

# OGC Kelly Report to the Financial Secretary to the Treasury

## Improving Competition and Capacity Planning in the Municipal Waste Market

May 2006

## Acknowledgements

Throughout the Kelly review of the waste management market, the Office of Government Commerce (OGC) has consulted with a wide range of stakeholders including the Department for the Environment, Food and Rural Affairs (Defra), HM Treasury, the Department for Communities and Local Government (DCLG), the Office of Fair Trading (OFT), other central government departments, the Regional Centres of Excellence (RCEs), the Local Government Association (LGA), local authorities and industry.

Defra and OFT have provided resources to support this study and this report is published in parallel with a report by the OFT into competition in the waste management market<sup>1</sup>. In addition, Defra provided direct funding for the survey of local authority waste procurement needs. OGC thanks both of these organisations for their assistance and support.

OGC also thanks everyone in the public sector and industry who contributed to this study – particularly the local authorities that completed the extensive OGC / Mott MacDonald waste survey in 2005.

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<sup>1</sup> More Competition, Less Waste: public procurement and competition in the municipal waste management sector (2006) OFT841

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## **PART 1: MANAGEMENT SUMMARY**

1. The purpose of this document is to report on OGC's analysis of the municipal waste market, undertaken as part of the Kelly Programme. The OGC Kelly Programme has focused on achieving a more systematic and strategic approach to stimulating and managing major government markets and providing industry with clearer information on public sector demand, in order to improve competition and long-term capacity. This was in response to the Chancellor's Pre-Budget Report of November 2002 in which OGC was asked to consider what steps could be taken to increase competition and long-term capacity planning in markets where government has significant purchasing power.
2. As part of the Kelly Programme, and working with key stakeholders including Defra, OGC has undertaken a detailed analysis of the municipal waste management market.
3. It has consulted a wide range of stakeholders and conducted a comprehensive survey of local authorities and their waste management plans. Based on this work, OGC presents a series of findings on the health of this market, highlighting its main features and the issues that have an impact on its operation. OGC also makes recommendations for actions that government should be taking now and in the near-term.
4. There are examples of good practice and of 'success stories' in procurement in this market. However, OGC's analysis shows that as a whole, the municipal waste market is not operating efficiently. In particular, OGC notes the following issues:
  - the public sector as a whole (central and local government together) has not adopted a sufficiently systematic approach to how it interacts with this market;
  - there is a lack of market intelligence. Suppliers need greater clarity on policy and clearer information on local authorities' plans for delivery;
  - there are too few suppliers bidding, therefore reducing competition;
  - the difficulties faced by new market entrants can restrict competition; and
  - many local authorities lack the specialist skills and experience required to procure in this market, resulting in a reliance on external advisors.

5. OGC's overall conclusion is that there is a need for more rapid investment in this market by tackling the procurement barriers and bottlenecks.
6. From the Second Kelly Market (SKM) analysis, **OGC has identified a programme of actions that government should be taking now and in the near-term, to begin to improve the operation of the municipal waste management market.** As a result of the impetus of the SKM work, Defra has begun to implement these actions through its current Waste Strategy Consultation and the recently established Waste Infrastructure Development Programme.
7. OGC's near-term, headline SKM recommendations are:
  - I. **Government, in partnership with local authorities, should develop, maintain and publish a coordinated picture of local authority waste procurement plans and progress. From this, potential opportunities for greater collaboration between authorities and a better flow of projects through the procurement 'pipeline' can be identified. This will also address the need of suppliers for clearer information on government's plans for delivery.**
  - II. **Government should provide access to a greater pool of procurement and project expertise and advice for local authorities, using the coordinated picture to best focus the allocation of these resources.**
  - III. **The funding and procurement model adopted for a waste project should be appropriate to the nature of the service or facility being procured. Also, in its assessment of whether particular projects are ready to go to the market, Defra should favour those that are participating in a 'coordinated picture' collaboration (Recommendation I. above).**
  - IV. **Government should publish procurement timetables for all major waste projects to both local authorities and industry; and benchmark the delivered outcomes with a view to reducing project timescales.**
  - V. **Government should put in place appropriate mechanisms for monitoring and reporting on progress against the SKM recommendations.**

8. Longer-term strategic challenges include:
- reducing waste production and increasing the recycling rate;
  - tackling the perception that waste-related policies are not sufficiently joined-up;
  - reducing land-use planning risk and uncertainty; and
  - better linkage between the management of municipal waste and other waste streams.
9. The Government has a range of waste-related initiatives underway – including Defra’s Waste Strategy Consultation<sup>2</sup>, joint HM Treasury / Defra / DCLG work in the run-up to the Comprehensive Spending Review (CSR) 2007, and the Lyons Inquiry into Local Government. It is OGC’s view that these major initiatives represent the best and most appropriate means for government to resolve the longer-term challenges facing waste management in England. Longer-term recommendations by OGC at this stage, in advance of the Waste Strategy 2006 and the CSR2007, would simply add to existing uncertainty over government’s policies and approach in this market.

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<sup>2</sup> Review of England’s Waste Strategy – A Consultation Document February 2006 (Defra)

## **PART 2: BACKGROUND**

### **The Kelly Programme**

10. In the 2002 Pre-Budget Report, the OGC was commissioned by the Chancellor of the Exchequer to consider what further steps could be taken to increase competition and encourage better long-term capacity planning in markets where the Government has significant purchasing power. An OGC team led by Sir Christopher Kelly produced a report<sup>3</sup> that was published with the Pre-Budget Report in 2003 together with an action plan to implement the recommendations.
11. Following from the Kelly report, OGC's Kelly Programme has focused on achieving a more systematic and strategic approach to stimulating and managing major government markets and providing industry with clearer information on public sector demand, in order to improve competition and long-term capacity planning.
12. The work of the Kelly Programme supports the four key Kelly principles: increased competition, more responsive markets, greater security of supply, and reduced dependency on a limited group of key suppliers. It complements the procurement reforms associated with Efficiency Review implementation.
13. Construction was selected as the 'First Kelly Market' (FKM). An extensive programme of research and analysis into public sector demand and supply was concluded in the Spring of 2005 and the recommendations set out "a strategic approach to construction procurement reflecting both demand and supply, which together with improved industry consultation should lead to greater predictability of the project pipeline"<sup>4</sup>.

### **The Second Kelly Market (Municipal Waste)**

14. The Second Kelly Market (SKM) study focused on municipal waste including household waste, civic amenities waste and waste from street cleaning.

