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OXFORD CITY COUNCIL

To:	**Cabinet**
Date:	**19 December 2019**
Report of:	**Head of Financial Services**
Title of Report:	**Transformation Funding for Oxford Direct Services Limited**

Summary and recommendations	
Purpose of report:	To present the funding and budget requirements of the Oxford Direct Services Transformation Project for approval and for recommendation to Council.
Key decision:	No
Cabinet Member:	Councillor Ed Turner, Deputy Leader and Cabinet Member for Finance and Asset Management
Corporate Priority:	Efficient and Effective Council.
Policy Framework:	Constitution.

Recommendations: That Cabinet resolves to:

1. **Approve** the business case for the transformation project within ODS and the capitalisation of £1.25 million revenue costs by the Council related to the Oxford Direct Services Limited Transformation project in accordance with the Statutory Guidance on the Flexible Use of Capital Receipts and in line with the approved capital budget**;**
2. **Provide** a capital grant to Oxford Direct Services for the capitalised transformation revenue costs to be drawn down upon the Head of Financial Services being satisfied as to the evidence of expenditure provided and to include a repayment clause operated if the forecast returns are not achieved;
3. **Enter into a legal agreement** with Oxford Direct Services Limited relating to the capital grant for the capitalised revenue costs of the Oxford Direct Services Limited Transformation project subject to the Head of Law and Governance in consultation with the Head of Financial Services drawing up and being satisfied as to the terms of such agreement; and
4. **Include progress of the transformation project** and updates on the financial returns achieved and forecast to be included annually in the Council’s Capital Strategy.

Appendices	
Appendix 1	Project costs
Appendix 2	Detailed cashflow

Introduction and background

1. Oxford Direct Services Ltd (ODS) went operational on 1st April 2018 in the delivery of services back to the Council including building works, street cleaning, highways and refuse and recycling together with the provision of traded services for commercial waste collection, vehicle maintenance, highways and building works/construction in open competition. The expectation was that ODS would deliver dividend returns and efficiencies back to the Council of around £1.5 million in 2019-20 rising to around £3 million from 2023-24.
2. The delivery of returns to the Council is reliant on significant investment from the Council of around £18 million, supported by robust business cases in the following three areas:
    a. **Depot rationalisation –** A business case is currently being developed which seeks to rationalise the depots currently occupied by Oxford Direct Services onto ideally one site. Feasibility work is being carried out including obtaining the view of planning officers on the preferred option and as this moves along the process to Full Business Case, further report(s) will be brought forward for project approval by Cabinet.
    b. **Electric Vehicles –** The electrification of the vehicle fleet to drive efficiencies, reduce emissions and deliver savings in the following areas:
        i. the business as usual replacement of vehicles with electric or ultra low emission vehicles where economically feasible within the current capital budget
        ii. the Energy Superhub Oxford (ESO) trial vehicles and charging infrastructure
        iii. the conversion of 70 “grey fleet” (i.e. vehicle owned and provided by employees) to fleet vehicles. With a grey fleet, there is no control over the emissions, utilisation, tracking to optimise service delivery; we need to ensure properly ensured, serviced, MOT’d etc so there are both significant environmental and service challenges in having a grey fleet
        iv. the further electrification of ODS to achieve the Paris targets (Electrifying Oxford)
    c. **Transformation –** The transformation of the operating model including materials supply chain, computer systems and work allocation in the day to operation of the business, which is the subject of this report.
3. The overall intention of the Transformation project is to transform the operations of Oxford Direct Services (ODS), increase their competitiveness and therefore increase the dividend paid back to the Council. The project consists of a number of

elements including the replacement of assets, restructuring the workforce and improving the ICT systems used by the Company. This report is concerned with the capitalised revenue costs of the transformation relating to technology, project management, consultancy and voluntary redundancy. There is already £1.25 million in the capital programme to cover the costs of this, however formal approvals around process are needed and the Council must formally agree the projected returns from the capitalised revenue aspects of the project.

Outline of the Business Case

4. An extract from the outline Business Case shown at paragraph 10 shows that the capital grant will be fully recovered by the Council within year 6 with an additional £280k profit available for dividend (ignoring any corporation tax that may be payable on any trading portion).

