Local Authority Controlled Company

Joint Steering Group Report

January 2017

South Hams District Council

West Devon Borough Council

Working together

South Hams District Council | West Devon Borough Council | Working together

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1. Executive Summary

1.1 South Hams District Council and West Devon Borough Council (the Councils) have previously commissioned PwC to produce a detailed business case and implementation plan so that they could consider and determine whether or not to establish a Local Authority Controlled Company (LACC). A report by PwC has been considered by members at their respective full council meetings in July 2016. Both Councils resolved at their respective full Council meetings in July 2016, to establish a Joint Steering Group (JSG). That group has been formed and consists of Members from both Councils as follows:
South Hams – Cllr John Green, Cllr Michael Hicks, Cllr John Tucker, Cllr Keith Wingate
West Devon – Cllr Bob Baldwin, Cllr Neil Jory, Cllr Robert Sampson, Cllr Phillip Sanders

1.2 The JSG's primary purpose has been to oversee work in resolving a number of key issues that the July Councils considered required more detailed analysis before making a final decision on whether or not to establish a LACC.

1.3 The JSG has held seven meetings to consider the key issues around establishing a LACC

1.4 The 9 key issues that the JSG considered were:-

- Teckal compliance
- State Aid implications
- Governance and Shareholding
- Reserved matters
- Ability and mechanism for adding new partners
- Exit Strategy
- Business Planning
- Corporation Tax and VAT
- Pensions

1.5 The LACC project team commissioned expert advice from Bevan Brittan Solicitors and Grant Thornton Accountants in order to establish the position for each of the 9 key issues

1.6 Advice, options and recommendations were presented to the JSG who, after due consideration, have come to conclusions on each of the 9 key issues as set out below

2. High Level conclusions and recommendations

The JSG has considered a number of key issues identified by the July Councils that needed to be considered before the Councils could decide whether or not to establish a LACC. Following consideration of these issues the JSG conclude that there are solutions to all of the key issues at a high level (with further detail set out in the paragraphs that follow):

2.1 Teckal Compliance - the Councils and the LACC will need to be continually aware of the requirement to comply with the Teckal rules, however, this is an issue which will be addressed through the drafting of governance documents and will be a critical test to be applied in pursuing future trading opportunities to avoid exceeding the 20% permissible income from external trading

2.2 State Aid implications will need to be managed by the Councils Section 151 officer and Monitoring Officer with lending of monies and use of council assets (such as accommodation) at market rates to prevent breaching state aid regulations

2.3 Governance and Shareholding - A Company limited by shares is the recommended legal entity for the LACC, and that a Joint Shareholder Committee comprising Members from both Councils be formally established to oversee the formation of the company and decide on matters reserved to the Councils. The Joint Steering Group further recommend a Board consisting of 7 Directors be appointed by the Joint Shareholder Committee and that Members do not take up roles on the Board. Board Members should be appointed for an initial 3 year term, with a maximum of 3 terms (9 years total). (See section 5 of this report).

2.4 Reserved Matters demonstrate to Members how control is retained over the LACC by the Councils. A list of reserved matters has been developed with Members and it is recommended that these be taken forward into contractual documents should the project proceed to implementation (see section 6 of this report).

2.5 There are solutions and options to the Taxation issues identified by the Councils at their respective July 2016 meetings. However there are some activities that will need to be undertaken once the contractual and governance documents are drafted during implementation phase. Confirmation will need to be obtained from HMRC that a Cost Sharing exemption does not apply (to ensure that the Council does not incur any irrecoverable VAT), the LACC will need to register for VAT and a Mutual Trading Exemption will need to be applied for so that corporation tax is not applied to any profits on transactions between the owning Councils and the LACC (see section 7).

2.6 In terms of Pensions and Staffing, a LACC would be a designated body for pensions and the Local Government Pension scheme be closed to new employees of the LACC. The earliest date for transfer of staff to the LACC would be 1st October 2017 (see section 8).

2.7 Business Planning and Financial Modelling – there is the potential to deliver services for other organisations at a profit. The implementation of a LACC would however result in additional costs to the Councils in the early years of operation, particularly in respect of increased pension contributions. Payback periods are as set out in Section 9 for this report.

2.8 The ability to add new partners will be important. While the preferred route for adding new partners should be considered on a case by case basis, the current views of the Joint Steering Group are that Option 2 (Level two participation) and Option 3 (Group Structure with subsidiaries) are the preferred options in order to protect the interests of the founding two Councils while still allowing the new councils some say over the overall company direction (see section 10).

2.9 If the LACC project proceeds to implementation, the requirements for the exit plan should be established during implementation phase with a full exit plan being delivered to the Councils within the first 12 months of operation. A 12 month notice period will be required by either Council to quit the arrangement and the Council triggering the exit would be responsible for meeting the cost of that exit (see section 11).

Conclusion

In considering the 9 issues set out above, the JSG concluded that there are no legal or technical matters that would prevent the Councils implementing a LACC. There are however additional initial costs (particularly Pensions contributions) in establishing a LACC and therefore the recommendation to both Councils (by 5 votes to 3) is to not proceed with the implementation of a LACC as currently proposed.

3. Teckal Compliance

What is Teckal?

3.1 Teckal is the leading case on public to public contracts and their exemption from the procurement rules. The case confirmed that contracts awarded by a contracting authority to a legally distinct person will fall within the procurement regime unless the three tests below are satisfied. This case law has now been codified and the relevant provisions are to be found in regulation 12 of Pubic Contracts Regulations 2015.

3.2 The exemption is therefore a recognised mechanism which enables a Local Authority to contract directly with a company which it wholly owns, (subject to a number of tests) without having to follow the usual procurement regulations.

3.3 The JSG sought the advice of Bevan Brittan Solicitors in order to fully understanding the implications of Teckal compliance and how these could be overcome. The following sets out the tests required by Teckal and the ways in which the Councils can seek to ensure that these tests are satisfied.

Test 1 – The owning council must exercise control over the company, which is similar to that control which it currently exercises over its own in house departments

3.4 There would be a contract with the LACC which would include a number of reserved matters. These are covered in detail later in this report (paragraph 6 below), however in summary, these are decisions which the Council considers to be important enough that it wishes to retain the final decision making –for example, the ability to add a new partner to the LACC

3.5 The contract would be managed to ensure that the LACC delivers services to an agreed standard as set out in the Contract specifications.

3.6 The Councils would make appointments to the board of the LACC to ensure that it can direct the activities of the LACC

3.7 The Councils would approve the Annual Business Plan of the LACC to ensure that the LACC only pursues opportunities which are not contrary to those of the Councils' priorities and strategic aims.

Test 2 – The Company must deliver more than 80% of its activities for the owning councils

3.8 At least for the first couple of years, the focus of the LACC would be on delivering services to South Hams District Council and West Devon Borough Council however one of the primary reasons for establishing a LACC would be to deliver services for other organisations and individuals and make a profit (trading).

3.9 The commercial orientation of the LACC risks eroding compliance with this test over time if not managed closely and so this will be closely monitored. .

3.10 In pursuing trading opportunities, the LACC would undertake an assessment of the opportunity to ensure strategic fit (it is in line with the Councils aims and objectives) and that the LACC does not exceed the 20% of turnover that it is permitted to deliver to other organisations, or explores alternative solutions.

3.11 One alternative option would be to admit a new Council looking to buy our services as a new partner to the LACC. This is covered later in section 10 of this report.

3.12 Another option would be to establish a subsidiary company for any external contracts over the 20% threshold.

Test 3 – there can be no direct private capital

3.13 At present, there are no forms of investments in Teckal bodies authorised in UK legislation.

3.14 This would be managed by the Finance Director of the LACC and the Councils' Section 151 officer as part of their day to day roles.

