POLICY AND RESOURCE COMMITTEE – 13 JUNE 2022

PART

2. LEISURE FACILITIES MANAGEMENT CONTRACT – REPROFILING OF MANAGEMENT FEE

1. Summary

1.1 The purpose of this report is to provide details of the reprofiling of the management fee, associated revenue implications of the Leisure Management Contract (DBOM) due to the impact of COVID 19.

2. Details

2.1 TRDC have entered in a 20 year DBOM (Design, Build, Operate and Maintain) Leisure Management Contract with Sports and Leisure Management (SLM) on 1 July 2018.

2.2 Following the implications of Co-vid 19, with the facilities being either closed or restricted usage during the two years, a deed of variation for 2019/20 and 2020/21 was agreed. This was primarily based on the principle of TRDC continuing to pay the management fee to SLM for Rickmansworth Golf Course and deferring the management fee from SLM to TRDC for William Penn Leisure Centre and South Oxhey Leisure Centre. Any waver of payment by TRDC is to be paid back by SLM using an 80:20 surplus split in favour of the Council for the remainder of the year and this element remains unchanged.

2.3 As the sector recovers from Covid 19 and operators are planning for the forthcoming year (2022/23) there are still challenges in recovery and Operators across the Country are seeking to renegotiate their contracts in respect of the management fees due or to be paid.

2.4 Overall the general rationale for this includes:

- Income and participation is generally not at pre covid levels (indeed the Moving Communities data suggests an average of 70% recovery)
- There has been a loss of two years of growth in the market
- Increased costs (such as utilities) have factored into the future projections. Although it should be recognised that this is not necessarily due to Covid and dependent on the contract could be dealt with through utilities benchmarking.

2.5 With respect to SLM, the effect of the pandemic continues to impact on income levels, particularly with fitness membership levels and swimming lessons. Even though in recent months there has and continues to be growth, they remain well below bid target level.

2.6 Further discussions between the Council and SLM prior to the new financial year (2022/23) have resulted in a request from SLM for the management fee payments over the next several years to be reprofiled in order to reflect the ongoing period of recovery and the loss of previously projected income growth during the pandemic. Following detailed negotiations around the level of re-profiling and an increase in management fee of £100,000 spread over the next two years, SLM are proposing an amended management fee of £299,000 in 2022/23, a variance of £495,000. They also improved the management fee position for 2023/24 by £50,000 from their initial request. In total, the proposal reduces the management fee in 2022/23 and following five years by £978,068. This amount is recovered over the remainder of the contract.

2.7 In parallel to negotiating with SLM, alternative options to agreeing a Deed of Variation with SLM were explored. These options are included at Appendix 1. The overall conclusion is that given the current market negotiation with SLM was the most beneficial option.

3 Financials

3.1 For 2022/23, the budget for the net management fee taking into account RGC is £793,800. This is the budget as per the original management fee without inflation. The budget remains at this level across the MTFP.

3.2 SLM are looking to reprofile the management fee from 2022/23 onwards. See Appendix 2. The proposal reduces the management fee in 2022/23 and following five years by £978,068. This amount is recovered over the remainder of the contract. The breakdown of the shortfall is set out in the table below.

£'000	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Variance to original management fee (excluding inflation)	495	203	92	66	42	80

3.3 Three Rivers currently charges the lowest amount of all neighbouring authorities for swimming lessons and prices are lower than alternative private providers. In order to partially mitigate the impact of the reduction in management fees, SLM have provided the Council with proposals to increase swimming lessons from 1 September which will reduce the gap by circa £33,000 in 2022/23. If the fee increases are applied this will increase the overall management fee to the Council year on year over the life of the contract and reduce the deficit against the budget in the MTFP. The proposals for swimming lessons along with comparisons of neighbouring authorities are set out in Appendix 3.

3.4 It is recognised that an increase in costs may disproportionately impact on those households with the lowest incomes. In order to promote participation and tackle inequalities a scheme will be developed as part of the Council's Shared Prosperity Fund bid to provide subsidised swimming lessons for the most disadvantaged children within the district.

3.5 The table below summarises the management fee over the remainder of the contract (April 2022 – 30 Jun 2038), in five year increments.

