

3. REPORT OF THE WORKS OPERATIONS/PLANT AND BUILDING SERVICES WORKING PARTY

RR 9940

Officer responsible City Manager	Author Ian Hay
Corporate Plan Output:	

The purpose of this report is to update Councillors on the deliberations and set out the recommendation of the Working Party that was set up by the Council at its meeting of 25 February 1999. The Working Party had a mix of Council and independent membership. Members were:

Councillor David Close (Chairman)
Councillor Dennis O'Rourke
Councillor Ron Wright
Derek Anderson
Doug Marsh
David Spence
Bernie O'Brien
Mike Richardson
Ian Hay

BACKGROUND

The objective of the Working Party is to recommend the best sustainable future arrangements for the Council's achievement of its physical works while taking into account the broader objectives of the Council. The scope of the study is focused on the activities currently carried out by the Works Operations, Plant and Building Services Units, and Canroad Construction Ltd. The study was to place a particular emphasis on the role and structure of own resources (e.g. own forces, own company) in these activities, together with consideration of policy issues arising.

The Terms of Reference were to:

- (a) Identify options for consideration.
- (b) Consider key strategic objectives in relation to each option.
- (c) Undertake analysis of options including business plans and financial projections. Where appropriate this may also include preliminary valuations.
- (d) Consider possible financial and legal structures and taxation issues relevant to each option.
- (e) Consider the impact of each option on Council organisation and policy.
- (f) Consider the impact of each option on market conditions.
- (g) Anticipate the requirements of a possible subsequent Establishment Unit.

The Working Party has kept in mind the key strategic objectives identified in the February report to the Council, namely “that the Working Party be advised that the City Council’s key strategic objectives include:

- (a) *certainty of competitive prices over the long term without compromising on the quality of the services provided for the maintenance and development of Council assets.*
- (b) *Sustainable jobs.*
- (c) *Certainty as to availability of resources in the event of Civil Defence events and for rural fire fighting.*
- (d) *Maintenance of intellectual capital of value to the cities infrastructure.”*

LEGAL FRAMEWORK

With regard to this report, it is important to appreciate at the outset that there are effectively two separate processes involved:

- (a) a ‘due consideration’ of advantages and disadvantages under section 247D of the Local Government Act 1974. The purpose of this report is to enable this ‘due consideration’ and
- (b) the statutory process under Part XXXIVA of the Local Government Act 1974 with the appointment and work of an establishment unit if the Council decides to transfer part or all of the Works Operations Unit and/or Plant and Building Services to a LATE.

The Working Party has been involved in (a) only.

The legal basis of the Working Party’s work is found in section 247D of the Local Government Act 1974, which provides in part:

- (1) *A local authority may carry out its works and perform its functions –*
- (a) *By using its own staff; or*
 - (b) *by entering into an arrangement or contract with –*
 - (i) *The Crown; or*
 - (ii) *Any local authority, department of State, State enterprise, public body, local authority trading enterprise, person, or organisation.*
- “(2) *In deciding ... how to carry out any work or to perform any function, the local authority shall –*
- (a) *Have regard to the requirements of section 223C of this Act and to the objectives stated in its annual plan under section 223D of this Act; and*
 - (b) *Give due consideration to the advantages and disadvantages of different options.”*

The Council is required to have regard to the requirements of s.223C and the objectives stated in its annual plan.

Section 223C provides:

- (1) *Every local authority and, where applicable, every community board shall, in conducting its affairs, ensure that, --*
- (a) *Its business is conducted in a manner that is comprehensible and open to the public:*
 - (b) *Clear objectives are established for each of its activities and policies:*
 - (c) *Conflicting objectives and conflicts of interest are resolved in a clear and proper manner:*
 - (d) *So far as is practicable, its regulatory functions are separated from its other functions:*
 - (e) *Its performance is regularly measured by it in relation to its stated objectives and is capable of being so measured by persons and organisations interested in the performance and activities of the local authority or community board.*
 - (f) *Its local communities, and, where appropriate, central Government, are adequately informed about the activities of the local authority or community board:*
 - (g) *So far as is practicable, where a committee of a local authority or community board is charged with, or has responsibility for, regulatory functions, that committee shall not be charged with or have responsibility for functions that are not regulatory functions:*
 - (h) *So far as is practicable, its management structure—*
 - (i) *Reflects and reinforces the clear separation of regulatory functions from other functions; and*
 - (ii) *Is capable of delivering adequate advice to the local authority or community board or any committee of the local authority or community board so as to facilitate the explicit resolution of conflicting objectives.*

The Council's objectives are set out in the 1998/99 Annual Plan.