Joint Steering Group Conclusion – Teckal Compliance

3.15 There needs to be a strong awareness of the Teckal requirements in establishing a LACC as breaching this could lead to a challenge from other providers in the market and legal action.

3.16 Compliance with Teckal will need to be managed through drafting of the contracts/ governance documents (including agreement of Reserved Matters) and will need to be a critical test applied by the Board in its decisions to pursue future trading activities

3.17 Overall however, compliance with the Teckal exemption is manageable and does not prevent the Councils from implementing a LACC.

4. State Aid Implications

Introduction

4.1 State Aid issues arise if state resources are used to provide assistance that gives the company an economic advantage.

4.2 The LACC and Councils would need to be mindful of State Aid Implications. State Aid can include:

- Loans on non-commercial terms
- Provision of premises on a free or discounted basis
- Sales of goods or services to the organisation at an undervalue
- Purchase of goods or services from the organisation at an overvalue
- Guarantees

4.3 Payments of cash are the most obvious form of aid, but aid can (and more usually does) consist of a state body foregoing revenue which it would otherwise receive - for example, tax exemptions, favourable interest rates on loans or outstanding payments, extending lines of credit, guarantees covering liabilities to third parties etc. It can also include the provision of assets at less than a market value.

4.4 While it is important to be fully aware of State Aid regulations, compliance with State Aid can be managed through the drafting of the contract and governance arrangements put in place and will not prevent the Councils from implementing a LACC.

Joint Steering Group Conclusions - State Aid

4.5 Any loans to the LACC , asset transfers and rental arrangement would need to be on commercial terms

4.6 Compliance with State Aid regulations must be managed by the Councils' Section 151 officer, however State Aid regulations should not prevent the implementation of a LACC

5. Governance and Shareholding

5.1 The JSG obtained advice from Bevan Brittan Solicitors on governance and shareholding matters. In considering the governance of the LACC, it is important to demonstrate enough control in order to ensure compliance with Teckal requirements but allow enough freedom for the company to make timely commercial decisions.

What form of company should the LACC take?

5.2 As set out in section 3, the LACC would be a Teckal compliant Company. A Teckal compliant company can be awarded contracts for delivery of services by its owning councils with no need to undertake a procurement. If the LACC was not Teckal compliant, the Councils would need to run a procurement where the LACC would need to bid for the contract alongside any other interested provider, and the contract would be awarded to the best provider based on the procurement criteria.

5.3 There are a number of forms that a company can take:

- Company Limited by Shares – this is the tried and tested form of company for Local Authority Trading and allows distribution of profits to its shareholders (the Councils)
- Company Limited by Guarantees – these are typically used as a vehicle for embedding “social” values and are more difficult forms to be able to distribute profits back to shareholders (the councils)
- Community Interest Companies – very much utilised for “social” purposes and has additional requirements from the CIC regulator

5.4 There are therefore, two suitable options available for the legal form of the company – Company Limited by Shares or Company Limited by Guarantee.

5.5 A Company Limited by Shares is a ‘tried and tested’ company vehicle for local authority companies and gives possibility for an income return to the shareholders, subject to there being sufficient profits available.

5.6 As such, a Company Limited by Shares is recommended as considered the most appropriate form of company for a LACC. The advantages and disadvantages for each option can be seen in Appendix A (Options of Company Models) to this report.

5.7 South Hams District Council and West Devon Borough Councils would own the company (i.e. be the shareholders). There cannot be any private sector ownership within a Teckal company.

5.8 The LACC would be regulated by its constitutional documents and Company Law. The statutory constitutional documents include, articles of association, memorandum of association, certification of incorporation, special resolutions and certain ordinary resolutions etc. The shareholder agreement may also form part of the company’s constitution

5.9 The company would be required to comply with the Companies Act – including submitting confirmation statements and filing accounts each year. These would be a matter of public record and available through Companies House website.

Who would run the company?

5.10 The company would be overseen by a Board consisting of a number of Directors. These individuals would be accountable for the successful operation of the company and must at all times operate in the best interest of the LACC.

5.11 The Board composition is important in ensuring a commercial direction for the LACC whilst demonstrating sufficient control over the LACC by the Councils in order to comply with the Teckal exemption. It should be of a sufficient size to ensure an appropriate spread of skills and experience but not so large that it inhibits timely and flexible decision-making by the LACC.

5.12 Bevan Brittan Solicitors advised that the LACC board should consist of 7 -9 board members.

5.13 The advice from Bevan Brittan set out that the JSG should think carefully about Councillors being Non-Executive members of the LACC board (this means members of the Board who are not members of the LACC). While it is completely lawful for Councillors to be Non-Executive Directors of Council companies, conflicts of interest need to be carefully managed. These considerations relate to both code of conduct issues and risks associated with Councillor decisions where s/he is also a LACC Director, being challenged on the basis of bias/predetermination. Directors must act in the best interest of the company at all times and in accordance with the company's constitution..

5.14 Members would still be (and in fact it is a requirement for Teckal compliance) to be able to exercise a decisive influence the direction of the company through reserved matters and approval of the annual business plan for the LACC without being on the Board.

5.15 Having been considered by the JSG, the recommendation is that the company would have 7 Directors on the Board and that this should not include Councillors.

5.16 The Board would comprise a number of Executive Directors (Senior Managers of the LACC). The Executive Directors would lead the operation of the LACC on a day-to day basis.

5.17 There would also be Non-Executive Directors. These could be retained employees of the council or independent persons with the right skills to ensure that the LACC is successful (for example, an independent person with a commercial background). To avoid any conflicts of interest, it is recommended that any Non-Executive Directors from the Council would not be the Head of Paid Service, Section 151 or Monitoring Officer. Where retained employees of the Council are appointed to the board of directors, there are again, issues of conflicts of interest which will need to be considered and managed.

5.18 Finally, an Independent commercially experienced Chairman would lead The Board. The Independent Chair would take an objective view of the business and the matters that the Board will deal with.

5.19 The Councils would jointly recruit to the post of Independent Chair and the Non-Executive Directors through an external recruitment process.

5.20 The Directors would each serve for a 3 year initial term with a maximum of three terms. Ideally these terms would be staggered to ensure continuity of the board.

How would the Councils exercise control over the company?

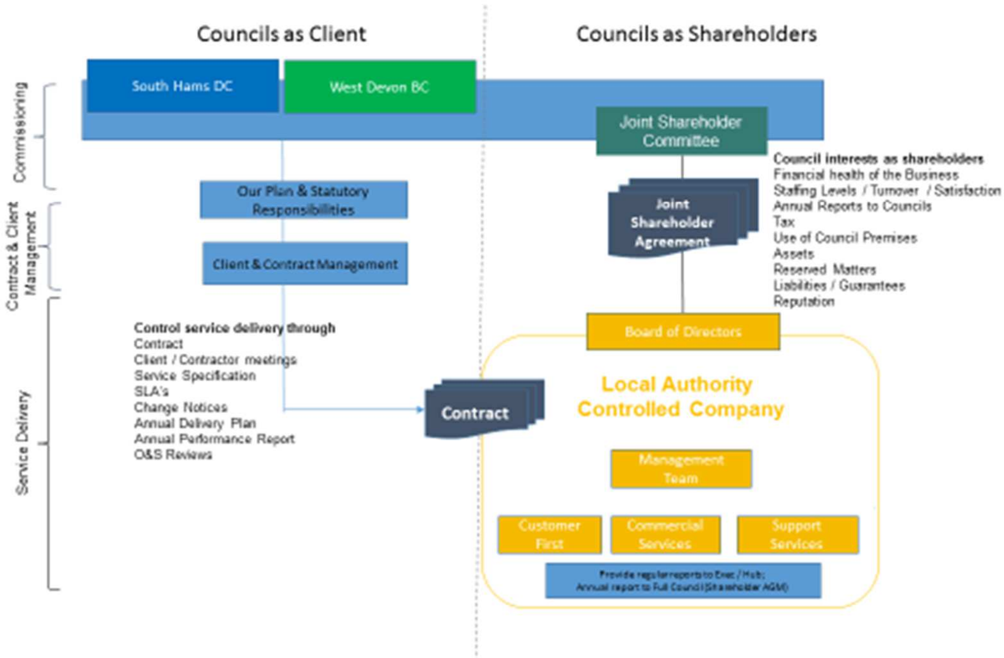
5.21 There would be a number of relationships between the Councils and the Local Authority Controlled Company including owner and as client for the services

5.22 As the owners of the LACC, it is important for the Councils to retain a degree of control over the LACC. This is a key requirement of ensuring Teckal compliance. There would be a contract between the Councils and the Local Authority Controlled Company. This will set out the relationship between the parties.

