

EAST LONDON WASTE AUTHORITY

7 FEBRUARY 2011

FINANCE DIRECTOR'S REPORT

REVENUE & CAPITAL ESTIMATES AND LEVY 2011/12	FOR APPROVAL
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1 Executive Summary

- 1.1 This report sets out the projected outturn for 2010/11, and the proposed budget and levy for 2011/12. The proposals set out in this report have been prepared in accordance with the ELWA financial strategy for the next three years as agreed at the November 2010 Authority meeting.
- 1.2 Based on the budget monitoring information to date it is anticipated that the Authority's expenditure will remain within budget in 2010/11. It is therefore proposed that the revised revenue estimate is the same in total as the original revenue estimate of £49,920,000.
- 1.3 It is proposed that ELWA agree a 2011/12 budget of £53,236,000. The increase in relation to the 2010/11 projected out-turn arises primarily from an increase of £8 per tonne in landfill tax, tonnage increases and contractor inflation.
- 1.4 The Financial Projection and Budget Strategy report agreed by Members on 22nd November 2010 highlighted a projected increase in 2011/12 levy of 10% compared with 2010/11. The proposal in this report is for a levy in 2011/12 of 9.6%.
- 1.5 The 2011/12 ELWA estimates are based upon the Annual Budget & Service Delivery Plan (ABSDP). This issue is considered elsewhere on this agenda.
- 1.6 ELWA Members will understand the impact of its levy on the budgets and Council Taxes of its constituent boroughs particularly against the background of the recent Government Comprehensive Spending Review. Therefore, as in previous years, a balance has been sought between prudent financial management that secures the long-term operational viability of ELWA while keeping annual increases in the levy requirement to a minimum. It is likely that ELWA will face further volatility and uncertainty in the future and given the economic recession, new financial pressures cannot be ruled out.
- 1.7 A prudent level of general reserves is recommended to ensure levy stability in future years because of the uncertainties faced by the Authority. These include uncertainties connected with the overall level of waste tonnages, and the implications of recent EU and UK legislation. The proposed Levy for 2011/12 reflects a further use of reserves; it is proposed to transfer £6.0m from PFI reserves and £2.5m from revenue reserves. The residual level of reserves remains appropriate based on an analysis of the risks and uncertainties facing ELWA. The transfer in respect of the PFI reserve reflects a change in the treatment of the PFI grant which in future will be paid on an annuity rather than a declining balance basis. However in the medium term it is proposed that an action plan will need to be put in place to increase reserves so that ELWA can effectively manage the transition and risks that will need to be faced at the culmination of the PFI contract.

- 1.8 Members' attention is drawn to the current projections for the ELWA levy in 2012/13 and 2013/14 at 9.6% and 9.8%. If increases at this level are to be avoided, work must continue to progress with Shanks to find further ways to reduce costs.
- 1.9 The ELWA Management Board supports the contents and recommendations, and the Finance Service of each constituent Council has been advised of the potential levy increases.

2 Introduction

- 2.1 This report sets out the background to the levy, the assumptions and cost pressures determining the levy, the strategic use of reserves to mitigate cost increases to Boroughs, the revised revenue estimates for 2010/11 and the revenue estimates for 2011/12. Members are asked to consider these matters and determine the levy for 2011/12.
- 2.2 The key strategic themes of this report were set out in the Financial Projection and Budget Strategy 2011/12 to 2013/14 report as agreed at the November 2010 Authority meeting. The Constituent Authority were made aware of this and the proposed levy increase.
- 2.3 ELWA is required to inform the constituent Councils as to the amount of its levy requirement by the 15th February each year. The levy is made by issuing a demand to each Council, specifying the dates on which payment is to be made and the amounts involved.
- 2.4 There is no specific power enabling ELWA to make a supplementary levy during the course of the year should it require additional resources due to unforeseen circumstances.
- 2.5 The levy requirement is made up of the ELWA budget plus any contingency provisions, and drawings from/ contributions to reserves including the PFI reserve.
- 2.6 ELWA recommended and its constituent Councils unanimously agreed to the following levy apportionment arrangements with effect from 2002/03:
- (a) A levy based on waste tonnage for costs attributable to Household Waste;
 - (b) A levy based on Council Tax Band D to apportion other costs attributable to, for example, Reuse and Recycling Centres, Aveley I landfill site.
- 2.7 At the September 2010 meeting ELWA agreed to maintain this levy apportionment arrangement and to wait until the 2013/14 levy setting process to formally review the Levy methodology once more.
- 2.8 In compiling this report ELWA Technical officers have undertaken Equality Impact Assessments of the proposals in it. I am advised there is no adverse equalities impact on service users or staff.

