

EAST HERTS COUNCIL

EXECUTIVE - 6 OCTOBER 2015

REPORT BY THE AMBASSADOR AND EXECUTIVE MEMBER FOR
SHARED SERVICES

THE HERTFORDSHIRE BUILDING CONTROL PROJECT

WARD(S) AFFECTED: ALL

Purpose/Summary of Report

- The report provides an update on the progress of the Hertfordshire Building Control project. The project is a joint venture between seven District Councils in Hertfordshire.

RECOMMENDATIONS FOR EXECUTIVE That:

(A)	the full business case and the joint arrangements for the provision of Building Control functions, as now submitted, be approved;
(B)	authority be delegated to the Director of Neighbourhood Services, in consultation with the Portfolio Holder, to take all necessary steps to proceed with (A) above; and
(C)	the start-up funding arrangements, as detailed in paragraphs 5.13 to 5.16 of the report submitted, be approved.

1.0 Background

1.1 Local Authorities (LAs) have a statutory duty to provide a Building Control Service. This means that if an application is submitted to the authority, it has a duty to ensure that the works comply with building regulations. Originally LAs were the sole supplier of this service. However, in 1997 the government gave powers that allowed Approved Inspectors (AIs) to also act in this capacity. This competitive environment has meant that it is more difficult for LAs to retain their market share and grow new commercial work. Consequently many LAs, including East Herts have struggled to

ensure that the Building Control service they provide is both value for money and cost neutral. In order to sustain the service, new options for service delivery will need to be explored.

2.0 Report

2.1 East Herts District Council together with six other authorities (Welwyn Hatfield, North Herts, Stevenage, Three Rivers, Hertsmere and Broxbourne) has been working on proposals for joint arrangements.

2.2 The Council were concerned about the following issues:

- The majority of Hertfordshire LA Building Control services are run at a cost
- LAs find it difficult to market their services to commercial clients and are struggling to maintain householder client base as Als are seen as more flexible and value for money.
- It is becoming increasingly difficult to recruit and retain high quality and specialist staff. Most LAs now have an ageing Building Control workforce.
- It is difficult to run services efficiently with current resources and overheads.

2.3 In order to take the model forward a project board was set up consisting of the seven Chief Executives or their nominated Directors and the East of England Local Government Association (EELGA). The board appointed a Project Manager and a Project Officer from North Herts Council for 15 hours per week to progress the project. In addition it was decided that the model would need some funding to pay for initial set up costs, therefore all seven authorities contributed to a central fund.

2.4 Expert legal advice for the project has been procured and this has led to the board deciding that a corporate structure would be the most efficient way to set up and run the arrangement, offering maximum flexibility with minimum exposure to procurement regulations and Corporation Tax.

2.5 The Executive at its meeting on 5 August 2014 approved the proposals now detailed, that the report be noted; and in principle, the project move forward and a full business case be submitted for approval at a later date.

3.0 Proposed Corporate Structure

3.1 The proposals are to establish three new corporate vehicles as follows:

- Delegable building control functions to be supplied to the Councils will be delivered on a non-profit making basis by a company limited by shares referred to as LA7;
- Approved Inspector work, work for any customers other than the Councils including other local authorities, private developers etc. and any work other than AI work which the 7 Councils may wish H7 to perform will be delivered on a profit making basis by a company limited by shares referred to as H7; and
- A new company limited by shares will be formed to act as a holding company for LA7 and H7 (HoldCo)

3.2 The proposals will have the following advantages:

- It will create efficiencies in terms of back office costs such as ICT and building charges.
- It will allow for rationalisation of resources.
- There can be greater flexibility in the way that staff are deployed, based on market need.
- The set up will allow for greater flexibility in terms of incentives and training for staff, improving retention, attracting specialist staff and job satisfaction.
- The model allows for any surplus to be re-invested in terms of incentives and training for staff, improving retention and job satisfaction.
- The model allows for any surplus to be re-invested in both the company and the Local Authorities.

3.3 In the report, HoldCo and its subsidiaries are referred to as the Building Control Group.

3.4 This will be supplemented by up to 6 of the Councils delegating building control functions which may not currently lawfully be externalised to LA7 or H7 to a single Council (LA1) under section 101 of the Local Government Act 1972.

3.5 The Councils delegating such functions would need to make a formal resolution to do so for a set period of time (although a Council can always elect to cease its delegation) and the Council accepting the delegations would need to make a formal resolution to accept such functions. The terms of the delegation including any payments towards the costs of LA1 as the Council which

employs the officer(s) who are to exercise the statutory functions and make decisions could be covered in an inter-authority agreement.

