

## Report of the Director of Environment and Neighbourhoods

### Report to the Executive Board

**Date:** 20<sup>th</sup> June 2012

**Subject:** Waste Solution for Leeds – Residual Waste Treatment PFI Project – Final Business Case and Contract Award

Are specific electoral Wards affected? If relevant, name(s) of Ward(s): ALL	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Are there implications for equality and diversity and cohesion and integration?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Is the decision eligible for Call-In?	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No
Does the report contain confidential or exempt information? Access to Information Rule 10.4 (3) Appendices 2b and 3	<input checked="" type="checkbox"/> Yes	<input type="checkbox"/> No

### Summary of main issues

This report provides Executive Board Members with an update on the progress of the Residual Waste Treatment PFI project (the “Project”) since the last Executive Board update at the Final Tender Stage in November 2011. It requests Executive Board approval to submit the Final Business Case to the Department for Environment Food and Rural Affairs (Defra), explains progress to date, and details the work required to progress to financial close of the Project, including the award of the contract to Veolia.

### Recommendations

Members of Executive Board are recommended to note the contents of this report and to:

1. approve the submission of the Final Business Case (FBC) to the Department for Environment Food and Rural Affairs (Defra);
2. approve the submission of this report and subsequent minutes to Defra;
3. note the financial implications for the City Council set out in **appendix 2a** and the exempt **appendix 2b** of this report, and approve expenditure as set out in **appendix 2a** and the exempt **appendix 2b** to this report provided that the total estimated Unitary Charge for the Contract at the date of Financial Close is less than £502m, as set out in paragraph 3.7 of **appendix 2a**;

4. confirm the arrangements at section 5.5 of this report, and (for the avoidance of doubt) authorise the Director of Environment and Neighbourhoods (or delegate) to exercise the delegated powers, as set out at Part 3 Section 3E of the Constitution regarding PPP/PFI and other Major Property and Infrastructure Related projects, in relation to this Project;
5. approve the award of the contract to Veolia ES (Leeds) Limited, which is a wholly owned subsidiary of Veolia ES Aurora Ltd, and the process of achieving financial close as set out in this report; and
6.
  - i) note and confirm that the conditions of the General Disposal Consent are satisfied at the date of this report;
  - ii) approve the disposal of the site at an undervalue in excess of £100,000; and
  - iii) authorise the Director of City Development (or an officer with appropriate delegated powers) to take all action required to conclude the disposal of the site including carrying out the actions described at paragraph 4.9 of this report which may include seeking the consent of the Secretary of State prior to disposal if the circumstances set out at paragraph 4.9 change

## **1 Purpose of this report**

This report provides Executive Board Members with an update on the progress of the Project since the last Executive Board update at the Final Tender Stage in November 2011. It requests Executive Board approval to submit the Final Business Case to Defra, explains progress to date, and details the work required to progress to financial close of the Project including the award of the contract to Veolia.

A glossary of terms is appended at the back of this report.

## **2 Background information**

### Strategy and procurement process

- 2.1 The Project has been developed in response to the need to move away from the current reliance on landfilling for residual municipal waste due to its environmental impact and associated financial implications. Landfill Tax is currently at £64 per tonne, and will increase each year by £8 per tonne to a minimum of £80 per tonne by 2014. In 2011/12, the cost to the Council of Landfill Tax was £9.2m. An £8 per tonne annual increase in Landfill Tax equates to an additional cost of £1.5m per annum based on 2011/12 tonnages, which would see the Council incurring £13.7m per annum in Landfill Tax by 2014/15 alone, excluding disposal gate fees. Continued reliance on landfill is therefore unsustainable. The Integrated Waste Strategy for Leeds and subsequent updates include the following key targets:
- to increase recycling of household waste to 55% by 2016, with a long-term aspiration target to exceed 60%;
  - to recover value from 90% of all household waste by 2020.
- 2.2 The Project will provide a substantial contribution to the City's household waste recycling performance, and is fundamental to the achievement of the recovery target and the associated reduction in landfill.
- 2.3 The Outline Business Case (OBC) for the Project was approved by Executive Board in November 2007.
- 2.4 The City Council carried out a site selection study prior to the commencement of the procurement. This identified the former wholesale market site ("the Market Site"), owned by the City Council, and three other sites within Leeds which were deemed suitable for residual waste treatment. This study, together with its update in 2009, has been incorporated into the evidence base for the Natural Resources and Waste Development Plan Document (NRWDPD). The NRWDPD has been subject to a number of rounds of public consultation and approval by the Executive Board, and has undergone a formal Examination in Public by the Planning Inspector.
- 2.5 In July 2008, the Executive Board authorised officers to commence procurement of the Project in accordance with public procurement law and the City Council's Contract Procedure Rules by advertising in the Official Journal

of the European Union (the OJEU notice). The procurement was to be undertaken using the competitive dialogue process. The procurement was neutral regarding the location of any facility and the technology to be used. Further reports have been submitted to Executive Board to update progress at subsequent stages of the Project in November 2008, February 2010 and November 2011.

