WEST LONDON WASTE AUTHORITY

Report of the Finance Director 23 September 2022

Finance Strategy

SUMMARY

The Finance Strategy has been developed by working with borough Finance Directors and Environment Directors over a number of months and it incorporates their feedback during that period. The key points are:

- The work, analysis and wide range information and considerations shared over the last few months have identified no material improvements which can be made to the draft Finance Strategy which is largely as reported to the Authority in June
- The impact of legislative change is summarised in this report. The required change will be significant and will reduce waste, improve recycling and improve the carbon footprint. However both the Authority and boroughs will see costs rise to deliver these benefits.
- New income provides an opportunity and options for managing that change and risk with two thirds of the income passing through to boroughs and one third retained by the Authority
- A total of £10.3 million of new income and excess reserves will be disbursed to boroughs following approval of the draft Finance Strategy
- The modelling of electricity income provides a positive but uncertain outlook for 2022/23 but has the potential for disbursements next year.
- Borough Finance Directors formal feedback regarding the Finance Strategy is included in Section 5 of this report.

RECOMMENDATION(S)

The Authority is asked to:

1) Approve the Finance Strategy (Appendix 1)

2) Approve the distribution of new income and excess reserves per Section 3.

1. Introduction

The draft Finance Strategy (appendix 1) had already incorporated the feedback from borough Directors and was reported to the Authority in June.

Whilst developing the strategy and from discussions with stakeholders a range of additional information was requested in order to finalise the strategy. This information was produced, shared with borough Directors and considered in joint meetings.

Although the information identified no material improvements for the Finance Strategy, there were three pieces of information that were particularly interesting:

- A pack identifying significant risks on the horizon
- The finalisation of income and receipt of funds
- Electricity income scenario modelling

2. Risks on the Horizon

As previously reported, the waste sector will see significant legislative change in the coming years. The Authority and boroughs are working collaboratively to understand and respond to this change.

Although the details of the legislative change are yet to be clarified, the risks can be identified from consultation documents and wider published principles. The items of legislation considered include:

- Extended Producer Responsibility (EPR)
- Deposit Return Scheme (DRS)
- Consistency
- Emissions Trading Scheme (ETS)
- Net Zero / Climate Emergency / Air Quality
- Plastic Tax
- Landfill Ban

A brief summary of these is provided in Appendix 2.

Analysis work considered the impact of each of these legislative changes on each material stream and a detailed assessment has been shared with borough Directors. These are summarised in the table below and **in overall terms, the analysis indicates that environmental benefits will be delivered through changes which increase borough and Authority costs.**

Given the early stage of most legislative change, it is not possible to quantify the impact. However it is possible in most cases to draw reasonable although subjective conclusions about the direction of impacts based on Officers collective knowledge of legislation, consultations, wasteflows, operations and the market, as summarised below:

Waste Material	Collection Costs	Disposal Costs	Carbon Reduction	Waste Reduction	Recycling Increase
1. Residual	↓	↑	✓	✓	✓
2. Green	↑	↑	✗	✗	✓
3. Food	↑	↓	✓	✓	✓
4. Glass	↑	↓	?	✓	✓

5. Paper	↑	↓	✓	✗	✓
6. Card	↑	↓	✓	✗	✓
7. Plastic	↓	↓	✓	✓	✓
8. Aluminium Cans	↓	↓	✓	✓	✓
9. Other Cans	↓	↓	?	✓	✓
10. Textiles	↑	↑	✓	?	✓

It should be noted that at a material level the effects are complex with a lot of interaction between legislative impacts. This includes compounding effects (e.g. the effect of one piece of legislation becomes bigger because of another piece of legislation) and gaps (e.g. where producers/contractors exploit gaps in legislation leading to costs elsewhere).

This analysis will be updated as legislation becomes clearer and incorporated into the thinking and ongoing collaborative work to develop the Joint Municipal Waste Management Strategy.

A major new risk has also developed over the recent months, the cost of living crises. From a financial perspective the forecasts of double digit inflation will be an important driver of increased costs in the coming year. Many individuals and businesses are also struggling, particularly with rising fuel and power costs and this could lead to disruption of services through for example industrial action or business failure.

3. Finalisation of New Income and Payment to Boroughs

At the end of June the Authority received a payment of £10.6 million as the Authority's share of income earned by the contractor from the energy from waste plant. This is slightly more than previously reported.

