Business Opportunities for Investment in Municipal Waste Management Through the Private Finance Initiative

Introduction

Waste management supports Defra objective 5 (to promote sustainable management and prudent use of natural resources domestically and internationally) and represents a key environmental challenge for the UK. It is an area in which spending has grown and is set to continue to grow significantly in the coming years. This is being reflected in the extent to which waste is being raised up the political agenda both locally and nationally and in terms of the settlement for credits to support the private finance initiative (PFI) in waste, coming out of the government’s Spending Review 2004. The focus for government and local authorities on meeting increasingly challenging targets, both now and through time mean we are seeing ongoing growth in what is, in many ways, a whole new business sector. This growth in demand needs to be mirrored by development of the private sector capacity, supported by increases in bidder resources. This document considers the size of the investment challenge in waste (specifically for municipal waste), the main sources of funding to meet that challenge and Defra’s approach to enabling investment in waste management infrastructure, focussing on the role of PFI in waste.

Background

The UK currently produces in the order of 22 million tonnes of municipal solid waste (MSW)\(^1\), of which over 80% is landfilled; the highest level in Europe. Local authorities in England alone spend around £1.6bn a year on waste collection and disposal, largely spent through contracts with the private sector and dominated by disposal at landfill sites. The EU landfill however requires the UK to achieve challenging targets to reduce landfill by 2020, with milestones at 2010 and 2013\(^2\). The Strategy Unit report, ‘Waste Not Want Not’, estimated that the infrastructure investment required to achieve these targets is around £600m to £700m per annum for the next 10 years. The industry itself estimates this to be greater.

Longer term, Defra’s aim is to ensure investment takes place where it is most efficient for it to do so and where it will bring the greatest level of benefit and value for money nationally and locally. The vehicle for delivering this is the Waste Implementation Programme, established in line with a recommendation contained in ‘Waste Not Want Not’. The main central government sources for funding capital investment available to local authorities are shown in table 1 below.

Table 1 – Funding Sources for Capital Investment in Waste

<table>
<thead>
<tr>
<th></th>
<th>£ millions</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2004/05</td>
</tr>
<tr>
<td>Capital grants to LAs*</td>
<td>73</td>
</tr>
</tbody>
</table>

\(^1\) MSW is waste collected by, or on behalf of a local authority and is around 80% constituted of household waste.

\(^2\) Article 5 of the EU landfill directive requires the UK to reduce landfill of MSW, as a proportion of 1995 waste arisings, to 75% by 2010, 50% by 2013 and 75% by 2020.
PFI credit approvals

* Including 2003/04 carry forward. Fully replaced by a performance reward grant from 2006/07.

In addition local authorities can undertake locally funded capital expenditure, in line with the new prudential financing regime. Whilst, in public sector terms this represents a significant increase in infrastructure investment, there is still a sizeable gap, which represents a major investment opportunity for the private sector; estimated variously at around £8bn over 10 years. A key tool for attracting much of this investment will be the waste PFI.

**PFI: The Current State of Play**

Since the conservative government introduced PFI in 1995, 9 projects receiving central government support have reached commercial and financial close, representing £594.8m of capital investment and total contract values of £5.6bn. A further 7 projects are in procurement with expected capital values totalling £456.1m and total contract values of £3.9bn. The projects are detailed in table 2.

Table 2 – Waste PFI Projects Signed or in Procurement

<table>
<thead>
<tr>
<th>Project</th>
<th>Total Capex £m</th>
<th>Total Contract Val £m</th>
</tr>
</thead>
<tbody>
<tr>
<td>Isle of Wight (signed 1997/98)</td>
<td>9.1</td>
<td>91.9</td>
</tr>
<tr>
<td>Kirklees (signed 1997/98)</td>
<td>44.0</td>
<td>332.7</td>
</tr>
<tr>
<td>Hereford and Worcester (signed 1998/99)</td>
<td>80.9</td>
<td>872.8</td>
</tr>
<tr>
<td>Surrey (signed 1999/2000)</td>
<td>103.0</td>
<td>737.3</td>
</tr>
<tr>
<td>South Gloucester (signed 2000/01)</td>
<td>34.7</td>
<td>248.7</td>
</tr>
<tr>
<td>East London WA (signed 2002/03)</td>
<td>103.0</td>
<td>1,413.9</td>
</tr>
<tr>
<td>East Sussex (signed 2002/03)</td>
<td>144.5</td>
<td>1,064.9</td>
</tr>
<tr>
<td>West Sussex (signed 2003/04)</td>
<td>27.5</td>
<td>533.8</td>
</tr>
<tr>
<td>Leicester City (signed 2003/04)</td>
<td>48.1</td>
<td>318.7</td>
</tr>
<tr>
<td>Central Berkshire (in procurement)</td>
<td>48.4</td>
<td>468.6</td>
</tr>
<tr>
<td>Gloucester (in procurement)</td>
<td>46.0</td>
<td>686.4</td>
</tr>
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<td>West Berkshire (in procurement)</td>
<td>26.8</td>
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</tr>
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<td>Cornwall (in procurement)</td>
<td>76.7</td>
<td>572.0</td>
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<td>Nottinghamshire (in procurement)</td>
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<td>Lancashire (in procurement)</td>
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</tr>
<tr>
<td>Northumberland (in procurement)</td>
<td>73.2</td>
<td>516.6</td>
</tr>
<tr>
<td>Totals</td>
<td>1,050.9</td>
<td>9,509.5</td>
</tr>
</tbody>
</table>

Notes:
1) Figures are estimates for projects still in procurement.
2) Figures are based on prices in the year of contract signature.
3) Includes all projects approved up to August 2004.