£'000	Apr 2022 – Mar 2027 (5 years)	Apr 2027 – Mar 2032 (5 years)	Apr 2032 – Mar 2037 (5 years)	Apr 2037 – Jun 2038 (15 months)	Total (16 years 3 months)
Original Management Fee	(3,747)	(3,152)	(3,728)	(1,004)	(11,631)
Revised Management Fee (RMF)	(2,849)	(3,419)	(4,238)	(1,125)	(11,631)
RMF including swim lesson increase	(3,009)	(3,579)	(4,398)	(1,165)	(12,151)

Note: figures in brackets are payments to the Council and exclude indexation

3.6 The table above illustrates that the revised management fee proposal from SLM maintains the same overall contract payments for the remainder of the contract but the profile changes so that there are lower payments in the first five years and greater payments in later years. The Revised Management Fee does not take account of inflation.

7. **Options/Reasons for Recommendation**

7.1 The recommendations in this report are not within the Council's agreed policy and budgets. Officers are recommending to the Committee to approve the financial settlement package with SLM outlined under the financial implications at paragraph 4.4 of this report.

7.2 It is clear from the current contract performance that the recovery and rate of return of customers to facilities has not returned to pre-pandemic levels of income and also the growth has not been at the level anticipated prior to the impact of Covid-19. As a result, SLM have proposed a revised management fee payment schedule which dramatically reprofiles the payments to the Council over the short and medium term. The Council is unlikely to be able to extract additional management fee income from SLM about that which has been proposed

7.3 There are a number of options available to the Council other than supporting SLM, however all of these are likely to cause disruption to the service and also be more costly. The other options would also make it more likely that the recovery of the Centres once the market gets back to normal would be longer and more costly.

8. **Legal Implications**

8.1 Deed of variation of the original DBOM contract are in place for 2020/21 and 2021/22 are in place. A further deed of variation will need to be put in place for 2022/23, as set out within the provisions of the Leisure Management Contract.

9. **Equal Opportunities Implications**

9.1 **Relevance Test**

Has a relevance test been completed for Equality Impact?	No
Did the relevance test conclude a full impact assessment was required?	No

7. **Staffing Implications**

7.1 None.

8. **Community Safety Implications**

8.1 None.

9. **Public Health Implications**

9.1 The Council is in a key position in being able to tackle the health and economic crisis that COVID-19 has presented and into the future. As a major provider of leisure services locally, by keeping our centres open it will clearly have a positive impact on the physical and mental health of our residents as well as on wellbeing, productivity and growth in the district. Leisure and sport will be critical to the recovery effort and improving the health of people in our communities.

10. **Customer Services Centre Implications**, **Communications and Website Implications and Environmental Implications**

10.1 None

11. **Risk Management and Health & Safety Implications**

11.1 The Council has agreed its risk management strategy which can be found on the website at http://www.threerivers.gov.uk. In addition, the risks of the proposals in the report have also been assessed against the Council's duties under Health and Safety legislation relating to employees, visitors and persons affected by our operations. The risk management implications of this report are detailed below.

Nature of risk	Consequence	Suggested Control Measures	**Response** (treat, tolerate, terminate or transfer)	**Risk Rating** (combination of severity and likelihood)
The cost of Covid 19 to the council in terms of the lockdown period and the recovery phase	Financial support required to enable leisure centres to re-open and operate through the recovery phase	Establish agreement between the council and SLM on a reprofiled management fee position for the recovery phase which is reviewed and reconciled on an ongoing basis until normal trading resumes	Treat	4 x 4 = 16
Operator is unwilling/unable to continue operating the Council's leisure centres due to a lack of agreement on a provisional revised management fee position	Council will need to either a. keep facilities closed until a new operator is procured (c. 9 months-1 year) or; b. deliver the services directly through an in-house model or a Local Authority Trading Company There are reputational and financial implications for both options	TRDC to undertake financial modelling on the alternative management options including set-up / mobilisation costs and identify the operational implications for the council	Treat	4 x 4 = 16
Reduced income increases the risk of the operator being unable carry out robust management of the council's assets	Council's assets are not suitably or safely maintained Reputational risk to council and customer dissatisfaction	Recovery phase forecast shall include sufficient funds for maintenance of assets in accordance with SLM's contractual obligations	Treat	3 x 3 = 9
Lack of secure management fee position during the recovery phase	Council will have to accept a provisional position which is subject to regular review and reconciliation during the recovery phase	Quarterly review and reconciliation based on transparent, open book approach in partnership with SLM	Treat	3 x 2 = 6
Staff/public dissatisfaction with the administration and Council Failure to manage the communication effectively regarding the operation of the leisure centres during the recovery phase	Damage to political and organisational reputation	Appropriate communications messaging to residents and SLM staff	Treat	3 x 2 = 6

