

29. CITY CARE LTD PROPOSAL

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| Officer responsible Director of Operations | Author Chris Kerr, Business Improvement Manager, DDI 941-8671 |
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The purpose of this report is to table a proposal from City Care Ltd that would reduce City Council costs by net \$1m and to provide a strategic framework for assessing this proposal.

BACKGROUND

During 2002 City Care Ltd entered into informal discussions with City Council management regarding a proposal to reduce City Care contract costs in return for extended contract periods and a number of other operational changes. After some discussion and negotiation City Care Ltd determined to bring forward a proposal that effectively traded off contract price with contract length, this proposal is attached as Appendix A.

SUMMARY OF PROPOSAL

The City Care Ltd proposal offers a reduction of \$1.5m in contract costs for an extension of three years on a number of strategic, assigned and negotiated contracts. All of these contracts were covered by the LATE agreement.

The proposal to reduce contract costs by \$1.5m has a net impact on Council finances of approximately \$1m as the reduction in cash-flow will reduce the value of the dividend received by the Council. These savings, if agreed, have not yet been factored into the Annual Plan.

The proposal reduces the contract rates for the contracts set out in Appendix A by reducing the gross margin applied by City Care Ltd. It does not increase the efficiency of service delivery or lower the level of service provided. It keeps the door open for ongoing improvements in efficiency, levels of service and form of contract as agreed by the parties.

The extension in contract length of three years is calculated to ensure that overall company value remains as it currently is despite the reduction in cash-flow.

CITY CARE LTD

The Council created City Care Ltd to achieve a number of strategic goals:

1. To maximise the protection of employment for the staff who worked in the then business unit Works Operations.
2. To keep the industry honest by providing a local government owned competitor.
3. To ensure Council had access to a suitably resourced and knowledgeable emergency response force in case of a civil defence emergency.
4. To create a successful business.
5. CCC contract savings.

It is worth re-evaluating these goals to see if they are still valid today.

1. Employment of staff.

The transfer of staff from the Works Operations business unit to City Care Ltd was successful and the great majority of positions were re-created. City Care Ltd is a substantial employer and the City Council still holds some contingent liability for redundancies based on the LATE Agreement through to 2009.

2. Keeping the industry honest.

City Care is a large player in a number of the contracting markets. Experience has shown however that the contracting market will respond to opportunity and through competition can provide cost competitive pricing and ever-improving levels of service. Evidence would suggest that overall the impact of City Care Ltd on the market is relatively minor.

3. Emergency response.

City Care is a key player in emergency response, however, a number of the larger contractors have shown themselves quite capable of handling these situations (flooding, slips etc). The major exception to this is rural fire response capability. Typically in rural areas this is provided by volunteers, as a large urban area with a small rural fringe Christchurch does not attract a volunteer service. The loss of City Care in this role would be a setback.

4. Creating a successful business.

City Care is now generating 25% of its gross revenue from work won outside of Christchurch. In terms of shareholder value and returns to shareholders City Care is performing well. While the Council continues to own City Care Ltd it is to the Councils benefit to support the growth of City Care Ltd.

5. CCC contract savings.

Contract saving goals were included in the LATE Agreement and these have been achieved. This proposal suggests further financial benefits can accrue to the Council through the performance of City Care Ltd.

It is concluded that to a large part these issues are still valid and as such provide a useful framework for assessing the tabled City Care Ltd proposal

CONTRACT PHILOSOPHY

In putting City Care Ltd in place the Council agreed to a range of strategic, negotiated and preferred supplier contracts with a total value in the range of \$25m per year, these were detailed in the LATE Agreement. It was intended that:

1. The strategic contracts would continue to be provided by City Care Ltd based on regular re-negotiations. Strategic contracts include rural fire fighting and waterways maintenance.
2. Negotiated contracts would be re-negotiated at the end of the contract period, it was not a requirement to tender them. These formed the majority of the work and included area parks maintenance and building maintenance contracts.
3. Preferred supplier contracts could be tendered at any time dependent on contractor performance. Contracts included a number of miscellaneous maintenance contracts for waste, parks and streets, as well as the transfer stations. Built into this agreement were a number of contracts that would be tendered to 'test the market place'.

This overall approach protected a stream of valuable work for City Care Ltd for a period that allowed them to establish themselves as a viable and successful contractor. It is intended that over time all of the contracts included in the LATE Agreement will be re-negotiated. As this happens these contracts will no longer be bound to the LATE Agreement but will be stand-alone contracts between the two parties similar to the wide range of contracts Council has in place for its other activities. This process will remove the 'strategic', 'negotiated' and 'preferred supplier' status of the contracts but not remove the Council's contingent liability for redundancies relating to these contracts which is in place until 2009.

While it is not stated explicitly it is fair to assess that the Council's general direction for this work is for it to be tendered at the appropriate time. The ability to tender contracts is an important negotiation lever for Council staff working with City Care Ltd or with any contractor. As such it is a position to be given away with care and only after due consideration of the viable alternatives.

One of the critical considerations therefore for this proposal is whether to accept the extension of the contract period with its \$1m saving, hence reducing the leverage for negotiation, or to support a more pro-active public tendering strategy for the \$25m worth of work.