In addition, further projects are at OBC stage or are expecting to make submissions to Defra over the next 6 to 8 months. These are shown with their MSW waste arisings in table 3.
Table 3 – Short Term Forward Deal Flow

<table>
<thead>
<tr>
<th>Project</th>
<th>Arisings KTPA*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greater Manchester</td>
<td>1,400</td>
</tr>
<tr>
<td>Coventry &amp; Solihull</td>
<td>240</td>
</tr>
<tr>
<td>Cambridgeshire</td>
<td>270</td>
</tr>
<tr>
<td>Shropshire</td>
<td>200</td>
</tr>
<tr>
<td>Southwark</td>
<td>140</td>
</tr>
<tr>
<td>Wakefield</td>
<td>200</td>
</tr>
<tr>
<td>Norfolk</td>
<td>440</td>
</tr>
<tr>
<td>Derbyshire</td>
<td>520</td>
</tr>
<tr>
<td>Dorset</td>
<td>200</td>
</tr>
</tbody>
</table>

*Sourced from business cases and LASU survey data.

This clearly represents a growing demand for PFI on the part of local authorities. We recognise however that the private sector has historically had a number of concerns about the waste sector, leading to some reticence on the part of the existing UK waste industry to crank up their investment resources and on the part of banks and insurers to enter the market in the first place. This has resulted in Defra commissioning studies on bank issues and barriers to new entrants. These studies involved talking to a number of banks and overseas waste management companies, the outputs from which were considered in work shops. The key findings of the two workshops are shown at appendices B and C respectively.

Some of the issues identified are already being tackled by government and include:

- a £30m programme of investment in pilot schemes demonstrating new and alternative technologies to process waste;
- more detailed guidance for local authorities on procurement (in particular the development of a waste PFI procurement pack, work led by the 4Ps);
- local authorities being required to have in place robust, widely agreed joint municipal waste management strategies, waste local plans and sufficient project management resources before being awarded PFI credit support;
- a wider ranging review of and consultation on the criteria for waste PFI to be undertaken towards the end of 2004; and
- the inclusion of refuse derived fuel (RDF) in the upcoming review of renewable obligation certificates (ROCs).

However, these do not address all the issues identified and it is the need to address the gap that forms the basis of our approach to waste PFI in the medium term.

**The Way Forward for Waste PFI**

The overriding requirement is simply to increase the level of investment in waste infrastructure. PFI will clearly need to play a major part in encouraging this growth. The key elements of our approach include:

- raising awareness in the private sector about the waste sector;
- the development, identification and dissemination of best practice in the procurement of waste services and infrastructure;
the role of government in addressing those risks that are for government to address;
the need to open up market supply side capacity in waste;
Increasing funder capacity; and
Providing a forum for identifying and resolving key sector delivery issues.

**Raising awareness:** There is a need to address the perceptions that exist with regard to the waste sector. Certainly there are very valid issues and concerns on the part of the private sector that need to be addressed. The key ones include:

- certainty on future deal flow;
- the time and costs associated with procurement; and
- risk transfer in terms of planning, new/alternative technologies and deferred/unspecified solutions.

There is also a certain amount which is based on history and perception. The waste sector has come on significantly in recent years and there is a far greater emphasis being given to waste by central and local government and a number of agencies. We need to make the private sector more aware of this activity and to keep it up-to-date once we have begun that dialogue. As such we propose to increase the work done by Defra, 4ps and PUK on engaging with bidders and funders.

As a starting point we have developed a communications plan for waste PFI which seeks to address these perceptions, raise the profile of waste PFI and to act as the basis for a forward communications programme. The details of this plan are included at appendix C.

**Best practice:** As the market matures and lessons are learnt, it is important that local authorities, contractors, funders and advisors are not continually reinventing the same wheels. We recognise that improving the knowledge of and building procurement expertise at local authorities will go a long way towards building confidence in the market. We also recognise that local authorities and the market can benefit from local authorities having clear guidance on the procurement process. Finally, there is a need to ensure that the bid costs associated with the PFI procurement process are not unreasonably high and that the process itself is not unduly long.

The intention is to build up our evidence base and to use this to inform best practice and to further develop the procurement guidance for the waste sector, building on the waste management PFI procurement pack developed by the 4Ps and the Waste and Resource Action Programme. Beyond Defra and the 4Ps advising local authorities as part of the outline business case (OBC) process, we intend, working with the 4Ps, to be more proactive in continuing to monitor and support local authorities as they go through the main procurement process itself, up to and including full business case (FBC) approval. As part of this 4Ps are engaging directly in supporting key projects and dealing with key sector issues as they support local authorities to procure. Enabling greater LA networking and sharing of knowledge gained through experience will steadily build public sector expertise. This taken together with
building up sector specific procurement guidance will ensure that procurement
times and costs for both the private and public sectors are minimised. This
development will include close liaison with Partnerships UK to ensure broad
compliance with the latest version of the Treasury’s Standardisation of PFI
Contracts (SoPC).