5.23 As a recipient of services from the LACC, the Councils will need to enter into a services agreement with the LACC. The contract for services will be subject to services specifications with detailed performance indicators (KPI). The services contract will be managed on behalf of the Councils by staff that are retained and employed by them.

5.24 A Joint Shareholder Committee would be formed consisting of Members of both South Hams District Council and West Devon Borough Council as the Shareholders. This Committee would be formally constituted as a Joint Committee in order that it can make decisions on reserved matters delegated to it by the Councils, act on behalf of the shareholders, oversee the implementation of the LACC (See Section 6 for more information on Reserved Matters). There would also be the ability for the Joint Shareholder Committee to refer certain decisions to Full Council. A Joint Shareholder Agreement will be required between the two Councils to reflect the respective Council’s position.

5.25 The following diagram sets out the key governance interfaces for the LACC



5.26 The services contract would be developed through the implementation phase and will set out the requirements on all parties. The contract will have a number of schedules including:

- Payment schedule (how much the Councils will pay the LACC and the frequency of payments)
- Staffing schedule (a list of the staff that are transferring under TUPE)
- Service Specifications (setting out the services to be provided and the required performance levels)

5.27 The recommendation is to have one services contract - with both Councils and the LACC being parties to that contract. The contract will separately set out the liabilities of each Council – for example in respect of each councils staffing, pensions and asset liabilities in the event of services being brought back in house in the future.

5.28 The Shareholder Agreement would be put in place to restrict and control what shareholders and Directors can do on behalf of the LACC. The high level aims of the agreement would be:

- To manage and govern the relationships between the shareholders, including decision making and voting rights
- To restrict the abilities and authorities of the LACC Directors, so that the Councils and members are satisfied that the assets and employees of the LACC are adequately protected (see paragraph 6 on Reserved Matters)

Would both Councils have the same amount of control?

5.29 The Councils currently have a Collaboration Agreement which sets out how the Councils work together (February 2015). One of the governing principles within this agreement is that each Council has equal standing regardless of size or financial contribution.

5.30 It is intended that this principle would also be adopted in the Shareholders Agreement in relation to ownership and voting rights concerning the LACC. Therefore the voting ratio for any decisions affecting the Company would be split on a 50:50 basis for each Council when the LACC is established. These decisions would include any matters concerning the Company that are escalated to shareholders or that are matters reserved for the shareholders (e.g. decisions to bid for major contracts, decisions requiring parent guarantees, Directors remuneration, etc.)

5.31 If the LACC is established, there is no intention to transfer any assets from either Council into it and the entire value of the company on day 1, will only be equal to the value of the contracts that it holds with the two Councils to deliver Council services.

5.32 Therefore it is proposed that the value of each Council's shareholding is in proportion to the value of its share of the contracts (this is different from the voting rights).

5.33 For example, if the total value of the two contracts was £10million with the South Hams contract being worth £6m and the West Devon contract being worth £4m then the value of the shareholdings would be 60% and 40% respectively.

5.34 Any profit or dividend would also be in proportion to the value of each shareholding, so following the example in the previous paragraph any dividend would be split on a 60:40 basis.

5.35 The intention would be for the ratio to be maintained for the duration of the contracts with the company. However, a review of the ratio might be triggered if there was a significant change in the individual contract values during that period e.g. the withdrawal of a particular service by one Council from their contract would significantly impact on the value of the contract and overall company. This would lead to a reduction in the ability to comply with Teckal requirements.

5.36 Another trigger to review the ratio could be if a third party were to become a shareholder and establish a contract with the LACC. In this case their share value could also be in proportion to the value of the contract that they bring to the Company.

How will the Councils ensure that the LACC delivers what the Councils want?

5.37 On a day to day basis, stakeholders (Staff, Councillors, public, businesses etc.) would not notice a difference in the way services are delivered. They would have the same access to staff as they currently do.

5.38 During the implementation phase, service specifications will be developed setting out the required performance levels and requirements on each service. In addition, the LACC would undertake to deliver an Annual Performance Review and Annual Business Plan to the Councils for approval.

5.39 The Annual Performance Review would take the form of a report to the Councils into the performance of the Contract, whereas the Annual Business Plan will set out performance and plans for the company in the coming year/s

5.40 The Annual Business Plan is detailed in Section 9 of this report.

Management of the Contract

5.41 As previously mentioned, there would be a number of relationships between the Councils and the Local Authority Controlled Company including Owner and also as Client for the services. It will be important to be clear who is operating in which role if the LACC Project proceeds to implementation. It is not possible (or necessary) to differentiate between the Councils and the company interests at the implementation stage as it would be the Council that is making all of the decisions in relation to the set up.

5.42 There will be a point when the LACC establishes its own identity (once the board of directors is appointed and starts operating) and there will need to be negotiation between the Councils and the LACC to set up appropriate ongoing governance and contractual arrangements.

5.43 The contract management function would be carried out by the Lead Specialist Place and Strategy and Lead Specialist Commercial Services & Waste within the Councils' Strategy and Commissioning Service. They will be responsible for the overall management of the contract with the LACC.

5.44 The three key elements of contract management are:-

- Service Delivery Management – this is about ensuring that the actual service provided by the LACC is in accordance with the agreed standards and prices. It is important that the performance measures for the LACC are able to demonstrate the success of the relationship.
- Relationship Management – it is important that the relationship between the Councils and the LACC works effectively and that there is a constructive environments to enable the delivery of the contract. To aid this, there must be the ability for horizontal lines of communication between the organisations – for example, the contract Manager for the Councils must have a clear opposite within the LACC.
- Contract Administration - keeping the contract documents up to date is important to the smooth running of the whole contract management function and to ensure that all parties are clear on their obligations. Prior to implementation, a contract change procedure must be established setting out how any changes should be progressed

5.45 It is important to note that while the role of managing the contract is retained within the Councils, the post holder will be ensuring that all parties to the contract deliver against their obligations and not just hold the LACC to account.

5.46 In progressing with the LACC, the Councils should look to appoint its contract manager very early in the Implementation phase - as such this should be one of the first actions taken forward when moving to implementation.

5.47 The Lead Specialists managing the contract would need to have parallel lines of communication (so similar level – ELT equivalent) with nominated individuals within the LACC. These individuals must be empowered to negotiate positions with the Councils Lead Specialists within parameters agreed with LACC Directors). The aim would be for this to be accommodated within existing resourcing within the LACC transferring staff. These roles will also be identified early in any implementation.

5.48 Performance Monitoring would be undertaken by the retained Business Development Team as it currently is to ensure that Members continue to have access to timely performance data.

What will happen to the Councils Statutory Officers & functions?

