BUDGET 2017-18
WDA/04/17

Recommendation

That the Authority:

1. approves the revised budget for 2016-17;

2. approves the revenue budget for 2017-18;

3. considers the Levy proposals set out in Appendix 2 to this report and agrees the proposal for a Levy of £65,591,099;

4. notes that the Levy proposal in recommendation 3 is likely to lead to a prospective overall Levy increase of 11.5% in 2018-19. Measures to mitigate future costs may alter this position;

5. authorises the Levy to be made on the constituent District Councils for 2017-18;

6. agrees the payment dates for the levy; and

7. transfers the remaining Capital Fund (a previously “earmarked” revenue fund) back into the General Fund

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BUDGET 2017-18
WDA/04/17

Joint report of the Chief Executive and the Treasurer

1. Purpose of the Report

1.1 The Authority is required to prepare a budget and to set a Levy each year. The level of Levy to be charged to each of the constituent Local Authorities needs to be agreed annually alongside a Levy payment schedule. The Authority also needs to consider and approve capital programme proposals.

2. Background

2.1 The Authority is statutorily required to manage the disposal of household waste for Merseyside District Councils and also provides services on behalf of Halton Council. The Authority delivers this principally through contracts with private sector contractors who provide waste management and disposal facilities.

2.2 Until the start of 2016-17 the Authority had, for a number of years, relied upon the Landfill Contracts held by Mersey Waste Holdings Limited (that the Authority has access to) and the Landfill Top-Up Contract which together provide access to landfill for the Authority's residual household waste. At the beginning of the year that landscape started to change as the Authority's long term procurement of an alternative to landfill, an Energy from Waste plant (EfW) under the Resource Recovery (RRC) contract began to take on increasing amounts of disposal tonnages during the commissioning process and as the contract progressed to operational full service.

2.3 The other key contract is the Waste Management and Recycling Contract (WMRC) operated by Veolia ES. The WMRC includes the provision of transfer stations, waste transport, household waste recycling centres; materials recycling facilities, food waste processing, and has the potential for green waste composting.

2.4 Together these contracts have enabled the Authority to manage the recycling, treatment and disposal of Merseyside and Halton's household waste. In addition the Authority also leads for the Strategic Waste Partnership on waste minimisation and education initiatives, as well as managing historic closed landfill site liabilities.

3. New disposal arrangements

3.1 The Authority signed the Resource Recovery Contract (RRC) in December 2013 which will enable the Authority to move away from disposal by Landfilling. The contract was originally signed with Sita Sembcorp UK , who have since been renamed as Merseyside Energy Recovery Ltd (MERL). The contract was for the construction of an Energy from Waste plant in Redcar and a Rail Transfer Loading Station in Knowsley. Eventually all the waste for disposal, delivered by the constituent District Councils and Halton Council (under an Inter Authority Agreement), will be transferred by rail from Knowsley to Redcar where it will be used by the contractor to generate electricity.

3.2 In very large part the construction of both of the facilities, at Kirkby in Knowsley and at Wilton in Redcar has gone to plan and been successful which enabled the Commissioning of the plants to commence in April. However, there have been a small number of technical problems with the way the new facilities have been found to operate in practice which have led to some delays in moving from Commissioning and into full contract handover.

3.3 The technical problems which have held up the handover of the facilities for full operations under the contract have included the effectiveness of compactors. There has also been a need for an investigation and additional works required arising from addressing concerns that have been expressed to the operators over odours which may, in part, have arisen from the Knowsley Rail Transfer Loading Station. At Wilton the plant has been operating under commissioning conditions successfully. There has been an issue over the need to review the effectiveness of a Water Cooled Condenser, and the contractor has been able to isolate that part of the plant and carry out the required works to ensure the plant is able to operate at its designed capacity.

3.4 The technical issues which the contractor and its subcontractors are required to deal with before the plant can be fully handed over, have had an impact on the planned tonnages that have been required for commissioning the plant, which means that tonnages that were due to go to the plant in full operation have not been achieved in 2016-17.

3.5 The operational difficulties in disposing of waste under the new contract have been exacerbated in the latter part of 2016 because of unplanned difficulties in the use of the landfill site at Arpley. When the RRC was signed it was anticipated that the Arpley landfill site would close in 2020-21 . The operators FCC informed the Authority in July of 2016 that this date would be brought forward to the end of January 2017, which would not be a significant issue for the Authority if the RRC was on time, or even a little late. However, partly as a consequence of the RRC commissioning tonnages not being as high as expected, and partly due to the delay in handover the Authority has continued to send tonnages to the landfill site, meaning that it has filled up more quickly than anticipated. As a consequence the landfill site at Arpley was no longer available after mid-December 2016.

3.6 The delays in commissioning, full operation and the closure of the main landfill facility means the Authority's contracts team has made alternative arrangements, via the landfill operator's alternative facilities, through the RRC contractor's facilities and via their temporary arrangements with Suez to ensure that the Authority has sufficient disposal points available for Merseyside's waste. This has been achieved through strong working relationships between the contracts team, the District Councils and a number of contractors, not least Veolia, who have continued to respond flexibly and supply transport for waste to various disposal points including landfill after the date when their planned fleet was no longer due to go to landfill.

3.7 In terms of the main RRC contract, it is anticipated (at the time of writing) that this will move to full operation during February 2017 (although Members may receive a verbal update at the budget meeting), and the budget has been prepared on this basis. The cumulative effect of a combination of additional landfill and disposal costs, an extension to commissioning beyond planned dates, and a delay in facility operation means that the Authority will spend less by the end of 2016-17 than had been anticipated; this is reflected in the revised estimate and the reserves available to support the levy.

3.8 The early years of the contract will be challenging financially as the opportunities for sharing income from third party sales of treatment facilities and electricity income are limited in the first years of the contract. The Authority's flexibility to manage those costs without an impact on the Levy was limited when the Sinking Fund which became the Waste Development Fund was returned to constituent District Councils. The RRC overall is a very good environmental and financial deal for Merseyside and

Halton, but the transition from Landfilling to the full operations under Contract has been more difficult than expected.

