

# North Yorkshire County Council

## Executive

21 February 2023

### Creation of new Property and Estates Company – Align 2 (APP2)

#### Report of the Assistance Chief Executive (Legal and Democratic Services)

**Appendix A to this report contains information of the type defined in paragraph 3 of Part 1 of Schedule 12A Local Government Act 1972 (as amended) (*information relating to the financial or business affairs of any particular person (including the authority holding that information)*) and it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information**

#### **1.0 Purpose of Report**

- 1.1 To provide Members with the Business Case for the establishment of a new company (APP2) by the Council for the provision of property projects and estates services which would adhere to the Teckal exemption in the Public Contracts Regulations 2015.
- 1.2 To seek Members' approval to the establishment of the new company which will be wholly owned by the Council (transferring to North Yorkshire Council from 1 April 2023) and limited by shares on the basis of the Business Case.
- 1.3 To notify Members that Align Property Partners Limited will operate on a commercial basis in the future without the benefit of the Teckal exemption.

#### **2.0 Background**

- 2.1 On 27 September 2016 the Executive approved the Business Case for the creation of a property services company, now trading as Align Property Partners Limited (APP). This company was created on the basis that it would make use of the 'Teckal' exemption from the Public Contracts Regulations 2015 which has the benefit that the Council is able to directly award contracts to the company without undertaking a procurement exercise providing certain criteria are satisfied.
- 2.2 On 14 August 2018, a report was taken to Executive with a business case to establish a new Teckal company for the provision of property projects and estates services. This was approved; however the company has not yet been set up. Due to the lapse in time since this decision was taken, this report is being brought back to Executive for a decision on the revised business case to proceed with setting up a new Teckal company.
- 2.3 Since creation APP has undertaken a range of work for the Council but has also been working on a strategy to develop its commercial offer, capitalise on the buoyant market and expand trading to organisations outside of the Council. It has seen significant success in this aim. Whilst this success has been testament to the good work of APP over the last six years, the growth in external income generation seen in the past two years could result in the loss of the ability to rely on the 'Teckal' exemption.
- 2.4 In order to benefit from the Teckal exemption, both the Control and Functional tests must be satisfied with the key criteria of these tests being:

- the contracting authority exercises the same amount of control over the company that it does over any of its internal departments; and
- more than 80% of the company's turnover is derived through activities performed for the contracting authority; and
- there is no direct private capital participation in the company.

2.5 If APP undertakes more than 20% work other than for the Council the company would no longer be Teckal compliant. The benefit of the exemption would be lost which would result in the Council no longer be able to make direct awards of contracts to APP and having to ensure that any future contracts are subject to procurement processes.

2.6 A substantial market exists for the services provided by Align, with the Company well placed to capitalise on its existing reputation in the commercial space. The growth is being driven by non-NYCC externally generated income and indicates that Company trading aspirations have outgrown the initial Teckal-based operating model.

### 3.0 Options

3.1 As a result of the issue highlighted above a number of high level options were tabled and discussed at Align Property Partners Board meeting:

- 1) ensure APP are compliant with the Teckal exemption which could limit opportunities to trade commercially in the future;
- 2) create a new company which is 'Teckal' compliant and novate the existing Council contract to this company, leaving APP to continue to trade commercially;
- 3) create a new company which would not be 'Teckal' compliant and trade all external income through that company, leaving APP as Teckal compliant.

3.2 The considerations when evaluating each of the above three options are:

- i. the acquisition and retention of customers at a profitable return
- ii. demonstrating trading history and size of company in bids for external work – common questions in tender exercises include a requirement to demonstrate history of providing similar services;
- iii. the potential disruption to existing clients;
- iv. additional costs of managing more complex governance arrangements;
- v. balancing commercial freedom with retention of effective company oversight, thereby protecting NYCC's investment and ensuring that trading activities are carried out in accordance with the authority's ethos and values.

3.3 Option 1, which is to limit future opportunities to ensure APP remains teckal compliant does not fit the criteria to allow for the acquisition and retention of customers at a profitable return as customers would necessarily have to be limited to ensure teckal compliance. This is contrary to the business model of APP which is to grow the company.

3.4 Creating a new Teckal company which is teckal compliant would meet all of the criteria above and is therefore the preferred option. The customer base would be enabled to grow which should lead to increased profitability while leading to minimal disruption for existing clients as external clients would remain with the existing APP company. As the existing company would bid for the external work under this proposal, APP would be in a strong position to bid for tender work as there would be an ability to demonstrate trading history through the existing company. However, there would be additional costs associated with managing more complex governance arrangements in terms of a second company.

3.5 As option 3) would not allow trading history to be demonstrated when bidding for external work as set out above, this option has not been considered further.

