Nottinghamshire County Council

**Report to Finance & Property Committee**

**9 November 2015**

**Agenda Item: 4**

# REPORT OF CORPORATE DIRECTOR FOR PLACE

# ESTABLISHING A JOINT VENTURE FOR PROPERTY DESIGN AND OPERATIONS

## Purpose of the Report

1. This report presents the final business case to proceed with establishing a Joint Venture company with Scape Group Ltd (currently Scape Systems Build Limited) for Property Design and Operations.

## Information and advice

2. This report contains exempt appendices, which are not for publication by virtue of paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended) (Information relating to any individual and the business affairs of a particular person (including the authority holding that information)). Disclosure of this information would prejudice the parties' commercial interests.

### The Current Position

3. In late 2014 the Property Group put forward outline business cases for two options that were approved by the County Council as part of its Medium Term Financial Strategy (MTFS) earlier this year. The options which have already been explored are leaving the service as it is, outsourcing to the private sector and developing a Joint Venture with a partner whose ethos aligns with that of the County Council.

4. It was identified at the point that the option for change was put forward last year that maintaining the current model for service delivery would not be sustainable beyond the start of the financial year 2016/17 as there will not be a sufficient volume of work. This would result in a reduction of posts and therefore an erosion of skill base as a result. Consequently any remaining work would need to be serviced by external contractors at a cost premium to the Council.

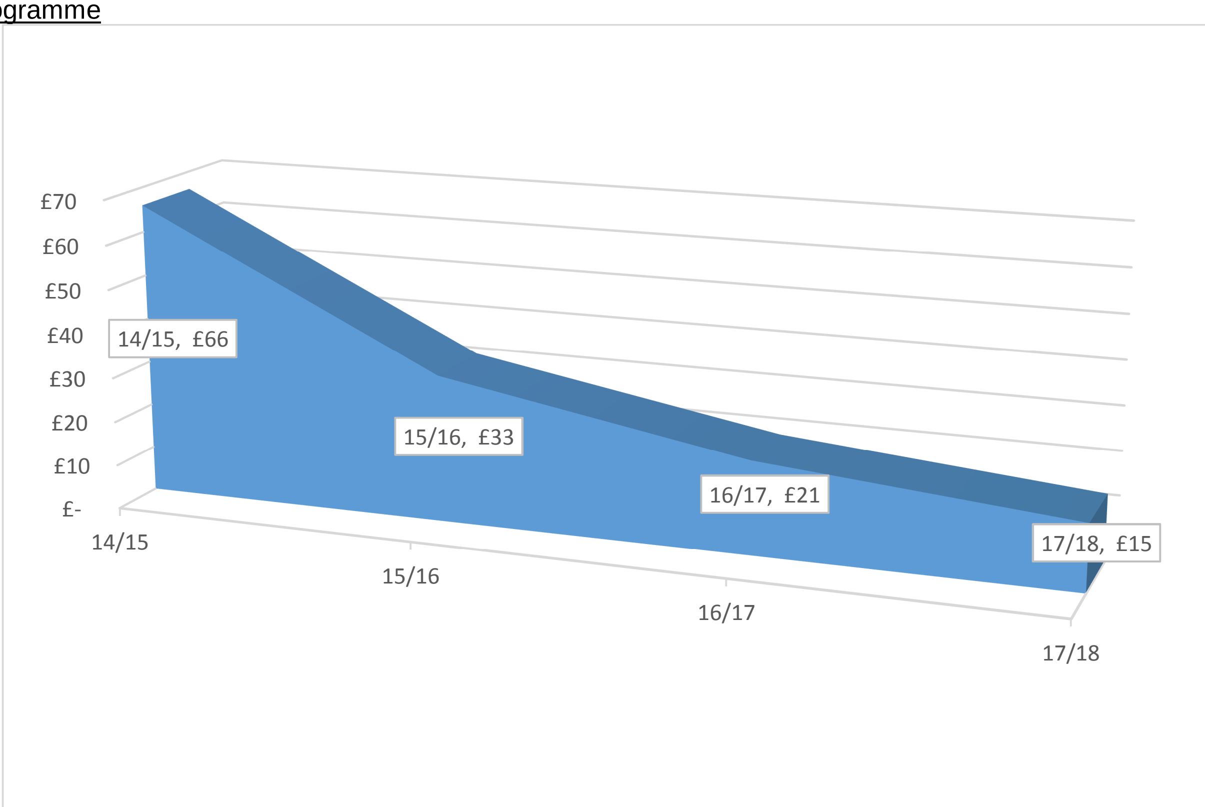
5. Outsourcing services through open competition could reasonably be expected to take 12 – 18 months to procure and will be a costly exercise. There is no certainty that acceptable bids would be received or that staff would be retained given the declining turnover. This taken together with the projected reduction in the size of works over the same period means that staff reductions would have to be made before the revised arrangements are in place, which would result in considerable costs to the Council. In addition outsourcing is not a collaborative partnership model and most importantly it will diminish the County Council's control and influence leading to possibly higher costs for the Council. Accordingly, this option is the least preferred.