4. External factors

4.1 The general economic climate and the Government's spending reviews have meant that local government generally, and Merseyside in particular, continues to face very significant changes in the levels of funding available. The Government has once again set very challenging financial targets for Councils and although they have responded well to the changes in their financial resources up to now, those challenges mean that very difficult decisions are having to be made about the shape and size of local government services in the future.

4.2 In 2016-17 Merseyside Councils continued to face very significant savings targets, and for 2017-18 and beyond further very significant savings are required. The Councils have so far been able to make the additional savings but this has been through redesigning services and service provision. They are already looking towards 2018-19 and beyond where additional large savings continue to be required.

4.3 The financial climate for the Councils means that the onus on the Authority is to ensure that the Levy agreed does not impose an unnecessary burden on the Council budgets. The Authority, District Council Treasurers and District Council Chief Executives and Leaders have been discussing the Levy and the strategy for both supporting Districts while at the same time enabling this Authority to meet its statutory and fiduciary duties in the most prudent manner.

4.4 The Authority has not increased its Levy on District Councils in overall terms for a period of seven years. The Authority had planned to increase the Levy with a number of relatively small increases over a period of three years in last year's budget consultations. However, at the budget meeting last year the Authority was asked to consider a last minute request from the leaders of the City region to respond to a request for another year of freeze (initially the request was a freeze in cash terms for each Council, but that could not be agreed by Districts as it would have meant a change to the Levy Mechanism and Councils could not agree to that).

4.5 The Authority responded positively to the request and agreed a 7th year where the Levy did not increase in overall terms. It was only able to do that by utilising its available reserves on a one off basis (once they're gone they're gone), and reported that the consequence of acceding to that request was a likely need for a 4% overall increase in the Levy for 2017-18.

4.6 The need for the Authority to close the gap between its current Levy and the expected level costs associated with dealing with waste delivered by householders and districts has not diminished. There remains a very significant gap between income and expenditure (£8.8M) which needs to be plugged. The temporary solution of using reserves is not sustainable in the medium term and until Councils and Households are able to deliver very significantly lower amounts of waste for disposal, the costs to the Authority, and hence the need to raise the levy will not diminish. The Authority has a statutory duty to balance the planned budget with available reserves and, in common with all local authorities, statutorily may not plan to have a deficit in its budget.

4.7 While this has been possible for a period of time it is increasingly looking more difficult to achieve going forward. Since 2014-15 and taking into account the dispersal of the Authority's Waste Development Fund to Districts the Authority has planned to support Districts with £44M of reserves and contributions. This will not be sustainable in the longer term as all of the Authority's reserves will have been fully utilised.

4.8 The pressure from the District Councils is understandable, but is increasingly difficult for the Authority to respond to. The vast majority of the Authority's costs are generated from waste arisings, and the costs associated with treating them. Unless the overall amount of waste, both for disposal and recycling, reduces by a considerable amount it is difficult for the Authority to reduce the budget and to set a Levy in line with or lower than prior years.

4.9 When the Authority was asked by the City Region leaders to respond to a further year of levy freeze, at the same time it was also asked to agree to contribute to a City Region wide review of waste collection and disposal, he Strategic Review. The review was led by the Mayor of Liverpool City Council and the Chief Executive of Wirral Council and the Authority was asked to contribute. The Authority has also been asked to contribute to the implementation phase of the review and will be working with colleagues across the City Region to ensure the best outcome for waste collection and disposal across Merseyside.

4.10 The Strategic Review has not been fully finalised, but a summary of its draft findings has been shared with the City Region Leaders and Mayor. When the Strategic Review has been finalised its findings will be shared with the Authority. There are likely to be issues for the Authority to consider in terms of proposals for changes to governance arrangements within the City Region, savings options and possibly to the Levy mechanism.

4.11 The Authority's Chairperson and Chief Executive offered to discuss the Levy in the context of the strategic review with Leaders and Chief Executives of the constituent councils. From the initial discussions with the Leader and Chief Executive it was clear that Mayor and Leaders had been convinced that the reduction in the Levy they may have hoped for was unlikely as the Authority and its contracts were already considered to be efficient. Therefore the Wirral Chief Executive had initially recommended a Levy freeze to the Leaders and Mayor. The effect of this proposal would be that there will be no levy rise and that the Levy Mechanism is suspended, giving each constituent Council the same Levy in 2017-18 as they had in 2016-17.

4.12 The financial position of the Authority remains difficult. The gap between estimated expenditure and the proposed Levy freeze is some £8.8M. This may be plugged on a one off basis in 2017-18 by utilising virtually all the Authority's reserves. This would then leave the real prospect of an 11.5% Levy increase the next year to close the gap, as there would be no reserves left. In addition, the following year a further 5.2% rise would be required to continue to close the gap.

4.13 Following the meeting with the Wirral Leader and Chief Executive, and a further meeting with the St Helens Council Leader and Chief Executive the Chairperson to the Authority wrote to the Mayor and Leader to explain the effect of the Levy freeze, as well as showing the impact of the freeze compared with the option of a zero levy increase under the existing mechanism, under which four of the five Councils were better off. The letter also showed the impact of a 4% Levy increase and an illustration of the impact of an 11.5% increase in the following year. The letter also included a further offer from the Chairperson to speak with Leaders and Chief Executives.

4.14 The Chief Executive and Director of Finance were then invited to the meeting of the Leaders and the Mayor on 6th January, and the Chief Executive was asked to comment on the difference between the Levy Freeze proposal, and the Levy at zero increase under the current mechanism. Following the explanation from the Chief Executive, the meeting of Leaders and Mayor asked the Chief Executive to propose to Members of the Waste Disposal Authority that the Levy remain the same in 2017-18 in overall terms, but that it be allocated to District Councils on the basis of the existing Levy Mechanism.

