

18th September 2017**Agenda Item: 5****REPORT OF THE SERVICE DIRECTOR FOR ENVIRONMENT, TRANSPORT
AND PROPERTY****Nottinghamshire County Council PFI Waste Management Contract****Purpose of the Report**

1. To inform the Committee of the current status of the Council's Private Finance Initiative (PFI) Contract for Waste Management and allow members to consider whether there are any actions they require in relation to the issues contained within the report.

Information and Advice**PFI Contract Basics**

2. PFI contracts are generally long term arrangements for the private sector to Design, Build, Finance and Operate (DBFO) assets which might not be affordable to the public sector in other circumstances due to the large capital costs involved in developing the contract facilities.
3. The basic principle of PFI is to ensure value for money is secured by ensuring that the risks and costs of a project are allocated to the people most able to manage them effectively through the lifetime of the scheme.
4. Hundreds of PFI contracts have been let across the UK to deliver new hospitals, prisons and other accommodation projects, roads, schools and waste facilities by various central and regional government bodies and the health sector with varying degrees of success, and not without public controversy.
5. The costs of the construction of the new or refurbished contract facilities, and any ongoing maintenance or renewals costs, are met by the private sector, and are either corporately (from the balance sheet of the companies involved) or project (bank) financed with the public sector meeting the ongoing cost of the operation and payback of the capital over an extended concession period, often 25 years plus. The assets then transfer back to the public sector at the end of the contract.
6. The PFI Waste Management Contract with Veolia ES Nottinghamshire Ltd was signed on 26 June 2006 and runs until 31 March 2033, and is corporately financed by Veolia with no bank involvement. Details of the contract coverage and cost are included in Appendix 1.

Special Purpose Vehicles (SPV's)

7. Most contracts are operated by Special Purpose Vehicles (SPV's) which are companies specifically established to develop and operate the facilities comprising a number of specialist partners usually including construction contractors facilities management (FM) providers (for accommodation projects), funders, and other specialists companies experienced in specific areas of work (such as waste) or in pulling together all of the partners to provide a seamless service to the local authority.
8. In respect of the PFI Waste Contract the SPV is not a partnership, but is a wholly owned subsidiary of Veolia Environmental Services (UK) plc - Veolia ES Nottinghamshire Ltd.

Funding Arrangements

9. Her Majesty's Treasury (HMT) through sponsoring departments (the Department for Environment, Food and Rural Affairs (DEFRA) in this case) provide fixed (non-inflating) ring fenced grant payments, generically known as PFI credits (although on waste projects they are actually "Waste Infrastructure Credits"), to the client organisations to offset some of the costs associated with this private sector finance based on the submission of a detailed business case to support the proposals. This leads to two anomalies;
 - i. No two projects receive the same level of PFI credit payments as they are not based on a fixed formula or calculation;
 - ii. There is an ever widening gap between the fixed level of funding through the PFI credits and the escalating (inflated using a suitable index such as Retail Price Index (RPI)) operational costs.
10. Councils normally therefore establish a "PFI reserve" at the start of a project to build up a sum of money (before the facilities are operational and the unitary charge payments commence or ramp up) to offset these costs through the life of the project, based on expected budgets, modelled costs and inflation assumptions assessed in an affordability model.
11. Unfortunately in some circumstances these assumptions can prove wrong, particularly in turbulent financial times as have affected the UK since 2007. A number of PFI projects are therefore currently proving to be unaffordable to the client organisations (particularly in the health sector).
12. The overall reserves held by the County Council to support the Nottinghamshire PFI Waste Management project are around £28m, and are currently deemed sufficient to cover potential costs for the rest of the contract term.

Contract Metrics and Monitoring

13. PFI Contracts are usually output based, with significant freedom allowed to the contractors to meet the agreed specification within the confines of an agreed cost and quality envelope.
14. Various service elements such as waste treatment and Recycling Centre operation or additional waste disposal arrangements are subject to regular benchmarking (cost/quality comparison) or market testing (tendering) by the contractor to ensure they continue to offer value for money.
15. Payments to Veolia are made monthly through a "Unitary Charge" which covers all of the service elements provided, offset by any deductions made for performance failures or lack of availability. That way the contractors are incentivised to ensure services are provided effectively and any defects or service failures are rectified promptly.

16. Contracts are often referred to as self-monitoring as the contractor provides the performance data to support the payments requested each month, although a degree of oversight from the client is always required to ensure continued contract compliance.
17. Deductions can be for items as simple as failure to have a waste facility open due to a breakdown or not providing accurate billing or performance data or can be more significant such as failing to achieve annual landfill diversion targets. Obviously the timescales for rectification, or any financial penalties applied reflect the impact of the failure on the service provided to the Council and or the public.
18. An outline of the performance measures and metrics are included at Appendix 2, with detailed information for 2015-16 contained within the Veolia Annual Report at Appendix 3. The 2016-17 Veolia Annual Report has not yet been finalised.