5.49 The Councils share three statutory officers – Head of Paid Service, Section 151 Officer and Monitoring Officer.

5.50 The Councils are required by law to designate one of their officers to undertake these statutory duties. Although it is possible to delegate the roles undertaken by these statutory officers to an officer not directly employed by the Council and therefore, an employee within the LACC, the Councils constitution currently limits such designation to employees of the Council. It is therefore not possible under the current constitutional arrangement for such officer not to be directly employed by the Council. There are a number of considerations to be given to this matter.

5.51 There is a risk of conflict between the officer role and the employment relationship with the LACC. For example, if one or more of the Statutory Officers are required to advise on matters that may lead to decisions in conflict with those of their LACC employers.

5.52 It should also be considered that there is no tested case law on the parameters of the Statutory Officers being employed by a different organisation.

5.53 There are a number of alternative solutions such as offering Statutory Officers joint contracts of employment. These will be explored further should the project proceed to implementation.

5.54 In addition to the Statutory Officers detailed above, there are also a number of statutory functions carried out by other officers of the Council. This work will need to be mapped and addressed should the project proceed to implementation.

Joint Steering Group Conclusions – Governance and Shareholding

Good Governance and control will be critical to the successful and legal operation of a Local Authority Controlled Company. The JSG have considered a number of issues and concluded that if the Councils proceed to implementation:-

5.55 A Company limited by shares is the appropriate legal entity for the LACC

5.56 A Joint Shareholder Committee comprising members from both Councils, should be formed to oversee the formation of the company and manage reserved matters ongoing

5.57 That a Board consisting of 7 Directors be appointed by the Joint Shareholder Committee and that Members do not take up roles on the Board.

5.58 Board Members be appointed with Non-executive Directors serving for an initial 3 year term, with a maximum of 3 terms (9 years total)

6. Reserved Matters

6.1 It is usual in Council / LACC arrangements for certain decisions to be reserved to the Councils. These 'reserved matters' are the decisions which the Councils consider important enough to require specific approval by both Councils before they can be implemented.

6.2 There needs to be a balance between the Reserved Matters (to ensure that Teckal control is demonstrated and in order to reflect the fact that the LACC is owned by the Councils and operating largely with public money) and the ability of the LACC to make commercial decisions.

6.3 There is no standard list of Reserved Matters, and they can vary considerably in number, depending on the organisation concerned. The types of decisions usually included in lists of Reserved Matters fall under the following general headings:

- Matters affecting the constitution of the LACC
- Matters affecting the business of the LACC
- Admitting new organisations to the LACC
- Financial matters

6.4 Workshops were held in both Councils to understand from Councillors the types of decisions they would want to retain and these are summarised as follows:-

Reserved but delegated to Joint Shareholder Committee	• Approval of expenditure by LACC above agreed financial threshold. • Approval of constitutional documents of LACC such as, memorandum of association, articles of association and all documents required for the purposes of registration of LACC such as statement of capital and initial shareholding. Members need to agree, initial number of shares, value and class of shares, and names of directors etc. • Approval of Substantial Transactions. These are defined as transactions which are likely to result in the LACC spending sums in excess of or entering into a contract with a third party in excess of £1m • Authorisation of litigation where such litigation is likely to involve expenditure of significant sums • Approval of minor amendment to the articles. These are amendments which are not likely to result into substantial change or alter the structure, type of business and shareholding of the LACC. • Approval of change of name • Approval of change of registered office and filed with registrar • Approval of amendments to articles of association • Approval of appointment and removal of Exec and Non Exec Directors • Approval of directors remuneration • Approval of substantial employment packages • Approval of directors service contracts • Alteration of share capital. Ordinary resolution is required and this must be filed with registrar. • Approval of composition of board • Approval of changes to type of business undertaken by LACC

	• Appointment on independent chair • Appointment of non-executive directors
Reserved to Full Council	• Appointment and/or removal members of Joint Shareholder Committee • Approval of addition new shareholders i.e. Another Council • Approval of annual business plan for LACC • Approval of resolution to dissolve or wind up LACC • Approval of Joint Shareholder Committee scheme of delegation • Dismissal of any statutory officers that may be employed by the LACC

6.5 The reserved matters would be captured in the Shareholder Agreements and the company's Articles of Association. The Articles of Association detail the rules about running the company.

Joint Steering Group Conclusions – Reserved Matters

6.6 Reserved Matters demonstrate to Members how control is retained over the LACC.

6.7 The list of Reserved Matters set out above form a number of control measures over the LACC and it is recommended that these be taken forward into contractual documents should the project proceed to implementation.

7. Taxation

VAT

7.1 Both Councils can currently fully recover their VAT. The Councils commissioned Grant Thornton Accountants to undertake a review of both Councils' VAT positions. The conclusion is that there should be no irrecoverable VAT by moving to a LACC.

7.2 The VAT recoverable position of the LACC was also considered. Potentially, the cost sharing exemption could apply to the LACC which would mean that the LACC would incur irrecoverable VAT. Although Grant Thornton concluded that the conditions for the cost sharing exemption could not be met, given the amounts involved, they recommended that a ruling is obtained from HMRC that the cost sharing exemption does not apply. This is a separate ruling from HMRC than the ruling that would also need to be obtained from HMRC on Corporation Tax (see 7.11 below).

7.3 Currently, the Councils can claim VAT incurred on expenditure used for both taxable and non-business activities. For example, taxable activities would include off-street car parking facilities, building control fees, ferry services. Exempt activities include the provision of stalls at markets, crematoria services and rental of commercial units. Non-business activities include income from the provision of on-street parking, building inspections and waste collection and disposal (domestic and trade).

7.4 Due to both Councils being involved in making exempt supplies, each year they must undertake a partial exemption calculation to ensure that they are within their 5% partial exemption limit. In the case of SHDC, its 2014-2015 partial exemption limit came in at 4.31% whereas for WDBC it was 0.59%.

7.5 The requirement for the Councils to undertake annual partial exemption calculations will not change because the expectation is for both Councils to continue to provide existing services as principal but with the LACC contracted to provide management services (i.e. it will act in an agent capacity for both Councils).

7.6 The broad effect of this means that for both Councils

- output tax on taxable supplies such as off-street car parking facilities must continue to be accounted for through the Councils VAT returns
- exempt supplies such as rental of markets stalls will continue so partial exemption calculations will be necessary to identify the attributable exempt input tax
- non-business activities such as the collection and disposal of domestic waste will continue
- the VAT incurred on expenditure will increase significantly (this is due to the VAT that is chargeable by the LACC on its management charges) see below.

7.7 Although using the LACC to provide management services will increase the input tax incurred by the Councils, most of that input tax incurred is expected to be attributable to the Councils' non-business and taxable activities which means that there should be a positive impact on the Councils ability to recover VAT attributable to its exempt activities

7.8 If the Councils were to take on running certain activities for other public bodies (rather than just provide management services), planning and thought would need to be applied to running these activities through the Councils (rather than through the LACC), to remove the risks of irrecoverable VAT being incurred. One example is the rent of commercial units.

7.9 As a separate legal entity, the LACC will need to register for VAT, however this will be managed in order to protect the Council's position during implementation of the LACC and is not considered to be an issue.

7.10 Full details of the VAT position are set out in exempt Appendix B to this report (GT VAT & Corporation Tax report)

Corporation Tax

7.11 Corporation tax is a tax on a company's profits. Corporations don't generally pay tax on dividends. The current rate of corporation tax is 20% however this will be reducing to 19% from 1st April 2017 and to 17% from 2020.

7.12 The LACC would apply to HMRC for clearance in order for the transactions with the two Councils to be classed as Mutual Trading. Provided that this clearance is received, the LACC should be exempt from corporation tax on any profits arising from transactions with the two Councils.

