

South Hams Council



Title:	Agenda																														
Date:	Thursday, 25th February, 2016																														
Time:	10.00 am																														
Venue:	Council Chamber - Follaton House																														
Full Members:	<p style="text-align: center;">Chairman Bramble</p> <p style="text-align: center;">Vice Chairman Smerdon</p> <p><i>Members:</i></p> <table style="width: 100%; border: none;"> <tr> <td>Baldry</td> <td>Hopwood</td> </tr> <tr> <td>Bastone</td> <td>Horsburgh</td> </tr> <tr> <td>Blackler</td> <td>May</td> </tr> <tr> <td>Brazil</td> <td>Pearce</td> </tr> <tr> <td>Brown</td> <td>Pennington</td> </tr> <tr> <td>Cane</td> <td>Pringle</td> </tr> <tr> <td>Cuthbert</td> <td>Rowe</td> </tr> <tr> <td>Foss</td> <td>Saltern</td> </tr> <tr> <td>Gilbert</td> <td>Steer</td> </tr> <tr> <td>Green</td> <td>Tucker</td> </tr> <tr> <td>Hawkins</td> <td>Vint</td> </tr> <tr> <td>Hicks</td> <td>Ward</td> </tr> <tr> <td>Hitchins</td> <td>Wingate</td> </tr> <tr> <td>Hodgson</td> <td>Wright</td> </tr> <tr> <td>Holway</td> <td></td> </tr> </table>	Baldry	Hopwood	Bastone	Horsburgh	Blackler	May	Brazil	Pearce	Brown	Pennington	Cane	Pringle	Cuthbert	Rowe	Foss	Saltern	Gilbert	Steer	Green	Tucker	Hawkins	Vint	Hicks	Ward	Hitchins	Wingate	Hodgson	Wright	Holway	
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Substitutes:	Named substitutes are not appointed																														
Interests – Declaration and Restriction on Participation:	Members are reminded of their responsibility to declare any disclosable pecuniary interest not entered in the Authority's register or local non pecuniary interest which they have in any item of business on the agenda (subject to the exception for sensitive information) and to leave the meeting prior to discussion and voting on an item in which they have a disclosable pecuniary interest.																														
Committee administrator:	Member.Services@swdevon.gov.uk																														

1. Urgent Business

the Chairman to announce if any item not on the agenda should be considered on the basis that he considers it as a matter of urgency;

2. Exempt Information

to consider whether the consideration of any item of business would be likely to disclose exempt information and if so the category of such exempt information;

3. Declarations of Interest

Members are invited to declare any personal; or disclosable pecuniary interests, including the nature and extent of such interests they may have in any items to be considered at this meeting;

4. Proposals relating to a Local Authority Controlled Company 1 - 160

to consider a report that proposes the establishment of a company jointly owned by the Council and West Devon Borough Council;

5. Exclusion of Public and Press

to consider the following resolution to exclude the public and press:-

“That in accordance with Section 100(A)(4) of the Local Government Act 1972, the public and press be excluded from the meeting during consideration of the following item of business in order to avoid the likely disclosure to them of exempt information as defined in paragraph 7 of Part 1 of Schedule 12A to the Act”;

6. Planning Enforcement 161 - 168

to consider an exempt report that seeks to .approve the Planning Enforcement plan.

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NOT FOR PUBLICATION

Appendix C to this report contains exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972

Report to: **SPECIAL COUNCIL**

Date: **25 February 2016**

Title: **Proposals relating to a Local Authority Controlled Company**

Portfolio Area: **Leader of the Council - Strategic Vision**

Wards Affected: **All**

Relevant Scrutiny Committee: **N/A**

Approval and clearance obtained: **Yes**

Urgent Decision: **N/A**

Date next steps can be taken: **Immediately**

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(NOTE: a version of this report was considered by the Executive at its meeting on 4 February 2016 and the subsequent recommendations generated at this meeting are reflected below)

Recommendations:

That the Executive RECOMMEND to Council:-

- 1. to produce a detailed business case and implementation plan to enable for further consideration of the merits of establishing a Local Authority Controlled Company jointly with West Devon Borough Council to deliver services for South Hams District Council and West Devon Borough Council, and to other organisations as contracts are won; and**

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- 2. That both Councils' costs for the preparation of the detailed business case and implementation plan of £300,000 are met from a budget provision of £150,000 being set aside in both Councils for this purpose, and that draw down of these funds be delegated to the Executive Director (SD &CD) in consultation with the Leader and Deputy Leader.**

1.0 Executive Summary

- 1.1 This report proposes the establishment of a company jointly owned by South Hams District Council and West Devon Borough Council for the purpose of:
- Delivering services to the communities of South Hams and West Devon;
 - Generating income by delivering services on behalf of other organisations;
 - Creating a vehicle which gives both councils a mechanism to generate profit from certain activities; and
 - Ensuring the future viability of both organisations through appropriate strategic positioning in the public sector.
- 1.2 The staff and services currently provided by the councils' Commercial Services, Customer First and Support Services would be transferred across to the new company, with the view that the company would be operational with effect from April 2017.
- 1.3 A contract between the Council and the company would be put in place for the delivery of the services that are transferred.
- 1.4 The company would also be able to generate income and profit by delivering a full range of services to other organisations.
- 1.5 The company would only be established by agreement of both Councils.
- 1.6 A similar recommendation was made to the Hub Committee at West Devon Borough Council on 26th January 2016 and the following recommendation was agreed: *"To recommend to Council to establish a Local Authority Controlled Company jointly with South Hams District Council to deliver services for West Devon Borough Council and South Hams District Council, and to other organisations as contracts are won, subject to the further approval of a detailed business case and implementation plan"*.
- 1.7 Two further recommendations concerning the funding of the business case and implementation costs, and the transfer of the current out-sourced waste collection and street cleansing services

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into the new company, subject to approval of the detailed business case, were also agreed by West Devon Borough Council.

2.0 Background

2.1 In 2013-14, South Hams District Council and West Devon Borough Council embarked on an ambitious transformation programme called "T18". This consisted of 4 main elements:

- The restructuring of functions and processes;
- A culture change programme based on IMPACT behaviours;
- An IT and systems development programme to support new ways of working; and
- A review of organisational structure and governance to ensure the future delivery of services to the community, with an ambition for growth.

It is this final element that is the subject of this report.

- 2.2 Since 2010 Local Authorities have been subject to increasing budgetary pressures and decreasing grant income from central government. This position is looking significantly worse for the future given the recent budget settlement.
- 2.3 The purpose of the councils' T18 transformation programme had been to position both councils to meet their financial obligations until 2018 and to be able to continue to deliver the full range of services without cuts or long term reduction in quality. However both councils are keen to secure the future of services beyond 2018.
- 2.4 The success of the T18 programme in delivering efficiencies (joint savings of £5 million) has meant that both councils are in a position to generate a surplus for the financial year 2016/17, however this will not be the case for 2018 onwards, therefore this is the right time to be considering any investment in the organisation.
- 2.5 There is an opportunity for the councils to position themselves at the forefront of this emerging market for delivering services, and therefore able to take advantage of opportunities provided by other, less forward-thinking organisations.
- 2.6 The opportunity has arisen to include the West Devon waste collection and street cleansing contract with the other services that would transfer into the company. These services would need to be transferred in April 2017, and at their meeting on the 26th January the West Devon Hub Committee agreed to recommend the inclusion of these services to their Council at the meeting scheduled for 16th February 2016. If required, it may be possible to extend the implementation period, but it is not recommended that this extension be longer than April 2018 due to budget forecasts and market opportunity.

Proposals relating to a Local Authority Controlled Company

- 2.7 During 2015/16 the councils have reviewed their priorities and Members from both Councils agreed that their top priority for each organisation is to achieve financial sustainability. Both councils have also stated that they do not want to see a reduction in the level and quality of the services delivered to their communities.
- 2.8 It is acknowledged that whilst the T18 programme has been very effective at making efficiencies, more will need to be done to generate income and reduce cost from 2018 onwards if the councils are to meet their aims.
- 2.9 In terms of the national context, the Local Authority landscape is changing rapidly and a mixed economy is emerging which provides opportunities for councils such as South Hams and West Devon as well as threats. The opportunities include the ability for councils to form companies to trade and generate income and to provide services to other councils and organisations at a profit. Whilst Local Authority restructure is not currently being proposed by the Government, there is a clear threat that if councils start failing due to financial pressures then there may be a requirement for take-overs, combined councils or unitary arrangements; however, this could also be an opportunity for well-placed councils to step in for mutual benefit.
- 2.10 This proposal affects both South Hams District Council and West Devon Borough Council, the communities they serve and the staff they employ. The intention is for the range of services to the communities to carry on being provided to at least the current standard, albeit from an arms-length, wholly-owned company, so that residents and communities should not feel any adverse impact from this proposal.
- 2.11 Staff in Commercial Services, Customer First and Support Services would be transferred to the new company. This would be subject to TUPE regulations (Transfer of Undertakings: Protection of Employment) so that staff would be transferred on their current employment terms and conditions.
- 2.12 No restructure or redundancies are proposed, it would be a simple transfer of service delivery staff into a new entity. The staff would continue to provide services to the councils in the same way, but with an opportunity to expand and grow the business.
- 2.13 The company would have a two-fold relationship with the two councils:
- As a provider of services to the councils, controlled by a contractual relationship;
 - As a wholly owned asset of the councils controlled through the shareholders agreement and the associated governance structures.

3.0 Outcomes/outputs

Proposals relating to a Local Authority Controlled Company

- 3.1 The proposal is to establish a company that will be able to deliver services to both the councils efficiently and effectively. In doing so, this will create the opportunity to sell these services to other organisations.
- 3.2 It is intended initially to set up a company that is controlled by the two authorities and does the majority of its work for these authorities; this arrangement follows the rules that allow the councils to pass the work to the company without the need to tender in the open market. This is known as a Teckal exemption, an explanation of which can be found in the LGIU briefing note (see **Appendix A**).
- 3.3 Under the Teckal arrangement the company would also be able to win contracts and deliver services to other organisations for a profit but only up to 20% of its turnover. Once the 20% limit is reached an additional company can be set up purely to provide services to other organisations and generate profits for its shareholders (this is allowed for under section 95 of the Local Government Act 2003 and we will refer to this as a "section 95" company for the purposes of this report).
- 3.4 Based on the calculations by Grant Thornton, the proposed company will generate a turnover of £6.7 million in year one. This means that under the Teckal exemption, it could deliver services to other organisations up to a value of £1.34 million before the addition of a section 95 company would need to be explored.
- 3.5 It is proposed that the company would be established to start trading by April 2017. External advice from Grant Thornton suggests an ideal implementation period of 18 months.
- 3.6 During the first couple of years of trading, the strategy would be to deliver good quality services to the two councils within budget and establish the reputation and track record of the company. From the perspective of the public, Members and staff, services would continue to be delivered and received as usual. This will then allow the company to use this track record of delivering services to bid for work from other organisations. Winning external contracts will improve the economies of scale within the company thus reducing the cost of the services delivered to South Hams and West Devon and provide additional income for the company and a profit for the shareholders. Initially it is proposed the shareholders will be South Hams and West Devon.
- 3.7 Traditionally councils have provided the services that the company will be offering in-house. However, as the effect of the budget settlements are felt over the next 4 years this will become less sustainable and other ways of delivering services will need to be found. It is this opportunity to provide services to other councils and organisations at a lower cost that the company will seek to exploit. As financial pressures bite, some councils may no longer be viable, but services will still need to be provided to their communities. This is the type of opportunity the company will be

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able to exploit and it is anticipated that the Government will be interested in such solutions when faced with failing councils.

- 3.8 Another way to achieve growth, economies of scale and further efficiencies within the company would be for other public sector organisations to buy shares in the company, thus allowing them to commission services through the company using the Teckal exemption described above.
- 3.9 To understand the size of the market available we can calculate the cost of services delivered by District Councils in any particular area from their published statements of accounts. It should also be noted that there are some services, particularly those of a transactional nature, which can be delivered for other councils nationally as the use of IT means that the geographic location of an organisation is not important. Most of these services are currently delivered in-house and this is the market that the company would target. For example, Devon District and Unitary Authorities spend approximately £60m on the services within scope of the proposed company. Therefore every 1% of the market that is won represents £600k business for the company. This reasoning could be extended to Somerset and beyond and will be further explored thorough the detailed business case.
- 3.10 It is not anticipated that the company would win significant contracts within the first couple of years of business and it must be stressed that this proposal should not be seen as the entire solution for ensuring future financial sustainability. The intention is to position the councils to take advantage of the future opportunities in this market, thus affording prospects to generate income and profit through the company for the benefit of the councils. In addition it will be possible to find further efficiencies for the delivery of the council's services through the company.
- 3.11 It is also relevant to note that should the structure of the current two-tier system of local government in Devon change, then the ownership of the company would transfer to any successor organisation along with the contracts for the delivery of services. This would provide a good degree of protection to the level and quality of the services provided to our communities and to the staff employed by the company.
- 3.12 The success of the company will be measured through:
- how well it delivers the contracts that it will hold with the councils (i.e. within budget and to the quality specified);
 - savings that it makes on the delivery of these services;
 - the income that it generates through winning and delivering work to other organisations; and
 - the long term growth of the company.
- 3.13 The company would expect to be bidding for contracts from its second year of operation. It would also expect to be achieving

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further efficiencies on the delivery of the councils' services during the second year of operation.

- 3.14 There are also opportunities to maximise efficiencies and/or find economies of scale from operations such as the Lower Dartmouth Ferry and the extension of the waste collection service to other authorities.
- 3.15 The current out-sourced waste contract for West Devon expires in April 2017, therefore the councils' decision on the establishment of a company from which to deliver this service is critical in order to achieve the required timescale for company implementation and the transfer of services. This was the reason for a supplementary report to be commissioned which gives more specific financial information to Members in relation to the waste and cleansing services for West Devon and South Hams. Whilst the focus of the supplementary report concerns the transfer of the West Devon waste collection and street cleansing service, it provides some useful analysis of the South Hams service and should help inform the decision of the South Hams Members. (Members can find this report at Appendix C, however due to the financial information this report contains it is exempt from publication).
- 3.16 The ability to carry out our waste services across more than one council supports the municipal waste strategy for Devon which looks to align collection materials and supports the previous work of the Executive Waste board which hoped to further the implementation of services being carried out in clusters. A LACC solution would allow us to offer services to others in line with the countywide intention, and may well be more politically acceptable than previous proposals.
- 3.17 There will be significant challenges in meeting a start date of April 2017 for the transfer of all services including the West Devon waste collection service and to that end FCC Environmental (the current West Devon waste contractor) could be requested to extend the existing arrangements. Early indications are that they would be willing to negotiate an extension, though this would come at a cost to West Devon Borough Council.

4.0 Options available and consideration of risk

- 4.1. A variety of approaches have been reviewed when considering the future organisational and delivery structures for the council including: keeping the current "as-is" arrangements (combination of outsourced and in-house); further outsourcing of services; a joint venture with a private sector partner; establishing a co-operative/mutual/charity/trust to deliver services; establishing a Teckal type Local Authority controlled company (LACC), and; establishing a section 95 Local Authority controlled company.
- 4.2. These have been considered against the following criteria:
- Degree of control and flexibility retained by Councils
 - Ability to generate further savings/efficiencies

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- Ability to make a profit and generate income for the Councils
 - Ability to passport work without procurement
- 4.3. Consideration has also been given to the ability to maintain the level and quality of services, the impact on staff and the implications of the changing Local Authority landscape.

Comparison of Alternative Service Delivery Models Available to WDBC / SHDC

Model	Will Council retain control and service flexibility?	Can it make a profit to generate income for the Councils?	Can Councils passport work without procurement?	Ability to generate further efficiencies
As Is option (mainly in-house, some outsourced contracts)	✓ Best option for control and flexibility	✗	✗ <small>for outsourced contract. N/A for in-house</small>	✓ Very limited
Teckal LACC	✓ through company ownership but less than As Is option	✓	✓	✓
Section 95 LACC (Only set up for External Trading, not Council Service Delivery)	✓	✓	✗	✓
Further outsourcing to private sector	✗ Tied in to contracts	✗ Any profit goes to the private sector	✗	✗ Tied in to contracts
Joint Venture with private sector	✓ But limited - needs private sector partner agreement	✓ Shared with private sector partner	✗ Need to be LA controlled to do this	✓
Co-operative / Mutual / Charity / Trust	✗ Tied in to contracts	✗	✗ Need to be LA controlled to do this	✗

- 4.4. Following consideration of the options against the criteria, officers have refined the options down to two for further consideration and these are the focus of this report:

Option A - continue with the current arrangements (the "as is" option), or;

Option B - establish a Teckal type LACC with the option to add a section 95 company at a later date.

- 4.5. The critical reason for discounting the other options is that none of them allow for the pass-porting of work without procurement. This

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would prevent the council passing services across to the company to deliver, thus establishing a track record in trading these services. There were also limitations to flexibility, control, generation of income for the councils, and future efficiency savings that were considered when narrowing the options.

- 4.6. Staff, Trade Unions and Members have been consulted on the possibility of a LACC being implemented and the impact that this would have on staff, service delivery and governance. All stakeholders have been open to the changes and will continue to be consulted as plans develop. There has not been an adverse reaction to the proposals.
- 4.7. The staff working within Commercial Services, Customer First and Support Services would transfer directly into the new company and TUPE would apply. The company would gain 'admitted body' status to the Local Government Pension Scheme (LGPS) so that staff could continue to access the benefits of that scheme. The company may decide to make different pension arrangements for new staff joining the company. Any difference between, or changes to, terms and conditions for staff would be carefully considered and negotiated to ensure the most beneficial arrangements for both the business and the affected staff. It is in the interest of the business to be known as a good employer.
- 4.8. The councils' relationship with the new company would be twofold: as the clients commissioning services from the company; and as the owners and shareholders of the company. Control over the delivery of services would be exerted through the contract and through the annual service delivery plan, to be agreed by the Council and monitored by Overview and Scrutiny. Control over the company would be exerted through the Board of Directors and a Joint Shareholder Committee made up of Members of both Councils.
- 4.9. The risks associated with Option A concern the limitations of the Council to generate additional income in the future and to be able to maintain services, resulting in a potential loss of service or potential outsourcing of services.
- 4.10. Option B does give the opportunity to make further savings and generate additional income, however there is the risk that the company may fail to do this, that the predicted market may not materialise or that the company does not attract the business required to generate sufficient income.
- 4.11. To aid the evaluation of the proposals contained in this report, officers commissioned the accounting and consultancy company Grant Thornton to provide an independent review. They were also commissioned to provide a financial appraisal of the options for the waste contract. Their reports are attached as **Appendix B – Options appraisal for the establishment of a local authority controlled company**, and **Appendix C – Waste report**.

