

Proposals relating to a Local Authority Controlled Company

NOT FOR PUBLICATION

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

Report to: **SPECIAL COUNCIL**

Date: **25 February 2016**

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

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

Wards Affected: **All**

Relevant Scrutiny Committee: **N/A**

Approval and clearance obtained: **Yes**

Urgent Decision: **N/A**

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

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

Recommendations:

That the Executive RECOMMEND to Council:-

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

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

1.0 Executive Summary

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

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

2.0 Background

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

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

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

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

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

3.0 Outcomes/outputs

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

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

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

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

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

4.0 Options available and consideration of risk

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

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

Comparison of Alternative Service Delivery Models Available to WDBC / SHDC

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

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

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

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

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

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

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

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

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

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

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

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

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

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5.0 Proposed Way Forward

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

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

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

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

6.0 Implications

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

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

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

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Other implications		N/A
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Supporting Information

Appendices:

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

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

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

Background Papers:

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

Approval and clearance of report

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