7.13 The Mutual Trading exemption essentially sets out that the outcome of any transactions where entities are in effect trading with themselves are not subject to corporation tax.

7.14 The Councils would need to obtain a ruling from HMRC and their agreement that the 'Mutual Trading exemption' applies. This can only be applied for when the company is being established as HMRC will want to see the governance documents.

7.15 If HMRC were to reject the application for the Mutual Trading exemption, an alternative solution could be to set up two subsidiary companies – one to operate the activity of the two Councils (for which mutual trading status would be applied for) and a separate one to operate the activity with third parties e.g. where the LACC wins external business.

7.16 While Corporation tax would be applied to 'third party profits' it is not seen as an issue in preventing the formation of a LACC.

7.17 Grant Thornton's detailed paper on Corporation Tax is as set out in exempt Appendix B to this report

Employment Tax

7.18 The LACC would need to register as a new employer with HMRC and arrange for a new PAYE scheme to be set up and register as a contractor under the Construction Industry Scheme however this is a relatively simple process and would form part of the implementation plan

Joint Steering Group Conclusions– Taxation

7.19 The Joint Steering Group has reviewed the advice from Grant Thornton and concluded that, subject to the following actions being undertaken and confirmation received, that there are workable taxation solutions in the formation of a LACC and that during the implementation;

- That the Councils' section 151 Officer applies to HMRC early in any implementation for confirmation that the cost sharing exemption does not apply to ensure that it does not incur irrecoverable VAT
- That VAT registration is commenced once the company is incorporated
- That a mutual trading exemption is applied for from HMRC

8. Staffing and Pensions

Which Services will transfer to the LACC?

8.1 The council currently delivers the majority of its services in house. The following services are proposed to transfer to a LACC
- Support Services – HR, Legal, Finance, ICT, Design and Internal Service Desk and Communications
- Customer First – Environmental Health, Planning, Enforcement, Customer Services including call centre, Localities
- Commercial Services – South Hams Waste, Street Scene, Salcombe Harbour
- Communications

8.2 The services that would be retained are those within the Strategy and Commissioning service (Member Support, Electoral Services) and also Audit which is currently within Support Services.

8.3 The Audit function would remain with the Councils and move from its current location in Support Services into Strategy and Commissioning. The role of the Audit team would change slightly in that it will be auditing the contract with the LACC but as part of that can also audit the services within the LACC. This would be captured in the contract between the Councils and the LACC.

8.4 In addition to In House services, the Councils have some commissioned services where they have a contract with other organisations to deliver services on behalf of the Councils. The following commissioned services would remain with the Councils:
- FCC waste contract (West Devon Managed service for two years)
- Fusion Leisure Contract (Joint)

8.5 The T18 model has seen the Councils share staff and implement a structure of Case Managers and Specialists to ensure that a customer case is seen through to its conclusion in a structured way. The staffing structure that was developed means that services can be transferred into a Local Authority Controlled Company with no need to significantly restructure them. Services included in scope for transfer to the LACC are Support Services, Customer First and Commercial Services. These services represent the majority of the directly employed workforce.

8.6 The potential breakdown of staff that will transfer and retained is as follows:

Council	Total Staff No's	Transferred to LACC	Retained by Council
South Hams	322	312	10
West Devon	79	70	9
Total	401	382	19

8.7 There are still considerations needed to be given to the transfer of South Devon AONB staff as the AONB Board may wish to explore alternative delivery options. While it is considered that there will be benefits to the AONB staff in transferring to the LACC, this decision is for the AONB to take and would not impact on the overall LACC business case should they decide not to be a part of the venture.

8.8 There will be no requirement for restructures of existing services or for individuals to reapply for their roles as the proposal largely sees the whole of the Service Delivery and Commercial Development function of the organisation transferring to the LACC.

Structure of the retained Services (Strategy and Commissioning)

8.9 The Councils retained services would be structured largely as they currently are. The function of managing the contract with the LACC would be undertaken within the Lead Specialist Place and Strategy role.

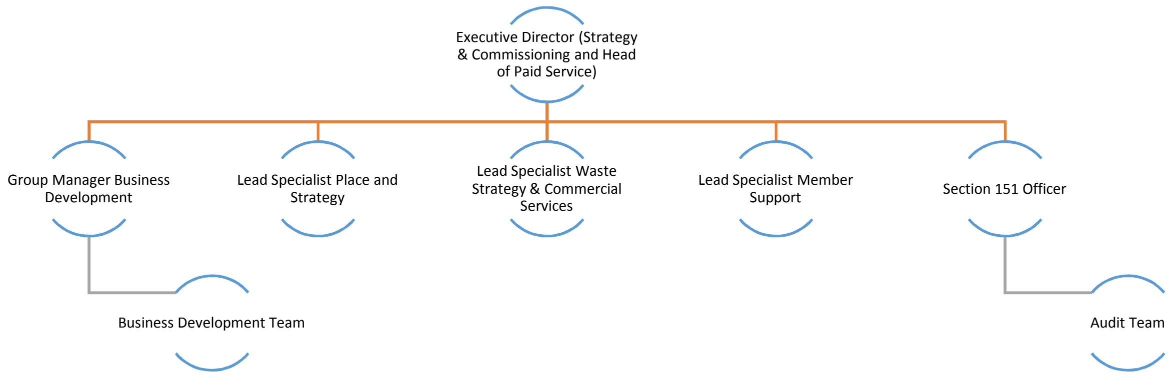


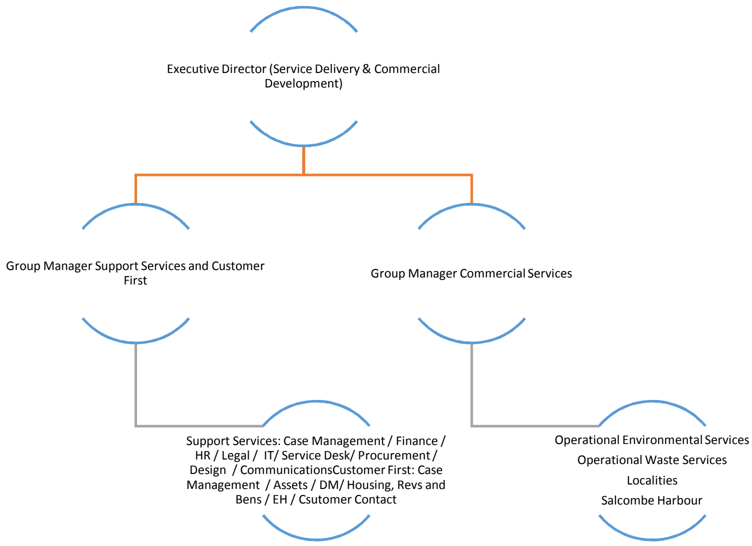
Diagram A – Structure of retained services

8.10 The current arrangements with Devon Audit Partnership would continue with the overall responsibility for the Audit team coming under the Section 151 Officer.

8.11 The role of managing the contract would be undertaken by the Lead Strategy Specialists. The contract management function is covered in Section 5 to this report.

Structure of the transferring services

8.12 There would also be minimal impact on the structure of services that transfer to the LACC. The most notable change to existing structure is the moving of the communications team to the Service Delivery & Commercial Development side and therefore within the LACC. A summary of the LACC structure is as follows.



8.13 As the LACC looks to pursue trading opportunities, capacity would need to be developed to support this however this will not require additional resources in the early years. Initially we would consider and review the skills (around areas such as marketing and selling) of existing officers and provide training where required. Future additional resourcing requirements would be built into pricing for future contracts.

How and when will staff transfer to the LACC?

8.14 The current proposal would be for staff to transfer to the LACC no earlier than October 2017 to allow sufficient time to ensure compliance with the TUPE regulations and appropriate staff consultation. Based on a decision being made before April 2017, an October transfer of staff would be feasible however this will be subject to detailed planning during the implementation phase.