General PFI Contract Issues

19. The major concerns in many PFI deals are the level of ongoing charges levied by the contractors leading to elevated “super profits” and affordability issues. “Gold Plating” where assets well above the standards required to operate effectively were procured during times when funding was plentiful and are now therefore unaffordable. And the perceived inflexibility of the contracts and therefore the assets and services provided, including the inability of the client authorities to renegotiate deals to remove any now unaffordable “Gold Plating”.
20. Additionally financial windfalls achieved by the providers from “refinancing” projects post construction, when the majority of the risk has been removed and much more favourable financial terms can be achieved, has allowed some providers in early projects to reduce the baseline costs without offering a corresponding financial benefit to the public sector clients.
21. Many of the issues identified above are significantly reduced or removed altogether in later deals concluded under Standardisation of PFI Contract (SoPC) terms, however poor perceptions of private finance deals still exist and few contracts are currently being procured under the latest Private Finance 2 (PF2) process despite it being much more robust for the client authorities.
22. As the PFI Waste contract follows the appropriate standard (SoPC Version 3) contract terms (in fact the project was used as a DEFRA “Pathfinder” project in helping to finalise the national guidance) it has the appropriate protections in place.

Other Nottinghamshire County Council PFI Projects

23. Members will be aware that the County Council is party to two further PFI contracts for the provision of schools and leisure centres (on behalf of the relevant Borough and District Councils) in East Leake and Bassetlaw signed in 2002 and 2005 respectively.
24. All the contracts follow slightly different standard PFI contract formats as the PFI market developed significantly between the signing of the East Leake contract, and the Waste contract.
25. The County Council was also at one time involved as a partner in the PFI Nottingham Express Transit (NET) line one tram project (the City Council hold the contract) although the Council subsequently withdrew from those arrangements.
26. Additionally the PFI funded “Building Schools for the Future” (BSF) project, through which the Council had proposed a number of further school renewals, was abandoned by the government in 2010 in response to the austerity conditions prevalent at the time.

Change Management

27. Despite perceptions to the contrary well developed PFI contracts offer a significant degree of flexibility in the way services are provided, and can deliver adaptable services which can be changed to meet ongoing pressures and developing aspirations.
28. All of the Council's projects incorporate change mechanisms which allow for minor variations which do not require approval from the sponsoring departments. These mechanisms are used constantly to review what facilities are provided and how the waste service operates.
29. It is important however that where these minor variations are made the capital and lifecycle impacts are identified, and revenue streams secured to ensure the changes do not have a significant cumulative impact on budgets. The need to ensure the contractor is placed in a no better/no worse financial position can also impact on the value for money of any changes.
30. Changes to a contract beyond the scope of the original procurement could also potentially open the Council up to the risk of a procurement challenge if the changes are significant enough for the variation to be deemed a new contract. Specialist technical, financial and legal advice is therefore usually sought for major variations, often from outside of the Council.
31. In addition DEFRA has to be consulted on any more significant contractual changes, and may require the submission of a Variation Business Case (VBC) prior to agreeing to any amendments. This can also lead to reassessment of the PFI Credits payable in certain circumstances. It is unlikely that any reassessment would lead to anything other than a reduction in the level of grant payable.

PFI Waste Contract Changes

32. The waste contract has previously been varied using the existing Revised Project Plan (RPP) process included in the contract, and submission and approval of a VBC, to change the residual waste treatment solution proposed in the original deal in response to the failure of Veolia Environmental Services (the SPV) to obtain planning permission for the major contract facility, an Energy Recovery Facility (ERF) at the former Rufford Colliery in Rainworth.
33. The RPP provided for the waste which was to be sent to the Rufford ERF by Bassetlaw District Council, and Newark and Sherwood District Council via their contract Waste Transfer Stations (WTS) to be delivered to an existing Veolia ERF in Sheffield instead, and also allowed the council to renegotiate a number of other key contractual terms to deliver a significant financial benefit to the Council in excess of £1m pa, and even more flexibility going forward.
34. A further variation to deliver part two of the RPP, and construct a further WTS in Kirkby in Ashfield, and conclude long term contracts for the treatment of the waste delivered to that site by Ashfield and Mansfield District Councils, was concluded in November 2016 and delivered a further financial saving to the Council of around £400kpa. This WTS became operational on 31 March 2017.
35. Failure to develop the Rufford ERF has however led to DEFRA reassessing the level of PFI credits payable to the Council, reducing them by around 1/3rd to £2m per annum, since the capital spend on the project has also reduced. Overall affordability has still been improved as a result of the wider renegotiation with Veolia.

