

Devon Catering and Cleaning Services

Proposed Joint Venture

Business Case

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1. Executive Summary

As part of the strategy with Children and Young Peoples Service (CYPS) to make budget savings, the current subsidy provided to Devon Catering, Cleaning and Caretaking (DCCS) is being completely removed from 2011/12. This will require the service to recover over £2 million by increased charges to service users.

The ability of DCCS to become more efficient within a Local Authority is very limited and expanding the business has not been successful due to the limitation under the Local Authorities (Goods and Services) Act 1970. However, under the provisions of the Local Government Act 2003, there is greater scope to trade commercially provided this is undertaken through a company.

The opportunity of forming a Joint Venture with another public body allows the benefits of public ethos together with commercial flair. There is considerable scope in this partnership to “grow the business” giving benefit to staff, schools and the Authority who, over time, will benefit from the financial savings and surplus.

The business case outlines the issues facing the Authority together with the associated risks with schools. Over 250 school based staff have attended the road shows, the feedback made clear that there is clearly a market for a more cost effective and customer focused service which considerably reduces the financial burden on the Authority.

2. Background and Overview

Since the changes triggered by Compulsory Competitive Tendering Devon Catering and Cleaning Services (DCCS) has been regarded as a trading service, but in recent years it has been increasingly subsidised through the Dedicated Schools Grant (DSG) (for Fresh Start healthy eating strategies) and by DCC to cover the additional costs arising from Job Evaluation. Setting aside these subsidies, which total £2.786m, the cleaning and caretaking strands make a small annual surplus, and the catering operations make a trading loss. The annual turnover of DCCS is some £17m, of which £12m is catering, including corporate and functions.

The services trade predominantly with schools with some services being provided to 43 NHS contracts and 42 other non-DCC and DCC corporate locations, such as; Larkbeare House and the Coaver Club.

DCC provides catering services to 266 out of 328 primary schools and 7 out of 37 secondary schools; including provision for schools that have transferred to Academies. This represents an uptake of 73% of primary schools and 18% of secondary schools. The remaining schools make their own arrangements.

The delegation of budgets in 2000 changed the relationship between schools and DCCS as provider. The current arrangements for cleaning are very clear and schools receive an individual price for the service which they pay annually. This process is being developed for catering. The level of satisfaction has generally been good but there are some concerns about performance and standards.

Recent in-depth reviews have generated savings through driving down procurement costs, a phased transfer of Job Evaluation (JE) cleaning costs to schools, and remodelling service infrastructures.

The national position of a fall in uptake of school meals since the introduction of new nutritional standards has however been reflected in Devon and this coupled with the central government policy of encouraging schools to become self-governing has meant that the trading position is not secure.

The take-up of Free School Meals in Devon is 178,981 (April-June 2010), a 12% increase on the same period last year.

3. Service Constraints

The Council has commissioned two separate independent reviews to examine the service constraints upon DCCS. The following key issues have been identified.

DCCS is presently limited in the extent to which it can trade commercially in a wider market limiting their ability to increase profitability through growth.

The adoption of Job Evaluation has increased the salaries of some staff, in both catering and cleaning functions, so that they are now significantly above the national market rates for comparable posts.

Central government policies to encourage more schools to become self-governing (Academies) has considerably added to the pressure and opportunities available for DCCS to demonstrate that they can be competitive and customer focused.

In comparison to similar services in the market there is a top heavy management structure and lack of commercial and strategic management. The limited strategic management has resulted in loss of commercial edge and the absence of any apparent appetite to capitalise on modern systems for business support, marketing or the use of technology.

There is duplication and thus inefficiency in the cleaning and catering infrastructure teams.

The Reviews conclude that re-modelling, in which a number of posts will inevitably be identified as at risk, will ultimately save jobs by making the service more cost effective whilst also providing higher quality services.

4. Outline of Joint Venture Contract Objectives

The Council's broad aspirations for this venture are improving outcomes for children and young people, parents and carers, and securing value for money and sustainability.

The Council looked at several alternative strategies for continuing delivery of these services to schools and other clients:

- Preserving the status quo, with services continuing to be delivered by in-house operations
- Transferring the operations to private sector providers through EU procurement, tendering the various contracts
- Ceasing to deliver these services
- Transferring the services into a Joint Venture Company formed with another public sector-owned provider.

Cabinet considered, in September 2010, the detailed analysis undertaken by the DCCS Project Board on a number of options for remodelling (or terminating) the service. Their conclusion was that a joint arrangement, through a joint venture company and preferably one in which a local authority ethos should be sustained, would provide value for money, maximise income generation in a competitive market and benefit the overall financial position of the Council and schools.