- 2.6 The OJEU notice was published on Wednesday 30th July 2008. Following publication and receipt of expressions of interest, a pre-qualification (PQQ) stage was undertaken. Thirteen bidders participated in the PQQ stage, and evaluation of the PQQ submissions subsequently reduced these to ten bidders who progressed to being invited to participate in the competitive dialogue process with the City Council.
- 2.7 The evaluation criteria and methodology were approved by Executive Board in November 2008 and have been used throughout the procurement. The evaluation criteria included a series of sub-criteria. At each stage of the procurement a series of subgroups have analysed each aspect of the submissions in accordance with this evaluation methodology and criteria.
- 2.8 The Invitation to Submit Outline Solutions (ISOS) was issued to bidders in November 2008 as the initial stage of the competitive dialogue procurement. Nine bidders offering a wide range of technology solutions, submitted proposals at this bid stage. Between them, they proposed to use three different sites, with the majority of the bidders proposing to use the Market Site. After the ISOS evaluation, four bidders were invited to submit detailed solutions.
- 2.9 The Invitation to Submit Detailed Solutions (ISDS) was issued to bidders in June 2009. The four bidders who participated in this bid stage were reduced to two bidders following evaluation of their detailed proposals against the criteria referred to above. The final two bidders were Aire Valley Environmental (a joint venture between Covanta Energy Ltd and Kelda Water Services Ltd) (“AVE”) and Veolia ES Aurora Limited (“Veolia”).
- 2.10 Following further refinement of these bidders proposals, the City Council requested that the final two bidders submit tenders and these were received on 15th July 2011. The evaluation of the tenders concluded that the most economically advantageous tender was submitted by Veolia, and it was therefore recommended that Veolia be taken forward to the preferred bidder stage.
- 2.11 The outcome of the evaluation of tenders was noted by the Executive Board in November 2011 and authority was given to proceed to the Preferred Bidder Stage, including formally appointing Veolia as the preferred bidder.

#### Veolia's technical solution

- 2.12 The solution proposed by Veolia is for a Recycling and Energy Recovery Facility (RERF).

- 2.13 The RERF comprises a first stage of mechanical pre-treatment (MPT) of the incoming waste to extract recyclate. The MPT will target the separation of ferrous metals, non-ferrous metals, paper, card and a range of plastics.
- 2.14 Veolia have guaranteed that the MPT facility will recycle a minimum of 10% of the input waste and, based on this level of recycling performance and the 164,000 tonnes per annum Energy Recovery Facility (ERF) capacity (see below), this equates to a Facility capacity of 183,000 tonnes per annum. However, Veolia have an aspiration to achieve up to 20% recycling of the input waste (e.g. as a result of waste composition changes, technical developments and innovations, etc.), and aim to maximise plant availability further wherever possible. The approval sought through the planning and environmental permit application will therefore be based on a maximum theoretical plant capacity of 214,000 tonnes to ensure the flexibility to enable these aims to be achieved.
- 2.15 Following the extraction of recyclate within the MPT, a single line energy recovery facility (ERF) is expected to process 164,000 tonnes per annum of prepared waste. The ERF will incinerate the non-recyclables under tightly controlled conditions and generate a significant amount of electricity (around 11MWe, sufficient to power 20,000 homes). The generated electricity will be exported to the electricity grid (see paragraph 4.10 of this report for the commercial arrangements).
- 2.16 Based on the projected tonnages for the first full Contract Year (2016/17), the RERF will accept 149,000 tonnes of Leeds' residual household waste ("Contract Waste"). It is proposed that the additional capacity in the RERF be used either to accommodate potential increases in Contract Waste above those forecast, or to process commercial and industrial waste from within Leeds of a similar nature to household waste (see paragraphs 4.3 and 4.4 for further detail in this regard).
- 2.17 Veolia's proposed RERF is also 'enabled' for the provision of Combined Heat and Power (CHP). Further information regarding this proposal is provided at paragraph 4.10 of this report.
- 2.18 In the first instance, Veolia propose to transport Incinerator Bottom Ash (IBA) to an off-site IBA Aggregates facility in Sheffield for processing. This will be operated by a third party. Should more local IBA processing capacity arise during the life of the Contract, Veolia will be able to review their outlet for this material. Once processed, the IBA will be used as aggregate in the construction industry.
- 2.19 The only residue from the process that will be landfilled is the flue gas treatment residues. However, there is the potential for these to be processed in the future with the result of further reducing landfill.

### **3 Main issues**

- 3.1 A draft of the Final Business Case (FBC) has been submitted to Defra and its Waste Infrastructure Delivery Programme (WIDP) on 25th May 2012. Subject to gaining approval from the Executive Board, a final version will be issued to

Defra for approval prior to financial close of the Project. The current draft of this FBC is provided as an exempt document in the Members' Library for inspection.

- 3.2 Since 2010, Veolia have undertaken a series of pre-planning consultation discussions with the City Council's City Development Directorate. Following this pre-planning phase, the planning application for the RERF is due to be submitted by Veolia prior to the Executive Board meeting at which this paper will be considered. The application comprises a comprehensive set of documents, which include a Design and Access Statement, an Environmental Statement reporting the results of the Environmental Impact Assessment and figures and photomontages (an artist's impression and site plan are included at **appendix 1**). These documents were subject to a formal review by the procurement team and its advisers to ensure they were sound and robust. The Planning Authority will process the planning application and obtain the views of consultees. It is anticipated that the application will be considered by Plans Panel East in early 2013.
- 3.3 A Gateway 3 review with a particular emphasis on the planning process, was carried out by Local Partnerships during week commencing 28<sup>th</sup> May 2012 to provide an independent assessment as to the likelihood of successfully completing the next phase of the programme and to identify any major risks going forward.
- 3.4 Full details of the Project timetable to date and proposed timetable through to Service Commencement is indicated below:

<b>Preferred Bidder Stage</b>		<b>Decision Maker</b>
City Council approval to appoint Preferred Bidder stage	November 2011	Executive Board
Central Government support for proceeding to Preferred Bidder stage (approval of draft PPB FBC)	November 2011	DEFRA (via WIDP)
Authority to award contract to the Preferred Bidder and approval of submission of the FBC	June 2012	Executive Board
Final approval of project funding (approval of FBC)	June 2012	DEFRA
Contract finalisation and Financial Close*	July - September 2012*	Director of Environment and Neighbourhoods (under delegated powers)
<b>Post Contract Award Stage</b>		
Planning permission	Spring 2013	Plans Panel
Construction Commencement	June 2013	N/A
Commissioning	Late 2015	N/A
Service Commencement	Early 2016	N/A

\* This date is dependent upon the timing of the Executive Board approval (Call-In, etc.) and Defra approval, but any delay should not impact on the overall programme as this is dependent upon the planning decision timetable.