8.15 Staff transfer to the LACC will be subject to TUPE (Transfer of Undertakings: Protection of Employment) meaning that staff would transfer on their current terms and conditions of employment.

8.16 The Joint Steering Group met with representatives of Unite and Unison and discussed a number of matters including the ability for transferring employees to continue access to the Local Government Pension Scheme, see below for more details on this matter.

How will the Pensions positions be treated?

8.17 Effective treatment of Pensions is critical to ensuring that a LACC is financially viable. The Council has commissioned expert advice on the most suitable pension models with officers having discussions with the Actuaries, Devon Peninsula Pensions, Bevan Brittan and Grant Thornton Accountants to ensure that the LACC proposal is financially viable.

8.18 The primary consideration is to find a way to ensure that transferred employees' membership of the Local Government Pension Scheme (LGPS) is protected. Two main options have been considered – Admitted Body and Designated Body Status.

8.19 There are clear advantages to the Councils to the Designated Body route over the alternative method of Admitted Body status. The Admitted Body route requires:

- The prior agreement of the LGPS for admittance as an Admitted Body
- An admission agreement to be signed
- Requisition and payment for actuarial valuations re contributions
- Bond, indemnity or guarantee (actuarial estimate of a bond is £779k for West Devon and £3,017k for South Hams)
- Timescale of several months

8.20 Designated Body status does not require the above; the decision to become a member of the LGPS is one to be made by the LACC once it has been formally set up and it is a more cost effective, timely and viable way for the LACC to contribute to the LGPS. Bevan Brittan & KPMG have advised that this is a legitimate way forward under the rules.

8.21 Whilst a bond is not required under Designated Body status, Devon Peninsula Pensions may require a guarantee from the Councils guaranteeing future liabilities regarding the LGPS. These liabilities lie with the Councils in any event so this is not an unreasonable request and can be achieved by a written agreement (but which will not require a bond).

Type of membership of LGPS

8.22 As part of the decision on Designated Body status, the LACC can decide whether to have an 'open' membership (this means both the employees transferred from the Council to the LACC and any future employees of the LACC) or a '**closed'** arrangement which restricts membership to the transferred employees only. The LGPS would be closed to future employees save for limited designated posts exceptions. A resolution could be passed by the LACC at a future date if it wished to designate LGPS membership for other post holders.

8.23 The majority of new employees to the LACC would be offered an alternative pension scheme which is less costly than the LGPS.

8.24 The difference between the 'open' and 'closed' membership options is a question of initial and future costs. It is proposed that a very small number of new staff may be eligible to join the LGPS (nominated posts only; other new staff will be offered an alternative pension scheme) and the Actuary advises that the 'closed' membership option is more appropriate because the 'closed' rate is designed to allow for the ageing membership of the existing staff transferred over to the LACC (with the potential exception of a very limited number of new members to the fund through the nominated posts).

8.25 With the 'open' membership arrangements, the contribution rate requires the average age of the membership to remain stable. If the average age of the active LGPS membership increases then the 'open' contribution rate will not be sufficient and higher levels of contribution will be required in future (Actuary's report attached at exempt Appendix C).

8.26 The Actuary's conclusion is that, whilst the initial contribution costs may be higher on the set up of the LACC (at the point of the transfer of the existing staff) for a 'closed' membership arrangement, the following years' contributions would decrease because people will naturally leave the LGPS and new entrants would join an alternative scheme. The initial contribution costs are higher because the scheme is being treated as being closed to new entrants and therefore where schemes are closed the pension contribution rate is always higher than schemes that are still 'open' for new entrants to join the LGPS.

What accounting treatment will be used in respect of pensions?

8.27 There are two types of accounting treatment that can be applied to defined benefit pension liabilities depending on responsibility of the actuarial risk within these liabilities, either accounting for these pension liabilities on a Defined Benefit Basis or a Defined Contribution Basis.

8.28 Following discussions with the Actuaries, Bevan Brittan, and Devon Pensions the most beneficial treatment would be the Defined Contribution Accounting approach. KPMG, the Council's auditors, have said that whilst they accept that this is technically possible, they cannot comment on whether it will be applicable to the LACC without having seen the detailed arrangement.

8.29 However they have also said that if the Councils desire to draft the contractual relationships with the LACC in such a manner which results in the actuarial risks to the past service and future service pension liability remaining with the Councils, and hence the contributions required from the LACC becoming more akin to a defined contribution type arrangement with a fixed level of contribution, they would not have any concerns with this and would not expect it to give rise to any concerns from the LACC audit perspective either.

8.30 Whilst arrangements structuring the responsibility for the actuarial risks to allow the liabilities to be accounted for on a defined contribution basis are more common place for Private Sector Employers entering the LGPS, we are advised that these arrangements are now being considered retrospectively by other LACCs as the accounting issues had not been fully appreciated at the outset and implemented where possible. Full details of both accounting options are set out in Appendix B

8.31 Financial modelling as set out in Appendix F demonstrates that there are clear financial benefits for both councils in future years. See the Business Planning section of this report for more information.

Joint Steering Group Conclusions – Pensions and Staffing

8.32 That a LACC would be a Designated body for pensions

8.33 That the pension scheme liabilities be accounted for on a defined contribution basis to ensure the LACC is financially viable

8.34 That the Local Government Pension scheme be closed to new employees of the LACC

8.35 That the earliest date for transfer of staff to the LACC would be 1st October 2017

8.36 That there would be additional pension contribution costs result in a payback period as set out in the financial modelling Section 9 of this report.

9. Business Planning & Financial Modelling

Development of a business plan

9.1 Officers are currently developing a business plan based on a CIPFA template. The business plan will set the direction for the LACC and be updated annually. It will be approved by Council as a Reserved Matter.

9.2 The key headlines for the business plan would be:-

- Focus for the first two years would be on delivering quality services to the Councils (contract for £27m each year) while exploring opportunities to make a profit on work that can currently only be undertaken on cost recovery
- Developing the market and setting out our offering to other organisations

9.3 A draft of the business plan can be found in Appendix D to this report however if the LACC progresses to implementation, this will be further developed with the Councils.

Market Opportunities

9.4 The LACC Directors, as part of their normal engagement with other Local Authorities would be exploring opportunities to win further work and the LACC would be actively promoting what it can offer.

9.5 The Councils Executive Directors have been in discussions with other local authorities who are considered alternative models for delivery of their services and it is clear that there is potential for opportunities to become available in the coming years

9.6 All Local Authorities are now required to publish opportunities through Contract Finder. The LACC would ensure that this is regularly reviewed so that opportunities can be explored at an early stage. When Councils go to market for whole services, they are likely to undertake soft market assessments at a very early stage. This would be an opportunity for other Councils to define their strategy for commissioning the services.

9.7 Work has previously been undertaken by Officers and members to benchmark the LACC against potential competitors. This demonstrates that the LACC would be competitive in the market. This work is as set out In Appendix E.

9.8 The LACC will need to develop a detailed marketing and trading strategy during the implementation phase.

Duration of the Contract

9.9 The LACC would need to be given sufficient time to establish itself and demonstrate that it can successfully deliver services back to the Councils in order to bid for new contracts.

9.10 The recommendation from the Joint Steering Group is that a contract for 5 years with the Councils option for a two year extension be awarded should Members resolve to implement a LACC.