6. The third option involves the establishment of a Joint Venture for Property Design and Operations with another publically owned organisation that is able to complement in-house skilled resources.

7. In September 2015 this Committee unanimously agreed to proceed with producing a final business case for developing a Joint Venture with Scape Group Ltd.

8. Members are already aware that Property Design and Operations is facing a sizeable decrease in the value of its capital programme as a result of changes in government funding.

Figure 1: Forecast Property Capital programme value (£ millions) – Figures taken from **approved** capital programme




9. The underlying assumptions on the programme are summarised below:

   a. Although there is 'exclusivity' agreed with the Joint Venture, the County Council is not guaranteeing turnover as it will depend on future funding decisions made by NCC
   b. The programme figures for 2016/2017 and 2017/2018 mirror the approved capital programme of the Council, except for those items listed below:
      i. The Basic Need programme is fixed for year 1 only. However, the projected figures beyond 2016/2017 in this respect reflect prudent estimates of likely provision requirements in the coming years
      ii. Similarly the SCRP for 2017/2018 and beyond is yet to be approved and the figures shown reflect the likely need
      iii. There are no figures in the capital programme for School Access Initiative or Libraries Modernisation project for year 3. It has been assumed that these will roll forward at the same level as year 2,

    iv. The Energy Programme is a NCC funded programme. For 2016/2017 and 2017/2018 half the funding has been approved. For 2018/2019 the funding is yet to be considered by the Council.

  c. All projects included are within scope to be delivered by the JV and associated costs are factored in to the Financial Performance schedule

10. On a related subject the Committee should note that the elements of the programme projections beyond 2016/17 include assumed increases which are set out in Exempt Appendix C as no decision in this regard has yet been made by the Council.

11. For the service to reduce at an equivalent rate to its source of income would see a reduction of up to 50% in the current establishment over the medium to long-term. It would mean that key skills are lost and the Council would be increasingly reliant on specialist external expertise at a cost premium. There would also be the cost of making redundancies which could amount to up to £1 million.

12. To avoid this situation NCC is seeking to develop a Joint Venture arrangement with a partner to provide Property Design and Operations services back to the Council. It is believed that a commercial partner would drive more cost effective procurement supply chain management as well as developing income opportunities from other areas. For example from Academies and schools, other public sector bodies such as health, fire and police, other local authorities and from the private sector, to replace the reduction in work from NCC.

**The Proposed Partner**

13. Scape is a 100% publicly owned and managed collaborative organisation working in the built environment. It is owned by the four Local Authorities of D2N2 and two other councils. It seeks to continuously improve and innovate in the delivery of projects and services in the public sector. It also provides strategic procurement, transformational and design services. Its corporate structure is known to the Council (as one of its shareholders.

14. The principal reasons to pursue an arrangement with Scape are as follows;

- Scape is a publicly owned organisation whose values align with NCC.
- NCC and Scape have an existing long-term working relationship that has successfully delivered projects over the last 10 years.
- NCC has services that align with Scape's service offer which creates a mutually beneficial business model.
- Pooling of knowledge and experience to consolidate and enhance both NCC and Scape's current offering.
- NCC is a shareholder in Scape holding company, along with 5 other local authorities.

**The New Arrangement**

15. The proposal is to develop a Joint Venture between NCC and Scape. The Joint Venture would be a 'Teckal Company' which means it is controlled by local authority(s) and can trade outside by up to just under 20% of its turnover and this has

been introduced into law by the Public Contracts Regulations 2015. Being 'Teckal compliant' also means that a procurement exercise is not required for the establishment and operation of the Joint Venture to deliver services for NCC and back to Scape Group Limited. External legal advice has been sought to ensure that the proposals satisfy the Teckal test and they are structured to minimise the risk related to procurement law requirements.