Section 247D has been considered by the High Court in a case in 1996 involving Hamilton City Council, which decided to divest itself of its Works Unit. In that case the Council was challenged by the Public Service Association as to the decision to divest, and one of the grounds of challenge was that the Council had not, as required by section 247D(2) given due consideration to the advantages and disadvantages of different options.

In its decision the Court considered what it was that a council must do to comply with this section. The Court stated:

“Significantly, neither counsel attempted to advance a meaning for the words “due consideration”. Nor do I think they should, or could have. An endeavour to substitute another set of words for plain parliamentary language would be wrong in principle, and ultimately unfruitful. The intention, in functional terms, is quite apparent. There are different ways essential services may be provided, and doubtless numerous combinations and permutations on basic models. A local authority is under a duty to actively turn its mind to possible options and consider their merits and demerits in each particular instance. But the duty does not extend beyond that.

All that can be said here, and all that needs to be said, is that there is an affirmative duty to consider the options. The consideration must be that due to the problem, which necessarily means realising its input, and weighing of the advantages and disadvantages of the particular options.

The assessment method actually employed by the council for assessing competitiveness in this case was defensible. Generally speaking a council does not need to exhaust all possible methodologies. Further, assessing competitiveness is at best an inexact science.”

So here the duty on Councillors is to consider the options and consider the merits and demerits of each one and then reach a decision.

THE PRESENT SITUATION

“Works Operations” is currently a collection of a number of “businesses” delivering services to Council client Units.

“Works Operations” include seven components:

1. *Greens Maintenance* business providing maintenance of green spaces including parks, reserves, roading landscapes and grounds and also specialist and horticultural services in major tree works landscape construction and spraying.

Turnover: \$9.4M.
Staff: 132
Major client Units: Parks, City Streets, Water Services and Property Units.
Work Volume: City divided into 12 Parks maintenance areas with Works Operations currently holding all contracts, plus contracts for other work.
Risks and key Issues: All Council work done by Works Operations. Large workforce with 15% of work currently tendered.

2. *Waterways Maintenance* business providing the maintenance of Christchurch waterways for the Council. This includes weed spraying \$1M and weed harvesting \$0.25M.

Turnover: \$2.42M.
Staff: 42
Major client Unit: Water Services who provide close to 100% of the turnover.
Risks and key Issues: One negotiated contract.

3. *Water Maintenance* business providing maintenance of the water reticulation system.

Turnover: \$2.2M.
Staff: 28
Major client Unit: Water Services who provide close to 100% of the work.
Risk and key Issues: One negotiated contract.

4. *Piping Construction* business providing installation of pipes and associated structures for water mains, stormwater drainage and sewers plus water and sewer lining repairs. Market share approximately 25% of Christchurch City Council work.

Turnover: \$1.7M.
Staff: 22
Major client Units: Water Services and Waste Management.
Risk and key Issues: Currently fully competitive tender process. Skills also used for Water and Sewer maintenance.

5. *Roading business* providing the construction and maintenance of roads, paths and resurfacing of both. Market share of approximately 25% of Christchurch City Council market.

Turnover: \$6.4M.
Staff: 77
Major clients: City Streets, Canroad Construction, Utility Service Authorities who provide close to 100% of the work volume.
Risk and key Issues: Full competitive tender for most work with significant value contracts.

6. *Cleaning business* including street sweeping, litter bin collection, refuse collection and sewer maintenance for the Christchurch City Council.
 - Turnover: \$4.0M,
 - Staff: 52
 - Major client Units: City Streets and Waste Management who provide 100% of the work.
 - Risk and key Issues: One competitively tendered contract for street Amenity cleaning. Small contracts for sewer and central city Refuse Collection work.

