STATES OF JERSEY

ENERGY FROM WASTE FACILITY: FUNDING

Lodged au Greffe on 20th May 2008
by the Minister for Treasury and Resources

STATES GREFFE

PROPOSITION

THE STATES are asked to decide whether they are of opinion −

> in accordance with Article 11(8) of the Public Finances (Jersey) Law 2005 to amend the expenditure approval for 2008 approved by the States on 18th September 2007 in respect of the Transport and Technical Services Department head of expenditure, to permit the withdrawal of an additional £102,810,000 from the consolidated fund for its capital expenditure in order to fund the provision of the preferred solution for the replacement of the Bellozanne incinerator of an Energy from Waste facility, as set out in sections 8 and 10.1 of the Report of the Transport and Technical Services Department dated 20th May 2008.

MINISTER FOR TREASURY AND RESOURCES

REPORT

ENERGY FROM WASTE FACILITY: FUNDING

Executive Summary

- The Minister for Transport and Technical Services has asked the States, in accordance with its Solid Waste Strategy, to approve a preferred solution for the replacement of the Bellozanne incinerator with an Energy from Waste facility subject to the necessary funding being made available.

- The Public Finances (Jersey) Law 2005 requires that the total cost of a capital project be available for withdrawal from the States Consolidated Fund in the year that project commences. The total cost of the Minister for Transport and Technical Services' preferred solution is £106.3 million. The States has currently only approved the withdrawal of £3.5 million for this project in 2008. Additional expenditure approval of £102.8 million is therefore required in order to commence the project.

- The States has in the 2008 Business Plan made provision for the withdrawal of a Capital Allocation of £7 million per annum from 2009 to fund the procurement of the preferred solution. Full provision of the anticipated cost was not proposed because the Financial Forecast at the time of the Business Plan indicated insufficient funds would be available without cancelling all other States capital expenditure. At the time the final cost of the preferred solution was not yet known, but it was envisaged that the £7 million allocation would be used to service some form of loan that would enable the full cost of the project to be paid for over a 25 year period.

- Since the approval of the 2008 Business Plan the States Financial Forecast has improved, to the extent that the current Financial Forecast indicates there will be sufficient unallocated funds available in the Consolidated Fund to permit the withdrawal of the full cost of the project from the Fund in 2008.

- Whilst the Public Finances (Jersey) Law 2005 requires the full cost of the scheme be provided for in 2008, the majority of project cashflows will be spread over a period of 3 years: £36.9 million in 2008 £36.4 million in 2009 and £26.4 million in 2010. The States will have sufficient cash balances from which to make these payments in those years.

- Treasury analysis shows that funding the project from the States own cash balances now will be cheaper than borrowing for it over 25 years with the existing £7 million allocation. The necessary funds being available in the Consolidated Fund, the Minister for Treasury and Resources is proposing the States approve the required additional expenditure approval for 2008.

1.0 Background

1.1 On 13th July 2005 the States approved proposition P.95/2005 which proposed the Solid Waste Strategy and charged the then Environment and Public Services Committee:

> *(v) to investigate fully alternative and conventional technologies to provide the final disposal route for the residual waste remaining following the implementation of the systems and facilities as set out in (previous) paragraphs (above) and to recommend a preferred solution for a replacement of the Bellozanne incinerator to the States with an accompanying cost/benefit analysis, environmental and health impact assessment no later than December 2008.*

The Minister of Transport and Technical Services' proposition seeks to meet this requirement.

1.2 In the same States debate, the then Policy and Resources Committee was asked:

> *to propose the inclusion of a funding strategy for the capital projects identified in (v) above (i.e. including the replacement facility) within the States Business Plan 2006-2010 by, if necessary, re-prioritising or deleting existing projects, or identifying additional sources of funds.*

1.3 The States has addressed this requirement, in part, by approving £7 million per annum allocations from 2009 onwards to a project sinking fund in the Capital Programme approved in the States 2008 Business Plan. At that time it was envisaged those allocations would be used to service borrowing for the full cost of the scheme, insufficient funds being available for withdrawal from the Consolidated Fund.

1.4 Since the approval of the 2008 Business Plan the States Financial Forecast has improved significantly such that the current Financial Forecast indicates there will be sufficient unallocated funds available in the Consolidated Fund to withdraw the full cost of the project from the fund in 2008. The Treasury Department has accordingly assessed the relative merits of utilising the States own cash balances over the borrowing solution.