4.15 As a part of the discussion of the Levy the Chief Executive was asked to comment upon the financial consequences of taking up the zero levy increase. The Chief Executive confirmed to the Leaders and Mayor that the impact would be the need for an 11.5% increase in the Levy in the following year, and provided the same example to the meeting as shown in Appendix 2 to this report at option E. The Leaders and Mayor have been shown an example of the likely impact of the 11.5% Levy increase that will be required in 2018-19.

4.16 The Chief Executive also confirmed that the Authority was more than prepared to work with the Leaders and Mayor on identifying options for mitigating the impacts of any Levy increases, through implementing the proposals that may be contained within the Strategic Review.

4.17 The Chief Executive also confirmed to the meeting that the Levy proposals leave no reserves for the Authority to cushion unexpected rises in costs, for example from additional waste collected by Councils. That would mean that any additional expenditure would cause an overspend in the year, which would be the first call on any levy in the next year, the additional costs would simply be passed on in an unplanned and un-cushioned way.

4.18 The meeting with the City Region Leaders and the Mayor was very helpful in the context of the Levy and use of the Authority's balances to support the revenue budget. The Leaders and Mayor gave the Chief Executive and Director of Finance a clear view that their preferred option for the Levy for 2017-18 was for no increase and that instead of a cash freeze that the Levy be apportioned to District Councils on the basis of the existing Levy Mechanism.

4.19 The Leaders and Mayor asked what the implication would be for the Levy for 2018-19 and it was confirmed to them that the Levy increase would be 11.5% if there was no change in waste arising. It was also confirmed to the Leaders and Mayor that as this would leave the Waste Authority with no balances, the risk of any future over spend caused by additional waste flow for example, would be passed on to the Councils in an unplanned and un-cushioned way. The Leaders and Mayor's group clearly understood the financial position faced by the Authority.

4.20 It was agreed that implementing the outcome of the Strategic Review would be important if the potential impact of the Levy for 2018-19 is to be mitigated.

4.21 In the interim, whilst awaiting the outcome of the strategic review, the Authority's own review of its facilities and the impact on Districts of changing any arrangements for receiving or treating waste has been delayed as these proposals were due to be considered under the strategic review. Where appropriate, within the parameters of the strategic review, we will continue take forward any proposals to work with the contractors to determine whether there are any further savings that may be made, without simply transferring costs from this authority back to individual district councils.

5. <u>The budget</u>

5.1 The revised estimates for 2016-17 have been established from the Authority's projected activities in the year and the projected levels of spending by the Authority; including the effective management of the Authority's contracts and from the current and projected waste tonnages arising. The outcome of the revised estimate exercise is that the projected level of spending for 2016-17 is likely to be £71.981M which is £3.511M lower than originally agreed. The majority of this decrease has arisen because of the delays in commissioning and starting to achieve full service on the RRC.

5.2 The overall effect of this is that the planned level of support from the General Fund balance for 2016-17 may be decreased from £9.101M down to £6.390M. In the context of the Authority's overall budgets this is helpful and leaves the Authority with additional balances which enable it to plan to continue to mitigate some of the impacts of cost growth in the budget in the next year. These reserves can only be used once and even taking account of proposed savings, without levy increases going forward, the Authority's financial position is at risk of being untenable.

5.3 The Authority's proposed budget for 2017-18 is presented at a time when the Authority faces significant financial challenges. From February 2017 (at the time of writing) the Authority expects to be fully utilising the RRC facilities to dispose of residual waste arising in Merseyside and Halton. The Authority's contracts team has worked closely with the contractor to develop a shared understanding of the tonnages flowing into the contract, the gate fees for those tonnages and the pass through costs (for example the share of NNDR at the facilities) which together with the gate fees form the monthly unitary charge.

5.4 At the same time both the Authority and the contractor are working hard to develop a similar shared understanding of the potential for income streams to flow from the utilisation of the EfW plant, both through electricity sales and the potential for sales of surplus treatment capacity to third parties. Neither of these potential income streams are fully predictable as they depend upon the scale and prices achieved for each, which will depend upon the market conditions encountered during the year. As an example, if the cost of oil increases internationally it is likely that the price achieved for electricity generation could increase, but this is not certain. Until the contract has been managed in full operation for some time it is difficult to take account of the potential for income.

5.5 During this phase of transition to the RRC the Authority faces a peak in its costs as the initial costs come fully on stream. Over the life of the contract as the amount of waste anticipated to be treated from Merseyside and Halton reduces the prospects of the unitary charge being held at a relatively steady cost, despite inflation, is realistic.

5.6 In the event that the waste sent by Merseyside for treatment starts to reduce and follows the Guaranteed Minimum Tonnage (GMT) in the contract then the contractor will also have the opportunity to sell the freed up surplus capacity to the third party market. Under the terms of the contract then there will be opportunities for income sharing with the Authority, which may become significant. The incentive for the contractor to sell any additional capacity is tied up not just in sales income, but also in the efficient running of the plant, which works best when near to capacity and the electricity sales that can be generated from that, which are needed to achieve the contractor's base case, but once beyond that are useful for the authority as an income sharing arrangement is in place.

5.7 While the medium to longer term of the contract is very likely to be financially very helpful for the Authority, the transition to the new arrangement and the initial operational period is financially difficult. This difficulty cannot be managed through a sinking fund, as that was transferred to a waste development fund and passed back to the constituent councils on their request. As reported in the Budget approved by Members in February 2016 this was done with the understanding at the Authority that there would need to be modest Levy increases thereafter as the transitional fund was no longer in place. In light of the request to defer any Levy increase last year and once again this year, the need for Levy increases in future budgets will become more stark and modest increases will no longer bridge the gap between the cost to the Authority of dealing with the tonnages delivered by Districts and Households and the amount currently raised through the Levy.

