The London Waste and Recycling Board

Investment Framework 2015-2020

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Introduction

The Investment Framework has been developed following discussions with LWARB's Investment Committee and Board members, industry, London boroughs and GLA. A new programme of investment has been developed that proposes a number of investment methods. Partnerships are key to the successful delivery of all these investment methods. In particular partnerships will deliver equity and venture capital investments.

This Investment Framework will allow LWARB to continue to deliver new infrastructure projects, through project finance and a new equity investment vehicle. It will also support existing businesses to expand and improve their operations through corporate investments. New infrastructure developments will also be helped through the offer of secure development loans and, for early stage businesses, LWARB will look to create a venture capital fund with industry partners.

The forecasted budget available for the infrastructure programme for the period 2015-2020 is £20 million. The actual available budget will depend upon the performance of existing and new LWARB's investments and so the Investment Framework is intended to be flexible, both in terms of capital available for investment and market demand for investment. Capital amounts allocated to investment methods in this Investment Framework are therefore intended to be indicative, and will flex according to available budget and uptake.

Section 1: Market Outlook

Capacity Analysis

The GLA have commissioned SLR to undertake an analysis of London's waste management capacity and provide an estimate of any capacity gaps. This analysis takes into account the targets set by the London Plan to achieve waste self-sufficiency (Policy 5.16) and will be subject to further work to check that the understanding of existing capacity is accurate. The analysis estimates a large demand for recyclate bulking and material recovery facilities with an annual requirement for c.1 million tonnes of new capacity by 2031. These estimates are based upon achieving recycling rates of 60% for Local Authority Collected Waste (LACW) and 70% for commercial waste (there is projected to be very little industrial waste arising) by 2031.A smaller gap exists in organic waste treatment, c.0.6 million tonnes per year, and just 0.3 million tonnes estimated for additional residual capacity by 2031.

The European Commission, in their Communication, "Towards a circular economy: A zero waste programme for Europe", has proposed that 70% of municipal waste is reused or recycled by 2030. If this target is enshrined in legislation London will need further additional recyclate sorting and bulking capacity, as well as organic waste capacity. Considering the needs of a more circular economy, significant new reuse and remanufacturing infrastructure will also be required.

The Mayor of London's Infrastructure Plan identifies the need for an additional 40 new waste facilities by 2050, as well as replacing existing facilities as they reach the end of their life. Construction, Demolition and Excavation (CDE) waste is also expected to increase, and therefore the number of waste facilities needed to treat this waste, as London's builds the transport, housing and green infrastructure that is needed to accommodate population growth. CDE waste capacity will have to be considered when developing the new London Plan, planned for 2016.

Market Analysis

LWARB has consulted with industry stakeholders to discuss the barriers to waste infrastructure development in the capital and the products that LWARB could deploy to alleviate those barriers.

Barriers to Development in London:
Discussions with industry revealed that barriers to infrastructure development are considered to be:

- Land prices. Land is cheaper on the periphery of London;
- Perceptions around planning risk – there was a view that London is a complex place to do business;
- Export of waste. The availability of incineration capacity in Europe and the UK, usually at marginal gate fees, has the potential to stymie development of thermal treatment and other treatment plants. There was no consensus on the future availability of European capacity. there was however acknowledgement that if waste arising rise in Europe, local waste will displace UK waste.

Opportunities
The market view is that investment opportunities for LWARB fall into four key areas:

Development loans: The provision of secured development loans is regarded as having the potential to unblock some barriers to investment and development of projects. An advertised offer may well bring projects forward at an accelerated timescale. Secured development loans offer developers an alternative debt route, and provide LWARB with a good return on investment.

Early Stage Investments: These would be typically small scale investments, each have a relatively high risk. The market appetite for this type of investment needs to be tested. There could be an opportunity to leverage private sector funds to create a waste focused externally managed venture capital fund. LWARB will engage with waste companies and others to explore the opportunity for matched funding in this area

Expansion Opportunities – corporate debt and asset finance: There is a market view that the new regulations aimed at MRF operators and the new Waste Regulations (with the requirements to produce high quality recycling) will require operators to introduce new separation technology in order to comply with and continue to service existing contracts. Similarly, MRF operators will require London boroughs and commercial trade waste collectors to deliver high quality materials. London has a myriad of small to medium sized (SME) waste operators and these may be interested in corporate finance to assist with expansion where it is not available from the market. Market finance may not be available because of the continued difficulties experienced by SMEs in accessing debt, lack of assets on which to secure debt, and/or high existing levels of indebtedness. Any investments made would need to take account of these issues. Where waste businesses require specific equipment, LWARB will look to deploy asset finance. LWARB will also be willing to lend to waste collection businesses.