7. *Refuse business* including refuse station management and transport to landfills, composting of green waste and recycling market share close to 100%.
 - Turnover \$4.5M.
 - Staff: 52
 - Major clients: Waste Management Units and Recovered Materials Foundation.
 - Risk and key Issues: Unique business.

Plant and Building Services is made up of three components.

1. *Building Services* providing a full range of services to Council Units with a predominant workload in maintaining Council stock of Elderly Persons Housing and rental properties.
 - Turnover: \$2.9M
 - Staff: 28

2. *Mechanical Services* providing a maintenance facility for all Council plant and equipment.
 - Turnover: \$4.1M
 - Staff: 25

3. *Plant Hire.* The Unit currently has plant with a book value of \$15.99M which is owned by the Unit.
 - Turnover: \$10.9M
 - Works Operations Component: \$8.2M*
 - Other Business Unit Component: \$2.7M*
 - Staff: 4
 - Major client Units: Works Operations, Property and Waste Management.

Analysis of Current Situation

The Working Party has determined that in their opinion the current work environment is not sustainable. The requirement of Council and Transfund regulations to obtain competitive prices through tendering or other means, has inevitably reduced the size of Works Operation's business. At the same time the constraints of the Local Government Act unreasonably constrain the business, by preventing it from competing for private sector work to spread the business risk and add value. They are only able to compete for work commissioned by local authorities.

The inevitable outcome has been the loss of work traditionally undertaken by Council Business Units as private operators aggressively compete to gain market share in the highly competitive Christchurch market. This is evidenced by the contract price received being well below estimates in many cases.

The Working Party is of the view that the strong Council presence, through Works Operations in these competitively contested markets has considerably reduced service delivery costs to the Council over time by way of lower overall prices and market attenuation. An independent review by KPMG of bitumen product prices in Christchurch compared to other main centres in New Zealand clearly highlights that Christchurch prices are lower than other centres. The costs below show the advantage Christchurch has in overall roading construction and maintenance costs.

	Friction Course Asphalt \$ price per tonne	Grade 4 chip seal \$ per square metre
Christchurch	73.00	1.34
Auckland	99.96	1.72
Wellington	135.90	1.87
Hamilton	115.66	1.47
Dunedin	97.86	1.57

Note: These prices have been adjusted to allow for the lower cost of aggregate in Christchurch.

This leads to the conclusion that where the Council is a major buyer of services it should maintain a strong market presence to ensure a competitive market is retained.

This presence must be in the form of a business which is able to compete on a fair basis with private contractors.

One of the key areas identified in discussions was the need to ensure any changes would provide a viable business operation which was structured and resourced to succeed in the current and future operating environment. The Working Party also took into account the information and reporting needs and views of infrastructural Policy Units who provided information to the Working Party regarding service requirements, and also outlined Council obligations for Civil Defence and rural fire fighting capability.

It was also identified that in conjunction with any structural changes future work arrangements including timeframes would need to be clarified and agreed. For example, the Council units should negotiate preferred supplier contracts with performance criteria included for a specified period of time in some areas. The certainty of tenure for the defined period is an essential element of any transition to alternative working arrangements and structural changes.

Canroad Construction Ltd

The business was set up to meet Transfund requirements and tender for roading contract work on behalf of the Christchurch City Council. It also owns and operates one of three bitumen plants in Christchurch and had a total turnover for the year ended June 1998 \$5.1M, with 11 staff employed. For the reasons identified above it is essential this operation is retained as part of the overall business.

POLICY UNIT VIEWS

After extensive consultation the following is a summary of the main infrastructural unit views on future service delivery arrangements in the key areas where tendering of all activities has not been fully established. Where infrastructural maintenance activities critical to Council operations are currently carried out by negotiation between service provider and client it is appropriate to continue with this arrangement through a transition process to provide certainty and allow any new operation to re-organise. Negotiated contracts will include performance measurement criteria to ensure the Council is continuing to receive value for money.