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<sup>3</sup> Increasing Competition and Improving Long-Term Capacity Planning in the Government Market Place

<sup>4</sup> Budget 2005: Economic and Fiscal Strategy Report

### ***Selection of the Municipal Waste Market***

15. An initial assessment of municipal waste suggested that this market was sub-optimal and suitable for applying a Kelly approach with a view to improving competition and capacity. Some key characteristics of the municipal waste market relevant to the selection criteria were:

- municipal waste collection and disposal is an important component of local government expenditure, totalling £2.2 billion in 2004-05<sup>5</sup>;
- local authorities have a statutory obligation to manage municipal waste;
- the declining availability of landfill is placing capacity constraints on the market. Moreover, with the desire to move to more sustainable waste management, there is legislative pressure to send less waste to landfill and so to adopt alternative disposal methods, which will significantly increase waste management expenditure; and
- concern that competition is limited, with too few players dominating.

### ***OGC's Approach to Analysis of the Municipal Waste Market***

16. OGC has consulted extensively with a wide range of stakeholders in the production of this report. Qualitative and quantitative information has been captured using the following means:

- a survey sent to all local authorities in England. 280 responses were received, representing 71% of Waste Collection Authorities (WCAs), and 72% of Waste Disposal Authorities (WDAs) and Unitary Authorities (UAs);
- one-to-one interviews with existing waste management companies, potential new entrants and funders;
- scenario planning workshops with public sector stakeholders; and with the Associate Parliamentary Sustainable Waste Group (APSWG);
- local authority case studies;
- Institution of Civil Engineers (ICE) workshop – construction and waste industry participants; and
- desk research and consultation with other Government Departments, local authorities and industry bodies including: the Department for Environment, Food and Rural Affairs (Defra), the Department for Communities and Local

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<sup>5</sup> ODPM – Revenue Outturn 2004-05: Environmental Protective and Cultural Services

Government (DCLG), the Local Government Association (LGA), the Regional Centres of Excellence (RCEs), the Environment Agency and the Environmental Services Association (ESA).

17. OGC has also worked closely with the OFT throughout this project. The role of the OFT has been to provide competition economics expertise and in particular, advice on the relationships between public procurement and competition in the waste management sector. This work has built on the analysis set out in the OFT's preliminary procurement research, published in September 2004<sup>6</sup>.

## **The Waste Landscape**

### ***Central Government***

18. Under the Waste Framework Directive<sup>7</sup>, the Government's main role is to take necessary measures to ensure that waste is recovered or disposed of without endangering human health or the environment.

19. Defra leads on the development and implementation of waste policy and the statutory framework. Defra also leads on most waste negotiations at EU level, although the responsibility for responding to some EU Waste Directives is split between Defra and DTI as both have major interests. DCLG leads on planning for waste management facilities as part of its wider responsibility for planning policy. HM Treasury, DCLG and Defra have responsibility for funding waste management.

20. The Environment Agency is the regulatory body for most waste management activities in England, including collection, treatment, recovery and disposal.

### ***Local Government***

21. There are nearly 400 local authorities in England, which are responsible for managing municipal waste. These include:

- 273 WCAs, typically district councils, which have a statutory responsibility for the collection of municipal waste. In-house providers (known as Direct Service Organisations (DSOs)) are major players in the municipal waste collection

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<sup>6</sup> Available at <http://www.of.gov.uk/Business/Market+studies/procurement.htm>

<sup>7</sup> 75/442/EEC as last amended by 91/692/EEC

sector, holding around 50% of contracts by tonnage. Waste management services suppliers hold the remaining contracts;

- 40 WDAs, typically county councils that are responsible for treating and disposing municipal waste from their WCAs. There are nine Local Authority Waste Disposal Companies (LAWDCs) that provide in-house provision; the remaining contracts i.e. a large majority, are held by a small number of large waste management services providers; and
- 81 UAs, which are responsible for both the collection and subsequent treatment and disposal of municipal waste.

22. Local Authorities also have the responsibility to act as waste planning authorities – identifying and delivering suitable potential sites for waste treatment or disposal facilities.

### ***Waste Growth and Affordability***

23. Annual municipal waste growth is approximately 1.5%, which has decreased from 3.5% over the period since 2000<sup>8</sup>.

24. The disposal of waste in landfill sites is the dominant method of disposal with 72% of municipal waste sent to landfill in 2003-04<sup>9</sup>. However, landfill sites are declining in availability and are no longer seen as a sustainable method of disposal. The move to adopting new, more sophisticated management technologies has implications for costs, which are likely to increase considerably.

### ***Market Size***

25. When compared to other waste streams, the market for municipal waste management is relatively small (representing approximately 8% of the total waste<sup>10</sup>). However, it remains strategically important to local authorities and to the private sector where municipal waste management represents reliable, long-term contracts.

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<sup>8</sup> Review of England's Waste Strategy – A Consultation Document February 2006 (Defra)

<sup>9</sup> Municipal Waste Management Survey 2003/04 (Defra)

<sup>10</sup> The Environment in Your Pocket (Defra) 2003

### ***Landfill Directive***

26. The EU Landfill Directive<sup>11</sup> puts in place measures to reduce the negative environmental and health effects of landfill disposal. Article 5 sets specific targets for the UK to reduce the disposal of Biodegradable Municipal Waste (BMW) to landfill, as a percentage of 1995 BMW arising, to 75% by 2010, 50% by 2013 and 35% by 2020.

### ***Landfill Allowance Trading Scheme (LATS)***

27. In order to incentivise local authorities to meet the targets, LATS was introduced in 2005 under the Waste and Emissions Trading Act 2003. Individual waste disposal authorities have been allotted progressively decreasing landfill allowances for each year from 2005 to 2020, which they can trade, bank and borrow to ensure that England as a whole meets its landfill targets in the most efficient way. Local authorities will be penalised £150 per tonne if they exceed their annual landfill allowances.

28. The Landfill Tax Escalator<sup>12</sup> will also increasingly divert both municipal and non-municipal waste from landfill to alternatives such as recycling, composting and energy from waste treatment.

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<sup>11</sup> EC Directive 1999/31/EC

<sup>12</sup> Budget 2003: Report Chapter 7 – Protecting the Environment

## PART 3: FINDINGS

### Summary of OGC's Findings

29. During the course of the SKM analysis, OGC collected information from a wide variety of sources, including a comprehensive survey of local authorities and their waste management plans. Detailed results (derived from the local authority survey) are published alongside this report<sup>13</sup>.
30. OGC's findings, based on the synthesis of all the collated information, are summarised below.