5.8 As part of the Authority's continuing drive for efficiency, the way the organisation utilises its resources will continue to be reviewed during the next budget cycle. Where there is scope for additional efficiencies or outcomes to be delivered, then a business case will be developed to outline for Members the costs and benefits of any proposal on an 'invest to save' basis. Where there may be benefit to the Authority from a proposed service development, Members will be asked to approve the release of funds where they are necessary to deliver additional efficiency. Normal improvements in services that may be achieved at no additional cost will be implemented as part of the normal business of the Authority.

6. The Levy Mechanism and recycling credits

6.1 The Levy Mechanism is the methodology used to divide the Levy among the constituent District Councils. The way the Levy is divided is statutory and is based on unanimous agreement by the District Councils over the way the Levy should be apportioned (in the absence of an agreement there is a statutory fallback or 'default' mechanism). The current Levy mechanism was agreed in January 2005 and included an element that related to recycling credits; the mechanism is explained in Appendix 2 to this report at option A.

6.2 The Waste Disposal Authority has continued to provide a system of recycling credits to constituent District Councils at their request, although the mandatory requirement to provide such credits was removed in 2006.The Authority agreed with the Districts that this continued arrangement incentivised Districts to move away from collecting waste for Landfill. In the Authority's budget for 2016-17 the following amounts were provided:

	£
Amount included in Levy via tonnages	**(5,742,157)**
MWDA Expenditure on Recycling Credits	**5.742.157**

6.3 The total amount planned to be spent and the total amount planned to be raised via the tonnage elements of the levy were the same. In effect this has been a circular flow of funds between the Authority and the Waste Collection Authorities.

6.4 The removal of the recycling credit levy has been discussed by District Council Treasurers on a number of occasions over recent years, but there has been no consensus for the removal of the credits. This forms part of the Levy mechanism so the Authority cannot unilaterally remove the circular collection and payment of the amounts, despite the changes brought about in 2014 by the Local Audit and Accountability Act, which mean that the financial impediment to the removal of the Recycling Credits has been eliminated and so the proposal could be considered.

6.5 For 2017-18, if recycling credits were to be removed, the headline impact would be to reduce the Levy by £4.925M.

7. Underlying and future costs facing the Authority

7.1 The Authority continues to keep its funding and affordability model under review now that all the new contracts for long term treatment and disposal of waste have been finalised. At the outset of the procurements, a funding envelope that set an annual levy increase at 15.4% was agreed with District Council Treasurers. That envelope allowed the Authority to provide for a Sinking Fund and to plan to use the fund over time to offset future very significant rises in the Levy. (For comparison; if the Levy had continued at that level of increase, the Authority would currently be seeking funding of over £130M from District Councils – for 2017-18 the Authority's proposed Levy demand will, in fact, continue to be nearer to half that amount).

7.2 In reviewing the model, the Authority was able to reduce the Levy increase to 12% in 2009-10 and then, in 2010-11, it was able to introduce a zero increase in the overall Levy. In 2011-12 the Authority reduced the Levy by almost £3M with the 'maximum of zero' levy for all constituent Districts. In 2012-13 this 'maximum of zero' approach was repeated and the Authority's overall levy reduced by over £2.5M in the face of increasing cost pressures. In 2013-14 the Levy increase was only £132k or just 0.2% while the overall Levy did not increase for 2014-15 because the Levy was cushioned by a £2.96M contribution from the General Fund. In 2015-16 that cushioning continued with a planned £2M contribution from General Fund and a £4M contribution from the Authority's wholly owned company Mersey Waste Holdings Limited (i.e. a total of £6M). In 2016-17 the

Authority sought a modest increase and was asked to agree a static Levy again, which meant a planned contribution from reserves of £9.901M was required (eventually due to delays in Commissioning this is estimated to be down to £6.390M).

7.3 This approach is unsustainable as the Authority's reserves will run out. The gap between Levy and the costs of dealing with the amount of tonnes delivered by District Councils and households needs to be closed. Tonnages are not reducing and so the need to increase the Levy is imperative. Despite this the City Region Leaders and Chief Executives have asked for a freeze in the cash level of the Levy for 2017-18. This means the financial situation of the Authority will deteriorate further, the gap between expenditure and funding remains, and the one off use of balances to close the gap cannot be continued for more than one year.

7.4 If the Authority agrees to the proposal from the Chief Executives and Leaders then the consequence is that a Levy increase of at least 11.5% will be required in 2018-19.

7.5 The WMRC contract continues to minimise costs to the Authority and the Authority has been able to manage with lower than expected levels of Levy. The costs of the landfill which has been the most significant challenge over a number of years has largely ceased, as the Authority's transition to Commissioning and then to full operation of the Resource Recovery Contract (RRC) presents the biggest challenge, both operationally and financially, over the medium term.

7.6 Once the RRC is in full operation the underlying costs of the Authority will stabilise and the growth in the authority's costs as reflected in cost of the contracts taken together is below 2% per year, but to reach that point a gap between the Levy and the costs will have to be bridged.

8. Budget options

8.1 Over the last seven years the Authority has delivered initially significant Levy reductions and thereafter has maintained a broadly neutral Levy at a time when its cost base has continued to increase. This has been achieved through a combination of active contract management, re-engineering of service provision and the regular review of management and administration practices and budgets. This reflects the concern at the Authority to minimise the cost of the Levy to District Councils in a very difficult financial period.

8.2 This approach to minimising the cost of the Levy to districts will continue to underpin the Authority's financial planning in the medium term. However, this comes with a large caveat. The gap between the Authority's budgeted net expenditure and the amounts raised from Districts has been growing; while this has been subsidised from use of balances for 2015-16 and 2016-17 for 2017-18 it is estimated that the gap will be at £8.8M. The fortuitous nature of the delay in commissioning the RRC allows for that to be funded on a one off basis from Balances but the matter that needs to be dealt with is the gap between the Levy and the costs.