## **4 Legal, Commercial and property disposal issues**

4.1 The primary contract documentation for this Project is based on the government's Standardisation of PFI Contracts (SoPC) drafting that has been specifically amended by Defra to cater for the waste sector. References to SoPC drafting in this report refer to this Defra specific drafting. Some Project specific amendments have been made by the City Council and these will all be agreed by Defra before the contract is signed. The basic allocation of risk between the private and public sector that is set out in SoPC (and that applies in respect of each of the City Council's PFI Projects) has not been changed. The City Council's legal advisors (DLA Piper) will also be providing a report to the City Council prior to contract signature detailing any key risks, any project specific contract terms and stating their opinion of whether the risk allocation and contract terms agreed are in line with the City Council's needs and SoPC principles.

4.2 There are some project specific items that Members should be aware of and these are set out in paragraphs 4.3 to 4.11 below:

### **4.3 Contract waste priority**

The waste to be treated at the RERF will predominantly be waste from Leeds households. The remaining capacity may be used to process commercial waste sourced from within the Leeds City Council administrative boundary, and the City Council shares in the financial benefit of using the excess capacity in this way.

Waste that is delivered by the City Council has priority over commercial waste and therefore:

- (i) City Council waste collection vehicles will not be turned away from the RERF or made to wait for commercial deliveries to take place; and
- (ii) if the amount of waste that is generated by Leeds households exceeds expectations, the additional capacity can be used to treat this excess waste.

### **4.4 Non Leeds waste**

As described in the July 2008 Executive Board report, the main purpose of this RERF is to process Leeds household waste but, as there are wider benefits to the City Council and the City as a whole, any excess capacity may be taken up by Leeds commercial waste (i.e. waste from businesses within the current Leeds City Council administrative boundary). The anticipated profit from processing that commercial waste is used to offset the monthly service charge, and any additional profit beyond that assumed by Veolia is shared with the City Council.

Members will be aware that the current municipal and commercial arrangements for disposing of waste involve waste crossing the Leeds City Council administrative boundary, including both Leeds waste that is exported

prior to processing and waste that is imported from neighbouring areas for processing. As agreed by Members of the Executive Board in November 2008, the contract contains a restriction that is designed to ensure that the balance of waste imported and exported to and from the Leeds City Council administrative area does not significantly change as a result of this facility opening. The amount of waste that can be imported into the Leeds City Council administrative area to process at the RERF in any one year is limited to 1,700 tonnes, representing approximately 1% of the household waste that the City Council anticipates it will deliver in any one year. Members should note that this restriction does not apply in respect of the reciprocal waste arrangements detailed at paragraph 4.5 which are subject to their own restrictions.

#### **4.5 Reciprocal Waste Arrangement**

During periods of planned maintenance, which are anticipated to be approximately two weeks per annum, the RERF will not be able to process waste. In order to avoid disposal to landfill during the shut-down period, and ensure that 100% of Processable Contract Waste from Leeds households delivered to the RERF will be diverted from landfill, the City Council has the benefit of an option whereby Veolia will be required to take this waste to another similar facility (to be agreed with the Council) within 100 miles of Leeds. In exchange for this, Veolia will process an equivalent tonnage of waste from other Veolia facilities at the RERF. There is a maximum cap of 9,000 tonnes of such waste that may be imported throughout each 12 month period (being the approximate equivalent of the two weeks worth of waste which may be exported from Leeds during the planned maintenance period), and the tonnage imported may not exceed that exported.

#### **4.6 Guaranteed payments and substitute waste**

In line with SoPC principles, the City Council will make minimum monthly payments to Veolia based on the City Council delivering 120,000 tonnes of waste per year. These payments are required in order to give Veolia some certainty that their substantial investment in the construction of the RERF will be worthwhile.

The assumption of delivering at least 120,000 tonnes of waste per year, and the consequent minimum payments, is set at a level significantly below the City Council's anticipated annual deliveries of household waste, therefore it should not result in the City Council paying for a service that it is not receiving. It is also important to note that these projected tonnages are based on the assumption that the Council has made very substantial increases in the level of kerbside and other recycling prior to the RERF becoming operational. For this reason, the minimum tonnage referred to above provides adequate headroom should recycling exceed expectation or should the level of residual household waste for treatment be reduced for any other reasons. The Council also has other waste streams not assumed within the projections that could be delivered for processing at the RERF should there be a risk of falling below the minimum tonnage requirement.



In addition to this, Veolia is obliged to use reasonable endeavours to keep the RERF working to capacity using Contract Waste or, if there is excess capacity, Leeds commercial waste. If Veolia breaches this obligation and the City Council does not deliver 120,000 tonnes in any year, the minimum payments do not apply. If Veolia fulfil this obligation, and manage to fill any capacity caused by a failure of the City Council to deliver 120,000 tonnes in any year, income derived from the processing of commercial waste will be used to off-set any minimum payments that have been made by the City Council.

#### 4.7 Planning

As set out at section 3.2, following pre-planning consultation, the planning application for the RERF is expected to be submitted prior to the Executive Board meeting at which this paper will be considered.. The contract is, however, expected to be signed before planning permission is granted. This is a different position to that taken on other City Council projects but is standard for waste PFI projects. The reasoning behind this is that a planning application for a facility of this size and nature can typically take up to a year to process. It is in both parties' interests to have some certainty as to how any delays to the project and planning requirements will be dealt with and that the tendered prices and terms and conditions will be honoured.

