

Report title: Review of Essex Education Services	
Report to: Cabinet	
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Date: 22 May 2018	For: Decision
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County Divisions affected: All Essex	

Confidential Appendix

This report has a confidential appendix which is not for publication as it includes exempt information falling within paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972, as amended.

1. Purpose of Report

- 1.1. Essex Education Services ('ESS') is a traded part of ECC which provides services to schools. This report seeks agreement to conduct the sale of EES with a view to maximising the return to the Council because we believe that selling EES now would unlock value for ECC and would enable the business to be developed to the next level in the hands of the buyer.

2. Recommendations

- 2.1. Agree that, subject to the remaining recommendations, the Council sells Essex Education Services (EES) via a

competitive auction process which includes the disposal of the asset, liabilities and contracts of EES.

- 2.2. Authorise the Cabinet Member for Education (in consultation with the Leader, the Cabinet Member for Resources, the Cabinet Member for Health and Adult Social Care, the Chief Executive, Executive Director for Corporate Development and the Executive Director for Corporate and Customer Services (S151 Officer)):

- Approve the final process to be followed;
- Approve the criteria to be used to select the winning bid;
- Finalise the Information Memorandum (IM) for the sale transaction for EES;
- Select the winning bid; and

- Enter into a contract for the disposal of EES in a form approved by the Director, Legal and Assurance.
 - Enter into a contract for the future provision of serviced office space and IT infrastructure to the purchaser during a six-month interim period following the sale.
 - Enter into a contract for the disposal of EES in a form approved by the Director, Legal and Assurance.
- 2.3. Agree that Essex County Council (ECC) will purchase a three-year insurance backed bond of £3m to cover the liability of the new employer to make pension contributions to the Essex Pension Fund with respect to EES employees who transfer from ECC to the new employer.
- 2.4. Agree that:
- (a) the cost of such bond may be drawn down from the Transformation Reserve; and
 - (b) the cost of the bond be returned to the Transformation Reserve on completion of the sale.
- 2.5. Agree that the Council's Essex Outdoors, Schools Advertising and Initial Teacher Training services should no longer be managed by EES and that they should be retained by the Council.
- 2.6. Agree to the drawdown of up to £82,000 from the transformation reserve to cover the legal costs of the project.

3. Summary of issue

Background

- 3.1. EES is a traded business of Essex County Council (ECC) with its own recognisable brand in the market place. A key product, Target Tracker (TT), holds a 25% market share in primary school assessment software, securing its place as the market's largest single provider. It has more than 4,500 customers nationally, with a limited additional customer base internationally. EES is not a company but it operates as a traded service within ECC. This means that all EES staff are employees of ECC and all contracts with EES customers are contracts with ECC.
- 3.2. EES is a profitable business and it has grown steadily in recent years, developing both its product and customer bases. In recent years parallel schools funding has become increasingly constrained and new sales have not continued at the same rate of growth experienced as in previous years since 2016-17.
- 3.3. In 2016 the service had reached a pivotal point in its growth strategy. It was decided that in order to continue to grow and meet the demands of its customers, significant investment would be required both in existing and new products, and also the capabilities of those delivering the services. It was recognised that whilst ECC has built an excellent and valuable asset in EES and whilst EES is generating significant revenue for ECC. However, as a mature and sensible investor it was recognised that EES may require specialist investment, meaning that ECC may not be the best long-term owner for the business.