3 Cost Pressures on Revenue Budget

- 3.1 The two broad determinants of the levy are the cost pressures facing ELWA mainly from the Integrated Waste Management Contract and secondly, the ability to use

reserves to mitigate against these cost pressures. The following paragraphs detail the main cost pressures.

ABSDP

- 3.2 The key item within the revenue budget is Shanks East London's Annual Budget and Service Delivery Plan (ABSDP). The current provisional contract cost forecast for Shanks East London for 2011/12 is £53,833,000, an increase of £3,462,000 compared with the budget estimate of £50,371,000 for 2010/11. This is approximately 95% of ELWA's total gross expenditure.
- 3.3 The revenue budget has accounted for further increases in landfill tax of £8 per tonne each year. Based on the draft 2011/12 ABSDP and built into the IWMS contract pricing structure the increase in landfill tax is £1.5 million in 2011/12. It is anticipated that there will be further increases in landfill tax of £1.8 million in 2012/13 and £1.5 million in 2013/14.
- 3.4 Under the IWMS contract, landfill tax is met by Shanks up to £15 per tonne. ELWA bears the excess over £15 on the levels of landfilled waste provided the contractor has achieved the contracted diversion from the landfill target.
- 3.5 As a consequence of additional Landfill Tax rises, the revenue budget has assumed subsequent increases in commercial waste disposal charges to the boroughs of the equivalent amount.
- 3.6 These Financial Projections and Budget Strategy assume no income for the anticipated surplus Landfill Allowances accruing to the Authority nor any penalties for any potential deficit of Landfill Allowances for the years 2012/13. This is because the current value of any sale of surplus allowances is likely to be nil.
- 3.7 Managing waste levels is a key pressure for constituent Councils and it will be affected by the pace of development of the Thames Gateway and the impact of the Olympics and its legacy, which could significantly add to waste growth over the next decade. Based on technical officer advice, an estimated increase in tonnages of 7,000 tonnes for 2012/13 has continued to be reflected in the projection to allow for the impact of the Olympics.
- 3.8 As required in the contract, annual cost inflation has been built into the projections. This is based on the Retail Price Index at the previous October each year. This is 4.6% for 2011/12 and projected to be 3.5% for 2012/13 and 2.5% for 2013/14.
- 3.9 The provisional ABSDP for 2011/12 assumed a total ELWA Waste figure of approximately 469,600 tonnes.

Non-Contract Costs

- 3.10 As reported at the November 2010 Authority meeting, over the three-year period it is assumed that there will be no increase in the employees, support services and service level agreement budgets as any inflationary pressures would have to be offset by identified efficiencies. The results of the 2010 triennial valuation of the ELWA pension fund shows a shortfall of £78,000 which will need to be funded from the Revenue Budget.

Income

- 3.11 ELWA receives interest on its balances and the total income generated depends on the level of balances and interest rates. ELWA's Treasury Management Strategy continues to focus on security rather than returns. Interest rates remain low but may increase later in 2011/12.
- 3.12 There are some other income streams within the revenue budget projections. These are commercial waste charges to the Boroughs and trade waste royalty income.

