

ITEM NUMBER: 18.1

CONFIDENTIAL REPORT

MATERIALS RECOVERY FACILITY (MRF)

Pursuant to Section 83(5) of the Local Government Act 1999 the Report attached to this agenda and the accompanying documentation is delivered to the Council Members upon the basis that the Council consider the Report and the documents in confidence under Part 3 of the Act, specifically on the basis that Council will receive, discuss or consider:

- d. commercial information of a confidential nature (not being a trade secret) the disclosure of which could reasonably be expected to prejudice the commercial position of the person who supplied the information, or to confer a commercial advantage on a third party; and would, on balance, be contrary to the public interest.**

Recommendation – Exclusion of the Public – Section 90(3) (d) Order

1. That pursuant to Section 90(2) of the *Local Government Act 1999* Council hereby orders that the public be excluded from attendance at this meeting with the exception of the Chief Executive Officer and Staff in attendance at the meeting in order to consider Report No: 459/19 Material Recovery Facility in confidence.
2. That in accordance with Section 90(3) of the *Local Government Act 1999* Council is satisfied that it is necessary that the public be excluded to consider the information contained in Report No: 459/19 Material Recovery Facility on the following grounds:
 - d. pursuant to section 90(3)(d) of the Act, the information to be received, discussed or considered in relation to this Agenda Item is commercial information of a confidential nature (not being a trade secret) the disclosure of which could reasonably be expected to confer a commercial advantage on a third party.

In addition, the disclosure of this information would, on balance, be contrary to the public interest. The public interest in public access to the meeting has been balanced against the public interest in the continued non-disclosure of the information. The benefit to the public at large resulting from withholding the information outweighs the benefit to it of disclosure of the information.
3. The Council is satisfied, the principle that the meeting be conducted in a place open to the public, has been outweighed by the need to keep the information or discussion confidential.

Item No: **18.1**

Subject: **MATERIALS RECOVERY FACILITY (MRF) (Report No: 459/19)**

Date: 10th December 2019

Written By: Chief Executive Officer

CEO: Mr R. Bria

SUMMARY

This report seeks approval from Council for the Southern Region Waste Resource Authority (SRWRA) to incur expenditure and borrowings to design, build and operate a Materials Recovery Facility (MRF) at its resource recovery and landfill site located at 112 Bakewell Drive, Seaford Heights, to manage the municipal commingled domestic recyclables from SRWRA's constituent councils and its customer councils/waste authorities.

This report is the culmination of approximately nine months investigation into the MRF project by SRWRA and its Board. Relevant experts have been employed over the nine months to develop and refine the business case over that time.

The SRWRA Board at a special Board Meeting held on 2 December 2019 resolved to proceed with the construction of a Material Recovery Facility subject to the subsidiary councils approving the budget variation required and the commitment of their Comingled recycling being processed through the proposed MRF. Each constituent Councils will consider the proposal at their respective 10 December 2019 meeting.

The MRF report and the prudential report were considered by the Audit Committee on 4 December 2019 as part of the prudent financial governance process before it is presented to Council. The Audit Committee resolved the following:

"That the Audit Committee note the Materials Recovery Facility (MRF) Report and the MRF Prudential Report prepared for SRWRA by UHY Haines Norton and support its presentation to Council for their consideration and adoption."

RECOMMENDATION

That council:

- 1. receive the Materials Recovery Facility Prudential Report prepared for the SRWRA by UHY Haines Norton (attachment 2).**

2. **approve the SRWRA request to borrow up to \$8.0 million from the Local Government Finance Authority if the SRWRA Board consider it necessary and prudent to do so.**
3. **note that the level of borrowings noted in resolution 2 will be reduced through the SRWRA continuing to seek**
 - a. **Further State and Federal funding**
 - b. **Additional Council or Waste authority customers**
 - c. **Opportunities to partner with private enterprises for capital investment and / or operation of the MRF**
4. **approve the SRWRA incurring capital expenditure of up to \$17.523 million (including 10% contingency) for the building and implementing of a Materials Recovery Facility.**
5. **resolve to commit all commingled domestic recyclables to be processed at the SRWRA MRF.**
6. **note that the gate fee for SRWRA to receive and process Council's commingled domestic recyclables is modelled at [REDACTED] and will be subject to contract clauses relating to:**
 - d. **contamination rates of recyclables**
 - e. **commodity market rise and fall**

RETAIN IN CONFIDENCE - Section 91(7) Order

That Council:

1. **having considered Report No: 459/19 Material Recovery Facility in confidence under section 90(2) and (3)(d) of the *Local Government Act 1999*, the Council, pursuant to section 91(7) of that Act orders that the Report, Attachments and Minutes be retained in confidence for a period of 24 months and that this order be reviewed every 12 months.**

COMMUNITY PLAN

Environment: Building an environmentally resilient city

Environment: Using resource efficiently

Environment: Fostering an environmentally connected community

Culture: Being financially accountable

Culture: Supporting excellent, efficient operations

COUNCIL POLICY

Prudential Management Policy

STATUTORY PROVISIONS

Section 48 of the Local Government Act

BACKGROUND

SRWRA is a Regional Subsidiary established in 1998 under Section 43 of the Local Government Act, 1999 by the Onkaparinga, Marion and Holdfast Bay Councils (constituent councils). In accordance with its Charter, SRWRA is responsible for providing and operating waste management services on behalf of the constituent councils, including developing or facilitating activities or enterprises that result in a beneficial use of waste.

SRWRA's resource recovery and landfill site located at Seaford Heights is one of the State's major landfill operations, receiving more than 100,000 tonnes of waste per annum. SRWRA's current catchment extends from Holdfast Bay through the Fleurieu Peninsula and Kangaroo Island, representing an estimated 388,644 people.

The constituent councils currently generate around 90,000 tonnes of waste per annum of which approximately 26,100 tonnes are commingled domestic recyclables.

The proposal is for SRWRA to design, build and operate a 31,100 tonne per annum MRF at its resource recovery and landfill site located at 112 Bakewell Drive, Seaford Heights, to manage the municipal commingled domestic recyclables from SRWRA's constituent councils and its customer councils/waste authorities.

The proposed MRF is a key initiative in SRWRA's Strategic Plan 2019-2026. The Business Case for the proposed MRF was approved by the SRWRA Board at its meeting on 4 February 2019 and was included in its 2019/20 Annual Business Plan and Budget as presented to the constituent councils and adopted by the SRWRA Board on 3 June 2019.

In accordance with clause 1.7.1 of the SRWRA Charter, the Authority has the power to incur expenditure and/or to borrow money in accordance with the approved budget of the Authority. The approved 2019/20 budget includes expenditure of \$7.58 million for the proposed MRF and income from grant funding of \$3.75 million.

Therefore, in accordance with clause 1.7.1(d) of the SRWRA Charter, as the estimated capital expenditure of the MRF Project is \$17.523 million and will require SRWRA to borrow up to \$8.0 million, before SRWRA proceeds with the MRF Project it requires a formal resolution from all the constituent councils approving the expenditure and borrowings.

REPORT

In response to the structural changes in the global recycling markets, the SRWRA constituent councils identified a strategic need to ensure the long-term security, certainty and control over their kerbside recyclables and in accordance with the objects and purposes of the SRWRA Charter requested the Authority to investigate solutions.

Market Analysis

Industry Information

In 2017 China enacted the so-called 'China National Sword Policy' which effectively closed the market for kerbside recyclable materials by banning 24 import materials and applying a stringent contamination threshold on imported product.

The closure of the Chinese market and the subsequent tightening of controls by other countries importing kerbside recyclable materials has resulted in a collapse in the sale value of these low quality kerbside recovered materials on global markets.

Australia is set to ban the export of its recycling to other countries from as early as July 2020. The ban will apply to all waste that isn't being turned into a valuable material overseas. Glass will be the first product to stay onshore, beginning from July next year. Mixed plastics will be banned one year later and tyres by December 2021. The rest including paper and cardboard will no longer be sent overseas by the end of June 2022.

As a result, South Australian councils and national recycled commodity markets are caught up in a structural rather than cyclical shift in the international markets for low quality kerbside recyclables.

The increase in the cost for SRWRA's constituent councils alone to manage their domestic recyclables as a result of this structural change in global markets is estimated at \$2.44 million per annum. This cost to Constituent Councils is anticipated to increase as commercial MRFs continue to increase their gate fees in response to market conditions.

In the City of Holdfast Bay our recycling processing costs have gone from a net -\$10 per tonne to \$60 per tonne, since the China Sword issue. We have been notified that this is increasing to \$80 per tonne. This is a net increase of \$90 per tonne over the last 12-18 months. Having an impact of approximately \$360k per annum.

The Future – Market Risks, Opportunities and Activities

SRWRA considers that the current challenges with the kerbside recycling markets are a subset of a megatrend of growing environmental problems internationally, which can be framed and managed using a circular economy and materials flow mindset. Accordingly, an underlying objective of SRWRA's is to apply a circular economy lens to kerbside recycling markets.