Appendix C is exempt from publication. The public interest test has

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been applied and it is considered that the public interest lies in not disclosing this report because it contains financial information which could prejudice the Councils if the information was disclosed at this time.

- 4.12. In relation to the options to continue with the current arrangements or for the establishment of an LACC to provide services (Options A and B), the Grant Thornton report concludes that:

"Option A – 'as is' has been successful and enabled the Councils to develop new ways of working and begin to develop a commercial culture. The key risk of this option is that existing service levels would have to change to meet future financial challenges and that existing arrangements would be unable to meet the recently identified budget funding gap.

Option B – a LACC, will provide greater longer term opportunities to reduce cost and generate additional income from outside the Councils from other public sector bodies and the private sector. However, it will take at least two years before it will become profitable, 2019 at the earliest".

- 4.13. In their report Grant Thornton have set out projected income and expenditure for the first year of trading and this identifies a budget deficit for the company of £360k. However, 90% of this deficit (£330k) is due to depreciation cost of assets transferred to the company. A different approach to the treatment of assets could take out the depreciation costs altogether and the associated deficit.
- 4.14. If the Councils decide to progress with the establishment of the LACC then a detailed business case will need to be prepared which will give further consideration to key features including:
- The financial business case from the perspectives of both the councils and the company
 - Governance arrangements
 - Tax considerations
 - Pension considerations
 - Assets and depreciation
 - Terms and conditions of new LACC employees
 - Market Analysis and potential income streams
- 4.15. In October 2014 the Councils agreed to set up a company for the purposes of generating income. This company has been dormant to date. It would be possible to use this as the basis for the new companies (either the Teckal LACC or the Section 95 Company) or to start afresh. The detailed business case would assess the best option.

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5.0 Proposed Way Forward

5.1. If the councils decide to progress with the LACC then officers will need to procure professional support to complete the detailed business case and implementation plan. This work will be subject to a value-for-money procurement exercise. It is estimated by Grant Thornton that a budget of £328,500 will be required and this will need to be split 50:50 between the two councils subject to both councils agreeing to proceed. Currently each Council has a budget provision of £150,000 identified in their budget reports. Grant Thornton's estimate is broken down on page 31 of their report attached at **Appendix B** (see below for extract) and further detail is given on page 32 of their report.

	South Hams LACC	West Devon LACC	Total
Estimates			
Staff Change Management	10,000	10,000	20,000
Pension Administration	8,500	8,500	17,000
Legal Advice	44,500	44,500	89,000
Finance Support & Advice	22,500	22,500	45,000
IT system & resource	5,000	5,000	10,000
Recruitment	11,250	11,250	22,500
Project Management & Implementation	25,000	25,000	50,000
Cost of full business case and implementation plan	37,500	37,500	75,000
Total	164,250	164,250	328,500

It should be stressed that these are initial estimates from Grant Thornton to be used as a guide for budgeting purposes.

- 5.2. Officers will continue to engage with Staff, Members and Trade Unions to ensure that all stakeholders are appraised of developments and progress.
- 5.3. If agreed, it is anticipated that the full business case and implementation plan will be presented to Members in June 2016 for a decision on whether or not to proceed.

6.0 Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/ Governance		<p>The Councils can only trade for commercial purposes through a company. In order to do this, the Councils must approve a business case.</p> <p>Local Authority trading powers as contained in Local Government Act 2003, Localism Act 2011, Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009 have been considered and there are no known legal risks to the Councils in proceeding with this option. However, more detailed legal advice</p>

Proposals relating to a Local Authority Controlled Company

		<p>will be required should the Council adopt the report and agree to the setting up of a controlled company on matters such as, pensions, tax, incorporation, shareholder agreement, TUPE. Incidental powers to participate in external organisations (Local Government Act 1972) have also been considered and again, no legal risks to the Council have been identified.</p> <p>This report makes it clear that if the recommendation is adopted a detailed business case will need to be prepared and brought back before the Councils for approval.</p> <p>Detailed governance arrangements and constitution of the company will need to be agreed between the councils. The constitutional documents will need to be clearly drafted so that the newly formed company can satisfy the Teckal requirements as codified in the Public Contracts Regulations 2015.</p> <p>In relation to waste, Public Contracts Regulations 2015 will need to be complied with should the need to re-procure or extend the term arise.</p> <p>Appendix C is exempt from publication because it contains information about the Council's financial affairs as defined in Paragraph 3 of Schedule 12A to the Local Government Act 1972. The public interest test has been applied and it is considered that the public interest lies in not disclosing this Options Appraisal because it contains financial information which could prejudice the Council if the information was disclosed at this time.</p>
Financial	Y	<p>One-off Investment costs of setting up a Local Authority Controlled Company of £328,500 have been identified. (This is set out on Page 31 of Grant Thornton's report, Appendix B). Each Council has made a budget provision of £150,000 in their Revenue Budget reports for 2016-17 to meet these costs.</p> <p>Grant Thornton's Executive Summary (Page 7, Appendix B) on the Local Authority Controlled Company (LACC) states that they have not identified any significant hurdles that would prevent a LACC being established, conversely neither have they identified any distinct benefits that make a LACC the preferred option.</p> <p>A LACC will provide greater longer term opportunities to reduce costs and generate additional income from outside the Councils from other public sector bodies and the private sector. However, it will take at least two years before it will become profitable, 2019 at the</p>

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		<p>earliest. Its profitability will be dependent on it generating additional income, how this income will be generated is currently unclear.</p> <p>In their report Grant Thornton have set out projected income and expenditure for the first year of trading and this identifies a budget deficit for the company of £360k. Over 90% of this deficit (£330k) is due to depreciation cost of assets transferred to the company. A different approach to the treatment of assets could take out the depreciation costs and the associated deficit.</p>
Risk		<p>A key risk is the capacity to get everything in place for April 2017, particularly given that the organisation is still undergoing significant change from the implementation of the T18 programme. A consideration could be to phase the transfer of services into the new company. However, this would be much more complex and very unlikely to yield the economies of scale and other efficiencies due to the way in which the organisation is now structured following T18 and the cost of implementation would be as much, if not more, therefore this is not recommended.</p> <p>If the West Devon waste contract is to be included then the councils will need to work to a timetable of setting up and getting the new company operational by April 2017 so that the contract can be transferred to the new company.</p> <p>If West Devon Borough Council at their Council meeting on 16th February 2016 were to opt not to establish the LACC, SHDC will be unable to pursue this option and the officer recommendation would be rescinded. A fresh review and benefit analysis would need to be prepared in order to determine the best course of action.</p> <p>See also page 65 of Appendix B for a summary of the key risks identified by Grant Thornton.</p>
Comprehensive Impact Assessment Implications		
Equality and Diversity		N/A
Safeguarding		N/A
Community Safety, Crime and Disorder		N/A
Health, Safety and Wellbeing		N/A

Proposals relating to a Local Authority Controlled Company

Other implications		N/A
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Supporting Information

Appendices:

Appendix A – LGiU Policy Briefing 10th December 2015 Local Authority Trading Companies: A Policy in Practice Briefing

Appendix B – Grant Thornton Options appraisal for the establishment of a local authority controlled company

Appendix C - Grant Thornton Waste Review (exempt from publication)

Background Papers:

- Agenda Item 4 entitled "Transformation Programme 2018" presented to SHDC Special Council on 31st October 2013
- Agenda Item 11 entitled "Torridge and the Future Operating Model" presented to SHDC council on 2nd October 2014

Approval and clearance of report

Process checklist	Completed
Portfolio Holder briefed	Yes
SLT Rep briefed	Yes
Relevant Exec Director sign off	Yes
Data protection issues considered	Yes
If exempt information, public (part 1) report also drafted	Yes (Appendix C only)

Local Authority Trading Companies: a Policy in Practice briefing

10 December 2015

Alan Weaver LGiU associate

Summary

- Local authorities are becoming more interested in Local Authority Trading Companies (LATCs), particularly for income generation purposes
- Local authorities can set up LATCs providing Teckal exemptions, and other statutory requirements are met
- LATCs are developing rapidly, particularly in areas like social care and housing
- There have been LATC successes, failures, and challenging circumstances, particularly for social care LATCs
- A useful methodology to apply to the setting up and development of LATCs is Grant Thornton's 'Spreading the Word' model
- Major issues or sticking points when developing LATCs include: strategic fit of the LA and the LATC; business planning; governance and staff.

Briefing in full

Background

As councils have come under financial pressure, they have considered how to reduce costs, generate income and improve efficiency by developing commercial approaches to their services. Two recent briefings have dealt with commercial activity and income generation in local government. This briefing specifically deals with Local Authority Trading Companies (LATCs).

LATCs are bodies that are free to operate as commercial companies but remain wholly owned by the parent local authority. As trading bodies, they can provide their services to a much wider market than a council department. Part of the reason for the growing interest in LATCs is local government's desire to generate income to protect other services. But there are also secondary drivers including:

- the need for certain services to compete in a wider geographical area to be sustainable;
- a view that greater commercialisation will drive efficiency;
- a view that non-essential services would be better managed separately;

- a view that a different statutory and service environment will provide more flexibility and impact, eg housing development, social care.

Local authorities are also attracted to the fact that less bureaucratic organisations like LATCs may be able to react more quickly and sensitively to changes in markets. Also, unlike with outsourcing, the scope to retain control of the company and reverse their decision if things go wrong appeals to some local authorities.

This year, many local authorities have taken decisions to adopt LATCs. For example, [Newcastle](#) has established 'Newco' a new trading body to help the council expand its current trading ventures. [East Cambridgeshire District Council](#) is currently recruiting a Chairman of the Board to provide independent leadership and a strategic vision to its LATC.

Legislation

The Local Government Act 2003 enables local authorities to establish LATCs to trade in a wide market. The General Power of Competence under The Localism Act 2011 allows local authorities to expand their trading activities into areas not related to existing functions. It also removes geographical boundaries to local authority activity so that they can set up a trading company that can trade anywhere in the UK or elsewhere.

If trading is to be done in the wider commercial market with a view to generating a profit (rather than just on a broad cost recovery basis) the council must establish a company. This can be a company limited by shares, a company limited by guarantee or an industrial and provident society. The 2009 Trading Order requires that a business case ('a comprehensive statement') be prepared and approved before exercising trading powers. Local authorities cannot trade in services they are already statutorily required to provide.

Teckal

When councils want to sell goods or services to other councils or public bodies, they will only be dealing with each other and not operating in a wider market. These are 'shared services' or public-public partnerships. They do not have to put the work out to competitive tender, are still able to generate a profit and are not restricted to cost recovery – as long as they only trade with each other. This avoids the downside of a company status, including the need to pay VAT and corporation tax. If a local authority wishes to set up a company the EU procurement regulations usually require them to undertake a prescribed competitive tendering process before they can award work to the company. This poses a problem as there is no guarantee that the trading company will win the tender. However, local authorities can set up a company without competitive tendering provided they undertake not to trade significantly with external organisations. This is known as the 'Teckal' exemption from procurement rules.

The tests for whether a local authority owned company qualifies for the Teckal exemption are:

- The council(s) must control the company and its activities in the same way as their own departments and activities (control test);

- The company must predominantly undertake work for its controlling council(s) – any activity undertaken for external bodies is minimal (function test).

The council must have decisive influence and control over all decision making. A Teckal company cannot focus on trading commercially in the wider market. If councils are seeking to do this, they must put any work out to tender. A limit of 20% of turnover from external trading activity is now applied. In practice, an early decision the council should make is whether it wishes to use the company for commercial trading, or as a vehicle primarily for delivering the council's own services.

Development of LATCs

Leading LATCs - LACTS have been around for over many years in the form of large, standalone bodies such as airports, and also organisations like [Commercial Services](#) (formerly Kent Commercial Services)- described in a recent [briefing](#). LATCs have developed more recently into areas such as highways, housing and social care.

The best examples of recent successful LATCs include Norse Group, Kingstown Works Limited, and CORMAC.

[Norse Group](#) is by far the largest LATC in the country and has an annual turnover in excess of £250 million. It is a holding company owned by Norfolk County Council and the Group brings together three local authority trading companies concerned with: facilities management; property design and management consultancy; and providing residential care homes and 'housing with care' schemes. Collectively, the group employs over 10,000 people nationwide and have good relations with their staff and unions. UNISON has signed a recognition agreement with them and praised them for their staff training and development programme, apprenticeship schemes, staff morale and low turnover rates.

[Kingstown Works Limited \(KWL\)](#) is a LATC delivering building maintenance and repairs work to Hull City Council, but they also trade with other local councils and housing associations. Created in 2006, by 2012 it had returned over £3 million to Hull City Council in the form of surpluses. It employs 390 local people and has recruited 107 apprentices in the period 2007 to 2015.

[CORMAC](#) are two wholly owned companies of Cornwall Council which has been trading since 1982, and using the CORMAC brand since 1992. In 2012, two companies were formed into a Teckal company for the work passported from Cornwall Council; and a trading company. Since then CORMAC has increased its turnover by an additional £35m per year; increased staffing numbers by 16% and returned benefits to the Cornwall Council to the tune of £20m over three years through productivity improvements and from profit on external work. The vast majority of the work is in highways maintenance and construction. From April 2016, it will manage a 10 year joint venture company responsible for highways and fleet management services for Nottinghamshire County Council. CORMAC is a living wage employer and the majority of the 690 highways staff currently employed by Nottinghamshire CC will transfer to the new company with existing terms and conditions.

Social Care

Social Care LATCS have become prevalent in the last six or seven years as demographic changes, continuing funding cuts, constraints on in-house service provision, and new Care Act responsibilities have increased pressures on local authorities. A key issue has been the barrier on service provision to those receiving direct payments – the principal customers for care and support and upon which the viability of community based provider services are

based. It has been estimated that about 20 social care LATCs are now trading in England and Scotland with many more in the pipeline. Examples of the more prominent social care LATCs are [Buckinghamshire Care](#), [ECL](#) (formerly Essex Cares), [Optalis \(Wokingham\)](#), [Olympus Care Services](#) (Northampton), [Your Choice](#) (Barnet) and [Tricuro \(Dorset\)](#).

The sector has developed rapidly but it has not been without problems. Chelsea Care was set up by Kensington and Chelsea Council in 2008 as a wholly owned trading company to provide home care and brokerage services in the borough. After running into significant financial problems, Chelsea Care was put into liquidation in May 2011, when the council refused to inject further capital into the business to enable it to keep trading. ISSK was set up as a trading company owned by Stockport Council in 2009, with a view to making adult social care and support services more cost effective. However by 2012 the council had serious concerns about both the value for money and quality of care of the company. A period of consultation led to a decision to take back in-house some of the key services that had gone out to the company – reablement, intermediate care and night support teams. The council cited significant changes in the focus of services which meant that the trading company was no longer appropriate:

Essex Care became England's first successful social care LATC when it was launched in 2009 and quickly became a cash cow for the council. In 2010-11, it made a profit of £3.5m, but in 2012-13, the profit, though still healthy, had dropped to £1.5m and last year the company made a pre-tax loss of £828,000. The result has been a 'reshaping' of the organisation, with new multi-skilled community teams and cuts in administration and management. The company also acquired a new name ECL. ECL employs 900 staff and supports more than 50,000 mainly older or disabled people at home or in activity centres. Its services remain popular with high levels of customer satisfaction. It offers a wide range of workplace training and also has a contract with West Sussex County Council, providing reablement services to people who are regaining independence.

By the beginning of 2014, Optalis Ltd had been trading successfully for three years, increasing turnover to £12m and reaching savings targets. However, Optalis reported an operating profit of just £5K in year ending March 2014, a drop from £143K the previous year. Another social care LATC, Your Choice Barnet, set up in 2012 and projected to make a surplus of £500K by 2015-16, has also run into trouble. Staff salaries were recently reduced by 9.5% and a Care Quality Commission report earlier this year branded the company's supported living services inadequate.

Tricuro, launched in July 2015, is the first cross boundary social care LATC. The original plan was to set up a single plan for Dorset County Council but it was quickly realised that county wide company taking in Bournemouth and Poole would offer significant economies of scale. Its services include residential care, day services and catering and it is also the largest social care LATC, with a budget of more than £38 million and 1,200 staff.

Housing

There has also been a proliferation of housing LATCs. A [survey](#) published in August 2015 indicated that more than 50 councils in England have either set up or are considering setting up their own housing company. This has been particularly attractive for those authorities who do not have sufficient borrowing headroom within their Housing Revenue Account (HRA) or who want to explore other funding opportunities to develop housing outside the HRA. The most common approach is the creation of a 100% council owned subsidiary or council owned company, usually constituted as a company limited by shares with council officers acting as directors and company secretaries. Purposes include the provision of new build private sale, mixed tenure and affordable homes; the purchase and repair of affordable homes; the provision of affordable rented property by leasing empty property, etc. However, not all local authorities are attracted to the idea. A common reason is that the expected

revenue is not high enough to make a business case for such a company. This is often the case where house prices are very low. Uncertainty also arises from a lack of clarity over the government's position and the threat to take measures against council owned housing companies that circumvent Right to Buy legislation.

There are also LATCs set up to provide DLO housing maintenance work or to include it within their proposed work, eg. Kingstown Works Limited.

