

North Somerset Council

Report to the PCOM

Date of Meeting: 2 March 2023

Subject of Report: NSEC Shareholder update

Town or Parish: N/A

Officer/Member Presenting: Councillor Ashley Cartman - Executive member for corporate services and assets

Key Decision: N/A

Reason:

Report for information and feedback

Recommendations

That PCOM receive the NSEC shareholder update

1. Summary of Report

This report gives an update on North Somerset Environment Company Limited (NSEC), the Council's wholly owned subsidiary company. It is an overview by the shareholder from a governance perspective on the activities and performance of the company, which has seen a marked improvement. The Executive has appointed Cllr Ashley Cartman as its shareholder representative.

Operational aspects are covered by the client relationship with the council and subject to Place Scrutiny arrangements, so are not covered in this report.

2. Policy

NSEC Ltd was established to support North Somerset Council's corporate plan in the following areas:

- A thriving and sustainable place.

The Council is able to have more influence on the waste service to better ensure that it contributes to North Somerset Council's corporate plan priorities of being;

- A great place for people to live, work and visit
- Welcoming, safe and clean neighbourhoods
- To be a carbon neutral council and area by 2030

- An open and enabling organisation

NSEC Ltd contributes to North Somerset's corporate plan priorities related to innovation and efficiency which are:

- Encourage continuous improvement and innovation

- Manage our resources and invest wisely
- Provide professional, efficient and effective services
- Collaborate with partners to deliver the best outcome

NSEC Ltd operations are covered by the council's Recycling and Waste Strategy 2021-2023

3. Details

3.1. Background

The Council agreed to establish its own recycling and waste Company in 2020 using a Teckal exemption to deliver North Somerset services, in order to:

- Overcome commercial viability issues within the waste market
- Enable financial flexibility to deliver efficiency and
- Have greater control over environmental issues in its net zero strategy

Whilst the company was primarily established to deliver services on behalf of the council, it would also have the flexibility to trade with third parties for a profit (within the Teckal threshold of 20%). The council will also seek to explore the delivery of other services through NSEC, where it is beneficial to do so.

3.2. Governance

3.2.1. North Somerset Council Governance

The company is governed by its articles of association and these reserve several matters for the shareholder, including but not limited to:

- Changes to company structure
- Appointment of board members
- Approving the business plan
- Major financial decisions such as loan agreements, credit facility, contracts above a certain level
- Determining directors' remuneration

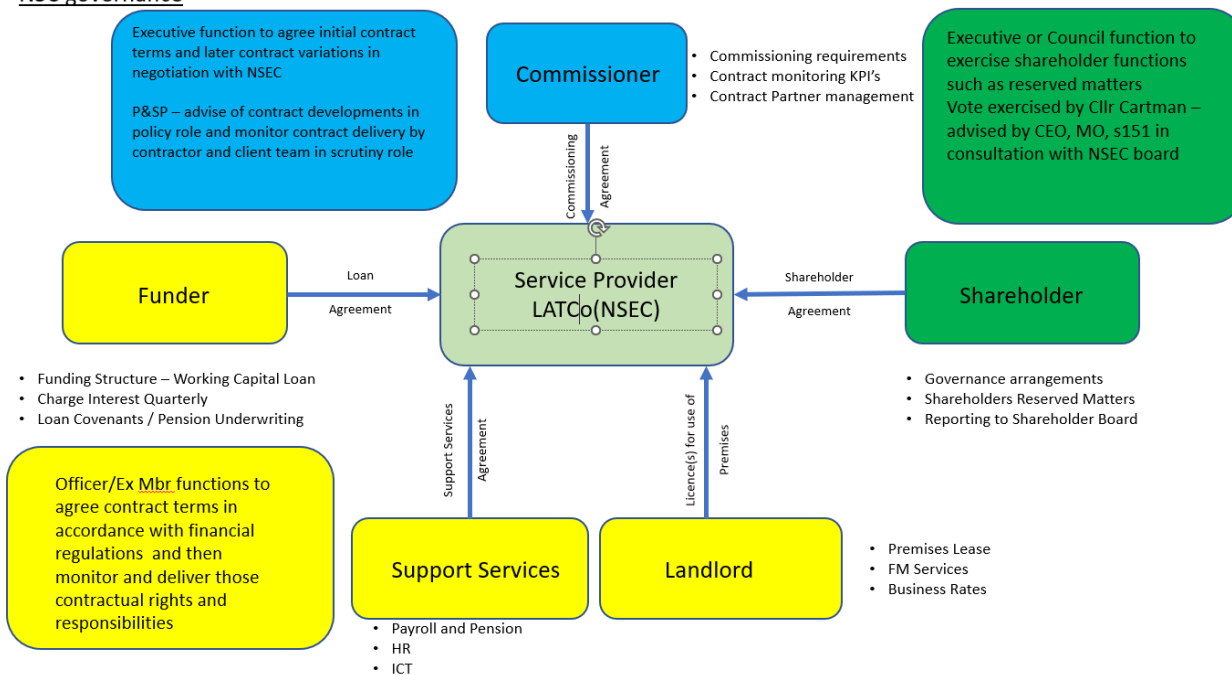
The shareholder has agreed a Memorandum of Understanding with the company which determines reporting standards for key areas which cover:

- Financial update including forecast
- Operations overview/ KPIs
- Health and Safety, environment and compliance
- Employee, workforce and trade union related matters
- Strategic risk register
- Issues of concern
- Shareholder decisions/ reserved matters

Whilst the company was in its early stages and there were numerous decisions to be taken on reserved matters, the NSEC shareholder board met every 6 weeks, approximately. Now that the company and key documents are established, meetings will be held quarterly through 2023 as standard with flexibility to arrange ad hoc meetings as required.

3.2.2. Governance Diagram – this report relates to the Shareholder elements depicted on the right

NSC governance



3.2.3. NSEC Company Governance





Director appointments to the board are a reserved matter for the Shareholder. The current board is made up as follows:

- Sue Turner – Non-Executive Chair of the Board
- Brian Veale – Managing Director
- Stuart Jellings – Operations Director
- Chris Butters – Non-Executive Director
- Vacant – Non-Executive Director

3.3. NSEC performance

3.3.1. Strategic Performance Indicators

NSEC reports its operational performance to the client team on a monthly basis, including detailed breakdown against a suite of Key Performance Indicators (KPIs). The shareholder representative has agreed a number of high-level measures which will be monitored by the shareholder board on a quarterly basis, focussed on environmental impact, customer experience and finance. Performance to date is summarised overleaf:

	Base indicator	Latest performance	Direction of travel
Repeat missed collections	832 (Apr- Jun 22)	487 (Nov-Jan 23)	-41% 
Kerbside recycling rate	45.7% (2021-22)	45.2% (2022-23 to date). NSC is expected to be in the top 10 performing councils for 2022-23	-0.5% 
Recycling centre rates	60.01% (2021-22)	62.04% (2022-23 to date)	+2.03% 
Responding to complaints within 10 days	62.8% (Jan-Mar 22)	77.9% (Oct-Dec 23)	+15.1% 

3.3.2. Financial performance and forecast:

Throughout the year NSEC management have shared with the Council the measures they have been taking to improve efficiencies, deal with issues that were not foreseen during the process of transferring the contract from the previous operator and close the gap between the budget and forecast outturn.

£000	2021-22	2022-23
Turnover	13,162	13,781
Costs	13,501	13,593
Net profit	(339)	(188)
Variance	(2.58%)	(1.36%)

3.3.2.1. 2021-22 performance

The first Statutory Accounts for NSEC cover the period from October 2020 to March 2022 and are available on Companies House and received a clean audit opinion.

The key drivers of the adverse variance of £339k (2.58%) during 2021-22 were:

- Covid pandemic and “pandemic” impact on staff availability and cost of cover and hire of smaller vehicles
- National Shortage of HGV drivers; the company inherited 10% driver vacancies and incurred agency and training costs

3.3.2.2. 2022-23 performance

Monthly management accounts are prepared for the NSEC board and these are made available for the shareholder to review with detailed reporting on a quarterly basis.

The key drivers of the forecast variance of £188k (1.36%) for 2022-23 are:

- Agency costs arising from vacancies and COVID impacts early in the year
- Insurance costs greater than contract budget due to claims experience of new company – retendered 2023
- Condition of vehicle fleet leading to unplanned hire costs and repairs – minor procurement in 2023 with major procurement in 2024

3.4. NSEC Business Plan

NSEC has been developing its business plan 2023-2028 for approval by the shareholder. Whilst the company was primarily established to deliver services on behalf of the Council and therefore these opportunities are considered as contracts come up for procurement, it has the flexibility to trade with third parties for a profit (within the Teckal threshold of 20%).