Having received these funds the Finance Strategy's income sharing mechanism can be applied. On this basis the boroughs' two thirds share is £7.1 million.

The Authority's 2021/22 out turn position has also indicated excess reserves (i.e. the amount above the approved level for managing risks) of £3.2 million.

It is recommended that these latest positions are used for making payments to boroughs in October. A breakdown of sums receivable by each borough follows:

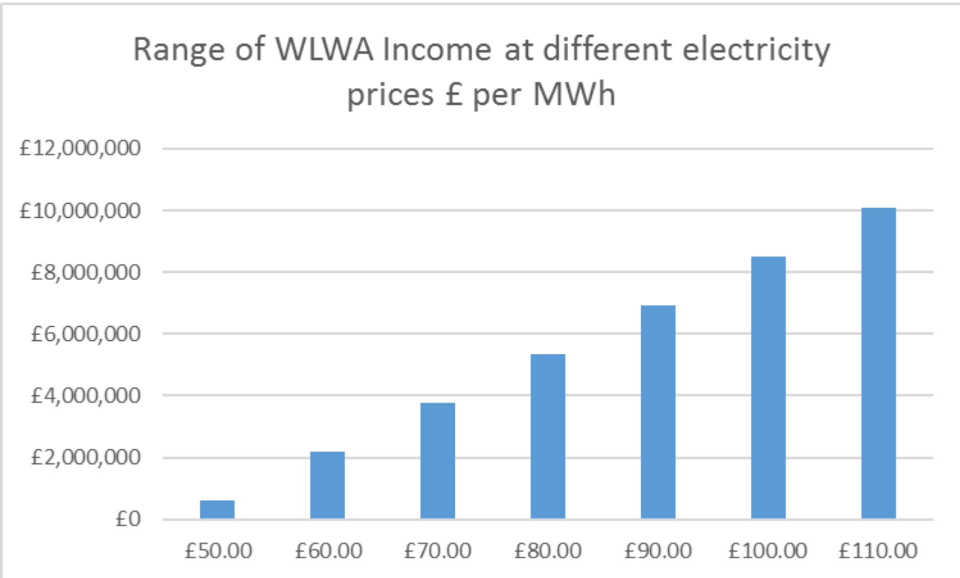
Borough	Approved Council Tax Base	New Income (£000s)	Excess Reserves at end of 2021/22 (£000s)	Total (£000s)
Brent	99,868	1,205	553	**1,758**
Ealing	118,649	1,432	658	**2,089**
Harrow	90,597	1,093	502	**1,595**
Hillingdon	103,840	1,253	575	**1,828**
Hounslow	86,769	1,047	481	**1,528**
Richmond	88,703	1,070	492	**1,562**
Total	**588,426**	**7,100**	**3,261**	**10,361**

These are reflected in the updated Finance Strategy.

4. Income Scenario Modelling

The income from electricity is a helpful source of funding to help meet the challenges of new legislation.

Forecasting electricity income requires forecasting electricity prices. In the present volatile market it is impossible to forecast electricity prices. So recognising the risk of predicting market prices, the table below shows the total WLWA income at different market prices.



It should be noted that there are a number of risks around income, both the volume and price are unpredictable. Additionally, there is a risk of windfall tax being imposed on energy producers should the economic and political climate remain challenging.

<u>There is a significant risk in forecasting electricity prices and readers of this information are advised NOT to plan any spending based on this information.</u>

The draft Finance Strategy provides a simple mechanism for distribution of the income and the above electricity income analysis does not indicate any obvious advantages for changing that mechanism.

Officers will continue to monitor electricity prices and the impact on WLWA income during the year.

Whilst electricity prices are a significant current matter, it is important to note that the finance strategy is about far broader and longer term financial management. It identifies the controls, mechanisms and transparent arrangements which will ensure the effective long term financial management of the Authority.

5. Formal feedback from borough Finance Directors

Finance Directors informal feedback at the September West London Treasures meeting appreciated the transparent and collaborative approach to developing the Authority's finance strategy. Two written responses were received. These can be found in Appendix 3.

Ongoing Officer attendance at quarterly West London Treasurers meetings will ensure borough Finance Directors are updated on all key matters over coming years and there is an opportunity to discuss, plan and feedback on Authority's activities.