Thurrock Council set up a wholly owned housing company, [Gloriana Thurrock Ltd](#). Gloriana will enable the Council to kick start house building through directly developing around 1,000 new homes. It aims to accelerate housing delivery over the next five years and support regeneration objectives in growth locations. Council land is sold to the company at a commercially valued rate and Gloriana borrows prudentially against the council general fund to fund the housing development. Gloriana pays the interest on the loan through its rental income and the debt can be repaid when the homes are sold. The design of the first Gloriana development at the St Chad's scheme in Tilbury for over a hundred homes has secured a top [national award](#)

Nuneaton and Bedworth Council set up its trading established trading arm, named Nuneaton and Bedworth Community Enterprises LTD (NABCEL) in March 2014. The first business stream chosen for [NABCEL](#) was the purchase of properties to rent out at full market rent. As well as generating income, this also helps address the local need for affordable rented properties. A capital budget of £1m was approved as part of the 2014/15 budget. This has so far secured seven properties and with a further two to three being planned. Forecast income generation for 2015/16 is £50k, which will go towards protecting services and jobs.

Ashford Borough Council has set up a council owned housing company to build new homes for rent because its housing market is not keeping pace with demand for privately rented accommodation or providing alternatives for people without sufficient income to buy their own homes. The council is seeking to target this gap in the housing market through a new trading company to provide additional housing capacity. The new property company will be council owned and funded initially by council borrowing. The company will offer homes to rent and sale, with a mix of rent levels. It will also provide an income stream for the council through the borrowings.

South Cambridgeshire District Council set up Ermine Street Housing in 2014 and invested £7 million in property to rent as an "ethical commercial landlord". During the pilot Ermine Street Housing generated £100,000 of income for the Council. The company now owns 34 properties worth a total of £6,837,970 providing homes for people who cannot get an affordable housing tenancy. [South Cambridgeshire District Council have now expanding a Council owned housing company investing £100 million to acquire a property portfolio of 500 homes over the next five years.](#)

Approaches to LATCs

A useful 'Spreading Their Wings' model to consider LATCs has been developed by Grant Thornton. Its three stage process and comprehensive range of steps model is listed below together with a link.

[SPREADING THEIR WINGS MODEL](#)

1.DECIDING TO SET UP A LATC	2.SETTING UP A LATC	3. BUILDING A SUCCESSFUL LATC
<ul style="list-style-type: none"> • Consider the strategic fit of the company with the council’s vision • Appraise options • Develop an outline business case 	<ul style="list-style-type: none"> • Obtain the right professional advice • Company registration • Trading • People • Pensions • Governance • Financing and Taxation • Transfer of assets and support service costs • Performance Management and contracting 	<ul style="list-style-type: none"> • Put the right leadership team in place • Create the right culture • Reconsider reward • Build a customer focus • Build an appropriate vision and gain the commitment of the local authority • Prepare for the future • Creating and promoting the brand • Get to grips with costs • Build appropriate risk management and group governance

Each of the steps in developing a LATC merits careful examination or problems will be experienced. In addition, there are a range of major issues or sticking points which cause problems across most LATCs and these warrant closer attention.

Strategic Fit of the Company Vision with the Local Authority Vision – This is sometimes overlooked by local authorities because income generation usually overwhelms other considerations. But the strategic fit needs to be examined in far more detail. The council and the LATC need to have clarity about how the LATC will fit with the council’s longer term strategic priorities and how the company will grow. A failure to properly address this can and will cause tensions between the council and the LATC, particularly over company growth and expansion and the redistribution of profits. In addition, it is almost inevitable that the vision and strategy will need to be refreshed as the company develops.

Grant Thornton feels that most problems arise when council and company are not on the same wavelength and where councils set ‘heroic’ savings targets. CORMAC appear to have negotiated this issue ‘well’. The council was clear it was not just about achieving savings. It was about increasing its client base and offering increased job opportunities for the people of Cornwall. CORMAC sees commercial opportunities and partnerships with other councils as the future, while the council describes the current position as a “ nice little corridor between the public and private sector”.

Business Planning - Business planning is a key element. The lack of a business plan for the transfer of council services into the company is a common failing.

Buckinghamshire Care saw the first step as developing a business case as it enabled the council to determine whether the business would be a success but also gave a clear objective in the first year of trading.

For more details of LATC business planning, please access publicly available reports and models produced in respect of [Tricuro](#). The report considered in October 2014 anticipated that the LATC would save £6.8m over five years or around £1.4 million per year from the base budget. The report contains a high level options appraisal and detailed business plan and a risk assessment, equality impact account, a five year profit and loss and balance

sheet forecast is presented. Details of staff consultation arrangements and results, market research, implementation and programme management sections are also available.

Governance – LATCs need appropriate governance, including board chairship and composition, and appropriate procedures, protocols and systems to support human resource and risk management and service planning and associated monitoring and reporting arrangements. How these are developed, managed and balanced within the context of a new relationship with the local authority can be fraught with ambiguity, controversy and problems.

Effective governance is key to protecting Norse and the councils working with Norse. Over time, Norse has established a clear governance structure that supports the business and provides surety to Norfolk County Council in risk management. Key factors are:

- The two council appointees on the board have double votes and therefore control of company decisions;
- A shareholder committee has oversight of the company and receives a quarterly report;
- Each group company has a liaison board that holds the company to account.

For [Buckinghamshire Care](#), the council felt that it was important to give Buckinghamshire Care directors sufficient space and control to drive the growth and develop the company. They also wanted to maintain strong links with the company – through the shareholders' scrutiny group – ensuring the company's direction was in line with the council's objectives. They wanted to have the flexibility to incorporate additional services in the future. To achieve this, Buckinghamshire Care's shareholder scrutiny group includes two council members, the Section 151 officer, the director of adult services, the commissioning director and contracts manager. The group meets quarterly and aims to hold the company directors to account for the quality and value of the services provided to the council. This group is an essential component for the council to exert influence over the company and therefore meet the requirements of the Teckal exemption¹. The structure aims to balance the council's need for control with the space the company needs to achieve the council's aims. The council remains 100% shareholder, thereby retaining a role in scrutiny and a level of control.

[KWL](#) is a company controlled by Hull City Council which is the sole shareholder. Democratic accountability is ensured through the Kingstown Works Limited Shareholding Committee which receives reports from the board of KWL, which is itself made up of eight elected members from Hull City Council. The organisational model developed by KWL prioritises tight financial controls ensuring that the company has the freedom to innovate and bid for work as it arises within an overall framework of democratic accountability. Indeed, one important condition of its success, as recognised by its Business Leader, is that the board offers an effective challenge and scrutiny to senior management.

Arrangements for social care and highways LATCS can be contrasted with some of the housing LATCs where service provision is more focused on discrete strategic outcomes with a small number of staff, and therefore less critical. For NABCEL, concerned with trading and the purchase of housing for rent in the private rental sector market, governance issues are slightly different.

For NABCEL, the company board structure comprises two non-executive directors – the council's director of finance and director of housing – and three executive directors who are councillors. NABCEL has an AGM which takes place at a full council meeting, as the council is the only shareholder in the company. NABEL has board meetings but there is no review by the council's scrutiny or audit committee.

In general, Grant Thornton believes shareholders committees are the most effective means of council governance.

People - The motivation and development of staff transferring to the LATC is a recurring and vital theme. Most LATCs cite this as a key factor in creating a successful company and it appears to have been a key feature of the success of successful companies like CORMAC, Kingstown Works Limited, Kent Commercial Services and Norsk Ltd.

LATCs have to find a way of winning the hearts and minds of the staff transferring into their LATC, and to tap into their creative potential and talents at a time when many may be feeling anxious, battered and bruised by threats of redundancy, a lack of information, and poorer terms and conditions.

Poorer terms and conditions are real tangible problems, often involving changes to sick pay, holiday entitlement, and pensions, although pension liabilities are often resolved by local authorities retaining responsibility for past and future pension liabilities associated with transferred staff.

Many LATCS have embraced organisational development interventions to help culture changes designed to build trust and flexibility within staff. Change agents or professional trainers are often engaged to develop commercial mindsets within their staff, when people are encouraged to develop and strengthen the business, and where they are trained, supported and developed.

At Ashford, taking a more entrepreneurial role in housing has enabled staff to develop new skills and services in house. The council now has its own architects for example.

Changing terms and conditions can provide opportunities to improve on some element eg reward mechanisms and improved rates of pay. At CORMAC, the initial TUPE transfer of staff to CORMAC gave employees the opportunity to move to CORMAC contracts. Key changes were on the sickness policy, with CORMAC not paying the first three days of sickness. This was mitigated with increases in rates for overtime pay and unsocial hours, where the council was struggling to offer competitive industry rates. In addition, a small bonus based on the profit share of the company was also part of the new CORMAC contracts. Take up of the CORMAC contracts was significant.

Comment

LATCs are interesting developments in the local government world. Many members and officers may perceive LATCs as one of the more positive developments at a time when there appears to be little light at the end of the tunnel for local government resourcing and service delivery.

However, LATCS are not excluded from the prospects of a bumpy ride, not least because of continuing changes to the public service environment driven by central government, particularly in respect of housing and social care. That aside, when contemplating and planning the role of LATCS, local authorities need to think beyond shorter term public service environment, income generation, and Teckal considerations to the long term implications i.e. on the local authority side – to the acceptance of likely long term loss of direct control over discretionary service provision, on the LATC side to exposure to the vagaries to a commercial environment where growth or survival is dependent on the ability to adapt and develop new ways of delivering services, and where no safety net exists.

Within this context, the development of LATCs may present a way forward in many areas and some grounds for optimism.

Related briefings

[Income Generation – Charging & Trading: Policy in Practice Briefing](#)

[Income Generation – General: Policy in Practice Briefing](#)

LGiU and Mears report

[Under Construction](#)

Sources of information

[Grant Thornton – Spreading their wings – Building a successful local authority trading company \(LACT\)](#)

Highlights key principles and details in developing successful LACTS. Considers TECKAL issues. Considers a range of detailed case studies.

[Grant Thornton – External Audit Update for the Corporate Governance and Standards Committee of Guildford Borough Council](#)

Contains a summary of the above and other relevant Grant Thornton financial reports but also a summary of existing local authority trading companies.

[LGA - Supporting housing – A Case Study Guide](#)

Provides examples of entrepreneurial activity led by councils to provide new homes in response to the demands of their local housing market and housing pressures and shares some of the learning from these councils. Considers a whole range of housing delivery options and case studies plus issues to consider in selecting the investment and delivery model, including those involved in council owned housing companies eg. Ashford – Housing, Thurrock - Housing.

[LGA – Enterprising Councils – getting the most from trading and charging](#) Guide designed to help councillors and senior officers to navigate their way through difficult choices to be made about engagement in trading activities. Includes 3 case studies (The South West Audit Partnership; Norse Group, Essex Cares, Kent County Council).

[Branch Unison Guide to local authority trading companies](#) A different perspective looking at LACTS and procurement rules, how they can be challenged and case studies.

[Capita – Creating council commercialism – A conversation](#) – The purpose of the paper is to unpack the notion of ‘commercialism’ applied to councils and to offer some observations about how the councils that wish to pursue a degree of commerciality potentially achieve it.

[Localis - Commercial Councils – The rise of entrepreneurialism in local government](#) – The report outlines how local government can secure its finances and boost local growth

prospects by developing entrepreneurial approaches. It has a range of case studies dealing with local authority traded services. (Civic Enterprise Leeds, Kent Commercial Services, Barnet and Capita Joint Venture).

[Localis – Policy Platform – Trading Councils: How Local Authorities can innovatively use commercial powers](#). A range of local government leaders consider local authority capacity to trade and reap the rewards of commercial opportunities.

Other Sources

West Lindsey District Council Commercial Plan 2015 to 2020

South Hams District Council – Creating a LACT

Folkestone – Regeneration and Housing Company – Purpose and Options

Guardian – Gloriana Thurrock – Is this the future of council house building

AgendaNi – Service and Savings: the ALMO model

www.dorsetforyou.com Tricuro – LATC – Adult and Community Services in Dorset

Wokingham BC – range of LACTS

Range of articles and publications relating to the Barnet Group

Range of LGA Case studies

For more information about this, or any other LGiU member briefing, please contact Janet Sillett, Briefings Manager, on janet.sillett@lgiu.org.uk

South Hams District Council and West Devon Borough Council

Options appraisal for establishment of a local authority
controlled company

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13 January 2016



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14 January 2016

Dear Sirs

Option appraisal for proposed set up of a local authority controlled company Consultation Draft

We have pleasure in enclosing a copy of our report (the 'Report') containing the findings from our review in relation to South Hams District Council and West Devon Borough Council's (the 'Councils') proposal for establishing a local authority controlled company ('LACC'). The scope of this review was agreed in the Letter of Engagement dated 20 November 2015.

Notwithstanding the scope of this engagement, responsibility for management decisions will remain with the Councils and not with Grant Thornton UK LLP.

Context

The Councils have worked closely together for a number of years, providing a range of shared services to the residents of South Hams and West Devon. The Councils have made a decision to consider setting up a jointly owned local authority controlled company to reduce costs further and generate income. The Councils are therefore seeking advice to assist them to understand the likely costs and benefits to be gained from introducing a LACC to deliver services.

The findings for this work will enable the Councils and their elected members (Members) to understand if a local authority controlled company will meet the strategic objectives of the Councils.

Limitation of liability

We draw the Councils' attention to the limitation of liability clauses in paragraphs 3.1 to 3.9 contained in our engagement letter dated 20 November 2015.

Forms of report

For the Councils' convenience, this report may have been made available to the Councils in electronic as well as hard copy format, multiple copies and versions of this report may therefore exist in different media and in the case of any discrepancy the final signed hard copy should be regarded as definitive.

Chartered Accountants

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Confidentiality and reliance

This report is for sole use of the Councils. We stress that our report and other communications are confidential and prepared for the addressee(s) only. They should not be used, reproduced or circulated for any other purpose, whether in whole or in part without our prior written consent, which consent will only be given after full consideration of the circumstances at the time. We agree that an addressee may disclose our report to its employees, officers, Members, directors, insurers and professional advisers as required by law or regulation, the rules or order of a stock exchange, court or supervisory, regulatory, governmental or judicial authority without our prior written consent but in each case strictly on the basis that we owe no duties to any such persons.

To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the addressee(s) for our work or for our report and other communications.

To the fullest extent permitted by law, we do not accept any responsibility for any loss or damages arising out of the use of the report or other communications by the addressee(s) for any purpose other than in connection with the Purpose.

General

The report is issued on the understanding that the management of the Councils have drawn our attention to all matters, financial or otherwise, of which they are aware which may have an impact on our report up to the date of signature of this report. Events and circumstances occurring after the date of our report will, in due course, render our report out of date and, accordingly, we will not accept a duty of care nor assume a responsibility for decisions and actions which are based upon such an out of date report. Additionally, we have no responsibility to update this report for events and circumstances occurring after this date.

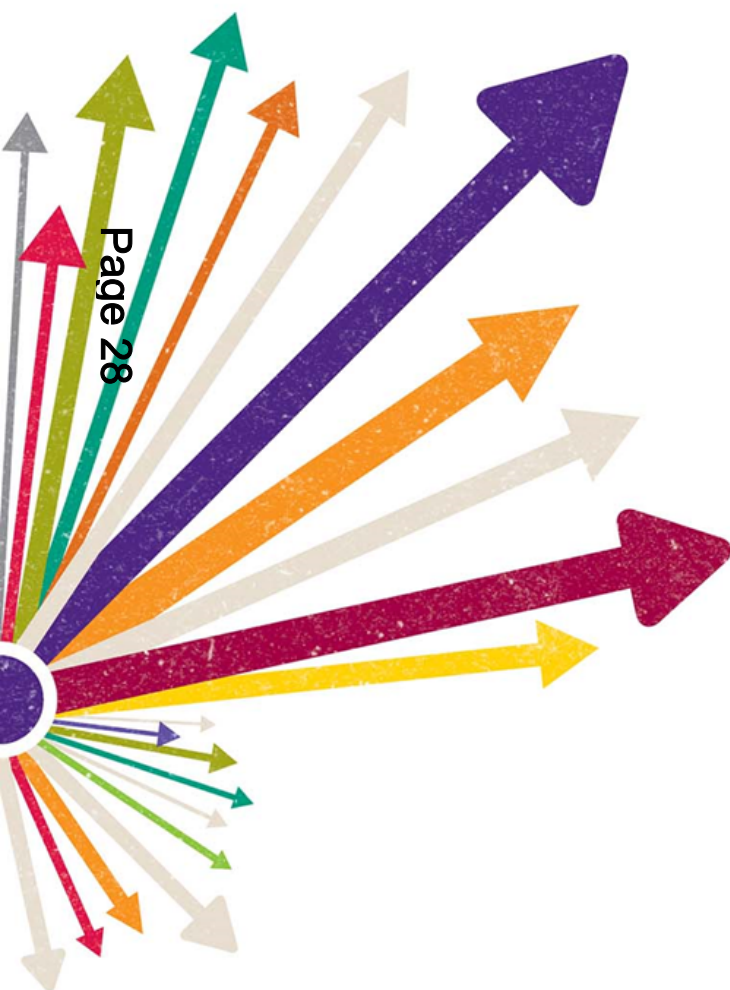
We would like to thank the Councils' officers for making themselves available during the course of the review.

Yours faithfully



Grant Thornton UK LLP

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Executive summary



Executive summary

Background

South Hams District Council and West Devon Borough Council (the Councils) have worked closely together for a number of years, providing a range of shared services. Through the transformation programme, T18, the Councils have brought teams and services together into the following service blocks:

- Customer First
- Commercial Services
- Support Services.

The Councils have demonstrated their ability to be agile and have delivered new ways of working achieving a Gold Award for 'Delivering through Efficiency' and the Silver Award for 'Council of the Year at the Improvement and Efficiency Social Enterprise Awards (iESE). Through the transformational programme they plan to deliver £2.1m in savings by 31 March 2016.

