

DECISION-MAKER:	CABINET		
SUBJECT:	ALTERNATIVE SERVICE DELIVERY MODEL FOR SOME COUNCIL SERVICES		
DATE OF DECISION:	20 DECEMBER 2016		
REPORT OF:	LEADER OF THE COUNCIL		
<u>CONTACT DETAILS</u>			
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STATEMENT OF CONFIDENTIALITY			
None			
BRIEF SUMMARY			
<p>The purpose of this report is to seek approval to commence a transformation project and procurement process leading to:</p> <ol style="list-style-type: none"> 1. The setting-up of a Local Authority Trading Company (LATCo) for the management, delivery and commercialisation of the following Council services: <ul style="list-style-type: none"> • Street Cleansing and Waste Management & Collection; • Housing Operations & Management and Parks & Open Spaces; • Car Park Operations, Facilities Management and Itchen Bridge Operations; • Transport. 2. Negotiation for the appointment of one or more public and/or private sector partners to support the LATCo in the discharge of its duties as a wholly owned company of Southampton City Council (SCC). <p>The outcome of any negotiations arising from the procurement process will be presented back to Cabinet and or Council (as determined by the Constitution) for final decision.</p> <p>The recommendations are put forward following consultation with the market,</p>			

subsequent options appraisal and an evaluation of the existing transformation activity of the in-scope services.

RECOMMENDATIONS:

(i)	To delegate authority to the Chief Operations Officer, following consultation with the Leader, Service Director: Legal & Governance and the Service Director: Finance and Commercialisation, to establish a Local Authority Trading Company (LATCo) for the management, delivery and commercialisation of the in-scope services.
(ii)	<p>To agree that in scope services to be included within the LATCo / procurement will (subject to further decision at the conclusion of the procurement process) include:</p> <ul style="list-style-type: none"> • Street Cleansing and Waste Management & Collection (including Fleet); • Housing Operations & Management and Parks & Open Spaces (including Fleet); • Car Park Operations, Facilities Management and Bridge Operations; • Transport.
(iii)	To delegate authority to the Chief Operations Officer, following consultation with the Transformation Implementation Board (TIB), Service Director: Legal and Governance and the Service Director: Finance and Commercialisation, to determine the LATCo company structure, the terms of any contract between the Council and the LATCo for the delivery of in scope services and to finalise the governance arrangements in relation to the Council / LATCo and any public / private partner organisations procured to support the LATCo.
(iv)	To delegate authority to the Chief Operations Officer, following consultation with the Transformation Improvement Board (TIB), Service Director: Legal and Governance and the Service Director: Finance and Commercialisation, to undertake all actions necessary to appraise and consult on the options available to the Council in relation to a finalised staffing structure (operational based within the LATCo and commissioning client retained by the Council) in order to recommend a staffing structure and the delivery route for the same at the conclusion of the procurement process.
(v)	To delegate authority to the Chief Operations Officer, following consultation with the Transformation Implementation Board (TIB), Service Director: Legal and Governance and the Service Director: Finance and Commercialisation, to commence a procurement process to select one or more public and/or private sector partners to support the LATCo in the discharge of its duties.
(vi)	To note that the final decision on the services to be delivered through the LATCo, the staffing provisions, governance arrangements, financial implications and the appointment of one or more public and/or private