Project Debt and Equity Opportunities: LWARB is aware of a pipeline of development activity, including opportunities for thermal treatment, mixed waste MRF and pre-treatment processes. However, the project pipeline is not sufficiently broad nor adequately developed. In 2015/16, LWARB will focus on business development activity to expand and diversify the nature of the projects included in the pipeline. LWARB will seek to invest in waste projects or waste businesses primarily within London, but also outside of London providing that such facilities accept significant amounts of waste from London. To this end, the market has a view that LWARB should continue to offer a project finance debt product. The ability to utilise London specific equity funding is also viewed as providing an advantage to London, and so should also be offered, potentially through a new London Green Fund.

The factors leading to some of these opportunities are:

- The implications of separate collections and requirement for improved quality flowing from the revised Waste Framework and the MRF Regulations. The implications these might have on the collection and processing of material streams it unclear, but it is expected that given the composition of housing stock in London it is likely that we will still be reliant on some form of mechanical sorting technology. It is likely that exiting MRF operators will need to upgrade and improve their equipment to enhance sorting and improve quality;

- External drivers include the Chinese ‘green fence’ requiring that the quality of exported recyclate is improved.

- The shift towards a circular economy, as more companies focus on designing products that can be easily disassembled and reused. Such approach which has also been adopted in the London Infrastructure Plan 2050 should create new opportunities for reuse and remanufacture.

LWARB could also map suitable/affordable land identified in local authority waste Development Plan Documents (DPDs). Also, following the example of the Sustainable Industries Park in Barking and Dagenham, LWARB should encourage the exploitation of more affordable land owned by the Greater London Authority.

Section 2: Investment Objectives

1. To accelerate the delivery of waste infrastructure;

2. To achieve a return on investment of 10%.

Section 3: Investment criteria

It should be acknowledged that given the value of its available funds, LWARB can only help to deliver a small number of waste infrastructure projects which are not sufficient to address London’s waste infrastructure capacity challenge. LWARB’s focus is on optimising leverage of funds and delivery by helping to de-risk those projects that are on the margins of private sector delivery.

The following elements underpin LWARB's investment criteria:

- Flexibility: LWARB's offering is flexible and can be tailored to suit the requirements of the project, within the limits of state aid legislation and LWARB's risk appetite. The type of finance product or combination of products that is actually deployed is based on the risk profile of the individual project.
- Commerciality: Projects must be commercially viable and capable of taking on board investment at commercial rates. LWARB will only consider sub-commercial positions in exceptional circumstances and has in the past only awarded sub-commercial terms to third sector organisations. Any financial support made through LWARB must comply with European legislation regarding State Aid.
- Non-displacement of private sector funders: LWARB funding should not be viewed as the first option for project developers. Project sponsors will need to demonstrate that they have explored private sector funding options before approaching LWARB.
- Additionality: LWARB believes that it must lever-in significant private sector finance through its investments. However, given the urgent need to develop additional waste infrastructure in London, LWARB will not be setting any leverage targets, but will judge each project on its merits whilst reporting leverage achieved.
- Project location: LWARB will seek to invest in waste projects or waste businesses primarily within London, but also outside of London providing that such facilities accept significant amounts of waste from London.
- Public and private sector support: LWARB will support projects that are being developed by the public or private sector (or a combination of both).

Section 4: Return Expectation

LWARB is not a business and if it were to follow a strategy aimed at becoming self sufficient for its own sake, it may be inconsistent with its statutory objectives. This is because the Mayor's Municipal Waste Management Strategy requires LWARB to do a number of things other than develop infrastructure, such as run the Local Authority Support Programme. Also, LWARB should not be in competition with the private sector, potentially displacing external sources of finance. This would not be an appropriate use of LWARB funds.

The price of any product will be determined through LWARB's normal processes which seek returns commensurate with risk. Based upon LWARB's experience to date, it is estimated that a blended return on investment of 10% is achievable. However the primary focus will be on pursuing opportunities that are consistent with LWARB's statutory objectives and don't crowd out the private sector (while commercialising these as far as possible), rather than generating returns.

