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# POLICY BRIEFING

# Local Authority Trading Companies: a Policy in Practice briefing

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## 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 |
|---|---|---|
| • Consider the strategic fit of the company with the council's vision<br>• Appraise options<br>• Develop an outline business case | • Obtain the right professional advice<br>• Company registration<br>• Trading<br>• People<br>• Pensions<br>• Governance<br>• Financing and Taxation<br>• Transfer of assets and support service costs<br>• Performance Management and contracting | • Put the right leadership team in place<br>• Create the right culture<br>• Reconsider reward<br>• Build a customer focus<br>• Build an appropriate vision and gain the commitment of the local authority<br>• Prepare for the future<br>• Creating and promoting the brand<br>• Get to grips with costs<br>• 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 pf 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 exemption[1]. 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**