Commercial and industrial waste charges

- 3.13 Commercial Waste tonnage is anticipated to show an increase over the three-year period compared to 2010/11. Technical officers have advised that this is because the ABSDP assumed the outsourcing of trade collections in Havering and Barking and Dagenham and the latest projections do not.
- 3.14 ELWA makes charges to Boroughs for commercial and industrial waste disposal based on the tonnage disposed of. Under the IWMS contract Shanks must accept and deal with this waste.
- 3.15 To reflect the increased cost of landfill tax and inflation within the IWMS contract it is the view of the ELWA Technical officers that the normal charge for 2011/12 is increased from £96 to £107 per tonne and to incentivise Councils to recycle a lower rate of £70 per tonne in respect of recycled waste is proposed and this would be at the same level as 2010/11.

Capital Expenditure

- 3.16 Through the IWMS contract, Shanks.east London has had a major capital programme for the provision of new waste disposal facilities and the refurbishment of existing ones in the ELWA area. The costs of this are reflected within the contract charges.

In addition, consideration will be given by ELWA Officers to making bids for additional funding in appropriate circumstances including recycling and composting initiatives, but none are planned at the moment.

ELWA has had reports on developing its closed landfill sites and some capital works on these may be necessary in the next few years. If such work is required, a report will be brought to Members.

Capital financing charges are taken account of in the revenue estimates.

Summary

- 3.17 The table below summarises the movement and the increase in cost pressures which will have a direct impact on the levy.

	£m	Reference
Original Budget 2010/11	49.9	
Shanks contract - Increase in Landfill Tax	1.5	Para. 3.3
Shanks contract – Increase due to inflation	1.7	Para. 3.8
Increase in Tonnage and increased Landfill Diversion	0.3	Para. 3.9
Higher commercial waste income	(0.2)	Para. 3.13
Proposed Budget for 2011/12	£53.2	

4 Reserves Strategy

- 4.1 Given the cost pressures outlined in paragraph 3 and the potential impact on the levy, the use of reserves in mitigating these increases is recommended as detailed below.
- 4.2 The approach to reserves is a continuation of our long-term strategy. A higher level of reserves was put in at the start of the contract due to the uncertainty around the innovative nature of the contract, the technologies used and planning risk. Once the contract was established, reserves have been reduced in stages to an appropriate level. As reported to the November 2010 meeting this scaling down of reserves is to continue until 2013/14 when the PFI reserve and General reserve would be £2.0 million and £3.6 million respectively. There will need to be a process in the medium-term to build up the reserves to reflect risks that may arise towards the end of the life of the PFI asset.

PFI Reserve

- 4.3 The PFI reserve was put in place to smooth the IWMS contract step price increases in the early years of the contract. It was good financial practice and agreed ELWA policy that a suitable level of PFI Contract Reserve be set aside in the years prior to such changes to avoid large step increases in the levy for those years. Since then other pressures outside ELWA control such as the annual increases in landfill taxes have required financing. With Members agreement, the PFI grant has been used to support this. The current government policy is that the landfill tax will increase annually by £8 per tonne over the next three years to a cap of £80. It is proposed that the PFI reserve will be used to support the impact of these tax increases on the levy to constituent councils. PFI reserves stood at £5.7 million at 31st March 2012 with further transfers in 2012/13 and 2013/14. Further transfers are proposed for the next two years to help smooth the levy increase. There has been a change in the payment method of PFI grant which has impacted on this and this is dealt with in paragraphs 4.9 and 4.10. This may impact on ELWA in future years unless the reserves are built up again as proposed.