3.4.1. Introducing commercial services:

The business plan includes ambitions to trade externally which are forecast to generate additional turnover and profit for the company over the five year period to 2027-28. Surpluses will be used to offset the deficit from earlier years before a distribution of dividends to the parent Council will be considered – this is subject to agreed dividend policy.

New Income Stream	Turnover (rounded to nearest £000)	Costs	Forecast net profit over 5 year period
Driver Academy	1,879	1,719	160
Event Cleaning	308	266	42
Commercial Waste	1,966	1,772	193
Commercial Vehicle Servicing	612	551	61
Total	4,765	4,308	456

3.4.2. Expansion of Council services

3.4.2.1. Highways

On 8 November 22 Council agreed to progress the highway reactive and cyclical maintenance work package via direct contract award under Teckal exemptions to North Somerset Environment Company for an initial term of 7 years commencing 1 April 2024.

The contract value is expected to be in the region of £2.2m per year and deliver a variety of benefits to the Council:

“The business case clearly shows that delivering the reactive and cyclical maintenance service through NSEC delivers the best financial value, the most social value, the best alignment to the council’s strategic priorities and helps to deliver the NSEC business plan. A full NSEC business case for expansion to include this service has also been produced and analysed in tandem with the options analysis work and has been approved by the company board and shareholder.”

Benefits to the Company will include economies of scale, back office and management efficiencies and greater use of assets and capabilities within the company. It is expected that this contract will yield £65k of overhead savings per year over the life of the contract which will be available to offset cumulative deficits. The proposal submitted by NSEC was approved by the Shareholder prior to submission to the Council.

3.4.2.2. Expanding waste delivery elements

NSEC has submitted a bid to the Authority for 2 lots of the Waste Processing contracts as of 31/01/23, the bid is currently being reviewed by the Client Officers.

The first Lot is for the 7-year contract to run the Waste Transfer Station on Aisecombe Way, currently operated by Enovert and up for renewal in April 2024. This is where NSEC already deposit the Residual (Black Bag) and Garden Waste adjacent to the existing Household Waste Recycling Centre. There are several potential synergy opportunities as NSEC would gain end to end control of the supply chain and would assist with a key Business Plan objective to increase Commercial Waste collections.

The second Lot is for the haulage, or onward forwarding, of the Residual and Garden Waste to the end destination processing facilities, currently located in Avonmouth and Cheltenham. This would sit well within the NSEC portfolio as it would be an extension of their existing HGV operations.

3.4.2.3. Plan to recover deficit

NSEC first year performance reflects the period of six months from the registration of the Company on 26/10/2020, through to the mobilisation of the Waste and Recycling contract on 27/03/21, in addition to the full trading year from April 21 through to March 22.

The audited accounts of NSEC for 21/22 reported a trading deficit of 339k. For the trading year 22/23 the latest forecast is that NSEC will post a further deficit of circa £188k, the total being £527k trading deficit after the first two years.

The circumstances which contributed to the losses included the impact of the COVID pandemic, HGV Driver shortage and hire fleet costs, which are all now significantly improved in the third quarter of 22/23. Whilst most of the Fleet assets sit with the accounts of North Somerset Council, a further targeted objective has been to make investment in assets directly for NSEC to improve contract delivery, which total £ 250k to date and are being depreciated over the next 5 years. NSEC has incurred no capital borrowing to date.

The plan to recover the incurred deficit involves two key initial elements over the five years of trading from April 2023 to March 2028, the first being the successful award of the Highways Cyclical and Reactive Maintenance Contract which is budgeted to deliver a surplus of £325k over the first 5 years. The second key element being the launch of commercial services as outlined in the Business Plan with a forecast surplus nett profit of £455k at the end of the first 5 years trading. Combining the two forecasts therefore includes a contingency of some £181k being over 30% of the deficit total. Our intention will be to avoid any further cost overrun within the delivery of the Waste and Recycling Contract to prevent increasing the deficit. Through effective delivery of the Business Plan and new service Contracts the Company will aim to outperform the financial forecast and reduce the amount of time taken to clear the deficit and take the Business into a profitable position by 2026-27.