The Council staff organisation has embarked on a major drive to improve the type and form of contract being used. This has led to the following improvements and areas of work on City Care contracts:

- A new property Facility Maintenance Management performance based contract put in place with City Care as the lead contractor,
- Second generation performance based parks area maintenance contracts being put in place including rationalisation of contracts and a strong focus on partnering,
- Second generation performance based water and waste maintenance contracts being put in to place including the bundling of various contracts into one lead contract and strong key performance indicators, and
- A review of contracts in the solid waste area including work on aligning the transfer station, Recovered Materials Foundation and waste collection contracts.

Further detail of current and proposed improvements to contracts in the Parks and Waterways area is set out in Appendix B.

This stream of work is focused on ensuring that the contractor, City Care Ltd, is performing to the appropriate standard, that best practice contracts are in place, that the prices the Council are paying for work are competitive, there is ongoing focus on improving efficiency and that the Council's contract management capability is improving.

It is appropriate to ensure that benchmarking is undertaken to provide confidence that these improvements are being achieved. It is also important that the contracts are assertively managed by Council staff in terms of proactive measurement of City Care Ltd's performance by agreed (and currently being developed) sharp Key Performance Indicators (KPI's) and that these are reported to the Council through the relevant Units via the 6/12 month monitoring process.

RISKS AND BENEFITS OF THE PROPOSAL

The Corporate Team has assessed the benefits and risks of the proposal as follows:

Potential Benefits

- It is our company, our interest in it being successful.
- Easy \$1 million net saving.
- Cements an ongoing key relationship/partnership.
- Puts the onus on us to make that partnership work.
- We are not yet really ready to go out to market anyway.
- City Care provide key rural fire and emergency services.
- It is difficult to write performance contracts in these areas, so advantages in staying with City Care.

Key Risks

- City Care could become less focused on achieving contract efficiencies.
- Public perception of Christchurch City Council looking after its own and not testing the market.
- City Care are not yet performing well enough, so why extend (and we are not yet managing them well enough).
- Forgoes the option, or at least the threat, of testing the market.

OPTIONS FOR CONSIDERATION

There are three essential options available to Council:

Option 1 - Status Quo

Continue with the current contract periods with the intent of re-negotiating or tendering when these contracts fall due.

Option 2 - Accept the City Care Ltd Offer

Accept the reduction of net \$1m for the proposed contract extension of three years for the nominated contracts and carry on with the process of improving the form of contract and contractor performance. Expect to tender at least some of the contracts at the end of these extended periods.

Option 3 - Embark on a Proactive Tendering Programme

Decline the City Care Ltd offer and look to publicly tender the various contracts at the earliest possible time.

The following table scores the three above options against the strategic criteria set out earlier in the report.

Scoring:

- ✓ ✓ - strong fit
- ✓ - reasonable fit
- - neutral
- ✗ - reasonable weakness
- ✗ ✗ - strong weakness

| | Option 1 | Option 2 | Option 3 |
|--------------------------------|----------|----------|----------|
| Employment of Staff | ✓ | ✓ ✓ | ✗ ✗ |
| Keeping Industry honest | □ | ✗ | ✓ |
| Emergency response | ✓ ✓ | ✓ ✓ | ✗ |
| Creating a successful business | ✓ | ✓ ✓ | ✗ ✗ |
| CCC contract savings | □ | ✓ | ✓ ✓ |
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The biggest weaknesses from this evaluation are the risks to the continuing employment of staff and the ongoing commercial viability of City Care Ltd from undertaking a more aggressive public tendering process (Option 3). It is anticipated, based on previous evidence, that City Care Ltd can expect to lose up to 50% of their current contracts from such a process. This would directly impact on the value of the company and on their ability to provide employment for their current staff. On the strengths side it is anticipated that the contracting industry would react positively to the opening up of this work under Option 3 with likely financial benefits to the Council.

Based on the original criteria Council employed for putting City Care Ltd in place, and updating this criteria to today's currency, the favoured option is Option 2 - accepting the City Care Ltd offer.

SUMMARY

The Council has received an offer from City Care Ltd to reduce contract costs by \$1.5m (net \$1m) for an extension in contract length for a range of strategic, negotiated and preferred supplier contracts. An evaluation of this proposal using criteria Council applied to the original decision to set up City Care Ltd supports the acceptance of this offer.

Staff

Recommendation: That:

1. The Council accept the City Care offer as made.
2. The Council and City Care Ltd commit to a programme of improving contracts between the parties to provide ongoing efficiencies and improving levels of service.
3. Benchmark information and appropriate Key Performance Indicators be provided to the to the six and twelve month monitoring meetings of the respective Standing Committees on the performance of City Care Ltd on these contracts.
4. The transfer station contract will be included in the overall schedule of contracts in this proposal but the Council and City Care Ltd recognise that contract review processes currently underway may result in changes, including the possibility that the City Care contract could be terminated, to the contract and to contract roles and any such changes will be negotiated in good faith between the parties.

5. The Council and City Care Ltd agree to remove contracts that have been re-negotiated, and to remove contracts as they are re-negotiated, from the LATE Agreement, noting that the contingent liability for redundancies remains in place for these contracts until 2009.

Chairman's

Recommendation:

That the above recommendation be adopted.