8.3 The prospects for 2017-18 and beyond are more difficult, reserves can only be utilised once, and when they are gone there is no more cushion available to support expenditure. In 2017-18 the gap between the Authority's likely expenditure and the current level of the income from the Levy is £8.8M. This gap will remain in 2018-19, but the level of reserves available to support the Levy that year will be minimal, meaning that a Levy rise of 11.5% will be required that year to fund the likely level of expenditure.

8.4 These are very significant demands on the Authority's remaining General Fund. While some of that demand may be met from the remaining General Fund in 2017-18 on a one off basis, it does not address the underlying difference between funding and expenditure facing the Authority in 2017-18 and beyond.

8.5 Working towards the Strategic Review has provided an opportunity for the Authority to work with the constituent District Councils to review potential savings opportunities, both from the Authority's perspective and from the perspective of the Districts in a strategic and equitable way. If those savings opportunities can be identified it may impact on the scale of future proposals for Levy increases to ensure the financial gap is closed.

8.6 In looking at future potential savings opportunities for the Authority it is important to try to ensure that simply withdrawing services currently provided by the Authority does not load additional costs onto one or more of the District Councils. For example, in Huyton there is a waste transfer station that serves parts of Knowsley and Liverpool. It would be a very simple decision for the Authority to save the costs of providing that transfer station by closing it down, the knock on effect would be that Knowsley and Liverpool Councils would have to take their waste to the Knowsley Rail Transfer Loading Station. The effect of this closure would be to increase Liverpool and Knowsley Councils'and Liverpool's costs directly as they would then need to employ additional vehicles and crew to make the additional journeys necessary to ensure the waste could be delivered for disposal.

8.7 Each time the savings from services are considered the Authority must take account of the knock on effect on both waste flows, which do not go away, and on any additional direct costs on District Councils, which do not fall in the equitable way that the Levy was designed to.

8.8 To ensure all options are considered the Chief Executive and Director of Finance have modelled a number of scenarios showing what the Authority has been asked to consider by the Leaders and Mayor as well as the initial smoother option proposed by the director of Finance.

Option 1 – Do nothing – this shows when the Authority will run out of funds if it is unable to increase the Levy (i.e. in 2018-19)

	Budget 2017/18 £M	**Budget 2018/19 £M**	**Budget 2019/20 £M**	**Balance £M**
Projected spend	74.404	75.612	76.916	
LEVY – **DO NOTHING**	65.591	65,591	65.591	
Resources gap	**8.813**	**10.021**	**11.325**	
Use of Reserves	(8.813)	(2.503)	0	
UNFUNDED balance	**0**	**7.518**	**11.325**	**18.843**

Option 2 – in line with the previous year's proposal

	Budget 2017/18 £M	Budget 2018/19 £M	Budget 2019/20 £M	Balance £M
Projected spend	74.404	75.612	76.916	
LEVY increases **4%, 5.3% & 5.6%**	68.215	71.862	75.891	
Reserve contribution	**6.189**	**3.750**	**1.070**	
Net Expenditure	0	0	0	
Remaining Reserves	**(5.127)**	**(1.377)**	**(0.307)**	**(0.307)**

Option 3 – No Levy increase in 2017/18

	Budget 2017/18 £M	Budget 2018/19 £M	Budget 2019/20 £M	Balance £M
Projected spend	74.404	75.612	76.916	
LEVY increases **0%, 11.5% & 5.2%**	65.591	73.109	76.961	
Reserve contribution	**8.813**	**2.503**	**0**	
Net Expenditure	0	0	0	
Remaining Reserves	**(2.503)**	**0**	**0**	**0**

8.9 In each case the effects of this are shown at Appendix 2.

8.10 Responding positively to the Leaders and Mayor's proposal brings the real prospect that the Authority's financial position will lead to the need for what came to be known as 'Cliff Face' increases in the Levy in 2018-19, with no reserves available to soften or cushion the impact of any unexpected increase in the Authority's costs, for example from a growth in waste. With the cliff face and no reserves the Authority will have no choice but to pass on those costs directly to the constituent councils via the levy in the next year in an un-plannable way.

8.11 If the Levy remains static for 2017-18 then the increases in subsequent years would need to be 11.5%% and 5.2% respectively as a minimum to get the Authority back into balance, before allowing for any rebuilding of the Authority's balances.

8.12 If this proposal is taken forward then implementing the outcome of the Strategic Review will become even more significant as it will provide some way of mitigating the impacts of the Levy in future years.

8.13 Members of the Authority have to consider their fiduciary duty to Merseyside as a whole in taking account of the request from Leaders and the Mayor. They may also consider the potential for savings that the Strategic Review will bring. In response to the request from the Leaders and Mayor, Members may wish to approve the Levy at the same level in 2017-18 as was approved for 2016-17. This is possible for 2017-18, as the Authority has sufficient reserves to set a balanced budget for 2017-18 with a small General Fund reserve left to support future years.

8.14 If the zero levy increase option is approved it will be on the understanding that the Strategic Review is critical to the delivery of cost mitigation for the Authority and the City Region. Members of the Authority and the City Region Leaders and Mayor understand that without savings from the Strategic Review there will be the need for a cliff edge increase of 11.5% or more in the next budget. This impact of that increase in 2018/19 is illustrated in Appendix 2 which sets out other scenarios for Members. This would also mean that the Authority has no reserves after 2018-19 and any additional costs would fall back to the District Councils, which again is clearly understood by the Leaders and Mayors group, as well as by Members of this Authority.

8.15 There may be scope for some additional savings to be identified through reviewing services and where they are provided, but that does not address the underlying issue, that by far the largest part of the Authority's costs come from the amount of waste generated, which is outside the Authority's control. Significant savings are unlikely to be achievable without a very significant drop in the amount of waste delivered for treatment. Simply withdrawing services is unlikely to have the required effect as in most cases the waste does not disappear, it will have to be treated at some point and can add significantly to the costs of each District Council in an inequitable way.