16. The jointly owned Teckal Company would be resourced, financed and supported jointly by the partners as an 'in-house' department, common to both partners.

17. Scape will hold the majority of shares (80:20) in the Joint Venture and it forms part of the commercial offer. The Board of the Joint Venture will have representatives of both shareholders as both need to demonstrate control for the purposes of the 'Teckal' test. Further, the Shareholders' Agreement will include a series of Reserved Matters being those items that require unanimity and thereby offering the Council a veto on the JV undertaking certain activities.

18. If the JV is able to generate efficiency savings (or surplus) from the work it does for NCC or Scape or generates a return (equivalent to profit) from work undertaken for third parties, such sums will be shared 50:50. The projections in respect of this are included in Exempt Appendix C.

19. Strategic commissioning and contract management would rest with the Authority as a client.

20. There will be a commercial and exclusive Service Contract between the Authority and the Joint Venture for the provision of building design and operations. However, this excludes schools devolved budgets such as minor day to day works. The exclusivity covers programmes and projects (Capital and Revenue) delivered through the Council's property group and departmental property budgets which are currently procured through framework agreements, as well as via in-house services such as the property operations team. This exclusivity is required to ensure that the Joint Venture has income in the same way that the service does now. This exclusivity is essentially assurance of extending the current arrangements with the in-house units. However, the Council cannot and will not guarantee work from third parties (including any future Alternative Service Delivery Models that may be created). Commercial risks in this regard will be a matter for the Joint Venture.

21. The terms of the Service Contract, will be agreed through commercial negotiations as part of the due diligence before the Joint Venture goes live. Outline Heads of Terms have been developed which include provisions setting out the processes to be followed by the parties including how new projects will be instructed; how KPIs may be revised; payment, certification, invoicing and the preparation, negotiation, approval and signing of construction contracts. The heads of terms outline exclusivity and how it may be suspended or lost (such as a lack of agreement on a brief or costs for a new project or poor performance). Further, details on the governance and operational regime (written warnings; improvement plans; fee adjustments; loss of exclusivity; termination) are included within the service contract. An outline high level project plan is attached at Appendix A and details the main areas of focus.

22. It is intended that the newly formed company would commence operating from 1st April 2016. The Authority would enter into a contract for an initial 5 years with the option to extend this to a further 5 years subject to satisfactory performance.

23. The Authority will consider the performance of the Joint Venture against the service contract on a regular basis with an annual review. The review allows for service

change and to ensure performance is as required. The Services Contract will contain rights to terminate for poor performance as detailed above.

24. A fully detailed business plan will be prepared as part of the development of the shareholders agreement that will detail how the Joint Venture will set out its high level objectives as described in the Business Case (Exempt Appendix D). This business plan will be prepared in consultation with NCC as part of the shareholders agreement.

25. The principle of this arrangement is that the Authority would set out what it requires the Joint Venture Company to deliver through a Service Contract and what resources it can afford to provide. Projects delivered through the Contract would include ad hoc design advice, feasibility studies and full design, delivery and supervision of individual capital and revenue schemes for new build, alterations and extensions/ refurbishments to existing premises. It would also include the management and delivery of reactive repair works and general consultancy advice/ guidance, including the use and integration of sustainable energy technologies.

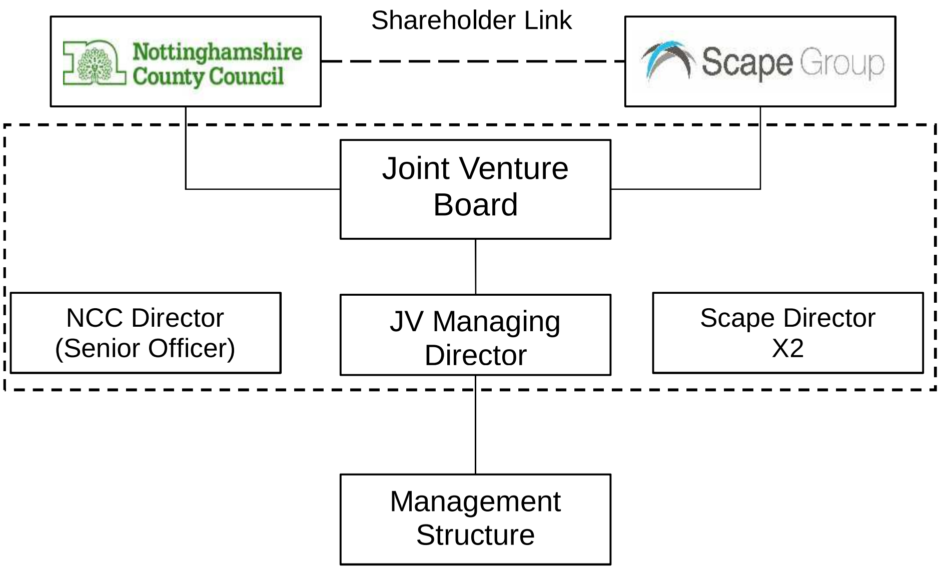
26. Staff currently employed by the Authority in Property Design and Build services would transfer to the new company under TUPE provisions, i.e. on their existing terms and conditions. An ‘Admitted Body’ pension fund is to be created for the new company based on actuarial valuation.