The aim is to deliver the following benefits to Devon County Council:

- Provide better value for money through improved performance
- Help to sustain the local community with a positive social impact
- Provide continuity of service and employment
- Maintain greater Council control than a traditional outsource
- Share profits from increased access to external markets and revenues
- Build on a current successful public -private partnership.

5. Baseline Budget for Cleaning Service

Cleaning & Caretaking Service					
Budget Summary 2011-12	Total	Service	JE	Total	Total
	Expenditure	Income	Funding	Income	Net
	£'s	£'s	£'s	£'s	£'s
Service Management, Training etc.	607,767	73,637	147,684	221,321	
Devon Primary & Special Schools etc.	3,649,731	4,285,496	373,054	4,658,550	
Devon Secondary Schools	514,575	565,911	38,577	604,488	
Non DCC Services	273,036	441,583	0	441,583	
Portable Appliance Testing	17,753	25,900	134	26,034	
Apportioned DCCS Overhead	281,281	0	0	0	
Apportioned Central Service Overhead	170,082	0	0	0	
Contingency	153,000	0	0	0	
Totals	5,667,225	5,392,527	559,449	5,951,976	
Budgeted Surplus (repaid to Catering)					284,751

The Baseline Budget for Cleaning Service for 2011/2012 will be 1% higher to cover pay awards. In addition the recovery of a further £559k will be needed to cover JE costs.

A turnover of circa £4.5m would support the establishment of a JVC. This would broadly reflect a buy back level of approximately 75%.

The proposed management structures will need to be reviewed if there is a significant variance in the level of buy-back from that assumed.

6. Baseline Budget for Catering Service

Catering Service					
Budget Summary 2011-12	Total	Service	JE	Total	Total
	Expenditure	Income	Funding	Income	Net
	£'s	£'s	£'s	£'s	£'s
Management, Training etc.	645,368	232,201	40,057	272,258	
Devon Primary & Special Schools	7,469,030	5,423,145	1,329,099	6,752,244	
Devon Secondary Schools	1,150,680	1,053,800	96,880	1,150,680	
Civic Catering Services	619,178	558,345	60,833	619,178	
Function Catering Services (DCCS)	118,750	129,000	9,492	138,492	
Apportioned DCCS Overhead	368,327	0	0	0	
Apportioned Central Service Overhead	222,718	0	0	0	
Totals	10,594,051	7,396,491	1,536,361	8,932,852	
Budgeted Deficit					(1,661,199)
Cleaning Surplus					284,751
DSG Fresh Start/Healthy Eating Subsidy					1,376,448

The Baseline Budget for Catering Service for 2011/2012 will be 1% higher to cover pay awards. In addition a further £1.5 million will be needed to cover JE costs.

As the transfer of the catering operations would be second phase transfer the 'viability' turnover is less clear. The Phase II business case will need to examine in depth not only the projected turnover but also the geographical distribution of sites and individual premises' business volumes. The management structures will need to be reviewed in the light of this examination.

7. School Crossing Patrol service

The management of the School Crossing Patrol Service is undertaken within DCCS and the matter is under review. At this juncture no recommendations can be made about whether the function should be transferred into a joint venture.

8. Corporation Tax

As an internal organisation DCCS is not subject to corporation tax.

Under a joint venture which will be designed to generate surplus income (Profit), Corporation Tax will be paid on any profits at the current rate of 28%, subject to any tax planning advice the JVC may receive. If the profit model is based on profits being generated on non-DCC operations, specialist tax planning advice will be required both during incorporation and during operations. It should be noted that profits to DCC will be appropriated after tax. Declaring and guaranteeing the rebate prior to the start of the financial year means that there would be zero tax liability for DCC.

9. Value Added Tax (VAT)

In order that school meals can be supplied free of VAT there has to be a 'principal and agency' arrangement. The meals must be supplied to the principal (the school) by the agent (the caterer) for onward supply to the pupils; the function is thus classified as incidental to education.

This applies both to maintained and self-governing schools, such as Academies, but Academies entering into this arrangement must seek their own tax advice as the Council cannot legally provide it to them.

Technical VAT matters will be resolved by Council officers with the contractor when drawing up the joint venture contractual arrangements.

10. Cash Flow

Currently, payment for cleaning services is made by schools to DCCS at the start of the financial year but in future it is proposed that services will be invoiced monthly. Invoices will be raised on the first of each month, with payment due on or before 25th of the same month. This will remove the need for support for business cash flow in the early stages of the JVC.

It is not expected that there will be a requirement for cash flow support for catering or for the support for the cleaning operation to extend beyond September 2010.