The contract sets out the obligations of each party relating to the progress of the planning application, which are broadly as follows:

- (i) responsibility for obtaining planning permission lies with Veolia and they must use all reasonable endeavours to do so;
- (ii) if the Project is delayed, or the contract is terminated, as a result of any delay or failure to obtain planning permission in circumstances where Veolia have not used all reasonable endeavours, they receive no compensation;
- (iii) if the Project is delayed as a result of any delay in obtaining planning permission in circumstances where Veolia have used all reasonable endeavours, Veolia receive compensation that will leave them in a "no better, no worse" position. This compensation can be paid as a lump sum payment, an increase to the monthly service charge or a contract extension;
- (iv) if the Project is terminated as a result of any failure to obtain planning permission in circumstances where Veolia have used all reasonable endeavours, they receive compensation (as set out in paragraph 3.8 and of confidential **appendix 2b** to this report) to cover the costs of the planning application plus any breakage costs incurred as a result of cancelling any foreign exchange rate hedging instruments;
- (v) in the event that planning permission is refused, or includes conditions that were not anticipated by the contract, there is an appeal fund available as part of the Project budget. Once this sum has been exhausted, the costs of any appeal are split 90/10 between the City Council and Veolia respectively; and

- (vi) in the event that the planning authority requires anything above and beyond what is required in the contract (e.g. additional landscaping, changes to building design or amendments to the way the RERF operates) and these requirements are not successfully appealed, these costs are met by the City Council.

#### 4.8 Permit

In order to operate the RERF the contractor must obtain an operating permit from the Environment Agency. The City Council has agreed a risk allocation with Veolia that improves on the SoPC position as responsibility for obtaining the permit and the consequences of failing to do so lies entirely with Veolia.

#### 4.9 Property disposals

The site (as set out in the plan attached as appendix 1) will be leased to Veolia for the term of the contract. This constitutes a “disposal” for the purposes of section 123 of the Local Government Act 1972.

The lease will be based on receipt of a nominal rent of £1. The lease is structured in this way because any rent that was charged for the premises would simply be re-charged to the City Council through the monthly service charge plus the costs of administering the payments.

The tender from Veolia was priced to include this assumption and the City Council is receiving value for money for the transaction as a whole.

In all transactions local authorities need to take into account the fiduciary duty that is owed to council tax payers. In this case officers are satisfied that the fiduciary duty has been fulfilled as there has been no loss of income to the Council, as described above to have a charged a rent for this site would simply have resulted in the rent plus administration costs being re-charged to the Council through the monthly service charge. This transaction facilitates a project that, as described at paragraph 5.4 of this report, will result in a saving of approximately £200m to the Council over the 25 year project term when compared against the “do nothing” scenario.

However, this means that the City Council is considered to be disposing of this site at less than the best consideration that can reasonably be obtained for it. This is a common situation on PFI projects that involve a lease of land.

The City Council’s asset management team have carried out a site valuation including an assessment of undervalue in accordance with circular 06/03 “Local Government Act 1972 general disposal consent (England) 2003 disposal of land for less than the best consideration that can reasonably be obtained” (“the General Disposal Consent”). The valuation report is attached as a confidential appendix 3 to this report. Appendix 3 contains exempt information under Access to Information Rule 10.4(3) as it contains commercially sensitive information detailing the value of City Council owned property, disclosure of which may prejudice future property development and disposals and where the benefit of keeping the information confidential is considered greater than that of allowing public access to the information.

The General Disposal Consent permits local authorities to authorise disposals of land at an undervalue providing the disposal will promote or improve the economic, social or environmental well being of the whole or any part of the area and that the extent of the undervalue achieved for the site is £2 million or less. If the disposal does not fall within the parameters of the General Disposal Consent, the disposal must be approved by the secretary of state for Communities and Local Government.

The Director of City Development has wide powers to authorise disposals of land, including disposals at an undervalue, but all disposals at an undervalue in excess of £100,000 are subject to prior approval by Executive Board. The requirements of the General Disposal consent are satisfied if:

- (a) the local authority considers that the purpose for which the land is to be disposed is likely to contribute to the achievement of any one or more of the following objects in respect of the whole or any part of its area, or of all or any persons resident or present in its area;
  - (i) the promotion or improvement of economic well being;
  - (ii) the promotion or improvement of social well being;
  - (iii) the promotion or improvement of environmental well being; and
- (b) the difference between the unrestricted value of the land to be disposed of and the consideration of the disposal does not exceed £2,000,000 (two million pounds).

Where applicable, local authorities should also have regard to their community strategy (in this case the Vision for Leeds).

It is considered that this disposal meets these grounds for the following reasons:

Condition (a) (ii) – the disposal will contribute to the improvement of the social well being of the whole or part of the Leeds Metropolitan District as it will enable a project that will:

- (i) during the construction phase create approximately 250 jobs to be directly engaged on the project, with contractual targets to provide 170 of these jobs for Leeds residents and 50 for the long-term unemployed;
- (ii) during the operational phase create approximately 45 jobs to be directly engaged on the project with contractual targets to provide 30 of these jobs for Leeds residents and 15 for the long term unemployed; and
- (iii) create a visitor centre and community meeting place.