**Consultation**

27. There has been extensive dialogue and consultation with staff and trade unions from the beginning when the Outline Business Case options for the Property Joint Venture were developed and taken to the Committee for approval. Consultation has continued throughout the process leading to the formation of the outline business case and there is a consultation forum of staff and trade unions which has been managed proactively. There is an acknowledgement from staff that the formation of the Property Joint Venture with Scape is the preferred option. In the next stages there will be further consultations with staff and trade unions for which a project implementation plan will be developed in conjunction with HR.

## Governance

28. Effective governance is an essential component in creating the Joint Venture and to ensure that the requirements of the Teckal Exemption are satisfied, i.e. the need for the County Council to exert control and influence over the company. There is also a requirement to achieve a balance between the Council's strategic control and influence and enabling the Directors of the company to have operational responsibility for delivering the strategic objectives of the Council. It is anticipated that the company will have a structure and relationship to the Council as set out in the chart below:




29. Once the Joint Venture is established it would be governed by its board of Directors (four directors in total, one of which will be appointed from NCC) who will meet quarterly to review performance and make any strategic decisions required for the Joint Venture to develop and grow. The board representative from NCC will be a senior officer.

30. Elected Members will receive regular reports via the Finance and Property Committee in relation to contract performance of the new company.

## Project Staging and Timescales

31. **Mobilisation Stage – November 2015 -** Mobilisation will enable the detailed design of the JVC to be developed, including key documents and strategies, together with support services for the Joint Venture. The output will include:

- Draft Heads of Terms
- Draft Shareholder Agreement and Identification of Reserved Matters
- Draft Transfer Agreement
- Fully Detailed Business Plan
- Due Diligence Activity
- Service Contracts between the JVC and NCC for the delivery and management

of all services provided to NCC (and service contract between JVC and Scape) and their service users, including detailed service specifications and KPIs

32. **Service Specification Stage – December/ January 2016 -** Service Specification stage will be concerned with preparing staff for the transition and finalising the service specifications that will underpin the relationship between the Joint Venture and the Council. The outcome of this stage will be a set of service specifications that are agreed by the JVC and the Council. This stage will include certain key outcomes that need to be in place:

    - Incorporation of the company
    - Establishment of bank accounts
    - Registration with HMRC as employers and for VAT and corporation tax
    - New accommodation for the Joint Venture – paid for by the JV
    - Recruitment of the Managing Director for the new JV
    - TUPE consultation documents & Pension Transfer agreement
    - Gateway Review

33. **Transition Stage – February/March 2016 -** The final stage is focused on the transition to the new organisation. The Service Contract will be finalised, management and service structures will be formally put in place, ready to go live and will include:

    - Memoranda and Articles of Association for the company and all statutory registers.
    - Risk Register
    - Preparation for transfer to new company

**Transfer of Assets**

34. There are a number of assets that have been identified that would need to be transferred to the Joint Venture at the point it becomes operational. These are primarily assets that are used by the operations team and range from vehicles, to safety equipment and hand tools. This work is ongoing.

35. Fair market value of these items will need to be determined for the Joint Venture to reimburse the Council for their market value or (subject to negotiation) NCC will retain ownership and lease the assets to the JV to ensure the transfer of these assets are compliant with state aid rules.

36. A database of assets has been created so that the assets associated with each post can be identified and the process of determining market values for these assets is underway.

37. The vehicles have a trade value of around £205,000 and the hand tools have an approximate value of £10,000, giving a potential total value of assets of circa £215,000 to transfer into the Joint Venture on 1st April 2016. The commercial

arrangements around the transfer of assets will be agreed separately with the JV closer to the vesting date.

