

Insert report title here

Date: February 2024

Report of: Head of Property Management

Report to: Director of Communities, Housing and Environment

Will the decision be open for call in? Yes No

Does the report contain confidential or exempt information? Yes No

Brief summary

The council owns and manages approximately 19,000 homes in the West area of the city. The contract for the delivery of Responsive Repairs, Voids and Cyclical Maintenance (RR, V & CM) work in this area was awarded to Mears Group in April 2021 and commenced on 1st October 2021.

At commencement of the contract, the rates for delivery of services were fixed for the full 5-year term of the contract. However, due to demonstrable increases in material prices, labour rates and other contract delivery costs a 9.25% increase to the rates was agreed in October 2022.

Due to a continuation of these cost increases, this report seeks approval for a further rate increase of 12.5% applicable from 1st January 2024 with the addition of an index-linked rate review each subsequent year for the remainder of the contract term.

Recommendations

- a) That the Director of Communities, Housing and Environment approves an increase of 12.5% to the Schedule of Rates for the Responsive Repairs, Voids and Cyclical Maintenance contract between Leeds City Council and Mears Group.
- b) That the Director of Communities, Housing and Environment approves the application of this increase in rates from 1st January 2024.
- c) That the Director of Communities, Housing and Environment approves a variation to the contract, to make provisions for an annual rate review for the remainder of the contract term, (on 1st January 2025 and 1st January 2026) in line with *the BCIS Local Authority Maintenance Cost Indices – Services*.

What is this report about?

- 1.1 The council owns and manages approx. 19,000 homes in the West area of the city. The contract for the delivery of Responsive Repairs, Voids and Cyclical Maintenance (RR, V & CM) work in this area was awarded to Mears Group in April 2021 following a competitive tender exercise and commenced on 1st October 2021. The original contract value was estimated at £14.5m p/a and is for a fixed 5 year term with no option to extend beyond this period.
- 1.2 The remaining areas of the city, East and South, are delivered by the council's internal service provider, Leeds Building Services (LBS), the latter of these areas being in-sourced from an external contractor in July 2021.
- 1.3 The terms of the contract between Housing Leeds and Mears does not contain any price reviews during the 5-year period, i.e. the tendered Schedule of Rates for work delivered is fixed for the entirety of the contract. However, since the commencement of the contract, the industry, as with many areas of the economy, has seen significant challenge associated with shortages and increased costs of materials, labour and overheads (e.g. building costs, fuel and energy prices).
- 1.4 As a result of these unforeseen changes to the market brought about by factors such as Covid-19, inflationary increases and the war in Ukraine, Mears served an Early Warning Notice (EWN) in June 2022 setting out that its original tendered rates were no longer sustainable, and in October 2022, following a process of negotiation and consultation with internal stakeholders, a 9.25% increase was subsequently agreed to be implemented to the contract, in line with a number of sector-relevant indices.
- 1.5 The delegated decision report (DDR) relating to the decision to uplift the rates in October 2022 is included within the background documents as Appendix B to this report. The report includes further information regarding the rationale for the exclusion of a price review mechanism in the RR, V & CM contract at the original tender stage, a description of changes in market conditions, and also the rationale to support a 9.25% increase to the rates.
- 1.6 The decision taken to uplift the rates in October 2022 was intended as a one-off rate increase in-order to make the contract more sustainable and no decision was taken to vary the contract and build in an annual rate review mechanism. However, in-line with provisions of the contract, either party remains entitled to submit an Early Warning Notice where they become aware of any matter which could affect the total price of the contract or performance of the contract specification.
- 1.7 However, since October 2022, despite the agreed increase being applied to the contract rates, Mears has further reported that the financial sustainability of the contract has continued to be impacted by the challenging market conditions, raising inflation and pay awards and Mears has raised further concern that despite the 9.25% agreed uplift to the rates easing some of the financial pressures, the continuing market pressures have again rendered the contract commercially unsustainable.
- 1.8 There remains a shortage of workers within the construction industry which is recognised across the sector (CITB Construction Skills Network (CSN) Industry Forecast 2023-2027 reports construction industry will require an additional 225,000 workers). This reduced labour pool continues to push up labour and supply chain availability and cost.