Condition (a) (iii) – the disposal will contribute to the improvement of the environmental well being of the whole or part of the Leeds Metropolitan District as it will enable a project that will:

- (i) provide an iconic and sustainable municipal waste processing and recycling facility that achieves both BREEAM and CEEQUAL “excellent” status and is consistent with the eco-settlement aspirations of the Aire Valley;
- (ii) provide natural habitats that will promote bio-diversity in the area through the development of a living green wall along the southern façade of the building using native plant species, provide extensive landscaped areas and associated wetlands around the facility, and a green corridor along the eastern boundary of the site,
- (iii) provide a facility with sufficient flexibility to allow it to facilitate the development of a district heating scheme using heat generated by processing waste at the facility which could supply heat to a variety of commercial, industrial and residential properties should a scheme prove viable; and
- (iv) provide an annual reduction of an estimated 62,600 tonnes of CO<sub>2</sub> equivalents as a result of Leeds residual household waste being processed at the facility rather than sent to landfill, with annual improvements to this reduction targeted throughout the contract term.

Condition (b) is satisfied as the valuation report carried out by a surveyor within the City Council’s asset management team (attached at confidential appendix 3 to this report) states that the difference between the unrestricted value of the land to be disposed of and the consideration of the disposal does not exceed £2 million.

This disposal contributes towards a number of objectives set out in the Vision for Leeds 2011 – 2030 as follows:

<b>Vision objective</b>	<b>Contribution to achieving the vision objective</b>
increased investment in other forms of transport, such as walking and cycling routes, to meet everyone’s needs;	The disposal facilitates a project that includes the construction of a new cycle path linking the East Leeds Link Road to an existing cycle path in the Cross Green / Halton Moor area of Leeds.
successfully achieved targets to make Leeds a lower carbon city;	The disposal facilitates a project that will result in an estimated annual reduction of 62,600 tonnes of CO <sup>2</sup> equivalents as a result of waste being processed at the RERF rather than landfilled, with annual improvements to this reduction targeted throughout the contract term.

a commitment to find new ways to reuse and recycle;	The disposal facilitates a project that will ensure that a minimum of 10% of the household waste delivered to the RERF is recycled, which contributes to the City Councils overall recycling performance
increased its use of alternative energy supplies and locally produced food	The disposal facilitates a project that has the flexibility to be used to develop a district heating scheme using heat generated by processing waste at the RERF
buildings that meet high sustainability standards in the way they are built and run	The disposal facilitates a project that will provide an iconic and sustainable household waste processing and recycling facility that expects to achieve both BREEAM and CEEQUAL “excellent” status and is consistent with the eco-settlement aspirations of the Aire Valley.
people are motivated to reuse and recycle	The disposal facilitates a project that will promote “greener” and more sustainable attitudes to waste disposal among the citizens of Leeds through facility tours and education programmes.

Members are therefore requested to approve the disposal at an undervalue in excess of £100,000 and the exercise of the General Disposal Consent and note that the Director of City Development (or officer with delegated authority) will exercise his powers to complete the disposal.

If circumstances change (for instance as a result of a change in land values) and it is considered that the disposal does not fall within the parameters of the General Disposal Consent at any time before the decision to dispose is made Members are requested to approve the disposal at an undervalue in excess of £100,000 and note that the Director of City Development (or officer with delegated authority) will exercise his powers to complete the disposal providing that authority to dispose of the site is obtained from the secretary of state for Communities and Local Government.

The City Council’s asset management board have been consulted on this disposal and have no objections to it.

#### 4.10 **Electricity and Combined Heat and Power (CHP)**

The RERF will generate in excess of 11MWe which will be delivered into the national grid via a contract between Veolia and an energy supply company. The financial benefits of the energy generation will be used to reduce the monthly service payments payable by the City Council. The contract contains an assumed price for energy and if energy prices exceed this figure, 50% of

the benefit will accrue to the City Council. Should energy prices reduce below the assumed rate in the contract, the cost risk will be borne by Veolia.

In addition to the generation of electricity from the treatment process, the RERF is capable of generating heat in the form of steam or hot water, which can potentially be provided to local businesses or residential properties.

The RERF has the necessary infrastructure for heat off-take to be provided without substantial alteration to the plant. The City Council has the benefit of an option that enables it to develop its own proposals for use of this heat. This option is based on the principle that Veolia will be left in a financially “no better, no worse” position as a result of the CHP scheme rather than representing an opportunity for securing profit from the supply of heat. The City Council and Veolia are actively working together to identify genuine opportunities for heat off-take.

#### **4.11 Corporate Finance**

Veolia is intending to finance the capital cost of the Project from its own resources. This is relatively unusual for PFI projects, which normally use bank funding. While this funding structure assists in providing a lower cost solution for the City Council and relieves the Project of a number of complications associated with the involvement of banks, it also adds a limited level of risk, including in respect of Veolia’s ability to finance the Project, Veolia’s technical proposals and security for the City Council should the Project fail as in a more traditional PFI scheme the bank would help to mitigate these risks.

Consequently, the City Council has undertaken significant levels of due diligence in order to satisfy itself as to Veolia’s ability to raise the necessary finance, has (in addition to undertaking its own technical due diligence) jointly employed an independent third party to review Veolia’s technical proposals and has obtained a parent company guarantee from Veolia Environmental Services (UK) plc (with obligations to procure further security, should the parent company’s own strength of covenant reduce below set thresholds).

### **5 Corporate Considerations**

#### **5.1 Consultation and Engagement**

5.1.1 Community and stakeholder engagement has been an integral part of the Project. Communications have been focused on local Ward Members, local MPs, local businesses and residents within one mile of the proposed sites (approximately 11,000). However, there have also been opportunities for residents city wide to become involved. Communications have been delivered through various means at different times, and included press releases, briefing sessions, drop-in sessions, distribution of information leaflets, regular attendance at community meetings and the City Council’s website. It has been an iterative process, where new information has been provided to address issues raised.