3.6 The table below highlights how each of the options meet the evaluation criteria above;

	Option 1	Option 2	Option 3
The acquisition and retention of customers at a profitable return	This would be limited due to teckal compliance	This criteria would be met as creating APP2 would allow growth in external work	This criteria would be met as creating APP2 would allow growth in external work
Demonstrating trading history and size of company in bids for external work – common questions in tender exercises include a requirement to demonstrate history of providing similar services.	Yes but to enable teckal compliance would have to limit external work	Yes as external bidding work would be undertaken by existing APP company which would be a non teckal company	No as APP2 would be a new company with no trading history which would impact on ability to bid for external work
The potential disruption to existing clients.	No disruption to existing clients although some external work may have to be reduced for teckal compliance	No disruption to existing clients	Yes, some disruption to external clients as contracts would need to be transferred into APP2
Additional costs of managing more complex governance arrangements.	No additional costs incurred as remains one company	Additional costs would be incurred through 2 companies instead of 1	Additional costs would be incurred through 2 companies instead of 1
Balancing commercial freedom with retention of effective company oversight, thereby protecting NYCC’s investment and ensuring that trading activities are carried out in accordance with the authority’s ethos and values.	Not balanced as external work would need to be limited	This criteria is met as trading would be carried out in accordance with the authority’s ethos and values as it is now	This criteria is met as trading would be carried out in accordance with the authority’s ethos and values as it is now

#### 4.0 Business Case

4.1 In evaluating all options against the above criteria the report recommends option (2) – creation of a mirror company “APP2” which is ‘Teckal’ exempt and transferring the Council contract to it. The detailed business case sets out the financial implications of implementing this preferred option compared to option 1. A copy of the Business Case is attached as Appendix A.

4.2 The proposals to consider in this Business Case include:

- a) APP2 be a company limited by shares with the Council holding all shares. It is envisaged that the initial share capital will be 100 £1 shares. A loan may also be required for initial working capital and it is requested that approval is given for a loan facility of a maximum of £200k be approved for this purpose. Interest will be charged on this loan at a commercial rate.
- b) that a Board of Directors will be required to be established for the company in order to provide the company with effective governance. It is recommended that the board composition should match that of Align Property Partners such that the cost of governance is reduced as far as reasonable;
- c) that a name for the company will require to be identified which is appropriate within the context of the existing operation, namely Align Property Partners Limited;
- d) the primary objective of the company will be to continue providing high quality property, highways and estates services to the Council and associated bodies, while being Teckal compliant;
- e) the Council directly awards its contract for property, highways and estates services to the new company;
- f) the rights and obligations of the Council as shareholder of the company will be detailed within the Articles;
- g) it is envisaged that the Council will provide support services if required to APP2 on the basis of a Service Level Agreement which will also include current charging rates. The detail of this will be worked through in parallel to the set up of the new company;
- h) it is envisaged that APP2 will second staff working from Align Property Partners at an appropriate rate reflective of the market, again the detailed mechanism of this is to be worked through and will be in place prior to APP2 commencing trading.

## **5.0 Equalities**

5.1 Equalities Impact Assessment at Appendix B attached.

## **6.0 Finance**

6.1 The financial implications are set out in the Business Case at Appendix A which demonstrates the financial case for the recommended option 2), to create a new company (APP2).

6.2 The Council will create APP2 and invest through a combination of equity and debt in order to give the company an initial cashflow to meet its short term obligations. The company will be limited by shares, with nominal share capital requirement to be established and funded via 100 £1 shares held by the Council. Using the information in the Business Case the company has been valued to ensure the Council achieves value for money for its equity share. It is anticipated that a loan facility of a maximum of £200k will be necessary to cover cashflow which will be repaid within 1 year of draw down. Interest will be charged on this loan at a commercial rate.

- 6.3 The funding of the equity investment of £100 and any loan required for cashflow purposes up to a maximum of £200k will be met from the Strategic Capacity Unallocated reserve.
- 6.4 The Council's current property services contract is due to expire 31 March 2023. The intention is for the Council to award the new contract to APP2, with other Council contracts being novated as required from APP to APP2.

## **7.0 Legal**

- 7.1 The Council will rely on the general trading powers in conjunction with its powers to carry out the activity in question. Both general trading powers require the authority to trade through a company:
- Section 95 of the Local Government Act 2003 enables relevant authorities "to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions" i.e. anything they are empowered to do in legislation. The section 95 power can be limited by order and authorities exercising it must have regard to guidance issued by the Secretary of State
  - Section 4 of the Localism Act 2011 enables the local authority to do for a commercial purpose anything that it is empowered to do under section 1 (the general power of competence). The section 4 power is therefore wider than the section 95 power.
- 7.2 The section 95 and section 4 trading powers prescribe which company structures may be used, one of which is a company limited by shares.
- 7.3 The local authority must prepare a business case supporting the exercise of the section 95 power, which the authority must approve (Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009).
- 7.4 It is proposed that APP2 will comply with the Teckal exemption which has now been incorporated into the Public Contracts Regulations 2015. Regulation 12(1) enables a contracting authority to directly award contracts to a company it owns without undertaking a procurement exercise where the following criteria are satisfied:
- the contracting authority exercises the same amount of control over the company as it does over any of its internal departments. (This will be governed through reserved matters in the company's Articles of Association and the composition of the Board of Directors of the company which will contain a majority of Council directors); and
  - more than 80% of the company's turnover is derived through activities performed for the contracting authority; and
  - there is no direct private capital participation in the company.
- 7.5 It is proposed that APP2 will be set up and operated in a way which will fulfil all three criteria.
- 7.6 In the event that the company did want to provide services to contracting authorities other than the Council then it would be up to those organisations to consider, in accordance with their own procurement rules, whether to award a contract to the company. In such cases, the Teckal exemption would not apply as the company would not be a company controlled by those bodies. However, contracting authorities are able to collaborate to provide a service without undertaking a procurement exercise. This exemption is known as the "Hamburg Principle" and is set out in regulation 12(7) of the Public Contracts Regulations 2015. In order for the collaboration to comply the following conditions must be fulfilled:

- i. The co-operation between the participating contracting authorities must have the aim of ensuring that public services they have to perform are provided with a view to achieving objectives they have in common; and
- ii. The implementation of that co-operation is governed solely by considerations relating to the public interest; and
- iii. The participating contracting authorities perform on the open market less than 20% of the activities concerned by the co-operation.

7.7 The Hamburg Principle therefore provides the opportunity for other ‘non- shareholding’ contracting authorities to share in the benefits of a Teckal arrangement and deliver future services in a partnership environment. More detailed legal advice is contained in the confidential business case at Appendix 1.

7.8 The Council may provide equity to the company. The powers contained in the Local Government Act 2000 extend to authorising the local authority to giving financial assistance to any “person” and entering into arrangements or agreements with any “person”. Any agreement must be for a commercial purpose and may provide for grants, loans or guarantees. The provision of equity to the company by the Council is compliant with the Subsidy Control Act 2022 as capital is being provided in circumstances that would be acceptable to a private investor operating under normal market economy conditions. This can be taken to apply where a new company is set up with the public authorities holding the entire capital or a majority or minority interest, provided the authorities apply the same criteria as provider of capital under normal market economy conditions. The Council will be responsible for the debts and losses of the company to the extent of the nominal value of its shareholding (i.e. 100%) and to the extent of any specific guarantee or contractual arrangement that it has entered into.

7.9 APP2’s activities will be bound by the Public Contracts Regulations 2015.

7.10 When work is required pursuant to the Council, it is envisaged that contract staff will be seconded across from APP at market rates. The detail of this proposal is being worked through in line with the establishment of the company.

7.11 APP2 will have a Board of Directors to ensure proper governance and accountability to its shareholder. Proposals for the board’s membership are continuing to be reviewed but it recommended that it should initially comprise the Corporate Director – Strategic Resources, the Corporate Director – Business and Environmental Services, the Assistant Director – Strategic Resources and the Operations Director for Align Property Partners Ltd, which is sufficient to demonstrate control (these role titles will be amended after 1 April 2023).

7.12 It is proposed that where APP2 requires use of office accommodation it will enter into appropriate commercial leasing or licencing agreements.

**8.0 Climate Change**

8.1 The proposals in this report will enable APP to be better able to offer green advice and services to a broader range of customers.

<b>9.0 Recommendation(S)</b>
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- 9.1 Members are requested to:
- a) approve the implementation of a new wholly owned company (APP2), in accordance with the details set out in the Business Case at Appendix A;
  - b) approve the setting up of a company limited by shares;
  - c) approve the investment of 100 £1 shares in APP2;
  - d) delegate the approval of the articles, the company name and any other governance documents associated with new company to Assistant Chief Executive – Legal and Democratic Services;
  - e) delegate the Council entering into all other agreements and documents necessary for the establishment of the new company to the Assistant Chief Executive - Legal and Democratic Services;
  - f) delegate to the Assistant Chief Executive Legal and Democratic Services in consultation with the Assistant Director, Strategic Resources (BES and Central Services) to conclude all steps to agree a working capital loan for the company, up to a maximum of £200k to be funded from North Yorkshire Council reserves for which a market rate of interest will be charged;
  - g) delegate to Assistant Chief Executive Legal and Democratic Services to progress and conclude the working arrangements of APP2 including the method of the provision of support services, staffing and secondment arrangements;
  - h) delegate all other necessary steps to secure the implementation of the proposed Option to the Assistant Chief Executive – Legal and Democratic Services;
  - i) agree to the appointment of the Corporate Director - Strategic Resources, the Corporate Director - Business and Environmental Services and the Operations Director for Align Property Partners to the Board of Directors of the new company;
  - j) agree that the appointed officers to the board of directors of the company will be entitled to indemnity in accordance with the Council's Indemnity Policy for Members and Employees.

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Background Documents: None

Appendices:  
Appendix A – Financial Business Case CONFIDENTIAL  
Appendix B – Equality Impact Assessment