- 3.6 The decision made by LA1 on behalf of the other Councils would be routine and non-controversial decisions. The other Councils could elect to retain full decision making powers for strategic, policy-related or politically sensitive decisions if they wished.
- 3.7 The terms and scope of any delegation of functions can be drafted to reflect whatever each Council prefers. Although, uniformity between Councils terms of delegation will help streamline arrangements and drive efficiencies.
- 3.8 As part of the delegation, any Council would appoint one Council (LA1) as its agent for the purposes of the service contract with LA7 in order to streamline arrangements.
- 3.9 If one or more Councils wish to delegate their client or public administrative building control functions to another Council on its behalf then this should be through a delegation under S101 of the Local Government Act 1972 with the contractual back up and enforceability of an inter-authority agreement.

4.0 Proposed Contractual Structure

- 4.1 Each of the Councils will enter into contractual arrangements with LA7 for building control services to buy building control services from LA7 in return for the payment by them of a service charge to LA7.
- 4.2 Although there are a number of alternatives, Councils would delegate the purchase of building control services and/or non-delegable statutory functions to one Council (LA1). LA1 would act as the Councils' agent and in that capacity enter into a single bilateral contract with LA7.

5.0 Financial Implications

- 5.1 Detailed financial models based on partners' current cost/income and budgets have been formalised and consolidated in a uniform manner to provide a like-for-like comparison of each partners' financial position. This was then used as a basis to create a future cost model which looked to set the likely income and expenditure levels of the Building Control Group for 5 years from 2016/17 to

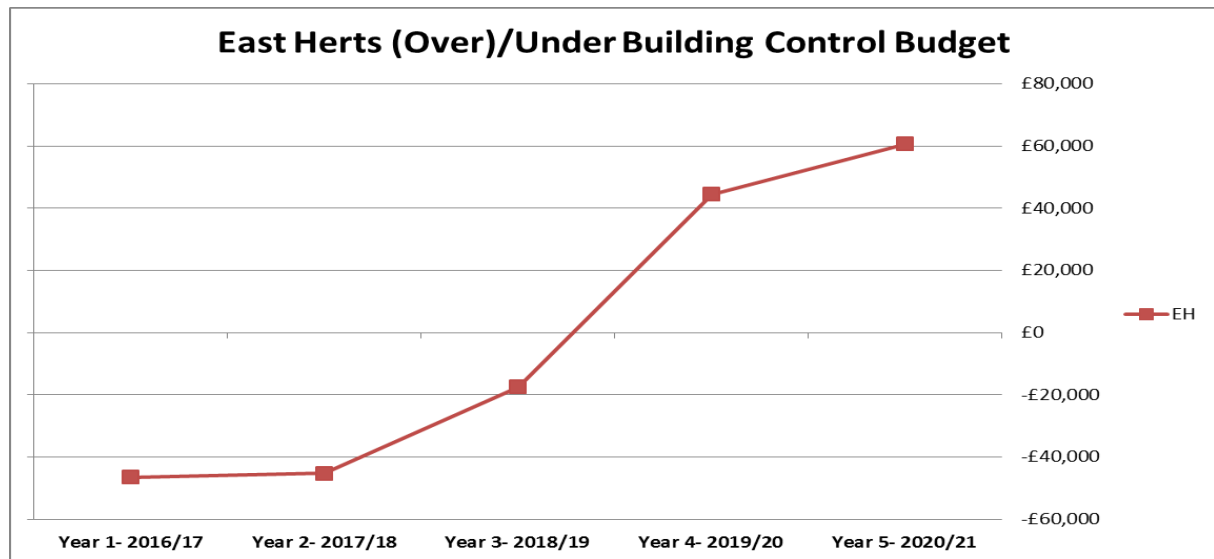
2020/21. These figures were compared to individual Local Authority (LA) budgets to identify their specific financial implications.

- 5.2 Within this exercise LA support services / overheads and premises cost were deemed out of scope and as such will be retained by the each LA. For East Herts this represents £169k support services and £35k premises budgets totalling £204k (In Table 1 below, the budget row reflects this treatment; the Year 0 As-Is budget including o/h+premises is £291k, compared to a budget of £88k in future years excluding o/h+premises).
- 5.3 The detailed East Herts position should it enter this partnership is outlined below in Table 1.
- 5.4 In summary, years 1, 2 and 3 would see the bottom line net cost to East Herts exceeding the remaining budget. This is not uncommon in new company start-ups as efficiencies will be gradual through the company's early years rather than a big bang immediately upon starting. However, the direction of travel in this period is positive and once at year 4, the cost is projected to fall below the remaining budget, illustrated in Graph 1 below.