5. Benefits will arise from ODS moving to the target operating model, which includes:

    a. Target Operating Model - Moving to a just-in-time stock delivery model supported by an integrated job management, scheduling and supply chain solution using the following software (Aareon QL, Kirona DRS, Kirona Project Planner and First Touch) that leads to lower travel time and higher first-time fix rates (non-cashable due to other dependencies such as d below)

    b. Ongoing reduction in materials costs for building services (cashable)

    c. Reduction in inventory (cashable)

    d. Being able to resell spare capacity arising from higher productivity (treated as non-cashable due to dependencies)

    e. Savings in administration and management (cashable)

6. The full benefits delivery will be supported by extending the fleet to include planned operations staff. By doing this this new group of operatives will have access to van stocks and this will enable a much wider pool of all operatives to carry out responsive and planned works, which will increase the overall productivity. The costs of these additional ‘grey fleet’ and productivity benefits will be allocated to that business case.

7. The costs of the changes are listed in the appendix.

8. The cost of capital used is 3.5%.

9. A contingency of 50% has been applied to the first year, 25% to the second year and 10% to the final years. The contingency makes allowance for the time to fully transition and optimise the new service.

10. The Net Present Value (NPV) of a project is effectively a measure of the time value of money in terms of the money spent on the project measured against the inflows of income or savings. Where the NPV is positive then the project is worth doing and conversely where negative it is not. The NPV has been calculated over a period of seven years, a typical contract period for a materials supply chain partner.

    The summary of the net present value is shown in Table 1 below:

	Note	Year 0 2019/20 £	Year 1 2020/21 £	Year 2 2021/22 £	Year 3 2022/23 £	Year 4 2023/24 £	Year 5 2024/25 £	Year 6 2025/26 £	Year 7 2026/27 £
Cashable Savings									
Reduction of Inventory	1	-	50,000	50,000	-	-	-	-	-
Reduction in Material Cost	2	-	220,000	220,000	220,000	220,000	220,000	220,000	220,000
Resale of Capacity / Reduction in Staff	3	-	92,523	92,523	92,523	92,523	92,523	92,523	92,523
Contingency	4	-	(181,262)	(90,631)	(31,252)	(31,252)	(31,252)	(31,252)	(31,252)
Total Cashable Savings		0	181,261	271,892	281,271	281,271	281,271	281,271	281,271
Project costs									
Technology & Consulting		(450,000)	-	-	-	-	-	-	-
Project Management		(150,000)	-	-	-	-	-	-	-
Programme Management		(150,000)	-	-	-	-	-	-	-
Total Transformation		(500,000)	-	-	-	-	-	-	-
Total project costs		(1,250,000)	0	0	0	0	0	0	0
Net Cashflow		(1,250,000)	181,261	271,892	281,271	281,271	281,271	281,271	281,271
Present value		(1,250,000)	175,131	253,814	253,690	245,111	236,823	228,814	221,076
Cumulative Present Value		**(1,250,000)**	**(1,074,869)**	**(821,055)**	**(567,364)**	**(322,253)**	**(85,430)**	**143,384**	**364,460**
Net Present Value		**364,460**							

Notes

1. Reduction of inventory – historically ODS carry far too much stock so going forward there will be less spend
2. Savings on Building Services materials based on an estimated basket of goods
3. Reduction in management and administrative staff
4. Contingency for transition / optimisation period

The NPV is shown as £364k over the seven years and therefore makes a positive contribution to the Company. The savings will be passed back to the Council through increased dividends reflected in the Council's Medium Term Financial Plan. The increase in dividends to the Council will more than cover the cost of the grant given by the Council to the Company, thus satisfying the terms of the capitalisation

Flexible Use of Capital Receipts

11. As a general rule it is not lawful to use capital resources to finance revenue expenditure; this is based on legislation applying to local authorities. DCLG issued the Statutory Guidance on the Flexible Use of Capital Receipts in March 2016. The Local Government Act 2003 ("the Act"), section 15(1) requires a local authority "… to have regard (a) to such guidance as the Secretary of State may issue, and (b) to such other guidance as the Secretary of State may by regulations specify …". The guidance on use of capital receipts flexibility is issued under section 15(1) of the Act and authorities are therefore required to have regard to it. A Direction made under section 16(2)(b) of the Act was also published to give the actual statutory powers to apply this flexibility. The guidance has been updated to include the financial years 2016/17 to 2020/21.