In the meantime, there are many potential improvements that need to occur to kerbside recycling markets and systems:

- packaging design and community education;
- improvement in processes to generate less mixed paper and plastics;
- better collection and sorting infrastructure to produce higher quality sorted recyclable materials; and
- development of Australian re-manufacturing capacity and end-markets for clean material.

In response to the structural changes in the global recycling markets, the constituent councils identified a strategic need to ensure the long term security, certainty and control over their kerbside recyclables and in accordance with the objects and purposes of the SRWRA Charter requested the Authority to investigate solutions.

MRF Project

The proposed MRF is a key initiative in SRWRA's Strategic Plan 2019-2026. The original business case for the proposed MRF was approved by the SRWRA Board at its meeting on 4 February 2019 and was included in its 2019/20 Annual Business Plan and Budget as presented to the constituent councils and adopted by the SRWRA Board on 3 June 2019.

Key benefits

The key benefits for SRWRA in undertaking the MRF Project are:

- Provides SRWRA's constituent councils and its customer councils/waste authorities with long term certainty and control over the management of their municipal commingled domestic recyclable waste in response to the structural shift in global recyclable markets resulting from the China National Sword Policy;
- Provides SRWRA's constituent councils and its customer councils/waste authorities with a cost effective, environmentally responsible waste management solution to their municipal commingled domestic recyclable waste;
- Manages stakeholder and community expectations to efficiently, effectively and socially responsibly deal with their waste;
- It responds to the need for a MRF to service the southern metropolitan and peri-urban areas as identified in SA's Waste and Resource Recovery Infrastructure Plan (February 2018);
- It achieves one of the three objectives of the SA Waste Strategy 2015-2020 to ensure a resource efficient economy where the best or full value is secured from products and materials produced, consumed and recovered across the State;

- SRWRA will own all the assets which will be a source of revenue for future capital expenditure;
- It will create up to 20 FTE permanent jobs; and
- The operation of the MRF creates the opportunity to stimulate the local circular economy through the creation of new industry to re-use, re-purpose and recycle the recovered resources. New industry translates to new local jobs and greater economic prosperity for the community.

Volumes of recyclables

The expected product streams to be recovered by the MRF based on the latest kerbside bin audits of the constituent councils kerbside recyclables is outlined in the table below.

Recyclable commodity	% Revenue	Output % (tonnes)	Output (tonnes)
Cardboard – Local			
Newspaper & catalogues			
Mixed paper			
Glass			
Steel			
Aluminium			
HDPE clear			
HDPE coloured & polyprop			
PET clear			
CDL			
Landfill			
Total	100%	100%	31,100

Procurement

Procurement of the MRF plant and equipment and MRF building has been undertaken as separate design and construct tenders in accordance with SRWRA's Procurement Policy.

Regulatory Environment

Local Government Act

The SRWRA Board, at its special meeting on Monday 2 December 2019, considered an updated Prudential Report on the MRF Project prepared by Haines Norton as required by S48 (7) of the Local Government Act (i.e. the provisions of S48 of the LG Act requiring a council to consider a prudential report extend to subsidiaries as if a subsidiary were a council).

Refer Attachment 2

Development Approval

The proposed MRF received Development Plan Consent (DPC) from the City of Onkaparinga on 4 June 2019. A variation to the DPC was granted on 21 November 2019 to relocate the building to an alternate location within SRWRA's licensed area due to engineering advice on required footings.

Environment Protection Authority (EPA)

SRWRA has Environmental Authorisation under Part 6 of the Environment Protection Act 1993 for a 'Waste or Recycling Depot'. Under the terms of its Licence, SRWRA must not carry out any activity without the written approval of the EPA. Accordingly, SRWRA has submitted a Section 54C application seeking formal approval from the EPA for the proposed MRF.

SRWRA Charter

In accordance with clause 1.7.1 of the SRWRA Charter, the Authority has the power to incur expenditure and/or to borrow money in accordance with the approved budget of the Authority. The approved 2019/20 budget includes expenditure of \$7.58 million for the proposed MRF and income from grant funding of \$3.75 million. Therefore, in accordance with clause 1.7.1(d) of the SRWRA Charter, as the estimated capital expenditure of the MRF Project is \$15.93 million and will require SRWRA to borrow up to \$8.0 million, before SRWRA proceeds with the MRF Project it requires a formal resolution from all the constituent councils approving the expenditure and borrowings.

Project timeframe

It is estimated that the Project will take 15 months to deliver from the date of approval by the constituent councils. Therefore, contingent on the constituent councils approving the Project at their meetings on 10 December 2019 the MRF will be operational by April 2021.

