Commissioning Options Appraisal and Extension Review for Mid Suffolk District Council and Babergh District Council

Draft Summary Report

Emma Tilbrook

Tessa Lee

Alex Davies

Dominique Sandy

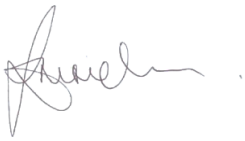
23/11/2018

Report for the Mid Suffolk District Council and Babergh District Council.

Prepared by Emma Tilbrook, Tessa Lee and Dominique Sandy

Approved by

Emma Tilbrook



Project Director

Eunomia Research & Consulting Ltd
37 Queen Square
Bristol
BS1 4QS

United Kingdom

Tel: +44 (0)117 9172250
Fax: +44 (0)8717 142942

Web: www.eunomia.co.uk

Disclaimer

E.1.0 Executive Summary

Extending the current Serco contract or adopting a new commissioning option is a significant decision, especially considering the importance of these services to residents of Mid Suffolk District Council (MSDC) and Babergh District Council (BDC) and the length of the commitments associated with these contracts. This report is designed to support this decision making process for the authorities by introducing the financial and qualitative factors associated with making such a decision.

The commissioning options modelling is intended to provide a decision-support framework to help members and senior officers arrive at the right, balanced decision for the authorities.

The authorities and Eunomia agreed that the following commissioning options would be considered and appraised as part of this project:

- Extension of the current Serco contract: based upon the extension proposal provided to MSDC and BDC by Serco.
- Outsourcing: conduct a new procurement exercise and engage an external contractor to deliver the environmental services, this could of course be Serco again.
- In-house: bring the services in-house, or in-sourcing, is another common service delivery model to deliver environmental services.
- Local Authority Company (LAC): deliver the environmental services through a LAC (commonly referred to as a Teckal company), either by setting up a new company or use an existing company founded by another authority to deliver the services. This service delivery model is growing in popularity, although it is still relatively uncommon.

Eunomia undertook the commissioning options appraisal by assessing the following two components, which are also described in the following sections:

- cost modelling and financial assessment; and
- assessment of qualitative aspects and risks.

Cost Modelling and Financial Assessment.

This phase of the assessment entailed:

- building a bottom-up cost model of the current environmental services; and
- creating a financial model for the waste collection for each of the commissioning options (listed above).

The main factors driving the results of the cost modelling and financial assessment relate to differences in assumptions on unit labour costs, including pension contributions, and corporate overheads and profit margins.

The cost modelling and financial assessment concluded that:

- the order of results of the cost modelling between the Outsourcing and In-house options will depend on the profit margin targeted by the potential bidders;
- the LAC option delivers the lowest modelled cost solution for new options, but is not a lower modelled cost than the cost of extending the Serco contract ; and
- an extension with Serco at the currently understood future cost would be the cheapest of all of the options and offer savings in terms of one-off costs and give the authorities a level of certainty in the level of service being delivered. This is due to the fact that Serco are modelled not be making a profit on the current contract, meaning that the authorities are currently receiving good value for money for their services, however this position is not commercially sustainable.

Based on the corporate overhead and profit margins modelled, the Outsourced and In-House options are both more expensive than the cheapest modelled solution.

Assessment of Qualitative Factors and Risks

Ultimately, the preferred approach for any of the two authorities will depend on the level and type of acceptable risk. A summary of the key risks and considerations is provided in Table 1

Table 1: Summary of Key Considerations

Qualitative Factor	Description
Control and Ability to Change	The main consideration around this risk area is the ease with which the authorities could implement service changes once the services have been commissioned. Such changes might be driven by the need to reflect the local priorities of the administration and the aspirations of residents and service users. Within the extension and Outsourced option, these changes would have to be negotiated with Serco or a new contractor, and the authorities are unlikely to receive the full benefit of these efficiencies. In the LAC and In-house options, it should be possible for authorities to maximise the benefits of change.

Qualitative Factor	Description
Financial Risk	Financial risk transfer is central to the concept of outsourcing service provision to an external contractor and reflects a fundamental difference between this commissioning option and the In-house and LAC options. While financial risk cannot be fully transferred, the Outsourced (and for clarity extension option) typically provides more insulation from this risk than either the LAC or In-house option.
Expertise Acquisition and Management of Workforce	When considering the effective recruitment and management of a workforce, the employment terms and conditions, and policies and procedures set out will determine the ability that the service provider (outsourced, LAC or in house) has to manage the service effectively. TUPE regulations will apply to all transferring staff, protecting the terms and conditions of employment. However, the policies and procedures will be set by the employer. This can be challenging for in-house providers who will use council policies and procedures to manage a manual frontline workforce. The LAC can choose to create its own policies and procedures, which allow it to operate the services as effectively as possible.
Operational Risk	No commissioning option will allow the authorities to fully insulate themselves from the practical and reputational risks associated with service delivery and operational failure. However, within the In-house and LAC options, responsibility for day to day operation, legal compliance, etc. (including the reputational risks associated with failure) would ultimately fall with to the authorities. In the Outsourced option, the authorities could reasonably assume that they will be able to appoint or retain a contractor with the relevant capability and experience to operate the services on its behalf.
Reputational Risk	

Qualitative Factor	Description
Demonstrating Best Value	The modelling process undertaken as part of this project has demonstrated that the extension option proposed by Serco offers good value to the authorities. Being able to demonstrate best value in the provision of services is quite straightforward in the Outsourced because the procurement process allows this to be effectively tested at the time of commissioning. Demonstrating best value is more complicated with an in house and LAC service, because there is no competition to drive down service costs. However, with the appropriate annual review processes and the periodic review of service efficiency, an ongoing understanding of the value services offer can be provided.

Market Intelligence

As part of this work Eunomia undertook an investigation into the waste market of East Anglia, London and the South East to help better understand any emerging trends.

Market congestion is expected to be at its highest for contracts starting between 2019 and 2021. MSDC and BDC are fortunate to be at the end of this busy period and we would therefore expect a well-run re-procurement to be successful, however a risk still remains around keeping enough contractors in a procurement process to generate competition.

Summary

In summary, the option to extend the current Serco contract represents good value for money for the authorities, which it may not be possible to get from re-procuring services or delivering services in another way. Additionally, if MSDC and BDC can negotiate additional KPI measures with Serco as part of the extension proposal this will provide additional confidence in the performance of the contract and allow the authorities to proactively manage service issues.