- 5.1.2 Following the appointment of the Preferred Bidder, the City Council's Waste Strategy team and Veolia set up a Communications Working Group to discuss and resolve items such as knowledge sharing, exhibition venues, protocols for finalising consultation materials and the role of City Council officers.
- 5.1.3 Veolia have also undertaken their own pre-planning consultation activities to ensure that local Ward Members, local MPs, local businesses, local residents and other relevant stakeholders have been able to examine and comment on the detailed proposals. Information has been provided by mail shots to local residents and businesses, a dedicated web page, public exhibitions and question and answer sessions at various locations, press releases, and attendance at community meetings. Veolia's principal consultation activities took place between January 2012 and March 2012, prior to the planning application being submitted in June 2012.
- 5.1.4 In addition, Veolia have set up a Community Liaison Group comprising representatives from a broad spectrum of community interests. Its members have been drawn from people who registered their interest following Veolia publicising the group via press releases, mail-outs and at the public exhibitions. The members of the Group provide independent points of contact for community members to discuss issues and pass on their comments to Veolia. The group has met five times since February 2012, and some members visited the operational Energy from Waste facility in Sheffield. Meetings will continue to take place throughout the lifetime of the Project, including during the construction and operational phases. The concerns most frequently raised during the public consultation were regarding traffic, odour, nuisance, visual impact and potential emissions. These concerns have been addressed by Veolia within their planning application by developing for example a protocol to ensure that Veolia HGVs would not use residential roads addressing concerns about traffic. In addition, Veolia's explanation of the building design and layout helped alleviate concerns regarding odour, nuisance and visual impact. The provision of further information about the clean-up, monitoring and regulatory processes provided a response to concerns regarding amenity, emissions and health impacts.

## **5.2 Equality and Diversity / Cohesion and Integration**

- 5.2.1 An equality impact assessment workshop was carried out on the Project in February 2010 and Veolia's proposals meet the requirements identified in the assessment process. Through the final tender evaluation process in July 2011, Veolia's tender was scrutinised to ensure that it complied with the City Council's Equality, Diversity and Community Cohesions Policies and relevant legislation.
- 5.2.2 In May 2012, an Equality, Diversity, Cohesion and Integration Screening document was completed, incorporating an Equality Impact Assessment.
- 5.2.3 Veolia also developed an Employment Skills and Business Engagement Plan, which set out targets to achieve and deliver training and employment opportunities, which will be available to the local workforce.

- 5.2.4 Veolia will also implement a Corporate Social Responsibility programme, which includes access to potential funding for local community projects to benefit the local area.
- 5.2.5 As part of the preparation of the planning application, an Environmental Impact Assessment has been developed to look at the impact that the project as a whole might have on the environment. The findings of the assessment have been used to develop Veolia's proposals and an Environmental Statement summarising the results of the assessment accompanies the planning application which is due to be submitted prior to the Executive board meeting at which this paper will be considered.

### 5.3 Council policies and City Priorities

- 5.3.1 In 2006, the City Council adopted its Integrated Waste Strategy for Leeds. In addition to waste prevention objectives, the Integrated Waste Strategy for Leeds describes how targets for recycling and reducing waste sent to landfill will be met. Since the strategy was adopted significant progress in improving waste collection services in Leeds has been made including:
- introduction of garden waste collections to over 190,000 properties;
  - piloting weekly food waste collections; and
  - closing out remaining gaps in the city-wide provision of kerbside recycling services.
- 5.3.2 The recycling rate in Leeds has continued to improve from 22.3% in 2006/7 to 37.3% in 2011/12. In December 2011, the Executive Board approved an increased recycling target for household waste by 55% by 2016, and a longer-term target of 60%.
- 5.3.3 However, the need for a solution to divert the remaining residual waste from landfill remains a clear priority, and the cost of disposing of this waste increases each year, with Landfill Tax rising to £80 per tonne by 2014.
- 5.3.4 The focus of the Project is to provide residual waste treatment infrastructure to ensure that the City Council increases recycling, meets its targets for the recovery of value from waste, and diverts waste from landfill. The development of this infrastructure represents a radical change in terms of how Leeds' waste is managed and will deliver a major reduction in the impact of this waste on the environment. In addition, significant electricity exceeding 11MWe will be produced by the plant with the financial benefits of this being used to reduce the contract cost. Also, the potential for heat off-take from the RERF represents a genuine opportunity to contribute to environmental and economic aspirations for this area of the City.



## 5.4 Resources and value for money

5.4.1 Attached at **appendix 2a** is a financial report setting out the affordability and value for money of the Project, along with other key financial risks that may arise both before and after financial close.

5.4.2 **Appendix 2a** demonstrates that the estimated cost of the contract to the City Council is approximately £200m less than the approved price ceiling for the Project. The current estimated unitary charge for the Project is £457.113m over the 25 year operational period as shown in the table below.

<b>City Council Cash Flows</b>	<b>Cost position as provided to Executive Board November 2011</b> Nominal £m	<b>FBC</b> Nominal £m
Unitary Charge (including NNDR*)	452.854	457.113
Landfill Tax	12.451	-
Contract Monitoring	3.737	3.737
<b>Total City Council Costs</b>	<b>469.042</b>	<b>460.850</b>
Less PFI Credit income	(134.111)	(134.111)
<b>Total required City Council budget</b>	<b>334.931</b>	<b>326.739</b>

\* NNDR (National Non-Domestic Rates) payable by the Contractor.

5.4.3 Attached at **appendix 2b** is a detailed financial report containing exempt information under Access to Information Rule 10.4(3) as it contains commercially sensitive information on the City Council's approach to procurement issues, affordability position and commercially sensitive pricing and information about the commercial risk position of Veolia where the benefit of keeping the information confidential is considered greater than that of allowing public access to the information.