The Councils are now considering the next stage of joint working and are looking to establish a local authority controlled company (LACC). All services will transfer to the LACC, with only a small number of people remaining with the Councils; the Strategy and Commissioning function. Within this report we have considered the following two options, as requested by the Councils:

- Option A - 'as is' position – continuation of the current arrangements
- Option B - establishment of a Teckal exempt, LACC (the proposed company) to deliver all services.

Other alternative delivery models have not been considered as they are outside the scope of this review. The setting up of the LACC would result in the Councils no longer directly delivering services and the Councils functioning as commissioning Councils.

Options for waste services delivery

Grant Thornton have been commissioned by the Councils to produce cash flow projections for the Councils' waste services and to quantify the potential risks and benefits posed by the options available to the Councils going forward from expiry of the FCC Environment contract.

Therefore waste services for both Councils are outside the scope of this review and have been reported separately by Grant Thornton.

Approach

Our approach included:

- stakeholder meetings (officers and key Members), to understand the risks and benefits
- documentation review and analysis, in relation to relevant information such as staff, accommodation and service costs
- an income and expenditure forecast for the first year of operation for the LACC, based on information and assumptions provided by officers. This has enabled us to take account of the savings and income generating opportunities that might arise, such as staff costs, economies of scale and increased revenue.

Executive summary

Purpose

We were engaged to identify the risks and benefits of the two options and in particular to consider the risks and implications for the Councils if they were to establish a LACC.

Summary findings

We have not identified any significant hurdles that would prevent a LACC being established; conversely neither have we identified any distinct benefits that make a LACC the preferred option.

Option A – 'as is' has been successful and enabled the Councils to develop new ways of working and begin to develop a commercial culture. The key risk of this option is that existing service levels would have to change to meet future financial challenges and that existing arrangements would be unable to meet the recently identified budget funding gap.

Option B - a LACC, will provide greater longer term opportunities to reduce costs and generate additional income from outside the Councils from other public sector bodies and the private sector. However, it will take at least two years before it will become profitable, 2019 at the earliest.

Its profitability will be dependent on it generating additional income, how this income will be generated is currently unclear. In order to generate additional income the proposed company will need to develop its commercial skills and ensure its culture is aligned to being a commercial entity. This can be achieved by building on the changes began through the T18 transformation programme and investing in cultural change within the LACC.

The Council should consider the most appropriate time to establish the LACC taking into account how the investment costs will be funded and the lead time required before it will be able to generate additional income. Based on our review we have not identified any clear indications as to whether it would be more beneficial to phase the transfer by service block.

The Councils are proposing a LACC which will include over 400 members of staff TUPE transferring as well all services transferring to the proposed company. This may result in services transferring to the LACC which may be subsidised by the Councils. However, these services could still be provided by the LACC to other councils and provide additional income for the proposed company.

The first year will be a transitional year, as the new company adapts and identifies its potential market. As a result we have assumed that no additional income will be generated in the first year, but some savings will be made as a result of restructuring; this is shown in the summary Income and Expenditure forecast, set out overleaf.

The opportunities are likely to increase as other councils look for others ways to meet the financial challenge. These opportunities could be maximised if the LACC was able to demonstrate its competitiveness in the relevant markets. Public sector organisations are also more likely to commission services from other public sector organisations than commission the private sector, but this will vary between organisations.

Within the proposed company the Councils should satisfy themselves that existing staff have the appropriate skills and capacity to drive the change in culture from the beginning. In our experience, successful LACCs have invested considerable amounts in staff consultation, change management and commercial leadership to ensure the development of its commercial acumen from the outset. Delaying this aspect is likely to extend the time it will take for the LACC to become commercially successful.

The Council should be aware that neither option A or B will enable the Councils to meet their short term funding gaps identified as a result of the recent spending review. If successful the LACC will provide a longer term solution, for the short to medium term alternative solutions will be required.

Executive summary

Summary income and expenditure forecast

The table below sets out the expected income and expenditure for the proposed company in its first year of operation. A deficit is forecast in the first year of operation.

LACC forecast income and expenditure account

	£m
Income	(6.67)
Expenditure	7.12
Savings	(0.0.9)
(Surplus)/deficit	0.36

Source: The Councils' 2015/16 budget

Investment costs

There are one-off investment costs involved in establishing the LACC. We estimate that based on discussion with officers these could be in the region of £329,000. These costs are important to ensure the transition is effectively managed, the LACC is set up appropriately, both from a financial and legal position and the LACC is able to effectively operate in a commercial environment. Further details are set out in Appendix 2.

In our experience other councils have incurred expenditure in the region of £400,000.

The Council should consider how these costs are to be funded and if this has an impact on when the LACC should be established.

Strategic fit

The future for local authorities is uncertain, both as a result of financial constraints and as English authorities begin to consider devolution. Both Councils recognise that change is inevitable and have begun to develop their vision and strategic direction within their corporate plans. These are at differing stages of development and are consistent with the Councils' objectives for transformation:

- financial sustainability
- maintain and protect front line services
- provide quality services.

Both options are not able to guarantee financial stability, although the proposed company would provide greater opportunities with more possibilities to generate income from outside the Councils. The LACC offers longer term solutions which existing arrangements are unable to provide without having an impact on existing service provision.

More detailed information can be found in Appendix 3.

Executive summary

In order to assess the two options for the direct delivery of services we have compared the two options below using the following considerations: governance, financial, people and tax.

	Key features	Governance	Financial	People	Tax
As is	<ul style="list-style-type: none"> All services are directly controlled by the councils Members are able to affect changes through their committee structure as set out in each individual constitution Future uncertain as a result of devolution More difficult to identify further savings 	<ul style="list-style-type: none"> Elected Members within each council are accountable and the key decision makers Slow decision making process in comparison to commercial organisations 	<ul style="list-style-type: none"> South Hams: <ul style="list-style-type: none"> net budget - £8.7m Total budget gap over five years to 2020/21 is £1.4m West Devon: <ul style="list-style-type: none"> net budget - £7.3m Total budget gap over five years to 2020/21 is £1.1m Limited external revenue generation opportunities 	<ul style="list-style-type: none"> No significant changes, employees will remain employed by the councils on the existing terms and conditions The culture is likely to remain the same Employees will remain in the Devon County Council Pension Fund (DCCPF) 	<ul style="list-style-type: none"> There will be no impact
LACC, with teckal exemption	<ul style="list-style-type: none"> Wholly owned company Councils being equal shareholders Greater freedom to make quicker commercial decisions Greater risk and potentially greater reward Potential to reduce costs and increase income Preferred cultural fit in comparison to other models eg. outsourcing or joint venture 	<ul style="list-style-type: none"> Control through LACC Board and shareholder committee Development of stronger commissioner side in the Councils Financial and reputation risk of failure Exit strategy required 	<ul style="list-style-type: none"> Turnover in the region of £6.7m with a £0.36m deficit Will take at least two years to be profitable Investment costs - £329,000 Market – limited unlikely to deliver benefits for two years Separate accounts required 	<ul style="list-style-type: none"> Over 400 people will TUPE transfer Potential to revise T&Cs Cultural change required Pensions – agreement on past deficit and admission of LGPS required 	<ul style="list-style-type: none"> Subject to corporation tax (currently 20%; 19% from 2017 and 18% from 2020) Potential to apply to HMRC for dispensation from CT where trading solely to the Councils VAT registration required The activities will be regarded as business activities and the normal VAT rules will apply, but important to understand the nature of the LACC activities and to model precise tax impacts on the Councils

Executive summary

Next steps

The establishment of a LACC is complex and will require at least 18 months to set up. The Councils are aware of this and are considering operating shadow arrangements prior to becoming fully operational.

The proposed timeline is as follows:

- February 2016 – Councils decide if a detailed business case for a LACC should be developed
- June 2016 – Councils decide if a LACC should be established
- April 2017 or April 2018 - the LACC would be operational

If the Councils agree to proceed then we consider that the following should be undertaken:

- strategic business case
- outline business case
- detailed business case, which should include detailed market analysis.

Detailed legal advice has not been provided as part of this report and we recommend that it should be obtained to support the next stage of this process.

Structure of this report

During the remainder of the report we set out our detailed findings in relation to the two options that have been considered.

For both option A 'as is' and option B 'LACC' we have considered the following key features:

- governance
- financial
- people
- tax considerations.

The appendices that provide more detailed information on:

- scope of the services
- investment costs
- strategic fit and drivers for change
- LACC income and expenditure forecast
- account and asset considerations
- market analysis
- tax considerations
- pension considerations
- strengths and weaknesses
- key risks.

Evaluation of Option A: 'As-is'

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Option A: 'As-is'

Summary

Existing partnership arrangements between the two Councils have delivered new ways of working and transformational savings. Further savings are planned in the short term, but the savings required to meet the budget gap in the medium to long term require further development. The Councils need to consider if there are still other opportunities within the existing arrangements that are not yet explored to reduce costs, or whether the opportunities have been exhausted.

In order to establish the continued fitness for purpose of the direct delivery of services we have compared this option to a LACC using the following criteria: governance, financial, people and tax considerations. This should help the Councils to identify the model that best meets their future requirements

	Key features	Governance	Financial	People	Tax
As is	<ul style="list-style-type: none"> All services are directly controlled by the councils Members are able to affect changes through their committee structure as set out in each individual constitution Future uncertain as a result of devolution More difficult to identify further savings 	<ul style="list-style-type: none"> Elected Members within each council are accountable and the key decision makers Slow decision making process in comparison to commercial organisations 	<ul style="list-style-type: none"> South Hams: <ul style="list-style-type: none"> net budget - £8.7m Total budget gap over five years to 2020/21 is £1.4m West Devon: <ul style="list-style-type: none"> net budget - £7.3m Total budget gap over five years to 2020/21 is £1.1m Limited external revenue generation opportunities 	<ul style="list-style-type: none"> No significant changes, employees will remain employed by the councils on the existing terms and conditions The culture is likely to remain the same Employees will remain in the Devon County Council Pension Fund (DCCPF) 	<ul style="list-style-type: none"> There will be no impact

Option A: 'As-is'

Key Features

Type of delivery vehicle

The majority of services are delivered directly by the Councils, although leisure and West Devon waste services are outsourced. Members are able to effect change through their committee structure as set out in each individual constitution. Members are involved and good relationships exist between officers and Members.

Accounting requirements

Councils in the United Kingdom are required to prepare their statutory financial statements in line with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which is based on International Financial Reporting Standards (IFRS), except where these are inconsistent with specific statutory requirements. This will remain unchanged.

Assets and transfer arrangements

No asset transfers are required for the continuation of in-house service. Further information can be found in Appendix 5.

Market analysis

Local authorities are able to generate additional income and do so by charging for services which they provide, such as car parking and licensing and regulation services. Evaluation and looking at ways of maximising their income is outside the scope of this review.

The Councils are able to trade with other public bodies without setting up a company. They can do this under Section 1 of the Local Authorities (Goods and Services) Act 1970, which enables local authorities to sell certain goods and services to other "public bodies" at cost. However, few take advantage of this option as it does not enable them to make a profit.

Further information on the market analysis can be found in Appendix 6.

Governance

Structure

The elected Members within each Council are the key decision makers. In West Devon Borough Council a committee structure is in place and issues will be discussed first by the 'Hub' committee, before decisions are made by full council. Whereas in South Hams District Council an 'Executive' decision making process is in place. Both systems result in a slow decision making process in comparison to a commercial organisation.

The Councils do not have robust contract management controls in place. These are not considered necessary for in-house services, as a result service level agreements are not in place. Service delivery is monitored against key performance indicators, but the level of monitoring varies. At present the Councils' contract management arrangements are focused on outsourced services, such as leisure and waste services (West Devon). These arrangements are considered adequate by the Councils.

Exit Strategy

An exit strategy is not required for this option.

Option A: 'As-is'

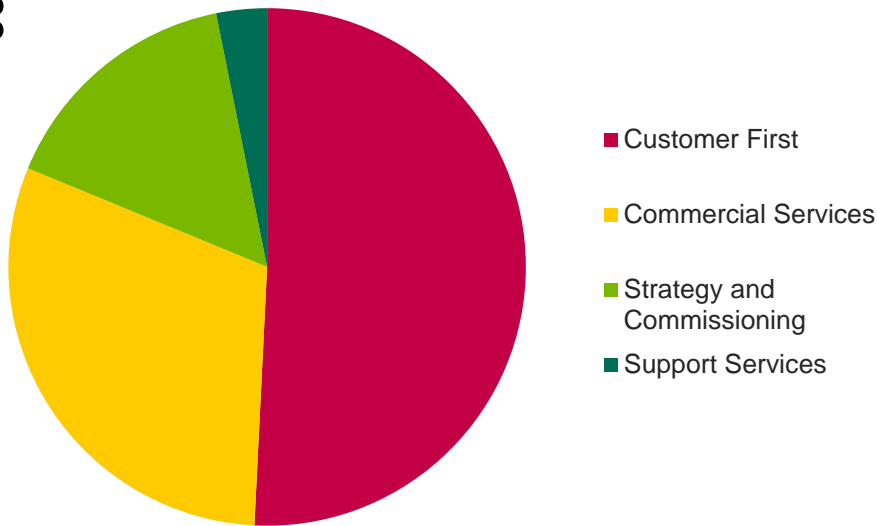
Financial

Financial Case

The charts below illustrate the net budget for each Council in 2015/16. The Councils need to deliver £2.5m in savings by 2020/21. The Councils are currently looking to identify how this budget gap will be met. The Councils will have to identify how these funding gaps will be achieved, which ever option is selected.

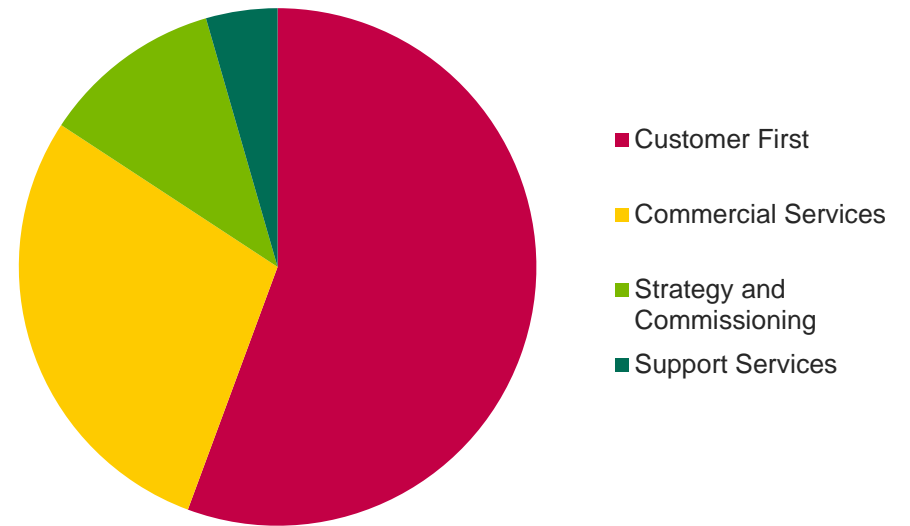
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South Hams DC
2015/16: Net budget – £8.7m



Total budget gap over the five years to 2020/21 - £1.4m.

West Devon BC
2015/16: Net budget – £7.3m



Total budget gap over the five years to 2020/21 - £1.1m.

Option A: 'As-is'

People

There is no impact on people as they will continue to be employed by either South Hams District Council or West Devon Borough Council.

Savings could be achieved through changes to the terms and conditions, such as changes to sickness absence, travel expenses and redundancy benefits.

Staff savings have been delivered through the T18 programme and will continue in 2016.

Culture

Through the transformation T18 programme the Councils have begun to change and develop a more commercial culture. This has begun through the recruitment process with both new and existing staff being recruited by behaviours, which include commercial attributes. Going forward the Councils need to consider how cultural change could be further stimulated.

Pensions

Both Councils participate in the Devon County Council Pension Fund (DCCPF), also known as the Peninsula pension fund. The contribution rates differ between the two Councils as identified opposite and would continue for the foreseeable future.

Further information can be found in Appendix 8.

Pension contributions by Council

	2014/15		2015/16		2016/17	
	%	£	%	£	%	£
WDBC	12.2	417,000	12.2	432,000	12.2	452,000
SHDC	14.1	141,000	14.8	146,000	14.8	153,999

Tax

VAT

The existing VAT arrangements are VAT efficient and the Councils will not suffer any irrecoverable VAT in its provision of services.

Corporation tax

The Councils, as local authorities are exempt from corporation tax on any surpluses arising from the provision of services.

Employment taxes

As there would be no change existing arrangements would continue.

Further information can be found in Appendix 7.

Key risks

A significant risk for this option is that it will be unable to meet the planned budget gap without having to change or stop the delivery of some services. Further risks are identified in Appendix 10.

Evaluation of Option B:
A local authority
controlled company

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Option B: A local authority controlled company

Summary

The establishment of a LACC will require significant change across the Councils. The LACC has the ability to generate additional income from other public sector bodies and the private sector, but needs to develop its commercial skills to ensure this opportunity is realised.

Key features	Governance	Financial	People	Tax
<ul style="list-style-type: none"> Wholly owned company Councils being equal shareholders Greater freedom to make quicker commercial decisions Greater risks and potentially greater rewards Potential to reduce costs and increase income Preferred cultural fit in comparison to other models such as outsourcing. 	<ul style="list-style-type: none"> Control through LACC Board and shareholder committee Development of stronger commissioner side in the Councils Financial and reputation risk of failure Exit strategy required 	<ul style="list-style-type: none"> Turnover in the region of £6.7m with a £0.36m deficit Investment costs - £329,000 Market – limited unlikely to deliver benefits for two years Separate accounts required 	<ul style="list-style-type: none"> Over 400 people TUPE transfer Potential to revise T&Cs Cultural change required Pensions – agreement on past deficit and admission of LGPS required 	<ul style="list-style-type: none"> Subject to corporation tax (currently 20%; 19% from 2017 and 18% from 2020) Potential to apply to HMRC for dispensation from CT where trading solely to the Councils VAT registration required The activities will be regarded as business activities and the normal VAT rules will apply, but important to understand the nature of the LACC activities and to model precise tax impacts on the Councils

Option B: A Local authority controlled company

Key Features

Type of delivery vehicle

The proposed vehicle is a local authority wholly owned company, limited by shares with Teckal exemption. The proposed company would have equal share ownership between the two Councils and have limited liability.