Financial position of the LACC

9.11 Financial modelling has been developed to understand the potential positions for both Councils and the LACC as a separate body.
9.12 The financial modelling developed incorporates a number of assumptions regarding staff turnover, pensions liability, future pay awards and inflation and looks to forecast these elements over a 25 year period.
9.13 In addition to this, assumptions have been made relating to the ability to generate 3rd party income over the period including cost, profit and any resulting Corporation Tax liability from the activity.
9.14 The ability to generate 3rd party income is the area with least certainty, therefore the financial modelling considers three possibilities; no 3rd party income, low 3rd party income in initial years and high 3rd party income in initial year (maximising Teckal threshold earlier).
9.15 Details of the assumptions built into the financial modelling can be found in Appendix G.
9.16 The below table summarises the LACC's projected (profit)/loss after tax over a 25 year period. Modelling for each year can be found in Appendix F.

	Year 5 *£000's*	**Year 10** *£000's*	**Year 15** *£000's*	**Year 20** *£000's*	**Year 25** *£000's*
No 3rd Party Income	0	0	0	0	0
Low 3rd Party Income	(214)	(474)	(523)	(578)	(638)
Teckal Threshold	0	(427)	(523)	(578)	(638)

9.17 Retained profits would be distributed to the Councils as dividends based on their contract share (i.e how much they pay the LACC each year for its services)

The Councils Positions if a LACC is implemented

South Hams District Council Position

9.18 The table below summarises the (profit)/loss financial impact to South Hams District Council for entering into the LACC. Modelling for each year can be found in Appendix F.

9.19 The tables set out the position for South Hams District Council assuming no income from third parties , low level income from third parties and finally, income at the maximum level the LACC would be permitted to trade to third parties

Table SH1 – No third Party Income

SOUTH HAMS DISTRICT COUNCIL MODELLING	Year 5 *£000's*	Year 10 *£000's*	Year 15 *£000's*	Year 20 *£000's*	Year 25 *£000's*
No 3rd Party Income Model					
MTFS Positions	0	0	0	0	0
Additional Pension Costs	70	(214)	(448)	(648)	(826)
Additional Running Costs	58	64	71	78	86
Dividends	0	0	0	0	0
No 3rd Party Annual Total	**128**	**(150)**	**(378)**	**(570)**	**(740)**
No 3rd Party Cumulative Total	**947**	**728**	**(722)**	**(3,197)**	**(6,563)**

Table SH2 – Low Third Party Income

SOUTH HAMS DISTRICT COUNCIL MODELLING	Year 5 *£000's*	Year 10 *£000's*	Year 15 *£000's*	Year 20 *£000's*	Year 25 *£000's*
Low Income Model					
MTFS Positions	0	0	0	0	0
Additional Pension Costs	70	(214)	(448)	(648)	(826)
Additional Running Costs	58	64	71	78	86
Dividends	(125)	(277)	(304)	(335)	(369)
Low 3rd Party Annual Total	**3**	**(427)**	**(682)**	**(905)**	**(1,109)**
Low 3rd Party Cumulative Total	**671**	**(816)**	**(3,730)**	**(7,818)**	**(12,959)**

Table SH3 – Teckal Threshold Income

SOUTH HAMS DISTRICT COUNCIL MODELLING	Year 5 *£000's*	Year 10 *£000's*	Year 15 *£000's*	Year 20 *£000's*	Year 25 *£000's*
Teckal Threshold Income Model					
MTFS Positions	0	0	0	0	0
Additional Pension Costs	70	(214)	(448)	(648)	(826)
Additional Running Costs	58	64	71	78	86
Dividends	(250)	(277)	(304)	(335)	(369)
Teckal Threshold Annual Total	**(122)**	**(427)**	**(682)**	**(905)**	**(1,109)**
Teckal Threshold Cumulative Total	**338**	**(1,213)**	**(4,127)**	**(8,215)**	**(13,355)**

9.18 The table SH2 (Low Level Income) demonstrates that:

- In Year 5 (2022/23), there are additional pensions costs of £70,000 and additional running costs of the LACC of £58,000 and the net income from profits from third party income after corporation tax would be £(125,000). Therefore in Year 5 there is a net cost of the LACC of £3,000. The cumulative effect of all of the costs and income from the LACC from Day 1 up to the end of Year 5 is a net cost of £671,000.
- In Year 10 (2027/28), there are net savings from pensions of (214,000) and additional running costs of the LACC of £64,000 and the net income from profits from third party income after corporation tax would be (£277,000). Therefore in Year 10 there is a net saving from the LACC of (£427,000). The cumulative effect of all of the costs and income from the LACC from Day 1 up to the end of Year 10 is a net saving of (£816,000).
- The figures for later years, Year 15, Year 20 and Year 25 are shown in the Table.
- There are initial costs of setting up the LACC from additional pensions costs (which vary from £106,000 in Year 1 and rise to £203,000 in Year 3 and then start reducing as the number of staff on the LGPS scheme reduces) and additional running costs (which vary from £50,000 to £60,000 per annum).
- Income from third party profits is projected to be £60,000 in Year 3 and would rise to £277,000 by Year 10).

South Hams Financing of Initial Costs of LACC

9.19 In the first five years of the LACC, under the 'Low Income' model, net additional costs of £671,000 (payback period is 8 years) would need to be funded by the Council. Under the 'High Income' model this figure reduces to £338,000 (payback period is 7 years) because there is more income from third party profits to pay for the additional costs. If no income is achieved from third party profits in the first five years, the net additional cost over the five years to be funded by the Council increases to £947,000 (payback period is 13 years).

9.20 As is demonstrated in the modelling, there are a number of additional costs incurred by South Hams District Council in establishing a LACC. Given the three different scenarios modelled for the different income assumptions, there are three potential payback periods, indicating the year that the LACC has repaid the initial additional costs incurred. These are set out in the following table.

South Hams Payback		
Model	**Financial Year**	**Year**
No third party income	Year 13	2030/31
Low third party income	Year 8	2025/26
Teckal level third party income	Year 7	2024/25

9.21 Recommendations would need to be made as to how these initial costs are financed. Options could include the use of reserves to fund the initial costs until payback commences or crystallisation of income generation ideas currently being progressed.

West Devon Borough Council Position

9.22 The tables below summarise the (profit)/loss financial impact to West Devon Borough Council for entering into the LACC. Modelling for each year can be found in Appendix F

Table WD1 – No Third Party Income

WEST DEVON BOROUGH COUNCIL MODELLING (ALTERNATIVE WASTE SAVINGS (50%))	Year 5 *2022/23* *£000's*	Year 10 *2027/28* *£000's*	Year 15 *2032/33* *£000's*	Year 20 *2037/38* *£000's*	Year 25 *2042/43* *£000's*
No 3rd Party Low Income Model					
MTFS Positions	0	0	0	0	0
WDBC Waste Service Savings	(177)	(177)	(177)	(177)	(177)
Additional Pension Costs	49	(27)	(88)	(139)	(184)
Additional Running Costs	58	64	71	78	86
Dividends	0	0	0	0	0
No 3rd Party Annual Total	**(70)**	**(140)**	**(194)**	**(238)**	**(275)**
Alternative No 3rd Party Cumulative Total	**(57)**	**(623)**	**(1,489)**	**(2,593)**	**(3,895)**

Table WD2 – Low third party income

WEST DEVON BOROUGH COUNCIL MODELLING (ALTERNATIVE WASTE SAVINGS 50%)	Year 5 *2022/23* *£000's*	Year 10 *2027/28* *£000's*	Year 15 *2032/33* *£000's*	Year 20 *2037/38* *£000's*	Year 25 *2042/43* *£000's*
Low 3rd Party Income Model					
MTFS Positions	0	0	0	0	0
WDBC Waste Service Savings	(177)	(177)	(177)	(177)	(177)
Additional Pension Costs	49	(27)	(88)	(139)	(184)
Additional Running Costs	58	64	71	78	86
Dividends	(89)	(199)	(221)	(244)	(270)
Low 3rd Party Annual Total	**(160)**	**(339)**	**(415)**	**(482)**	**(545)**
Alternative Low 3rd Party Cumulative Total	**(253)**	**(1,729)**	**(3,654)**	**(5,932)**	**(8,533)**