- 1.9 Pay awards, at a higher rate than the budgeted level, have impacted further on labour costs after the National Joint Council for Local Government Services approved a rise of £1,925 for 2022/23 and 2023/24 which represents a rise of 9%-10%.
- 1.10 Alongside increasing overhead costs (including high fuel and fleet management costs), Mears has also reported increasing material costs, which mirrors the national trend. Although there has been some slowdown in the rate of material cost increases in 2023, market data indicates that material costs have increased c.19% since mid-2021 when the contract commenced.
- 1.11 These pressures prompted the submission of a further EWN to Leeds City Council from Mears in June 2023 highlighting that, "The ongoing nature of UK cost inflation has continued to exacerbate the issue that Mears have experienced since the contract was tendered. Mears 2020 tender assumption was 1.35% per annum. The uplift agreed by Housing Leeds in 2022 did assist Mears to bridge some of the cost inflation but costs are circa 16% higher at this point than they were when Mears tendered the contract even after our tender inflation assumption and the 2022 price increase is considered." A copy of this EWN is included as a confidential appendix A.
- 1.12 Upon receipt of the EWN, Housing Leeds engaged colleagues in PACS and Finance to ensure internal governance processes and Council guidance were followed in assessing how most appropriately to respond to the situation.
- 1.13 An Options Appraisal was undertaken to ensure all available options were assessed, ensuring that Housing Leeds continued to deliver these essential, statutory services while ensuring a preferred option also delivered best value to the council.
- 1.14 As the pressures highlighted by Mears were objectively demonstrable, it was agreed that the most appropriate response was for the Council to negotiate with Mears to agree an uplift to the current Schedule of Rates.
- 1.15 It was also agreed that given the significantly changed and unstable market conditions since the original tender preparation, in addition to negotiating a contract rate increase, the future provision of an annual rate review within the contract should be explored.
- 1.16 These negotiations were informally concluded in December 2023, subject to appropriate governance and approvals. The outcome of these negotiations is the recommendation that a 12.5% uplift to the Schedule of Rates is applied from 1st January 2024.
- 1.17 It is also recommended that a variation to the contract is approved in-order to incorporate an annual rate adjustment mechanism into the contract for the final term of the contract. This review will be applicable on 1st January 2025 & 1st January 2026 and will be based on the *BCIS Local Authority Maintenance Cost Indices – Services*.

What impact will this proposal have?

- 2.1 Responsive repairs, voids and cyclical maintenance to council-owned homes is an essential service for the residents of Housing Leeds, ensuring homes are well maintained in a safe manner, compliant with a range of health and safety legislation and meet the needs of Housing Leeds' diverse customer base.
- 2.2 Failure to deliver an effective service would not only have significant reputational damage for Leeds City Council, but also risk the Council's ability to deliver a range of statutory

services, including fire safety works and electrical safety inspections as well as the reservicing of empty homes.

- 2.3 Due to the unprecedented situation being seen in the industry, including major disruption to material supplies and labour shortages, as well as increases in energy and fuel costs, the cost of delivering these services has increased significantly since the commencement of the contract. This can be evidenced utilising financial tracking indices such as the Consumer Prices Index, as well as more industry specific measures such as *BCIS Local Authority Maintenance Cost Index – Services* and *BCIS General Building Cost Index*, all of which have seen steep increases over the course of the last 18-24 months.
- 2.4 As a result, and despite the application of the 9.25% agreed rate increase in October 2022, the tendered rates submitted by Mears for delivery of services in the West of the city meant the contract was no longer financially viable. This has resulted in the submission of a further EWN to Leeds City Council requesting a further increase to the rates.
- 2.5 Following receipt of the EWN, an Options Appraisal was undertaken to ensure all available options were assessed, ensuring that Housing Leeds continued to deliver these essential, statutory services while ensuring a preferred option also delivered best value to the council. The options considered were:
 - 2.5.1 **Refuse the request and remain on tendered rates (+9.25% October 2022 increase).** This option was ruled out on the basis that it would likely lead to termination of the contract on the basis of financial viability.
 - 2.5.2 **Reprocure the contract.** This option was ruled out on the basis that re-tendered rates would be significantly higher than those previously submitted as a result of the market pressures highlighted above, plus the ongoing instability in the market.
 - 2.5.3 **Insource service to LBS.** This option was ruled out on the basis that LBS has recently undergone significant expansion in the South of the city and remains in the 'normalisation' phase of delivery. Further expansion at this time was deemed too high a risk, putting the effectiveness of the service across the city at risk.
 - 2.5.4 **Negotiate with Mears to reach a mutually agreeable position.** This was identified as the preferred option on the basis of 'best value' (i.e. would still represent the least costly option for Housing Leeds) and operational continuity.
- 2.6 Colleagues in Finance and PACS were engaged throughout this process to ensure all options and negotiations followed LCC guidance and governance processes.
- 2.7 The outcome of the subsequent negotiations with Mears have resulted in the recommendation of a 12.5% increase to the Schedule of Rates, applicable from 1st December 2024. This equates to an increase in value of approx. £500k for the remainder of FY2023/24 and approx. £2m per full year thereafter.
- 2.8 Adequate budget has been identified in the Housing Revenue Account (HRA) for the remainder of FY2023/24 to manage this pressure and built into the budget provision for future years.