Table 1: Financial Model Summary

	<u>Year0</u>	<u>Year1</u>	<u>Year2</u>	<u>Year3</u>	<u>Year4</u>	<u>Year5</u>
	<u>AS IS</u>	<u>2016/17</u>	<u>2017/18</u>	<u>2018/19</u>	<u>2019/20</u>	<u>2020/21</u>
	<u>(inc. o/h + prem.)</u>	<u>(exc. o/h + prem.)</u>	<u>(exc. o/h + prem.)</u>	<u>(exc. o/h + prem.)</u>	<u>(exc. o/h + prem.)</u>	<u>(exc. o/h + prem.)</u>
Fee	(19,520)	47,762	48,931	76,751	138,742	154,865
Non-fee + Other	(271,147)	(164,831)	(164,831)	(164,831)	(164,831)	(164,831)
ICT	In above	(17,093)	(17,093)	(17,093)	(17,093)	(17,093)
Net (cost) / income	<u>(290,667)</u>	<u>(134,162)</u>	<u>(132,993)</u>	<u>(105,172)</u>	<u>(43,182)</u>	<u>(27,059)</u>
Budget	291,964	87,720	87,720	87,720	87,720	87,720
Variance	<u>1,297</u>	<u>(46,442)</u>	<u>(45,273)</u>	<u>(17,452)</u>	<u>44,538</u>	<u>60,661</u>
	<u>under</u>	<u>over</u>	<u>over</u>	<u>over</u>	<u>under</u>	<u>under</u>

Graph 1: Projected forecast for East Herts Building Control



5.5 The financial model is based on two main parts;

- Fee
- Non-fee+Other

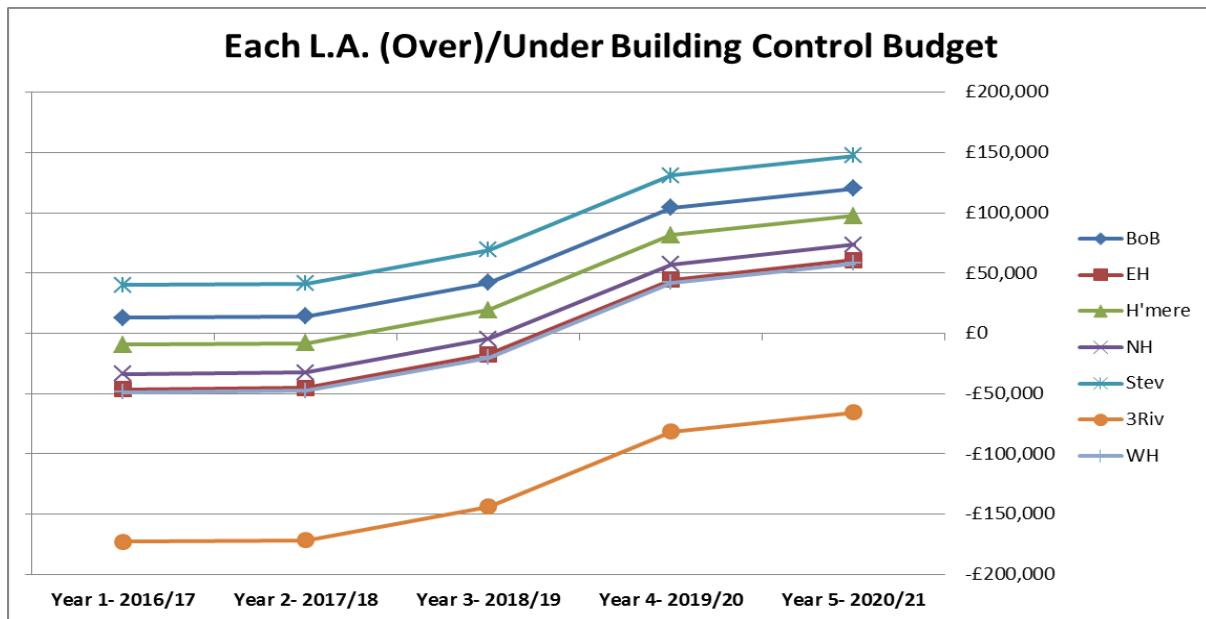
Delegable (LA7) functions will be found in both areas above, whilst non-delegable (in-house) and Approved Inspector (H7) are predominately Fee based.

5.6 The financial positions of all partners against their remaining budgets are illustrated in Graph 2 below for years 1 to 5 of the partnership.

5.7 The East Herts position is relatively low on this graph for two reasons;

- East Herts has the largest Non-Fee+Other net cost of the partners. This will be charged to the LAs based on actual consumption, with the consequence that East Herts will therefore be charged more than other partners for this part of the service provision
- As Fee service net income can only be extracted legally based on equal shares (1/7th each) there will be winners and losers depending on the actual amounts of fee income each LA brings to the partnership. As the largest income partner, East Herts is inevitably a loser financially (compared to Stevenage as the lowest income partner appearing towards the top of the graph).