**Government’s role in addressing risk:** One of the major benefits of PFI
has always been that those risks are managed by those best placed to
manage them; i.e. recognising that in terms of delivering major infrastructure
projects to time and budget and managing the ongoing service provision that
goes with it can often be better managed by the private sector than by the
public sector. However, there are a number of areas where government can
reasonably work to better enable the development of this sector. Planning,
end user markets and uncertainty around new and alternative treatment
technologies are all areas where building the management and pricing of risk
into contracts are raising real difficulties for the sector. Government can and
will do more to act as an enabler in addressing these issues.

On planning, we are working very closely with the Office of the Deputy Prime
Minister (ODPM) as part of the review of the waste specific planning guidance
that is due to go out to consultation in late 2004. Likewise, in liaising with the
Department of Trade and Industry (DTI) on the review of the renewable
obligation certificates, also due to go to consultation later in the year, we have
ensured that RDF is to be included in that review. Through the Waste and
Resources Action Programme (WRAP) we are also making funds available to
pump prime the development of markets to utilise recyclates.

Another area where we are proactively enabling market development is in the
area of new and alternative technologies. This is being addressed through
the investment of £30m to fund a number of pilots over the next 3 years, to
establish their credentials as working technologies, thereby enabling the real
risk of such technologies to be measured and allowing that risk to more
readily be priced in the future. This programme includes the development of a
data centre on such technologies which will be freely available to local
authorities, thereby enabling more informed debate by stake holders and
more robust planning decisions.

**Supply side capacity:** Some history and perception has, we recognise been
responsible for discouraging the greater involvement of banks and other
financial institutions. This is on of the factors acting to constrain the capacity
of the market to undertake major PFI projects. As touched on earlier in this
document, bid costs are also proving to be a deterrent for some organisations.
Also, uncertainty over deal flow prevents the private sector from clearly
assessing the extent of the potential opportunity or the timing of the resources
they would require to take advantage of that opportunity.

Greater and more explicit management of the deal flow to the market will start
to allow greater clarity of foresight, enabling more informed planning in the
private sector whilst the work on best practice and procurement guidance will
start to have a positive impact on the procurement timetable. The sector itself
has moved on considerably since the early days in waste PFI and the
communications plan at appendix C will be key in ensuring that the market is
kept more up-to-date with what is happening in the sector. Defra and 4Ps officials are also undertaking meetings with private sector and funder organisations to appraise them of developments in the sector and to hear what issues they have regarding the waste sector. This includes looking to parts of the private sector other than the conventional market players as technology potentially opens the door for engineering solutions to be brought to waste management. Results to date are encouraging, but there is clearly more to do and we also recognise the need to keep communications forums going.

Dependant on the success of the waste PFI, there is likely to be a point where the existing level of credits available is exhausted and we need to look at other approaches to help meet the investment needs of the sector. Researching alternative funding sources (e.g. EU grants) and variants on and alternatives to the conventional PFI contracting model (e.g. joint venture, equity models, regional procurement models) could deliver further solutions to help build the level of investment in infrastructure.

**Review**

We believe this document to be the first that sets out the government's position on the waste PFI and what strategic direction we are taking going forward. Over time however, things will move on and legislative and other changes will come about. Accordingly, the approach we are taking will be kept under regular review and revised as necessary.
Current Issues faced by banks in financing waste PFI

Introduction
This report summarises the outcome from a workshop that investigated the reasons why banks are reticent to become involved in the waste PFI sector. It draws on an earlier interim report produced by Partnerships UK and the experience of the PFI Delivery Panel.

Summary
The Waste Implementation Programme (WIP) within DEFRA has responsibility for ensuring the UK meets its targets for recycling and diversion of biodegradable municipal waste (BMW). These targets will only be met if local authorities move rapidly to procure new methods of sorting and treating municipal solid waste (MSW) through Integrated Waste Management (IWM) contracts. To assist in what is a significant increase in capital expenditure in this sector the Government has introduced PFI funding. However, the level of participation by banks has been poor compared to other sectors and this is some matter for concern as there is limited time to procure and develop these new facilities before the targets have to be met.

The workshop considered the various issues reported by the banks that were creating these barriers to investment. These revolved around;

- Local authorities understanding of the procurement process
- Technology
- Land availability (sites)
- Planning
- Permitting
- Materials market risk
- Contractual and legal complexity

These issues were reviewed against current programmes of work to consider if there were any gaps that needed to be addressed in order to introduce more confidence and thereby competition into the market for finance.

The overall conclusion was that several initiatives had already begun to improve the perception of the banks and these needed to be built upon and strengthened in some areas. Perhaps more importantly it was agreed that the various initiatives should be drawn together to present a cohesive approach to the perceived barriers through a process of continuous communication. The details of these issues and the initiatives identified to resolve them are given in the report that follows.

