

NORTH LONDON WASTE AUTHORITY

REPRT TITLE	
LANDFILL ALLOWANCE TRADING SCHEME - TRADING STRATEGY	
REPORT OF	
FINANCIAL ADVISER	
FOR SUBMISSION TO	DATE
AUTHORITY MEETING	19 SEPTEMBER 2007
1. SUMMARY OF REPORT	
<p>This report provides an overview of the Landfill Allowance Trading Scheme and recommends a medium-term trading strategy.</p>	
2. RECOMMENDATIONS	
<p>The Authority is requested to:</p>	
<ul style="list-style-type: none">(i) Agree the medium-term LATS trading strategy as set out in section 5 of this report.(ii) Delegate authority to the Authority's Trading Officer (NLWA Finance Officer), in consultation with the Financial Adviser and Head of Waste Strategy and Contracts to implement the medium-term LATS trading strategy as described in section 5 of this report.	
Signed by the Financial Adviser:	
Date:	

3. **Background**

- 3.1 The Landfill Allowance Trading Scheme (LATS) is one of the Government's key measures to reduce the amount of biodegradable waste going to landfill (Waste and Emissions Trading Act 2003 – WET Act), and in so doing, to meet the requirements of the European Landfill Directive. The scheme came into effect on 1st April 2005.
- 3.2 In total about 68% of municipal waste is biodegradable and only this waste is counted for LATS.
- 3.3 The United Kingdom is required to reduce the amount of biodegradable municipal waste (BMW) sent to landfill to:
- 75% of 1995 levels by 2009/10
 - 50% of 1995 levels by 2012/13
 - 35% of 1995 levels by 2019/20.

As a consequence the amount of biodegradable waste that can be landfilled in England (there are separate arrangements for Scotland and Wales) for these target years is limited to:

- 11.2m tonnes in 2009/10
 - 7.46m tonnes in 2012/13
 - 5.22m tonnes in 2019/20.
- 3.4 For the period to 2019/20 the Government has announced an allocation of landfill allowances that match the limit of waste that can be landfilled in the target years. The allowances have been allocated to waste disposal authority's (WDAs) based upon their share of the biodegradable municipal waste generated by all WDAs in 2001/02. Again using 2001/02 data the Government has calculated a base year entitlement for each WDA. In the early years of the scheme and up to the first target year annual allowances have been 'back-end loaded' to recognise that authorities need time to bring waste management facilities online. After 2009/10 allowance allocations between target years are calculated by making equal year-on-year reductions from one target year to the next. As a result of these calculations the NLWA has been allocated landfill allowances of 312,933 in 2005/06 (year one), rising to 358,996 in 2009/10, and then reducing to 239,117 in 2012/13 and to 167,318 in 2019/20. The Government's chosen method of allocating allowances and the NLWAs existing relatively high level of landfill avoidance has meant that the Authority enjoys a rising allocation up to and including the first target year.
- 3.5 WDAs that have insufficient landfill allowances for the amount of waste that they landfill are at risk of incurring a fine of £150 for every tonne landfilled above the total of allowances they hold. In addition, the Government has reserved the right to pass on any European fine imposed on the UK for missing the Landfill Directive targets. This could mean that failing WDAs could be responsible for their share of fines reaching £180m a year, or £0.5m a day, until the Directive's demands are met.
- 3.6 WDAs are able to trade their allowances. This means that a WDA that needs to landfill more waste than its allocation can buy extra allowances from WDAs that

landfill less than their allocation. Alternatively, a WDA can also borrow up to 5% of its future allowances from future years, and also bank unused allowances in one year for use in a future year. However, no trading – including both ‘banking’ and ‘borrowing’ – is permitted across target years, i.e. 2009/10, 2012/13 and 2019/20. This means that landfill allowances unused at the end of 2008/09, 2011/12 and 2018/19 would become worthless if not used.

