

CIF Project #773 – Stranded Asset Analysis

Background

In his letter of August 14, 2017, the Minister of Environment and Climate Change provided direction to Stewardship Ontario (SO) and the Resource Productivity and Recovery Authority (the Authority) to develop a proposal for an amended Blue Box Program Plan (BBPP). Direction was provided that the proposal be consistent with several principles, including a general principle statement on stranded assets as follows:

- *“Avoiding stranded assets to the extent possible in a collaborative manner”*

Stranded assets, in the context of the Blue Box Program, could include land, buildings, equipment, vehicles and even things like carts which a municipality has previously purchased, but which will be considered surplus following transition to an extended producer responsibility scheme. These stranded assets are normally considered ‘stranded’ if they are not fully depreciated or are still considered to have residual value by the time they are declared surplus.

SO issued a draft amended BBPP for consultation in December 2017 which included a general outline of the proposed approach to minimize stranded assets (Section 7.12). Included in Section 7.12 are statements that SO commits to:

- *“Provide sufficient time for public and private operators to assess the redeployment, reuse, refurbishing or recapitalization of those assets...”*; and
- *“Provide Communities with the opportunity to divest, lease out, or repurpose their facilities...”*.

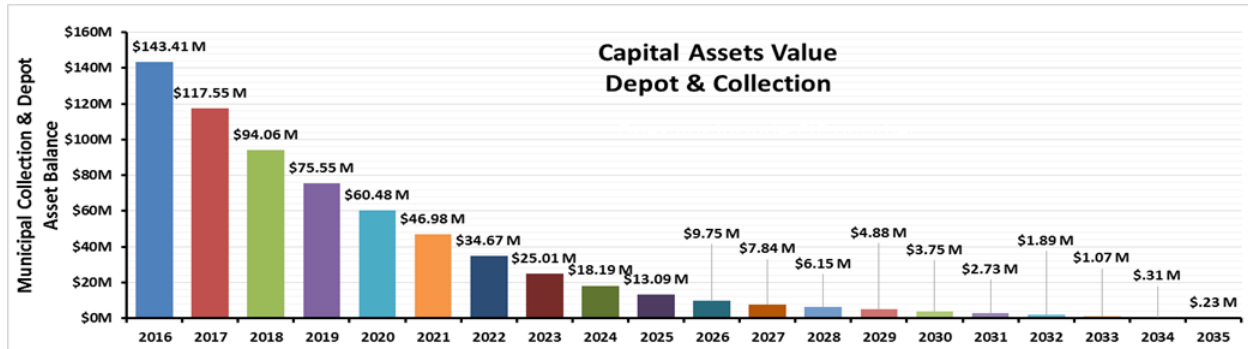
These and other statements included in Section 7.12 are supportive of the objective to avoid stranded assets, but few details on timing or procedural logistics were provided.

CIF has been actively involved since early 2017 in assisting municipalities to reduce their exposure to stranded assets. Actions already completed or underway include:

- Quantifying the potential exposure to stranded assets through review of the Authority’s datacall submissions;
- Projecting future changes to stranded asset valuations;
- Assisting AMO in communicating to municipalities, the need to develop an asset management strategy;
- Providing direct assistance to municipalities seeking guidance on paths forward; and
- Developing and offering tools to assist municipalities in asset valuation.

Summary of Results

CIF reviewed the Authority's municipal datacall submissions and determined the total retained value of eligible assets to be approximately \$220 million as of year-end 2016. Future capital asset valuations using prescribed datacall depreciation rates were determined and are summarized below.



Analysis of the current, municipal transfer and processing infrastructure found \$107M in municipal transfer and processing assets in operation today and determined that the majority of the assets will not be fully amortized until 2020. This projection excludes any capital investments since the 2016 datacall submissions. While the future valuations above are likely somewhat understated as they do not account for new purchases, most municipalities have deferred any significant capital expenditures based on their knowledge of the potential for imminent transition. As shown above, ongoing deferral of capital expenditures by municipalities will reduce exposure to stranded assets to a relatively small amount province-wide within six years assuming no further investments are made.

While the deferral strategy reduces the exposure to stranded assets, it also greatly reduces the operational capability of the Blue Box Program as most assets will have been extended to, or beyond, their expected useful life. Moreover, in the absence of further investment, the processing infrastructure will become increasingly unable to cope with the never ending evolution of packaging design. If provincial implementation of transition activities does proceed consistent with the expected timelines, the infrastructure deficiency caused by deferrals of capital purchases will cause excessive repair and maintenance costs and ultimately a potential degradation in overall system performance.

CIF assisted AMO in issuing a June 2017 communication bulletin updating municipalities on the need to develop a local strategy to address the potential for stranded assets in their communities. CIF offered direct assistance to municipalities needing a better understanding of the risks posed by stranded assets associated with the transition to extended producer responsibility.

CIF has also been developing tools to assist municipalities in determining key background information necessary to support informed decision-making on whether to continue as a contracted service provider following the transition period. Tools include:

- Sample RFQ for MRF land and building appraisals;
- Sample RFP for MRF business valuation;
- Proposal evaluation template for RFP described above;
- Sample RFQ for MRF equipment valuation; and
- MRF inventory template to assist in the RFQ described above.

Learnings

- 1) Municipal exposure to stranded assets will be greatly reduced over time. However, if the transition period is delayed beyond current expectations, deteriorating assets have the potential to degrade overall system performance and escalate costs through excessive repair costs and lower value for marketed materials.
- 2) CIF tools developed to support the municipal transitions have been well utilized. The tools streamline standard activities required to develop an asset management strategy to support decision making.
- 3) CIF technical guidance has been well received and demand is expected to continue throughout 2018.
- 4) The timetable for transition needs to be more definitively established to help guide municipal decision making on options minimize stranded assets.
- 5) Action is required by producers and municipalities to address the risk municipality's face in making further investments into their programs to legitimate performance and maintenance issues prior to and during transition. This could include agreement by producers to fairly compensate municipalities for such investments should they become stranded where producers have agreed to the investments on a case by case basis.