Scope of report
The WIP within Defra is tasked with facilitating an increased level of recycling and diversion of BMW from landfill. To achieve this it has set up a number of
initiatives aimed at developing the market working alongside the PFI Delivery Panel. The panel is investigating a range of issues to encourage greater participation and competition within the sector. The area of concern in this report is the banking sector.

In order to inform the panel about the issues a report was commissioned by Defra with Partnership UK. The aim of this report was to:

- Improve Defra’s understanding of bank attitudes towards the financing of projects in the sector;
- Identify barriers to greater competition for the provision of finance.

A copy of the report is at Annex A.

This report is based upon the findings of the Partnership UK study and a workshop with the PFI Delivery panel; the aim of the workshop was to discuss and review the findings and make recommendations concerning further action.

**Background to issues**

The market opportunities in the Municipal waste sector over the next 5 to 10 years are significant and have been variously estimated at around £8.0bn.

The market is driven principally by EU Directives that place an obligation on the UK to reduce its reliance on landfill, which it is meeting in part by seeking to increase its level of recycling. The first key date for landfill diversion is 2010. Government has passed down these targets to local authorities who have a responsibility for waste management (and collection). In order to meet these targets local authorities face a significant challenge, as they have to move from the current simple arrangement for landfill disposal to what is termed “Integrated Waste Management” contracts. These contracts involve a range of processes aimed at sorting, separating and treating MSW; the processes are often new to the UK market and there is limited appreciation of how they work, the impact they will have on the local environment and consequently how they should be regulated. This all adds up to complexity often delaying decision making.

At the same time these represent major capital-intensive projects (compared to landfill which was largely financed by the private sector) aimed at serving the community over 25 years and as with other sectors the Government has introduced PFI funding to assist in this development.

The use of PFI finance in itself has introduced a further new area for many local authorities adding to the list of new skills they need to learn in order to produce a coherent and practical waste management plan and prosecute the negotiation of the tender to a successful and timely conclusion.
Waste PFI contracts also vary from other PFI sectors as a result of the need to transfer the existing waste disposal service from day one of the contract and then add in the new infrastructure (and planning permissions) according to the targets (and to manage affordability), such that capital is rarely utilised immediately. This will nearly always be different for each LA, as the demographics of waste production and availability of assets varies from location to location, of which there are over 200. These, plus other factors peculiar to waste management, introduces risks that are not always well understood by the stakeholders and has been a particular concern of the banks. These include:

- LA understanding of the procurement process
- Technology
- Land availability
- Planning
- Permitting
- Materials market risk
- Contractual and legal complexity

As a consequence, the rate of successful tendering has been slow, which is of concern, as the landfill diversion targets are rapidly appearing on the horizon. Part of this inertia has simply been that many local authorities do not realise the magnitude of the task in front of them, however, there are a number of contracts that have run up against severe difficulties post financial close, that has led to banks treating the sector with some caution.

These factors have conspired to limit the number of banks entering the market and to threaten the rate at which new IWM contracts have been rolled out.

**Review of issues**

In order to evaluate and determine what actions need to be taken to reverse the above position the issues were reviewed in terms of their impact on the procurement process to assess whether they were material barriers or simply perception. This was done by reviewing the work currently in hand by Defra, WRAP, Partnership UK and 4Ps and establishing what further actions could usefully move the process forward.

In the banks view the main barriers were;

- Local Authority procurement capability
- Difficulties in the procurement and operation of the contracts
- Sporadic deal flow
- Risk and reward profile
- The inflexibility of PFI contracts with regard to planning and sustainable markets for materials

Many of these issues were interlinked and started with the LA’s approach to planning for waste management procurement. It was felt that with better
planning at the outset issues like setting realistic targets, identifying operational sites, identifying technologies and associated planning issues, and the materials output from the processes could be considered from the outset and mitigated.

This would in turn assist in identifying many of the key risks at the time of tendering and mean that the stakeholders would understand the issues at the outset and could focus their negotiation on the purely commercial issues at stake; reducing the time to financial close and the need for intervention by various advisors; all contributing to increased cost. All in all leading to a more rapid conclusion of contracts and improving deal flow. The fact that many more local authorities have now applied for PFI credits means that deal flow should be less of a problem (see table below).