Current Contract Performance

36. The waste contract is achieving unprecedented levels of customer satisfaction at the Recycling Centres, which also reach class leading recycling performance, and the contract as a whole is delivering significant landfill diversion performance for the Council.
37. Overall county wide recycling levels are generally static at around the national average of 44%, but since $\frac{3}{4}$ of the tonnage managed is collected from the kerbside they are very much dependent on the service provided at borough and district council level. In Nottinghamshire this varies between around 20% in Bassetlaw and almost 50% in Rushcliffe.
38. An outline of the performance measures and metrics are included at Appendix 2, with detailed information for 2015-16 contained within the Veolia Annual Report at Appendix 3. The 2016-17 Veolia Annual Report has not yet been finalised. Further information is available through the background papers.
39. Despite judicious application of the payment and performance mechanisms contract deductions on the project have generally been minimal, with all output targets met to date, indicating the diligence of Veolia and the quality of the facilities and services provided.

Current Factors Affecting the Project

40. Common issues affecting all of the PFI projects include the lack of suitably skilled and experienced staff able to manage the detailed operational and commercial issues behind the contracts and the complex interfaces between the partners involved. Resourcing to effectively manage the risk and cost of these (and other) major projects is a key issue for the County Council if it is to ensure that the contracts continue to offer value for money.
41. Economic fluctuations affect the level of inflation paid on contract rates, which can widen the affordability gap by increasing the difference between the fixed payments made by HMT and the monies paid to the contractors. Specifically in the waste arena the state of the economy is directly reflected in the growth of waste tonnages, increasing contract costs, and historically significant year on year increase in landfill tax rates have driven similar increases across all treatment solutions.
42. Although contractual disputes do not occur often, when they do they are usually complex to resolve, and where they involve national government or local authority partners may have a significant political dimension.
43. Going forward, ensuring continued robust contract management and appropriate financial planning is in place to ensure the various arrangements remain affordable will be essential to their continued sustainability.

Contract Management Resources

44. The waste project is valued at around £30m per annum, and is currently managed by the Group Manager, Waste and Energy Management within the Environment, Transport and Property Division of the Place Department, although the department itself is in the process of being restructured.
45. The waste management team (including the non PFI element) is operated by a small group of specialist staff with strong project management and commercial skills, acting as the retained intelligent client function of the Waste Disposal Authority (WDA) for Nottinghamshire. This includes providing waste treatment and disposal arrangements, and strategy and policy guidance in respect to the management of all Local Authority Collected Municipal Waste (LACMW) in the County.

Other Options Considered

46. None at this stage although in considering this report Members will identify whether there are any actions they require in relation to the issues contained.

Reason/s for Recommendation/s

47. Members of the Committee will no doubt appreciate the high value and complex nature of the PFI Waste Management Contract.

48. In considering this report they will identify whether there are any actions they require in relation to the issues contained, however it is considered that Members can at this point be satisfied that, with appropriate staff and financial resource allocation, the PFI Waste Contract will continue to deliver affordable and high quality waste management services for the County Council until the end of the relevant contract term.

Statutory and Policy Implications

49. This report has been compiled after consideration of implications in respect of crime and disorder, finance, human resources, human rights, the public sector equality duty, safeguarding of children and vulnerable adults, service users, sustainability and the environment and ways of working and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

Financial Implications

50. Although this report is for information only the PFI Waste Management contract represents a significant financial commitment for the County Council and continues to offer a value for money mechanism for delivering the relevant services. The PFI Financial model is updated annually to accommodate changes in tonnage levels and inflationary increases, current forecasts are that the predicted costs will be contained within the PFI Reserve and annual revenue budget.

Legal Implications

51. PFI contracts are complex contractual arrangements for the delivery and long term management of high value projects and as such are subject to significant scrutiny and oversight by the County Council, HMT, and sponsoring Government departments. Contracts have to be managed, and where appropriate varied, within tight guidelines and best practice standards, and therefore both schools contracts, and the waste contract, have been suitably supported by both internal and external legal advice.

Implications for Service Users

52. The waste service is well liked by the public with high customer satisfaction scores, achieves high levels of landfill diversion, and all at a cost which puts the Council in the bottom quartile of all Waste Disposal Authorities in England.

53. The contract continues to provide a value for money solution to meet the requirements of the residents of Nottinghamshire.

Implications for Sustainability and the Environment

54. The PFI Waste Contract has delivered significant investment into the County in order to help improve recycling performance and reduce reliance on the use of landfill for waste disposal.

Recommendation

1. That members consider whether there are any actions they require in relation to the issues contained within the report.

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For any enquiries about this report please contact:
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Constitutional Comments (SLB 25/08/2017)

Finance and Major Contracts Committee is the appropriate body to consider the content of the report. If Committee resolves that any actions are required it must be satisfied that such actions are within the Committee's terms of reference.

Financial Comments (SES 29.08.2017)

There are no specific financial implications arising directly from this report.

Background Papers and Published Documents

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

The following Reports to Environment and Sustainability Committee;

3 November 2016 - Performance Report – Waste Management – 2015/16 outturn

21 July 2016 - Waste Management PFI Contract – Mansfield and Ashfield Residual Waste Treatment Solution

4th September 2014 - Waste Management PFI Contract - Revised Project Plan

30th January 2014 - Waste Management Contracts

Electoral Divisions

All