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Appendix 1 West London Waste Authority Finance Strategy

1. Background

The environment that the Authority and Boroughs work in is rapidly changing. Recent and emerging legislation will result in challenges and risks that we will need to manage and things that we will need to do, which won't be optional.

Net Zero, Climate Emergency, Consistency, Extended Producer Responsibility, Deposit Return Scheme and the Emissions Trading Scheme are some examples of where we already have or will soon see new legislative requirements.

The scale of the change required will be significant and a key question for both the Authority and boroughs is how will we fund that change?

The March 2022 WLWA Strategy Day with borough stakeholders commenced collective work to develop the Authority's strategy and understand/prepare for the implications of this legislation. This collaborative work will continue and will result in the development of long-term action plans in the coming years working towards a joint vision for 2030.

The Finance Strategy provides a framework for supporting the delivery of those action plans.

2. Aims

For several years the Authority's financial management has delivered:

- A strong financial platform allowing the funding of strategic plans/projects for both the Authority and boroughs
- Effective cost control and containing growth in levies to well below inflation
- Certainty and predictability about costs and levies over the longer term
- Effective management of financial risks through reserves
- Disbursements of any excess balances to boroughs

These are the continuing aims of the Finance Strategy.

3. Finance Strategy

The Finance Strategy brings together a number of key long established considerations and processes together with recent developments such as new income and the need to fund developing strategic plans.

- Cost control and stability – this includes the procurement rules which drive good value and sustainable purchasing. It also includes the budget setting process (in particular the scrutiny from a variety of stakeholders providing suitable challenge) which provides a focus on costs and levies. To give certainty to all stakeholders, each years overall variance from the balanced budget will be absorbed through reserves, meaning no in-year levies in the event of an overspend.
- Financial planning for stability – long term financial plans, modelling and sensitivity analysis identify and provide an understanding of the business's key strategic financial drivers, opportunities and risks through their impact on costs and levies. This also facilitates effective cash and debt management and ensures planning for suitable levels of liquidity throughout the term. Long term plans will be reviewed at least annually and also on emergence of any significant projects.

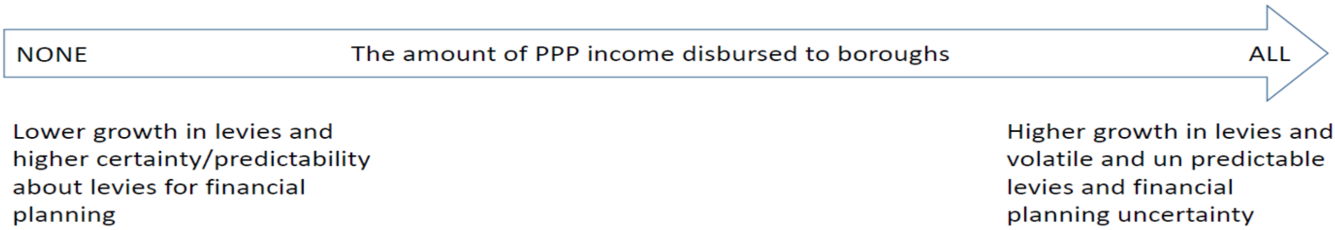
- Risk and reserves – key financial risks are managed through reserves (less artificial revaluation gains). Essentially an amount is set aside to deal with the risks should they materialise. This is reviewed annually as part of the budget setting process to determine a suitable level of reserves to maintain. Reserves are gradually built up when necessary through accumulation of surpluses arising during years when overall levies exceed overall costs.
- Disbursement of excess reserves – when the level of reserves (other than artificial revaluation gains) materially exceeds the sum needed by the Authority to manage risks (as budgeted), the excess is apportioned using the council tax base and disbursed to boroughs. This is reviewed annually on production of the draft financial statements. Additional disbursements have been made possible by deploying Authority reserves to fund borough improvements that are aligned to the Authority's strategic plans – e.g. food waste.
- Business cases – any significant project requires a business case to demonstrate that the return (financial or other) for either the Authority or boroughs is commensurate to the investment. Importantly, business cases can consider benefits from a holistic west London perspective which means boroughs can benefit directly rather than the project being of benefit to the Authority, provided they are aligned to the Authority's objectives. The business case will be approved by the appropriate decision making body per the delegated authority.
- Funding – the options for funding strategic plans/projects, principally includes the use of new income set aside in reserves or borrowing financed through future levies. To minimise the impact on levies, using reserves is the preferred option. This is explained in more detail in section 4. Reserves will have to be built up accordingly, through new income.
- New income – the PPP contract has provided the opportunity for generating new income. There will be income over the short term, significantly relating to 2021/22 with a likelihood of some relating to 2022/23. Over the short term this is largely from increased electricity prices. Over the longer term there may also be opportunities to secure income by increasing third party waste volumes processed at the SERC. Two thirds will be passed on to boroughs directly and one third will be retained by the Authority to fund strategic plans/projects.
- Reserves – this will comprise of reserves built up to manage risks (as identified earlier) and new income set aside (less any subsequently used) to fund Authority strategic plans/projects. Anything in excess will be disbursed to boroughs as identified earlier. Suitable liquidity will be maintained to ensure funds are readily available for these purposes. Reserves set aside for strategic plans/projects will also be reviewed annually as part of the budget setting process to ensure levels are suitable and not excessive, with disbursement being made accordingly.