### Total current contracts 242 over 27m tonnes waste

### Contracts due for re-tendering between 2004-2006

<table>
<thead>
<tr>
<th>Contract</th>
<th>2004 tonnage</th>
<th>Contract</th>
<th>2005 tonnage</th>
<th>Contract</th>
<th>2006 tonnage</th>
</tr>
</thead>
<tbody>
<tr>
<td>West Sussex</td>
<td>330</td>
<td>Buckinghamshire (part?)</td>
<td>190</td>
<td>Kent</td>
<td>520</td>
</tr>
<tr>
<td>Tower Hamlets</td>
<td>195</td>
<td>Windsor &amp; Maidenhead</td>
<td>88</td>
<td>Bexley</td>
<td>110</td>
</tr>
<tr>
<td>Central Berkshire</td>
<td>210</td>
<td>Croydon</td>
<td>173</td>
<td>Southwark</td>
<td>120</td>
</tr>
<tr>
<td>West Berkshire</td>
<td>120</td>
<td>Warwickshire</td>
<td>185</td>
<td>West London Waste (part)</td>
<td>200</td>
</tr>
<tr>
<td>Dorset</td>
<td>145</td>
<td>Sandwell</td>
<td>75</td>
<td>Wiltshire</td>
<td>55</td>
</tr>
<tr>
<td>Gloucestershire</td>
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<td>Walsall</td>
<td>120</td>
<td>Greater Manchester</td>
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<td>180</td>
<td>Conwy</td>
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<td>Staffordshire</td>
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<td>Derbyshire</td>
<td>440</td>
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</tr>
<tr>
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<td>Highland</td>
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<td>Cambridgeshire</td>
<td>250</td>
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<tr>
<td>Wakefield</td>
<td>170</td>
<td>Warrington</td>
<td>120</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sunderland</td>
<td>125</td>
<td>North Yorks</td>
<td>380</td>
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<td></td>
</tr>
<tr>
<td>Lancashire</td>
<td>750</td>
<td>York City</td>
<td>110</td>
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<td>Cumbria</td>
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<td>Denbighshire</td>
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<td>Bridgend</td>
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<tr>
<td>Merthyr Tydfil</td>
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<td>Gwynedd</td>
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<td>Clackmannishire</td>
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<td>Vale of Glamorgan</td>
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<td></td>
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<tr>
<td>Dumfries &amp; Galloway</td>
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<td>Rhonda Cyon Taft</td>
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<td>Aberdeenshire</td>
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<td>East Ayshire</td>
<td>75</td>
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<tr>
<td>South/North Lanarkshire</td>
<td>380</td>
<td>Edinburgh</td>
<td>95</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>West Dunbartonshire</td>
<td>40</td>
<td></td>
<td></td>
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<tr>
<td><strong>Total</strong></td>
<td><strong>4568</strong></td>
<td><strong>Total</strong></td>
<td><strong>3803</strong></td>
<td><strong>Total</strong></td>
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<td><strong>Cumulative tonnage</strong></td>
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<td><strong>Cumulative tonnage</strong></td>
<td><strong>11252</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Some figures are for landfill disposal only and will be an underestimate. Figures in Bold denote PFI funding (granted or applied for).

Matters concerning technology choice had two implications for the banks. The first being whether the technology was proven and the consequences of who picked up the liability if it failed; often the technology providers are small and have a weak balance sheet and are unable to provide the required warranties and guarantees. Secondly the uncertainty and delays surrounding planning applications and the timing of these within the contract that can often be programmed to occur some months or years after financial close (linked again
to targets and affordability); raising the question about who takes the risk of technology failure and the delay in finance being released (compared to the banks expectations).

These issues together with the risks associated with materials markets (again the banks need to see contractual certainty for the placement of these materials for the term of the contract) highlighted some difficulties with the rigidity of the rules for PFI contracts. This lead to the question of whether PFI was the right vehicle in these instances or whether contracts could be split or reduced in term to enable the issue of materials markets to be dealt separately from the core infrastructure contract.

The question was also raised as to how the banks decided which sector to invest in and how much.

**The way forward**

As a result of these discussions it was clear that progress was being made to improve the situation in a number of areas already and that the impact of this work was beginning to filter through. It was felt that by drawing all the strands together and adding in further initiatives identified by the PFI delivery panel, Defra could build upon the current work and be able to demonstrate a clear and coherent strategy, identifying by way of an integrated communications process the successes so far and the aims of the future work. The overall purpose being to introduce more confidence into the market by demonstrating that the barriers were being addressed and resolved systematically.

For simplification the issues were divided into several key areas identifying the current activity and the future actions and responsibilities, these are summarised in the tables below.

In addition to the specific outcomes in the tables it was concluded that the various initiatives identified within the actions below should be drawn together and presented by way of a seminar or other function to the banking community, demonstrating a coherent programme of actions where Defra were clearly shown to be leading the way and removing barriers and that this flow of communication should be frequently updated and reinforced as successful projects emerged into the market.
## Local Authority Procurement

<table>
<thead>
<tr>
<th>Issue</th>
<th>Current Activity</th>
<th>New Action</th>
<th>Responsibility</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning for procurement</td>
<td>4ps assisting local authorities with business cases and general advice</td>
<td>Continue activity and links with Defra</td>
<td>4ps/Defra</td>
<td>Improved quality of business case for PFI leading to more effective tendering</td>
</tr>
<tr>
<td>Standardisation of contract terms</td>
<td>4Ps and WRAP about to launch procurement pack</td>
<td>Increase Defra involvement and link support</td>
<td>4Ps/WRAP/Defra</td>
<td>Improve procurement process and negotiations</td>
</tr>
<tr>
<td>Sharing experience of procurement</td>
<td>4Ps network groups enable local authorities to learn from each others’ experience and from live projects</td>
<td>Continue activity</td>
<td>4Ps</td>
<td>Create best practice and remove contract snags</td>
</tr>
<tr>
<td>SoPC3 – Standardisation of PFI contracts</td>
<td>Treasury – updated guidance on PFI contracts (links with procurement pack above)</td>
<td>Advise local authorities that they will have to follow this line closely</td>
<td>Defra/4Ps</td>
<td>Improve procurement and contractual negotiations</td>
</tr>
</tbody>
</table>