Contents

1.0 Introduction 6

1.1 Project Objectives 6

1.2 Structure of this Report 7

2.0 The Future Commissioning Options 8

2.1 Extending the Current Serco Contract 8

2.2 Continuing to Outsource the Services 8

2.3 Using a Local Authority-Owned Company 9

2.4 Bringing the Services In-House 10

3.0 Cost Modelling and Financial Assessment of Commissioning Options 12

3.1 Cost Modelling Methodology 12

3.2 Commissioning Cost Modelling Results 12

3.3 Serco Extension Proposal 14

4.0 Assessment of Qualitative Factors and Risks 15

4.1 Control and Ability to Change 15

4.2 Financial Risks 16

4.2.1 One-Off Financial Considerations 18

4.3 Expertise Acquisition and Management of Workforce 20

4.4 Operational Risks 21

4.5 Reputational Risk 23

4.6 Demonstrating Best Value 23

5.0 Market Intelligence 25

5.1 Conclusion 27

6.0 Summary and Conclusions 28

1.0 Introduction

In April 2007, MSDC and BDC awarded a joint waste and recycling collection contract of up to 21 years to Serco. The initial term of this contract comes to an end in March 2021, with the option for the authorities to extend this arrangement. In October 2018 Serco submitted an extension proposal to the authorities for a further 7 year term up until 2028.

In October 2018, Mid Suffolk and Babergh District Councils (the authorities) appointed Eunomia Research & Consulting Ltd (Eunomia) to appraise the future commissioning options available for the delivery of their waste services. This work included:

- A review of the value for money provided by the Serco extension proposal;
- Modelling of alternative options for the delivery of the waste services contract including re-procuring, bringing services into a Local Authority Company and bringing these services in house;
- An appraisal of the qualities risks and considerations associated with each option; and
- A review of the current market place for waste and recycling collection contracts to understand any trends and risks that the authorities would need to be aware of.

The following report describes the results of the analysis.

1.1 Project Objectives

This project considers three core commissioning options: continuing to outsource the service, using a local-authority owned company, and bringing the services in house (defined in more detail in Section 2.0 below), alongside the option to extend the current contract with Serco. The implementation of any different commissioning option other than outsourcing services will entail a major operational and cultural change for the authorities. Decisions on the service commissioning route for universal front-line services such as the waste and recycling services are complex.

The analysis consists of the two main components:

- the financial component, which models the costs of the different commissioning options. This analysis identifies the main cost differences between the options and areas of relative savings. However, it does not provide a conclusive answer on the absolute cost of the service under each commissioning option; and
- the qualitative and risk component, which is much more nuanced than the financial modelling discusses the risks associated with the commissioning options.

1.2 Structure of this Report

The report is structured as follows:

- **Section 2.0** introduces the discussion about the three commissioning options explored as part of this project.
- **Section 3.0** describes the commissioning options appraisal.
- **Section 4.0** summarises the main qualitative factors and risks.
- **Section 5.0** shares Eunomia's market intelligence.
- **Section 6.0** summarises the results and outcomes.

2.0 The Future Commissioning Options

There are a number of future commissioning options open to the authorities. The authorities and Eunomia agreed to undertake an assessment of the following options:

- extending the current contract with Serco (Section 2.1)
- continuing to outsource (Section 2.2),
- using a local-authority owned company (Section 0), and
- bringing the services in house (Section 2.4).

The three options in Section 2 (Outsourcing, LAC and In-house) are the dominant ways in which other local authorities deliver their environmental services and therefore our analysis excludes lesser used commissioning options such as mutuals and joint ventures, which the authorities did not view as viable options.

2.1 Extending the Current Serco Contract

This option has some clear benefits over the other three options investigated. These largely relate to the fact that this option is the continuation of a well performing service with a contractor with whom the authorities already have a good working relationship. Additionally, the authorities have the opportunity to introduce an improved level of Key Performance Indicator (KPI) reporting to improve the service offered to residents. This consideration is layered on top of the key advantages to an Outsourced contract discussed in Section 2.2.

In line with the fact that this option is an extension of the current service contract, this option would result in the lowest one-off costs, a significant consideration which could save the councils in the region of £300,000. More information about this is shown in Table 4.

2.2 Continuing to Outsource the Services

Key advantages of the contracting out commissioning option are:

- to benefit from market competition to secure a price-competitive contract;
- to provide relative certainty of service cost for the life of the contract; and
- to demonstrate best value through transparent, open competition.

The ability of the authorities to exploit these advantages will largely be determined by the following factors:

- the degree of competition achieved through the procurement, driven by the attractiveness of the contract to the market relative to other opportunities (discussed further in Section 5.0) ; and
- the structure of the contract tendered, including the authorities' and the contractor's attitude to the sharing of financial risk related to future costs and income, and the mechanisms used to regulate payment and performance.

In terms of underlying market competitiveness, this has varied over time. In more recent years, competition has reduced slightly, mainly due to market consolidation (e.g. Kier acquiring May Gurney, Amey acquiring Enterprise; Focsa being bought by FCC; and Verdant and Cory being acquired by Biffa). A substantial amount of this consolidation occurred while a number of the most price competitive businesses grappled with large contracts that were delivering a loss to the organisations. This background has resulted in a number of the consolidated companies being less proactive in bidding for contracts than previously. The current position of the market, specifically in the East of England, is discussed in more detail in Section 5.0.

Another feature of many Outsourced contracts over the last five to ten years is the winning bidder under-estimating the resources that are required to deliver the services to specification (especially so within output based contracts). There is continued pressure on business development teams to assume low resources in order to reduce bid prices, but bad publicity from under-resourced contracts has, in the last few years, driven the market towards a more risk averse approach to resource estimations.

2.3 Using a Local Authority-Owned Company

Local authority companies (LACs), otherwise known as Teckal companies, are becoming a popular vehicle for providing local authority services. An LAC is an independent legal entity, which is owned and controlled by a local authority or multiple shareholding local authorities. They can be set up to perform statutory and non-statutory services, and can provide third-party trading services. The legal framework under which they can be established was until recently primarily based on case law, but has now been codified and clarified through the Public Contract Regulations 2015.

Under this option, staff currently employed by the contractors on the existing environmental services contracts in scope (e.g. waste and recycling services, street cleansing and grounds maintenance) would transfer to the LAC upon expiry of the existing contract. These former contracted-out staff would therefore become employees of the company not the authorities, and as such would not acquire an automatic right to membership of the LGPS. This would allow the authorities to contain the cost of delivering the services as far as pension costs are concerned. LACs generally seek to avoid making a profit on services provided to the shareholding authorities, as any profit made is, in effect, ultimately owned by the authorities and could be subject to corporation tax. This doesn't preclude LACs making a profit from providing commercial services to third party customers, although there are limitations on the proportion of revenue that a LAC can obtain through third-party trading.

We note that the authorities could choose to offer the LGPS and local authority terms and conditions to LAC employees, albeit this would undermine one of the key financial benefits of this option. However, this is ultimately a financial and political decision.