(a) Water Services Unit

Water Reticulation Maintenance

The preference is for a negotiated long term supplier relationship with a single supplier for water reticulation maintenance. The preferred minimum timeframe is 5 years and should be performance based to enable the supplier of services to add value after an initial learning curve. Current Works Operations team members have a significant knowledge base of the water reticulation system strengths and weaknesses built up over a number of years.

Waterways and Wetlands Maintenance

For reasons of access to private property and knowledge of operations a preferred supplier contract is the recommended option for this service delivery.

(b) Waste Management Unit

Again the knowledge of the Sewer system strengths and weaknesses ideally suit a long term preferred supplier basis with a minimum 5 year contract.

With the pending changes to landfill and refuse transport operations it is deemed prudent for the Council to retain ownership of the refuse station component of the waste cycle. Works Operation team members currently operate the facilities on behalf of the Waste Management Unit with a long term preferred supplier relationship identified as the best option for the Council at this time.

The Water Services and Waste Management Units piping and construction work is currently fully tendered with both Units happy to continue this arrangement.

Repairs to water and sewer pipes is seen as essential to the infrastructure and should be treated on a long term preferred supplier basis.

(c) Parks Unit

Parks Unit favoured a preferred supplier arrangement in specific areas including arboricultural and landscape construction work. General park maintenance work can be competitively tendered but they consider the ideal relationship is a small number of preferred suppliers partnering to achieve the Unit's vision for green areas in Christchurch.

Options considered by the Working Party

During investigations the Working Party considered a wide variety of options and combinations for future service delivery. In particular the following options identified in the 25 February report to the Council included:

- (a) *Putting the whole of both Units into a LATE, together with Canroad Construction.*
- (b) *Putting the same group into a number of smaller LATE's.*
- (c) *Putting part of the same group into a LATE (or LATE's) and keeping the remainder as a Business Unit (or Units) with the main Council organisation.*

All of the above options were fully addressed by the Working Party with the conclusions and recommendations included later in the report.

- (d) *Sale of part or all of the group to outside interests.*
Again this option was considered but the Working Party agreed that for the reasons identified elsewhere in the report this option should not be progressed. A major reason is that where the Council is a significant buyer of services it should have a strong presence as a supplier to ensure maximum competition in the market place. The issue of diversity of services, critical mass and sustainability were also considered and added weight to the Working Party forming this view.

- (e) *Joining forces with other local authorities to form a LATE.*
This option was also considered during the process but members felt that in the interest of retaining value for the Christchurch City Council it is appropriate to re-organise our own operations first to ensure that CCC objectives are met as a priority in the first instance.

The recommendations later in the report are a very significant step for the Council at this time and we need to ensure resources are available to effectively put the new organisational structure in place to add value before discussions with other organisations are contemplated. Issues of joining forces with other organisations are for the Board of the new company to investigate and make recommendations to the Council as the shareholder in future as appropriate.

CONCLUSIONS OF THE WORKING PARTY

1. **Activities that should remain as Business Unit Operations with preferred supplier arrangements.**

Building Services – The Working Party is of the view that this activity should stay as an in-house operation. The section currently delivers cost effective total solution services to the housing team and has consistently won the work by competitive tender and will continue to provide a resource to maintain the significant Council property assets. The in-house operation also has an advantage in pricing by comparison with other competitors relating to the treatment of GST.

2. **LATE Vs Business Unit**

As identified earlier under current legislation (Local Government Act), Council Business Units are prohibited from competing for private sector work. With the continued pressure to competitively tender Council service delivery operations an organisation to be viable and have the opportunity to grow and provide ongoing sustainable jobs needs the ability to diversify its client base and type of operation to the private sector.

There are several key advantages that favour a LATE structure as opposed to a Business Unit.