5.4.4 The main issues covered in confidential **appendix 2b** are:

- Hedging strategy to mitigate foreign exchange risk prior to the receipt of planning permission;
- Details of Veolia's funding structure; and
- Termination of the Contract – the estimated termination payments that could be payable by the City Council to Veolia in the event that the contract is terminated early.

## 5.5 Legal Implications, Access to Information and Call In

- 5.5.1 The draft FBC, **appendices 2b and 3** to this report contain exempt information under Access to Information Rule 10.4 (3). A copy of the current draft of the FBC is available in the Members' Library as an exempt document.
- 5.5.2 This report is subject to Call In.
- 5.5.3 This Project has accessed legal advice from officers within the City Council's Public Private Partnerships Unit and DLA Piper. The Project has been developed using the Defra standard form Waste PFI contract. Key commercial, legal and property disposal issues relating to entering into this contract are set out at paragraph 4.
- 5.5.4 Following approval of this report, and in order to enable financial close, a further report will be submitted to the Director of Environment and Neighbourhoods recommending the exercise of his existing delegated powers under part 3 section 3 E of the constitution (officer delegation scheme) in relation to PPP/PFI and other Major Property and Infrastructure Related projects, that he make arrangements for, and approve the final documentation needed to reach financial close. Subject to the Director of Environment and Neighbourhoods being satisfied that the FBC has been approved by Defra and that Project is within the scope and affordability limits approved by Executive Board and receipt of a satisfactory report from DLA Piper the Director of Environment and Neighbourhoods will be asked:
- (i) to approve the terms of all Project related contractual, property and other documentation; and
  - (ii) to make arrangements for and approve any delegations necessary to effect commercial and financial close including any final amendments to such documentation at commercial and financial close.

The Director of Resources and the City Solicitor will be asked to exercise their powers under part 3 section 3 E of the constitution (officer delegation scheme) to provide an appropriate certificate to the contractor under the Local Government (Contracts) Act 1997, along with an indemnity to the Director of Resources in respect of any personal liabilities that arise from this certificate.

- 5.5.5 The decisions set out at recommendations 7.3, 7.5 and 7.6 are Key Decisions and any subsequent decisions that are required to be taken to achieve financial close of the Project will be Administrative Decisions provided that the Project remains within the parameters agreed by Executive Board.

## 5.6 Risk Management

- 5.6.1 As with any project of this scale, there are a number of issues and risks to be managed in moving towards contract close. The main risks at this point relate to obtaining planning permission for the RERF.
- 5.6.2 Further risks that may arise in relation to the programme are:

Risks prior to financial close ;

- Some 60% of the capital costs of the RERF will be purchased in Euros as the specialist equipment is sourced from Europe. Fluctuations in the Euro exchange rate could therefore have a significant impact on this cost. It is intended that Veolia will manage this risk, however there will remain some limited financial risk to the City Council in relation to foreign exchange post financial close (see section 1 of the confidential **appendix 2b** of this report).

Risks post financial close;

- The City Council's wasteflow projections were established in 2011 based upon the best data available and the Project has been designed around these wasteflow assumptions but does have significant flexibility to accommodate changes. In particular it should be noted that the unitary charge costs set out in the table at 5.4.2 above are based upon the City Council's wasteflow forecast. The unitary charge payable could increase in the event that the City Council's residual wasteflow increases, or could decrease (subject to the minimum payment referred to at paragraph 4.6) in the event that the City Council's residual wasteflow decreases.
- Changes to the NNDR (business rates) estimate provided to Veolia and incorporated in their financial assumptions. The City Council will pay the actual costs which may be different to the estimates.
- Actual inflation rates higher than the average annual rate of 2.5% assumed in the financial model. Latest figures published by the Office of National Statistics (ONS) in December 2011 suggest RPIX rates are currently 4.95%. If the higher RPIX rate of 4.95% was the average over the life of the contract, it would increase the unitary charge over the life of the Project by c.£8m.
- A delay to the planning approval date (beyond the 12 months included within the current programme) will increase the cost of the Project. It is estimated that a 6 month delay will result in an additional cost to the City Council of approximately £350,000 per annum for the operational life of the contract.

## **6 Conclusions**

- 6.1 The Project will deliver a flexible, affordable and environmentally sustainable method of treatment of Leeds' residual household waste which maximises recovery and diversion from landfill.
- 6.2 The procurement is nearing completion and requires approval of the Final Business Case and approval to the final arrangements for achieving contractual and financial close. The draft Final Business Case is provided as an exempt document in the Members' Library.

- 6.3 The Project remains well within the price ceiling approved by Executive Board in November 2011 and the remaining financial assumptions to be resolved are currently favourably placed to allow the Project to proceed to financial close on the basis set out in **appendices 2a and 2b**.
- 6.4 The necessary delegations to enable the Director of Environment & Neighbourhoods to complete arrangements and finalise contract documentation, subject to approval of the FBC are set out in detail in this report.
- 6.5 Financial close and contract signature will, once planning permission has been obtained, enable mobilisation and commencement of the construction of the RERF. The commencement of services is scheduled for 2016 when the City Council's reliance on landfill as its primary disposal method for residual waste will cease.