- 3.7 Previous reports have advised that the Authority expects to be in a favourable trading position, at least up to and including the first target year in 2009/10. Based upon work carried out to support the development of the Authority’s Procurement Strategy, the latest forecasts suggest that the Authority could have in the region of 205,969 surplus allowances in the lead-up to the first target year. This body of work also concluded that the Authority could have surpluses in subsequent trading years to 2012/13. The forecast figures are summarised below:

2005/06	14,560 (actual)	}	
2006/07	84,886 (actual)	}	These surpluses have to be used
2007/08	49,065	}	
2008/09	57,458	}	
2009/10	71,195		Available for 2009/10 only
2010/11	141,901	}	These surpluses have to be used
2011/12	45,763	}	
2012/13	35,217		Available for 2012/13 only

- 3.8 It should however, be borne in mind that these projections are strongly influenced by a number of inter-related factors, particularly:

- (i) The rate of growth in the waste stream.
- (ii) The rate of growth in recycling and composting activities by the boroughs and the timely availability of new waste treatment facilities or services.
- (iii) The maintenance of existing landfill avoidance treatment facilities, particularly in the case of the Edmonton Energy from Waste (EfW) facility, where loss of incineration capacity for only a short period of time could significantly increase the Authority’s use of /need for allowances.

- 3.9 In relation to the latter point Members will be aware that in the first year of LATS the incineration capacity of the Edmonton EfW facility was significantly reduced so that the boilers could be upgraded to meet the requirements of the Waste Incineration Directive. Other than this the Edmonton facility to-date has had a relatively good track record for maintaining high incineration levels. Nevertheless with an ageing facility and the possibility of having to meet further legislative environmental improvements there is always a risk that incineration levels could be adversely affected. This is particularly important when considering the potential risk of selling future year’s surplus allowances which have yet to be determined.

- 3.10 Income from the sale of surplus allowances can only be used in the year that the surplus arises, or some future year if the net cash proceeds from a sale are carried

forward to a future year, i.e. it is not possible to use the income from the sale of a future year's allowance until the surplus has been recognised in that year's accounts.

4. Current Market Conditions

4.1 At the national level the price at which allowances are sold, or offered for sale, is also strongly influenced by those factors identified at paragraph 3.8 above.

4.2 In both 2005/06 and 2006/07 there were very few allowances offered for sale on the LATS market for either the 2005/06 or 2006/07 trading year; most offers (but here again relatively few in number) were for trades in future year's allowances where the demand was likely to be the greatest. The Authority does not have access to actual sales/purchase data but for accounting purposes DEFRA/CIPFA has determined that based upon the average value of actual trades each allowance should be valued at £20.20 in 2005/06 and £17.98 in 2006/07.

4.3 Although there is currently no detailed information of the number of actual surplus allowances available in the LATS system at 31 March 2007, the number of allowances offered for sale in recent months for the 2006/07, 2007/08 and 2008/09 vintage allowances suggests that there is a very substantial surplus of allowances in the system. The perceived wisdom is that this is due to a downturn in the growth in the waste stream coupled with a general improvement in recycling and composting levels. For the year to-date, primarily in the past few months, some 1.3m allowances have appeared on the market for sale, comprising:

	Offer Price Per Allowance
2006/07 Vintage Allowances – 480,000	£4.80 to £10
2007/08 Vintage Allowances – 605,000	£4.80 to £20
2008/09 Vintage Allowances – 205,000	£15

4.4 With the value of most offers for sale pitched at the lower end of the above price range it is quite possible that surplus allowances will have little real value in the period up to the first trading year. If so, it is likely that most waste disposal authorities could be left with surplus allowances that if not used or sold will lapse and have no value. This is a problem for both sellers and buyers of allowances, as deciding when to sell or buy is influenced on the one hand by the desire to gain some value from the sale of surplus allowances, and on the other, not to bear unnecessary costs in what appears to be a buyers market. If waste stream growth changes adversely, or if recycling and composting levels flatten, or if planned new facilities do not come on stream, perhaps because of a failure to obtain planning consent, this could lead to a scramble for the purchase of allowances during the 2008/09 reconciliation period (June to September 2009).

4.5 At present only one offer to sell has been posted on the LATS notice board for 2009/10, i.e. the first target year, and is on offer at a price of £50 per allowance. No offers have been posted for subsequent years, although a number of disposal authorities have posted an interest to purchase. Subject to the Authority achieving

the surpluses currently projected for the period 2009/10 to 20012/13 this is the period in which the Authority might reasonably expect to obtain some real value from the sale of surplus allowances.