With this option the authorities would have ultimate control over the delivery of the services, including the flexibility to implement changes to the service in the future without having to negotiate with a private sector contractor. LAC governance arrangements would require a clear process to be followed to bring about service change,

but the authorities would ultimately be able to exert direct control. It would, however, operate at arm's length from the authorities and as such would potentially allow for the services to be operated on a more commercial footing, including in relation to the development of commercial waste and recycling services. In the context of service provision to the authorities, 'more commercial' is likely to mean utilising management systems and processes more commonly found in the private sector regarding efficiency and productivity, HR and workforce performance management, financial reporting, and governance.

The corollary to this commissioning option is that, as the shareholder, responsibility for any service failures, staff or management disputes, commercial risk related to future increase in operational costs, or decrease in income from traded services will also lie wholly with the authorities (or jointly with the owning bodies in the event that the authorities join a pre-existing LAC already established by other local authorities).

Commissioning services via an LAC could be done either through the LAC successfully tendering through a competitive public procurement exercise or via direct award without going through public procurement. Avoiding a public procurement exercise would represent a saving on procurement costs but could only be achieved through the LAC meeting specific exemption rules. The benefits of including an LAC in a competitive procurement process is that it would be easier for the authorities to demonstrate that best value has been obtained and it would allow for the operational budgets and service plans to be properly and rigorously tested through a competitive process to ensure they are fit for purpose.

2.4 Bringing the Services In-House

The option of bringing services In-house (or in-sourcing) is always open to local authorities at the end of a contract, as there is no legal requirement to retender services, provided best value can be demonstrated. One advantage of In-house services is that they are inherently more flexible, as the local authorities are not constrained by the terms of a contract with a third party. (Having said that, contracts can also be drafted to be flexible, although this tends to be at the expense of a greater degree of retention of financial risk by the contracting authorities.)

Ultimately, compared with an Outsourced provision, an In-house service provides the authorities with the control required over future service changes without the need to negotiate with a contractor. The In-house service option also avoids the cost of meeting a contractor's corporate overhead and profit margin cost, albeit this saving is countered by the additional staff costs incurred in an In-house commissioning model, the main one being the public sector pension costs. Compared to re-tendering, while the authorities would avoid one-off procurement costs, there would also be a need to manage significant legal and management costs to manage the transition to an in-sourced service.

The lack of access to the market as a source of creativity, innovation and problem solving can also represent an inherent limitation of the in house commissioning model. Our understanding of the current position is that the authorities do not have most of the expertise necessary to run the full range of waste services In-house and would almost

certainly have to either rely on the capability of those managerial/supervisory roles that would be expected to transfer to the authorities under TUPE regulations or on buying-in such expertise. Making a success of regaining responsibility for direct operational service management would depend heavily on identifying and appointing the right people.

Perhaps a key issue with bringing services In-house relates to workforce pension costs. Once an employee has been transferred from the employment of a contractor to the authorities, that employee would become eligible for membership of LGPS. This would be likely to significantly increase the unit labour cost associated with delivering the services. Significant further cost would arise if the authorities subsequently decided to outsource the service again. In this case, the pension cost would be retained in the long term, as the contractor would likely be required to provide a comparable scheme, or to become an 'admitted body' to the LGPS. So, in addition to increasing the unit labour cost through the provision of a much more expensive pension, the authorities would also have to pay a profit margin to the contractor. This double effect could see any financial benefits of subsequent outsourcing being removed.

3.0 Cost Modelling and Financial Assessment of Commissioning Options

This section presents the financial modelling of the commission options including:

- the cost modelling methodology (Section 3.1), and
- modelling results

3.1 Cost Modelling Methodology

The financial modelling undertaken allows the authorities to understand the comparative cost of each commissioning option. By using current service costs as a baseline position, we are able to effectively model the impact of the main changes under each option (such as the inclusion of pension contribution under a local government pension, or corporate overhead and profit). An important consideration is that the modelling identifies areas of savings between the commissioning options, but it does not provide a conclusive answer on the absolute cost of the service under each commissioning option

The cost modelling process entails building a bottom-up cost model of the current baseline service resources (workforce, vehicles and plant, consumables and overheads) and then testing different commissioning option scenarios based on that underlying resource model.

The following activities are completed as part of the cost modelling process of the commissioning options appraisal:

- Data gathering – Collection of operational and financial data for the current service to develop the baseline model for the waste and recycling services.
- Build baseline cost model – The objective of this step is to understand the current costs of delivering the service and reflect this in the model. The baseline is built in order to calibrate key variables within the model, such as the current contractor profit margin. This is important as it provides the basis for the key monetary aspects of the modelling of the future options.
- Build commissioning cost models – Once the baseline model of the current service is established, changes to key variables are overlaid in the model to represent what may happen if each of the different commissioning options were to be implemented.

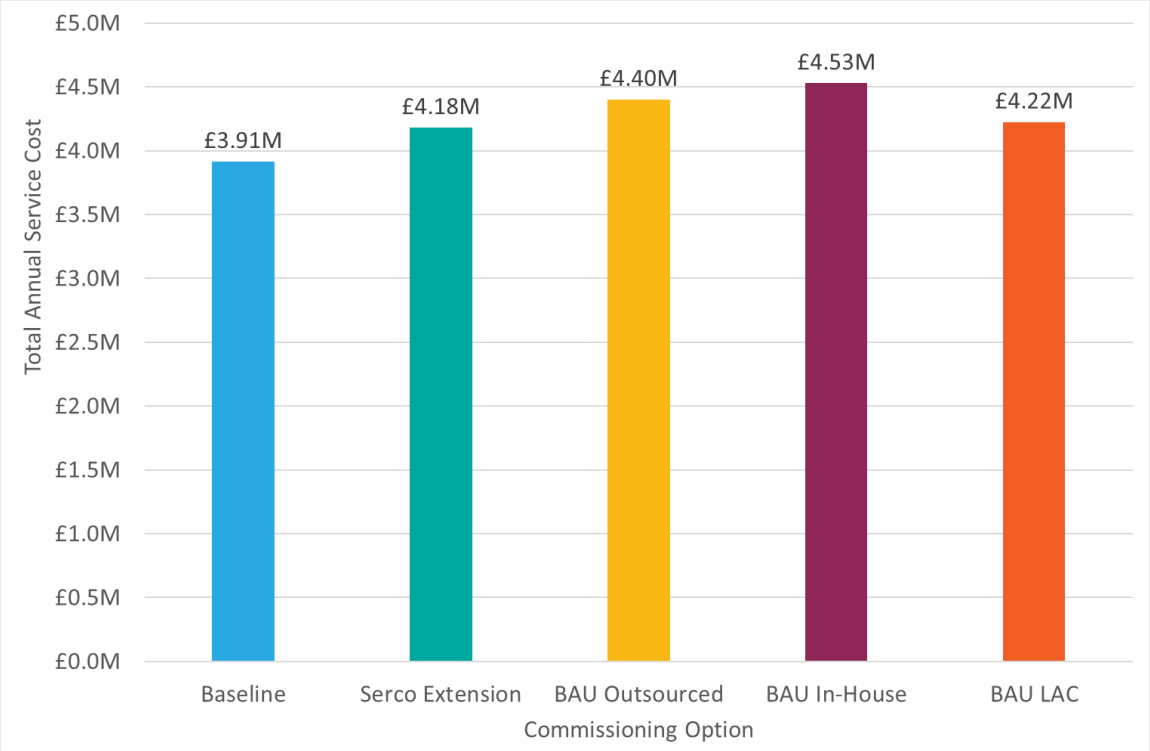
3.2 Commissioning Cost Modelling Results