	partners to support service delivery will be referred to Cabinet / Council prior to the conclusion of the procurement process (currently expected in late 2017).
REASONS FOR REPORT RECOMMENDATIONS	
1.	To enable the on-going transformation of a range of in-scope council services, particularly the need for a new operating model that supports cost efficiency in the delivery of services back to the Council together with further commercialisation and potential trading opportunities.
2.	To maximise the effective, efficient and economic management and operation of the in-scope services.
3.	To develop a commercial capacity that can, where appropriate and in the public interest, profitably trade the services with other councils, public sector organisations, businesses and, where relevant, residents of the City and the broader commercial market.
4.	To support the Council in achieving its aim of continuing to grow the local economy, bringing investment into the city and increasing employment opportunities for local people.
ALTERNATIVE OPTIONS CONSIDERED AND REJECTED	
5.	<p>The options appraisal considered a number of other options which were rejected:</p> <ul style="list-style-type: none"> • Retain and operate the services ‘in-house’; • Outsource; • Joint Venture; and • Disposal. <p>These options did not support the aims and aspirations of the Council to the same extent as the recommended approach and the further detailed rationale for rejecting the above proposals are outlined in the report.</p>
DETAIL (Including consultation carried out)	
	<u>BACKGROUND</u>
6.	<p>In June 2016, a paper was presented to Transformation Improvement Board (TIB) outlining a proposed alternative delivery model for some council services. The objective was to consider the next stage of organisational development for these services with a view to:</p> <ol style="list-style-type: none"> 1. Maximising the effective, efficient and economic management and operation of the services; and 2. Developing a commercial capacity that can profitably trade the services with other councils, public sector organisations, businesses and, where relevant, residents of the City and the broader

commercial market where appropriate.

The paper proposed 4 options for Alternative Service Delivery Models for Street Cleansing; Waste Management and Collection; Housing Operations and Management; Parks and Open Spaces; Car Park Operations; Facilities Management; Itchen Bridge Operations; Fleet Management (incorporated within service area bundles); and Transport (including Adults & Children). The options included outsourcing; joint venture; disposals; and the establishment of a LATCo. The provision of services through the current in-house operation was also considered.

Outsourcing was considered but rejected as an option because although it could help the Council with the objective of improving the efficiency and effectiveness of services, it was not considered by TIB to align with the Council's strategy and ambition of developing a commercial and trading capability that can be used to generate income as a means of mitigating the current and forecasted funding pressures from central government.

Since then, and following a market consultation day and further discussion at TIB, two other options were rejected:

1. Joint Venture (JV): The potential to utilise a Joint Venture model was considered and identified as a viable option that could support both the delivery of operational efficiencies, as well as the development of new trading opportunities. However, it was not considered a preferred option as this model would require the Council to at best share governance and control of the vehicle and its operations with a partner and, more likely, relinquish such control to the partner. A JV arrangement would not benefit from exemptions to the need to procure JV partners requiring the conduct of an extensive and complicated procurement process for the supply of services to the Council and complicated financial and governance structures. The use of a JV as the overall delivery vehicle for all services was therefore rejected, although it was recognised that a JV arrangement may be considered suitable to develop particular services or elements of them and / or remained an option for the delivery of services to the proposed LATCo itself in due course.
2. Disposal: The possibility of disposing of some assets / services such as car park operations was considered but rejected following market feedback and best value considerations.

The preferred alternative service delivery option for the transformation of the in-scope services was the creation of a LATCo as it was considered that it would deliver a number of additional managerial, operational and commercial advantages over the baseline option of retaining an in-house operation. The LATCo option has the potential to:

	<ol style="list-style-type: none"> 1. Provide management with greater flexibility to shape service provision; 2. Build on existing service quality and improve the service experience to customers (citizens, businesses and visitors) through the development and improvement of service offerings; 3. Support quicker decision making and more organisational agility in responding to, and proactively addressing, changes in the market; 4. Enable the Council to pursue income generation activity (rather than just cost recovery) across all service sectors and price / charge for its services accordingly subject to restrictions on the percentage of services provided to non-company members; 5. Enable the Council to attract commercial acumen by partnering with organisations that can evidence this expertise, and transfer or share the risk (and reward) of pursuing new trading ventures while retaining overall governance and control of the operations; and 6. Establish the foundation for future partnering or cross council / public authority working, potentially supporting SCC and neighbouring Councils in implementing elements of the current devolution agenda. <p>For detail of the background and process followed to arrive at this option (including consultation with Unions) please refer to the Alternative Service Delivery Model Background Paper.</p> <p>An explanation of the evaluation of the LATCo option against continuing to deliver services in-house is provided below.</p>
In-House vs LATCo Service Provision	
7.	<p>Although comprising the ‘baseline’ option, choosing to retain and operate the services ‘in-house’ was not considered a ‘no change’ option. Indeed, the services in scope have been subject to various changes over recent years and a number of them are also currently subject to various transformation initiatives, most notably through the digital and procurement transformation projects.</p> <p>The changes to the services in scope will deliver significant cost efficiencies and also place the Council in a better position to respond to service requests quicker, freeing up officer time to pursue additional income generating opportunities.</p> <p>A comparison of the relative merits and challenges of the in-house and LATCo service delivery options must therefore be underpinned by a consideration of both the current endeavors, and future objectives, that are</p>