A LACC would enable the Councils to retain control and where there is a commercially viable proposition, to trade separately through a commercial vehicle. They have become increasingly popular, as authorities need to reduce costs and look to how they might generate additional income. The range and type of services they provide is also becoming more diverse.

This type of legal entity enables profits to be both retained by the proposed company and to be shared by the Councils. It also offers greater flexibility in how the profits will be shared, between the two Councils and across different services.

At present the profit share is uncertain, but is likely to reflect the same proportion as resources invested into the proposed company.

The main purpose of the proposed company will be to deliver existing Council services, whilst it develops its commerciality and ability to trade. The Teckal exemption allows the Councils to award contracts directly. The contracts with the Councils would be protected and have legal exemption from European procurement laws. It also gives the proposed company freedom to trade up to 20% of its turnover, in the region of £1.33m in the first year. It should be noted that this figure is indicative only and detailed work will be required to understand the level of activity and turnover for each service provided by the proposed company.

In order to meet the Teckal requirements, the proposed company has to satisfy the control and function test. The Councils have to exercise control over the proposed company similar to that which it exercises over its own departments, the control test. The function test requires that the majority (80%) of activity undertaken by the proposed company should be undertaken for the controlling Councils.

Accounting requirements

Implications for the proposed company

In the UK, the Companies Act 2006 allows companies, other than charities to prepare their accounts in accordance with either the International Financial Reporting Standards (IFRS) or the Companies Acts and UK Generally Accepted Accounting Practices (UKGAAP). The Financial Reporting Council (FRC) has issued three new accounting standards, FRS 100-102, which will replace all existing FRS's, SSAPs and UITFs. The new financial reporting framework will be applicable on a mandatory basis for the majority of UK entities for reporting periods starting on or after 1 January 2015.

Implications for the Council

The Councils will be required to prepare their statutory financial statements in line with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which is based on International Financial Reporting Standards (IFRS), except where these are inconsistent with specific statutory requirements.

The Code requires Councils to prepare group accounts in accordance with IFRS10 Consolidated Financial Statements and that Councils with interests in subsidiaries, associates or joint arrangements may need to prepare Group Accounts in addition to their single entity financial statements, unless their interest is considered not material.

Each Council will need to consider whether the company is a subsidiary, associate or joint arrangement before establishing how to account for the proposed company. The Councils will need to account for any initial investment in the proposed company in its single entity accounts.

Option B: A Local Authority controlled company

Assets and transfer arrangements

The Councils have a number of options relating to the use of assets:

- retain ownership and lease to company, either operational or finance lease
- sell the assets
- transfer the assets to the proposed company

It is likely that the Councils will use a combination of the above. Within the Income and Expenditure forecast we have assumed that land and property have remained with the Councils and that other assets would transfer to the proposed company. This would have the effect of putting value into the company's accounts. However, legal advice should be taken to ensure the proposed company is not given an unfair advantage and state aid is not being provided.

Further details can be found in Appendix 5.

Market analysis

The proposed company will need to develop and build on its existing commercial expertise and as a result will require at least two years to develop its skills and understanding of the market before it can expect to generate additional income. Therefore we have not included any additional income within the company's income and expenditure forecast.

Currently there is no clear market for which the proposed company should focus, but a range of possible opportunities which will require significant development before the company might win new business.

In the potential market areas we explored we found that the most successful traders were private companies such as Capita or joint venture companies, where the local authorities had established a company with an experienced private sector partner.

The indications are that demand across Devon and Somerset is limited as a large proportion of services are provided in-house, where services have been outsourced the proposed company will have to compete with these experienced commercial companies.

However, opportunities are likely to increase as other councils look for other ways to meet the financial challenge. These opportunities could be achieved if the LACC was able to demonstrate its competitiveness in the relevant markets. Public sector organisations are also more likely to commission services from other public sector organisations than commission the private sector, but this will vary between organisations. This may give the proposed company an advantage over the private sector if the other councils have a limited appetite to trade with the private sector in the South West.

Therefore the Councils have made the assumption that as other councils in the south west look for ways to reduce costs then a far wider range of service contracts may become available to the proposed company. They have assumed that if the proposed company was able to win 1% of the net budget from the Devon districts, this could generate £600,000 in additional income. If this assumption is correct then similar benefits would be possible from within Somerset and Cornwall. However, the cost for the LACC to deliver this service is unknown at the stage, so the likely profit is also unknown.

More detailed information can be found in Appendix 6.

Option B: A Local authority controlled company

Governance

Structure

Appropriate governance arrangements are essential and important to both the Councils and the proposed company.

Page 44 The proposed company requires a Board of Directors with clear roles and responsibilities to drive and develop the LACC's purpose, culture and values in order to achieve success. The Board requires a chair and membership from both Councils, to enable it to influence the activity of the company but also in order to retain control – a Teckal requirement. This can be achieved by appropriate membership on the Board or through a shareholder committee, also members of the board can have double voting rights to achieve this.

Membership of the Board requires further consideration, the following is a possible option and the additional costs have been taken into account within the Income and Expenditure forecast in Appendix 4:

- Independent Chair (part time) – recruitment of a suitable candidate required
- Managing Director – post to be filled by the Executive Director, employed by the LACC
- Councils' Representative (possible 2 votes) – Executive Director, employed by the Councils
- Other Councils' representative members to be identified.

The role of elected members also needs to be considered. Elected Members could be members of the Board or members of the joint share holder committee, which is discussed below.

A critical success factor for establishing a successful LACC is the ability to create a commercial culture and to develop commercial skills across the workforce. The proposed company Board has to be commercially aware and lead the cultural change. The Managing Director should have the skill set to drive the change required, to enable it to compete and generate additional income. Local authority experience will be beneficial in the transition period as the company moves from a local authority culture to a competitive commercial focus, but is not essential.

The Council should also consider the benefits of other councils joining the proposed company and becoming a shareholder, once it has been established. This is possible for a LACC and the governance arrangements should be future proofed when the company is being established, such as the company's article of association. Legal advice may be required to ensure the Councils' future requirements are met and potential shareholders are not excluded.

Shareholder/Commissioner relationship

To begin with the proposed company will be focused on its formation, but needs to ensure its relationship with the shareholders and the commissioner/client function is developed and effective. The Councils will have to hold both these roles.

At this stage only one LACC is being considered; the business case should consider if more than one LACC would be beneficial.

Option B: A Local Authority controlled company

Shareholder/Commissioner relationship

Shareholder committees are an effective means of council governance as they provide:

- an effective focus for contact between the LACC Board and the Councils
- a mechanism for the shareholders to communicate their views to the LACC
- the ability to evaluate the effectiveness of the Board in line with its agreed strategic objectives without becoming involved with the operational detail.

In order to provide oversight, avoid duplication between the Councils and prevent members becoming involved in the operational detail we suggest that the proposed company should have a shareholder committee. It would include elected members and should operate as a sub-committee of both Councils in order to be effective and ensure timely decisions are made.

The shareholder committee would need to have delegated authority and be able to make decisions relating to the proposed company. The proposed company could lose its competitive edge and not be able to react quickly enough if decisions have to be passed to the Executive in South Hams DC and to the hub committee in West Devon BC. Although reserved matters could be identified for decisions by the Executive or the hub committee, we recommend that due consideration is given to these to ensure an effective approach is adopted.

The Councils anticipate having a strong commissioner/client side role with the proposed company which will be distinct and clearly separate from its shareholder role. The Councils intend to have clear contract management arrangements in place. At present a soft approach is taken and robust procurement controls are not maintained over the Councils' in-house services. The Councils consider that these capabilities and skills require development, as a result they intend to invest in these skills and incur additional cost to the Councils.

In our experience having strong contract management arrangements in place is highly contentious and strongly resisted by LACCs. In some instances such arrangements were considered to have had an impact on service delivery and stifled the LACC's commercial freedom.

Exit Strategy

An exit strategy is a pre-agreed approach which would be followed if the LACC was no-longer beneficial and beginning to make significant losses. It should be agreed when the LACC is set up and not be considered when things begin to deteriorate. It should be a contractual agreement. The Councils should be clear as to the level and extent of support they would provide and how this might differ for separate aspects of the service. Although the LACC is limited by shares, and limits the Councils' liability, the Councils will need to take into account their reputational risk and their statutory responsibilities.

Consideration should also be given to whether all services would be brought in-house or an alternative supplier identified should the LACC fail. We are not aware of any Councils which have not met their liabilities when their LACC failed, but clarity is required and should be set out in the exit strategy.

The treatment of and transfer of assets and leases should be included. Any leases which will transfer to the LACC should have a defined length and should allow for transfer back to the Council.

Option B: A Local Authority controlled company

Financial

In the first year of trading, the LACC is expected to generate a deficit of £0.36m. The deficit position after one year of trading is in line with expectation given that the cost of service delivery is not expected to reduce and additional costs associated with operating as a commercial entity are anticipated.

Income and expenditure forecast for the proposed LACC

	£m
Income	(6.67)
Expenditure	7.12
Savings	0.09
(Surplus)/deficit	0.36

A detailed income and expenditure forecast is set out in Appendix 4.

Investment costs

There are one-off investment costs involved in establishing the LACC. We estimate that based on discussion with officers these would be in the region of £329,000.

The main costs associated with setting up a LACC are:

- Legal costs – registration of the company and associated documents e.g. memorandum of understanding
- Staff consultation and change management
- Creation of service contract between the Councils and the Company and agreement of associated key performance indicators
- Establishment of a governance structure – to manage the transfer and to effect the cultural change necessary for increased commerciality
- Project management and implementation

Further detail on the investment cost can be found in Appendix 2

What will remain with each Council?

South Hams

- Net budget – £1,358,000
- 16% of the council's original budget
- 15 FTE

West Devon

- Net budget – £820,651
- 11% of the council's original budget
- 14 FTE

Option B: A Local Authority controlled company

People

We would anticipate that the transfer of undertakings (Protection of Employment) Regulations 2006 (TUPE) would apply and that staff would transfer under these regulations. This is complex legislation and legal advice should be sought to ensure compliance.

If all service blocks including the South Hams waste services were to transfer the proposed company then over 435 people, equivalent to approximately 410 FTEs would transfer.

The transfer of people would be a key stage in establishing the company and would require careful consideration to ensure the process is effectively managed to ensure everyone is fully engaged.

A significant number of Councils are able to deliver efficiencies and savings through the introduction of a LACC. These are achieved through changes to the terms and conditions, scale economies as well as redesigning services.

The Councils are not anticipating delivering significant efficiencies through the establishment of the proposed company as efficiencies have been delivered through the T18 programme. Some management re-structuring is possible and this has been taken into account in the Income and Expenditure forecast in Appendix 4.

Many LACCs have taken the opportunity to revise the terms and conditions to transferring people. TUPE does not apply to new starters and some LACC have reviewed the terms and conditions for new starters.

The Councils do not intend changing the terms and conditions in the early stages of the process. We are aware that any changes have to be considered against equal pay and other legal requirements but this is one area where savings might be possible and the Councils should ensure they do not miss this opportunity.

The terms and conditions for individual services should be benchmarked against the market. This would identify if existing services are competitive and whether they would be able to compete for commercial contracts.

The Councils should also consider how best to communicate any changes to employment arrangements to employees with the aim of avoiding where possible a negative impact on employee morale.

Culture

The motivation and development of the people transferring to the proposed company will be a critical success factor and the development of commercial skills is vital.

Through the transformation T18 programme the Councils have begun to change and develop a more commercial culture. Further cultural changes will be required, but the scale of the transfer and the numbers involved are unlikely to result in positive changes without clear specific focus on what is required and how this can be achieved.

To begin with very few things will appear to have changed, everyone will continue to deliver the same work in the same location. There is also the risk that some staff may not view the change as positive change and this could have negative impact on culture. As discussed earlier this change in culture needs to be driven and led by the Board, building on the work already undertaken.

In our experience successful LACCs have invested in staff consultation, change management and commercial leadership to ensure development of its commercial acumen from the beginning. The Councils do intend to invest in one-off set up costs, but should also satisfy themselves that existing staff have the appropriate skills and capacity to drive the change in culture from the beginning. We consider that delaying these changes is likely to extend the time it will take for the LACC to be successful.

Option B: A Local Authority controlled company

Skills and capacity gaps

In order to win new work and generate additional income the proposed company will need to write bids and tenders. These skills may exist within the proposed company, but if they do not or there is insufficient capacity, they can be achieved either by directly employing someone with those skills or by buying in those skills as required. During the transition period the proposed company will develop existing skills, up-skill its workforce and will buy in these services as required.

Training is also likely to be required.

We do not anticipate that there would be any redundancy costs within the first year of operation of the proposed company.

Pension considerations

Whilst there are hurdles and some costs to overcome there should be no major issues associated with jointly setting up a local authority controlled company, whose employees have continuous membership of the Devon County Council Pension Fund (DCCPF).

The potential hurdles and costs are likely to relate largely to agreement over the treatment of any past service deficit associated with current employees, and with the completion of an admission agreement into the DCCPF.

We anticipate that the past service deficits for all employees of West Devon Borough Council and South Hams District Council are likely to be in the region of £7.0m and £3.1m respectively as at 31 March 2013. These figures are indicative only and will need to be recalculated, but provide a basis for discussion between the Councils and the proposed company. Agreement should be sought as to whether these deficits should remain with the Councils or transfer to the proposed company and how the deficits will be funded.

In our experience LACCs see pension costs as a significant hurdle and the cost of funding the deficit as prohibitive. In the majority of instances the pension deficit remains the responsibility of the council; or the council issue a guarantee indemnifying the LACC.

If the Councils were to retain the responsibility of the pension deficit then the contract rates could be increased to compensate. However, the proposed company needs to ensure it remains competitive wherever the responsibility for the deficit lies.

An admission agreement will need to be entered into with DCCPF. The Councils could offer open or closed membership for new starters. Although if the proposed company opted for closed admission this could provide an opportunity to control or reduce pension costs going forward. A revised contribution rate for the employees of each Council would be calculated and could be higher or lower than the current rates.

Pension arrangements are complex and will require both legal and actuary advice going forward and will contribute to the set up costs of the proposed company.

The Income and Expenditure forecast for the proposed company has not taken into account the cost of the pension deficit for the new arrangements, but does include existing pension deficit costs.

More detailed information is set out in Appendix 8.

Option B: A Local Authority controlled company

Tax considerations

VAT

VAT registration is compulsory if the UK turnover of taxable goods and services (any sales that are not exempt from VAT) over the previous 12 months goes over the VAT threshold. The proposed company will need to register for VAT as its taxable income is likely to exceed the current VAT registration threshold (currently £82,000 per annum).

Page 49 If the Councils transfer services to the proposed company, these activities will be regarded as business activities and will not be subject to any Special Legal Regime. This means that normal VAT rules will apply. If the activities are fully taxable (standard, reduced or zero rated) there should be no restriction on the input tax recovery. If, however, there are exempt activities then there may be some input tax restriction. This will depend on the nature of the activities and services that the proposed company is planning to supply.

Corporation tax

Currently Councils are not taxed on the profits arising from the provision of services. In contrast, a LACC will be chargeable to corporation tax on these profits.

A LACC can benefit from tax reliefs such as capital allowances. Further reliefs may also be available but these will rely on a holding company structure (reliefs could include group relief/consortium relief and capital gains tax relief).

It may be possible to achieve tax exempt status by setting up the LACC as an Arms-Length Management Organisations (ALMOs) in respect of some of the services to be undertaken by the LACC or by obtaining mutual trade status. These tax exemptions are only available when the services are provided wholly to Councils and not to third parties. (These are discussed in more detail in the corporate tax section in Appendix 7).

Employment taxes

There should not be any major employment tax pitfalls in setting up the proposed company, although this should be reviewed to confirm the position once draft arrangements are agreed.

The proposed company will need to set up a new payroll and ensure employment tax governance processes such as an expenses policy and system are in place. It might be possible to use the Councils' existing systems and processes in respect of this.

The proposed company should review what its approach will be to employee reward and benefits in the context of the governance requirements and design its benefits and (if applicable) incentive offering accordingly.

Option B: A Local Authority controlled company


Outline timeline

A number of possibilities exist depending on whether the outsourced waste services transfer into the proposed company. The timeline opposite is scenario one and two:

1. all services including West Devon waste services transfer when the existing contract expires on the 31 March 2017
2. as above but the waste contract would be extended for one year

If waste services do not transfer to the LACC then the timeline would be the same as scenario two.

Key decision/milestone	Deadline	
	Scenario one	Scenario two
Discussions began with people and trade unions	November 2015	November 2015
Councils in principle agree to establish a LACC	January and February 2016	January and February 2016
Full Business case developed	April 2016	April 2016
Councils agree to establish a LACC	June 2016	June 2016
Planning implementation stage	July 2016 to March 2017	July 2016 to March 2018
LACC established	January 2017	
Shadow run of LACC begins		1 April 2017
People and services transfer into the proposed company	1 April 2017	1 April 2018

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Appendix 1: Scope of Services

Scope of Services

Background

The Councils have worked closely together for a number of years, providing a range of shared services. Through the transformation programme T18 the Councils have brought teams and services together into the three service blocks. We have set out below the services that are expected to transfer to the proposed company within the three service blocks.

The 2015/16 budgets include those services that might transfer to the proposed company and exclude leisure services which are outsourced.

The FTE figures have been based on the employing authority, it should be noted that staff may work across both Councils.

Customer first

- Field based customer contact teams
- Customer Contact Centre/Reception
- Planning & Building Control
- Licensing & Enforcement
- Strategic Planning/Development Management
- Housing Advice
- Revenue & Benefits
- Environmental Health
- Assets & Civil Engineering
- Economic Development (technical advice).