The annual service costs for Mid Suffolk and Babergh District Councils in Figure 1 show that:

- We were able to reproduce the current contract cost of £3.91M in the baseline model (blue bar), providing confidence in the comparative modelling of future options.

- The modelling has indicated that Serco are currently making a slight loss on the contract of 5.28% (Assuming they are contributing 4% to corporate overheads). This means that all of the future options are modelled as being more expensive. The justification for this is that we have not expected any of these options to be delivered at a loss so an additional cost is required to make up for this current loss.
- The Serco extension option (teal bar) is the cheapest of all future options at £4.18M. This option assumes an additional cost per year of £265,000 which results in Serco making a profit after contribution to corporate overhead, albeit a small one.
- In comparison, re-procuring the contract was found to be the second most expensive option at £4.40M (yellow bar). For the future Outsourced option, we assume that the profit margin achieved would be higher and that this would be at the industry standard of 7%. This increase in profit margin explains the cost difference with the current contract.
- The In-House option is modelled as being the most expensive at £4.53M (purple bar). This is due to the increase in pension contribution and therefore staffing costs associated with bringing a service In-House. While terms and conditions could also be modelled to improve, the most substantial element of the staff cost change is the pension cost.
- The year-one LAC commissioning option is the second cheapest option (orange bar), after the Serco extension, modelling at £4.22M. This is because it benefits from savings associated with reduced pension contribution compared with the In-House option, and zero profit margin.

Figure 1: Annual Cost of Each Commissioning Option for Mid Suffolk and Babergh District Councils



3.3 Serco Extension Proposal

The extension proposal provided by Serco includes two main components which are made up of savings available to Serco and an increase in annual cost to the authorities.

Serco have reported that they are making a loss based on the current contract arrangement, this was reported to be approximately 6% in 2017. The baseline modelling undertaken confirms that after contributing to Corporate Overheads the contract is making a loss of 5.28%. This means that currently the authorities are modelled to be paying below market rates for their services.

The extension proposal allows Serco to improve the financial state of the contract, and return to a position where a profit is made from the contract, as well as providing a contribution to corporate overheads. The proposal requests an additional payment of £265k per annum for the additional seven years. Alongside this it states that savings of £198k could be made on the contract. These savings consist of:

- Removal of set-up costs, written off over the original contract term
  - *Contract set up costs*
  - *Depot set up costs*
- Routing Optimisation
  - *Introduction of optimised routes*
  - *Introduction of an additional round (offsets partial routing savings)*
- Improvements in Vehicle Maintenance

- *Reduction in unplanned maintenance*
- *Introduction of Ops Manager (off sets full vehicle maintenance savings)*

Should all of these savings be available and achieved, it is expected that Serco will be able to achieve the increase in revenue and return a profit over the final seven years of the contract. It is estimated that, having already accounted for a 4% contribution to Corporate Overheads, this profit could be up to 6.6% based on the baseline year of the contract, the additional contract cost, and the savings provided in the proposal.

In discussion with the authorities, it was agreed that these savings do not have an impact on the cost of the contract, and it is solely down to Serco to ensure the savings are made to ensure they can reach a position in which they are generating an acceptable level of profit. Therefore we recommend that it be agreed with Serco that this risk is retained, and should the savings not be realised there is no requirement on the authorities to contribute additional money.

Although this proposal offers good value to the authority, it is also advantageous to Serco, especially if the predicted efficiency savings (which Serco are confident of) can be made. Therefore, Eunomia would recommend entering into further negotiations with Serco regarding the additional £265k per annum payment, as this extension represents guaranteed long term turnover to the business for minimal investment and the authorities should be able to share in some of this benefit.

4.0 Assessment of Qualitative Factors and Risks

The following section contains a summary of the qualitative factors and risk associated with each commissioning option, broken down into:

- Control and ability to change (Section 4.1),
- Financial risks (Section 4.2),
- Expertise acquisition and management of workforce (Section 4.3),
- Operational risk (Section 4.4),
- Reputational risk (Section 4.5), and
- Demonstrating best value (Section 4.6).

4.1 Control and Ability to Change

The main consideration within this risk area is the control the authorities have over the day to day management of their services, and the ease with which the authorities could implement service changes once the services have been commissioned. Such changes might be driven by the need to reflect the local priorities of the administration and the aspirations of residents and service users.

Table 2 summarises the key considerations associated with each commissioning option.

Table 2: Control and Ability to Change

Commissioning Option	Key Considerations
Outsourcing	• Significant service changes or efficiency initiatives under the contracted out option are likely to involve extensive negotiations with a third party and sometimes also legal compliance considerations in respect of public procurement regulations. • Where the delivery of efficiency savings is the key priority, it is likely that savings would have to be shared with the contractor in order to incentivise the contractor to deliver change and also to avoid the risk of profit erosion from being priced against at the tender stage. • Flexibility can be built into contracts and provided for in the procurement process, but this is inevitably at the expense of a degree of financial risk transfer, with traditional fixed price contracts being less suitable where considerable flexibility and regular change is envisaged by the contracting authorities.
Serco Extension	Same as for outsourcing. • As the service provided by Serco is known and understood there is an option to implement KPI's to the extension, specific to Serco's current performance.
LAC	• Where efficiency savings have been identified the authorities should be able to recognise all of the financial benefit of these. • The risk of negotiating any potential changes to work practices or service delivery is the responsibility the authorities or the LAC to negotiate (as is the success of operational implementation).
In-House	

4.2 Financial Risks

Financial risk transfer is central to any decision regarding the ways in which services are commissioned.

This is one of the areas in which, theoretically, the commissioning options differ most greatly, with outsourcing providing the greatest insulation from financial risk. However, the reality of being able to transfer this risk is often more difficult.

Table 3 provides details of the key financial risk considerations associated with each commissioning option.