4. The Trade-off

The use of new income for funding can be considered as a scale with two options at polar opposite ends of that scale and many choices in between. The scale essentially represents a trade-off between

a) The level of certainty/predictability about growth in levies and
b) The amount of new income disbursed directly to boroughs

The more of new income that is disbursed to boroughs the more volatile and bigger will be the movement in levies, as illustrated over the page:



To explain the illustration in a little more detail:

At one end of the scale, all new income can be retained by the Authority to fund the strategic plans. This option will provide greater certainty/predictability about levies over the longer term and contain growth to well below inflation. This is because the option reduces the need to borrow and finance that borrowing through increased levies. Furthermore, it allows the benefits (financial, carbon etc.) to be seen by boroughs in subsequent years in accordance with the business cases. The disadvantage of this approach is that there is no disbursement new income to boroughs.

At the other end of the scale, all new income can be disbursed directly to boroughs. The disadvantage of this approach is that the levies will become less predictable and more volatile. The levies will depend on the timing of projects and the borrowing to fund strategic plans. This will create uncertainty for both the Authority and boroughs and financial planning will become more challenging in order to deal with the movement in levies year on year.

This reflects a typical short term benefit vs long term stability, financial planning trade-off.

5. The Balance proposed

There are two other factors worth considering in context of arriving at a suitable trade off, the scale of the new income and the financial challenges facing boroughs.

So, on the basis that the scale of new income is far more than anticipated as are the financial challenges facing boroughs, the strategy leans towards the majority (two thirds) of new income being passed through to boroughs directly. One third will be retained by the Authority for delivery of strategic plans.

However boroughs will need to be mindful of the risk of a rise in levies in the future if funding, beyond that retained by the Authority from new income, for projects becomes required.

6. Key Financials

The Finance Strategy provides a mechanism for delivering better financial certainty in uncertain times as described by the aims.

It also strikes a balance between different stakeholder needs and also supports the delivery of the wider strategy for the Authority currently being jointly developed.
These are illustrated in the following tables which provide a projection of key financials from the Finance Strategy.

a) New income

	2021/22	2022/23	2023/24	2024/25	2025/26
One off from electricity	9,591	16,400	0	0	0
Recurring	1,059	1,200	1,200	1,200	1,200
Total new income	**10,650**	**17,600**	**1,200**	**1,200**	**1,200**

The 2021/22 figures are from the draft out-turn position for the year. The split is notional based on latest negotiating positions.

The 2022/23 position is a tentative estimate assuming electricity prices will remain at current levels and is **subject to high degree of uncertainty**.

Caution – the estimates for 2022/23 onwards are notional and dependent on market electricity prices and success with securing recurring new income. Stakeholders are advised not to use the notional estimates above in financial planning.

b) Pass through to boroughs

	2021/22	2022/23	2023/24	2024/25	2025/26
2/3rd of one off	6,394	10,933	0	0	0
2/3rd of recurring	706	800	800	800	800
Total	**7,100**	**11,733**	**800**	**800**	**800**

The 2021/22 sum will apportioned and paid to boroughs in October and similarly when funds are received in subsequent years.

c) Reserves for Authority strategic plans

	2021/22	2022/23	2023/24	2024/25	2025/26
Brought forward	0	3,550	9,417	9,817	10,217
1/3rd of one off	3,197	5,467	0	0	0
1/3rd of recurring	353	400	400	400	400
Total	**3,550**	**9,417**	**9,817**	**10,217**	**10,617**