8.16 The Authority will monitor the financial position very carefully over the next year to ensure it mitigates the potential for Levy increases. This approach will be predicated upon discussions with District Council Treasurers to ensure that the levy has the least impact possible on the Councils.

9. Capital costs

9.1 The Authority has not proposed a significant capital programme for 2017-18 as the outcome of the Strategic Review may require revisions to the asset planning of the Authority. The way that “capital works” which were formerly charged to capital and then ‘impaired’ has been reviewed and amended. These works added little to the life or value of the assets, so going forward they have been re-designated and will no longer be treated as capital, and so will no longer be impaired. The impairment budget has been transferred to support the revenue funding required to continue to carry out these repairs, without them being treated as ‘capital works going forward.

9.2 The future programme in 2017-18 reflects the diminished financial resources available to the Authority as well as the requirement to complete a strategic review before any further expenditure is approved. The programme includes only basic maintenance and does not allow for any new developments as none are planned at this stage. Should the strategic review identify any further developments that may be required Members’ views and authority to proceed will be sought at that stage.

9.3 One of the consequential impacts of not developing a detailed capital programme at this stage is that the remaining ‘capital fund’ which was created from surplus revenue balances, may be returned to the General Fund to support the planned Levy proposals for 2017-18 and beyond.

9.4 Although there is no significant capital programme at this stage, Members are requested to be mindful of the need to continue to review the Estate, to consider whether it remains Fit for Purpose and meets all the Health and safety requirements we are required to meet. A survey of key parts of the Estate is under way to establish whether there are any significant issues. Should any significant issues be identified then there is a prospect that officers will have to return to Members setting out the issues and seeking permission for a Capital Programme development to be considered in future, that capital programme would have to be funded through the Prudential Borrowing framework as internal funds are no longer available.

10. Budget 2017-18

10.1 The Authority is asked to set a revenue budget of £74,404,967.

11. Levy 2017-18

11.1 The Levy for 2017-18 proposals is as follows:

- a 0% increase – setting the Levy at £65,591,099

11.2 Once again for 2017-18 the Levy is supported by a significant 'cushioning' contribution from General Fund balances: (£8.813M).

11.3 Members are recommended to accept the 0% increase option at this stage, although this must be accompanied by an acceptance by Members and from the City Region that in all likelihood there will be a cliff face increase for 2018-19 as the outcome of the Strategic Review may not have been fully implemented. The Levy "cliff face" will be at 11.5%, and Members will need to also accept that the overall Levy, expenditure, and reserves will need to be equalised properly in future years.

REVENUE BUDGET 2017-18

1. Introduction

1.1 The Authority is required by statute to set its Levy for 2017-18 by 15th February 2017. In so doing, it needs to consider the financial effects of all factors which impact on the Authority, its Budget, the Levy and the consequential effects on the District Councils on Merseyside. These factors are summarised in the Executive Summary to this report.

1.2 The Authority's Levy calculation is based on its budget estimates and the Local Government Act 2003 which imposes a requirement (under section 25) that:

- 'The Chief Finance officer of the Authority must report to the Authority on the following matters:

    a) the robustness of the estimates made for the purposes of the calculation; and

    b) the adequacy of the proposed financial reserves.'

1.3 The adequacy of the Authority's reserves are considered in paragraphs 3.1 to 3.6 of this part of the report.

1.4 The General Fund is available to support the Authority's budget over the medium term. The Authority must maintain a reserve to provide security against unforeseen events. Under the budget proposal for 2017-18 and beyond the Authority will have to consider the level of General Fund it is able to maintain in the face of significant pressure on the Levy, savings and transferring funds remaining in the Capital Fund (an earmarked reserve) to supplement the General Fund.

1.5 The budget proposals, as requested by the City Region Leaders and Mayor, reflect cushioning by the Authority of the impact of the budget on the Levy, and therefore on District Councils. This cushioning is possible for one year through the use of the General Fund. The risk of this approach is that after next year of the medium term plan there remains a large gap between the Authority's budget and the Levy.

1.6 Members are being asked to consider this issue in this budget round. The Authority must be prepared to continue to work hard to strip costs out of the budgets where possible; recognising that as most of the Authority's costs are tonnage related a large part of this cost reduction can only be achieved if District Councils reduce the tonnages they provide for the Authority to dispose of. The Authority is also likely to have to consider whether levy rises in this budget round and in the future will enable the Levy income to catch up with the Authority's budgeted costs. Without taking steps to equalise the Levy and expenditure in this budget and forward in the medium term there is a very real prospect, regardless of savings, of a cliff edge Levy next year.

1.7 The capital reserve was created from Revenue funds to contribute towards the costs of capital schemes offsetting the costs of borrowing. It will not be required to support a Capital programme for 2017-18 onwards. At this stage there is no significant capital programme development as the outcome of the strategic review in not known and may not require further infrastructure development. Any future capital programme requirement will be funded through the prudential borrowing framework.

1.8 The robustness of the Authority's budget for 2017-18 is considered against a table of components with the Authority's position identified against them.

COMPONENT	COMMENTS
Availability of reliable information	The budget is based on realistic assumptions of pay, price and contract increases and tonnage throughputs to recycling or landfill. This is coupled with an assessment of the major financial risks and how they are to be managed.
Guidance and strategy	The Authority's Financial Procedural Rules cover the management of its budget. The Budget timetable is well communicated and the Strategy is clearly outlined
Corporate approach and integration	Section managers identify budget pressures and risks at an early stage in the process, particularly the financial effects of landfill taxation, changes to waste management contracts and processes as well as litigation risks.
Flexibility	Flexibility in budget management is built into the Authority's Constitution.
Monitoring	The Authority operates a quarterly published monitoring regime, whilst monthly monitoring is undertaken by Section Managers and the Business Support Manager.