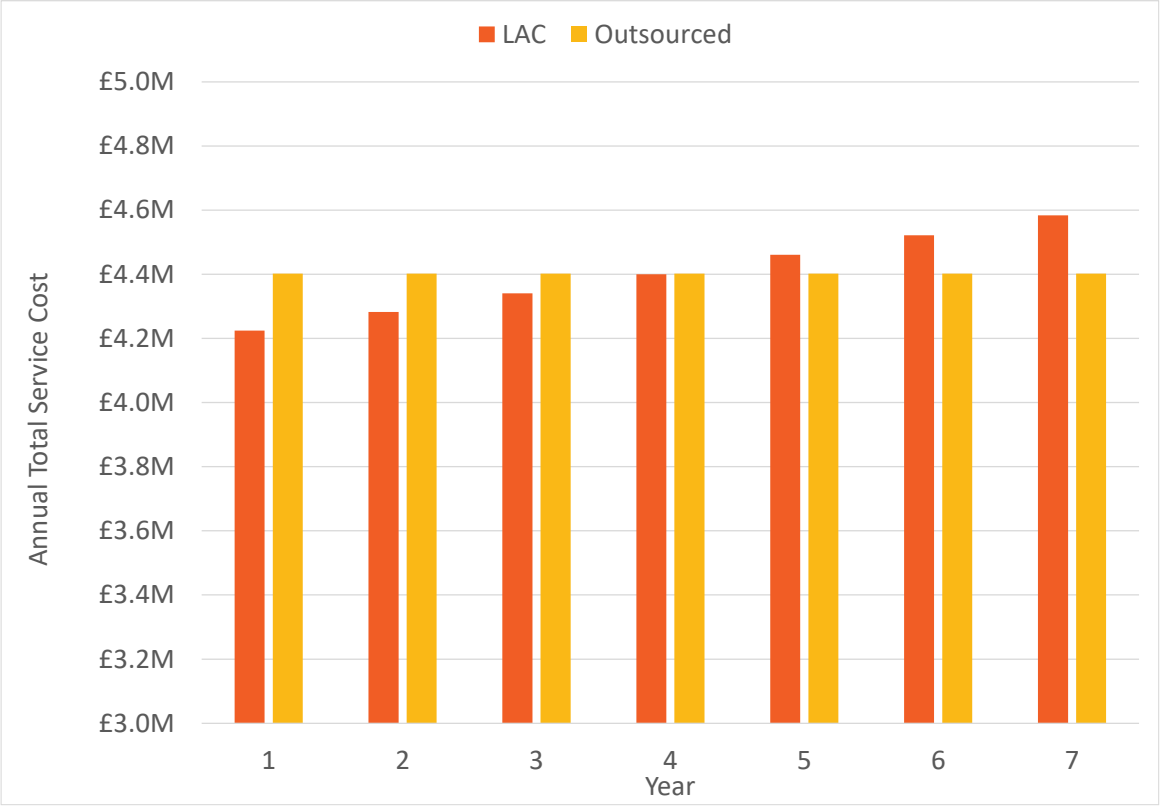
Table 3: Financial Risks

Commissioning Option	Key Considerations
Outsourcing	• The financial risk associated with the day to day management of the service (e.g. overtime working etc.) is retained by the contractor. • In practice, the market doesn't always work perfectly as a means of transferring financial risk. There have been a number of recent high-profile examples of outsourced environmental services contracts failing due to having been under-bid or terminating early due to contractor losses. In some cases, as part of these failures, the contractor has looked to vary the contract to minimise losses, or brought commercial claims to the authorities (which in some cases they have successful).
Serco Extension	Same as for Outsourcing. • The collaborative working adopted between the two authorities means that some of the day to day financial risk of running the contract is absorbed by the authority in terms of hours spent filling in for missing contractor staff. Planned changes in the way KPIs are used to manage service should address this issue by charging local authority time back to Serco.
LAC	• The true cost of providing the services must be understood with greater accuracy. • Operational and budget management must be extremely tight to reduce risk of overspend. • Where service change is minimal, the risk of overspend is considerably reduced, but there have been several recent examples of local authorities significantly overspending in service delivery areas such as waste collection services.
In-House	

Figure 2 provides an example of the impact of LAC overspend. It shows that only a 1.369% annual increase in the waste budget would mean that over a 7 year period the cost of delivering the service through an LAC would be the same as the modelled cost of outsourcing. This increase would be a total increase of 7.8% in budget over the 7 year period. The purpose of this analysis is to demonstrate that in comparison to an

outsourced contract the LAC does not have the same level of financial security and only a small increase in annual contract cost can easily erode any year one savings.

Figure 2: LAC vs Outsourced Overspend Analysis



4.2.1 One-Off Financial Considerations

While not included in the modelling, there are one-off costs associated with each of the options. These are shown in Table 4. This includes procurement technical support, other external support, detailed operational design and operational mobilisation, and legal support for the set-up of the LAC.

Most important to note here is how the costs change between the options themselves. External support for procurement is a significant saving for the In-House and LAC options compared to the Outsourced option. However, when opting for outsourced delivery of environmental services, preparation and mobilisation costs are not included here as a one-off cost, but are effectively included in the annual contractor payment. Specialist legal support associated with LAC set-up is clearly avoided in the two non-LAC options.

The Outsourced costs are based on the assumption a future contract would be procured by restricted procurement. A higher procurement cost would be expected if the contract were to be procured by Competitive Dialogue. The Serco Extension option is expected to have minimal one-off costs.

Table 4: One-off Costs

	Outsourced	Serco Extension	In-House	LAC
Procurement Technical Support	£30,000	-	-	-
Legal and Financial Support	£20,000	£10,000	£50,000	£50,000
In-House/LAC 'bid'/Mobilisation	-	-	£270,000	£290,000
LAC Set-Up Legal Support	-	-	-	£60,000
Contingency (10%)	£5,000	£1,000	£32,000	£40,000
Total	**£55,000**	**£11,000**	**£352,000**	**£440,000**

4.3 Expertise Acquisition and Management of Workforce

When considering the effective recruitment and management of a workforce, the employment terms and conditions, and policies and procedures set, will determine the ability of the service provider (outsourced, LAC or in house) to manage the service effectively. In all examples, TUPE will apply to transferring staff, ensuring that terms and conditions are not eroded or changed without agreement from trade unions. Examples of key areas of consideration are as follows:

- **Drugs and Alcohol Policy**: This is not part of the transferring employee's terms and conditions of employment, therefore, its form and use are at the discretion of the employer. This is a significant health and safety issue and one that all private sector contractors have a zero tolerance approach to, including the use of random drug and alcohol screening.
- **Disciplinary Procedure**: As above, this procedure is at the discretion of the employer. It is not uncommon to have a number of disciplinary issues 'live' in a service at any one time. It is essential that the disciplinary policy is transparent, fair and focuses on achieving the highest standards of health and safety.
- **Performance Related Pay**: To recruit the best candidates at a management and supervisory level it is often advantageous to provide performance related pay, linked to the overall KPIs and performance of a service. This is equally true for staff during times of change (such as service change) or as a reward for high levels of performance.
- **Sickness and Absence**: Sickness and absence is an ongoing risk to the success of any frontline operation. The way in which absence is managed and the provision for sick pay within employment contracts will help to mitigate this risk.