1.5 The Treasury has worked in conjunction with the Transport and Technical Services Department and its external advisers to gain an understanding of the project and its funding requirements. This report sets out those requirements and the Minister for Treasury and Resources' proposals for the full funding of the preferred solution.

1.6 Extensive details of the background to the scheme are included in the Minister for Transport and Technical Services' report and proposition. This report, therefore, focuses solely on the financial aspects of the proposal.

2.0 Funding requirement

2.1 Having conducted a tendering process the Minister for Transport and Technical Services has proposed, with the support of the Council of Ministers, to purchase a 105,000 tonne capacity EfW from that department's preferred bidder, a consortium headed by CNIM ('the CNIM consortium'), for a fixed price of £93.35 million.

2.2 There are a number of other costs associated with the project including enabling works, decommissioning costs and project management costs. The table below shows the total cost of the project.

	Capital cost (£ million)
Enabling Works	3.63

Engineering Procurement and Construction (EPC) Contract	93.35
Jersey Electricity Company (JEC) Connections	0.40
Decommissioning of the Bellozanne incinerator	2.08
Project Management (including incurred Feasibility costs)	6.85
Total Cost	**106.31**
Less existing budget	(3.50)
Total additional budget requirement	**102.81**

2.3 The additional funding requirement is shown to be £102.81 million because an allocation of £3.5 million has already been made available to the department from the 2008 States Capital Programme. The total cost of £106.31 excludes provision for contingency items which will be managed from within the risk element of the States Capital Reserve Vote.

3.0 Fluctuations – Exchange Rate

3.1 The Engineering and Procurement Construction (EPC) contract is partially subject to currency risk with certain agreed payments being quoted in Euros. The States therefore has a currency exposure to the rate of exchange between the Euro and Sterling.

3.2 This exchange risk will be eliminated upon the signing of the contract with the preferred bidder at which time the Euro/Sterling rate will be deemed to freeze for the purposes of the contract payments. All contract payments will be made in Sterling.

3.3 The Treasury has conducted a sensitivity analysis of the currency exposure and obtained expert advice on anticipated currency fluctuations. As with all States capital projects the Treasury will monitor and manage the fluctuations risk. The cost of any currency fluctuations will be met from the Capital Projects Reserve Vote in the event this increases the cost of the project.

4.0 Timing of project costs

4.1 The preferred bidder has agreed a fixed schedule of payments for the EPC contract these are set out in the table below together with the timing of the associated enabling, management and decommissioning costs.

	2008 £'000s	2009 £'000s	2010 £'000s	2011 £'000s	2012 £'000s	Total £'000s
EPC contract	29,423	35,096	25,395	3,436	–	93,350
Enabling Works	2,350	1,270	–	–	–	3,630
JEC Connections	400	–	–	–	–	400
Decommissioning	–	–	–	–	2,080	2,080
Project Management	4,710	1,120	1,020	–	–	6,850
	36,883	36,366	26,415	3,436	2,080	106,310

5.0 Funding Options

5.1 There are essentially two alternatives available to the Minister for Treasury and Resources to secure funding for the procurement of the EfW plant.

(1) To fund in full from the unallocated balance in the Consolidated Fund in 2008; and
(2) To borrow the funds and repay over the life of the asset.

5.2 Under the provisions of the Public Finances (Jersey) Law 2005 the States may authorise the withdrawal of the additional funding required provided the Financial Forecast indicates there is a sufficient unallocated balance in the Consolidated Fund at the end of 2008.

5.3 Based on the latest Financial Forecast there will be sufficient unallocated funds available in the Consolidated Fund from which to fund the full cost of the scheme in 2008. See Annexes A.1 and A.2 showing the forecast position with and without funding of the EfW.

5.4 It is noteworthy that actual States cashflows inclusive of this project are far healthier than a glance at the financial forecast (produced in accordance with the requirements of the finance law) might suggest. The States is in fact presently holding cash balances, excluding Stabilisation Fund and Strategic Reserve Fund monies, of approximately £240 million. The timing of cash inflows and the phasing of fully funded capital projects over several years are the main reasons for the healthy cash position relative to the Financial Forecast figures that are prepared on a budgetary basis.

Why use the Consolidated Fund unallocated balance rather than borrow?