Key risks

A detailed risk assessment of the MRF Project has been undertaken which was independently verified as part of the Prudential Review. A summary of the key risks for the constituent councils in engaging SRWRA to provide or not provide the MRF service to them.

Refer Attachment 1.

Finance

Financial Overview

The total initial capital cost of the MRF is estimated to be \$15.930 million (\$10.630M for the plant and equipment and \$5.3M for the building).

Revenue is driven by commodity markets for recovered materials and accounts for approximately [REDACTED] of revenue. Revenue from gate fees paid by the constituent councils and customer councils/waste authorities for processing the materials is approximately [REDACTED].

The required borrowings of \$8.0 million would be obtained by SRWRA from the Local Government Finance Authority (LGFA) and are based on a 10 year variable interest loan at 2.7%.

The financial modelling undertaken suggests that SRWRA tonnages alone are not sufficient to justify the investment in a facility when compared to the current market rates for recycling. To ensure that the MRF can operate on a sustainable basis, the model requires approximately 31,100 tpa of commingled recyclables or at least \$2.5M of government funding.

The South Australian State Government has indicated that they would be prepared to provide \$2.5 million towards the MRF for state of the art technology and representations are currently being made to the Federal Government.

With these economies of scale, current market rates of [REDACTED] to process recyclables, current commodity prices and without government funding the earnings rate before interest and tax is estimated at [REDACTED]. This provides SRWRA a return on investment marginally higher than they are achieving by having cash in the bank (SRWRA LTFP rate is [REDACTED]).

A summary of SRWRA’s financials for the MRF Project over a 15 year period is provided in the table below.

Tonnes per annum	31,100
Capex	[REDACTED]
Borrowings	[REDACTED]
Revenue	[REDACTED]
EBIT	[REDACTED]
EBIT %	[REDACTED]
ROI	[REDACTED]
Cashflow payback (years)	[REDACTED]

The volume of recyclables not able to be recycled and disposed to landfill (estimated at [REDACTED]) provides an additional income stream for SRWRA.

	Year One	Total
Revenue		
Operating expenses		
Gross Profit		

Contract terms

For the MRF to be viable the commingled domestic recyclables collections from the constituent councils will need to be redirected to the new facility for a minimum of 10 years to justify the initial investment in capital.

The constituent councils will require some certainty of pricing. However, given the heavy reliance on commodity markets, there will need to be an agreement to provide a certain amount of variability of gate fees over the long term in order to adjust both positively and negatively to the variability of the current commodity markets.

Approximately [REDACTED] of expenditure of the MRF is for the disposal to landfill of material that is not able to be recycled. To maximise the reuse of the waste and minimise the amount disposed to landfill there will also need to be an agreement on contamination rates within the commingled domestic recyclables collections from each of the constituent councils.

BUDGET

The budget for this project will be fully funded through SRWRA and will have no direct impact to the Council budget except for any equity movements that may occur as a result of the project.

Waste processing costs to Council may be effected by the implementation of the MRF, due to commodity price differences in the market. This would also be the case if Council were using an external MRF provider that had commodity price rise and fall clauses.

LIFE CYCLE COSTS

The lifecycle cost of the MRF will be absorbed within the SRWRA operation.

Attachment 1



Key risks of SRWRA providing/not providing the MRF service to the constituent councils

SRWRA providing the MRF for the constituent councils	SRWRA not providing the MRF for the constituent councils
Capital expenditure is greater than the estimates in the financial model affecting the return on investment	Inability for constituent councils to manage their kerbside recyclables due to the oligopoly market in South Australia (i.e. few providers in the market with limited and potentially finite capacity to process kerbside recyclables)
Inability to obtain the level of funding required to achieve desired return on investment	Constituent councils will be more likely to be at the mercy of predatory pricing from the small number of providers of kerbside recycling
Constituent councils carry the risk of commodity market prices which will be reflected in the gate fees	Constituent councils not able to future proof themselves from the structural shift in global recycling markets
SRWRA has limited operational expertise in managing a MRF including exposure to commodity trading which impacts profitability of the MRF	Relatively high cost of transporting the waste fraction to landfill
Reduction in SRWRA cash reserves results in lower interest income which impacts gate fees for constituent councils	Constituent councils subject to almost impossible to achieve contamination rate contract clauses with significant penalties
Ability to recover CDL as a result of change in legislation, change in waste streams or inability to recover through processing impacts financial sustainability (as CDL revenue is estimated at \$19.672M or 35% of commodity revenue)	Rise and fall contract clauses that impact on the constituent councils ability to present budgets with certainty