Revenue Reserves

- 4.4 Authority Members will be aware that in previous budget reports the Authority has agreed to set aside a minimum level of normal operational revenue balances based on an analysis of risk. This has been undertaken as part of this Budget Strategy process. It is now estimated that the total level of reserves that need to be held are £3.6 million at the end of 2011/12 compared to an estimated £6.1 million at the end of 2010/11. This level of revenue reserves must be seen in the context that a 2% increase in waste tonnage creates a cost pressure of £1 million on the Authority.
- 4.5 The effect of the levy and expenditure on Revenue Reserves in 2010/11 and 2011/12 is shown below:

	£'000
Working Balance at 31.3.2010	8,104
Transfer to support Levy for 2010/11	(1,978)
Estimated Working Balance at 31.3.2011	6,126
Transfer to support Levy for 2011/12	(2,500)
Projected Working Balance at 31.3.2012	3,626

The 2011/12 Contingency

- 4.6 In order to deliver a sustainable budget that is able to adapt to uncertainty, it is prudent for the Authority to set aside a provision or contingency for uncertain events.
- 4.7 The 2011/12 detailed Revenue Estimates do not include provision for pay and price rises. A contingency provision of £150,000 is recommended.

Capital Reserve

- 4.8 It is to be noted that there is a £400,000 Capital Reserve earmarked for future costs at the Aveley I site. In the opinion of ELWA Officers there continues to be the potential need for significant works e.g. concerning the proper environmental protection of the site and the continuation of existing operations on the site.

Change of Basis of PFI Grant

- 4.9 The Department of Communities and Local Government has recently advised that the annual PFI grant will be paid on an annuity basis rather than the declining balance basis with a final payment made in 2026/27. Work has been done on the impact of this change on the Authority. Overall the total grant in cash terms will be the same, however, the payment profile has changed. The main impact of this in the short term is that for the next three years the Authority will receive additional PFI grant of approximately £870,000 as follows:

	£
2011/12	137,682
2012/13	291,825
2013/14	439,802

It is proposed that the additional grant over this period is used to reduce the levy requirement in these 3 years.

The reduction in the number of years the grant is payable will result in increased financial pressures at the end of the asset and therefore adds strength to the strategy of building up reserves in the medium term.

The PFI reserve was put in place at the start of the project to deal with smoothing the PFI step price increases. As time has moved on, the reserve has been also used to mitigate against landfill taxes. It is recommended that the PFI reserve remains and is utilised as detailed in paragraph 5.6.

4.10 The effect of the levy and expenditure on PFI Reserves in 2010/12 and 2011/12 is shown as follows:

	£'000
Balance at 31.3.10	10,767
PFI credit to be received in 2010/11	4,014
Utilisation in 2010/11	(7,117)
PFI Contract Reserve balance at 31.3.11	7,664
PFI credit to be received in 2011/12	3,991
Utilisation in 2011/12	(5,987)
PFI Contract Reserve balance at 31.3.12	5,668

4.11 The Authority's Auditors in their Annual Reports over recent years have commented favourably on the Authority's medium to long-term approach to financial planning. This includes the need for the Authority to continue to monitor and agree the level of reserves it holds

5 2011/12 Levy/Three Year Period

2011/12 Levy

5.1 The levy requirement is made up of the ELWA net revenue estimate plus / minus any contingency provisions, and drawings from or contributions to reserves including the PFI reserve.

5.2 The levy for 2011/12 is recommended to be £44,749,000 including the contingency of £150,000 and after applying £5,987,000 from the PFI reserve and £2,500,000 of Revenue reserves.

5.3 The Finance Director's Financial Projection and Budget Strategy report agreed by Members on 22nd November 2010 highlighted a potential increase in 2011/12 of 10%. The proposal now is for an increase of 9.6%.

Levies 2012/13 and 2013/14

5.4 The table below highlights a potential levy in the region of £49.1 million for 2012/13 and £53.9 million for 2013/14. The reserves position at the end of 2013/14 is projected to be £3.6 million for revenue reserves and £2.0 million for the PFI Contract reserve.