Planned budget and FTEs for customer first

2015/16	South Hams	West Devon
Budget	£3,229,691	£3,292,825
FTE	119	49

Commercial Services

- Waste Management Function (South Hams waste services are provided in-house, whereas West Devon services are currently outsourced)
- Transport
- Environmental Services
- Grounds Maintenance
- Estates Maintenance
- Street Cleansing
- Car Parks & Park & Ride
- Management of Salcombe Harbour
- Management of Dartmouth Lower Ferry

Planned budget and FTEs for commercial services

2015/16	South Hams	West Devon
Budget	£2,648,058	£2,076,869
FTE	160.18	3

Scope of Services

Support Services

The third service block includes back-office services. These services would provide support to the LACC and the Councils should a LACC be established.

The budget for West Devon includes an element of cost for the pension deficit for all West Devon employees.

- HR
- ICT
- Finance
- Legal
- Payroll
- Project Management
- Print & Design
- Post / Logistics

Planned budget and FTEs for support services

	South Hams	West Devon
2015/16 Budget	£275,200	£324,280
FTEs	39	17

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Appendix 2: One off investment costs

Estimated one off investment costs

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	South Hams LACC	West Devon LACC	Total	Reference
Estimates				
Staff Change Management	10,000	10,000	20,000	Note 1
Pension Administration	8,500	8,500	17,000	Note 2
Legal Advice	44,500	44,500	89,000	Note 3
Finance Support & Advice	22,500	22,500	45,000	Note 4
IT system & resource	5,000	5,000	10,000	Note 5
Recruitment	11,250	11,250	22,500	Note 6
Project Management & Implementation	25,000	25,000	50,000	Note 7
Cost of full business case and implementation plan	37,500	37,500	75,000	Note 8
Total	164,250	164,250	328,500	

Source: The Councils and Grant Thornton

- We anticipate that an additional cost in respect of branding and marketing will be incurred as part of this investment, however, this will be at the discretion of the Councils.
- The Councils anticipate that there will also be some contingent costs which have not been factored into these estimates.
- There are potential savings to be made should the Councils decide to bring the West Devon waste and ground maintenance services in house, the Councils estimate that these savings will be in the region of £50k and £20k, respectively.

Assumptions of one off investment costs

Assumptions

General

- One off investment costs have been allocated 50:50 between South Hams and West Devon.

1. Staff Change Management

- This is based on our research of the appointment of 0.5 FTE salary of an external change management specialist over a period of 12 months. Change management will focus on cultural change for staff.

2. Pensions Administration

- This is based on the advice provided by our pensions experts. We have prudently assumed the higher allowance of £10,000 for actuarial costs for calculating and discussing the deficit allocation and calculating a contribution rate for a new body and £7,000 of consultancy costs for guidance of setting up a new admitted body and liaison with legal advisors, the DCCPF and actuarial advisers.

3. Legal Advice

- This is based on our experience of working with legal firms and includes £10,000 of legal costs associated with pensions, £15,000 for governance arrangements within the LACC, £6,000 for an options report, £10,000 for the incorporation of the company, £14,000 for the service delivery contract, £25,000 for the provision of the legal document for ten leases and £9,000 for the establishment of six Service Level Agreements.

4. Finance Support & Advice

- This is based on 30 days of external financial support for a fee of £1,500 per day.

5. IT System & resource

- This is based on information provided by the Councils' support services. It is anticipated that Civica will charge a one off fee of £6,000 and there will also be a requirement for internal resource for the initial process of £4,000.

6. Recruitment

- This is based on a recruitment fee of 25% of the anticipated external appointments' salary, including the NED, change management specialists and project manager.

7. Project Management & Implementation

- This is based on our research of an average salary for an external project manager over a period of 12 months. The project manager will focus on implementation of the trading company.

8. Cost of full business case and implementation plan

- For external support, in our experience, business cases for LACC's range from £50,000 to £100,000, we have therefore included a cost of £75,000 as an indication of what the Councils might expect to pay.

Appendix 3: Strategic fit and drivers for change



Strategic fit

Strategic fit

The future for local authorities is uncertain, both as a result of financial constraints and as English authorities begin to consider devolution. Both Councils recognise that change is inevitable and have begun to develop their vision and strategic direction within their corporate plans. These are at differing stages of development and are consistent with the Councils' objectives for transformation:

- financial sustainability
- maintain and protect front line services
- provide quality services.

The table opposite compares how these the Councils' strategic principles can be achieved by the existing arrangements and the proposed company.

Principle	'As is'	LACC
Financial stability	Further transformational change required. Both Councils have yet to identify how MTFP funding gaps will be met	Other opportunities in addition to T18 to reduce costs. Ability to generate additional income from the wider public and private sector
Maintain and protect frontline services	Services can be protected to a point through transformational change, decisions may then have to be made to reduce or stop some services	Offers longer term solutions and acts as a catalyst to reduce costs and generate new income Provides a commercial environment
Provide quality services	Achieved through 'soft' service delivery monitoring	The Councils intend to introduce more robust contract management arrangements to ensure quality is maintained

Drivers for change

Both Councils have faced (and will continue to face) significant financial pressures for the foreseeable future. The Councils have demonstrated their ability to be agile and have delivered new ways of working. Through the transformational programme T18, they have delivered £450,000 in savings in 2015/16 and plan to deliver £2.1m in savings by 31 March 2016.

Both Councils recognise that the financial pressures will continue and consider that opportunities within the existing arrangements are becoming more limited. As a result, they are exploring alternatives that will enable them to continue to focus on protecting their workforce and current service levels.

The key drivers for change are:

- financial pressures, the need to reduce costs and generate additional income
- protecting existing level and quality of service
- protecting the Councils' existing workforce
- to position the Councils where they can be flexible and more responsive to a rapidly changing environment and able to take advantage of any opportunities that the market may offer.



Appendix 4:
Local Authority controlled company
income and expenditure forecast –
Year 1

Local authority controlled company income and expenditure forecast – Year 1

	South Hams	West Devon	Total
Income			
Contract Income	(4,044,359)	(2,624,004)	(6,668,363)
Total Income	(4,044,359)	(2,624,004)	(6,668,363)
Services (inclusive of support services)			
Customer First	2,156,638	2,914,799	5,071,437
Commercial Services	1,258,711	1,792,081	3,050,792
Waste (outsourced (WD))		(2,348,955)	(2,348,955)
Recurring expenses			
Customer First Rent	449,884	195,830	645,714
Commercial Services Rent	179,126	70,249	249,375
NED (Independent Chair)	10,000	10,000	20,000
Procurement/bid expert	7,500	7,500	15,000
Audit & Tax advice	20,000	20,000	40,000
FD/Financial support	12,500	12,500	25,000
Depreciation	305,386	31,750	337,136
IT (system and licencing)	6,500	6,500	13,000
Total expenditure	4,406,245	2,712,254	7,118,499
Savings			
Savings - Restructuring	(45,786)	(45,786)	(91,571)
Total	(45,786)	(45,786)	(91,571)
(Surplus)/deficit	316,100	42,464	358,565

Source: The Councils 2015/16 budgets and Grant Thornton

Local authority controlled company income and expenditure forecast – Year 1

Assumptions

Contract Income

- We have assumed that rental charges will be included in the contract income.

Rent

Rental costs have been allocated based on the current market rates as estimated by the Councils under the following assumptions:

- This has been undertaken as a desk top exercise
- No measurements have been checked
- Rental Valuations are based on best estimates, no specific comparisons have been sought at this stage
- Split for HQ buildings has been based on a study of floor plans and assumptions of staff number splits.

Depreciation

- Depreciation has been calculated based on a listing of assets to be transferred to the trading company as provided by the Councils.

Pensions

- The current pension deficit costs for both Councils £583k have been included in the income and expenditure forecast, we have not included a revised estimate for the pension deficit should the LACC be established.
- We have assumed that the pension contributions will remain consistent.

FD/Financial Support


- This estimate is based on the Councils' assumption of the level of additional support required.

Procurement expert

- This estimate is based on the Councils' expectation that the majority of procurement/bid work will be performed using in-house expertise. We estimate that £15k will provide support for up to three bids.

General

- The total cost of services has been included on a net basis. For example for South Hams, car and boat parking income and expenditure totals £2.9m and £1.4m respectively. In our income and expenditure forecast this has been included as a net figure of £1.6m
- The contract income has been calculated on a net basis and assumed to be the cost of providing the service
- Costs have been allocated 50:50 between South Hams and West Devon where this has yet to be confirmed
- We have excluded waste from the cost of services for West Devon which totals £2.3m and therefore the associated contract income as this has been considered in a separate report.
- We have excluded leisure from the cost of services (South Hams £1.2m and West Devon £0.7m) and therefore contract income as this is currently outsourced.
- The total income and expenditure relating to housing benefits has been included in the income and expenditure forecast, however, as this is shown as an income and expenditure, it has a nil net impact.
- We have assumed on-costs of 40% for restructuring savings.

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Appendix 5: Accounting and asset consideration

Accounting and asset considerations

Introduction

In this section we set out the advice relating to local authority accounting implications and requirements in relation to the establishment of the proposed company. This includes our consideration of the accounting issues based on the Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 and any relevant statutory provisions in force at the date of the report. In particular, The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) provides specific statutory accounting requirements with regards to share capital.

Accounting frameworks for the Councils

Accounting framework and requirements

Councils in the United Kingdom are required to prepare their statutory financial statements in line with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which is based International Financial Reporting Standards (IFRS), except where these are inconsistent with specific statutory requirements.

Accounting requirements for the proposed company

Accounting framework and requirements

- In the UK, The Companies Act 2006 allows companies, other than charities to prepare their accounts in accordance with either the International Financial Reporting Standards (IFRS) or the Companies Acts and UK Generally Accepted Accounting Practices (UKGAAP). The Financial Reporting Council (FRC) has issued three new accounting standards, FRS 100-102, which will replace all existing FRS's, SSAPs and UITFs. The new financial reporting framework will be applicable on a mandatory basis for the majority of UK entities for reporting periods starting on or after 1 January 2015.

- It should be remembered that the statutory over-rides for items such as depreciation, pension costs, asset revaluations do not apply to companies, therefore the presentation of financial information is very different. Similarly there is no requirement for a company to revalue its assets, it can show at initial valuation or historic cost.

Assets

Options for transferring assets

The Councils need to consider how they would want to account for the assets used by the proposed company. Three options are available:

1. retain ownership and lease to the company
2. sell the assets to the company
3. transfer the assets to the company

1. Retain ownership and lease to the company

This option would mean that both Councils retain the legal ownership but transfer the right to use the asset to the proposed company for a rental income. This rental should at a comparable market value to avoid a risk of a claim of state aid.

These assets would be leased to the LACC and either be leased as an operating or finance lease, depending on the terms of the agreement. An accounting analysis will need to be undertaken to for each lease to determine the accounting treatment.

If the leases were operating leases, the proposed company would recognise rental expenditure. The Councils would retain the assets on their balance sheet and account for the assets as they currently do, considering whether these should be classified as investment property, and recognise rental income over the lease period.

Accounting and asset considerations

If the leases were finance leases, the proposed company would recognise the assets. The Councils would derecognise the assets on their balance sheet and recognise a finance lease receivable, treating the lease payment as principle repayment and interest charges. Principal repayments will need to be accounted for as capital receipts.

2. Sell the assets to the company

The Council's could sell the assets to the proposed company at market value. Thus making the assets from both Councils the property of the proposed company. The proposed company would need to pay, or establish a debtor, to the parent Councils. The cash would need to be generated through loans or the issue of share capital.

Both these options have legal implications that would need to be considered further, i.e. there are rules over councils making loans.

3. Transfer the assets to the proposed company

The owning Councils dispose of the assets at nil or nominal value and ownership is transferred to the proposed company. The proposed company on purchase of the assets, revalues them to market value. Thus negating the need for related party loans.

In holding this property, plant and equipment on the balance sheet LAAC will need to account for depreciation charges in profit or loss. Where a policy of revaluation is adopted, upward revaluations will be recognised in the revaluation reserve. Downward revaluations and impairment losses will also need to be accounted for in profit or loss (to the extent that revaluation reserves balances are not sufficient). Any gain or loss on disposal will need to be recognised in profit or loss when the item is derecognised.

This would have the effect of putting value into the proposed company balance sheet and giving the responsibility of the asset to the proposed company using the asset. LACC would account for acquisition as it would any other capital purchase, by an addition to Property, Plant and Equipment.

The Councils would account for the disposal of assets in the normal way showing the effects of disposal in the Comprehensive Income and Expenditure Statement and reversing the capital effects through the Movement in Reserves statement (Adjustments between accounting basis and funding basis under regulations), including any loss that might occur.

Legal advice should be taken to ensure the proposed company is not given an unfair advantage and state aid is not being provided.

Investment in companies

Accounting for interests in LACCs

The Councils need to consider:

1. whether the LACC is a subsidiary, a joint arrangement or an associate by assessing the Councils' control over the company. This will depend on how the company is established and voting and other decision making rights
2. this will then lead to consider whether group accounts need to be prepared, whether the arrangement should be accounted for as a joint operation in the single entity or alternatively that there is no impact other than third party transactions
3. accounting for the interest in the company will depend on the form of initial investment in the company, ie loan or share capital. This interest will need to be accounted for in the single entity accounts and the investment held at cost (if group accounts are prepared) or otherwise at fair value.

Further work

Each council will need to consider whether the company is a subsidiary, associate or joint arrangement, before establishing how to account for the company.

Appendix 6: Market analysis



Market analysis

Background and approach

We have explored potential markets in which the Councils could compete and identified competitors locally and nationally. We have considered services provided in-house and externally among local authorities in Devon and Somerset. We have looked at ten district Councils across Devon and Somerset, Torbay Council and Plymouth City Council as well as both county Councils.

In the following areas, we have established both the public and private sector markets in the UK, with a focus on Devon and Somerset:

- Customer First
- Commercial Services
- Support Services.

Where possible, we have attempted to estimate the income that could be generated from these activities.

The following sources have been used to inform our work:

- Fame (companies database)
- Standard Industrial Classification of Economic Activities (SIC) codes.

In addition, we have identified LACCs and other alternative delivery models across the UK competing in these markets to provide an indication of potential returns.

Overall potential market

The Councils have made the assumption that as other councils in the south west look for ways to reduce costs then the majority of services may become available to the proposed company. They have assumed that if the proposed company was able to win 1% of the net budget from the Devon districts, this could generate £600,000 in additional income. However, the cost for the LACC to deliver this service is unknown at the stage, so the likely profit is also unknown.

Customer First

Customer Contact Centre

While Councils in Devon run their contact centres in house, three Councils in Somerset have outsourced this service.

As part of a wider support service contract, Capita provides contact centre services to Mendip District Council, in common with many other Councils around the UK. Taunton Deane Borough Council and Somerset County Council commission this service to South West One, a joint venture between these Councils and Avon Police Authority, in partnership with IBM.

There are a large number of private sector providers of call and contact centre services – 11 based in Devon and Somerset and 960 nationally.

It is a largely unexplored market by public sector bodies and we have not identified any LACCs in the UK providing this service. Birmingham City Council set up Service Birmingham, a joint venture in partnership with Capita. Service Birmingham did run the Council's call centre but this proved unsuccessful and the call centre has since been brought back in-house.

We have been unable to quantify the value of this potential market. While research suggests that there are opportunities to provide these services to others, it is a highly competitive market in the context of both the public and private sector.

Planning and building control

We have considered the market for a fully outsourced planning service as well as looking specifically at planning application services and building control.

Few Councils in the UK deliver their entire planning service through outsourcing, although we have identified that Capita offers this service and is engaged to do so by three Councils in the UK. We anticipate that the likely level of income that could be generated from the running of planning services for a council in Devon and Somerset would be £6m per annum. However, it is unlikely that a LACC would deliver a comprehensive planning service to Councils and we have not identified any nationally.

Market analysis

Planning and building control continued

Planning application services in Devon and Somerset are provided in-house, with the exception of South Hams District Council for which IP&E provides a planning application report service at £160 per application. Another private company in this market is TerraQuest whose services include planning application validation, quoting £50 per application. The proposed company is more likely to be able to offer this type of service. In order to generate £10,000, this would require 63 applications at £160 per unit, or 200 applications at £50 per unit. In addition it would also need the skills and capacity necessary to compete, which are not currently available.

Building control services in Teignbridge, West Devon and South Hams are currently provided by Devon Building Control Partnership, a partnership set up by these Councils in 2005. Similarly, five Councils in Somerset and Dorset are in discussions over the formation of a Somerset Plus Building Control Partnership. Although it would be difficult for private companies to compete with the level of expertise and experience held by these partnerships, the nationally picture suggests there is an available market .

The market share held by private sector practitioners certified as 'approved inspectors' (therefore capable of providing building control services) has gradually increased nationally. While there are only two approved inspectors held on the Construction Industry Council register that are based in Devon and Somerset, there are 90 listed elsewhere in England and Wales.

A LACC competing in this market is Acivico Building Consultancy, set up by Birmingham City Council in 2012 to provide design and construction, facilities management and building control services across the public and private sector. It has reported small losses in its first two years of operation.

In Devon and Somerset we identified that the average spend on building control is £700,000. Therefore, if a LACC was successful and won a contract to deliver the building control services for a council in Devon or Somerset we anticipate the additional income might be in the region of £700,000.

However, the cost for the LACC to deliver this service is unknown at the stage, so the likely profit is also unknown. It should also be noted that there is likely to be strong competition from both local public sector partnerships and national private approved inspectors.

Licensing, enforcement, environmental health and strategic planning

These services are provided in house among Councils in Devon and Somerset. The market for these service areas is small but with the potential to grow as an increasing number of Councils in the UK are considering plans to outsource regulatory services.

We have not identified any LACCs in the UK which provide these services. In terms of alternative providers, Capita is essentially the only competitor. It has set up a joint venture with a Barnet Council to set up a company delivering licensing, strategic planning, environmental health and development management services to the Council. It has been in operation since 2013 and reported a £2.4m profit in 2014.

There is a potential market for these services in Devon and Somerset, if local authorities feel there would be a benefit to outsource these, although the proposed company could be competing with a joint venture.