required of the services in question.

As outlined above, the key drivers in this respect are:

1. The need for continuous operational service improvement and cost savings; and
2. An opportunity for a significant step change in trading the services with third parties, with a view to developing new markets and income streams to counteract reductions in General Revenue and other Funding streams. This will safeguard not only the quality and level of service currently provided to customers, also in some cases, their existence.

As such, an evaluation of the in-house and LATCo delivery models should consider both the qualitative strengths and weaknesses of both options, as well as their relative quantitative (financial) merits. The comparison that follows below is currently limited to a subjective assessment of the financial merits of both options. This is because the financial success of a more commercially oriented in-house service could only ever be measured and evidenced with the passage of time, while the monetary value of the cost, savings, guarantees and/or income generation capability of the LATCo can only be established once the market has been engaged in discussions through a procurement process.

As such, if Cabinet were to support the recommendation of this paper, it should be noted that the outcome of negotiations arising from a procurement process in relation to a LATCo would need to be presented back to Cabinet / Council for a final consideration of the financial merits of this model over the in-house option.

Benefits and Disadvantages of In-House Service Provision

8. The benefits and disadvantages of an in-house Council operation against each of the two aforementioned key objectives of a new operating model include the following:

Objective 1: In-House Operational Effectiveness, Efficiency and Economy

Benefits

- Services would continue to operate within agreed budget envelopes without any structural business disruption and no TUPE or change to the employment arrangements for staff.

Disadvantages

- In-house services are restrained by the Council's existing pay grade structure, inhibiting the ability to flex pay and remuneration to attract different types of employees

	<ul style="list-style-type: none"> • Funding arrangements and service delivery would continue to be subject to the Council's standards and policies. • Legal set up costs (for a separate vehicle) are avoided, although investment in employing commercial talent and continuous service improvement would still be required. • Further efficiencies could be made, but these will need to be limited to those arising from a reduction in central overheads rather than front line delivery, if service quality is to be maintained and not allowed to deteriorate further. 	<p>and reward good performance in a commercial environment.</p> <ul style="list-style-type: none"> • The service's ability to drive further efficiencies is limited to the size of the current operation which cannot take advantage of greater economies of scale from sharing assets or services with other partners.
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Objective 2: Trading and Commercialisation

Benefits

- The Council has a trusted local reputation and brand which is customer focused and delivered with a public service ethos.
- (Taking advantage of the 'Teckal' ruling and freedoms afforded by the Local Authorities (Goods and Services) Act 1970). An In-house operation can sell its services to other public authorities without the need for open market competition (see Alternative Service Delivery Model Background Paper for more information).
- The current level of trading within Commercial Waste and Grounds Maintenance services demonstrates that these services are performing above average compared to other authorities, (30% compared to 22%¹).

Disadvantages

- Although the Council's reputation and brand resonates with factors such as reliability and trustworthiness, the market's perception of quality varies between services and the Council does not engage in proactive marketing (as opposed to communication) of its services.
- The complex governance arrangements within the Council slow down decision making and management processes, making it difficult to respond swiftly to market opportunities. Although the council can charge for services, retaining services in-house inhibits the ability to trade services for

		profit save in certain limited areas (see section 4 Legal and Financial Considerations).
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Benefits and Disadvantages of a LATCo model

9. A LATCo is a company established by a local authority to offer services on a more commercial basis (i.e. to trade and make a surplus). The objective of the Councils LATCo, with support from public or private sector partners, would be to deliver a reduction in service delivery costs, maintain required performance / service levels within the operating budgets set by the council, while simultaneously seeking new commercial opportunities with other third party organisations. Any profit made by the LATCo from external trading would either be reinvested or returned to the Council as the owner of the LATCo. Partners engaged by the LATCo could also be incentivised through the use of a gain share mechanism in a similar way to how the Council currently incentivises Capita. For further information on a typical governance structure for a LATCo please refer to the Alternative Service Delivery Model Background Paper.

