

## **ITEM FOR FINANCE COMMITTEE**

### **HEAD 44 – ENVIRONMENTAL PROTECTION DEPARTMENT Subhead 297 Fees for operation of waste facilities**

Members are invited to approve supplementary provision of \$70 million under Head 44 Environmental Protection Department Subhead 297 Fees for operation of waste facilities.

#### **PROBLEM**

The approved provision for the operating expenses of waste management facilities under Environmental Protection Department (EPD) is inadequate to meet the anticipated expenditure in 2008-09 due to higher-than-expected inflation.

#### **PROPOSAL**

2. We propose to provide supplementary provision of \$70 million under Head 44 Environmental Protection Department Subhead 297 Fees for operation of waste facilities to meet the additional payments of the operation fees to waste management contractors in 2008-09 arising from inflation.

#### **JUSTIFICATION**

3. A provision of \$1,098.5 million has been approved under Head 44 Environmental Protection Department Subhead 297 Fees for operation of waste facilities in 2008-09. The major waste facilities include refuse transfer stations (RTS), landfills and Chemical Waste Treatment Centre (CWTC). RTS in urban areas are operated to compact household waste into cargo containers for transfer in bulk; landfills in remote locations are operated for final disposal of most types of solid waste and CWTC is operated for the treatment and disposal of chemical waste.

4. The development and operation of most of these waste facilities have been outsourced through a number of Design, Build and Operate (DBO) contracts. The contract periods of these DBO contracts cover construction, operation and, for landfills, aftercare of the facilities to ensure unity of responsibility and liability in the environmental performance of the facilities. As the contract periods of these waste facilities generally last over a long period of time (e.g. 15 years for RTS and over 20 years for landfills), it is fair and necessary to build in a price adjustment mechanism in the DBO contracts for the payment of operation and other fees under the contracts. For 2008-09, that part of the original provision earmarked for contract payments in respect of RTS and landfills is insufficient to meet revised expenditure for the operation of these facilities, due to higher-than-expected inflation.

5. For RTS, the operation fee is adjusted in accordance with the Consumer Price Index (B) (CPI(B)) published by the Census and Statistics Department. For landfills, because of the involvement of continual construction activities such as temporary roadworks, inert material cover over waste and landfill gas extraction system etc. during their operation, the operation fee is adjusted in accordance with a Composite Index comprising the construction materials index (40%) and labour index (25%) in addition to CPI(B) (35%). With such price adjustment mechanism in place, the monthly operation fees paid to the waste management contractors under the contracts could be increased or decreased<sup>1</sup> in accordance with the fluctuation of the relevant indices.

6. When EPD prepared the draft Estimates for 2008-09 in mid-2007, the original estimate of \$1,098.5 million (covering RTS, landfills and other waste facilities) was made for Subhead 297 having regard to the latest price indices available at that time i.e. CPI(B) for August 2007 and Composite Index for June 2007. For that part of the original estimate attributable to the operation of RTS and landfills, an inflation of around 2% was assumed for 2008-09 but this was expected to be offset by decrease in total waste intake at these facilities. Therefore, no additional funding catering for inflation was included in the 2008-09 original estimate for RTS and landfills.

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<sup>1</sup> The amount of monthly operation fee for each RTS and landfill is determined by the waste volume handled in that month multiplied by applicable unit rate in price schedule and price adjustment factor which is calculated based on the applicable current price index compared with the base price index as set out in the contract.

7. The higher-than-expected inflation rates since December 2007<sup>2</sup> have led to significant increases in price adjustments that could not have been foreseen by EPD, resulting in a significant increase in the operation fees for the RTS and landfills contracts over the relevant provisions included in the 2008-09 Estimates. To illustrate, the December 2008 CPI(B) has increased by 5.4% over the corresponding index in August 2007, while the October 2008 Composite Index has increased by 11.8% over the corresponding index in June 2007. In particular, the October 2008 construction materials index has risen by 35.0% over the corresponding index in June 2007. The trends of the CPI(B) and the Composite Index from April 2006 to the latest available indices are shown respectively in Enclosures 1 and 2.