## 7 Recommendations

Members of Executive Board are recommended to note this report and to:

- 7.1 approve the submission of the Final Business Case (FBC) to the Department for Environment Food and Rural Affairs (Defra);
- 7.2 approve the submission of this report and subsequent minutes to Defra;
- 7.3 note the financial implications for the City Council set out in **appendix 2a** and the exempt **appendix 2b** of this report, and approve expenditure as set out in **appendix 2a** and the exempt **appendix 2b** to this report provided that the total estimated Unitary Charge for the Contract at the date of Financial Close is less than £502m, as set out in paragraph 3.6 of **appendix 2a**;
- 7.4 confirm the arrangements at section 5.5 of the report, and (for the avoidance of doubt) authorise the Director of Environment and Neighbourhoods (or delegate) to exercise the delegated powers, as set out at Part 3 Section 3E of the Constitution regarding PPP/PFI and other Major Property and Infrastructure Related projects, in relation to this Project;
- 7.5 approve the process of achieving financial close as set out in this report, including the award of the contract to Veolia ES (Leeds) Limited, which is a wholly owned subsidiary of Veolia ES Aurora Ltd; and
- 7.6
- (i) note and confirm that the conditions of the General Disposal Consent are satisfied at the date of this report;
  - (ii) approve the disposal of the site at an undervalue in excess of £100,000; and
  - (iii) authorise the Director of City Development (or an officer with appropriate delegated powers) to take all action required to conclude the disposal of the site including carrying out the actions described at paragraph 4.9 of this report which may include seeking the consent of

the Secretary of State prior to disposal if the circumstances set out at paragraph 4.9 change.

## **Background documents<sup>1</sup>**

- Report of the Director Environment and Neighbourhoods to Executive Board, 14th November 2007: “Waste Solution for Leeds – Submission of the Outline Business Case for the Residual Waste Treatment Project”.
- Report of the Director Environment and Neighbourhoods to Executive Board, 16th July 2008: “Waste Solution for Leeds – Residual Waste Treatment PFI project - Evaluation Methodology and Update”
- Report of the Director Environment and Neighbourhoods to Executive Board 5th November 2008: “Waste Solution for Leeds – Residual Waste Treatment PFI Project - Evaluation Methodology and Update”
- Report of the Director Environment and Neighbourhoods to Executive Board, 12th February 2010: “Waste Solution for Leeds – Residual Waste Treatment PFI Project – Results of Detailed Solutions Stage”
- Report of the Director Environment and Neighbourhoods to Executive Board 5th November 2011: “Waste Solution for Leeds – Residual Waste Treatment PFI Project”
- Equality, Diversity Cohesion and Integration Screening: Residual Waste Treatment PFI Project May 2012
- Application for Planning Permission and supporting Environmental Statement (available for inspection at the offices of Leeds City Council, City Development, Leonardo Building, 2 Rossington Street, Leeds, LS2 8HD).

## **Appendices**

- Appendix 1: Site Plan and Artist’s Impression
- Appendix 2a: Finance
- Appendix 2b: Finance - Exempt / Confidential Under Access to Information Procedure Rules 10.4 (3)
- Appendix 3: Valuation Report - Exempt / Confidential Under Access to Information Procedure Rules 10.4 (3)

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<sup>1</sup> The background documents listed in this section are available for inspection on request for a period of four years following the date of the relevant meeting. Accordingly this list does not include documents containing exempt or confidential information, or any published works. Requests to inspect any background documents should be submitted to the report author.

## GLOSSARY

AVE	Aire Valley Environmental (a joint venture between Covanta Energy Ltd and Kelda Water Services Ltd)
CHP	Combined Heat and Power
Contract Waste	Waste delivered to the RERF by the City Council for processing, consisting mainly of Leeds' residual household waste
Defra	Department for Environment Food and Rural Affairs
ERF	Energy Recovery Facility
ESA95	The European system of national and regional accounts
FBC	Final Business Case
Gateway Review	A review of a procurement project carried out at key decision points by a team of experienced people who are independent of the project team. The process provides assurance to the Project Owner that their project can progress successfully to the next stage. The Gateway Review process in Local Government is managed by Local Partnerships.
IBA	Incinerator Bottom Ash is a form of ash produced in incineration facilities. Once any remaining ferrous metals have been removed, the IBA can be processed so that it can be used as an aggregate in the construction industry.
IFRIC 12	International Financial Reporting Interpreting Committee
ISDS	Invitation to Submit Detailed Solutions, a stage of the bidding process
ISOS	Invitation to Submit Outline Solutions, a stage of the bidding process
ISRS	Invitation to Submit Refined Solutions, a stage of the bidding process
MPT	Mechanical Pre-Treatment (to enable the removal of recyclates from the residual waste)
NNDR	National Non-Domestic Rates
NRWDPD	Natural Resources and Waste Development Plan Document
OBC	Outline Business Case
OJEU	Official Journal of the European Union
ONS	Office of National Statistics
Output Specification	Definition of Service Requirements included in PFI Contract
PFI	Private Finance Initiative
PPB FBC	Pre-Preferred Bidder Final Business Case
PPP	Public Private Partnership
PQQ	pre-qualification questionnaire
RERF	Recycling and Energy Recovery Facility
RPIX	A measure of inflation, equivalent to all the items in the Retail Price Index (RPI) excluding mortgage interest payments
RWT	Residual Waste Treatment
SoPC	The standard HM Treasury contract model for PFI Contract terms
Unitary Charge	The monthly fee payable to Veolia for the provision of services
Veolia	The contract will be with Veolia ES (Leeds) Limited, who are a wholly owned subsidiary of Veolia ES Aurora Limited. Veolia ES Aurora Limited are in turn a wholly owned subsidiary of Veolia Environmental Services (UK) Plc, who will guarantee the performance of Veolia ES (Leeds) Limited.
Waste Infrastructure Credits	Funding received from central government (Defra) as grant aid towards the project costs
WIDP	Waste Infrastructure Delivery Programme, the Defra sponsored organisation acting as regulator for the Government's PFI Waste Infrastructure Programme