- 2.9 The provision of annual rate reviews (to be undertaken on 1st January 2025 and 1st January 2026) utilising the *BCIS Local Authority Maintenance Cost Indices – Services*, will provide a more stable financial platform for the remainder of the contract term and more cost certainty for the council.

How does this proposal impact the three pillars of the Best City Ambition?

Health and Wellbeing Inclusive Growth Zero Carbon

- 3.1 Failure to deliver an effective service would not only have significant reputational damage for Leeds City Council, but also risk the Council's ability to deliver a range of statutory services, including fire safety works and electrical safety inspections as well as the reservicing of empty homes.

What consultation and engagement has taken place?

Wards affected:

Adel & Wharfedale, Armley, Bramley & Stanningley, Calverley & Farsley, City & Hunslet, Farnley & Wortley, Guiseley & Rawdon, Headingley & Hyde Park, Horsforth, Kirkstall, Otley & Yeadon, Pudsey, Weetwood

Have ward members been consulted? Yes No

- 4.1 The Executive Member for Communities, Housing and Environment has been consulted on the proposed recommendations of this report.
- 4.2 The Director of Communities, Housing and Environment has been consulted on the proposed recommendations of this report.
- 4.3 Senior colleagues in Finance, including Head of Finance, have been consulted and actively involved in the negotiations.
- 4.4 Senior colleagues in Procurement and Commercial Services (PACS) have been consulted and actively involved in the Options Appraisal process.

What are the resource implications?

- 5.1 The outcome of the negotiations with Mears have resulted in the recommendation of a 12.5% increase to the Schedule of Rates, applicable from 1st January 2024. This equates to an increase in value of approx. £500k for the remainder of FY2023/24 and £2.0m per full year thereafter.
- 5.2 Adequate budget has been identified in the Housing Revenue Account (HRA) in FY2023/24 to manage this pressure and built into future budget provision for future years.
- 5.3 As part of the consideration of the other options considered (see 2.5) it was identified that significant financial and staffing resources would need to be employed to deliver any of the options considered non-preferred. The staffing and internal resources in particular are currently operating at maximum capacity and delivering a procurement / in-sourcing exercise on this scale at the current time was considered to be 'very high' risk.

What are the key risks and how are they being managed?

- 6.1 There is a risk that other providers who tendered for the contract could challenge the decision on the basis that they tendered for the contract on the basis of a 'fixed price' Schedule of Rates for the full term. This is considered low risk due to the instability witnessed across the sector over the last 18-24 months, meaning other providers would likely be unable to stand by their tendered rates.
- 6.2 Failure to agree the rate increase with Mears may lead to contract termination, resulting in a threat to the continuation of statutory and other vital services.
- 6.3 The risks associated with this decision are recorded and managed through the Housing Leeds Property Management risk register and Housing SMT risk register.
- 6.4 In addition, the formal Risk Reduction process initiated by the submission of the Early Warning Notice in June 2023 has been followed and recorded accordingly.

What are the legal implications?

- 7.1 Failure to agree the rate increase with Mears may lead to contract termination, resulting in a threat to the continuation of statutory and other vital services.
- 7.2 Should approval not be granted and termination proceedings commenced, legal advice would need to be sought in relation to damages / costs.

Options, timescales and measuring success

What other options were considered?

- 8.1 **Refuse the request and remain on tendered rates (+9.25% October 2022 increase).** This option was ruled out on the basis that it would likely lead to termination of the contract on the basis of financial viability.
- 8.2 **Reprocure the contract.** This option was ruled out on the basis that re-tendered rates would be significantly higher than those previously submitted as a result of the market pressures highlighted above, plus the ongoing instability in the market.
- 8.3 **Insource service to LBS.** This option was ruled out on the basis that LBS has recently undergone significant expansion in the South of the city and remains in the 'normalisation' phase of delivery. Further expansion at this time was deemed too high a risk, putting the effectiveness of the service across the city at risk.

How will success be measured?

- 9.1 Continuation of statutory and essential services in the affected wards.
- 9.2 Performance will continue to be measured via the contract KPI framework.
- 9.3 Customer satisfaction (ref. KPI R4) with the quality of the service provided is considered to be the primary indicator of the quality of the service.

What is the timetable and who will be responsible for implementation?

- 10.1 Subject to approval of the recommendations contained within this report, the increase in the rates will apply from 1st January 2024.
- 10.2 A reconciliation of the works completed from 1st January 2024 to date of implementation of this decision will be completed by Property Management (Housing) and Finance colleagues.
- 10.3 Property Management (Housing) will be responsible for the implementation of this decision.

Appendices

- Appendix A - Copy of Mears Early Warning Notice (Confidential).
- Appendix B – Copy of DDR, Inflationary Uplift, October 2022.
- Equality, Diversity, Cohesion and Integration Impact Assessment.

Background papers

- None