Housing management and advice

These services are run in-house in Devon and Somerset, with the exception of Sedgemoor District Council. Homes in Sedgemoor, a LACC providing a housing management and advice service to the Council since 2007, has recorded a profit every year averaging £500,000. The management fee paid by the Council for 2014/15 was £8.5m. Although it does not currently offer its services to other local authorities, it has the potential to do so due to its high level of expertise transferred from the Council's previously in-house team managing its housing stock

Although there is a market for these services – five Councils in Devon and Somerset own housing stock – any competing LACC would need to acquire similar skills in order to compete.

Market analysis

Revenues and benefits

Although all but one council in Devon and Somerset keep this service in-house, many Councils across the country outsource this function to the private sector. This is a competitive market in which many well established companies are providers, including Capita, Civica and Liberata. There are no LACCs in the UK offering this service.

There is limited potential to compete in this market – any new entrant would require a unique selling point that sets it apart from its highly skilled and experienced competitors.

Commercial services

Grounds maintenance

District Councils in Somerset provide this service themselves, while the County Council uses South West One. In Devon, however, private companies are the main providers. ISS Facility Services Landscaping is contracted until 2021 to provide services to North Devon Council, Torridge District Council and Devon County Council. Teignbridge District Council buys services from Quadron Services, with which it has a five year contract to 2020 worth £543,000 per annum.

The private sector market is competitive locally and nationally. There are 226 companies offering grounds maintenance services in Devon and Somerset, and 9,096 nationally.

A LACC operating in this area is Streetwise, set up in 2014 by Rushcliffe Borough Council to provide grounds maintenance services to businesses in addition to the Council. The annual cost of the contract to the Council is £1.3m.

There are opportunities to offer this service to public sector clients after any existing contracts expire, but it is a highly competitive market. A LACC operating in Devon and Somerset could expect to generate annual income of £500,000, if it was able to break into the market.

Car park management

The majority of district Councils in Devon and Somerset manage their own car parks, while Exeter and Plymouth city Councils and local businesses either do the same or buy services from car park management companies, for example Devon based Premier Parking Solutions and Premier Park provide services for Plymouth City Council and Exeter City Council respectively.

There are 21 companies that manage car parks in Devon and Somerset and 1,438 nationally.

Glasgow City Parking, a LACC set up by Glasgow City Council in 2007, provides off-street and on-street parking management services to the Council. It has reported losses in each year of operation including £300,000 in 2014/15.

A LACC offering this service would face strong competition since the preferred provider is generally within the private sector, and would need to be able to convince local Councils of the benefits of outsourcing this service.

Transport

Community transport services in Devon and Somerset are provided by voluntary organisations and charities therefore no private companies compete in this market.

Buses are operated by First Group in Somerset and Stagecoach in Devon. Several authorities in other regions have set up LACCs to operate buses and other passenger transport, including Swindon Borough Council, which set up Thamesdown Transport in 1986. The company's recent financial history is mixed, with profits reported between 2009-12 and losses in the past two years (of £1.3m in 2014).

While there are opportunities to explore this area, competition with large national companies operating in the local area would be tough.

Market analysis

Support services

ICT services

In Devon, most support services are provided in-house. ICT services for three local authorities are delivered via a local authority wholly owned joint venture, Strata Service Solutions. Strata Ltd was formed in 2014 to provide ICT services to East Devon District Council, Exeter City Council and Teignbridge District Council. The company reported a £2.5m loss in 2014-15. ICT services for Plymouth City Council are provided by DELT a joint venture owned by Plymouth City Council and NEW Devon CCG.

In Somerset, Capita are the providers for Mendip District Council and South West One for Somerset County Council.

While there is scope to explore offering ICT services, a LACC would face competition from well established private sector providers and the two ADMs already operating in the region.

Finance, payroll, HR

In Devon, these services are provided in-house. In Somerset, South West One provides support services including finance, payroll and HR to Somerset County Council and Taunton Deane Borough Council. There is an opportunity to compete for these services when the contract with South West One expires in 2017. The annual charge for the services they provide is £5m.

Mendip District Council contracts many of its support functions to Capita, including ICT, finance and payroll, in addition to revenues and benefits. Other large private sector companies offering these services to Councils include Serco and Arvato.

The market for a comprehensive back office function is highly competitive due to the scale, expertise and experience of private sector providers.

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Appendix 7: Tax considerations

Tax considerations

VAT

If its services are transferred to the proposed company it will need to consider whether any of its services are likely to be exempt and could create an irrecoverable VAT cost. It is recommended that this is reviewed in detail once the final provision is agreed.

If the Councils transfer their services to a separate LACC, this will be a separate legal entity from the Councils. The LACC would also provide flexibility to provide services to third parties should it decide to trade more widely.

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The current VAT position

For VAT purposes, Councils are section 33 bodies which means that they have a Special Legal Regime and all VAT that they incur on the provision of non-business activities can be recovered. However, Councils also provide business supplies which are, in the main, subject to VAT, so the Council can recover all VAT incurred in relation to such business activities, subject to the normal rules.

Unlike other taxable persons, section 33 status also enables them to recover any VAT that they incur in connection with VAT exempt business activities provided certain conditions are met.

In fact, a local authority can recover any input tax (VAT on purchases) that it incurs that is attributable to VAT exempt business activities provided the total of such 'exempt input tax' is less than 5% of the total amount of VAT incurred by a local authority on business activities and non-business activities in a financial year.

Thus, the existing arrangements are VAT efficient and the Councils should not suffer any irrecoverable VAT in its provision of services.

Transfer of activities and assets into a LACC

The transfer of trade and assets to the proposed company will be subject to VAT unless the transfer can qualify as a Transfer Of a Going Concern (TOGC). When these rules apply, the transfer to a LACC will be treated as outside the scope of VAT. There are special rules which apply to a TOGC when it includes property, so should this be the case, we will advise you separately.

Transfer of services

If the Councils transfer services to the proposed company, these activities will be regarded as business activities in the LACC and will not be subject to any Special Legal Regime. This means that normal VAT rules will apply. If the activities are fully taxable (standard, reduced or zero rated) there should be no restriction on the input tax recovery. If, however, there are exempt activities then there may be some input tax restriction. This will depend on the nature of the activities and services that the proposed company is planning to supply.

It is advised that the proposed company should consider the VAT liability of its supplies and seek advice on how to maximise its taxable income. For example, if there is a transfer of commercial property to the proposed company, then it should opt to tax these properties.

The Councils will also incur additional VAT due to receiving these services, we would recommend a modelling exercise is undertaken to determine whether their 5% de minimis will be breached.

Also the proposed company could inadvertently make exempt supplies if it meets the conditions of the Cost Sharing Exemption, these are listed on the next page. If this were the case the proposed company may become exempt so it will incur irrecoverable VAT.

Tax considerations

VAT registration

The proposed company will need to register for VAT as its taxable income is likely to exceed the current VAT registration threshold (currently £82,000 per annum). VAT registration is compulsory if the UK turnover of taxable goods and services (any sales that are not exempt from VAT) over the previous 12 months goes over the VAT threshold.

Technically the proposed company could VAT group with one of the Councils. It cannot VAT group with both Councils as one of them needs to control the company. This is rarely done as it deprives the grouped Council from the benefit of the partial exemption 5% 'test of insignificance' rule.

Cost Sharing Groups (CSG)

Definition of a CSG

Where two or more organisations, with exempt or non-business activities, join together on a cooperative basis, to form a separate independent entity to supply themselves with certain qualifying services at cost, these supplies are exempt from VAT.

Criteria to be met if the supplies are to fall under CSG exemption

A CSG is a separate taxable person from its members, as a separate entity it is able to make supplies for VAT purposes to its members, these supplies will be exempt from VAT if the relevant conditions are met.

A 'member' of the CSG is defined as a business or organisation that is capable of jointly owning and controlling a CSG as well as receiving supplies from the CSG. Therefore, the Councils should enter into a joint agreement to form a new CSG entity. Both members will receive supplies from the CSG. Both entities will need to consider if there are other tax implications in respect of setting up this CSG entity.

The exemption applies to services provided to members, and not to third parties outside of the CSG.

The exemption will only apply to goods where they are ancillary to the main supply of services.

Exemption is mandatory for all supplies of services made by the CSG to its members that meet ALL of the following five conditions:

- An independent group of persons (CSG) supplying services to persons who are its members**
It must be a separate entity, but can take a number of different forms eg a partnership, or a limited company either by shares or guarantee. the proposed company would need to agree on the type of entity to be set up and there may be other tax implications that each member needs to consider. This condition could be met.
- All the members must carry on an activity that is exempt from VAT or one which is not a business activity for VAT purposes**
Both Councils carry on exempt and/or non-business activities. HMRC's guidance indicates that an entity would be eligible for CSG membership if 5% or more of its total supplies were exempt or non-business. It is considered that this condition could be met.

Tax considerations

3. The services supplied by the CSG must be ‘directly necessary’ for a members exempt and/or non-business activity

If the supplies are not ‘directly necessary’ the exemption would not apply and the supplies would be subject to normal VAT rules. HMRC’s guidance indicates the methodology which can be considered as outlined below; although there is an option for the CSG to suggest an alternative method if it is more appropriate:

Supplies of services received from the CSG, that can be directly attributable to the members exempt and/or non-business activities, will be regarded as ‘directly necessary’ and therefore qualify for exemption. If the CSG incur expenditure on services that are attributable to taxable and exempt/non-business activities these would not qualify as ‘directly necessary’, as they are not linked exclusively to exempt or non-business activities of the CSG.

Where a member of the CSG has wholly exempt and/or non-business activities or low levels of taxable activity, all the supplies they receive from a CSG will be regarded as ‘directly necessary’ for the exempt/non-business activities. HMRC consider that a low level of taxable is less than 15% of the members’ total activities.

It is understood that the Councils would meet this condition.

4. The CSG only recovers from its members, the members’ individual share of the expenses incurred by the CSG in making the exempt supplies to its members

Not all members have to receive the same services. Members can receive different volumes of service, but the CSG must only recover from its members, at cost, their share of the costs and expenses incurred by the CSG.

There should be no profit in the charges made by the group to its members. If supplies to members of the CSG by the CSG do include a profit element the exemption will not apply, and those supplies will be subject to the normal VAT rules.

It is understood that there is a clear audit trail of the services each member uses and the recovery calculation that the CSG undertakes.

5. The application of the exemption to the supplies made by the CSG to its members is not likely to cause distortion of competition

A CSG is a cooperative self-supply arrangement. It is not a commercial outsourcing arrangement therefore it does not exist or compete in a market. As long as all the conditions of the exemption are met, particularly that it can only supply its members on a ‘direct reimbursement’ basis, that is, it self-supplies at cost, distortion of competition is unlikely to occur.

It is considered these conditions could be met.

Tax considerations

Corporation tax

Under the current arrangements, the Councils have worked closely together to provide a range of services under Customer First, Commercial Services and Support Services. As the Councils are local authorities, they are exempt from the charge to corporation tax on any profits arising from the provision of services.

Page 75 Corporation tax implications – trading company

The creation of a LACC to carry out all of the above services will mean that it will be:

- chargeable to corporation tax on all its UK and worldwide profits. The rate of corporation tax from 1 April 2015 is 20% (and this is set to reduce to 19% from 2017 and 18% from 2020)
- required to file a CT600 tax return (electronically) within 12 months of the accounting date

Corporation tax liability

Depending on the level of profits in the company, and any associated companies, the LACC will either pay its tax either nine months and 1 day after the end of the accounting period or by quarterly instalments. This could have a significant impact on the cash flow of the LACC. If trading losses arise in a respective period, they can be carried forward in that company and offset against the first available taxable profits of the same trade in future periods. It is also possible to carry losses back and offset against profits of the previous 12 months.

Capital allowances

Should LACC acquire any equipment or other fixed assets of its own, any new assets would be accounted for accordingly with depreciation charged to LACC's accounts which would not attract corporation tax relief. Instead, capital allowances should be available in either the main or special rate pool (receiving tax relief on a writing down basis at 18 per cent or 8 percent respectively, depending on the assets acquired). The company must also own the plant or machinery as a consequence of incurring the expenditure. We will need to explore further how assets currently owned by the Councils are to be 'owned' and used by the LACC.

Group structure – losses and group relief

As the LACC will be a joint venture company wholly owned by the Councils, it will not be possible to pass on any trading losses incurred to either Council or any other companies owned by the Councils. However, if the company were associated with other companies in a group structure and it qualified as a group relief group, then broadly, current year losses in one company can be surrendered to shelter current year taxable profits in the other group company. For a 'group relief' group to exist in the structure, the ownership condition must be met, where:

- either one company has to be a 75% subsidiary of the other (i.e. indirect ownership must be at least 75%), or
- both have to be 75% subsidiaries of a third company

Tax considerations

Group structure - losses and group relief (cont.)

If the proposed LACC and any other future planned trading companies were separately owned by the Councils then group relief may not be available. This is because the relevant legislation states that a "company" does not include "a partnership, a local authority, or a local authority association". Therefore, a holding company should be considered within the proposed structure so that any future planned trading entities within the structure are still ultimately owned by the Councils but via a holding company. In this way, eligibility for group relief will be maintained. However, if a company is limited by guarantee it cannot qualify for group relief. (This may be in point further to the comments made under the section below regarding special tax status).

Consortium relief

Consortium relief is an alternative to group relief where current period losses of a consortium company can be transferred to consortium members and vice versa. However, a LACC jointly owned by the two Councils will not qualify for consortium relief as 75% of its ordinary shares will not be owned by companies.

Capital gains group

A capital gains group means that where assets are transferred from one company to another no capital gain or loss is triggered subject to certain conditions. Currently the Councils will not be able to achieve this capital gains group structure due to the percentage holding requirements. However, where a holding company wholly owns the trading company (and any future companies) the relevant requirements for a capital gains group should be met.

Special tax status

It may be possible for the LACC to mitigate its corporation tax liabilities through a special tax status. These may include:

- Local authority exemptions
- Mutual trade status
- ALMO tax status

We have provided a very high level overview of these. In addition, we will discuss, at a high level, the rebate system option and how we have seen this work in practice.

ALMO status

There are some circumstances when a company is not subject to corporation tax on all or some of its activities.

This is when HMRC agree that the nature of its activities lack the necessary element of commerciality to amount to trading, and therefore the activity is not subject to corporation tax. HMRC have agreed this treatment with Arms-Length Management Organisations (ALMOs). ALMOs manage, repair, improve and maintain the council's housing stock. The council remains the legal landlord. They also undertake a range of services; for example, collecting rents, dealing with arrears, tenancy enforcement, for which transactions with its council members are not viewed as taxable by HMRC.

Tax considerations

Almo Status (cont.)

HMRC takes account of a number of factors, including the fact that the company is usually a company limited by guarantee without share capital. The ALMO is funded by a management contract fee which is usually designed to break even and in the event of the ALMO being wound up, the surplus remaining is required by the articles to be paid back to the council.

We have recently seen HMRC grant ALMO status to the following activities carried out in separate companies including waste management of community and businesses, grounds maintenance, street cleaning, technical advice regarding transport and planning, and services to the council in respect of the acquisition of land and property, and the development of council owned sites including planning, development, marketing and disposal of land for housing and corporation use. The response from HMRC determined that these transactions were not trading and therefore not taxable however, the LACC would still be liable to corporation tax in respect of transactions with third parties or any other group companies.

HMRC have not explained the factors that were critical in determining this position but the companies were not companies limited by guarantee which is typical for ALMO status but limited by share capital. We would be happy to explore how this position may apply to this LACC if appropriate in terms of the Councils longer term planning and strategy for the LACC. In order to consider this further, it would be necessary to consider the following matters:

- how the Councils will control the governance of the company
- how the Councils will monitor/control the approved activities and what service level agreements will be in place

- what arrangements will be in place to manage the pricing of services, the budgeting process and the surplus generated by the company on these activities and how this will be ring-fenced for these activities in the future

Mutual trade status

Mutual trading is a concept where a company is not liable to tax on any profit arising from the mutual trade. There is no statutory definition of mutual trade, however HMRC consider that certain criteria should be fulfilled in order that an entity qualifies as a mutual trading company.

The key principles are that:

If a group of people join together for a common purpose their transactions with the umbrella body can be seen to be mutual trade if:

- the entity's transactions are with its customers who are also members
- the legal framework for the entity passes the tests for mutual trading
- the immunity from tax only applies to transactions in the nature of trade with the entity's members
- the founding principle as set out in case law if the trade between the two parties is identical i.e. mutual is that there can be no taxable profit on a surplus from trading with yourself

Tax considerations

Key characteristics

There are four essential requirements for mutual trading status as set out by HMRC:

- Complete identity as a class between the contributors to the mutual surplus and the participators in it
- Arrangements which ensure that the surplus ultimately finds its way back to the contributors and no arrangements for it to go to anybody else
- A reasonable relationship between the amount a person contributes to the surplus and the amount distributed to them on winding up
- The members must control the common fund

Strictly this falls within self-assessment, however, our expectation and experience to date is that mutual trading status would need to be agreed with HMRC and we can provide assistance in liaising with HMRC.

HMRC is not always consistent in their approach to mutual status. We are aware of one circumstance where mutual status was granted to a Teckal company and then subsequently withdrawn. From experience, HMRC will also challenge the situation where a company has share capital and technically a dividend could be returned to a shareholder. This conflicts with the concept that the surplus must be returned to the contributors to the trade.

Rebate system

Other local authorities have established commercial trading subsidiaries and have implemented a rebate structure with regards to passported revenue with their local authority parent.

If you were to pursue this option, the arrangements would need to be on arms-length terms to meet the tax requirements under UK transfer pricing rules. Our transfer pricing team could research and identify an arms-length range of operating margins earned by comparable independent companies performing similar services. The rebate paid, if appropriately structured, could be deductible for corporation tax purposes.

Tax considerations

Employment taxes

There should not be any major employment tax pitfalls in setting up the proposed company, although this should be reviewed to confirm the position once draft arrangements are agreed.

