

ANNEX A

LETTER OF 30 MAY 2008 FROM JOHN BURNS (DEFRA DIRECTOR OF WASTE IMPLEMENTATION PROGRAMME) TO TIM JUDSON, NLWA

Expression of Interest (Eoi) for Private Finance Initiative (PFI) funding – Round 4

Thank you for your submission of an Eoi on behalf of North London Waste Authority. I am writing to notify you of the results of the evaluation process.

The Eoi was evaluated by colleagues in the Waste Infrastructure Delivery Programme (WIDP) Scrutiny team taking into account comments from Government Office London, WRAP, the Greater London Authority, and the Environment Agency. The recommendation of the Scrutiny team was considered and approved by the WIDP Programme Board.

The primary aims of this stage of the application process are to provide an opportunity for:

- a) a review of the compatibility of the Authority's procurement strategy with Defra's programme objectives including compliance with the Departmental PFI criteria; and
- b) an assessment of the Authority's state of readiness in relation to the preparation of the Outline Business Case (OBC) required to secure PFI funding as according to the stated WIDP timeframes.

Accordingly we provide feedback under two separate headings.

Compatibility with Defra's Programme Objectives

I am pleased to confirm that, subject to the comments below, in the opinion of the WIDP Board, the Authority's procurement strategy appears likely to lead to the development of a project that is compatible with Defra's Programme Objectives and compliant with the Departmental PFI criteria.

As is clear in the waste PFI criteria, Authorities should be aware of the *Waste Strategy for England 2007* (WSE 2007) <http://www.defra.gov.uk/environment/waste/strategy/>. In line with WSE 2007, Defra is now strongly encouraging Authorities to give a high weighting to the relative carbon efficiency of different technological solutions - especially where they involve energy recovery. Combined heat and power (CHP) solutions are typically the most efficient outcomes giving the maximum climate change benefit. Your OBC will therefore be strengthened significantly if you can show that your procurement approach, evaluation and site selection criteria are developed in a manner that encourages the delivery of solutions that include CHP.

In considering your CHP options, please cast the net widely. CHP can be achieved in a number of different ways and potential heat use opportunities may not always be available adjacent to a heat source. (Please be aware of the information available regarding heat users in your area at

<http://www.defra.gov.uk/environment/climatechange/uk/energy/chp/>).

To facilitate the matching of heat production and heat usage, you may wish to consider a “fuel production / fuel use” approach whereby the Authority’s selected waste management solution produces a fuel which can be used to fire a CHP application in existing industrial plants. This is likely to involve converting CHP applications from gas to solid fuel firing with attendant energy cost, security of supply and energy efficiency benefits for the user and the Authority. An essential first step when considering this approach is to research potential industrial energy users in your region. The information available at the following website is a useful starting point although additional project specific studies are likely to be needed:

<http://www.industrialheatmap.com/download.php>

I would also draw your attention to the following issues relating to compliance with the Defra PFI criteria.

a) Criterion 1 – this criterion encourages applicants to explore the opportunities for joint working with neighbouring Authorities. Your EoI, while providing details of discussion with Hertfordshire and Essex which suggest a joint procurement is unlikely, is less definitive in relation to Tower Hamlets. We note the EoI states there are potentially significant advantages to joint working between NLWA and Tower Hamlets to manage residual waste. Therefore we would encourage you to continue discussions on possible opportunities for joint procurement or partnership working with Tower Hamlets, ideally reaching a conclusion before the OBC is submitted. Even if such discussions conclude there is no scope for working together, we would expect the OBC to include a full evidence base to justify the decision taken as to the right degree of joint working. WIDP will work with you to ensure that all possible avenues for joint working with neighbouring Authorities have been adequately explored prior to OBC submission, facilitated by either WIDP’s Regional Co-ordinator or your Transactor.

b) Criterion 2 - this criterion refers to “longer term national targets for recycling and composting.” WSE 2007 incorporates three explicit targets for Municipal Solid Waste management which Defra wishes to see reflected in all applications for PFI credits i.e.:

Recycling and composting of household waste – at least 40% by 2010, 45% by 2015 and 50% by 2020;

Household waste not re-used, recycled or composted - reduce to 310 kg per person in 2010, 270 kg in 2015 and 225 kg in 2020.; and

Recovery of municipal waste – 53% by 2010, 67% by 2015 and 75% by 2020.

Since Round 2 it has been mandatory for plans to meet or exceed these targets to be incorporated in OBCs for all projects. Any OBCs which do not incorporate these targets with appropriate evidence as to how they are to be achieved, are liable to be rejected by Defra. In this context, please note WSE 2007 highlights Anaerobic Digestion for food waste collections as a means of combining a recycling process with energy recovery and we expect to see Anaerobic Digestion considered as a means of achieving the above targets.

