WEST LONDON WASTE AUTHORITY

Report of the Managing Director and Treasurer 8 December 2017

Medium and Long Term Financial Plan (MLTFP)

SUMMARY

This report provides the medium and long term financial plan for the Authority.

RECOMMENDATION(S)

The Authority is asked to:-

1) Note the medium and long term financial position

2) Note the sensitivity analysis and impact of waste growth and inflation

1. Background

As part of work on the 2018/19 budget the longer term picture is also considered, including the medium term financial outlook.

The purpose of this work is to demonstrate that the Authority is a going concern and to identify the key risks effecting its financial plans.

2. Financial Model and Base Position

The basis of this report is a financial model that projects the financial performance (overall expenditure / levies) and financial position (balance sheet) over the term of the PPP contract, 24 years. The model also looks at the debt position and cash balances over the same period.

The model is predicated on delivering annual balanced budgets per regulatory requirements. The model uses the 2018/19 budget as the starting point and applies a range of 32 assumptions to different activities. For example, a salary inflation assumption is applied to payroll costs which increase by that inflationary amount each year.

The base position represents a set of assumptions which are reasonable and prudent (slightly pessimistic). These are applied to the 2018/19 staring position to produce a long term financial picture. An extract of the key assumptions is provided in the table below. The assumption for RPIX is 4.0% which is 2% higher than the assumption last year to reflect the current levels of inflation. The other key assumptions are unchanged.

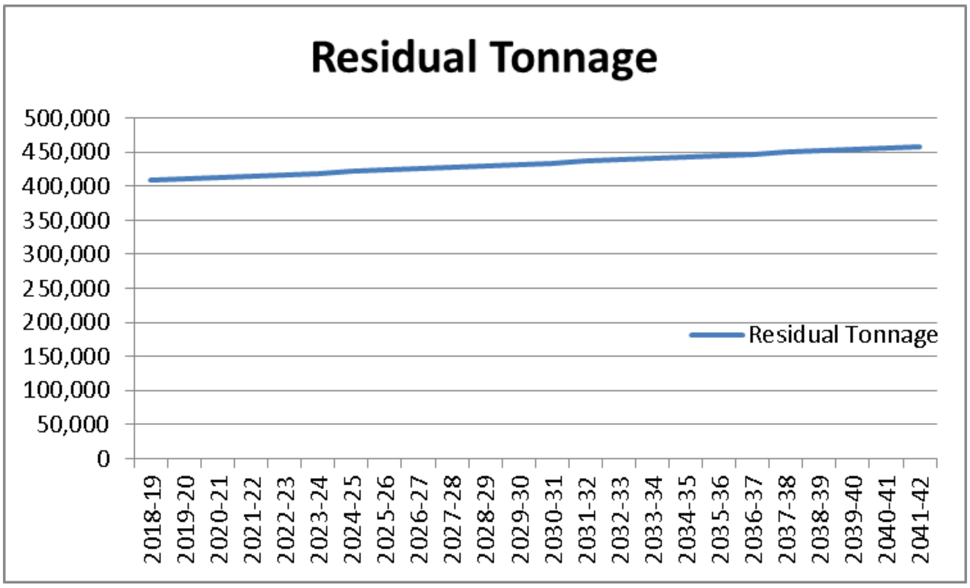
Activity Level Assumptions	
Annual increase in residual tonnage	0.5%
Price Change Assumptions	
Annual general contract inflation (RPIX)	4.0%

Note: the Bank of England's long term monetary policy inflation target is 2.0%.
The 4.0% assumption in the financial plan provides a cautious/pessimistic base scenario

