proven technologies which the Authority is using as a reference project.  |
|  | Does a significant market with sufficient capacity for these services exist in the private sector?   | Yes. The market consists of a range of players, including recent entrants from non-UK players. The activity in this market is fairly high but emerging new players mean that the capacity for provision of these services is still sufficient. |
|  | Is there likely to be sufficient market appetite for the projects in the programme? Has this been tested robustly? Is there any evidence of market failure for similar projects? | Yes. The Authority has already conducted a soft market sounding and has received 15 formal letters from large international waste and infrastructure contractors expressing very keen interest.  |
|  | Have any similar projects been tendered to market? Has the procuring authority's commitment to a PFI solution for this type of project been demonstrated?                        | Yes. There are already a number of similar projects which have been tendered to market and have demonstrated value for money. The Authority has experience within the PFI market and can demonstrate delivery of value for money solutions.    |
|  | Does the nature of the project suggest that it will be seen by the market as a profitable venture?   | Yes. Interest received from soft market sounding indicates that the market see this scheme as a profitable venture, particularly with potential sale of spare capacity, electricity and recyclables.   |

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|                              | Are the risks associated with design, development and implementation manageable bearing in mind the likely solutions to the project?  | The Authority has considered carefully the need to transfer risks which are value for money and has listened to the market in making sure the Authority retains and manages risks such as planning and site selection.   |
| <b>Other Issues</b>          | Is the procurement feasible within the required timescale? Is there sufficient time for: resolution of key Authority issues; production/approval of procurement documentation; staged down-selection and evaluation of bidders, negotiation, approvals and due diligence? | Leeds City Authority has a well established PPP Unit responsible for managing the procurement, which has signed 5 PFI schemes and has 5 more in procurement. The PPP Unit includes a team dedicated to setting up performance monitoring arrangements. This team works closely with the Authority's waste team who have already made 2 full time staff available to developing performance requirements. |
|                              | Is the overall value of the project significant and proportionate to justify the transaction costs?   | Yes, the overall value is significant with initial capital expenditure of £100m plus. Transaction costs are likely to be approximately £1m.  |
|                              | Does the nature of the deal and/or the strategic importance of the work and/or the prospect for further business suggest that it will be seen by the market as a potentially profitable venture?  | Yes. Results from soft market sounding indicate the project is attractive to the market. The authority has a strong delivery team and the project is seen to be profitable.  |
|                              | Does the Authority have the skills and resources to define, deliver and support the service throughout the procurement and the subsequent delivery period?  | Yes. The PPP Unit has fully skilled project management resources.  |
| <b>OVERALL ACHIEVABILITY</b> | Overall, is the accounting officer satisfied that a PFI procurement programme is achievable, given an assessment of the market, Authority resources and the attractiveness of the proposal to the market?   | Yes. The Authority believes that with funding allocated, it has the experience to manage risks, ensure delivery of the procurement and maximise the number of suppliers bidding.   |