

DECISION-MAKER:	CABINET		
SUBJECT:	CITY CATERING BUSINESS DEVELOPMENT PROPOSAL		
DATE OF DECISION:	16 SEPTEMBER 2014		
REPORT OF:	CABINET MEMBER FOR EDUCATION AND CHANGE		
<u>CONTACT DETAILS</u>			
AUTHOR:	Name:	Stephen Price	Tel: 023 80833087
	E-mail:	stephen.price@southampton.gov.uk	
Director	Name:	Alison Elliott	Tel: 023 80832602
	E-mail:	alison.elliott@southampton.gov.uk	
STATEMENT OF CONFIDENTIALITY			
<p>Appendices 1, 2 and 3 contains commercially sensitive and confidential information in the form of financial performance and trading data. Appendix 1 contains confidential legal advice that is subject to Legal Professional Privilege. Pursuant to the Council's Access to Information Procedure Rules paragraphs 1, 3, 4 and 5 such information should be treated as exempt. To place such information in the public domain at this stage would be of unfair commercial advantage to trading competitors if disclosed and would result in the release of confidential legal advice contrary to the principles of natural justice and maintaining the integrity of the solicitor / client relationship inherent in the administration of justice.</p>			

BRIEF SUMMARY

Cabinet approval is sought to agree in principle to the preferred option of the development of City Catering to a Charitable Mutual Company (Limited by Guarantee), subject to further consultation as required and clarification of the risks and costs around pensions, and to delegate authority to the Director of People after consultation with the Cabinet Member for Education and Change to take all such ancillary action to deliver the aspiration.

RECOMMENDATIONS:

- (i) That, subject to further consultation as required and clarification of the risks and costs around pensions, Cabinet approve in principle the transfer of the City Catering service to a Charitable Mutual Company (Limited by Guarantee) with effect from 1st April 2015
- (ii) To delegate authority to the Director, People to carry out such consultation, due diligence and other ancillary actions as may be necessary in relation to (i) above.

- (iii) To delegate authority to the Director, People to consider and determine the outcome of any necessary consultation referred to at (ii) above and, in light of all material considerations, to determine whether or not to proceed with the establishment of City Catering as a Charitable Mutual Company (Limited By Guarantee) following consultation with the Cabinet Member for Education and Change, the Cabinet Member for Adult Social Care, the Cabinet Member for Resources and Leisure and the Chief Financial Officer.
- (iv) To agree that, subject to the satisfactory conclusion of discussions with the Hampshire Pension Fund, the new Mutual Company becomes an admitted body member of the Hampshire Pension Fund; and to agree that this will be on the basis of a closed scheme (i.e. closed to new entrants)
- (v) To agree that the Council will act as guarantor for any future potential cessation deficit which could arise on the Mutual company's admitted body pension, as set out in paragraphs 24-30.
- (iv) To delegate authority to the Chief Financial Officer to approve the final arrangements with regard to the new Mutual Company gaining admitted body status.

REASONS FOR REPORT RECOMMENDATIONS

1. The evolving market place that City Catering operates in has changed and will continue to do so. Individual schools and academy groups are demanding bespoke service solutions that meet their individual needs, both in terms of service delivery and administrative support. City Catering's ability to offer flexible service solutions to this evolving market is significantly compromised by its current business structure.
2. If City Catering is to retain its market share and continue to support the education process in schools, and academic achievement of their pupils, in an economical and effective manner the service needs to evolve to meet the current and future needs of its customer base.
3. City Catering proposes a "spin-out" of the service to form a Charitable Mutual Company, funded and owned by the schools that it services and governed by a board of Trustees. This business model will allow the service to develop to meet its customer's future needs and retain market share. Further consultation on this option with key stakeholders may be considered should this be necessary to inform future direction and/or the final design of this service delivery option.

ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

4. Retain the service in-house and reduce the SLA charges to schools to lower the cost of service and retain levels of SLA buy back. Schools showed little interest in this option as it did not give them any greater control over future service provision / style and they questioned the sustainability of this offer. Five schools have recently withdrawn from the service and this is indicative of potential future trends.
5. Form a Local Authority Trading Company to deliver the school meal service. The formation of a LATCo does not deliver any greater control or influence

for schools, and therefore has little positive influence on the level of SLA buyback. This option is also the costliest for the council to implement.

6. Put the service out to tender to the private sector / other Local Authority catering service. This option was rejected as schools viewed this alternative as giving them even less influence / control over future service standards / costs. This option would require the majority of schools to sign up to it for it to be remotely viable. The funds generated by the service would, in effect, leave the city in the form of profit for the contractor.

DETAIL (Including consultation carried out)

7. Following previous presentations of the City Catering business development proposals to CMT, in April and October 2013, City Catering management gained funding support from the Cabinet Office Mutuals Support Programme (MSP) to engage (via a competitive tender process) legal and business service support to progress the spin out of City Catering into a Mutual.
8. Bates, Wells & Braithwaite (BWB), legal experts in social enterprise and charity business enterprises, and Mutual Ventures (MV), business experts in supporting public service / community groups to form viable social enterprise and charitable business ventures, were appointed by the MSP to support City Catering through the transformation process.
9. Various permutations of the most appropriate social enterprise model have been considered over the last year or so. The Council has previously sought separate legal advice from Veale Wasborough Vizards as there were numerous concerns over the then business model. Subsequently a significantly revised model has developed. Accordingly BWB have scrutinised the previous legal advice received by the council, which raised a number of issues relating to the business plan, including state aid, transfer of assets, public procurement, schools companies and governance issues, and have submitted revised advice parts of which required advice from Leading Counsel. Their final report on the legal options and governance available to the significantly revised enterprise model now being proposed is attached (Appendix 1).
10. MV have conducted robust financial modelling of the existing and future City Catering business and have identified a financially viable and sustainable model for the future. The financial modelling is featured in the attached business plan (Appendix 2).
11. With the support of these partners City Catering management has consulted with schools service users to identify which of the following three options, that had been identified at CMT, were their preferred choice:
 - a. Retain as an in-house service and reduce SLA charges to schools to lower cost of service.
 - b. Form a Local Authority Trading Company.
 - c. Form a Mutual Trading Company.
12. Following discussions with all schools a presentation was made at the Primary Heads Conference and to individual Secondary Head Teachers, where all three options were proposed and as a result option c was unanimously selected as the preferred choice. Consultations on revisions to that proposal

have been undertaken and received unanimous support. Further, limited, consultation will be needed with parents as end users as whilst the service provider will be changing the core service provision will not.

13. The City Catering Mutual business plan allows for the continued delivery of the City Care Meals service and the management of the Civic Hospitality catering service at no additional cost to the council, subject to further information sharing with service users affected by these proposals. The Mutual will seek to expand provision of the City Care meal service to a wider customer base at competitive commercial rates.
14. The creation of a Mutual would initially result in a negative financial impact on SCC, with the loss of contribution currently generated by City Catering (£450,200 budgeted in 2014/15) towards the service's overheads. The introduction of Universal Infant Free School Meals is estimated to generate up to an additional £384,000 of surplus income in a full year. This could represent a lost saving to the council if the service moves out of house.
15. However, the number of schools indicating their desire for a more flexible / tailored trading relationship is increasing and several large schools have indicated their plans to pursue alternative forms of provision in this current trading year. This will mean that within 12/24 months the level of contribution generated by City Catering will diminish dramatically.
16. The introduction of Universal Infant Free School Meal initiative, from September 2014 will improve the commercial viability of meal provision in smaller schools. This in turn has created opportunities and challenges. Smaller schools, that previously had no option but to pool their resources in a central school meal contract will now be now far more attractive to private sector competitors and it is essential that the City Catering of the future is equipped to compete in this market place.
17. Consultation has taken place with all schools that use the service and they have indicated their unanimous support for this proposal. As stated above no consultation has taken place with City Care Meals on Wheels users to date. This is primarily due to the reducing levels of uptake and alternative models of service are available and preferred. Appropriate consultation with City Care users would take place should agreement in principle to proceed be given by Cabinet.
18. In the unfortunate event that City Catering Mutual fails schools would have two options available to them. Firstly, they could opt to take the service provision in-house and manage it within the school – this would be the simplest and quickest solution. Secondly, they could opt to outsource the service provision to the private sector or neighbouring local authority – this option would require a procurement process. Staff would not automatically be protected under TUPE and implications for staff would have to be considered depending on the circumstances at the time.
19. An implementation strategy for the City Catering spin out to a Charitable Mutual Company is detailed in Appendix 4.