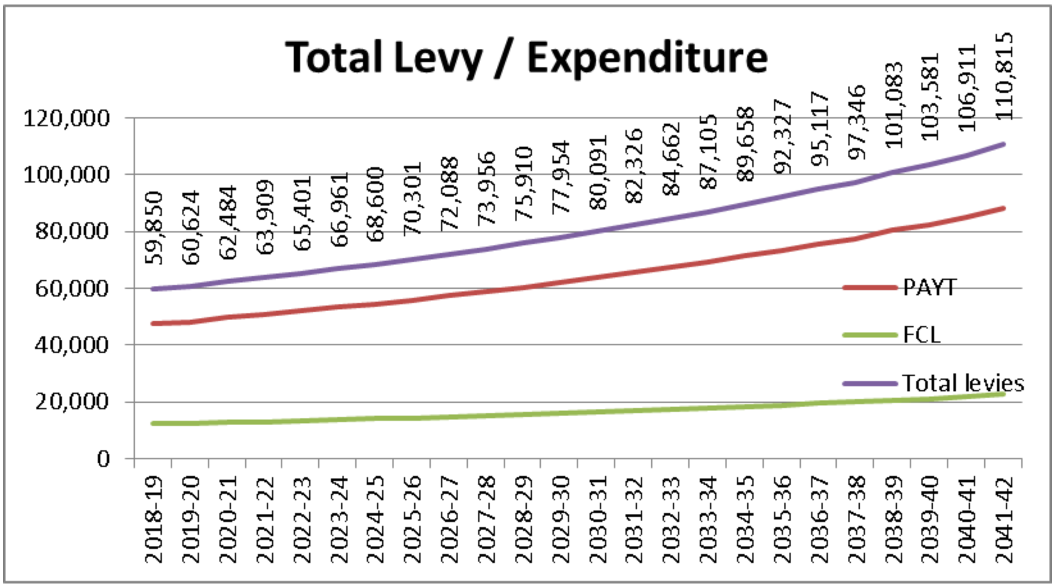
3. Outputs

Using the base assumptions, the model then gives us some outputs, for example how our costs (and consequently levies to boroughs) changes over time, or how our loan balance changes over time. The key outputs are illustrated below.

Tonnage – The chart below illustrates the impact of the base assumption of 0.5% annual growth in residual tonnage. Over the life of the plan the residual tonnage rises from 409,006 to 458,722 tonnes, although the impact of this growth could be mitigated by all boroughs achieving or exceeding the national 50% recycling target.



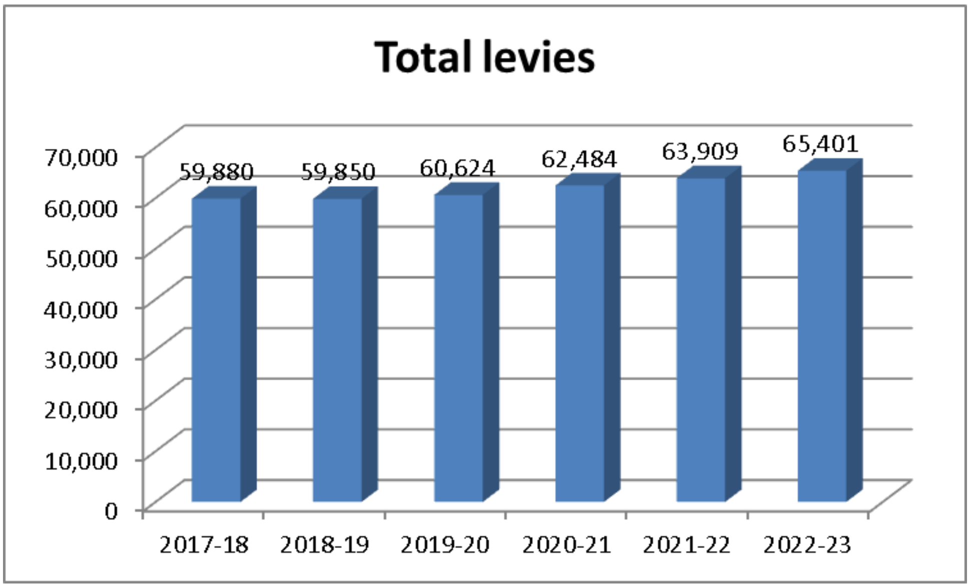
Overall expenditure – This equates to the total levies charged to boroughs and the chart below has been split to show the PAYT and FCL as well as the total. The chart illustrates the growth in overall expenditure and levies over time.



This chart above illustrates an average annual growth of 2.7% over the long term which is significantly lower than the 4.5% underlying growth from general contract inflation RPIX (4.0%) and annual growth in tonnages (0.5%).