The key benefits and disadvantages of a LATCo over in-house service provision are summarised in the tables below:

Objective 1: LATCo Operational Effectiveness, Efficiency and Economy

Benefits

- Spare capacity brought about through workforce improvements with the support of a partner could potentially be utilised by that partner for other business opportunities they hold, and/or new business that they can help generate. In either case, additional capacity can be seconded on other work rather than be made redundant.
- The Council could choose whether the LATCo would have alternative terms and conditions for staff as services would not be restrained by the existing pay grade structure of the Council, enabling the LATCo to flex pay and remuneration to attract

Disadvantages

- The establishment of a LATCo will incur additional expenditure in the form of one-off costs to set up the company and ongoing liability for company taxation (corporation tax, capital gains tax, VAT etc). This may be able to be mitigated by the way the LATCo is set up.
- The LATCo will have less favourable partial exemption recovery rules than the Council which may impact on VAT recovery for the company depending on which services are being delivered.
- The LATCo is expected to incur higher employee pension

¹ APSE Performance Review 2014/15 indicates that a council with a market share of 22% on the average market share for waste services is 22% with the best performers achieving c45%

	<p>different types of employees as well as leveraging talent and commercial acumen from partner organisations. This, however, would remain a policy decision that is taken by Council and instructed to the LATCo and employment law, including 'equal pay' considerations must be more fully explored.</p> <ul style="list-style-type: none"> • By leveraging the assistance of partner organisations, savings can be stretched further, corporate management overhead can be shared, and the partners' sales capacity utilised for the LATCo, ensuring the development of a more commercially focused work ethos. • Pooling the Council's and partner's buying power through a LATCo would also offer greater potential to leverage supply chain efficiencies, either by utilising the Council's existing partner supply network, or switching to the partners' own supply infrastructure. • Less complex governance and more flexible management arrangements may be an enabler for quicker decision making and changes to day to day operational deliverability. 	<p>contributions, the cost of which would need to be established as part of a more detailed business case and actuarial considerations.</p> <ul style="list-style-type: none"> • There would be project management and legal costs associated with the procurement. • A decision will need to be taken over asset purchase and ownership, as if the company is operating in a competitive environment the ability and cost of borrowing will need to be at a market rate.
Objective 2: LATCo Trading and Commercialisation		
Benefits		Disadvantages
<ul style="list-style-type: none"> • A LATCo is likely to draw the same public confidence, credibility and sense of service trustworthiness as an in-house 	<ul style="list-style-type: none"> • The appointment of a partner to support the LATCo in both the delivery of services and the development of new 	