- (a) Opportunities for growth in a wider market, diversification of client base and business leading to better profitability and sustainability. In all cases other suppliers are available or could be available to ensure a fully contestable tender process.
- (b) Opportunities for the introduction of cultural change, flexible work practices and multi-skilling, to improve productivity.
- (c) Management focus, providing the mechanism for the focus on core activities and bringing a wider range of skills and disciplines for the benefit of the business.
- (d) Most of the Services currently provided by Works Operations and Plant and Building Services are not a core competency required of the Council to maintain the infrastructure. The Working Party has identified parts of Waterways Maintenance, Water Reticulation and Sewer Maintenance, some specialist Greens areas as having local knowledge and skills and experience which the Council would wish to retain through preferred supplier arrangements at least in the medium term. It is expected that these core competencies would be protected by way of a preferred supplier contract at least in the medium term with either a LATE or Business Unit as the case may be. The skills are available elsewhere and the challenge is to ensure the Council meets its objectives of “certainty of competitive prices over the long term without compromising on the quality of services provided to maintain the infrastructure”. Ensuring we control a strong presence competing in the market place on an equal footing best achieves this objective.

- (e) An appropriate critical mass is required for a LATE to deliver competitive service delivery and to compete effectively in the market.

3. **Retention of Status Quo**

The Working Party considered the option of retaining all activities as Business Units but for the reasons set out relating to requirements of the Council to competitively tender, the legal restraints including Transfund and Local Government Act, this was not regarded as a practical option for the future.

4. **Structuring Options**

In light of the above the Working Party identified three alternatives available to be considered.

Option A (The one LATE Option)

Put everything in to one LATE with a mix of tender and preferred supply arrangements.

Roading Construction and Maintenance

Canroad Construction Limited

Amenity Cleaning

Greens Maintenance

Waterways Maintenance

Water Reticulation Maintenance

Sewer Maintenance

Piping Construction

Mechanical Services

Refuse Transfer Stations, resource recovery and composting activities.

Key **advantages** of one LATE include:

- Diversified operation.
- Lowering business risk.
- Some opportunity for Multi-skilling of staff.
- Minimum disruption to current operation.
- Critical Mass

Disadvantages

- Less focus and pressure on the performance of a single core business.
- Opportunities and suspicion of cross subsidy activities
- Seen as 'business as usual'

Option B (The "Two LATE" Option)

That two LATES be set up to enable management focus on core business, again with Building Services identified above retained as an in-house operation.

LATE 1 GREEN LATE

Green Maintenance
Waterways Maintenance

with a mix of tendered and negotiated performance contracts.

LATE 2 ROADING/UTILITY LATE

Roading
Piping Construction
Amenity Cleaning
Sewer Maintenance
Water Maintenance
Mechanical Services
Canroad Construction Limited

Refuse Transfer Stations, resource recovery and composting activities again with a mix of tendered and negotiated performance contracts for a defined period of time.

Advantages

- Focus on core activities with the flexibility to do so.
- Plainly ensure all activities viable and sustainable
- Facilitate concentration on growth in own expertise area.
- Change operations to effectively compete in core market.

Disadvantages

- Less diversified business risk.

Option C (The “Three LATE” Option)

That three LATES be set up to enable management focus on core business, again with Building Services identified above retained as an in-house unit.

LATE 1 GREEN LATE

Green Maintenance
Waterways Maintenance

LATE 2 ROADING LATE

Mechanical Services
Roading
Amenity Cleaning
Canroad Construction

LATE 3 UTILITY LATE

Piping Construction
Sewer Maintenance
Water Maintenance
Refuse Transfer Stations, resource recovery and composting activities

In all areas it is assumed ownership of plant relating to any activity will transfer to that activity.

Advantages

- More focus on core activities.

Disadvantages

- Small operation
- Less diversified cash flows
- Less diversified business risk
- Lack of critical mass

COMMENTARY

In all structuring options the need for preferred supplier arrangements to deliver some activities identified as best suited to a long term relationship with the Council is available. The Working Party see advantages of economies of scale and business practices in these activities being managed as part of a larger operation. It will ensure knowledge and skills built up over a long period of time are retained and enhanced for the benefit of the Council and will add a more business-like focus and best practice to provide value adding services in the future. As part of the transition process, performance-based contracts need to be re-negotiated in those areas where negotiated contracts exist at present or where there is a core competency to protect or no credible tenders in the market to ensure the benefits of improved focus and operations are shared for the benefit of both the new business entities and the Council.