Financial year	2023-24	2024-25	2025-26	2026-27	2027-28
Highways Contract Contingency	65	65	65	65	65
Business Plan Net profit	16	51	88	129	172
Total operating profit	81	197	350	544	781
Deficit/Surplus Carried forward	(527)	(446)	(248)	102	645

4. Consultation

N/A

5. Financial Implications

NSEC has not utilised any loan facilities offered by the council to support day to day operations or any other investment.

As the parent company and sole shareholder of NSEC, the council is ultimately responsible for any losses of the company. The ongoing profit and loss situation of NSEC is being closely monitored and the Council may need to consider making provision in its own accounts, if the deficit recovery plan is not successful. The accumulated losses for 2022-23 are not considered to be material to the council.

5.1. Costs

N/A

5.2. Funding

None arising from this report

6. Legal Powers and Implications

Local Authority Trading Companies (LATCOs) are contracted by the parent council (or councils) to provide services back to the council(s) via a service contract. The council opted to apply the Teckal or in-house exemption when establishing NSEC which allows the contracting for services without the requirement for a procurement exercise. It is based on case law and was been codified in the Public Contracts Regulations 2015. In general, the terms of exemption require:

- the council to control the vehicle as if it were an internal department, with there being no direct private share or ownership participation in the company (this is known as the control test)
- more than 80% of the vehicle's activities to be with its 'parent' council (this is known as the function test)
- If the council decides to undertake an open procurement, the Teckal requirements do not need to be in place.

NSEC is required to comply with the Companies Act 2006 and other legislation applicable to a limited company.

7. Climate Change and Environmental Implications

None arising from this report

8. Risk Management

Risk Management activities are undertaken by the board of NSEC and reported to the shareholder board and to the client team. There are no specific risks arising from this report. The risks associated with the council's shareholder function are identified in Appendix 1.

9. Equality Implications

None arising from this report

10. Corporate Implications

As identified throughout this report

11. Options Considered

N/A

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Appendices:

Appendix 1 – Shareholder risk register

Background Papers:

Report to council on set up of NSEC 22/09/20 (Confidential)
NSEC articles of association (available on Companies House)

<https://n-somerset.moderngov.co.uk/documents/s3991/6.%20Committee%20Report%20NSC%20-%20Commissioning%20Plan.pdf>

Appendix 1 – Shareholder risk register

Theme	Risk	Lead officer	Inherent likelihood (where 1 is very low and 5 is very high)	Inherent impact (where 1 is very low and 5 is very high)	Inherent risk	Inherent risk treatment	Mitigating / exploiting actions	Residual likelihood (where 1 is very low and 5 is very high)	Residual impact (where 1 is very low and 5 is very high)	Residual risk	Risk treatment
Corporate governance	Lack of robust governance leading to lack of clarity on performance and decision making	Director of Corporate Services/ s151	3	5	HIGH	MITIGATE	Appointment of highly qualified and experienced executive and non-executive directors of the company Shareholder board meetings Shareholder MOU and reserved matters Company articles of association, board meetings	2	4	MED	ACCEPT
Corporate governance	Other actions taken by, or issues with a parent company or major shareholder;	Director of Corporate Services/ s151	3	5	HIGH	MITIGATE	Appointment of highly qualified and experienced executive and non-executive directors of the company Shareholder board meetings Shareholder MOU and reserved matters Company articles of association, board meetings	2	3	LOWMED	ACCEPT
Residents and communities	Reputational impact of company activities	Director of Corporate Services/ s151	4	3	MEDHIGH	MITIGATE	Appointment of highly qualified and experienced executive and non-executive directors of the company Client team monthly meetings Communications lead for NSEC feeding in to corporate team/ planning Shareholder MOU Shareholder reserved matters CEO 1-1 meetings with Chair and MD	2	2	LOWMED	ACCEPT
Finance and resources (inc. staff)	The financial position and/or credit worthiness of a parent company or major shareholder;	Director of Corporate Services/ s151	4	4	HIGH	MITIGATE	Appointment of highly qualified and experienced executive and non-executive directors of the company Financial monitoring, Company business plan development including expansion of services providing contribution to overhead costs Deficit recovery plan	3	3	MED	ACCEPT