Table 5 provides details of the key considerations associated with each commissioning option.

Table 5: Expertise Acquisition and Management of Workforce

Commissioning Option	Key Considerations
Outsourcing	• TUPE will apply to transferring staff and terms and conditions. • Existing company policies will be implemented across the service. • Policies and procedures tend to focus on achieving the right outcome in terms of health and safety and efficient operational management of the service. • Unless agreed as an additional payment with the local authorities, additional payments (in terms of salary or incentive) will impact a contractor's financial performance.

Commissioning Option	Key Considerations
Serco extension	• Same employer so staff would be entitled to the same terms and conditions as current.
LAC	• TUPE will apply to transferring staff and terms and conditions. However, the authorities could choose to offer local government terms and conditions of employment and entrance to the LGPS. • The LAC is free to develop its own policies and procedures (this is a key mobilisation task). Therefore, to some extent it can benefit from the best of the outsourced and in house approaches. • The LAC is free to make additional payments to staff in terms of salary or incentives. However, these will need to be within the parameter of the business plan agreed by the shareholder board.
In-House	• Although TUPE will apply to transferring staff, a two tier workforce is unlikely to be acceptable to a local authority. Therefore, staff would be transferred on local authority terms and conditions. • In general these have more favourable sick pay and therefore, it is not uncommon to see sickness levels within a workforce increase. • A local authority is unable to financially incentivise staff performance as effectively, making times of change within the service more difficult to manage. • The disciplinary procedures within local authorities can sometimes be more complex, potentially making the service more difficult to manage. • As staff terms and conditions are likely to improve, this should support greater retention of staff within the workforce, increasing stability within the service.

4.4 Operational Risks

A key element of the qualitative assessment is understanding the confidence that the authorities have the ability to deliver services directly, as well as the appetite for the operational risk associated with service delivery. However, no commissioning option will ultimately allow the authorities to fully insulate itself from the risks associated with service delivery and operational failure.

Table 6 provides details of the key considerations associated with each commissioning option.

Table 6: Operational Risks

Commissioning Option	Key Considerations
Out Sourcing	• The authorities could reasonably assume that it will be able to appoint a contractor with the relevant capability and experience to operate the services on its behalf. • Day to day operational risk is passed to the contractor, with reputational risk being retained by the authorities (see Section 4.5 for further details).
Serco Extension	• Serco's competency at providing the service is already known and can be assumed will continue throughout the contract extension.
LAC	• Operational risk is the company's. However, as the company is wholly owned by the authorities, responsibility ultimately remains with the authorities. • Key back office functions such as HR, health and safety, payroll, pensions, procurement and IT would need to be mobilised to support these services. • Alongside these business support functions, additional management support would be required to transition and oversee these services, and also provide a business continuity role should the existing management team not transfer.

Commissioning Option	Key Considerations
In House	• Operational risk is the authorities' including all aspects of operational management and compliance. • Additional management support would be required to transition and oversee these services and also provide a business continuity role should the existing management team not transfer. • Back office and support functions would be provided by the authorities. • If the authorities do not run similar frontline services directly, it is likely that additional support in areas such as health and safety, and HR will be required to support these services. • The support required for an LAC and in house operation is usually broadly similar.

4.5 Reputational Risk

No commissioning option will allow the authorities to be fully insulated from the reputational risks associated with service delivery and operational failure. Therefore, to some extent the reputational risk is the similar under each option, depending on the approach of the authorities to publicly placing the 'blame' for any failure on a contractor or LAC.

If any of the authorities decide to examine the In-house or LAC commissioning options more closely, we would recommend the development of a clear and transparent method for monitoring the performance of the delivery body and that this forms a key part of the mobilisation of the services. This will ensure that the level of oversight and scrutiny of the quality of the service being delivered is comparable to that required were the authorities to outsource service delivery to a contractor.

The Serco extension option will not require a mobilisation or service transfer period. This will prevent any reputational issues resulting from teething problems during new contract/service structure. On the other hand, if the perception of the current service is not positive, a contract continuation may not be perceived as well as a change.

4.6 Demonstrating Best Value

Being able to demonstrate that any commissioning option demonstrates best value to the authorities (especially where this involves a change from the current approach) is key aspect of the business case for its implementation.

Table 7 provides details of the key considerations associated with each commissioning option.

Table 7: Demonstrating Best Value

Commissioning Option	Key Considerations
Out Sourcing	• This is quite straightforward in an outsourcing option, as the procurement process allows this to be effectively tested at the time of commissioning (this is not to say services always provide best value during the life of the contract). • However, the cost of the service will only be confirmed at the point of evaluation of the submissions, and will take into account not just the cost of delivering the service but also a view on the allocation of risk within the contract.
Serco Extension	• Our modelling demonstrates that an extension to the contract would provide good value for money for the authority. Typically towards the end of a seven year contract term it is not unusual to see more significant profit margins than currently being made by Serco, supporting the view that the contract price represents good value to the authority.
LAC	• Detailed modelling will be required to support the business case for change and also to underpin the ongoing business plan. • This is more complicated with an in-house and LAC provision, because there is no competition to drive down service costs. • With the appropriate annual review processes and the periodic review of service efficiency, an ongoing understanding of the value services offer can be provided.
In House	

5.0 Market Intelligence

The following section of the report provides an overview of the current market for waste and recycling collection services in East Anglia and the South East of England, based upon publically available data and information. The aim of this intelligence is to support decision making regarding any future changes to the way services are commissioned.

Local Authorities in London, the South East and East Anglia commission their services in a variety of ways, meaning that at one time there could be a number of authorities re-procuring services. Figure 3 summarises the way in which each borough currently commissions their waste and recycling services.