RESOURCE IMPLICATIONS

Capital/Revenue

20. A financial analysis of the four options for the service is attached at Appendix 3. The table below summarises the costs of the options:

Increase on 2014/15 base estimate (excluding Risk Fund)	2015/16	2016/17
Option 1 – In house	£845,000	£748,000
Option 2 – Local Authority Trading Company	£958,000	£661,000
Option 3 – Mutual Trading Company	£430,200	£430,200
Option 4 – Tender	£530,800	£530,800

21. The table illustrates that option 3 is the least costly option to the Council, assuming that significant numbers of schools will leave the service if it is kept in house.
22. The costs to the council of forming a Mutual are detailed in Appendix 3 and summarised in the table below:

Increase on 2014/15 base estimate (excluding Risk Fund)	2015/16	2016/17
Loss of City Catering income (net)	£450,200	£450,200
Reduction in central overhead charges	(£20,000)	(£20,000)
Rental income for Solent Suite	(£20,000)	(£20,000)
Charge for Meals on Wheels service	£20,000	£20,000
Total Option 3	£430,200	£430,200

23. A amount of £336,000 is currently budgeted for in the Council's Risk Fund in 2015/16, increasing to £422,000 in 2016/17 in the event that the proposal is progressed. The increased costs will be built into the 2015/16 budget process.
24. Pension impact
The staff assigned to the Mutual would TUPE transfer resulting in the need to obtain admitted body status to Hampshire's Local Government Pension Scheme. It is proposed that the scheme will be closed to new employees to the mutual post transfer. New staff will therefore not have access to the Local Government Pension Scheme but will be able to join a defined contribution scheme which would be put in place by the Mutual Board.
25. It is important to note that the Council is likely to be the ultimate guarantor for any deficit on the pension scheme that is not covered by a bond, should the Mutual become insolvent. There are two main risks:
26. Primary cover - this covers the cost of the additional pension liabilities from staff being made redundant above the age of 55 (benefits are paid unreduced at this age). The cost varies depending on the age profile of the membership at the date of redundancy. If, on premature termination of the Mutual (due to insolvency, winding up or liquidation), the service is transferred to another provider then the members may not be made redundant and therefore this

cost may never occur.