1.9 Based on the above arrangements, it is reasonable to consider that the Authority has a robust budget process.

2. Revised Budget 2016-17

2.1 Budget managers work with the Business Support Manager to review and monitor their budgets on a monthly basis identifying trends and any areas of potential under or overspending so that remedial action can be taken where that is necessary. The Authority formally monitors its overall revenue and capital budgets on a quarterly basis through the quarterly performance report and uses this to monitor the position at the end of the third quarter of the year to predict the outturn for the year in a Revised Budget which Members are asked to approve.

2.2 The Revised Revenue Budget for 2016-17 is shown at Appendix 1, in column 2 of the respective pages and details a total cost of £71,981,645 (net of contributions for additional costs) which is a decrease of £3,510,699 from the Original Revenue Budget for 2016-17 (Column 1 of the respective pages of Appendix 1) which totalled £65,591,099. This decrease has allowed the Treasurer to propose making the following additional adjustments to balances and reserves.

	£000
General Fund – reduced contribution from the Fund to support revenue	3,511

2.3 The initial balance on the General Fund is forecast to be at £8.886M at 31 March 2017.

2.4 The Capital fund will be added to the General Fund making a total General Fund of £11.316M at the year end. These are the total resources available to the Authority

2.5 The main areas for saving (-) or increased cost (+) in the Revised Revenue Budget for 2016-17 are as follows:

	£000
Establishment – reduction of £47k in employee costs accompanied by small savings across the budgets; offset by an increase in the cost of supplies.	-42
Contracts – savings arising from the delays in Commissioning of the RRC contract which have meant that full contract prices have not been passed on as quickly as expected and temporary alternative arrangements have resulted in lower costs. The RRC underspend of (£19.9M) is offset by Landfilling cost which have continued for longer than expected, resulting in higher	-2,797

contract and landfill tax costs than had been anticipated (£16.7M). An additional interim contract (£636k) for dealing with waste on a temporary basis has added to the costs. Estimates of additional trade waste income have offset some of the increase (£406k)	
Closed landfill – additional costs of EMS as applied to the wider waste contracts	+3
Rents, rates, depreciation – reduction in impairment charged as a result of changes to the way minor works are funded (£100k) offset by small increase in depreciation (£14k)	--86
Recycling credit payments – lower than expected for most District Councils (Liverpool -£67k, Wirral +£34k, Sefton -£633k, Knowsley -£19k, St Helens -£23k)	-707
Strategy & resources – lower spend on strategy update than expected in year	-11
City Region Strategic Review – unplanned additional cost – offset by GF contribution	+/-250
Interest – increase in net cost of interest	+143
Capital Adjustment account – technical accounting adjustment to reflect change in depreciation above	-14
TOTAL NET DECREASE	-3,511

3. Proposed Budget 2017-18

3.1 The proposed budget for 2017-18 is shown at Appendix 1, in Column 3 of the respective pages, and details a total cost of service of £74,403,966 (before the proposed General Fund contribution of £8,813,867) which is as a result of changes to contracts.

3.2 The main reasons for changes to the budget are as follows:

	£000
Establishment – employee costs are increased which is largely a result of an increase in pension contributions required (+£143k) and premises costs (+£30k) as a rent review has been taken into account. The cost of supplies and services has increased (+£11k) which is offset by savings on transport costs, other costs are stable	+164
Contracts – the overall cost of contracts is reduced compared with the estimated cost at the start of 2016-17. There is estimated to be a reduction in Landfill Tax and other contract costs (-£3.076k), offset by an increase in estimated RRC costs (+£3,128k), there is expected to be an increase in income from trade waste (-£394k).	-342
Closed landfill sites – minor operational savings offset a transfer from 'impairments' into the maintenance programme (+£61) and EMS compliance for contracts (+£5k)	+57
Rents, rates & depreciation – transfer of impairments budget (£100k) and a significant reduction in NNDR (-£207k), offset by small increase in depreciation (+£14k)	-293
Recycling credits – a decrease in demand for recycling credits from some District Councils (Liverpool -£35k, Wirral	-818

+£59k, Sefton -£851k, Knowsley -£5k, St Helens +£16k)	
Strategy and resources – increase in estimates cost of strategy update (+£25k) offset by reductions in the waste prevention programme (-£20k) and the re-use scheme (-£7k)	-2
Interest – reduction in interest receivable (£90k) as a result of falling levels of reserves and balances; added to an increase in interest costs (+£76k)	+166
Capital adjustment account – technical accounting adjustment	-9
Total	-1,077

3.3 The proposed Revenue Budget for 2017-18 has been prepared on the basis of the following assumptions:

- No inflation unless contractually unavoidable
- 1% pay inflation increase – as agreed through national pay bargaining
- That contingency sums are minimal

In addition each of the budgets has been reviewed in detail by budget managers and savings have been identified which have contributed to ensuring the budget is kept to a minimum.

3.4 The Authority's Balances are shown on the second page of Appendix 1 with the various amounts anticipated to be held at 31 March 2017 as follows:

	£M
General reserve	11.326
Capital reserve	0

3.5 The General Fund reserve has been applied for the following purposes in 2016-17:

- Unplanned support for the City Region strategic review £250k
- Support for MRWA review of assets £100k
- Support for Revenue expenditure (Levy support) £6,390k

3.6 The level of General Reserve has been reviewed as part of the medium term financial strategy. Taking into account the current headline levels of contribution towards a neutral Levy for 2017-18, and looking ahead into the following two years it is expected that by the end of 2018-19 the General Fund will be diminished to a level will be regarded as inadequate unless a combination of savings and significant levy increases is approved.

3.7 While the planned balances for 2017-18 remain at reasonable levels in the scenarios considered earlier in this report, albeit at the lower end of prudent; the prospects of holding any balances after 2018-19 and into 2019-20 are less uncertain and the Authority's financial position on those years is likely to become much more precarious.