12. Local authorities cannot borrow to finance the revenue costs of service reform. Local authorities can only use capital receipts from the disposal of property, plant and equipment assets received in the years in which this flexibility is offered. Local authorities may not use their existing stock of capital receipts to finance the revenue costs of reform. There will be sufficient capital receipts both from general sales and from the repayment of the vehicle leases in place between the Council and Oxford Direct Services Limited to finance the capitalisation of the Oxford Direct Services transformation costs.
13. The key criteria to use when deciding whether expenditure can be funded by the capital receipts flexibility is that it must be forecast to generate ongoing savings to an authority's net service expenditure. There should therefore be a costed business case that demonstrates payback to the Council that exceeds the cost of the transformation financed through capitalisation. A summary of the business case is shown in paragraphs 4 - 10. The returns to the Council from the transformation will be through increased dividend payments from ODS.
14. Details of any use of the Flexible Use of Capital Receipts permissions must be agreed by Council and progress on the project(s) and returns must be reported annually to Council. This will be achieved through reporting it within the Council's annual Capital Strategy, based partly on information provided by Oxford Direct Services Limited.
15. If returns above the amount of the capitalised revenue costs are not achieved then the expenditure must be transferred to revenue and the capital receipts funding reversed. It is therefore crucial that the transformation project is successful or else there will be adverse revenue implications in the future both on the Council from the impact on revenue of any costs that the Council is required to reverse to revenue together with any loss of dividend arising from decreased efficiencies and savings from the Transformation project

The Process for Capitalising Revenue Costs and Financing from Capital Receipts

16. An outline of the process the Council must adopt in order to use this power is as follows:

- The overall business case and related budgets must be approved by a Council meeting;
- Subject to approval of the recommendations in this report:
- The Council will finance the capitalised grant of £1.25 million relating to the Oxford Direct Services Limited Transformation Project through the capital programme, to be financed from capital receipts;
- The Council will provide a capital grant to Oxford Direct Services Limited for the capitalised revenue costs of the Oxford Direct Services Limited Transformation Project to be drawn down on evidence of relevant expenditure;
- The grant will be repayable to the Council (based on the grant conditions) if the anticipated returns to the Council arising from the transformation are not achieved;
- The progress of the transformation project will be reported to Council on an annual basis within the Council's Capital Strategy.

Financial implications

17. Within the Council's indicative Capital Programme an amount of £1.25 million has been included in connection with the ODS transformation costs. These costs largely relate to revenue expenditure and the Capital directive within this report allows such expenditure to be capitalised by the Council and funded from capital resources. In return for the Council giving a capital grant to ODS it will receive savings back from the company in the form of company dividends, the income from which has been included in the Councils Medium Term Financial Plan.

18. The figures shown in the outline of the business case (paragraphs 2 to 8) have been provided by Oxford Direct Services. It is the Company's responsibility to ensure that it achieves the savings proposed and passes these on to the Council.

19. The progress and delivery of the capitalised revenue cost element will be reported on an annual basis within the Council's Capital Strategy. The capital grant will paid to Oxford Direct Services with grant conditions that ensure it is repayable if the increased efficiencies and the increased dividend to the Council are not achieved.

Legal issues

20. The powers to take the course of action set out in the recommendations to this report are provided by the Local Government Act 2003 and the Direction and Guidance issued in relation to that this report.

Level of risk

21. The key risk arising from these proposals is that the transformation does not achieve sufficient saving or additional revenue to increase the payments to Council sufficient to cover the original costs. If this happens, the consequence is that the Council will have to finance the costs of the capital grant to the Company from revenue. Risks to delivery of individual projects are identified and monitored as part of the capital scheme approval and monitoring process.

Equalities impact

22. The procurement of capital works will be undertaken in line with the Council's policies to support the payment of a living wage and making apprenticeship and training opportunities available to local people. Many of the facilities funded out of the Capital Programme – such as community centres and social housing – will facilitate the narrowing of inequality in Oxford. There is no requirement to provide an Equalities Impact Assessment for this report.

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Background Papers: None