Figure 3: Waste and Recycling Collection Contracts in London, South East and of East Anglia

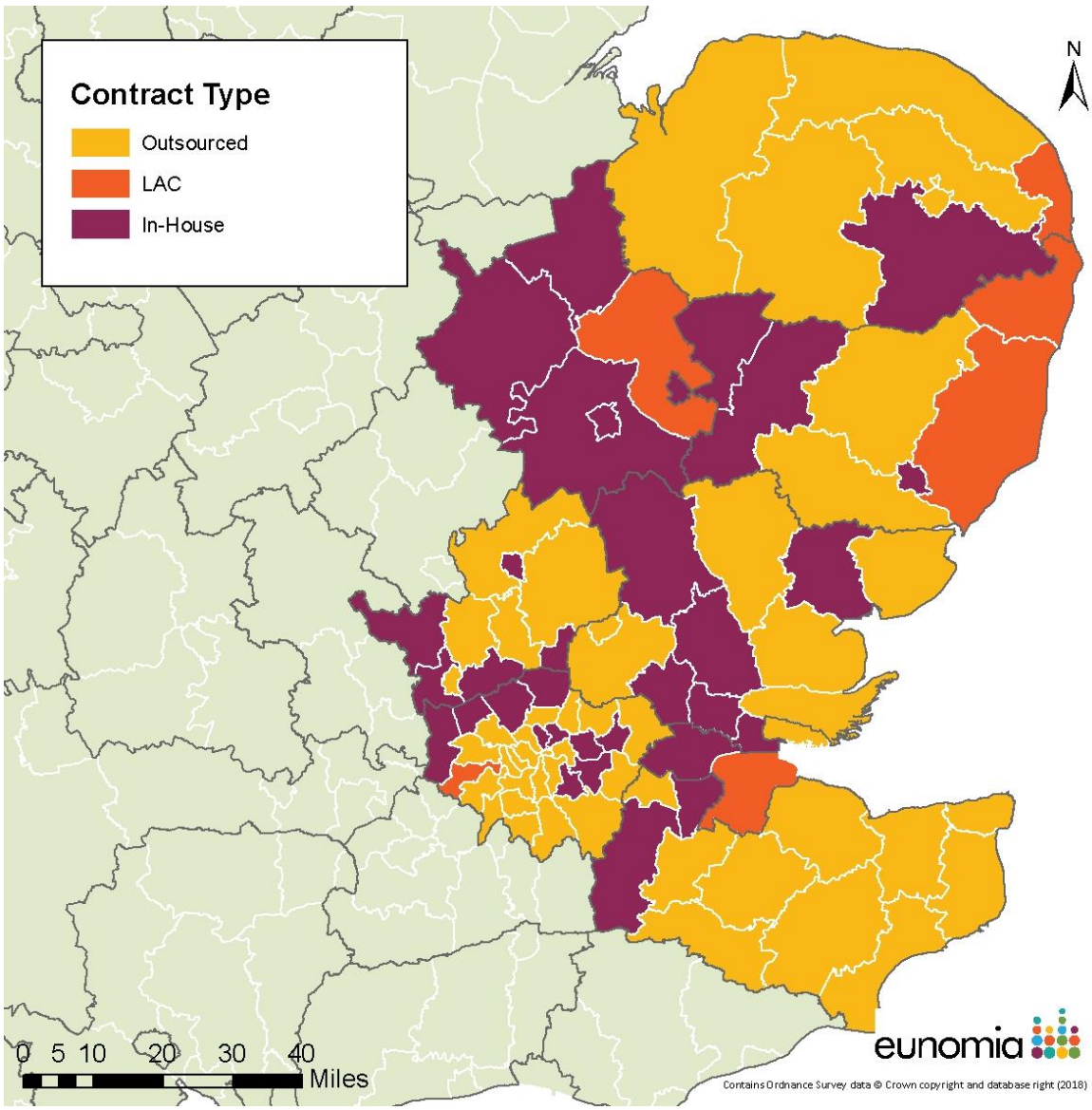


Figure 4 illustrates for those authorities who currently outsource their services, the geographical spread of contractors in the region. There is no dominant contractor in the area, with Biffa, Serco, Suez and Veolia operating regionally. This is relevant to the outsourcing commissioning option as contractors may be more likely to bid on a contract if they are working regionally already.