11. Staff Contracts

The current staffing structure relates to the level of businesses now in place. The ratio of management to income varies from cleaning to caretaking and reflects the present arrangements which will be subject to future scrutiny.

There are currently 1431 staff employed by DCCS on various contracts:

Staff Ratio	Total
Cleaning site based staff	664
Cleaning Management Team	12
Catering site based staff	726
Catering Management Team	13
Combined Infrastructure including finance	11
SCP Management	5

12. Management Structures

Two independent reviews have been undertaken of the Devon Catering and Cleaning Services. Both conclude that with the correct management structure and people in post, the cost of management can be substantially reduced whilst at the same time enabling the management and service to become more effective.

Proposed management structures, based on the analysis of the reviews have been drafted and will form the basis of formal consultation with staff and unions. These structures have been predicated on certain volumes of business, predominantly the buy back level from schools; they will need to be reviewed if there is a significant variance in the level of buy-back from that assumed.

It should be stressed that it is crucial to get the right people in the correct structure to secure the future of DCCS as a service. This will include a new strategic Director appointed to redesign the service to improve responsiveness, flexibility, profitability and governance.

13. Effects of projected forecasts

The current expenditure on management and infrastructure is approximately £2 million. It is expected that the proposed restructuring will bring savings of £500k given the same buy back levels.

Further savings would be expected to be realised through innovative use of ICT and a more commercial perspective on business processes in general.

No re-evaluation of JE grades has been assumed.

14. Pensions

The two options for pensions are:

- (a) to continue with the DCC Pensions Scheme with the new partner acquiring Admitted Body status or
- (b) providing a broadly comparable scheme. Broadly comparable means the benefits need to be of the same actuarial value to the Local Government Pension Scheme (LGPS).

It is intended that option (a) is pursued with the JVC joining the Devon fund as an admitted body. The pension costs of employees transferred to the JVC to be a 'pass through'. This results in DCC retaining the pension liabilities and hence retaining the risk. As the liabilities would remain with DCC, these would be included with DCC's FRS17 figures. This would mean that only the contributions made by the company are included in the JVC accounts and no account is required of any deficits.

However, pension deficits/surplus can arise due to actual experience of the fund and clearly the JVC partners will have control over pay awards. Thus the risks of any increase in employer contributions or termination payments (at closure) due to excessive pay awards will require further discussion and should be properly reflected in the JVC contract.

It is intended that the Authority's liability for future pension arrangements would be limited to those staff transferred from the Authority, working on Devon County Council contracts (including schools'). This will apply to contracts which subsequently transfer into the JVC, and to any which the JVC wins as a result of tendering, where the transferring staff are members of the DCC pension scheme. New employees who are not in the LGPS will not be offered the option of membership, and their pension arrangements would be the responsibility of the JVC.

15. TUPE - Transfer of Undertakings (Protection of Employment) Regulations

All staff employed in DCCS activities at the time of the establishment of the JVC will be transferred to the JVC under TUPE regulations. This transfer will occur with current (DCC) terms and conditions.

As has been highlighted above, some business remodelling on the grounds of economic, technical and organisational (ETO) necessity is vital if the service is to be resilient to the many pressures and market vagaries that are present now and will prevail in the future. It is intended that the Council's proposals for restructuring are completed before any phase of transfer.

This proposal follows the recommendation made to the Corporate Leadership Team in October 2010.

16. Procurement and the Teckal Exemption

In procuring a joint venture partner it is lawful for a local authority, or authorities, to appoint a local authority company to undertake services without competition (if this is compatible with "best value"), when the Teckal exemption from the public procurement regime applies to the local authority company.

The arrangement must satisfy both the Teckal conditions which are:-

- (1) the authorities must exercise no less control over the company than they exercise over their own departments;
- (2) the company must carry out the essential part of its activities with the authorities.

Further there must be no element of private equity and the authorities must have a power of decisive influence over the strategic objectives and significant decisions of the company.

Leading Counsel was asked to give an opinion on the proposed arrangement with Norse and concluded that notwithstanding that the Council had not conducted any formal procurement process it could enter into the arrangement with Norse. This was because he was of the opinion that the proposal fell within the scope of the Teckal exemption.

17. Norse Commercial Services

Norse Commercial Services is a leading services provider and a separate business arm of Norse Group. The Group has two separate business arms, the other dealing with property consultancy, with whom the Council already has a joint venture arrangement.

Originally an in-house division of Norfolk County Council, the Norse group now has a combined turnover in excess of £190 million, providing employment for more than 6000 people. The Norse Group Limited is wholly owned by Norfolk County Council and Norse Commercial Services is a subsidiary of the Norse Group.

Partnerships that harness the strength of the public sector remain central to both the day-to-day operations of Norse and its growth strategy which continues to receive favourable attention locally, regionally and nationally. JVCs now account for 50% of Norse's annual turnover.