**Pensions**

38. The total value of the pension liabilities for the cohort of staff transferring to the Joint Venture on 1st April 2016 is estimated at £7.072 million. The deficit on historic pension liabilities is £677k and this will fall on NCC. An actuarial valuation of these figures will also be undertaken closer to the transfer date. It should be noted that this historical deficit will have stayed with the Council even if the Joint Venture was not pursued. In other words the overall existing deficit on the pension fund for the County Council remains unchanged.

**Key Risks**

39. The main risks are identified and outlined in Appendix B, along with the mitigation measures. In principle these are:

    a. The JV fails to be developed
    b. The JV is unable to meet performance requirements
    c. Changes in policy prevent a steady flow of work from NCC to the JV, causing early service delivery failure
    d. Ensuring the JV delivery Value For Money
    e. The JV fails to win sufficient external income.
    f. The JV fails to deliver projected supply chain cost reductions.

**Summary of the Benefits**

40. The primary benefit from the establishment of these new arrangements would be the long term sustainability of a quality design and build operations service. The ability to be able to operate in a more agile and flexible way, including in the commercial market, would secure future income and external earnings for the Joint Venture.

41. One of the key benefits is the anticipated savings that will be achieved on major projects of work. The efficient management of the supply chain, it is anticipated, will drive down expected out turn costs which on large capital projects even small percentage reductions in costs equates to significant savings (see Exempt Appendix C). This will benefit both the JV and NCC.

42. A highly skilled and experienced workforce would retain their jobs and enhance the current offer of the Scape Group allowing them to extend their services into new markets.

43. Scape as a holding company is entirely owned by 6 local authorities; 4 of which are D2N2 Councils.

44. Scape is a very successful company that has achieved outstanding results in recent years. Uniquely through framework contracts and their status as a contracting authority, it has control/influence over 10% construction works in the public sector.

45. A Scape Joint Venture has the potential to grow in the region and create a modern service delivery model that will attract buy-in from other parts of the public sector

both regionally and nationally, such as District Councils, police, fire services and schools

46. There is robust governance through the influence the County Council has on the Scape holding company as a shareholder, the Authority would be in a position to shape business strategy and VFM outcomes. It will however need to ensure it distinguishes its roles as 1) shareholder in Scape; 2) Shareholder in the JV; 3) client to the JV and 4) provider in the JV.

47. Scape's offer is a uniquely new product in the market place which would be developed to provide better services and value for money services to its clients. The Design and Operational elements of the Property Group already operate on a formal commissioning and delivery model. The main changes will be the ability of the Joint Venture to bring commercial resources to play in the generation of new business opportunities.

48. A Scape Joint Venture could potentially become a 'new' player in the market/region; with a new brand and greater buy-in from other public sector bodies. Scape recognise this and are prepared to invest in new management, systems and marketing to establish a successful brand.

49. It is a local solution which retains Nottinghamshire money within the local economy.

50. Scape have influence over the supply chain through framework contracts in the public sector, which accounts for nearly 10% of the national market share of the public sector.

## Conclusion

51. It is recommended that the Council proceeds with establishing a Joint Venture with Scape as it provides the most sustainable option of meeting the financial challenges facing these services whilst retaining a high level of service.

52. This would result in the transfer of circa 75 Design & Operational staff into the joint venture, in response to a significant decline in capital and revenue budgets over the next 3 years.

53. The development of the JV will provide the opportunity to generate additional income and forecast surpluses within the 3 year timeframe.

## Reason for a decision being sought

54. A decision is being sought to enable the project to move into the next phase and for resources to be committed by both partners. This will include the appointment of senior posts and mobilisation of resources in order to achieve a start date of 1st April 2016.

55. A go-live date of 1st April 2016 has been identified as when the Joint Venture would become operational and this date has been selected for the following reasons:

- It is the start of the 16/17 financial year

- Although there is a healthy capital programme for 16/17 it is felt by both partners that for the Joint Venture to be successful in the following years then there will need to be a period of stabilisation for the Joint Venture where it establishes its operations, identifies efficiencies and starts looking to external opportunities for growth.

**Key strategic considerations**

56. This Joint Venture opportunity provides Nottinghamshire County Council with the platform that it needs to maintain its existing skill base, and to potentially enhance it, at a time when other local authorities are having to divest themselves of in-house property design and operational services.