Figure 4: The Contractors Working in the Outsourced East Anglian Authorities

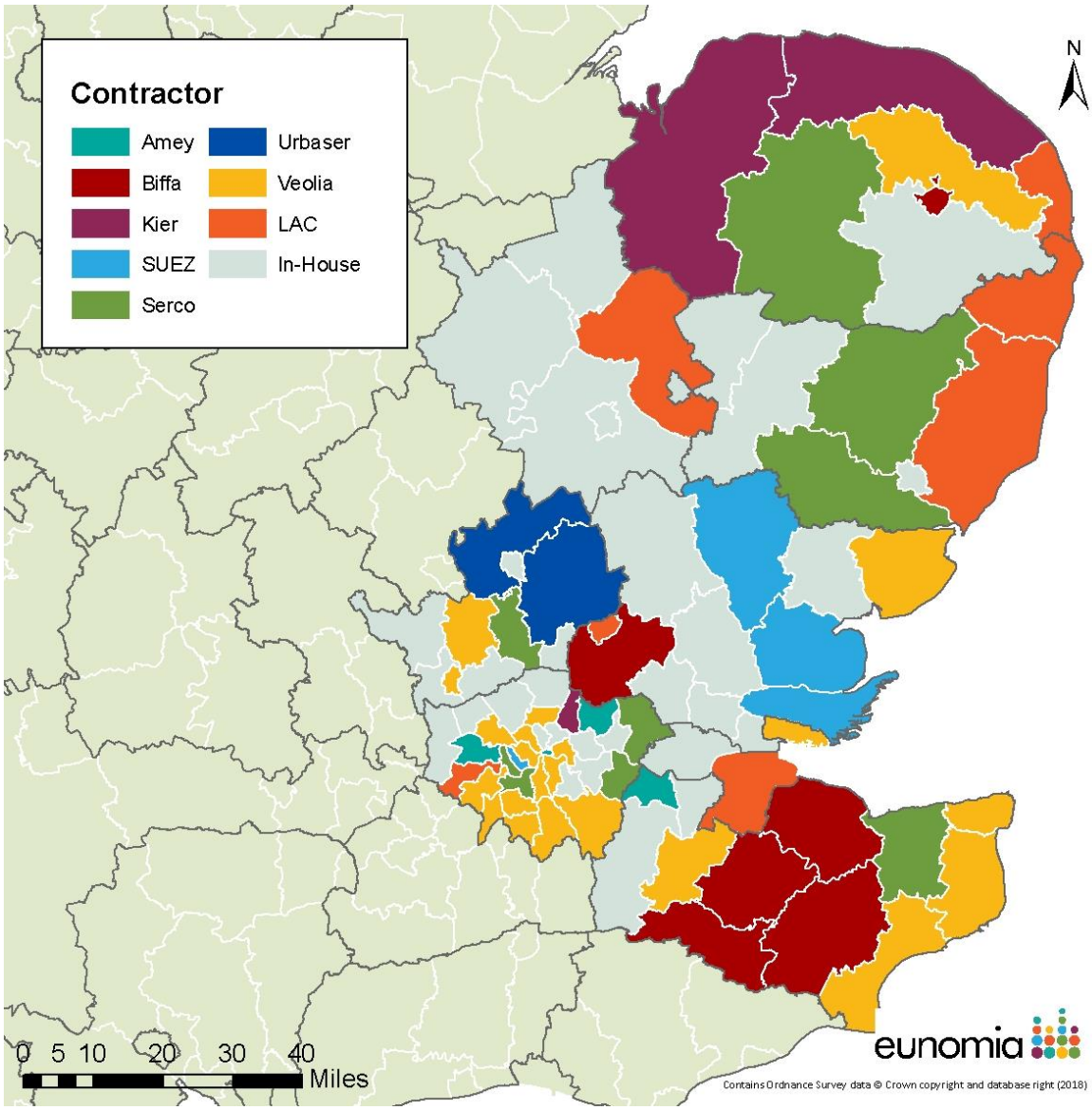
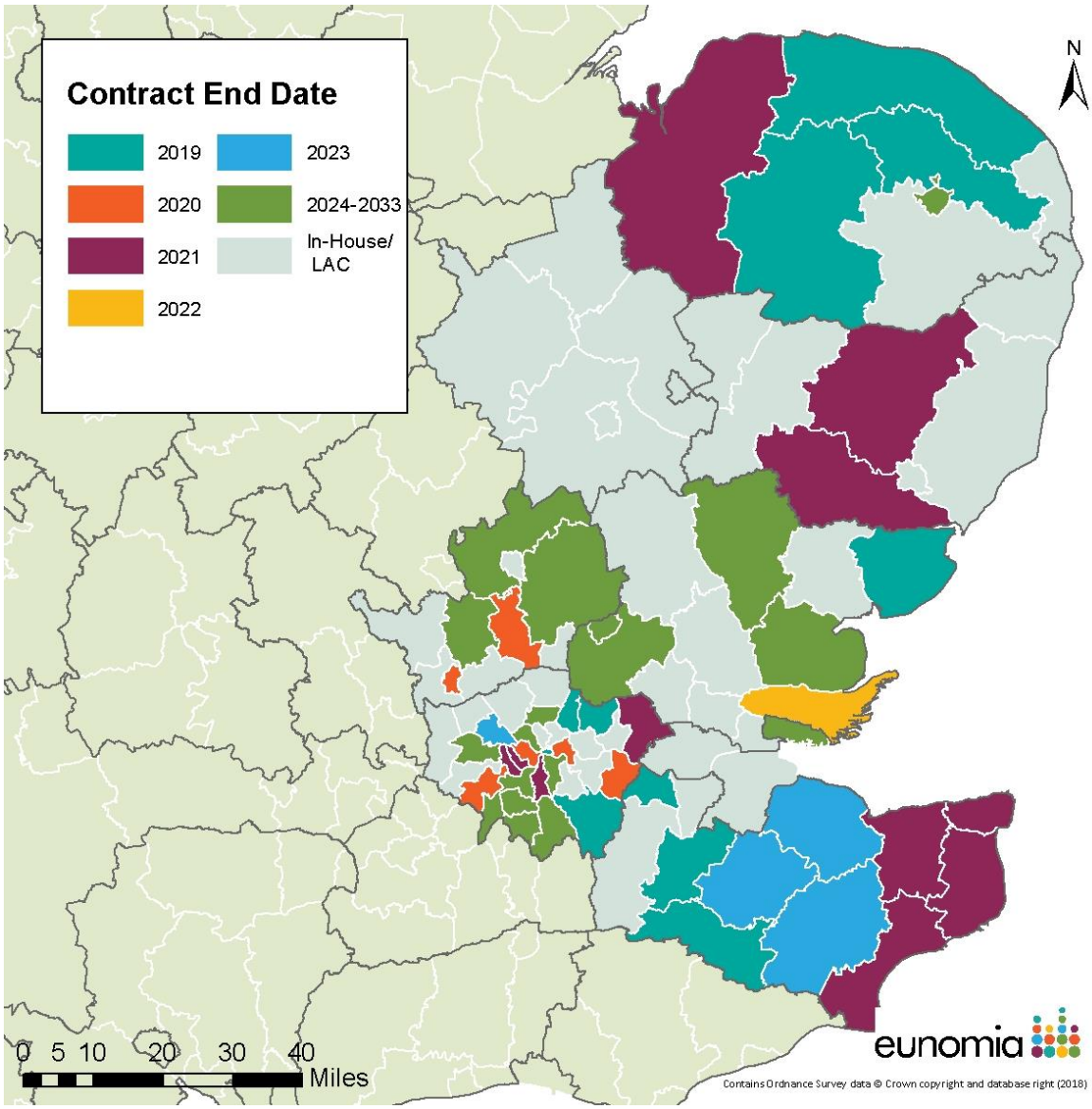


Figure 5: Contract End Dates (Calendar Year) for Outsourced Eastern Authorities



5.1 Conclusion

What is evident upon investigation of Figure 5 is that market congestion is expected to be at its highest for contracts starting between 2019 and 2021. MSDC and BDC are fortunate to be at the end of this busy period and we would therefore expect a well-run re-procurement to be successful

Unlike other regions, there is no particular dominance by any one contractor which indicates that all big players may be interested in bidding to strengthen their position. Contractors who are present in neighbouring authorities include SUEZ and Veolia, with Biffa and Kier also present in East Anglia. It should also be noted that we would also expect Serco to be interested should the contract be re-procured.

6.0 Summary and Conclusions

In summary, based upon the financial analysis undertaken, the Serco extension option offers good value to the authorities and has a lower cost than the other commissioning options. This reflects the fact that the profit margin is lower than would be expected in an outsourced contract and the corporate overheads and pension contributions are lower than would be expected for an in-house or LAC service.

The extension also has some significant benefits over the other the options. Firstly, extending the current contract means that the authorities will be receiving a tried and trusted service that is currently performing well for residents and officers alike. This has the benefit of absorbing some of the reputational and initial performance risks that may be more present in any of the other options. Secondly, having investigated the financial aspects of this option, we understand that the additional costs will enable Serco to derive a profit from this service, but not a particularly large one. This means that it is a financially beneficial proposition compared to re-procuring the contract where we would expect bidders to target an industry standard profit margin of 7%. Another benefit that extending the current contract has is that it would alleviate the need for high one-off legal, procurement and mobilisation costs.

The extension option with Serco would include the addition of certain KPIs which have their own value. While this option is, and all the other future options are, more expensive, the worth that can be derived by the implementation of these performance measurements should be considered by the authorities.

Market analysis indicated that the authorities' contract is due to finish during a very busy period of procurement for the region. Our interpretation is that as the contract end date is in 2021 and at the end of the busy period, a well run procurement would still be successful