- 5.5 The levy forecasts for 2012/13 to 2013/14 clearly can only be taken as an attempt to provide an indication for planning purposes. However, a change in any of a number of uncertain factors, for example changes in landfill tax, waste growth, inflation assumptions and any new legislation could impact on the overall projections. The effect of the Olympics will mainly be felt in 2012/13.
- 5.6 The indicative levy position and reserve figures for the next three years based on the data used for the 2011/12 levy is summarised in the table below:

Summary Budget	2011/12 £'000	2012/13 £'000	2013/14 £'000
Revenue Budget	53,086	56,234	58,080
Annual PFI Grant	(3,991)	(3,991)	(3,991)
Transfer to PFI Reserve	3,991	3,991	3,991
Contingency	150	150	150
Sub Total	53,236	56,384	58,230
Financed By			
Transfer from PFI Reserve	(5,987)	(7,295)	(4,355)
Transfer (from)/to General Reserve	(2,500)	(26)	
Levy	(44,749)	(49,063)	(53,875)
Levy Increase over previous year	9.6%	9.6%	9.8%
Year End Reserves			
PFI Reserve	5,668	2,364	2,000
Capital Reserve	400	400	400
General Reserve	3,626	3,600	3,600

The above year reserves projections reflect the current understanding and assessment by officers on the risks faced by ELWA. These matters will need to be kept under review and the advice may change in light of any future developments.

- 5.7 Increases in the levy in future years are likely to put pressure on the budgets of the constituent councils. As I have highlighted before, if increases of this level are to be avoided ELWA should work with Shanks.east London to find further ways to reduce costs.
- 5.8 Any changes on the estimates provided in the recent three-year plan will be reflected in the next three-year strategy due in November 2011.
- 5.9 The previous Government's capping regime did not apply to Waste Disposal Authorities like ELWA. The new Coalition Government has made public sector financial constraint a key feature of its policies. If ELWA continues to set levy increases around the 10% level there must be a risk that it will face some Government pressures or potential action. This reinforces the need for ELWA to seek ways to reduce future levy increases.

Apportionment of the 2011/12 levy and monitoring arrangements

5.10 The basis of the apportionment of the levy is explained in para 2.6 of the report. The detailed apportionment is given in the table below.

Actual Levy 2010/11		Tonnages	Apportion Tonnages	Band D Basis	Apportion Band D	Proposed Levy 2011/12
£'000			£'000		£'000	£'000
7,405	Barking & Dagenham	65,615	6,230	52,724	1,917	8,147
10,477	Havering	80,370	7,631	89,700	3,263	10,894
12,242	Newham	118,462	11,247	75,642	2,751	13,998
10,701	Redbridge	88,543	8,407	90,864	3,303	11,710
<u>40,825</u>	Total	<u>352,990</u>	<u>33,515</u>	<u>308,930</u>	<u>11,234</u>	<u>44,749</u>

5.11 Changes in the relative tonnages between boroughs and between household and non-household waste tonnage may reflect not only volume changes but also the re-classification of waste. Relative movements in household tonnages in respect of Newham and Havering have led to different levy increases for these boroughs compared to the overall levy increase.

5.12 In the past ELWA has agreed that each year's levy should be sought in four equal instalments payable in the middle of each quarter i.e. 15 May, 15 August, 15 November and 15 February or the nearest banking day thereto. It is recommended that the Levy be paid in the same way in 2011/12.

5.13 It is recommended that commercial and industrial waste charges and other expenditure and income continue to be sought in accordance with the existing arrangements i.e. based on quarterly claims and invoices. Current arrangements have generally worked well and it is recommended that these be continued, subject to further review as necessary.

6 Risks

6.1 In line with all public sector organisations, ELWA faces difficult financial challenges over the next few years. Consequently, it is vital that ELWA is aware of the risks it faces and has arrangements in place to mitigate these.

6.2 The risks that ELWA faces include ensuring that contractual performance targets are met to minimize the costs of landfill, avoiding major failure in technology, new legislation and ensuring that existing regulations continue to be complied with (Appendix B).