## Planning

<table>
<thead>
<tr>
<th>Issue</th>
<th>Current Activity</th>
<th>New Action</th>
<th>Responsibility</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>LA influence on public perception</td>
<td>Very little</td>
<td>Local authorities to prepare the ground more effectively</td>
<td>4Ps/Defra to advise as part of application for PFI funds</td>
<td>Planning and/or the preparation for planning are tackled prior to financial close</td>
</tr>
<tr>
<td>Waste strategy/waste local plan</td>
<td>4Ps advising as part of above activities</td>
<td>Better policing from Defra</td>
<td>4Ps/Defra</td>
<td>As above</td>
</tr>
<tr>
<td>Public perception</td>
<td>WRAP – public education</td>
<td>Coordinate more</td>
<td>Defra/WRAP</td>
<td>Create a balanced public</td>
</tr>
<tr>
<td>Appendix A</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>programme on recycling</td>
<td>widely to include residual waste as well as recycling treatment</td>
<td>understanding about waste and the need for disposal</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consultation on various parts of the planning system – PPG10, Defra comments to consultation</td>
<td>Defra to specifically focus on issues to do with waste planning</td>
<td>Defra</td>
<td>Greater confidence in Defra’s commitment to changing the planning environment</td>
<td></td>
</tr>
<tr>
<td>Compulsory purchase order - Part 8 of the Planning and Compulsory Purchase Act 2004</td>
<td>Defra to determine what this means for waste planning and advise local authorities accordingly</td>
<td>Seeking advice on this issue</td>
<td>Defra</td>
<td>Reduce the risk associated with planning</td>
</tr>
</tbody>
</table>
## Technology

<table>
<thead>
<tr>
<th>Issue</th>
<th>Current Activity</th>
<th>New Action</th>
<th>Responsibility</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>WIP New technology demonstration programme</td>
<td>Launched in March and now processing applications – anticipated to iron out various issues to do with new technology</td>
<td>Continue to roll out programme</td>
<td>WIP</td>
<td>Greater confidence with technologies for all stakeholders</td>
</tr>
<tr>
<td>WIP Technology data centre</td>
<td>Provide information on a range of technologies</td>
<td>Continue to role out programme</td>
<td>WIP</td>
<td>As above</td>
</tr>
<tr>
<td>Rigidity of PFI contract</td>
<td>No action</td>
<td>Review contracts as experience of WIP new technology programme gained</td>
<td>WIP</td>
<td>Identify means of encouraging appropriate technology</td>
</tr>
</tbody>
</table>

## Communications

<table>
<thead>
<tr>
<th>Issue</th>
<th>Current Activity</th>
<th>New Action</th>
<th>Responsibility</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>Need to join up all the initiatives into a coherent communication plan</td>
<td>Relatively minimal and much on a 1 to 1 basis</td>
<td>Prepare communication plan for different audiences</td>
<td>Defra/WIP</td>
<td>Improve confidence in the market and demonstrate leadership from Defra</td>
</tr>
</tbody>
</table>
Introduction
This report summarises the outcome from a workshop that investigated the reasons why foreign companies have not entered the UK waste PFI market. It draws upon interviews with a number of foreign waste management contractors carried out jointly by PWC and E&Y.

Summary
The Waste Implementation Programme (WIP) within Defra has responsibility for ensuring the UK meets its targets for recycling and diversion of biodegradable municipal waste (BMW). These targets will only be met if local authorities move rapidly to procure Integrated Waste Management (IWM) contracts. To date, apart from the French and Portuguese companies in the UK, there has been little interest in bidding for these contracts by foreign companies; this is despite the size and value of the market and the specific aim to move away from landfill to recycling and treatment, so much more part of European waste management practice.

The workshop reviewed the various issues emerging from the interviews, which were:

- Market structure in the UK inhibits entry
- Lack of knowledge / local presence
- Scope of services
- Procurement process and evaluation
- Contract structure

Whilst some of the companies claimed to know the UK waste market it became evident that most were not well informed and there views were based around a perception of opportunities.

On this basis it remained unclear as to whether any of these companies would seriously get involved unless they were more fully briefed which in itself might put them off. It was decided therefore to look at the possibility of briefing a number of the more interested companies in greater detail whilst generally improving the quality of information to potential foreign entrants using established Government trade briefings.

A further suggestion then arose as to whether efforts to encourage new entrants generally might be better focused on other industry sectors in the UK, specifically FM and the Civil Engineering operators who already have experience of PFI from other sectors. This was felt to represent a good opportunity and that further work should be done to facilitate this.

Scope of report
The WIP within Defra is tasked with facilitating an increased level of recycling and diversion of BMW from landfill. To achieve this it has set up a number of
initiatives aimed at developing the market working alongside the PFI Delivery Panel.
The panel is investigating a range of issues to encourage greater participation and competition within the sector. The area of interest in this report is foreign entrants into the waste PFI market.