	<p>Council operation, but unlike an in-house operation, it has greater flexibility to market its services more independently and/or differently to different market segments.</p> <ul style="list-style-type: none"> • A LATCo has the same opportunity to react and take advantage of the same incremental trading opportunities that an in-house operation would have. However, the knowledge and investment in proactive business development activity that can be brought to bear through a partner, will better position the LATCo to actively pursue 'market making' opportunities. • A LATCo can also take advantage of 'Teckal' (see Alternative Service Delivery Model Background Paper for more details) in order to sell its services to other public sector organisations. However, if the LATCo is commercially successful and generates more than 20% of its income from external trading with non-company members, it is likely that the Teckal exemption would be breached. While this is a risk to the company and the Council as the company owner, it arises only in the event of successful growth and in any case ensures that the Council is always getting the best value for money for the services it provides to its customers. • A LATCo supported by one or more external partners provides an opportunity for the transfer or 	<p>market opportunities will require an element of payment / gain share that dilutes the Council's income returns.</p> <ul style="list-style-type: none"> • A client function will need to be retained in house (albeit the scale and nature of such could be relatively light touch depending on the nature of services in scope) in order to ensure the LATCo could continue to use other Council services to support it if required and to address issues around non delegable functions of the Council. A decision will need to be taken as to size and resourcing of a retained client structure (to exercise the necessary element of 'control' required under Teckal and to deliver decision making functions reserved to the Council) and services the LATCo may be 'locked in' to receiving from the Council in order to achieve an overall financial benefit to the Council (as opposed to the in scope services)
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	<p>sharing of service cost and commercial risk. This transfer of risk also creates a greater drive for change and cost improvement, enabling services to become more commercially competitive.</p> <ul style="list-style-type: none"> • In agreement with the Council as sole owner, the LATCo could employ its own financial management tools, policies and cost management practices to support a more conducive approach to commercial activity and management. • It is potentially easier to attract other public authorities to share their services with SCC if these are integrated in an arm's length vehicle, rather than seen to be delivered (and 'controlled') by SCC or the partnering authority. A key advantage of the LATCo is therefore the potential of establishing a 'foundation' for new combined service delivery across the Solent area. 	
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Legal and Financial Considerations

10.	<p>The establishment of a LATCo is not something new or untested in local government. An increasing number of local authorities have set up LATCos (for example, NORSE, Barnet and Cormac, and others.) to varying degrees of success based primarily on having a grounded and proven market for trading activities or economies of scale. Norse is probably one of the more successful examples of a LATCo, established by Norwich County Council and now generating over £300m of turnover in services delivered to the County and other Councils.</p>
11.	<p>Local authorities may use powers to trade found in the Local Government Act 2003 and under the general power of competence in the Localism Act 2011. However, they <i>must</i> establish a company if they wish to carry on trading activities for profit. Any profits made by a wholly- or partly-owned company can, if returned to the Council by dividend from the LATCo, be</p>

	reinvested in other council services.
12.	Section 4 of the 2011 Act permits authorities, via the general power of competence, to provide a service on a commercial basis through a company.
13.	European Union public sector procurement rules require a competitive tendering process for any contract above certain thresholds. Contracts let by public bodies may be exempt from this requirement if the contract is let to a subsidiary body which only exists to provide services to the local authority/authorities that control it. This is known as the 'Teckal exemption'. Further details are provided in the Alternative Service Delivery Model Background Paper.
14.	Advice on the legal and financial considerations of establishing a subsidiary company was taken by the council towards the end of 2015 when Council was presented with options regarding the termination and internalisation of the current Capita arrangement. While much of this advice will be relevant to this situation, it will need to be refreshed and reconsidered against the current proposals and any commercial and financial position arising from a negotiation with the market as part of the proposed procurement process. In addition, the nature of the services included within scope for the LATCo proposed are substantially different in nature from those considered as part of the Capita arrangement and substantial work remains on determining the extent of any non-delegable duties covered by the proposals and how these can be structured to remain within the legal framework for the Council (e.g. through retained client structures to undertake the decision making functions that cannot be delegated to a contractor or company). Substantial further work is also required in relation to the proposed company structure (how to take advantage of 'mutual trading' designations and consequential tax liabilities and opportunities), opportunities for employee engagement and empowerment through beneficial trust involvement in the ownership of any company and / or performance related benefit opportunities, secondment and / or TUPE arrangements. The wider governance issues around the ownership and control functions of the Council required to maintain Teckal exemptions will also need to be considered along with Senior staffing structures and conflicts of interest under Companies Law. The impact of the proposals on the overall Council financial position vis a vis retained services and overhead costs that will remain with the Council and how these services can continue to have a relationship (both as customer and supplier) with the LATCo will be a consideration. Further details on risks, as currently assessed, are contained in the Alternative Service Delivery Model Background Paper.
15.	In setting up the LATCo, the Council has to consider whether to operate pension arrangements for Local Government Pension Scheme (LGPS) on an 'open' or 'closed' scheme basis. In an 'open' scheme, all transferring