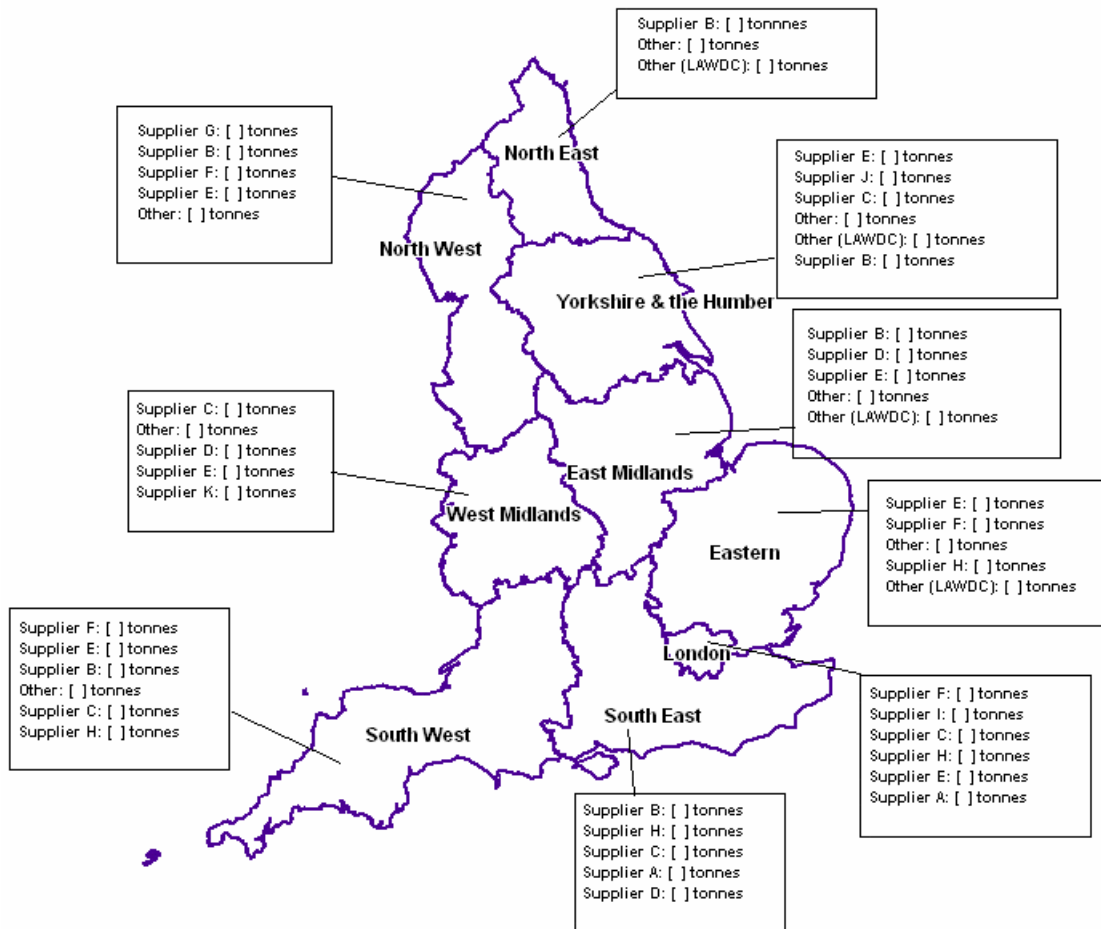
#### **Market Characteristics**

- a) There are few suppliers of waste treatment and disposal services (8-9 suppliers manage at least 78% of municipal waste by weight). Figure 1 (overleaf) shows that most suppliers have a regional or local presence, not a national one.
- b) There is evidence that, particularly for waste disposal, a supplier's ability to bid effectively is dependent on an existing regional presence (i.e. the ability to utilise or expand existing infrastructure to bid for new contracts as they emerge). On this basis, the SKM survey suggests that certain regions (e.g. London, SE) have a greater potential for future competition than others (e.g. NW, NE).
- c) Direct Service Organisations (DSOs) remain major players in the provision of waste collection contracts (53% of waste by weight). There is a perception amongst private sector suppliers that competitive neutrality is not maintained, though evidence suggests that *all* incumbents (whether public or private sector) have advantages when collection contracts are re-competed (see below).
- d) However, the success rate of incumbent suppliers at re-competitions varies across different waste management services. It is very high for collection and disposal contracts (60-75%), but lower for treatment contracts (<50%) and for end-to-end integrated contracts (<30%).

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<sup>13</sup> Analysis of Survey Responses  
<http://www.ogc.gov.uk/index.asp?id=1002796>

**Figure 1 - Top Treatment/Disposal Suppliers by Region, ranked by Tonnage<sup>14</sup>**



- e) Suppliers in the waste management market have been consolidating in recent years, a trend that looks set to continue – which is likely to further reduce the number of suppliers competing for major contracts. A key factor encouraging consolidation is that regulatory changes are driving the need to develop new facilities, and larger companies are better placed to be able to secure the investment to fund such development.

<sup>14</sup> Confidential information about suppliers derived from the SKM survey of local authorities in England (2005), that had a 71% response rate, has been anonymised. The data requested was for contracts procured over the last three years. However, in some cases LAs may have reported contracts dating back over a longer time period. The data shown came from LAs (i.e. the demand side) and has not been verified by suppliers.

- f) Whilst individual authorities are communicating their needs to the market, there is a lack of market intelligence available to suppliers on the public sector's procurement plans as a whole. Furthermore, market intelligence that is available is sometimes inconsistent and there is no coordinated source of reliable data. This complicates suppliers' forward planning, and makes it more difficult to attract new entrants into this market.
- g) The market faces various difficulties in relation to waste policy. In recent years, increasing awareness of the need for sustainable waste management has resulted in an extensive series of policy and regulatory changes in this market. There is a perception that waste policies are not sufficiently joined-up, and a lack of clarity over the relative priorities that should be given to different policies and initiatives.