In order to inform the panel about the perception of foreign companies a report based around a series of interviews was commissioned by Defra jointly with PWC and E&Y. The aim of the interviews was to assist Defra in developing an understanding of:

- The extent of UK market constraints and the potential capacity available abroad
- The likelihood of overseas companies entering the UK waste PFI market under current market conditions
- The potential advantages to the UK of new entrants to the market
- The actual or perceived barriers to entry identified by those companies
- What steps that might reasonably and properly be taken by central government to help reduce these barriers

This report is based upon the findings of the work by PWC and E&Y and a workshop with the PFI Delivery panel; the aim of the workshop was to discuss the findings and make recommendations concerning further action.

Background to issues

The UK is anticipating significant growth in the waste PFI contract market. This is being driven by the need to meet a series of targets concerning the recycling and recovery of waste, diverting it away from landfill. The first target date is 2010 when over 5 million tonnes of BMW will have to be treated rather than landfilled.

To date 9 PFI waste contracts have been signed and progress has been slow, although the rate of procurement is set to increase significantly over the next few years. Currently there are 21 local authorities that either have their credits or have submitted business cases. Defra through its WIP and other members of the PFI delivery panel are working on a range of other initiatives aimed at stimulating the market. It is expected that this will mean more applications increasing the deal flow (which may be given further stimulus depending upon the outcome of the July 2004 spending review).

There is a concern, however, that the UK waste industry will not have the capacity to either bid or service this number of contracts. There is a range of reasons for this but experienced tendering resources and financial limitations are probably the main ones.

As a consequence Defra are seeking to discover whether non-UK businesses are interested in entering the market and to find out what barriers they believe exist and possible ways to resolve them.
Review of issues

PWC and E&Y provided an overview of their findings by way of a presentation, which then led on to a discussion around the issues emerging.

Quite quickly it became evident that many of the interviewees were poorly informed about the market and perception rather than facts were determining their views. Although some were simply too occupied with their own markets to consider expansion abroad.

The areas most relevant included;

- Service requirements
- Procurement process
- Cost of entry and profitability
- The PFI contract model

Many had an outdated understanding of what the PFI waste market demanded in terms of separation, treatment and recovery technologies assuming the UK was still bent on landfilling everything! This in turn led to concern about access to landfill and the belief that this was dominated by the major UK waste companies leading to a significant barrier to market entry. They also believed that integrated meant treatment and collection together whereas their preference was to do one or the other.

Leading on from this, as many saw an entry point through acquisition of a UK company, they felt there were limited opportunities and that prices were high. This way of accessing the market was born out of a view that contract sizes were insufficiently large to enter the market on the back of one contract alone.

There was clearly very little understanding of the magnitude of the market or the procurement process; knowledge that existed tended to focus on the difficulties.

There were natural concerns about the cost of market entry but more speculation about the level of profit with the assumption that it was low in comparison to their native markets.

There was surprisingly little belief that the UK was seeking technical and environmentally solutions and some, possibly, well founded cynicism that cost was a principle driver.

There were some interesting observations about PFI contracts themselves: too inflexible; high risk; no guarantees of input tonnages and lengthy contract terms leaving little scope to renegotiate as technology advances or waste inputs change. This stimulated a debate about the structure of markets in Europe; which is clearly different from the UK and where there is much greater public/private cooperation; often infrastructure is financed upfront by the Municipality and operated over a shorter term (5-10 years) by the private sector.

This generated a debate about the suitability of the PFI model for waste contracts and whether a new model could be developed that separated plant
and equipment infrastructure from operating the service. It also highlighted again the poor understanding of how PFI contracts operate (both input quantities and technology changes can be dealt with within the contract albeit with some difficulty) but perhaps more significantly illustrated a different approach to risk sharing; probably cultural?

The way forward

The general conclusion emerging from the above discussions was that opinion was based around poor information about the structure and scope of the market, which led to a tendency to assign too much weight to some areas and misunderstand others. Consequently the barriers to entry were perceived to be high and complex, creating a risk adverse response.

This meant that until companies could be given a clearer picture of the opportunities and be allowed to judge risk more objectively then it would be difficult to determine their real appetite for entering the market.

It was felt that 2 courses of action could be developed to change this;

1. Consider providing a prospectus or seminar for those companies that requested further information to allow them to take an informed view of the market;

2. In the longer term ensure that briefings were provided to DTI in their role encouraging inward investment to ensure that the scope and opportunities in the market were well publicised.

By and large, however, it was believed that the scope for foreign entrants was limited which led to a further debate around other sectors from within the UK who could carry out this type of work.

The possibility of encouraging companies with experience and a track record of PFI in other sectors was considered and those with facilities management (FM) and civil engineering skills were identified as being the most appropriate.

This stimulated a review of some of the issues that had been discussed about foreign entrant which was also relevant to new entrants from within the UK, including:

- Concerns about the requirements for pre qualification – Currently demands were made for companies to specifically have waste management expertise, which largely arose from landfill experience.

- Requirements under the EPA 1990 – Concerned with the number of bidders required and the inflexibility this introduced.