These are retained in reserves and used to fund Authority strategic plans. The balances will reduce as reserves are spent.

d) Reserves to manage risks (i.e. excluding revaluation gains)

	2021/22	2022/23	2023/24	2024/25	2025/26
Brought forward	7,818	9,200	9,200	9,200	9,200
Surplus/(deficit)	722	0	0	0	0
Pension liability movement	3,921	0	0	0	0
Total	**12,461**	**9,200**	**9,200**	**9,200**	**9,200**
Reserves target	9,200	9,200	9,200	9,200	9,200
Excess reserves paid to boroughs	**3,261**	**0**	**0**	**0**	**0**

The reserves target will be set annually as part of the annual budget setting exercise and will be based on risks at the time. It is unlikely they will remain at £9.2 million.

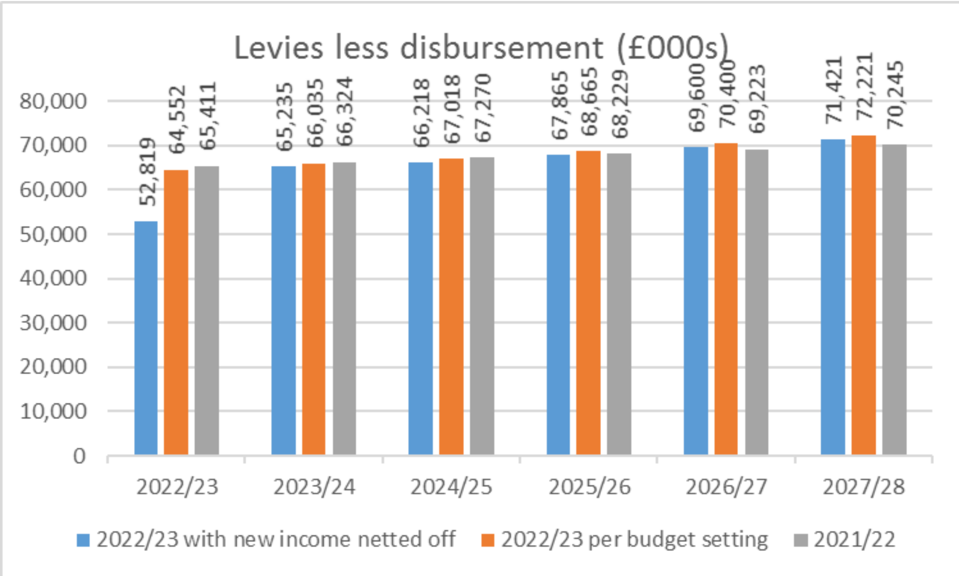
Excess reserves result from day to day operations and will be apportioned and disbursed/paid to boroughs using the council tax base.

e) Forecast levies

The long term financial plan has been updated to:

- use a long term assumption for inflation of 4% per year (2% was used when setting the budget).
- include the disbursement of income to boroughs netted off against levies

The impact on levies is illustrated in the table below.



This shows a continuing healthy financial position compared to the projections from 2021/22 and during the 2022/23 budget setting. The forecast is particularly better in 2022/23 due to new income (subject to significant uncertainty) and subsequently with recurring income largely offsetting the impact of the increased inflation assumption.

Appendix 2 – Brief summary of upcoming legislative change

Extended Producer Responsibility

This legislation applies the polluter pays principle. The costs of disposal/recycling of packaging waste will pass to manufacturers and retailers (i.e. the polluters).

The financial mechanisms will incentivise polluters to use more recyclable materials and this will effect waste flows across the entire system.

Local authorities will receive funding to cover some of the cost of disposal/recycling. It is unclear how the financial mechanisms will work and whether it will change the central government funding of local authority spending.

The legislative timeline for introduction of EPR has been delayed. The latest timeline is that a bill will come to parliament in 2023 and take effect from 2024, with data gathering and compliance/reporting for stakeholders commencing April 2024.

Deposit Return Scheme

This legislation will incentivise consumers to recycle single use drinks containers through a deposit (e.g. 20p) charged when purchasing a product (e.g. can of cola) which they can then get refunded at a range of recycling locations and facilities.

The legislative timeline is unclear with the earliest date for implementation being late 2024.

Consistency

This legislation will seek to introduce separate collections and cycles (e.g. weekly) for a range of materials including Dry Mixed Recyclables throughout the country.