- 3.4. To determine the business direction for EES, a report was commissioned from CIL Management Consultants in Summer 2016 to review:
- growth through acquisition (whether to obtain market share / profitability);
 - greater product range and/or management expertise/capacity);
 - realisation of the asset value through company sale (disposal);
 - continued organic growth only; and
 - growth through partnership.
- 3.5 The report concluded that 'the most suitable strategic option for this business is selling TT and investing in EES's professional and support services proposition via acquisitions, partnerships and through investment in organic growth'.
- 3.6 Furthermore, the report concluded *'without further investment, TT may currently be at the height of its market potential and risks losing ground to competitors if not developed further. Therefore, if EES decided that it did not wish to, or could not, back TT with investment or an acquisition, now is likely to be the ideal time to divest.'*
- 3.7 In December 2016, the then Executive Director responsible for EES commissioned a document to present the options around the future of EES and following consultation with the Leader soft market testing on the potential of selling TT was undertaken.
- 3.8 The feedback from the market was that EES is a 'market leading platform that is well positioned with the opportunity for growth'. Thus the market view was that ECC should consider selling EES in its totality, including TT.
- 3.9 During 2017 it became apparent that a significant downturn in the education professional development market was developing and this has continued to deepen into 2018. Despite significant restructuring EES is unlikely to recover to previous levels of profitability with additional significant investment.
- 3.10 In light of the market testing feedback a proposal to sell 100% or a majority of EES was developed. Market testing further confirmed that whilst a joint venture (JV) would enable ECC to be invested in, there was no appetite from the market. Despite the original recommendation from CiL of disposing only TT, and retaining the remainder of EES, evidence from market testing confirmed that this approach would not provide the Council with maximum value from the asset.
- 3.11 In June 2017 PwC were appointed, to provide 'consultancy services to advise on disposal of part or all of Essex Education Services'. Informal advice from PWC, as well as other experts in the education market, suggests that a private equity buyer for EES could be readily found.
- 3.12 In December 2017, PwC concluded that equity buyers "struggled to understand how a JV structure would work in practice given investment requirements and the need for control over ECC's exit. Based on our market soundings a

JV would be likely to severely limit the number of interested parties and adversely impact deal flexibility and value". The same report further concluded that "typically, private equity would seek to have control over key decisions and the timing of any future exit". Therefore the idea of the Council holding a majority share was removed from the proposed approach.

- 3.13 As a result it is now recommended that ECC should dispose of the whole of EES with the exception of Essex Outdoors and Initial Teacher Training.
- 3.14 All EES's services are non-statutory. Schools are therefore not required to buy from EES and EES is not required to sell to them.
- 3.15 In February 2018 PwC presented an update on their work which includes the parameters and outline timeline for sale.

Week ending

April 6	PwC completes the Vendor Due Diligence
April 27	PwC completes the growth strategy review
May 18	PwC completes the Information Memorandum (IM)
May 22	Cabinet meeting to review the proposed option to sell
June 8	PwC launch stage 1 of the sale which involves sending the Investment Memorandum to interested parties
June 29	stage 1 closes with first round offers
July 6	stage 1 round offer clarifications and shortlisting to approximately five or six bidders
July 13	PwC launches stage 2 with shortlisted bidders receiving Vendor Due Diligence, sales and purchase

	agreement (SPA) and access to the Virtual Data Room
August 10	stage 2 closes with final offers and mark up of SPA received
August 17	clarify offers / negotiate and agree exclusivity with preferred bidder
August 31	period of exclusivity with preferred bidder to finalise diligence / documentation. Final decision

- 3.16 The legal work on the transaction will be undertaken in house by ELS but the cost of the work will need to be funded from the transformation reserve as ELS is not funded by ECC for the cost of project work. Accordingly, approval for a drawdown of £82,000 from reserves is sought.

4. Scope of the transaction

- 4.1 All of the services listed below are proposed to be disposed of as part of the transaction:

Service area

Target Tracker	Software EES provides to allow primary schools to assess the educational progress of children.
Education Finance Support	A team who provide in school financial support and audit services
Support for Governors	Advice and guidance for subscribing governing bodies
Clerking Agency	Advice and guidance for subscribing governing bodies
Schools HR	A team who provide in school HR support and compliance services

Professional
development
Educational Visits

Training for all school staff and in school
educational support.
Advice and guidance for subscribing
schools on residential and other out of
school visits.

council services in terms of maintaining market share and
retaining customers. However, EES may decide to compete
against ECC services and offer these services.

4.2 In addition, EES manages Essex Outdoors and Initial
Teacher Training which are branded within EES and
recruitment advertising. The recommendation is that the
management of these services will be transferred to other
Council services.