*“A lack of clear policy direction is having a negative effect on potential entrants to this market. Legislation is an issue in relation to speculative building, creating nervousness in a rapidly evolving market.” (Delegate at ICE workshop)*

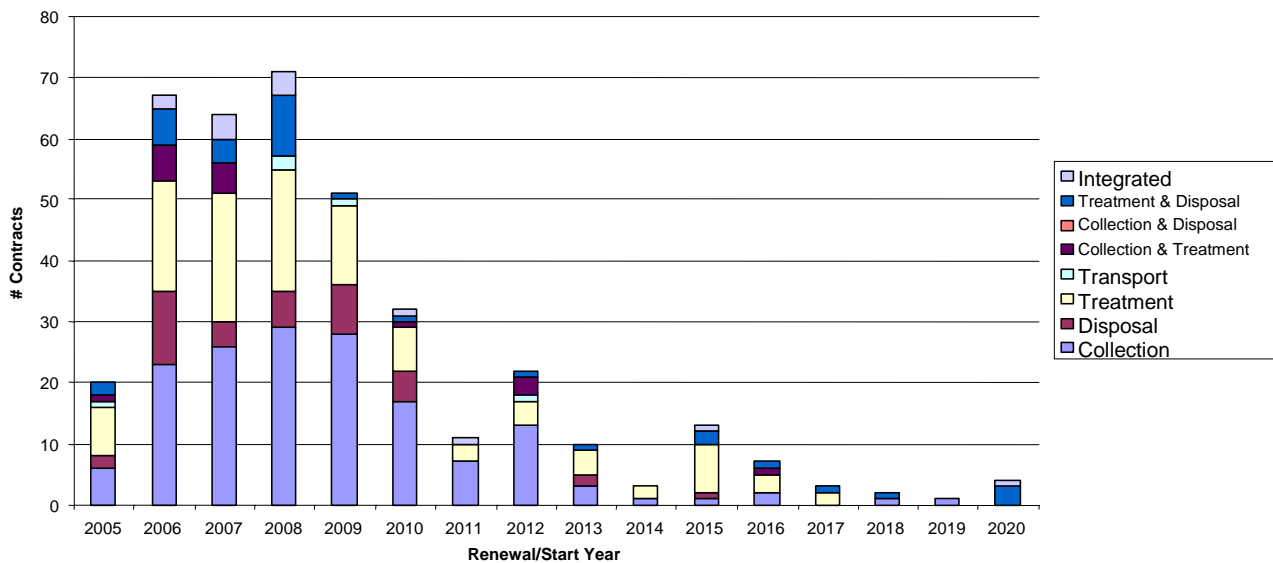
- h) The large number of channels communicating policy and information to the market adds to uncertainty. At least twenty different public sector bodies have a funding, regulation, planning and/or advisory role in the waste management market.
- i) Bid costs for all parties for waste management contracts are significant. Supply-side bid costs appear to be similar whether the project is small or large in scale.
- j) Potential new entrants perceive the waste management market as too risky. The construction sector is one source of possible new entrants into this market. Construction companies keen to enter this market identified a number of issues which they saw as constraints:
- high bid costs;
  - scarcity of local authority procurement skills to deliver complex waste procurements;
  - few opportunities to form consortia – to gain an understanding of the market and build capabilities;

- the limited range of funding / financing options available to local authorities for selection; and
- few opportunities for early supplier involvement – currently infrequent but would ease the bid process.

**Local Authority Plans**

k) The current contract ‘pipeline’ indicates that over 50 waste management contracts need to be awarded each year, for each of the next four years (Figure 2). These figures are based on the 71% response rate to the SKM survey; and so actual demand will be greater. Local government’s overall approach to the market is uncoordinated, and it is highly probable that the market lacks sufficient capacity to react competitively to this deal flow.

**Figure 2 – Projected Waste Contracts Pipeline**  
(Based on responses to the Kelly Survey)



l) Given the relatively small number of suppliers, the small size of suppliers’ bid teams, and the large number of contracts coming to market, there is the real prospect that public sector contracts will be competing against one another to attract the attentions of suppliers.

*“Supplier X withdrew from the contract early on, citing overstretched resources. The company is bidding for several*

*contracts and they had to drop the pursuit of one, the one turned out to be us.” (Local Authority Waste Manager<sup>15</sup>)*

- m) Typically, municipal and non-municipal waste streams are planned and managed independently. Some stakeholders have expressed the view that, given the difficulties already being encountered in achieving BMW targets, encouraging local authorities to broaden their activities to include commercial and industrial wastes is unrealistic. However, other stakeholders argue strongly that a more integrated approach is required, and for local government to focus solely on BMW is to miss opportunities for improved efficiency.

### ***Funding and Procurement***

- n) PFI is not being used optimally in the waste management sector. This has led to slow progress in the delivery and closure of waste PFI projects.
- o) There is a strong view amongst local authorities that the current PFI credits allocation process is not driving the right behaviours. There is evidence that, in a bid to obtain funding, local authorities are seeking to adopt PFI on projects more suited to other funding approaches. The allocation of PFI credits does not appear to prioritise those projects of greatest strategic importance.

*“Applications [by Outline Business Case – OBC] are currently over-optimistic about what can be achieved, purely to get credits. The OBCs are written to get the credits and aren’t the documents needed for delivery of the solution.” (Delegate at local authority workshop).*

*“The [PFI] credits were a carrot that pushed the local authority towards PFI.” (local authority representative).*

- p) There is a strong perception from industry that waste procurements are taking too long to complete and in some cases fail before financial close. In order to attract new entrants into this market, projects must be closed and facilities built at a much quicker pace.

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<sup>15</sup> Letsrecycle.com – 20<sup>th</sup> July 2005

- q) Local authorities have limited in-house experience and expertise in managing major waste procurements. There is a heavy reliance by local authorities on professional advisors, resulting in high financial costs. There is a concern that different local authorities in similar situations are paying to receive similar advice.
- r) Obtaining land-use planning permissions greatly complicates waste management procurements. Planning timescales can add hard-to-predict delays to project timescales; and there is evidence that local authorities may be under-estimating the true time that obtaining planning permission will take.

*“Financing major disposal facilities through PFI and bank borrowing is not effective when there is deep uncertainty and risk about planning permission. It leads to the cost of borrowing being higher, to cover risk, and so the public ends up paying more for market failure and lack of government coordination....” (APSWG workshop delegate)*

#### **Local Authority LATS projections**

- s) Of those responding to the SKM survey, some local authorities (WDAs and UAs) reported a lack of confidence in meeting their LATS targets under existing plans. 78% believed that they would achieve their LATS targets for 2006/07 (without purchasing additional allowances), but this figure decreased when considering the longer term. This reflects a recognition by many local authorities that the delivery of waste infrastructure needs to be improved in order to provide certainty that they would meet their targets.

#### **Municipal Waste Management – Key Observations**

- 31. Government recognises that the efficient and effective operation of the municipal waste management market is essential if England's waste problems are to be resolved, and the Landfill Directive targets achieved.
- 32. However, the features of this market identified in the SKM analysis point to weaknesses against each of the four key Kelly principles – the ability of the market to act responsively, security of supply to government, reduced dependency on a limited number of suppliers, and high/increased levels of competition.