3.8 If the City Region Mayor and Leaders proposals for the Levy for 2017-18 are approved the Authority will be left with £2.515M of balances at the end of 2017-18. The effect of this is that any subsequent use of those remaining balances will extinguish them (regardless of the prospect of an 11.5% Levy increase being required in 2018-19). The Authority will not be able to rely on any reserves remaining to insure itself against unexpected events and actions, including a growth in waste arisings. The financial impact of any such growth would then only have a single recourse; the additional costs would be passed on to the District Councils, in an unplanned and un-cushioned way in the next Levy. This prospect does not appear to be prudent and has little to recommend it., but is currently the action the Authority is being asked to consider.

Risks

Risk	Potential impact	Risk category
Facility fully operation - delays	Additional delays, likely to lead to increased landfill and interim contract costs. If this happens the General Fund remaining balances may need to be utilised to subsidise any additional costs.	Medium

4. Capital programme

4.1 The Authority's Capital programme is in abeyance for 2017-18 as the outcome of any work to implement the Strategic Review is unknown at this stage. There will be a medium term need to review the fitness for purpose of the Authority's Estate, and this may lead to capital programme requirements being brought forward for Members to consider at a future date. In the meantime the Capital Fund (which was an earmarked revenue fund) has been transferred into the General Fund, to provide additional revenue support for the Levy.

4.2 Any capital programme spending requirements in the future will need to be funded from an extension of the Authority's Prudential Borrowing. The impact of the existing prudential borrowing is set out in an annex to the Treasury Management Strategy Statement 2017/2018 elsewhere on this agenda.

5. The Levy

5.1 The Authority is required under section 74 of the Local Government Finance Act 1988, as amended, to issue its Levy demands upon the District Councils of Merseyside before 15 February each year.

5.2 The Levy is made by the issue of demands stating the dates on which instalment payments are to be made and the amount of each instalment. For the purpose of standardisation it is recommended that the Levy be paid by way of ten equal instalments on the following dates, in line with the Levying Bodies (General) Regulations 1992 payment schedules:

20 April 2017	19 October 2017
26 May 2017	23 November 2017
6 July 2017	4 January 2018
10 August 2017	11 February 2018
14 September 2017	15 March 2018

5.3 The Levy proposals are shown in the tables below.

Under the existing Mechanism with a zero increase

5.4 Members will recall that the levy apportionment methodology is based in the ‘polluter pays’ principle which means that tonnage based costs are based on the last full financial year’s tonnages (subsequently adjusted to actual in the year), and the balance of costs is apportioned on estimated population. For each of the constituent Districts there are changes in the levy demand, as calculated through the levy apportionment methodology.

5.5 This was the proposal eventually requested by the City Region Leaders and Mayor, this leaves the prospect of an overall 11.5% increase (at least) in the Levy for 2018-19.

2017/18 LEVY SET AT ZERO INCREASE WITH CURRENT MECHANISM VS 2016/17

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	2016/17 Levy	Levy Mechanism 2017/18	Increase/ Decrease (-)	% Increase/ Decrease
Knowsley	7,215,060	7,124,039	-91,021	-1.26
Liverpool	22,783,091	22,771,726	-11,365	-0.05
St Helens	7,359,243	7,660,761	301,518	4.10
Sefton	12,831,863	12,661,305	-170,558	-1.33
Wirral	15,401,842	15,373,268	-28,574	-0.19
	65,591,099	65,591,099	0	0.00

5.6 The proposal below would start to close the gap between the Levy and the Costs of the Authority in a more moderate way.

An overall 4% increase in the levy

4% INCREASE IN LEVY FOR 2017/18 COMPARED TO 2016/17 LEVY

	2016/17 Levy	Levy 2017/18 at 4% Total Increase	Increase/ Decrease (-)	% Increase/ Decrease
Knowsley	7,215,060	7,400,340	185,280	2.57
Liverpool	22,783,091	23,669,851	886,760	3.89
St Helens	7,359,243	7,994,075	634,832	8.63
Sefton	12,831,863	13,174,958	343,095	2.67
Wirral	15,401,842	15,975,483	573,641	3.72
	65,591,099	68,214,707	2,623,608	4.00

6. Risk Implications

6.1 The Authority's budgeted costs continue to increase as the vast majority are waste tonnage related, and there is no reduction in the tonnes the Authority is required to process. At a time when the financial pressure on constituent District Councils is severe, it is incumbent upon the Authority to mitigate the impact of the Levy as much as possible. For 2017-18 it is just about possible to utilise the Authority's reserves to mitigate the impact of the Levy.

6.2 However, in the longer term there will remain a budget gap that requires closing, probably through a combination of cost reduction where possible, prudent use of reserves and in all likelihood significant increases in the Levy going forward. If the option to freeze the Levy is taken then this risk is increased significantly and the need for a very drastic Levy increase in the next two years will become a reality.

6.3 In planning for savings the Authority will also take a risk, particularly where savings proposals involve reducing or removing services, and especially if those are services based in HWRCs that the full impact of savings may not be achieved in the year. This could be a particular risk where service reductions require consultation to take place and will depend to some extent upon the outcome of that consultation.

7. HR Implications

7.1 There are no HR implications in this report

8. Environmental Implications

8.1 There are no new environmental implications arising from this report, although it does cover the period when the Authority makes the transition from Landfill to the new Resource Recovery Contract.

9. Financial Implications

9.1 The financial implications run throughout this report.

10. Legal Implications

10.1 The Authority is setting a budget for 2017-18 which ensures there is sufficient income and resource to cover budgeted expenditure for that year, which it is required to do. Looking into the future decisions about how that will continue to be achieved will need to be made.

11. Conclusion

11.1 The Authority is required to establish and approve a budget for 2017-18 and to set a Levy for the same period that it applies to the constituent District Councils. The report and its appendices and recommendations enable Members to consider and approve the proposed budget and Levy.

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The background documents to this report are open to inspection in accordance with Section 100D of The Local Government Act 1972 - Nil.