57. The main issues a JV will resolve are:

    - A reducing demand for Design & Operational services
    - Ability to generate external income
    - Preserve a highly skilled workforce
    - Provide efficiencies in the delivery of schemes through better management of the supply chain
    - Availability of greater commercial resources
    - Reduction of risk to the Council
    - A local Public Sector solution

58. This report is seeking a decision from the Committee to proceed with the establishment of a Joint Venture that is aligned to the Council's strategic objectives.

**Reason/s for Recommendation/s**

59. The following recommendations have been made as they represent the best solution for the Council to retain access to skills and experience in the face of declining turnover.

**Statutory and Policy Implications**

60. This report has been compiled after consideration of implications in respect of crime and disorder, finance, human resources, human rights, the NHS Constitution (Public Health only), the public sector equality duty, safeguarding of children and vulnerable adults, service users, sustainability and the environment and ways of working and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

**Human Resources Implications**

61. The transfer of staff currently engaged on the delivery of construction related professional design and delivery services will fall within the scope of TUPE legislation. Approximately 75 staff would transfer to the new company in line with legislative requirements. The recognised Trade unions and the affected staff have been advised of the forthcoming transfer and will be invited to attend the formal consultation events.

## RECOMMENDATION/S

62. It is recommended that the Committee:

(i) Approves the establishment of a joint venture company, that is Teckal compliant, for the delivery of Property and Design Services, with Scape Group Ltd (currently Scape Systems Build Limited) as outlined in the report and Exempt Appendix C;

(ii) Notes the governance arrangements as set out in paragraph 29 of this report;

(iii) Note the draft contractual arrangements with Scape Group Ltd (currently Scape Systems Build Limited) for the Business Plan, the Shareholders Agreement and the Transfer Agreement and the Service Contract as outlined in the report and Exempt Appendix C ;

(iv) Delegates to the Chief Executive (or his nominee), the responsibility for developing and finalising the contractual terms of the Shareholders Agreement, the Transfer Agreement, the Service Contract and the Business Plan, in consultation with the Section 151 Officer and Group Manager - Legal, Democratic and Complaints;

(v) Delegates approval to the Chief Executive (or his nominee) to enter into any and all necessary legal documentation to give effect to the approved recommendations of this report, in consultation with the Chairman of the Committee, Group Spokespersons, S151 Officer and Group Manager - Legal, Democratic and Complaints.

**Tim Gregory**
**Corporate Director**
**Place**

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### Constitutional Comments (SSR 29.10.2015)

63. The recommendations set out in this report fall within the scope of decisions which may be approved by the Finance and Property Committee.

### HR Comments (AN 30.09.2015)

64. Subject to member's approval of the business case to enter into a Joint Venture with Scape, formal consultation with the recognised trade unions and affected employees will be initiated. To date early engagement for the purpose of sharing information has been undertaken on a regular basis to demonstrate transparency and to identify all available options. If the Joint Venture progresses, the transfer of staff currently engaged on the

delivery of construction related professional design and delivery services will fall within the scope of TUPE legislation.  Approximately 75 staff would transfer to the new company in line with legislative requirements. The recognised Trade unions and the affected staff have been advised of the forthcoming transfer and will be invited to attend the formal consultation events.

**Financial Comments (TMR 22/10/2015)**

65. Scape have produced an indicative financial plan (Exempt Appendix D). Currently the impact of external income has not been factored in.  The plan indicates that Scape feels the JV would be sustainable.  The figures have not been subject to due diligence by the Council so this view cannot be corroborated at this stage.  A significant proportion of the income relates to amounts assumed as capital which have not been approved within the capital programme.

66. There are a number of costs, benefits and risks to both the JV and the Council as a result of this proposal which are estimated and outlined in the financial implications section and elsewhere in the report.  The detailed financial implications cannot be identified until the details of the creation of the Joint Venture Company and its operational arrangements have been determined.

67. Detailed profit and loss, balance sheet and cash flow forecasts for the company have not yet been prepared.  The preparation of these documents will be the focus of further work during which due diligence to assess the reasonableness of the estimated revenues and operating costs of the company will be undertaken.

**Background Papers and Published Documents**

Except for previously published documents, which will be available elsewhere, the documents listed here will be available for inspection in accordance with Section 100D of the Local Government Act 1972.

**Electoral Division(s) and Member(s) Affected**

All

File ref.:  /SB/SB/09997
SP: 2922
Properties affected: 09997 – Policy