4.3 Previously ECC commissioners have bought outcomes from
EES, though these have largely ceased. The remaining
elements are:

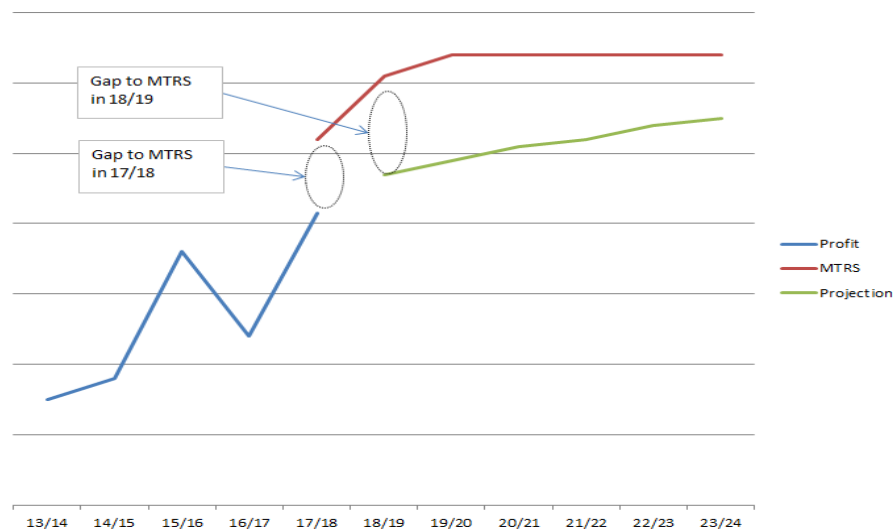
- Support for the recruitment of local authority governors
to schools (this is planned to cease in the summer
term 2018 with this being transferred to other parts of
ECC); and
- Support for the education partnership with China (this
will cease in 2018).
- EES supports the core Education team by managing
centrally paid money for the termination of contracts
for school based employees. This will be managed by
the core Education team.

4.4 In addition other services in ECC use EES resources to
support invoicing and marketing their traded services to
schools (Essex Legal Services, Health and Safety, Early
Years). This will cease after the transition agreement period
when the new company can decide to offer this service to
the Council if still required. This may impact on other

4.5 EES also occupies premises in County Hall. As part of the
transaction EES will lease this space from ECC on
commercial terms or find alternative accommodation. This
may lead to additional space in County Hall, although a
reduction in overall rental income.

Financial forecast

4.6 EES for Schools has grown significantly in terms of profit
without investment but has reached the point at which the
Council's expectation outstrips the ability of the service to
deliver. The graph below shows the performance of EES
without investment, previous years and original MTRS



5 Options

5.1 The options considered are:

- **A** service remain 'as is' without investment. The service will continue to deliver a contribution to the ECC revenue budget, although this will decline through lack of investment and as the market continues to change with competitors improving their offering. The 18/19 MTRS contribution from EES to the Council is £4.7 million.
- **B** invest in the development of renewing and improving the TT product. This option was reviewed extensively in 2016/17 and the conclusion was that the investment of between £4m - £7m into the business was unviable for

the Council and did not produce sufficient return at an acceptable risk.

- **C** the Council sells all of EES for Schools. This option produces a capital receipt for the Council without the need to invest. The range of potential values is wide depending on the individual buyer and the market at the time of sale.
- **D** the Council sells of part of EES for schools. This produces a capital receipt, albeit lower than option C, but retains potential for a dividend.

5.2 If ECC is focused on maximising the value of EES, Option C is the preferred option. This approach provides the opportunity to significantly reduce the risk to the Council in terms of challenges in the education market. It also does not require the Council to invest in EES to secure the financial future of the business. For EES the sale provides a shift of ownership more suitable for the business in terms of growth, as well as access to investment, specialist business support and sales channels.

5.3 The proposed approach to achieve Option C is an auction process, with a two-stage process to shortlist preferred bidders that will meet ECC's minimum requirements, track record, ability to pay and future potential. Market feedback suggests potential buyers require a quick agreement on completion of the auction.

5.4 The strategic objectives for the transaction are:

- To achieve the best value for the business whilst investor interest is high;

- Post transaction to retain a significant presence in Essex and remain part of the Essex Economic Growth story which means that the company is a medium size employer contributing to the economic prosperity of Essex; and
- For EES to be seen as an employer of choice in Essex which means that the Essex community gains through the growth of the business.

6 Next steps

- 6.1 If the Cabinet approve the recommendations in the report, the next stage of this process is for the Council's appointed advisers to bring the business to market towards the end of Q2, 2018.
- 6.2 The final decision as to who will be the successful buyer will be decided through an unrestricted auction process. This will invite bidders to submit an offer for 100% of the business.

7. Issues for consideration

7.1 Pensions

- 7.1.1 A report was commissioned from Barnett Waddingham (the UK's largest independent provider of actuarial, administration and consultancy services) 'to advise the administering authority on the pensions information required in respect of eligible employees transferring their

employment from Essex County Council (the Letting Authority) to a new employer'.