33. In particular, OGC notes the following issues:

- the public sector as a whole (central and local government together) has not adopted a sufficiently systematic approach to how it interacts with this market;
- there is a general lack of market intelligence. Suppliers need greater clarity on policy and clearer information on local authorities' plans for delivery;
- there are too few suppliers bidding, therefore reducing competition;
- difficulties faced by new market entrants can restrict competition; and
- many local authorities lack the skills and experience they need to procure in this market, resulting in a heavy reliance on external advisors.

34. OGC's overall conclusion is that there is a need for more rapid investment in this market by tackling the procurement barriers and bottlenecks.

35. The following parts of this report recommend ways in which Government should reduce this risk, proposing a series of urgent near-term actions for improvement and identifying the longer-term major strategic challenges that will need to be tackled.

## PART 4: RECOMMENDATIONS – URGENT ACTIONS

36. As is discussed in Part 5, there are major strategic issues that need to be tackled if England is to successfully manage its municipal waste. In addition to resolving these – through the work of the Waste Strategy Review and the CSR2007 – **OGC has identified a series of actions from the SKM analysis that government should be taking now and in the near-term, to begin to improve the operation of the waste management market.**

37. Recommendations to bring greater market confidence in the delivery of waste procurement projects, addressing concerns of both local authorities and industry, are discussed below.

38. Defra has already made progress in response to the findings of this report and has established a **Waste Infrastructure Development Programme (WIDP)** to be the main delivery body for implementing these recommendations. Its terms of reference are:

- to assist Defra in implementing the Government's municipal waste policy, specifically in relation to the infrastructure investment needed to comply with EU Landfill Directive targets;
- to facilitate and develop, in partnership with local authorities, a coordinated picture of local authority waste procurement plans and progress in line with the recommendations of this report; and
- by considering the required waste investment programme needs for England as a whole, to develop and implement measures that will accelerate the delivery of the Government's waste targets on a timely, value for money and affordable basis.

39. The WIDP includes four work streams covering Delivery, Guidance, Investment Analysis and Strategy. To deliver these cross-cutting recommendations, the Programme Board will include representation from Departments, local government and industry. The first meeting of the WIDP Board took place on 29 March 2006.

## A More Systematic and Strategic Approach to the Municipal Waste Market

40. Substantial private sector investment will be required if the facilities necessary for sustainable waste management are to be developed, in time to meet the UK's Landfill Directive obligations. Timing is a key priority: projects must be closed and facilities brought on-stream at a much quicker pace than has been the case. The scope for competition in the provision of major facilities is limited (especially given the likelihood of further market consolidation). The market may be perceived as too risky to attract significant numbers of new entrants.
41. The Kelly Report highlighted the importance of providing industry with clear information on the public sector's future needs. This is not happening sufficiently in the municipal waste management market. There is no coordinated picture of waste procurement plans and progress for England.
42. Furthermore, the absence of any overview of future market activity makes it more difficult for local authorities themselves to plan and schedule their procurements. The SKM evidence (Figure 2 paragraph 30 (k)) reveals an intense period of procurement activity over the next four years, with little or no coordination of deal flow. There is a real need for local authorities and the regions to be able to identify opportunities for greater collaboration, and to be better able to schedule deal flow to minimise 'congestion'. Government should play a more definite role in collating procurement plans and then communicating this information to the market. This will also address industry's need for clearer information on local authorities' plans for delivery. OGC therefore recommends that:

<b>Recommendation 1 - Government, in partnership with local authorities, should develop, maintain and publish a coordinated picture of local authority waste procurement plans and progress. This should include:</b>	
<b>Action</b>	<b>Timescales</b>
Collating local and regional plans to gain a clear oversight of current and future activity (including land-use planning for waste). This should aim to develop a comprehensive picture of the facilities local authorities believe are needed to manage their municipal waste-streams across England, to 2020 and beyond.	First draft plan/timetable for discussion at the WIDP by June 2006 (building on the already available Kelly data).
Working with local authorities and the regions to identify potential opportunities for greater collaboration and improve the	From April 2006 and ongoing. A local authority and an industry representative will be invited to sit on the WIDP Programme

flow of projects through the procurement pipeline.	Board.
Publishing details of local authority plans and progress to both the public sector and industry.	Publication of the first timetable of procurement plans by WIDP, to coincide with publication of the Waste Strategy Review 2006 - and ongoing at regular intervals thereafter.
Monitoring local authority and regional progress against procurement plans and targeting assistance where most beneficial.	WIDP. From publication of first timetable of procurement plans (as above).
Maintaining an accurate view of local authority plans through implementation of systems for the ongoing collection of data.	WIDP. Data refresh exercise in advance of publication of first timetable (see above), and ongoing thereafter.
Monitoring the competitiveness of the disposal and treatment market.	WIDP. April 2006 and ongoing thereafter.
Investigating ways to encourage and incentivise local authorities to deliver the objectives of the Government's waste policy, to be set out in Waste Strategy 2006.	HM Treasury, Defra, and DCLG to investigate possible financial incentives to local authorities in the context of CSR2007.

## Advice, Guidance and Support

43. Responsibility for procuring the facilities needed for England to meet its BMW targets falls to the local authorities. However, there is a shortage of expertise and experience in local government for implementing major waste procurements.
44. There is a reliance on the private sector to provide the expertise needed, particularly the legal, financial and technical expertise required on major waste procurements. Increasing demand for this private sector advice means that resources are stretched and there are concerns that this is driving up costs. There is a concern that different local authorities in similar situations are paying to receive similar advice, which does not represent good value for money. OGC recommends:

**Recommendation 2 - Government should provide access to a greater pool of procurement and project expertise and advice for local authorities. This additional procurement support should cover the whole range of procurement options available to local authorities and not be limited to PFI waste procurements. This should include:**

Action	Timescales
Identifying the resource needs of local authorities, consistent with delivering the	From April 2006 and ongoing. The WIDP has a work stream specifically focused on

projects in the coordinated picture of waste procurements (Recommendation 1). Monitoring who is advising whom and sharing lessons learnt and resources between local authorities.	providing further guidance and tools to local authorities for the delivery of waste infrastructure procurements. The WIDP Delivery Team includes additional legal and financial expertise from PUK and delivery expertise from 4Ps.
Assessing whether existing guidance is sufficient for local authorities on how to put together appropriate output specifications.	WIDP. By June 2006.
Using regional channels to deliver this advice where appropriate (for example by using the model being adopted by the South-East Regional Centre of Excellence).	Defra to review the South-East model as a potential regional model for wider roll-out by June 2006.