- PFI contract Structure – The possibility to reconsider the term of the contract and introduce greater flexibility.

- PFI credits and the assessment criteria – The opportunity to build into the criteria alternative model structures to improve flexibility.
As a general point it was agreed that a mechanism should be found to approach companies within the UK to test their appetite for the market and assuming a positive result followed up with a seminar and/or prospectus.

Many of the initiatives identified within the finance sector in the previous workshop would then also become relevant.
WASTE PFI COMMUNICATIONS PLAN

Introduction

This paper compliments the main ‘investment opportunities’ document for waste PFI. It sets out in greater detail the communications strategy which will support and help deliver what is set out in the main document. The objectives of this paper are to:

- set out our priorities in a clear and understandable way to a wide audience;
- establish our long term commitment to tackling the issues facing investment in waste and to the waste PFI; and
- set a reasonable level of expectation as to governments’ role on moving the agenda forward.

Issues

Lack of outward communication: History and perception have had a large part to play in the understanding that the private sector has about the waste PFI. However, the waste sector has moved on since 1995, when the conservative government introduced PFI and the Treasury PFI Task Force worked with local authorities to negotiate the first PFI contracts in waste. Some work has been done with local authorities to communicate this, but very little strategic communication has so far been undertaken with the private sector; thereby allowing rumour and legend to perpetuate. We therefore need to make clear to a wider audience our intentions with regard to the waste PFI.

Future demand: One major issue for banks and the investment boards of private sector organisations is to have a view of forward demand. Without this there is no certainty of an ongoing market or its size and organisations cannot assess the extent, if any, to which they may want to build up resources to invest in a sector. We recognise this issue and need to ensure the market place has as much information as possible on future demand for PFI.

Keep the news coming: Government can too easily slip back into its silos once the main messages have been shared. Once we have started talking to the wider world, we need to keep that communication going, ensuring consistent messages and that there are no undue surprises. This will be an important element of underpinning market confidence and stability. It will also be key in working with colleagues in local authorities and across government.

Proactive interaction at all level: Individual organisations will have specific issues and possibly specific strengths it can bring to the waste PFI market. We need to ensure we understand the issues and that any potential opportunities are not missed, that we understand what market players have to offer and how this can benefit the sector. This will need to happen at all levels and will need to include individuals and representative bodies if we are to have a comprehensive understanding of the issues out there.
Plan

In order to address these issues we need to start the ball rolling and then keep it rolling. We therefore have a six point plan which will form the basis of our communications with the outside world. This includes:

- introducing the private sector to waste PFI, related issues and what Defra, et al are doing in this field;
- ongoing communication/updates to the private sector;
- keeping the public sector up-to-speed and continually gauging demand;
- proactive engagement with current and potential players/stakeholders;
- selling the potential, but managing expectations;
- taking mythology and rumour out of the waste PFI and replace it with a regular flow of facts; and
- managing out concerns on costs by using procurement packs, standardisation, rigour on OBC approvals, site development to create a level playing field, timing the role of BPEO, etc.

Delivery

**Addressing the outside world:** It is important that we make clear our position and ongoing intentions with regard to the waste PFI. Defra is serious about tackling the issues in waste, delivering the EU landfill directive targets and supporting the development of the major infrastructure and service delivery projects that will play a major role in the delivery of those targets. Our ‘business opportunities’ document, of which this forms part, will be the first step in delivering that message. This will be reinforced with a major, Defra sponsored PFI event aimed at current and potential players in the waste market.

**Future demand:** Local authorities are and will always be at different stages of development in terms of their local waste management strategies, infrastructure, service delivery and contract commitments. It will continue to be important that when local authorities do go to market, that they have projects that are robust, bankable and deliverable. Working with the 4Ps, we need to regularly monitor the progress of individual local authorities and LA partnerships in order to assess if they will be best served by the PFI route and if so, when they are most likely to be ready for market. We then need to share that with the market place and ensure it stays up-to-date. This is likely to take the form of information made available on the Defra and 4Ps websites and through articles in various periodicals.

**Keep the news coming:** To ensure the momentum is kept going, we need to keep a regular flow of facts to all players and stakeholders, both private and public sector. This will be achieved through various routes, including; e.g. development of an informative and up-to-date web site, a flow of relevant information through various periodicals, developing networks, wider consultation on specific issues, development of marketing material on waste
PFI, improved monitoring and evaluation of projects in the market and continuous development of best practice guidance.

**Proactive interaction at all levels:** Both Defra and 4Ps have been meeting with some organisations on a one-to-one basis for some time, to gain an understanding of perspectives, discuss general issues around the waste PFI and to start to communicate our own position and developments. The intention is that this will continue.

We have also met with and have a regular dialogue with representative organisations in the waste sector. We shall need to expand on this; particularly as we seek to open up the market to bring in new players, perhaps from other areas of the private sector (e.g. civil engineering companies and service providers with PFI experience in other sectors).

**Review**

Over time, we know there will be developments and changes in legislation, technology, targets, etc. Accordingly, this document will be kept under regular review and revised as necessary to meet the changing environment the sector finds itself in.