	<p>employees, regardless of current pension entitlement, would be entitled to join the LGPS, as would any new future employees. Under the arrangements of a 'closed' scheme, it would only be necessary to ensure that those transferring individuals currently in the LGPS would be entitled to continue with these same pension arrangements.</p> <p>Based on an initial actuarial valuation provided by AON Hewitt (Actuaries to the Hampshire Pension Fund) in December 2015 when the Council was considering setting up a wholly-owned subsidiary, there is likely to be an increased employee pension contribution.</p>
16.	<p>The procurement process will be implemented as part of the broader procurement arrangements with Capita, although Council project management resource and specialist technical advice, including legal and financial support for the preparation of service specifications will be required. The levels of support required in resourcing a procurement of this scope should not be underestimated and additional resource will be required to support the proposals in this report. As elements of this project overlap with the Alternate Weekly waste Collection (AWC) initiative, it is proposed that such advice and project support be integrated to ensure a joined up approach.</p>
<p>Conclusions and Next Steps</p>	
17.	<p>If Cabinet approves the recommendations in this report, it is anticipated that the establishment of the LATCo, the procurement process for the setup of a LATCo and selection of one or more public/private sector partners would take approximately 12 months, however this time frame is subject to market response and the complexity of any of the packaged options. As such, it is possible that the transition of the in-scope services to the LATCo may happen in a gradual and phased approach over a period of time following the end of the procurement process.</p> <p>The outcome of any negotiations arising from the procurement process, LATCo arrangements, staffing implication and a final assessment of the legal, financial and risk implications will be presented back to Cabinet /Council for final decision on whether and how to proceed.</p>
<p>RESOURCE IMPLICATIONS</p>	
<p><u>Capital/Revenue</u></p>	
18.	<p>Additional resource will be required to support this project including but not limited to Project Management, Legal and Financial.</p>
19.	<p>The cost of additional resource requirements, allowing for the use of already identified AWC resources, is still to be determined but it is anticipated that this can be met from within the current Transformation budget provision.</p>

20.	Any associated Capital Costs of the project will be determined and reported to Capital Board for discussion and recommendation as relevant.
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Property/Other

21	There are no immediate impacts, however implications for the Council's accommodation and property holdings, asset transfer and other associated matters will be assessed in the final report to Cabinet / Council in due course.
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LEGAL IMPLICATIONS

Statutory power to undertake proposals in the report:

22.	S95 Local Government Act 2003, S111 Local Government Act 1972 and S1 Localism Act 2011, together with ancillary Regulations and guidance.
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Other Legal Implications:

23.	Any procurement will be required to comply with the Council's Contract Procedure Rules and UK procurement legislation. Detailed EIA and PIA requirements will be commenced and refreshed throughout the conduct of the procurement exercise and decision making processes and the range of service in scope for procurement assessed in terms of client structures / non delegable duties and retained responsibilities, employment law matters, state aid, tax liability, risk and financial viability in accordance with the Council's Best Value duties prior to determining final arrangements and governance structures.
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POLICY FRAMEWORK IMPLICATIONS

24.	<p>The recommendations in this paper support the delivery of the following outcomes within the Southampton City Council Strategy:</p> <ul style="list-style-type: none"> • Southampton has strong and sustainable economic growth; • Children and young people get a good start in life; • Southampton is an attractive modern city, where people are proud to live and work.
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KEY DECISION?	Yes
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WARDS/COMMUNITIES AFFECTED:	All
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SUPPORTING DOCUMENTATION

Appendices

1.	None
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Documents In Members' Rooms

1.	None
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Equality Impact Assessment

Do the implications/subject of the report require an Equality and Safety Impact Assessment (ESIA) to be carried out.	Yes
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Privacy Impact Assessment

Do the implications/subject of the report require a Privacy Impact Assessment (PIA) to be carried out.	YES
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Other Background Documents

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)
1.	Alternative Service Delivery Model Background Paper