45. Government recognises the role that it needs to play in providing advice, guidance and support to local government, in order to enable effective delivery. Defra, for example, currently provides a range of assistance as part of their Waste Implementation Programme (WIP) activity.
46. OGC believes that central government needs to build on this. If the LATS targets are to be achieved, further central support is needed for local government – and this support needs to be more carefully focused. Government should use the information in the better-coordinated picture of national waste (Recommendation 1) to target assistance where it is most needed.
47. Work is needed to assist local authorities in developing, and making better collective use of, expert resources in the local government sector. It is also recommended that Government have a role to play in better monitoring who is advising whom. This would include the provision of both public and private sector advice.
48. One area where further guidance is needed is in the preparation of specifications. As a general principle, good practice is for procurers to adopt an output or outcome based approach to specifying their requirements, concentrating on what is required rather than how it is to be delivered.
49. Indeed it is apparent that many local authorities have adopted a very outcome based approach to their tendering of waste management services, preferring not to

be prescriptive as to the types (technologies) of waste management facilities they wish to procure. This decision has been left to the tendering process, with bidders choosing their technology preferences.

50. However, in the specific context of waste and waste PFI, there are arguments that a fully outcome based specification is not always the best approach. Being wholly non-prescriptive offers greater flexibility to bidders but it adds complexity, time and risk to the bidding and decision-making process. There is also an argument that leaving the scope and technology choice exclusively to the bidders increases their bid costs, this reduces the number of companies capable of participating in the procurement.
51. The OFT report recommends that local authorities should weigh up carefully the costs and benefits of specifying inputs as opposed to outputs. Specification of inputs (i.e. which particular treatment technology a local authority wants to procure) risks restricting bidder participation as some suppliers prefer to use, or can only offer, certain technologies. Also, it may reduce the scope for innovation as suppliers are not able to develop their own solutions. Indeed, whilst local authorities may still need to give some clarity to prospective bidders about the type of services that will best meet their needs, fully specifying inputs may prevent the best solution from emerging.

## **Funding and Procurement**

52. A substantial number of waste management projects have been delayed and/or faced difficulties in reaching financial close, due to issues relating to funding and procurement. This includes, but is not limited to, the progress of PFI projects (which has been slow). Clarification is needed on the appropriate deal structures and optimal levels of risk transfer for waste procurements, including:
- developing a model for the appropriate 'mixed economy' of funding and procurement options including PFI / PPP, prudential borrowing variants, supply side initiatives (e.g. merchant sites), deployment of funding combinations, aggregation/disaggregation of requirements and early contractor involvement models;

- the optimum range of procurement and deal structures relevant to particular circumstances needs to be agreed. In the absence of this, advisors may be reluctant to think outside of current PFI conventions;
- determining the optimum range of approaches to site identification and planning;
- affordability and value for money of risk transfer is a key issue (e.g. clear expectations regarding optimal and affordable levels of risk transfer should be identified and communicated to local authorities); and
- adjusting the current PFI model to achieve a better value for money solution for delivering waste infrastructure<sup>16</sup>.

53. The funding and procurement model adopted should be optimal to the circumstances of each procurement. In line with the principles of a 'mixed economy', a number of different funding and procurement options need to be considered. Decisions should be made on a case-by-case basis, weighing up in detail the factors specific to each procurement. As a starting point for these deliberations, OGC proposes the outline model in Table 1. OGC recommends:

<b>Recommendation 3 - The funding and procurement model adopted for a project should be appropriate to the nature of the service or facility being procured, with different models for collection contracts and for different sizes and types of facilities.</b>	
<b>Action</b>	<b>Timescales</b>
OGC proposes the outline model in Table 1, as a starting-point for case-by-case considerations. Government should take account of this recommended model in future guidance and advice to local authorities.	WIDP. From April 2006 and ongoing.
Large-scale integrated end-to-end contracts (i.e. collection to ultimate disposal) should only be supported by exception. This should include reviewing the current SOPC(3) derogations and related template documentation that were developed with integrated contracts in mind.	WIDP. By June 2006.
In its assessment of whether particular projects are ready to go to the market, Defra should favour those projects that contribute to the 'picture' of facilities needed to manage municipal waste in England. (see Recommendation 1).	WIDP. By June 2006.

<sup>16</sup> PFI: strengthening long-term partnerships p.33 (HM Treasury March 2006)

54. The model below should also help to deliver a credible and ‘bankable’ series of major waste PFI / PPP projects to the market as part of the overall coordinated picture of waste procurement activity (see Recommendation 1). These projects should be ‘flagged-up’ well in advance to industry, and should be structured in such a way as to:

- encourage participation of a wide range of suppliers on a level playing field including e.g. the construction sector, overseas players;
- be attractive to a wide range of funders at both the initial funding and any re-financing stages; and
- develop a more liquid market in the build, operation and funding of these facilities over the medium to long-term.

**TABLE 1 – Outline Funding and Procurement Model for Waste**

<b>Type of Facility / Service</b>	<b>Procurement / Funding Model</b>
Collection Contracts	Operational Services Contract with a five to seven year term (i.e. the natural life of the assets). Assets retained by the Contractor.
Small Scale Facilities (e.g. Municipal Recycling Facilities and Transfer Stations)	Design and Build and Operational Services Contracts. Prudential Borrowing should be considered as a primary option for the capital expenditure. Ownership of assets retained, or revert to the public sector at the end of the initial contract.
Large Scale Facilities (e.g. EfW and MBT Plants) solely used for processing Municipal Waste	PFI should be considered as a primary option. Assets revert to the public sector at the end of the initial contract.
Large Scale Facilities used for Municipal Waste with potential third party revenue streams from the processing of other waste streams.	PFI should be considered as a way of providing anchor contracts to make viable the development of the wider facilities. Joint Venture structures and the encouragement of pure merchant plants should also be considered. Assets should not necessarily revert to the public sector but there should be a reward mechanism to reflect the public sector’s role and stake in the project.

***Fewer Integrated Waste Projects***

55. In procuring their waste management services, some local authorities have adopted the strategy of seeking one supplier to provide an integrated ‘end-to-end’ solution, covering all aspects of collection, treatment and disposal. This approach

has the advantage of reducing the number of contracts that an authority has to manage, and of transferring from local government the risks of the 'interface' problems that can arise between different waste service providers. The SKM survey results indicate lower levels of incumbency success at re-competitions of such integrated contracts, compared to discrete collection or treatment contracts.