Encls.  
1&2

8. The increase in the relevant indices from mid-2007 to mid-2008 has already caused a significant increase in payment of operation fees for RTS and landfills by \$47 million for the first ten months of 2008-09 compared with the cumulative amount paid in the corresponding period of 2007-08. Although the increase in price indices has slowed down in the third quarter of 2008, the price indices are still higher than expected even after taking into account the likely impact of the recent financial turmoil and economic downturn. Moreover, as the operation fees for RTS and landfills to be paid in the remaining months in 2008-09 will be calculated on the basis of CPI(B) up to January 2009<sup>3</sup> and Composite Index up to November 2008<sup>3</sup> respectively, any subsequent reduction in price indices would not have impact on the operation fees of RTS and landfills to be paid in 2008-09.

9. Based on the latest spending pattern and taking into account the inflation adjustment explained above, the revised estimates for the operating expenses of waste management facilities under Subhead 297, compared with the original estimates, are set out below –

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<sup>2</sup> Operation fees for RTS and landfills in 2008-09 will be calculated on the basis of CPI(B) for the months from February 2008 to January 2009 and composite index for the months from December 2007 to November 2008 respectively.

<sup>3</sup> Due to the timing required for the compilation of labour and materials price indices, the indices for December 2008 are expected to be released by the Census and Statistics Department in early/mid-March 2009. Therefore, the last payment for landfills operation fees to be settled in 2008-09 with invoices normally issued in February 2009 will be adjusted with the latest composite index (i.e. November 2008). For RTS, the last payment of operation fee for February 2009 will normally be issued in early March 2009; the index for January 2009 will be adopted for price adjustment.

<b>Major Operation Fees Item</b>	<b>2008-09 Original Estimates</b> (\$ million) (a)	<b>2008-09 Revised Estimates</b> (\$ million) (b)	<b>2008-09 Estimated Surplus/ (Shortfall)</b> (\$ million) (a) – (b)
Refuse transfer stations	322.1	351.2	(29.1)
Landfills	397.6	441.7	(44.1)
Other waste facilities <sup>4</sup>	378.8	375.6	3.2
<b>Total</b>	<b>1,098.5</b>	<b>1,168.5</b>	<b>(70.0)</b>

10. The revised estimates for the expenditure of the RTS and landfills would be \$29.1 million and \$44.1 million respectively higher than the original estimates due to higher-than-expected inflation, after taking into account a slight decrease in the total quantities of waste received.

11. The total additional requirement of \$73.2 million for the RTS and the landfills operation is expected to be partially offset by the lower-than-expected expenditure of other waste facilities. A supplementary provision of \$70 million is therefore required to meet the shortfall of the original estimates.

## FINANCIAL IMPLICATIONS

12. The latest estimates of Subhead 297 are as follow –

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<sup>4</sup> Other waste facilities include Chemical Waste Treatment Centre, Sha Ling Composting Plant, Low-level Radioactive Waste Storage Facility, Animal Waste Composting Plant, waste recycling & recovery programmes and operation of landfill charging scheme.

	<b>\$ million</b>
Approved provision	1,098.5
<i>Less:</i>	
Expenditure (including commitments passed for payments) from 1 April 2008 to 31 January 2009	965.6
Estimated expenditure from 1 February 2009 to 31 March 2009	202.9
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Estimated shortfall	(70.0)

13. We propose the provision of a supplementary provision of \$70 million to Head 44 Environmental Protection Department Subhead 297 Fees for operation of waste facilities for 2008-09. Subject to Members' approval of the proposal, we shall offset supplementary provision of \$20 million from Subhead 000 Operational expenses under the same Head in light of the lower-than-expected level of expenditure under this subhead. The remaining \$50 million will be offset by deleting an equivalent amount under Head 106 Miscellaneous Services Subhead 251 Additional commitments.

## **PUBLIC CONSULTATION**

14. We consulted the Legislative Council Panel on Environmental Affairs on the proposal on 21 January 2009. Members had no objection to the funding application. In response to Members' comments, we explained the rationale behind the use of construction materials index in arriving at the composite index for adjustment of operation fees for landfills. Moreover, Members considered that we should ensure that the price adjustment mechanism would provide for reduction of operation fees when there was downward adjustment of relevant price indices. In this respect, Members were informed that the price adjustment mechanism provided for both upward and downward adjustments, and that there had been reduction in operation fees to levels even below the contract prices due to significant downward movement of price indices in 2003.

**/BACKGROUND .....**

**BACKGROUND**

15. Currently, a total of seven RTS and three landfills are in operation. The total waste intake for RTS and landfills during the first ten operation months for payments made in 2008-09 has slightly decreased by 2% from 5 922 thousand tonnes to 5 813 thousand tonnes compared with corresponding period of 2007-08.

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Environmental Protection Department  
February 2009