6.3 Controls have been put in place to mitigate against identified risks and the success of these controls will need to be regularly monitored within ELWA's risk management arrangements. Paragraph 7.6 of this report states that an adequate level of reserves has been set giving the currently known risks facing ELWA. This level of reserves has been based on the assumption that these risks will be mitigated in line with ELWA's agreed risk management framework. The level of reserves held will need to be kept under review.

7 Robustness of estimates and adequacy of reserves

- 7.1 The Local Government Act (LGA) 2003 places duties on local authorities to reinforce good financial practice. In respect of the setting of ELWA's annual estimates and levy, I am required to provide professional advice on the robustness of the estimates and the adequacy of reserves. The Secretary of State has back up powers to impose a minimum level of reserves on any Authority that fails to make adequate provision.
- 7.2 The framework for the preparation of estimates is ELWA's three-year financial strategy. Monthly budget statements are prepared throughout the year for monitoring and control purposes. These anticipate cost pressures and take a prudent view on income estimates. The advice of the External Auditor and the experience of professional and technical officers of other Waste Disposal Authorities are also taken into account.
- 7.3 The major component of the estimates is the IWMS contract cost which is formally agreed between ELWA and Shanks, East London via the ABSDP. ELWA's other costs are as advised by ELWA Officers and Constituent Councils who are responsible for and carry out certain functions on ELWA's behalf. These costs are based on the advice of Council Technical Officers with appropriate support from Council Finance Officers and in particular their views on waste levels.
- 7.4 The view of ELWA Directors is that the proposed estimates are robust and the proposed levels of reserves are adequate given the currently known risks facing ELWA. These provide a reasonable and sound basis for the operation of ELWA next year and in the medium term but do need to be kept under review.
- 7.5 At present ELWA officers maintain detailed systems for budgetary control and also for waste/contract monitoring. It is vital these systems are maintained to supply effective data for Members and senior managers. This will better enable in year variances to be identified and mitigated.
- 7.6 In my view, having consulted relevant colleagues and following an analysis of the strategic, operational and financial risks and uncertainties facing ELWA, which are set out in this report, these risks and uncertainties are adequately addressed in the setting of the budget and levy and the proposed level of reserves, subject to the various remarks about mitigation in this report. A continued prudent level of reserves is again recommended to ensure levy stability in future years because of the uncertainties faced by the Authority. The levels proposed for future years will need to be kept under review in the light of any new developments which may impact on the Authority.
- 7.7 The details and balances of ELWA's proposed reserves are contained in this report. Subject to all the above, the levels of these reserves are deemed appropriate based on information supplied to me, my professional judgement and ELWA's previous experiences and future plans.
- 7.8 In my opinion, if ELWA follows the advice contained in this report then the relevant requirements of the Local Government Act 2003 are met.

8 Recommendation

8.1 Members are asked to agree:

- (a) The revised estimates for 2010/11 totalling £49,920,000 (paragraph 1.2 & Appendix A);
- (b) The revenue estimates for 2011/12, totalling £53,236,000 excluding contributions from reserves;
- (c) The charges for commercial and industrial waste for 2011/12
 - Commercial & Industrial Waste – recycled £70 per tonne
 - Commercial & Industrial Waste – other £107 per tonne
- (d) The utilisation of the PFI Contract Reserve of £5,987,000 for 2011/12 and the policy of utilising the increased PFI grant in the next 3 years to mitigate the levy increase in this period;
- (e) A Contingency Reserve of £150,000 for 2011/12;
- (f) A contribution from Revenue Reserves of £2,500,000;
- (g) That on the basis of (b) to (d) above, ELWA determines its levy for 2011/12 the sum of £44,749,000;
- (h) The policy on Reserves and associated criteria;
- (i) The continuation of existing arrangements for the payment of the levy and funding of Constituent Councils in 2011/12.

Geoff Pearce
FINANCE DIRECTOR

Appendices	
A	Summary of original and revised Revenue Budgets for 2010/11 and Forward Budget for 2011/12
B	Financial Risk Analysis 2011/12
Background Papers	
Returns from Constituent Councils	
Budget working papers	