56. However, considering this issue from the perspective of Kelly, collection of waste is labour-intensive, requiring lower capital investment, and is suited to competitive pressures on a five to seven year basis. The OFT report finds that barriers to entry in the collection sector do not appear to be significant, especially in comparison to the treatment sector. As the costs of entry and the main investments (i.e. collection vehicles) are likely to be fully or partially recoverable if a supplier decides to exit the market, there are likely to be few (non-procurement related) factors that should deter a firm from entering the municipal waste collection sector. In contrast, the treatment and disposal side is more asset-intensive and requires a significantly longer period to recoup investments. Where collection and disposal are combined in integrated contracts, the complexity and duration of procurements is greatly increased. This is problematic in the situation where, as shown in Figure 2 (paragraph 30 (k)), local government has the need to undertake a large number of waste procurements in a relatively short timescale. In addition, longer and more complex procurements deter potential suppliers (both new entrants and suppliers already operating in the sector) from bidding for contracts.

57. Furthermore, if such integrated contracts were widely adopted, market flexibility would be constrained. For example, Small and Medium-Sized Enterprises (SMEs) providing discrete services (collection or disposal) are likely to be squeezed out as direct suppliers. Even large companies will find it difficult to sustain a market presence in the long-term, if they are not successful in securing a range of the large integrated contracts. These dynamics will lead ultimately to a more restricted and rigid market. The complexities of these projects also constrain the appetite of the funding community at both the initial funding and any refinancing stage. OGC therefore recommends that large-scale integrated end-to-end contracts are only supported by exception (see Recommendation 3).

58. The OFT report highlights that care should be taken when considering which services are aggregated and why, when jointly procuring waste management services. Particular care should be taken when aggregating waste treatment and

landfill contracts as aggregating these services risks strengthening the regional dominance of suppliers who own landfill sites. Contract aggregation can deter potential bidders who do not have access to the requisite facilities, hence restricting competition.

59. There is a concern that the current SOPC (3) derogations and related template documentation were developed with integrated contracts in mind and a revised set is needed, aimed at discrete facilities. This approach should also facilitate the achievement of financial close much earlier and the more widespread adoption of funding competitions in this sector.

***Improving Project Timescales***

60. As Figure 2 illustrates, local authorities have a need to complete large numbers of procurements over the course of the next four years. In this situation – if the desired deal flow is to be achieved – it is very important that waste procurements are conducted quickly and effectively.

61. Waste management procurements have traditionally taken a long time to progress from publication of the Official Journal of the European Union (OJEU) Contract Notice to financial close. Given the pressing timescales of LATS and the Landfill Directive, there is real need to try to improve upon project timescales. OGC therefore recommends:

<b>Recommendation 4 - Government should publish procurement timetables for all major waste projects to both local authorities and industry; and benchmark the delivered outcomes with a view to reducing project timescales.</b>	
<b>Action</b>	<b>Timescales</b>
Publication of procurement timetables to industry.	WIDP. Publication of procurement timetables to industry to coincide with Waste Strategy Review 2006 (see Recommendation 1).
A benchmarking exercise of procurement timescales across local authorities.	WIDP. First benchmarking exercise to be complete by June 2006.

**Monitoring**

62. In implementing the SKM recommendations, it will be important to ensure that progress is monitored and developments are regularly reported to stakeholders. OGC recommends:

<b>Recommendation 5 – Government should put in place appropriate mechanisms for monitoring and reporting on progress against the SKM recommendations.</b>	
<b>Action</b>	<b>Timescales</b>
Defra and OGC to consider the most appropriate monitoring and reporting mechanisms to be put in place as part of WIDP programme.	WIDP Board to agree mechanisms by June 2006.

## PART 5: LONGER-TERM CHALLENGES

63. It is evident to all stakeholders that if England is to ensure the effective, efficient and sustainable management of its waste, there are major strategic challenges to be overcome. For example, in the course of its work on the municipal waste market, OGC has identified the following major challenges:

- **Waste Production:** although the rate of growth has slowed, the volume of waste produced continues to rise year-on-year and the recycling rate is much lower than that of leading European countries;
- **Increasing Costs:** the utilisation of new waste management technologies including the construction of new facilities will markedly increase costs;
- **Policy Uncertainty:** there is a perception that policies are not sufficiently 'joined-up', and that waste-related policies and priorities are not communicated clearly enough to the market;
- **Land-Use Planning:** decisions sometimes delay waste infrastructure projects, which creates risk and uncertainty for future schemes. Appropriate priority is not always given to facilitating the timely delivery of waste management facilities through the planning process – including effective use of existing financial incentives and planning powers;
- **Public Opinion:** public perceptions of waste management technologies are often unfavourable, sometimes resulting in a 'NIMBY' response. The public appear generally unaware of the benefits and drawbacks of key waste disposal methods;
- **Independent Waste Streams:** linkages between the management of municipal waste (a small proportion of total waste) and the other waste streams are not fully exploited, and local authorities are unclear on their responsibilities.

64. Government has two major initiatives underway to tackle the problems of waste management in England:

- Defra's Waste Strategy Review. Defra published a consultation into the review of England's waste strategy in February 2006<sup>17</sup>; and intends to publish a revised Waste Strategy in the autumn of this year; and

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<sup>17</sup> Review of England's Waste Strategy – A Consultation Document February 2006 (Defra)

- joint work by HM Treasury, Defra and DCLG on government spending on waste, in the run-up to the Comprehensive Spending Review (CSR) 2007.

65. In addition to these waste-specific activities, there are a number of other relevant initiatives underway:

- the Department for Trade and Industry (DTI) is currently engaged in an Energy Review. The review's consultation document "Our Energy Challenge" makes reference to the potential for additional energy generation from municipal and commercial waste;
- HM Treasury has commissioned the independent Barker Review into Land-Use Planning, to consider how planning policy and procedures can better deliver economic growth and prosperity alongside other sustainable development goals;
- the forthcoming Local Government White Paper will be addressing the form and function as well as the structure of local government; and
- the Lyons Inquiry into Local Government, under its extended remit, is considering questions relating to the function of local government and its future role.

66. It is OGC's view that these major initiatives represent the best and most appropriate means for government to resolve the longer-term challenges facing waste management in England. Longer-term recommendations by OGC at this stage, in advance of the Waste Strategy Review and the CSR2007, would simply add to existing uncertainty over government's policies and approach in this market.