Nature of risk	Consequence	Suggested Control Measures	**Response** (treat, tolerate, terminate or transfer)	**Risk Rating** (combination of severity and likelihood)
Delay in agreeing and signing the required Deed of Variation (DoV) to allow the leisure centres to stay open	Reputational risk to council and customer dissatisfaction	TRDC Legal to be instructed to draft and agree DoV with SLM Additional resource is required to complete DoV in timeframe to allow for reopening on the centres	Treat	3 x 2 = 6

12. **Recommendation**

12.1 That the Policy and Resources Committee recommend to Council:

- That the Shared Director of Finance be authorised to enter into a new Deed of Variation with SLM to implement the revised management fee profile as set out in this report.

- That Swimming Lesson Fees be increased in line with the proposals set out in Appendix 3.

12.2 That public access to the decision and report be denied until the matter is resolved.

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Background Papers

Leisure Facilities Management Contract 2018 - 2038
Swimming Lesson Fee Proposals

Appendices

Appendix 1 – Alternative Options and Way Forward
Appendix 2 - Revised Management Fee Profile
Appendix 3 - Proposed increase for swimming lessons and competitor analysis

Appendix 1

Alternative Options and Way Forward

1.1 This paper presents the alternative options available to the Council should Operators fail as an organisation or the contract is terminated by either party as a result of a breakdown in negotiations over future support. Any termination of the contract will however need to be considered in the light of each individual contract and the clauses which allow the Council to terminate the contract.

1.2 Within the leisure market there are a number of different management options and these are presented in Table 1 an overview of the detailed options available. The various options can be categorised into 6 different types as set out below.

- **In house option** – where the service is continued to be managed through an organisation on which the Council has control, either direct management or a Local Authority Trading Company (LATC).

- **A new Not for Profit Distributing Organisation (NPDO)** – where the service is managed by a newly established NPDO specifically set up to run the Council services. The NPDO could be one of a number of different types including a CLG, IPS, CIC, CIO and could be a co-operative or mutual.

- **An existing NPDO** – where the service is managed by an existing NPDO which operates services for other Councils. Typically these trusts have developed following an initial transfer of services through the creation of NPDO to deliver leisure services. They are usually either a CLG or an IPS but can be other types of NPDO and could be consider to be a co-operative. Examples of these include Freedom Leisure, GLL and Fusion Lifestyle.

- **Educational Establishment, Community Association or Sports/Leisure Club –** where the service is managed by an educational establishment, community association or local sports group. Typically this is undertaken where the group is the primary user and often sits with sports clubs, such as Bowls, Rugby, Cricket and Football.

- **Hybrid Trusts** – where the service is operated by a private sector Leisure Management Contractor, such as 1Life, Operators, SLM, through a NPDO organisation. It should be noted that within the private sector all of the major operators also have different operating models which enable the benefits of NNDR savings and VAT to be realised, commonly known as Hybrid Trusts. Indeed some of the organisations are now established as registered charities, such as Active Nation. Typically these organisations are CLG's

- **Private Sector** – where the service is operated by a private sector Leisure Management Contractor, such as 1Life, Places for People, SLM, without the use of a NPDO organisation. All the operators offer this potential as well as their NPDO organisation (Hybrid Trusts). In addition there are a number of major FM companies who are now running services such as libraries and other facilities as part of a major outsourcing approach. A joint venture approach could also fall into this category

  There are a number of advantages and disadvantages of the options which are explored later in this section. It should however be recognised that of the options set out above the following approaches are not considered appropriate for the Council's services, in the context of the current situation, as set out below

- Educational Establishment, Community Association or Sports/Leisure Club – as these operations are generally for smaller facilities and tend to be linked to club or school based facilities as opposed to leisure centre portfolios.

- Private Sector – tend not to be utilised any more as all of the leisure management contractors operate through hybrid trusts (to benefit from tax advantages), however if the Council decided to procure a partner then the private sector would be able to bid

- Establishment of a New NPDO – whilst this is technically an option for the Council, the establishment of a new Trust can take up to 12 months and would also require trustees to be appointed, which is likely to be a struggle in the current climate.