27. Secondary cover - The largest part of the risk relates to a potential deficit at the point of insolvency. The calculations below have been undertaken on the assumption that the deficit will equal 10% of the liabilities but clearly this could be higher or lower than this and there is a reasonable possibility that there could be a surplus at the point of insolvency. If the Mutual were to become insolvent then the Council would be at risk for this deficit, or benefit from any surplus. The likely option would be to add the deficit or surplus to the Council's own current past service pension deficit and spread it over the recovery period (currently 25 years).
28. There are two main options available to the Council for dealing with these risks, as set out below, with Option 1 being the option that will be adopted as it is the lower cost and less risky option for both the Council and the Mutual.
29. Option 1 (Subsumption funding with no bond) – Under this approach, on early insolvency, Southampton City Council is liable for any cessation deficit and the assets and liabilities of the pension fund would be subsumed by the group which contains the large councils (the Scheduled Body group). Hampshire County Council (as Administering Authority to the Fund) require a lower level of assets to back the liabilities than the orphan approach (Option 2) and the risk is estimated to be £669,000 (spread over the recovery period).
30. In addition to this risk, option 1 increases the employer's pension contribution for the Mutual to 18.4% resulting in an estimated additional annual cost of £60,000. This cost has been included in the Mutual's business plan (Appendix 2)
31. Option 2 (Orphan funding with bond) – Under this option, the Mutual would be set up as a stand alone body in the pension fund using a more prudent funding approach than that used for the Scheduled Bodies Group. Consequently they would be required to take out insurance for an indemnity bond to the value of £917,000 in order to cover the risks of the new organisation failing. This bond will need to be reviewed annually to ensure it is at the correct level. Ultimately, if the Mutual cannot cover all of its pension liabilities, the debt would fall back to the Council.
32. In addition to this risk, the Mutual's employer's pension contribution would increase to 27.6% resulting in an estimated additional annual cost of £164,000 under option 2.
33. Under option 2, it is the Pension Fund's normal policy to ensure that a new admission body starts 100% funded on the more prudent funding basis. In allowing the Mutual to start fully funded in this way, the overall level of liability for past service costs for the Council would increase by an amount of £69,700 per annum, based on a recovery period of 25 years.
34. All pension costs are based on Aon Hewitt's report dated 30th September 2013 and are based on a scheme that would be closed to future entrants. Consequently the figures quoted are subject to change.
35. Formal staff / Union consultation with City Catering staff (currently 290+) and their representatives will require HR support along with support for the TUPE process. IT support is required to achieve the transfer of systems and data.

In order to progress the proposal, support will be needed from Legal, HR, Property, IT and Finance with approximately 10-20 days resource anticipated. £10,000 has been allocated to fund additional support from BWB / MV. This funding will be repaid by the Mutual in due course.

Property/Other

36. City Catering will vacate its offices within the Civic Centre and relocate to external office facilities.
37. City Catering Mutual will require the Council to provide accommodation and office facilities for two Meals on Wheels coordinators who will remain located in the Civic Centre as part of the Meals on Wheels service provision.
38. City Catering will require continued use of the Solent Suite kitchen and associated offices / store areas etc. in order to continue the provision of the Civic Hospitality and Meals on Wheels services. Commercial rates will be negotiated for such use.
39. The Meals on Wheels coordinators will require continued IT support and Access to PARIS in order to maintain efficient delivery of the City Care Meals on Wheels service. An information sharing protocol will need to be developed to allow City Catering to continue to manage and operate the Civic Hospitality and Meals on Wheels services.
40. School kitchen assets (Heavy & Light kitchen equipment, food stock) will remain the property of the schools / SCC and be used for the continued delivery of the school meal service.

LEGAL IMPLICATIONS

Statutory power to undertake proposals in the report:

41. Section 1, Localism Act 2011 (the 'General Power of Competence')

Other Legal Implications:

42. The new mutual company will be a separate entity from in house Council functions. As such it will require a formal and robust governance structure and support with a Chief Executive Officer, Company Secretary, Trustees, finance, HR and legal support. Due diligence will take place following cabinet's decision and all these important factors will be considered in depth. If the decision is to proceed this will be the first social enterprise that the Council has developed and therefore some operational questions such as the ability of in-house support services to assist or offer services to the company will need to be resolved during the consultation and implementation processes. Further legal implications, including matters relating to procurement and state aid are set out in confidential Appendix 1

POLICY FRAMEWORK IMPLICATIONS

43. The proposals within the report are consistent with the Council's Policy framework.

KEY DECISION? Yes

WARDS/COMMUNITIES AFFECTED:	All
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SUPPORTING DOCUMENTATION

Appendices

1.	BWB Legal / Governance Paper V1 CONFIDENTIAL
2.	MV / City Catering Mutual Business Plan and financial projection CONFIDENTIAL
3.	SCC Financial Analysis of Proposals CONFIDENTIAL
4.	City Catering Governance Implementation Plan V1

Documents In Members' Rooms

1.	N/A
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quality Impact Assessment

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out?	No
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Other Background Documents

Equality Impact Assessment and Other Background documents available for inspection at:

Title of Background Paper(s)	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
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1.	N/A	
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