WSE 2007 also highlights the case for extracting energy from waste wood that cannot be readily re-used or recycled. The waste wood collected at your Civic Amenity sites has high biomass content. The OBC needs to consider how waste wood can be diverted from landfill and used to recover energy. The Authority should explore whether they can offer medium/long term contracts for both Solid Recovered Fuel and waste wood that could help energy users secure finance for the construction of combustion capacity. Please see WIDP's *Waste Wood Information Report*:-

Report - <http://www.defra.gov.uk/environment/waste/topics/woodwaste.htm>

Press notice - <http://www.defra.gov.uk/news/2008/080409b.htm>

c) Criterion No 8 - Authorities applying for PFI credits must commit to follow extant guidance for PFI procurement including Defra-issued specific guidance. Please note that this will include WIDP's new guidance on the development of the Payment Mechanism and Output Specification schedules to the PFI project agreement. These contractual documents determine how the Authority's payment will vary with variations in residual waste. Hence they are critical in determining whether the Authority's contractual commitments in respect of residual waste are consistent with its plans in relation to waste minimisation and recycling. This will be a key issue for Defra in evaluating the OBC and Authorities are requested to give early consideration to the guidance and set out how they intend to implement the guidance when completing the OBC.

d) Criterion 15 – this criterion states that Authorities are expected to take proactive action to acquire sites. For the avoidance of doubt, the OBC will need to provide confirmation that sites have been acquired or that steps have been taken that provide a high degree of confidence that sites will be acquired before the procurement process begins. If the latter course is adopted, Project Review Group approval is likely to be conditional on completion of the site acquisition.

Please note that these are provisional conclusions based on the information provided to WIDP to date. There is no commitment from Defra at this stage in relation to the allocation of PFI credits. The allocation of credits will be based on the approval of an OBC.

State of Readiness

The WIDP Board considers that in comparison to the other applicants in Round 4 the Authority has a lot more work to do to be able to submit a robust OBC by the deadline for Round 4 i.e. by 31 October 2008. The areas we would highlight as in need of further development for the Outline Business Case include:

- the determination of project scope;
- potential partnering arrangements with neighbouring Authorities;
- the acquisition of suitable sites that offer demonstrable planning comfort. As planning is a key issue for the project we would highlight the need to keep the issues raised in

WIDP's Planning Guidance under constant review and to liaise closely with your WIDP Transactor regarding the strategy for managing this risk.

- resolution of the LondonWaste Ltd joint venture arrangements;
- securing general conformity with the London Plan and the Mayor's Municipal Waste Management Strategy to attract the support of the office of the Mayor of London;
- progress towards the adoption of the North London Joint Waste Strategy (and attendant Strategic Environmental Assessment) particularly reflecting WSE 2007 growth rates, national waste reduction, recycling and composting targets for 2020 and demonstrating the support of the constituent Waste Collection Authorities .

The Process Going Forward

In developing the OBC we would be grateful if you would adopt the template WIDP has prepared to help ensure all OBCs cover all relevant points. A copy of the template (v 4.0) is attached.

The deadline for the submission of Round 4 OBCs is 31 October 2008. Your WIDP Transactor, Ben Prynne, will be available to assist you as you prepare the OBC over the course of the next few months.

We would also encourage your continued engagement with WRAP.

PFI Credit Allocations

Finally, please note that Defra's PFI credit allocation policy has been revised to bring it into line with other Government Departments. From Round 2 onwards the PFI credit awarded to an individual project will be a set percentage of the relevant capital expenditure in the OBC.

The relevant capital expenditure should be calculated in accordance with Section D of CLG's "*Local Government PFI Project Support Guide (2007-08)*" (<http://www.local.odpm.gov.uk/pfi/sg0708.pdf>). Supplementary guidance on how to interpret this guidance in the waste context is offered in Appendix E of the enclosed OBC template.

The minimum percentage applicable will be equal to 50% of the relevant capital expenditure. We will not reduce that percentage for any project, subject to WIDP satisfying itself that the capital expenditure figures are based on appropriate assumptions in line with market prices. We are currently reviewing the potential for higher awards for individual projects that make exceptional contributions to the objectives set out in WSE 2007. This requires Ministerial clearance and there is no commitment yet to such a process. We will contact you again shortly as soon as a decision has been taken.

A number of Authorities in Rounds 2, 3 and 4 are currently going through the PFI credit application process and it is possible that the credits allocated to Defra under the 2007 Comprehensive Spending Review (CSR07) will not be sufficient to fund all projects in those rounds.

In addition, as this current allocation of credits may have to be used by the end of the spending round, Defra is not currently in a position to allocate credits to projects that are scheduled to reach financial close after 31 March 2011. We believe that the end of October 2008 is the latest OBC submission date that is consistent with a reasonable level of confidence that the project can reach financial close by 31 March 2011. Therefore we have to inform all applicant Authorities that:

a) Although we will aim to allocate funding to those Authorities which can provide a compliant OBC by the Round 4 submission date i.e. 31 October 2008, over-subscription will inevitably introduce a competitive nature to the process and not all Authorities will necessarily secure funding. PFI credit allocations will be dependent on the requirement for residual treatment to deliver on UK Landfill Directive targets and other policy objectives, and on the availability of credits.

b) Authorities that submit OBCs (that are judged compliant) on or before 31 October 2008 will be given priority over those that need longer to complete and submit a compliant OBC.

c) Authorities that cannot submit compliant Round 4 OBCs until after 31 October 2008 may still be able to apply for PFI credits. However, PFI Credits will only be available if and when WIDP (i) determines there are valid policy reasons to allocate further PFI credits; and (ii) that unused PFI credits from the CSR07 period (if any) can be carried forward to 2011/12, or additional credits are allocated to Defra for 2011/12.

If you require any further information regarding the contents of this letter please do not hesitate to contact John Enright, Head of Project Development and Scrutiny for WIDP (020 7238 4313 or john.enright@defra.gsi.gov.uk).

Yours sincerely

A handwritten signature in black ink, appearing to read 'John Burns', with a horizontal line underneath it.

John Burns
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