5. **Proposed Medium Term LATS Trading Strategy**

- 5.1 The period up to and including the first target year is the most important time for immediate consideration. The issue for the financial year 2008/9 will be the loss of any value of banked allowances due to the likelihood of significant surplus allowances across the country. This will mean that prices are likely to be low. Therefore the key will be to capitalise on any demand remaining in the market prior to this and sell any excess allowances that the Authority has available by the end of 2007/8. Considering the risk of under performance for 2008/9 this is obviously an issue if any of the existing treatment facilities fail, thus a major problem with Edmonton could give rise to a risk of deficit if the plant is off line for any significant unplanned downtime. Even in this unusual circumstance LATS allowance availability in the current environment should still be high and therefore any need to purchase allowances should not be too expensive. However, as the Authority has already accumulated 99,446 surplus allowances at 31 March 2007, this is a large safety net and consideration for marketing this as early as possible should be considered to see if there is some value to be gained. Expectations, however, are that there will be minimal value for these.
- 5.2 The key question to address, however, is how best to determine ‘what is an acceptable price to trade for the allowances already held?’ As previously indicated, in 2007/8 and 2008/9 the Authority will be entering a market that is likely to be in over supply. Past values for 2005/06 and 2006/07 may not be achieved in the short-term as there is clear evidence in the year to-date that historic values are unlikely to be achieved. The best way forward may therefore be to review the current postings for sale on the LATS trading notice board and set the sale price at say 5-10% below the current volume-weighted average. Whilst, this would be the planned approach it is also important that the Authority is able to move quickly to close a potential sale, and therefore it is further recommended that officers should have the flexibility to sell above or below the volume-weighted average.
- 5.3 The Authority is forecast to have further surplus allowances in 2007/08 and 2008/09, however, it is felt that it might be prudent to test the market first with the sale of the authority’s banked allowances and to continue to review sale notices as they appear in order to judge the scope for offering more allowances to the market. However, it will be important not to leave the Authority in the potential position of a deficit, and therefore it would be prudent to allow for a headroom of 10% over the Authority’s likely use of allowances in each of the future trading years. As in the case of banked allowances the method described in paragraph 5.2 would also apply to determining the price at which 2007/08 and 2008/09 surplus allowances could be traded.
- 5.4 In relation to the pricing of future sales in the period 2009/10 to 2012/13, AEA Technology, the Authority’s technical adviser, has advised that the Authority should consider offering small parcels of say 1,000 allowances in each of the future trading years in order to determine the markets appetite to buy in the future. If the

take up is quick or if significant interest is shown then prices could be increased accordingly. As there is currently no price guide for trades in this period AEA has recommended an initial price range of between £40 and £75 which could be flexed, upwards or downwards depending upon trading circumstances. In coming to a view on any downward movement in price it would be necessary to take into account the merit of deferring a sale if there was reason to suggest that it could be beneficial to wait for the trading climate to improve.

6. **Conclusion**

- 6.1 The report concludes that the over supply in the market is likely to mean that allowances will have very little value in the period up to 2009/10. However, with the more challenging LATS targets that have been set for 2009/10 to 2012/13 there is reason to believe that the Authority should obtain greater value from the sale of surplus allowances that are generated in this period.
- 6.2 In order to make progress it is recommended that delegated authority is given to the Authority's Trading Officer (NLWA Finance Officer), in consultation with the Financial Adviser and Head of Waste Strategy and Contracts to implement the medium-term LATS trading strategy as described in section 5 of this report.

6. **Comments of the Legal Adviser**

- 6.1 The Legal Adviser has been consulted in the preparation of this report and has no further comments to add.

Local Government Act 1972 - Section 100 as amended

Documents used in the preparation of this report:-

Landfill Allowance Trading Scheme: Final Allocation of Allowances – 3rd February 2005

LATS Guidance – DEFRA

LAAP Bulletin 64 – Accounting for the Landfill Allowance Trading Scheme (CIPFA).

DEFRA LATS Public Register

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