- 7.1.2 The report was presented to ECC on 2 January 2018 and found that the EES part of the ECC pension scheme was fully funded as at 1 December 2017, with future employer contributions, if the scheme was closed to new employees, calculated at around £1m per annum.
- 7.1.3 Where private company employees are members of the EPF the fund requires a bond to be provided. The report concluded that any transitional agreement which would allow the introduction of a defined contribution scheme for new employees while guaranteeing the funding of any additional contributions in relation to the legacy defined benefit scheme would be more attractive to investors. The most buyer friendly position would see ECC pay the bond, which could be purchased from insurers for three years with contributions capped at the current level. Provision of a bond is a legal requirement.
- 7.1.4 The Council could provide the equivalent in terms of the bond value through an insurance scheme for three years. This is estimated to be at a cost 1% of the total bond value for three years per year. The exact figure can only be determined at point of sale. ECC would not provide a bond beyond the three year period.
- 7.1.5 The buyer will take on the responsibility of providing the bond or insurance after three years.

7.1.6 PWC advise that ECC should pay for the cost of the pension bond rather than take out insurance and recover this through the sale.

7.2 Ongoing services between EES and ECC

7.2.1 Given the speed at which the sale is likely to proceed, it is likely that there will be a requirement for ECC to carry on occupying its current premises and using some ECC support services for a short period after the sale. It is proposed that we would enter into an agreement with the buyer to provide these services.

7.2.2 The scope of this agreement will be defined depending on the buyer however will likely encompass office accommodation and use of ECC's IT infrastructure.

- Currently EES for Schools pays £117,589 per annum for office accommodation. This includes facilities management and services such as confidential waste disposal and office cleaning. It is proposed that ECC should allow EES to continue to use its current premises for up to six months after sale. This includes all existing FM services including confidential waste disposal and cleaning.
- Currently EES for Schools pays £466,610 per annum for information technology services. Again, it is considered to be necessary that this continues for up to six months after sale. This includes: email, file access, telephony, mobiles, printers, internet access, network support and computer hardware.

- There will be a charge based on the existing charges in the MTRS budget.

7.2.3 ECC now buys very little from EES and in order to avoid procurement law issues, it is proposed that ECC will not purchase any services from EES after the sale.

8 Financial implications

8.2 The financial implications are outlined in the confidential Appendix of this report.

9 Legal implications

- 9.1 The Council owns all EES assets and it is not required to provide any of the services that EES provides. As a result, ECC can sell its assets to the highest bidder and this is not considered to be procurement activity as the Council will not be buying anything. The Council will need to ensure that there is a transparent process which results in the best return for residents. As part of this we will need to have a clear process for disposal.
- 9.2 As part of any sale the buyer will wish to verify that ECC can demonstrate ownership of the assets which are to be included in the sale and that they can be lawfully transferred to the buyer. ECC will also be required to give warranties about ownership. Draft sale agreements will be included in the documents issued to tenderers.

- 9.3 ECC Financial Regulation 7.1.5 states that all disposals over £5m require the approval of Cabinet.
- 9.4 The employees working in EES will transfer to the purchaser under the provisions of the Transfer of Undertakings (Protection of Employees) Regulations 2006 as amended.

10 Equality and Diversity implications

- 10.1 The Public Sector Equality Duty applies to the Council when it makes decisions. The duty requires us to have regard to the need to:
- (a) Eliminate unlawful discrimination, harassment and victimisation and other behaviour prohibited by the Act. In summary, the Act makes discrimination etc. on the grounds of a protected characteristic unlawful.
 - (b) Advance equality of opportunity between people who share a protected characteristic and those who do not.
 - (c) Foster good relations between people who share a protected characteristic and those who do not including tackling prejudice and promoting understanding.
- 10.2 The protected characteristics are age, disability, gender reassignment, pregnancy and maternity, marriage and civil partnership, race, religion or belief, gender, and sexual orientation. The Act states that 'marriage and civil

partnership' is not a relevant protected characteristic for (b) or (c) although it is relevant for (a).

- 10.3 The equality impact assessment indicates that the proposals in this report will not have a disproportionately adverse impact on any people with a particular characteristic.

11 List of appendices

Equality Impact Assessment

Confidential appendix (not for publication)

12 List of Background papers

None.