5.5 The financial assessments undertaken by the Treasury indicate that the cost of financing the scheme if it is funded from the consolidated fund unallocated balance will be less than the cost of available borrowing given a variety of assumptions about returns.

5.6 Variable borrowing rates being inclusive of a margin, risk premium and arrangement fees are more expensive than the loss of return generated on the States cash investments. The relationship between these rates will be maintained into the future regardless of the absolute level of investment return or borrowing rate. For this reason entering into a variable rate loan has been discounted as an appropriate funding solution.

5.7 Borrowing at a fixed rate. The financial analysis indicates that although in the short term borrowing may appear attractive, over the longer term, longer dated investments in the financial markets indicate that funding the project from the consolidated fund is likely to provide the cheapest form of financing. In other words, utilising the unallocated balance on the Consolidated Fund has the advantage of not tying the States into a 25 year debt obligation that may well become unattractive in the future. Taking such a risk with taxpayers' money when the States retains sufficient cash balances of its own would be imprudent.

Possible implications of utilising the Consolidated Fund balance

5.8 If income falls below expectations measures may need to be taken to bring the estimated balance on the Consolidated Fund back into balance.

6.0 Conclusions

6.1 The recommended funding solution is to finance the procurement of the Energy from Waste facility from the unallocated balance in the Consolidated Fund.

6.2 Analysis indicates the utilisation of existing funds should be cheaper than borrowing. Borrowing is likely to be more expensive and to enter into long term borrowing at a time when the States has excess cash balances could be considered an unnecessary risk to take with taxpayers' money.

ANNEX A.1

cial Forecast before the proposed EfW ng solution

	2007	2008	2009	2010	2011
; Income					
Income Tax	430	460	475	490	510
0/10% Corporate Tax Structure	–	–	(9)	(77)	(82)
Goods and Services Tax	–	30	45	46	47
Impôts Duty	55	53	54	54	54
Stamp Duty	29	30	31	32	33
Tax/Stamp Duty on Share Transfer	–	1	1	1	1
Other Income	38	39	37	33	31
Island Rate	10	10	10	11	11
States Income	562	623	644	590	605
States Expenditure					
Net Revenue Expenditure	480	510	525	546	565
Net Capital Expenditure Allocation	42	40	38	39	39
Total States Net Expenditure	522	550	563	585	604
Forecast Surplus/(Deficit) for the year	**40**	**73**	**81**	**5**	**1**
One-off expenditure					
Income Support – Transitional relief	0	9.7	6	4	2
Revised Forecast Surplus/(Deficit)	**40**	**63.3**	**75**	**1**	**(1)**
Transfer to Strategic Reserve	**-10**	**0**	–	–	–
Transfer to Stabilisation Fund	**0**	**-38**	–	–	–
Estimated Consolidated Fund balance	**80**	**105**	**180**	**181**	**180**

ANNEX A.2

ial Forecast after the proposed EfW g solution

Income	2007	2008	2009	2010	2011
Income Tax	430	460	475	490	510
0/10% Corporate Tax Structure	–	–	(9)	(77)	(82)
Goods and Services Tax	–	30	45	46	47
Impôts Duty	55	53	54	54	54
Stamp Duty	29	30	31	32	33
Tax/Stamp Duty on Share Transfer	–	1	1	1	1
Other Income	38	39	37	33	31
Other Income reduced interest effect	–	(0)	(3)	(5)	(5)
Island Rate	10	10	10	11	11
States Income	562	623	641	585	600
States Expenditure					
Net Revenue Expenditure	480	510	525	546	565
Net Capital Expenditure Allocation	42	40	38	39	39
EfW Capital Expenditure Allocation	–	103	–	–	–
related reduction in States Capital Allocation	–	–	–	(7)	(7)
Total States Net Expenditure	522	653	563	578	597
Forecast Surplus/(Deficit) for the year	**40**	**(31)**	**78**	**7**	**3**
One-off expenditure					
Income Support – Transitional relief	**0**	**9.7**	6	4	2
Revised Forecast Surplus/(Deficit)	**40**	**(40)**	**72**	**3**	**1**
Transfer to Strategic Reserve	**-10**	**0**	–	–	–
Transfer to Stabilisation Fund	**0**	**-38**	–	–	–
Estimated Consolidated Fund balance	**80**	**2**	**74**	**77**	**78**