Local authorities will be allocated to a peer groups to assess relative performance.

The timeline for legislation is planned to be the same as EPR (i.e. 2024) so that the EPR funding formula can incorporate/incentivise good performance.

Emissions Trading Scheme

Energy from waste (EfW) plants are presently excluded from the Emissions Trading Scheme. A change in this legislation will include them and result in additional costs for operators.

There is presently no requirement/guidance/clarity regarding the scale of those costs or how operators will have to deal with them. Suez estimate it at £36 per tonne of residual waste..

However it is expected operators will seek to pass on costs through their contracts with others. This could include the power purchasers (and ultimately consumers) and customers including local authorities (and ultimately council tax payers).

The UK change in legislation is under consultation. However it is worth noting that the EU has already approved the change for their members which comes into effect in January 2026.

Net Zero / Climate Emergency / Air Quality

A variety of environmental legislation is a key element of the work of the Climate Emergency Officers Group.

The principle impact on waste streams will relate to the supply chain and logistics, principally transport and how they can aid delivery of much wider environmental targets.

Plastic Tax

A £200 per tonne plastic tax for plastic with less than 30% recycled content was introduced on 1 April 2022 which importers and manufacturers will be required to pay.

This was intended to change the behaviour of the supply change and so improve the recycling of plastic.

Landfill Ban

This legislation will ban biodegradable waste from landfill.

The timeline is uncertain and it is worth noting that Scotland who are planned to be early adopters have pushed back implementation to 2025.

Textiles

A consultation for new legislation is planned for 2022. This will apply the polluter pays principle, similarly to EPR.

Producers and retailers will pick up the costs of processing / disposal and will be incentivised to increase re-use and recycling.

Local authorities will receive funding to cover some of the cost of disposal/recycling.
At this stage with no indication of the legislative changes it is not possible to assess the impact accurately however Officers expectations are that costs will rise.

Appendix 3 – Finance Director's formal borough feedback

London Borough of Hounslow

Clive Palfreyman
Executive Director of Finance & Resources

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FAO
Mr Jay Patel
Finance Director
West London Waste Authority

Your contact: Clive Palfreyman
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Your ref:

Date: 02 September 20222

Dear Jay,

Re: Finance Strategy 2022

We have reviewed the Finance Strategy Report sent to us dated 19th July 2022 and would like to provide the following feedback.

We acknowledge the incorporation of the previous feedback from the borough directors and additional information provided by the Authority as requested.

The income sharing mechanism proposed in the Finance Strategy is agreeable and the rationale seems to be sound. The new income "Trade off" model illustrates very well the short-term vs long term stability. The proposal to pass two thirds of the one-off income to boroughs is acceptable although we would be happy to explore with you a model whereby 100% reinvestment in WLWA services were an option with the objective of driving down revenue costs.

We acknowledge the long-term forecast plan for levies has been updated with a 4% inflationary increase per year vs 2% during budget setting and that this has been partly mitigated through the new recurring income, especially for the year 2022/23. However, we understand that the inflation will be a growing concern for the Authority along with the legislative changes.

We acknowledge the appendices 2 & 3 on legislative changes and potential impact of legislative change by material. We note that the legislative change could increase the disposal cost of residual waste and green waste particularly. We note that the direct impact on levies is proposed to be minimised through the holding of reserves and possible new income.

We believe the Finance Strategy should provide a mechanism for delivering better financial certainty and will provide a framework for supporting the delivery of the long-term actions plans to understand/prepare for the implications of the emerging legislation changes.

We are looking forward to receiving Hounslow's share of the income earned by the contractor from the energy from waste plant share (c£1047k subject to final accounts) and disbursement of excess reserve of c£481k, in October 2022 and we note that it has no conditions attached.

We thank you for all your hard work in bringing this together and looking forward to working with you on the action/delivery plan.

Yours sincerely,

Clive Palfreyman

Executive Director of Finance and Resources

By email

Hillingdon welcomes the publication of the WLWA finance strategy and the presentation of a medium-term forecast which will assist our financial planning processes in this area. It was useful to have some opportunity to comment on the development of the strategy and we will be keen to support this process going forward. These discussions have identified that with respect to some issues there are differing financial preferences and positions amongst the constituent authorities and that the strategy will need to be flexible enough to accommodate those differences.

Andy Evans
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