Table WD3 – Teckal Level Third Party Income

WEST DEVON BOROUGH COUNCIL MODELLING (ALTERNATIVE WASTE SAVINGS 50%)	Year 5 *2022/23* *£000's*	Year 10 *2027/28* *£000's*	Year 15 *2032/33* *£000's*	Year 20 *2037/38* *£000's*	Year 25 *2042/43* *£000's*
Teckal Threshold Income Model					
MTFS Positions	0	0	0	0	0

WDBC Waste Service Savings	(177)	(177)	(177)	(177)	(177)
Additional Pension Costs	49	(27)	(88)	(139)	(184)
Additional Running Costs	58	64	71	78	86
Dividends	(178)	(199)	(221)	(244)	(270)
Teckal Threshold Annual Total	**(249)**	**(339)**	**(415)**	**(482)**	**(545)**
Alternative Teckal Threshold Cumulative Total	**(491)**	**(2,012)**	**(3,937)**	**(6,215)**	**(8,816)**

9.23 The table W2 (Low level third party income) for West Devon (with 50% of waste savings) shows that:-

- In Year 5 (2022/23), there are additional pensions costs of £49,000 and additional running costs of the LACC of £58,000 and the net income from profits from third party income after corporation tax would be £(89,000). There are savings from waste of £(177,000). Therefore in Year 5 there is a net income from the LACC of £(160,000). The cumulative effect of all of the costs and income from the LACC from Day 1 up to the end of Year 5 is a net income of (£253,000).
- In Year 10 (2027/28), there are net savings from pensions of (27,000) and additional running costs of the LACC of £64,000 and the net income from profits from third party income after corporation tax would be (£199,000). There are savings from waste of £(177,000). Therefore in Year 10 there is a net saving from the LACC of (£339,000). The cumulative effect of all of the costs and income from the LACC from Day 1 up to the end of Year 10 is a net income of (£1,729,000). The figures for later years, Year 15, Year 20 and Year 25 are shown in the Table.
- There are initial costs of setting up the LACC from additional pensions costs (which vary from £56,000 in Year 1 and rise to £84,000 in Year 3 and then start reducing as the number of staff on the LGPS scheme reduces) and additional running costs (which vary from £50,000 to £60,000 per annum).
- Income from third party profits is projected to be £42,000 in Year 3 and would rise to £199,000 by Year 10).

<u>West Devon Financing of Initial Costs of LACC</u>

9.24 In the first year of the LACC (2018/19), under the 'Low Income' model there is a net additional cost of £110,000 which would need to be financed. The cost is from the additional pension costs and the additional running costs. In year 2 (2019/20) the savings from Waste offset these costs moving forwards from Year 2 onwards.

9.25 As is demonstrated in the modelling, there are a number of additional costs incurred in establishing a LACC. Given the three different scenarios modelled for the different income assumptions, there are three potential payback periods, indicating the year that the LACC has repaid the initial additional costs incurred. These are set out in the following table.

Payback –West Devon		
	Financial Year	Year
No third party income	Year 5	2022/23
Low third party income	Year 4	2021/22
Third party income at maximum Teckal threshold	Year 3	2020/21

9.26 Recommendations would need to be made as to how these initial costs are financed. Options could include the use of reserves to fund the initial costs or crystallisation of income generation ideas currently being progressed.

Joint Steering Group Conclusions – Business Planning and Financial Modelling

9.27 The JSG noted the financial modelling as set out in Appendix F and as summarised in this report. The JSG carefully considered additional costs and payback periods for both Councils. Based on the payback periods, the view of the JSG is that it does not recommend forming a LACC in its current proposed form.

10. Ability and Mechanism for adding new partners

10.1 There is no legal limit to the number of contracting authorities (partners) to a Teckal body. Increasing the volume of services through admitting new partners increases the 20% of turnover that the LACC would be able to trade.

10.2 The adding of new partners would be a matter which is reserved for both Full Councils in demonstrating control over the LACC.

10.3 There are a number of options which could be considered should the Councils wish to expand the LACC by adding new partners in the future

10.4 Option 1 – Full participation by a new council. Any new partner entering on Full participation would have equivalent rights to the two founding councils (appointments to the board, same veto over reserved matters etc) It would also mean that the possibility of one of the founding councils being outvoted is increased.

10.5 Option 2 - Level two participation – a new council could join as a partner but with reduced rights and representation in comparison to the founding two councils, for example, reduced representation on the board.

10.6 Option 3 – Group Structure with subsidiaries. This would involve the LACC setting up a subsidiary company/companies which would have, as members, the LACC itself and then other councils. It would be possible for a subsidiary to be created every time a new council joined

10.7 Option 4 - Standalone companies for each new arrangement.

10.8 Bevan Brittan have provided the Joint Steering Group with their views on each of these options as set out in Appendix A

Joint Steering Group Conclusions – Adding New Partners

10.9 While the preferred route for adding new partners should be considered on a case by case basis, the recommendations from the Joint Steering Group are that Option 2 (Level two participation) and Option 3 (Group Structure with subsidiaries) are the preferred options in order to protect the interests of the founding two councils while still allowing the new councils some say over the overall company direction

11. Exit Strategy

11.1 A detailed strategy will be required in respect of exit from the LACC.

11.2 The contract will set out the requirements for the exit strategy which will need to be developed in the first 12 months of operation of a LACC and refreshed as required with significant changes within the LACC (for example, on admission of a new partner).

11.3 In the event that a Unitary authority is considered in the future, the contract with the LACC will novate to the new organisation with the contracts exit obligations passing to the Unitary authority

11.4 The LACC will work with the Councils to develop a detailed Exit strategy over its first 12 months of operation. This exit strategy will be approved by Councils through the "Winding Up" element of reserved matters.

11.5 Officers recommendation to the JSG is that intent to exit should require 12 months' notice with the Council that has triggered the exit bearing the costs of exiting the LACC.

Joint Steering Group Conclusions – Exit Strategy

11.6 If the LACC project proceeds to implementation, the requirements for the exit plan should be established during implementation with a full exit strategy being delivered prior to any transfer of staff

11.7 That a minimum 12 month notice period be required by either council to exit the arrangement

11.8 That the Council triggering the exit be responsible for meeting the full cost of that exit

12. Glossary of terms

TECKAL	
JSG	Joint Steering Group – The group of elected Members overseeing the finalisation of key matters in respect of the LACC
LACC	Local Authority Controlled Company
Pensions Deficit	The pensions deficit as currently appearing on the accounts of the Councils
JSC	Joint Shareholder Committee – this group of elected Members would oversee key matters of the operational LACC
SA	Shareholder Agreement
Members	Councillors
Officers	Has the meaning given in the Councils Constitution
Council	Either West Devon Borough Council or South Hams District Council
Councils	South Hams District Council and West Devon Borough Council
Council's Constitution	the constitution of South Hams District Council or the constitution of West Devon Borough Council
Contract Finder	Has the meaning given in regulation 106 Public Contracts Regulations 2015
CIPFA	Chartered Institute of Public Finance and Accountancy

13. Appendices

Appendix A – Bevan Brittan Legal Advice ***EXEMPT***

Appendix B – Grant Thornton VAT and TAX Advice ***EXEMPT***

Appendix C – Actuaries Report ***EXEMPT***

Appendix D – LACC Business Plan

Appendix E – Market Analysis ***EXEMPT***

Appendix F – Financial Modelling ***EXEMPT***

Appendix G – Financial Modelling assumptions ***EXEMPT***