Section 5: Investment Strategy

Investment Methods

The investment methods that LWARB will pursue in the period covered in this Investment Framework are described below.

Equity

The London Green Fund, in which LWARB has invested £18 million, is required to deploy its funds by 2015. The London Green Fund Investment Board has commissioned a review of the London Green Fund and will make recommendations for the operation of any successor fund. There are a number of potential opportunities for investment in a new equity vehicle. The London Enterprise Partnership has set aside £50 million for investment into future JESSICA style funds, which may include a portion for further waste related investments.

LWARB could contribute to any future London Green Fund that would incorporate ERDF funds managed by the London Enterprise Partnership. The advantage would be that LWARB's investment would have guaranteed leverage from ERDF funding in the same way that ERDF matched LWARB's current investment in the London Green Fund.

Alternatively, investment in a non-JESSICA equity fund could allow LWARB greater scope to define investment criteria. Such a fund could have a wider geographical and sectorial scope for example, thus attracting other funding partners and creating a bigger fund.

Both these routes will be investigated, and a determination on final investment will be made on advice from the Investment Committee and with the approval of the Board.

Project Finance

LWARB is most experienced in providing finance to establish new waste infrastructure projects. It has already invested a mixture of senior and subordinated debt into three major projects to date. LWARB has a small pipeline of projects as well as those of the Foresight Environmental Fund which may require debt investments alongside the equity provided by Foresight. LWARB will issue a new call for expressions of interest to improve the quantity and quality of the project pipeline. The previous two calls have yielded significant numbers of new leads. LWARB will seek to secure its project finance loans against land or other project assets.

Corporate Loans

This is a new area for LWARB. LWARB will target c.5 to 10 investments in this space. It will seek to develop partnerships in this area with other corporate debt providers where appropriate. The kind of businesses looking to expand that cannot attract corporate debt will typically present a higher risk to lenders. LWARB will seek to secure loans against property, or more likely, against purchased equipment. LWARB will also consider providing debt to collection business seeking to expand on the back of good operational history. As with all allocations, the amount that LWARB is seeking to invest may be flexed according to demand. Loans will be required to be contingent upon expanding London's collection or treatment capacity.

Development Loans

LWARB has some limited experience of providing development loans. It is also felt that the opportunities for this kind of product are limited. However, market players have asked that development capital be made available and LWARB will make limited amounts available but only on a fully secured basis.

Venture Capital

Where development capital is sought on an unsecured basis, LWARB will investigate the establishment of a venture capital fund. LWARB will look to invest c.£1 million in such a fund. However, LWARB believes that such a fund can only be successful and identify a sufficient number of projects in which to invest if it can attract suitable partners from the waste space. LWARB will therefore initially look to secure partners to leverage its investment and to provide suitable expertise.

Tables 1 and 2 show the outline allocation of finance to each investment method based on a forecasted budget of £20 million for the period 2015 to 2020. This allocation is intended to be indicative and flexible. If more interest is shown for a particular investment method, it is intended that more money should be invested. If less interest is shown in a particular route then less money will be invested. This will be done in consultation with the Investment Committee.

Table 1: Investment Fund Allocation (£ millions) and Targets

Investment Method	**Allocated Funds (£millions)**	**Targets**
Equity (e.g. LGF2)	7	Multiple investments by fund manager
Project Finance	6	3 projects
Corporate Loans	5	Multiple business loans / equity.
Development Loans	1	Limited number of loans
Venture Capital	1	New VC Fund set up
TOTAL	**20**	

Table 2: Indicative Investment Fund Annual Allocation (£ millions) by Year

Investment Method	**15/16**	**16/17**	**17/18**	**18/19**	**19/20**	**TOTAL**
Equity	7.00					7.00
Project Finance		1.50	1.50	1.50	1.50	6.00
Corporate Loans		1.00	1.00	1.50	1.50	5.00
Development Loans		0.25	0.25	0.25	0.25	1.00
Venture Capital		1.00				1.00

Risk tolerance

LWARB's risk tolerance is medium to high. This is required in order to make a positive difference to the market. As the economy continues to improve and more finance is made available, LWARB's position will not be a lender of last resort, but will be to help de-risk projects to the extent that private investment is able to enter. It is important to be mindful of the need to strike the right balance between risk and reward and complying with state aid.