Graph 2: Projected forecast for the LAs



5.8 Over and above the day-to-day costs of service in the years of provision, there are two additional sums of funding which need to be provided to the Building Control Group and therefore considered;

- Start-up loan funding of £647k;
 - £371k capital (for ICT hardware)
 - £276k revenue (for legal, recruitment, training etc.)
 This will be funded equally by the partners (£92k each LA) before year 1 begins. This will be subject to full principle and interest repayment, though the terms will have to be agreed upon start-up (the model currently assumes 5% over a 3 year repayment period).
- Income transfer for unfinished works; income is usually received with applications (i.e. before building control work begins) which will result in income held by LAs for work unfinished at the time of service transfer. Therefore a cash sum for these unfinished works will need to be transferred from LAs to the Building Control Group who will complete the work. Current estimates are that this would be approximately £200k for East Herts.

5.9 Key assumptions;

- Throughout the model, where estimates are used, these have been determined as conservative values, that is not overly optimistic or pessimistic

- Growth assumed;
 - Internal geographical, broadly 3%-5% annual growth
 - External geographical, increasing gradually to another 50% of current internal market (proxy)
- No accounting entry values are included within the model (i.e. pension deficit, accumulated absences, depreciation etc.)
- Price elasticity of demand for services has been classified as neutral (price changes do not affect total income received) to keep the model simple and manageable

This is not an exhaustive list of the model's assumptions, rather a summary of the most pertinent ones.

5.10 Key risks;

- As with any prediction model, whilst the best available information concerning likely quantity and costs have been used, it is an estimate so figures are "expected", they are not guaranteed
- Building Control operates in an external business environment as such it will be affected by market factors be them legal, economic or other. Whilst the model aims to estimate how those factors will affect the Building Control Group, it should be noted that unforeseen factors could impact the financial numbers quoted positively or negatively.

5.11 There will be significant support services / overheads and premises that the Building Control Group will need to procure and there is an option for the partner LA's to provide these. The model assumes £500k-£600k support service / overheads and premises per annum to cover the following activities:

- Human Resources (HR)
- Information, Communications & Technology (ICT)
- Finance
- Corporate
- Legal
- Premises

5.12 No decisions have been made by the Board as to who (if any) will win these contracts, as such the model above includes these costs in the Building Control Group's forecasts, it does not assume any awards of these to specific LA parties. Therefore, any subsequent award to a LA would improve the receipts / income from the Building Control Group (if the services are provided without additional cost to the LA).

- 5.13 The financial resources required to “pump-prime” the joint venture are summarised in Table 2 below.

Table 2: Funding requirements

	Year 0	Year 1	Year 2	Year 3	Total
Start-up Loan	92	(33)	(33)	(33)	(7)
Unfinished work income transfer	200	-	-	-	-
Supplementary budget	-	46	45	17	108

- 5.14 The start-up loan will be funded from the transformation reserve which will be replenished by the loan repayments as agreed with the Building Control Group (including interest at an assumed rate of 5% over three years).
- 5.15 The income transfer for unfinished work will be funded from the income budget within the building control service upon transfer of the service to the Building Control Group.
- 5.16 The supplementary budget requirement will be funded from the transformation reserve during years 1 to 3. The anticipated reduction in budget requirement from year 4 onwards will be used to repay the reserve. Once the total supplementary budget provision has been repaid in full any budget surplus will be offered as a saving.

6.0 Conclusion

- 6.1 East Herts and the other Councils involved in this project have recognised that the environment for the provision of Building Control services remains competitive and is likely to be more so in the future. The service arrangement proposed here will allow for the quality of service to be maintained – with appropriately skilled staff employed. It also allows the company to act competitively beyond the boundary of the combined Councils – something which the Council would find difficult to achieve individually.
- 6.2 There are good service delivery reasons for the Council to commit to these proposals therefore. There are costs however. Putting aside set up costs which can be recouped, the proposals result in additional service provision costs for the Council for the first three years of operation. There is a risk that service costs would

increase if the Council were not involved in this arrangement in any event and, in the longer term, the financial model predicts that service costs will fall below current levels.

6.3 Given the longer term savings position and the maintenance and potential improvement to the quality of service provision, it is concluded that the budget risks in this matter are outweighed and that the Council should resolve that it continues to confirm its involvement in the joint arrangements and take the necessary steps to bring the new arrangements to fruition.

7.0 Implications/Consultations

7.1 Information on any corporate issues and consultation associated with this report can be found within **Essential Reference Paper 'A'**.

Background Papers

None

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