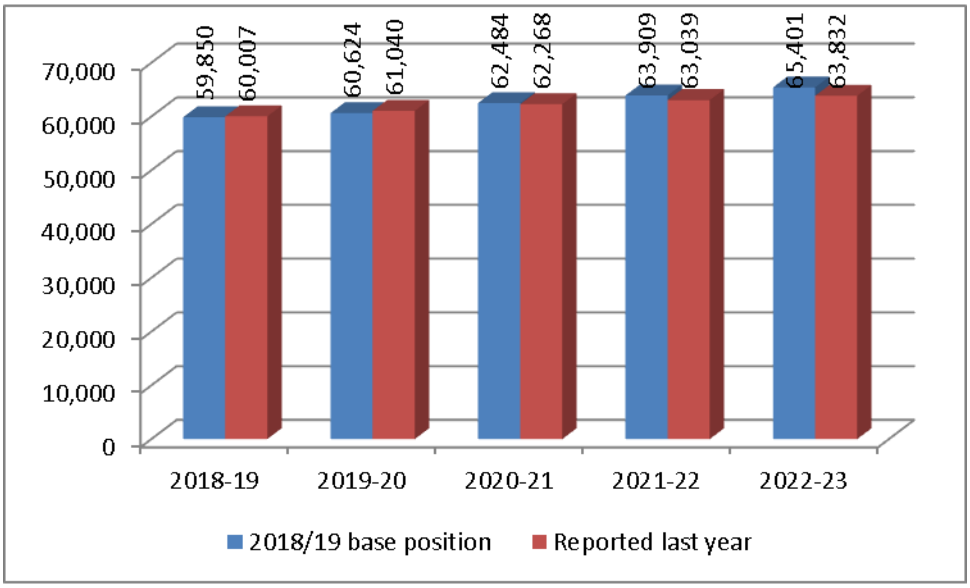
This is a result of the way the PPP contract is structured. The contract is for up to 300,000 tonnes of waste with the first 235,000 tonnes of waste incurring a 90% fixed price. This significantly dampens the effect of inflation over the whole life of the contract.

This is further illustrated in the medium term in the chart below.

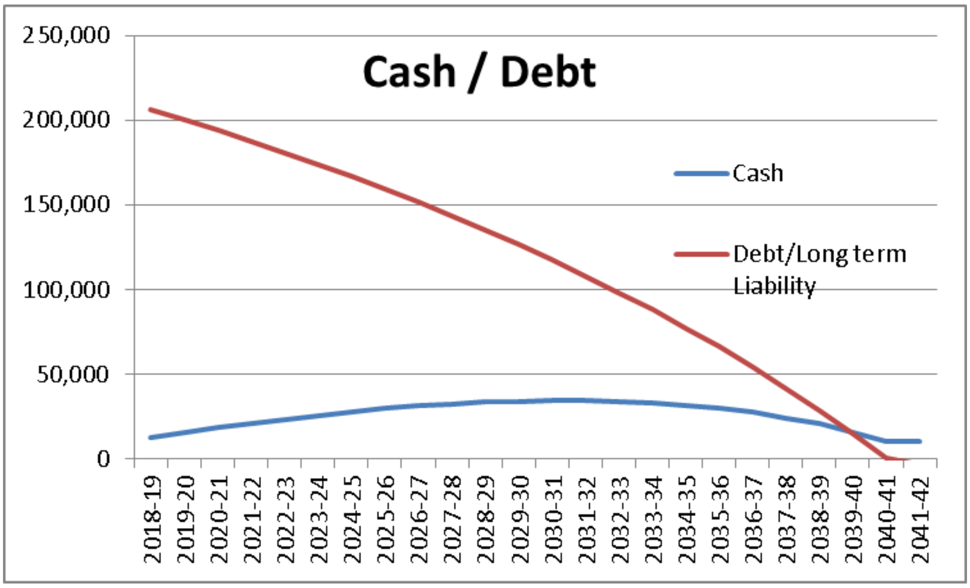


The table above shows an average growth in levies of 1.8% per year over the next 5 years. Boroughs may want to consider using this as an estimate of the increase in the WLWA levies within their medium term financial plans.