Risk Management

The level of risk associated with each investment method and the relative concentration of risk derived from the allocated funding is shown in the table below. It is difficult to be precise at this stage of development, as we do not have a set of developed projects on which to assess the risks. However, in general it is felt that net risk is least in corporate or project finance where seniority to other funds exists and collatoral is available. Corporate debt allows us to take a view on a company based on its balance sheet and trading history, but existing corporates in this space may have little in the way of assets and may well already be highly leveraged. Equity investments carry the highest risk which is offset by greatest potential returns. Development finance may well carry a high risk dependent upon the stage of development and any security available.

Table 3: Level of risk and concentration of risk associated with each investment method

Investment Method	Level of Risk	Relative Concentration of Risk
Equity	High	High
Project Finance	Medium	Medium
Corporate loans	Medium	Medium
Development Loan	High	Low
Venture Capital	High	Low

Annex 1 summarises the route to market and the estimated annual targets for each investment method. The annual targets are flexible on timeframes and categories as they will depend on market demand and opportunities.

Annex 2 lists the key risks and mitigation measures to achieving the objectives for each investment method.

Conclusions

The deployment of investment funds as described above will allow LWARB to invest in a range of projects. This should allow for a more constant rate of investment. Investments in existing businesses should accelerate delivery of infrastructure, while continuing to invest in new infrastructure projects, which typically take longer, will contribute to adding more new capacity to London. Investments in new innovative ventures will take many years to develop, but could be both lucrative and deliver exciting new opportunities for managing waste material.

This investment strategy will help to deliver LWARB’s long term aspirations to be self-sufficient by not relying on taxpayer funded grants. Its broader approach will also offer more opportunities to roll out the LWARB business model to other UK major cities.

Annex 1. Work plan 2015-2020: Route to market and estimated annual targets

Investment method	Route to market	Targets 15/16	Targets 16/17	Targets 17/18	Targets 18/19	Targets 19/20
Equity	- Contribution to a new equity fund with guaranteed leverage from other partners (JESSICA/LGF2 or returns from existing fund) - The fund will be set up by means of a competitive process which will also establish annual targets	New equity fund set up				
Project Finance	- Invite Expressions of Interest - Launch event/s - Engagement	- Q1:1st call for EoIs; - At least 10 projects added to the pipeline	1 project financed	- 2nd call for EoIs; - At least 10 projects added to the pipeline	1 project financed	1 project financed
Corporate Loans	- Invite Expressions of Interest - Launch event/s - Engagement - Loans provided in partnership with other corporate debt providers, or by bringing expertise in-house	- Market research; - Q1: 1st call for EoIs; - At least 10 projects added to the pipeline	2-3 loans agreed;	- 2nd call for EoIs; - At least 10 projects added to the pipeline	2-3 loans agreed	2-3 loans agreed
Development loans	- Invite Expressions of Interest - Launch event/s - Engagement - Loans provided in partnership with other development debt providers, or by bringing expertise in-house	- Market research; - 1st call for EoIs; - At least 5 projects added to the pipeline	1 loan agreed;	- 2nd call for EoIs; - At least 5 projects added to the pipeline	1 loan agreed	1 loan agreed
Venture Capital	Contribution to a VC Fund led by industry partners		New VC fund set up			

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Annex 2: Identified risks and mitigation measures

Risks	**Mitigation measures**
Limited number of Expressions of Interest (EoI) received	- Launch event and extensive promotion - Tailored approaches are developed for each investment method
The pipeline is of low quality and not diverse enough	- Focus on business development in 2015/16 to build a robust pipeline - 2nd call for EoI prioritises specific technologies
Projects do not reach Financial Close over the Investment Framework period	- Proactive role in engaging with project sponsors - Delivery of efficient business development and due diligence processes
Non repayment of LWARB loans from projects **Risk already identified in the risk register*	-Sponsors and project economics assessed as part of due diligence - Continued monitoring and reporting - Security taken where available
Level of return is lower than anticipated	- Appropriate due diligence - Step-in rights are included in the contacts - Suitable security packages are sought
A successor of the London Green Fund is not set up	- Funds are invested in an non-JESSICA equity fund. - A number of waste investments is ring-fenced for London
Partnership with other corporate/development debt providers is not secured	- Consider bringing expertise in-house - Allocated funding is shifted to other investment methods with higher demand