The proposed company will need to set up a new payroll and ensure employment tax governance processes such as an expenses policy and system are in place. It might be possible to use the Councils' existing systems and processes in respect of this.

The proposed company should review what its approach will be to employee reward and benefits in the context of the governance requirements and design its benefits and (if applicable) incentive offering accordingly.

The Councils should also consider how best to communicate any changes to employment arrangements to employees with the aim of avoiding where possible a negative impact on employee morale.

The Construction Industry Scheme (CIS) position should be reviewed if any construction work is going to be carried out by or subcontracted by the LACC.

New payroll set up

We understand that employees will be TUPE transferred in from the Councils to the proposed company. On this basis, the the proposed company will become a new employer for PAYE/NIC operation purposes, and a new PAYE scheme will need to be set up for this entity.

Depending on how the proposed company is structured, there might be more than one legal employer, in which case further PAYE registrations with HMRC are likely to be required.

Registration as a new employer online is likely to be the most efficient way for the proposed company to set up the new PAYE scheme(s).

PAYE Filing obligations for previous employers (the Councils)

The first step in determining the filing obligations for the previous employers (the Councils) is to establish whether the change in circumstances should be regarded as a 'succession' for PAYE purposes or a 'cessation'. In the case of a succession, the new employer takes over the pay records of the old employer and no form P45 is necessary. In the case of a cessation, form P45 needs to be issued and the new employer does not take over responsibility for the old employers' records.

On the basis that the LACC will be a jointly owned company set up between two parties transferring staff into a new PAYE scheme, it is likely that the TUPE transfer of staff from the previous employers should be treated as a cessation.

The employees leaving should be marked as leavers in the previous employers' RTI returns and forms P45 will need to be issued to the transferring employees by the previous employers. It is advisable to warn employees that this is the case and explain to them that it is only a consequence of the TUPE transfer and nothing to be concerned about.

Tax considerations

PAYE Filing obligations for new employer (the LACC)

Once the new PAYE schemes have been set up, the employees being TUPE transferred in should be marked as new starters in the new PAYE schemes and the information from the P45 input into the system.

PAYE/NIC should be operated and submissions made as required and amounts remitted to HMRC by the due dates.

Incentivising employees and employee benefits offering

Subject to governance requirements, there might be an opportunity to implement employee and management incentive plans with the objective of rewarding high performance from employees that would not be available within the traditional Local Authority environment. Such plans could be based on business profit targets or individual performance metrics.

Furthermore, (depending on what is currently being offered by the current employers) it may be possible to make increased use of salary sacrifice arrangements to maximise the value given to employees whilst making savings in employment costs for the employer. Salary sacrifice for cars, holiday buying and selling, mobile phones, bike to work and computer equipment are examples of possible schemes that may be considered.

Expenses and benefits

We recommend that in the new entity a written expenses policy is used to govern the incurring and reimbursement of employee expenses, and a system is put in place to control, check and authorise employee expenses.

P11Ds will need to be produced and filed with HMRC by 6 July following the end of the tax year for any benefits in kind that are not 'payrolled' in accordance with the legislation and HMRC guidance. However, any benefits or expenses covered by a tax exemption or a PAYE Settlement Agreement (see below) will not need to be payrolled or reported on P11Ds.

If the proposed company wishes to payroll benefits, the current position is that the benefits should be registered via HMRC's online Payrolled Benefits in Kind (PBIK) service. The rules are developing in this area, so this area should be reviewed again before the arrangements go live and the benefits offering is established.

The proposed company might provide taxable expenses or benefits to employees on which they wish to protect the employees from incurring a tax liability. Examples of this would be gift vouchers provided as an incentive for high performance, or teambuilding events that are 'fun' in nature. If this is the case, the new entities may wish to apply to HMRC for a PAYE Settlement Agreement (PSA) which will allow the employers to meet the cost tax and NIC on benefits and expenses included on behalf of employees.

Employment law position

We recommend that employment law advice is sought on any employment law issues (e.g. TUPE) that may arise in relation to this transaction as we are not employment lawyers and therefore cannot comment on any employment law implications.

Construction Industry Scheme (CIS)

We understand that it is unlikely that the proposed company will carry out any 'construction operations' and it should therefore not be within the CIS as a mainstream contractor. However, it may be necessary to register as a 'deemed contractor' as set out below. The proposed company will be required to register as a CIS 'deemed contractor' if it does not carry on a construction business but still spends an average of £1million per annum over a three year period on construction operations, calculated by reference to the accounts.

We recommend that the CIS position is reviewed if any construction work is going to be carried out by or subcontracted by the proposed company, whether in connection with the Councils or otherwise.

A decorative graphic on the left side of the page features a central blue circle from which numerous arrows of various colors (including orange, white, purple, yellow, green, and blue) radiate outwards. The background is a textured yellow.

Appendix 8: Pension considerations

Pension considerations

Summary

Whilst there are hurdles and some costs to overcome there should be no major issues associated with jointly setting up a local authority controlled company, whose employees have continuous membership of the Devon County Council Pension Fund (DCCPF).

The potential hurdles and costs are likely to relate largely to agreement over the treatment of any past service deficit associated with current employees, and with the completion of an admission agreement into the DCCPF.

Background

Both Councils participate in the DCCPF. The contribution rates following the Actuarial Valuation of the DCCPF as at 31 March 2013 are set out below

	2014/15		2015/16		2016/17	
	% pay	£	% pay	£	% pay	£
WDBC	12.2	417,000	12.2	432,000	12.2	452,000
SHDC	14.8	141,000	14.8	146,000	14.8	153,000

The difference in the '% pay' (the future service contribution) is due to the differing demographics and salaries within each Council for current employees. The difference in the '£' contributions (past service deficit cost) is due to the differences in accrued liabilities for each council since starting to accrue benefits within the DCCPF. In addition the deficit recovery period for WDBC is 20 years, with 27 years for SHDC.

A summary of relevant active membership data for the Councils as at 31 March 2013 is set out below.

	Number	Annual pay (£,000)	Average age
WDBC	117	2,944	45
SHDC	392	8,452	48

Pension considerations

Past service deficit

The past service deficit represents the excess of the value of the members' benefits (liabilities) built up in the fund, over the assets held in the fund. It is the responsibility of the employing body to meet this deficit over time (the recovery period).

When setting up a new body, the question arises as to who will take on the past service deficit for the employees being transferred.

- a) Will the transferring company keep responsibility for all or part of the liability to enable the new body a "clean slate" start?
- b) Alternatively, will the new body have to take on some or all of this liability itself?

The past service deficits for all employees of WDBC and SHDC were calculated as approx. £7.0m and £3.1m respectively as at 31 March 2013.

This could be complicated further when the new body is being formed from a combination of 2 transferring companies, with differing past service deficits. If a "clean slate" start is not used then careful agreement of how the past service deficits are funded in the future must be reached and clearly documented. If not then the transferring company with the smaller deficit would be subsidising the other.

Future service costs

A revised contribution cost would be calculated for the employees of each organisation transferred into the new employer. Depending on the average age and salary level of these members this may be higher or lower than the current future service contribution rates.

In addition, as mentioned above, altering the membership of any organisation will change the demographics of the Fund membership and will affect the contribution rate required. Removing a section of the membership from both WDBC and SHDC will consequently also affect their contribution rates, likely to apply following the results of the next actuarial valuation the Fund as at 31 March 2017.

Guarantees

On the admission of a new body into the Fund, the DCCPF will carry out an assessment of the basis on which it views the risks of admission. It is common for a Fund to subsequently ask for a guarantee or a bond to be put in place to guard against the risk of failure of the admitted body. This is generally negotiable.

In this case it could be argued that the new body is backed by WDBC and SHDC and so there is no reduction in security and so no further guarantees are needed.

Admission agreement/Documentation

An admission agreement will need to be entered into with DCCPF to document the admission of a new employing body. The new body must satisfy certain criteria to be included and it may be necessary to negotiate over or document any guarantee.

In addition, when an employer enters into a Local Government Pension Scheme it must also set out a policy in relation to the exercise of a number of discretions on issues such as redundancy and early retirement policies, which could have an impact on funding calculations.

Legal advice should be sought on the above in due course.

Pension considerations

Open or closed admission

WDBC and SHDC could take this opportunity to only offer membership of the DCCPF to current members and to set up an alternative pension scheme for any subsequent new starters. This could be used to better control or even reduce pension costs for new employees in the future, compared to current employees. This may be more relevant when considering the pending increase in employment costs for members of Local Government Pension Schemes due to the cessation of contracting out due in 2016.

Care would need to be taken however as this could affect the short term contribution rate payable on behalf of those remaining in the DCCPF. The deficit recovery period would reduce, as the membership grows older, and the pace of meeting deficit recovery payments would increase as a result. In addition, an older average membership would also lead to higher future service contribution rates, albeit for a reducing membership.

New plan implementation

If it is decided to no longer offer membership of the DCCPF to new starters then an alternative, auto-enrolment compliant, pension plan must be set up. It would be normal to also provide a group life insurance plan at the same time to replace life cover benefits associated with the DCCPF.

Auto-enrolment re-enrolment

Employees who opted out of the fund following the Councils' initial auto-enrolment Staging Dates will have to be re-enrolled approximately 3 years after the initial enrolment. This is likely to add to the pension costs of a new shared service company.

Potential costs

Pension contributions

Whilst the overall, long term costs of providing pensions for the employees of WDBC and SHDC will not change, the short term contribution rates may vary slightly due to the changes in the demographics of each employer and any agreement reached over the treatment of the past service deficit. Actuarial calculations will be needed to determine this.

Advisor costs

Legal costs – legal advice may be required to assist with the initial admission agreement, negotiation over a guarantee and with the drafting of an agreement between WDBC and SHDC over the treatment of the past service deficit. A reasonable allowance for such advice would be around £8,000–£10,000.

Actuarial costs – The DCCPF will accrue actuarial costs in calculating and discussing the deficit allocation and in calculating a contribution rate for the new body. A reasonable allowance for these costs would be in the region of £8,000 - £10,000.

Consultancy costs – You may require assistance in guiding you through the processes involved in setting up a new admitted body and in liaison with legal advisers, the DCCPF and actuarial advisers. Costs for this could be expected to be in the region of £5,000–£7,000.

Pension considerations

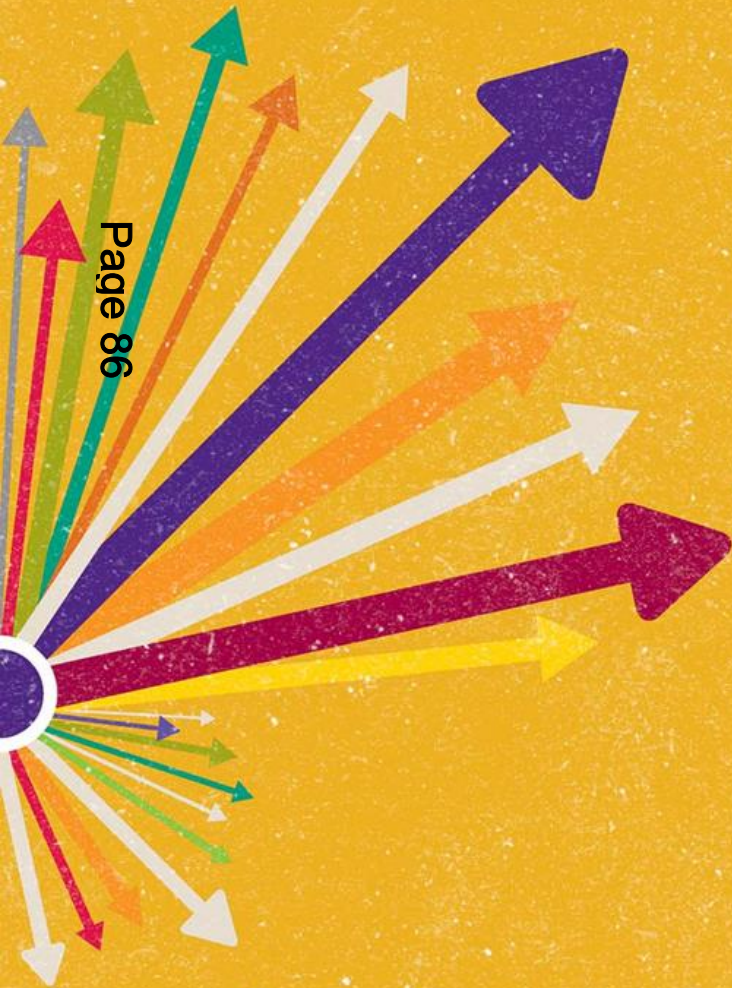
New plan implementation

The minimum company contribution rates to a new pension plan once auto-enrolment is fully active would be around 3% of employees' salaries. Companies can, and often do, offer higher contribution rates than this however, typically ranging from 3% - 10% of salaries.

Life cover, again can be provided at a number of levels, ranging from 1 times salary to 6 times salary. Costs of cover depend very much on the demographic of the employees but an approximate cost would be around £1 for every £1,000 of cover.

An adviser would expect to charge around £5,000 to set up a pension plan and £2,000 - £3,000 to set up a group life insurance plan. On-going advice would then cost in the region of £3,500 per annum and £2,000 per annum respectively.

Appendix 9: Strengths and weaknesses



Strengths and weaknesses

Strengths and weaknesses of the options

LACC strengths

- ✓ 'future proof'- services delivered from a model that more is adaptable and responsive to change
- ✓ may be able to protect staff as local authorities move towards devolution
- ✓ maintain control by the Council, but slightly reduced in comparison to option A
- ✓ able to generate additional income from other public bodies and the private sector
- ✓ greater financial stability
- ✓ build on T18 partnership working
- ✓ services passport from the Councils to the proposed company
- ✓ more responsive and rapid decisions making processes
- ✓ opportunity to review staff terms and conditions

'As is' strengths

- ✓ control maintained by the Council, members and officers
- ✓ stability for people in short term, as the financial challenge prevents long term stability
- ✓ tax efficient arrangements

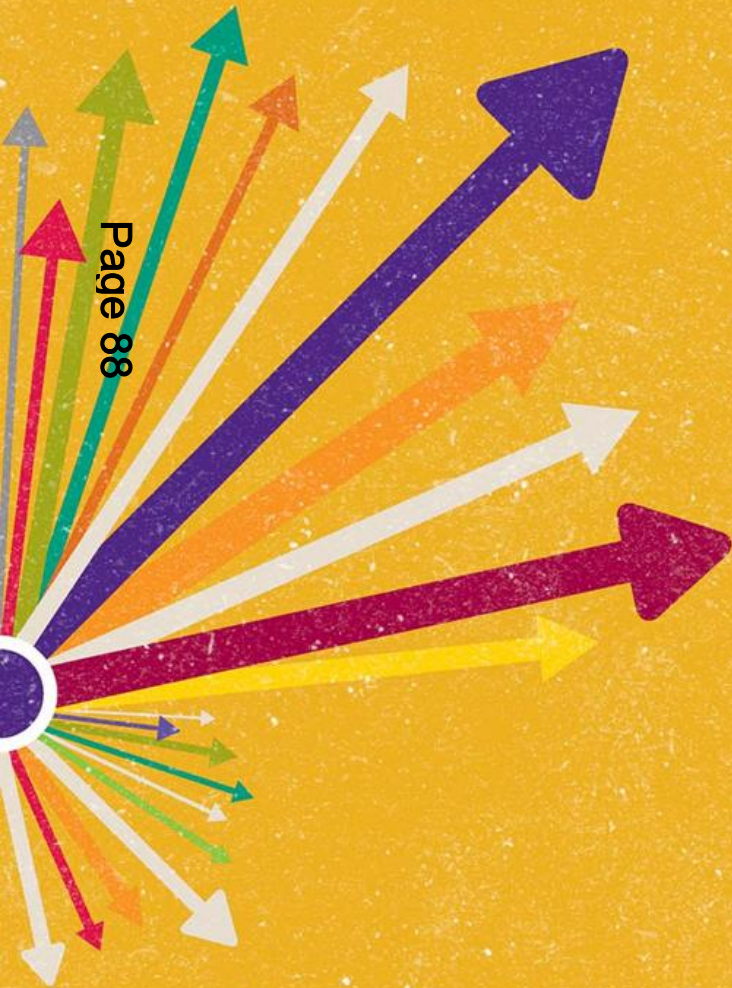
LACC weaknesses

- ✗ income unlikely to be generated for one to two years
- ✗ commercial skills and knowledge of existing staff may be insufficient to meet LACC requirements
- ✗ lack of capacity to develop new market
- ✗ individuals within the proposed company may lack the drive to lead the cultural change
- ✗ subject to complex legal, tax and financial requirements
- ✗ ownership uncertain under devolution

'As is' weaknesses

- ✗ 'as is' model is more likely to be slower to change and have innovation
- ✗ future uncertain as a result of devolution/ possible combined authority
- ✗ limited commercial skills and expertise
- ✗ unable to generate income from private sector and public sector
- ✗ unlikely to generate additional income from other public sector organisations
- ✗ additional financial savings will be required, likely to require changes to people and service delivery in the short to long term

Appendix 10: Key risks



Key risks

Option A 'as is'

The Councils

Council no longer financially viable, unable to meet financial challenge and revised budget gap

Services have to stop

The Councils' services are outsourced or delivered by other LACCs

Option B LACC

The Councils

Unable to agree and resolve an equitable approach to share the profit and any liabilities

Financial and reputation risk should the proposed company fail

Deterioration in service delivery due to ineffective contract/performance management

Proposed company

Board not able to drive a change in culture, due to a lack of commercial expertise. Recruitment limited to part time chair.

Innovation and commercial development not able to develop due to rigorous procurement controls

No market, unable to generate additional income

Pension deficit does not enable the proposed company to be competitive in the market

Failure to comply with legal requirements, such as tax and accounting requirements

Wrong alternative delivery model selected for some services, one approach may not be suitable for all services

Failure to effectively embed T18 and implement the LACC due to lack of staff capacity if full implementation is required by April 2017

Staff dissatisfied and reluctant to embrace the change

Elected Members too involved in operational detail and stifle the proposed company



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