The chart below shows how the current medium term plan compares to the plan reported last year. They show a very similar position despite the very significant increase in the long term contract inflation assumption.



Debt / long term liabilities and cash – The following chart illustrates the movement in the debt / long term liabilities as they are paid / settled. The repayments commence at a low level and progress at increasingly larger sums, resulting in the debt/long term liability curve. This effect is reflected in the cash balances which build up in early years when repayments are small and fall in later years when loan repayments are large.



At the end of the plan the Authority will be debt free.

Details of the income and expenditure, balance sheet and cashflow over the life of the plan, which are used to produce these charts can be found in Appendix 1.

4. Sensitivity Analysis

Changing the assumptions (sensitivity analysis) within the model allows us to see how the costs (and so levies) change and in doing so, understand the relative impact of key assumptions. This is an important element of long term financial planning and provides an understanding of long term risks and an appreciation of the business's financial capacity to take on strategic opportunities should they arise.

The table below shows the impact of changing tonnage assumptions and highlights that if residual waste can be reduced, this would have significant benefits in terms of overall costs and the levy.

Residual tonnage growth assumption	**Average annual growth in overall costs / levy**
Reducing residual tonnage to an annual 2% fall	-0.1%
Reducing residual tonnage to an annual 1% fall	1.1%
Reducing residual tonnage to an annual 0.5% fall	1.6%
No change in residual tonnage	2.2%
Base position residual tonnage growth of 0.5%	2.7%
Increasing residual tonnage growth to 1.0% pa	3.3%
Increasing residual tonnage growth to 2.0% pa	4.3%
Increasing residual tonnage growth to 3.0% pa	5.4%
Increasing residual tonnage growth to 5.0% pa	7.5%

Pricing and cost inflation also have an impact on overall costs / levies and the following table illustrates how the key output, total levies/costs, will change as the pricing inflation assumption is changed.

Pricing inflation assumption	Average annual growth in levies/costs
Reducing long term RPIX to 1.0%	0.6%
Reducing long term RPIX to 2.0%	1.3%
Reducing long term RPIX to 3.0%	2.0%
Base position of RPIX at 4.0%	2.7%
Increasing long term RPIX to 5.0%	3.5%
Increasing long term RPIX to 6.0%	4.3%

This sensitivity analysis indicates that even with the very pessimistic 6.0% RPIX scenario above for pricing inflation the annual growth in overall costs and levy would be dampened to 4.3% per year. Similarly if the Bank of England's long term inflation target of 2.0% is assumed then growth in costs / levies would be dampened to 1.3% per year.

From the sensitivity analysis above the assumption that has the largest impact on the overall financial picture is the change in residual waste tonnage over time. The Authority is also effected by pricing inflation but is well protected because of the dampening effect of the PPP contract.

This emphasises the importance of boroughs managing tonnage volumes as the key driver of future cost and levy growth.

5. Summary

Managing the growth of residual waste tonnages will be the driving factor for long term costs and levies. However, under current plans and building on the 2018/19 budget, the medium term financial position is strong.

- The effects of pricing inflation are significantly dampened as a result of the PPP contract
- over the long term overall costs/levies rise by an average of 2.7% pa despite an underlying growth of 4.5% used in base assumptions
- The Authority will be debt free at the end of the plan
- Healthy cash balances are maintained throughout the term of the financial plan and will mitigate any liquidity risk

6. **Financial Implications** – These are detailed in the report.

7. **Legal Implications** – There are no legal implications as a result of this report**.**

8. **Impact on Joint Waste Management Strategy** – Improvements to financial management in the Authority will continue to ensure that the Authority addresses policies of the JWMS.

Contact Officers		
	Jay Patel, Head of Finance	020 8825 9524
	jaypatel@westlondonwaste.gov.uk	
	Emma Beal, Managing Director	020 8825 9488
	emmabeal@westlondonwaste.gov.uk	
	Ian O'Donnell, Treasurer	020 8825 5269
	Odonnelli@ealing.gov.uk	