Local authorities reluctant to outsource key services to private contractors have found the Norse joint venture approach a robust and reliable alternative. It has also proved to be far more acceptable to public sector employees and their unions but has still enabled Norse to deliver significant savings, while improving service standards.

Norse currently provides catering, cleaning and caretaking services to more than 500 educational centres, from small rural primary schools to major high schools. The cleaning and facilities management operation accounts for around £25 million of annual turnover and employs over 2500 people, delivering support services to more than 1000 client sites. Each week the Catering Division meets the demand for quality, tailor-made operations with the emphasis on healthy, fresh and locally-sourced food providing 115,000 meals through 850 staff to 500 educational settings.

Norse Commercial Services invests heavily in its workforce aiming to make its staff feel part of a forward-looking and industrious team, fully confident in their abilities and performing at their best.

Norse's experience of joint ventures suggests that there will be an increase in external revenue streams in both the public and private sectors, which will lead to increased rebates in the future. This form of partnership will ensure maximum value for schools and the residents of Devon.

Norse have expressed their desire to form a joint venture company with the Council.

18. Outline of Contract Objectives with JVC

The Council's broad aspirations for this venture are improving outcomes for children and young people, parents and carers, and securing value for money and sustainability.

The primary objectives of the joint venture will be to:

- Provide better value for money through improved performance
- Develop a bespoke service meeting the individual needs of customers
- Help sustain the local community by keeping profits and jobs in Devon
- Maintain greater Council control than through traditional outsourcing
- Streamline management and introduce a commercial culture
- Develop external revenue streams, delivering profit share through the retrospective rebate
- Promote innovation and investment in the future
- Remove the need for costly and time-consuming procurement
- Enable a 'thin client' IT solution to realise further indirect savings in areas such as HR, Payroll, Finance and General Administration

The new JVC, formed with Norse, would be called Devon Norse and will focus on the provision of school cleaning, catering and some caretaking services but with provisions that will allow for other related Council services to be added over time.

Devon Norse would be jointly owned by Norse and Devon County Council, with the shares split 80% (Norse) and 20% (Devon County Council). A 10 year agreement is proposed, with the addition of a five year break clause. Profits will be shared on a 50/50 basis. The intention is that there will be six directors, three appointed by Norse, two appointed by the Council and a jointly appointed managing director. The Articles of the Company will make provision such that Devon Norse will not be able to take certain decisions without firstly obtaining the consent of the County Council and Norfolk County Council.

The intention is that the transfer of services will take place in September 2011, although it is hoped that cleaning can be transferred at an earlier date, hoped to be 1 June 2011.

The JVC system benefits from being totally integrated with a senior officer and an elected Member of the Council on the Board to ensure that Council's core objectives will be met. In this way, the joint venture has commitment to the Council's way of thinking and is focused on delivering services in accordance with that philosophy.

To ensure a clear voice for stakeholders an Operational Liaison Board (OLB) will be appointed, giving decision-making powers to those people directly involved in the day-to-day activities. The board would typically include senior Council members, chief officers, headteachers and other stakeholders.

The JVC contract and all service delivery agreements will need to be constructed and negotiated with commercial expertise to ensure Devon secures the most favourable terms available. In particular, consideration will be given to the terms, ensuring that the contract meets the strategic and economic aims of Devon both in the short term but also the providing best value and sound governance over the longer term.

19. Conclusions

Services provided by DCCS are fully delegated to schools or other budget holders and there are no statutory responsibilities on the Authority to provide them.

As a commissioning Authority the development of a Joint Venture gives a unique opportunity for the service to be provided by an organisation which will encourage flexibility and flair providing value for money without losing the principles established by members e.g. local sourcing and supporting the local economy.

At the last Cabinet meeting, held on 12th January 2011, members made it clear that subject to a satisfactory business case, support would be given to establishing a JV with Norse Commercial Service. Evidence from the road shows suggests there will be significant expression of interest to ensure the first phase could proceed and then schools would give the new arrangements a chance to prove its worth. Norse have a good reputation and have demonstrated in other partnerships experience and commitment to work with their customers.

At a time of financial uncertainty, schools are looking for stability with a service provider able to meet their individual needs.

The current subsidy on cleaning/caretaking and catering will, with the full cost recovery of Job Evaluation, mean that these services will not impact on the Authority. Arrangements with a partner will ensure that each customer pays the economic cost of the service

It is recommended that the Norse Group be formally invited to establish a Joint Venture with the Authority on the terms outlined in the Business Case subject to the satisfactory negotiation of the various legal agreements that will underpin this arrangement.