Civil Defence obligations and rural fire fighting capability can also be addressed satisfactorily by a mix of Policy Unit team members and by contract with Council suppliers of services. This area has been discussed at length with Policy Units. A strong LATE or LATES wholly owned by the Council will also guarantee this capability in the same way the current arms length Business Unit structure currently provides the service.

The view is that Mechanical Services should be provided as part of a larger LATE to give it critical mass and to recognise that the delivery of Mechanical Services is not of itself a core requirement of the Council. They will still have the ability to diversify the client base and contract services to other LATES and the Council.

The Working Party recognised that the LATE or LATES will need to be set up conservatively with minimal debt and sufficient working capital to ensure a strong start and provide strength to compete. Where necessary future investment may be required this should be provided at its conception.

The final issue addressed by the Working Party was the trade off between the formation of one “conglomerate” LATE that lowered commercial risk (through spread and increased critical mass) by comparison with the benefits to be achieved from the additional focus and flexibility of two LATES.

CONCLUSION

The Working Party was unanimous in its agreement that a corporate structure should be set up to manage future service delivery options for the Council. The strategic reason for the Council owning these businesses is to ensure continued access to competitive prices for supplying of City infrastructure. For this reason the SCI for a LATE(s) will require the company(s) to target a significant market share of City Council business, this objective to take priority over maximising the rate of return for such business. As stated previously the members agreed that where the Council is a significant buyer of Services they should also have a strong presence as a supplier to ensure maximum competition is available in the market place.

The discussion centred around one or two LATES and the value of each option. After full discussion it became evident that one LATE with two or three separate operating divisions could best achieve the objectives while providing critical mass, sustainability, strength and focus on different activities to ensure value is added to Council operations.

- Recommendation:**
1. That an Establishment Unit be set up to prepare and agree upon an Establishment Plan with the Christchurch City Council and in doing so:
 - (a) identify with reasonable precision the undertaking or undertakings that are to be transferred to a LATE;
 - (b) value any such undertaking or determine a method for its valuation;
 - (c) determine the price that should be paid or the method for determining the price that should be paid by the LATE for the undertaking and the extent to which the price should be met by the issue of equity securities and debt securities to the City Council;
 - (d) specify the debt securities required to be issued pursuant to Section 594zi of the Local Government Act;
 - (e) prepare in draft a Constitution and Statement of Corporate Intent for each LATE;
 - (f) determine the best manner in which, and time within which, the undertaking of the local authority should be transferred to the LATE;
 - (g) determine a fair and equitable system for the transfer of appropriate employees from the local authority to the LATE (but without making determinations in respect of individual employees).

2. That the Strategy and Resources Committee recommend to the Council that the activities of:

Roading Construction and Maintenance

Canroad Construction Limited

Amenity Cleaning

Greens Maintenance

Waterways Maintenance

Water Reticulation Maintenance

Sewer Maintenance

Piping Construction

Mechanical Services

Refuse Transfer Stations, resource recovery and composting activities.

be set up as a LATE and that while three different options are identified in the report the preference is for Option A with one LATE to be set up.

3. That all the activities be transferred to Canroad Construction Limited with an updated Constitution and SCI as the vehicle for the new expanded LATE.
4. That preferred supplier status for the activities identified in the report be subject to negotiation within the Establishment Unit process between the Establishment Unit and the City Council.
5. That CCHL be requested to interview and select three independent business representatives for the Establishment Unit who will form the nucleus of the new Board. In addition as the transition and re-organisation will entail a significant amount of Board time the remuneration for the first 18 months be negotiated and agreed with CCHL to compensate them for the increased time involvement.
6. That the other members of the Establishment Unit be:

Chairman of CCHL

Chairman of S & R Committee

Chairman of P & P Committee

City Manager

Director of Business Projects:

Councillor A James

Councillor D Close

Councillor R Wright

Mike Richardson

Ian Hay

And also Bernie O'Brien with up to two other external members to be co-opted if required by decision of the Chairman of CCHL, Strategy and Resources and Projects and Property Committees.

Chairman's

Recommendation:

That the above recommendation be adopted.