## ANNEX A – Stakeholders Consulted

Representatives of the following organisations were consulted by OGC during the Second Kelly Market (Waste) Study<sup>1</sup>:

<ul style="list-style-type: none"> <li>• Amec plc</li> <li>• Amey Ventures Ltd</li> <li>• Associated Parliamentary Sustainable Waste Group (APSWG)</li> <li>• Audit Commission</li> <li>• Biffa Waste Services Ltd</li> <li>• Broadland District Council</li> <li>• Cambridgeshire County Council</li> <li>• Confederation of British Industry (CBI)</li> <li>• Central Berkshire County Council</li> <li>• Cleanaway Ltd</li> <li>• Cory Environmental</li> <li>• Department for Communities and Local Government (DCLG)</li> <li>• Department for Environment Food and Rural Affairs (Defra)</li> <li>• Derbyshire County Council</li> <li>• Dibb Lupton Alsop (DLA)</li> <li>• Department of Trade and Industry (DTI)</li> <li>• East of England Regional Assembly</li> <li>• East London Waste Authority</li> <li>• East Sussex County Council</li> <li>• Edmund Nuttall Ltd</li> <li>• ECT Recycling</li> <li>• Environment Agency</li> <li>• Environmental Services Association (ESA)</li> <li>• Global Renewables UK</li> <li>• Gloucestershire County Council</li> <li>• Greater Manchester Waste Disposal Authority</li> <li>• Hills Minerals &amp; Waste Ltd</li> <li>• HM Treasury</li> <li>• Improvement &amp; Development Agency (IdeA)</li> <li>• Institution of Civil Engineers (ICE)</li> <li>• Isle of Wight County Council</li> <li>• Juniper Consulting</li> <li>• Kent County Council</li> <li>• Lancashire County Council</li> <li>• Leicester County Council</li> </ul>	<ul style="list-style-type: none"> <li>• Local Government Association (LGA)</li> <li>• London Borough of Southwark</li> <li>• London Community Recycling Network</li> <li>• Mott MacDonald</li> <li>• National Audit Office (NAO)</li> <li>• Norfolk County Council</li> <li>• Norfolk Environmental Waste Services Ltd</li> <li>• Northumberland County Council</li> <li>• North Yorkshire County Council</li> <li>• Nottinghamshire County Council</li> <li>• Office of Fair Trading (OFT)</li> <li>• Onyx Environmental Group plc (now Veolia Environmental Services)</li> <li>• Pinsent Masons</li> <li>• Portsmouth City Council</li> <li>• Partnerships UK (PUK)</li> <li>• Regional Centre of Excellence East</li> <li>• Regional Centre of Excellence South East</li> <li>• Scottish Executive</li> <li>• Shanks Waste Solutions</li> <li>• SITA UK</li> <li>• South East of England Development Agency</li> <li>• South Norfolk District Council</li> <li>• Suffolk County Council</li> <li>• Surrey County Council</li> <li>• Think London</li> <li>• Verdant Group</li> <li>• Viridor Waste Management</li> <li>• Wakefield Metropolitan District Council</li> <li>• Waste and Resources Action Programme (WRAP)</li> <li>• Waste Recycling Group (WRG)</li> <li>• Waste Reduction by Waste Reduction Europe Ltd (WRE)</li> <li>• Welsh Assembly</li> <li>• West Berkshire County Council</li> <li>• 4ps</li> </ul>
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<sup>1</sup> In addition to the OGC/Mott MacDonald Survey of all local authorities in England

## ANNEX B – Glossary

### Abbreviations

Abbreviation	Full Name
BMW	Biodegradable Municipal Waste
CA	Civic Amenity
CSR	Comprehensive Spending Review
DSO	Direct Service Organisation
EfW	Energy from Waste
FKM	First Kelly Market
HWRC	Household Waste Recycling Centre
ICE	Institution of Civil Engineers
LATS	Landfill Allowance Trading Scheme
LAWDC	Local Authority Waste Disposal Company
MBT	Mechanical Biological Treatments
MRF	Municipal Recycling Facility
MSW	Municipal Solid Waste
NIMBY	Not In My Back Yard
OBC	Outline Business Case
OJEU	Official Journal of the European Union
PFI	Private Finance Initiative
PPP	Public Private Partnership
PPS	Planning Policy Statement
RCE	Regional Centre of Excellence
RDF	Refuse Derived Fuel
SKM	Second Kelly Market
SOPC	Standardisation of PFI Contracts
UA	Unitary Authority
WCA	Waste Collection Authority
WDA	Waste Disposal Authority
WIDP	Waste Infrastructure Development Programme
WIP	Waste Implementation Programme

### Facilities

Facility Type	Definition
Energy from Waste (EfW)	Incinerating waste that in turn powers turbines.
Mechanical Biological Treatments (MBT)	A means of removing additional recyclable materials and treating the organic fraction prior to landfill. Also produces a fuel for EfW.
Transfer Station with CA Site (Civic Amenity)	Sites where waste is taken by the council but also where the general public can take their own household waste.
Municipal Recycling Facility (MRF)	Material Recovery Facility designed to process source separated/co-mingled dry recyclables. i.e. cans, plastics etc.

Other	<p><i>Autoclave</i> - This treatment involves sealing the waste and treating it with steam at 140-160oC, which sterilises the waste. When the treatment is complete the materials are discharged. Separated and sent for further recycling.</p> <p><i>Pyrolysis</i> - Pyrolysis is a thermal process, which uses high temperatures to break down any waste containing carbon. The pyrolysis process degrades waste to produce char (or ash), pyrolysis oil and synthetic gas (called syngas). Syngas has calorific value, so it can be used as a fuel to generate electricity.</p> <p><i>Anaerobic Digestion</i> - This treatment uses bacteria to break down organic material. Depending on the quality of the input material the residue produced may be suitable for composting, or it may only be suitable for landfill cover or as a fuel.</p> <p><i>RDF</i> - A solid, liquid or gaseous fuel derived from waste.</p>
Unspecified	Technology was not identified as one of the above.

### **Definitions of Service Types**

<b>Service Type</b>	<b>Definition</b>
Collection Only	Collection Mixed Source Separation Co-mingled Kerbside Sort Other Commercial/trade (Or any combination of the above)
Treatment/Processing Only	Transfer Station Materials Recycling Facility Aerobic Anaerobic Mechanical Biological treatment HWRC CA Site Other (Or any combination of the above)
Disposal Only	Landfill Thermal/EfW Other (Or any combination of the above)

### ***Definitions of Aggregated Contracts***

<b>Aggregated Contract type</b>	<b>Definition</b>
Collection and Treatment	At least one service from collection and one service from treatment/processing.
Collection and Disposal	At least one service from collection and one service from disposal.
Treatment and Disposal	At least one service from treatment/processing and one service from disposal.
Integrated	At least one service from collection, treatment/processing and disposal.
Transport	Transport only (note: if transport is included as part of an aggregated contract (above) then it does not alter its definition).