1.3 As a result of these issues it is considered that the Council has a number of alternative options available to it which are summarised in the table below which also includes the option of continuing to support Operators.

The Council also has the option of not opening the Centres either in the short term or long term, which is considered as well.

Table 1 – Options

Option	Description
A. Operators	• Support existing Operators through the current situation
B. In House	• Directly operate the service through the Council Structure
C. LATC	• Set up a Local Authority Trading Company (LATC) • Would be controlled by the Local Authority and established under TECKAL exemption
D. Operator	• Appoint a new operator to take on the service, which could be an existing NPDO, a hybrid NPDO or the private sector • This is likely to require a procurement exercise
E. Closing Centres	• The Council could decide to close the Centres either in the short term or longer term

With the exception of supporting existing Operators all of the other options would require the existing contract to be terminated, most likely through frustration of the contract. As a result of this TUPE may apply and is almost certain to apply if the contract is frustrated and the service is continued. However the basis of the termination will be for the Council to consider based on its individual contract.

Option Advantages & Disadvantages

For each of the options there are a number of issues and a range of advantages and disadvantages which is summarised in the table below.

Table 2 – Option Advantages and Disadvantages

Option A – Existing Operator

<table>
<tr><th>Advantages</th><th>Disadvantages</th></tr>
<tr><td>
Operators will maintain the Centre and can engage with customers to ensure the Centre is ready to be relaunched quickly
The costs will cover the maintaining of the Centre
Staff will remain on Operators payroll and be supported through any grants if they are reintroduced
The Centres will be in a position to get back to the agreed contract once the outbreak is over
There will not be the requirement to transfer the data (such as membership data) to the Council
The Council could be confident that continuity of service would be maintained and government guidelines will be met
</td><td>
Will be a short term cost implication for the Council, although this may be able to be offset with support from Central Government
The Council will need to be confident that the agreed arrangements with Operators are on market
</td></tr>
</table>

Option B – In House

<table>
<tr><th>Advantages</th><th>Disadvantages</th></tr>
<tr><td>
The Council will have full control of the Centres and be able to determine the approach to use and reopening.
There will be full transparency on any costs and the Council will be able to manage the staff and Centres in accordance with their policies.
</td><td>
If staff are transferred to the Council there will be a number if implications, including

Staff may be entitled to join the Council’s pension scheme if not already part of it.
This is likely to mean that the costs of staffing the facilities will be higher both in the short and longer term

There may be a break in continuity of opening the Centres as the Council establishes procedures and opens the Centres
It is unlikely that the Council will be able to benefit from NNDR relief as currently required
There will be a need to transfer all assets and data from Operators, which may become complicated if the contract is terminated
The Council would be taking the full risk on the performance of the Centres and income risk
</td></tr>
</table>

Option C – LATC

Advantages	**Disadvantages**
• The Council will have full control of the Centres and be able to determine the approach to use and reopening. • There will be full transparency on any costs and the Council will be able to manage the staff and Centres in accordance with their policies. • It is likely that a LATC will be able to claim discretionary rate relief as a not for profit organisation • There could be the potential to enable the LATC to continue with Operators staff terms and conditions and not harmonise staff with the Council's terms and conditions	• If staff are transferred to the Council there will be a number of implications, including the potential for staff harmonisation • There is likely to be loss of continuity of provision as the contract is terminated • The Council will have to pick up the full costs of operating the Centres • There will be a need to transfer all assets and data from Operators, which may become complicated if the contract is terminated • There will be a cost to establishing the LATC and setting up an infrastructure to support the company. • The Council would be taking on the risk of the operation, in that any changes in income would directly impact on the net position, thus meaning the Council as the sole owner will be required to pick up any shortfall.

Option D – Operator

Advantages	**Disadvantages**
• A new operator would potentially have the infrastructure to quickly deliver the service • Any new operator will be able to claim discretionary rate relief as a not for profit organisation • Staff would be transferred to the operator who would be able to maintain terms and conditions • In the long term an operator is likely to be able to deliver a greater return through improved income and savings on costs through economies of scale. The operator's structure is geared to delivering leisure services and maximising the opportunities for revenue generation • The Council will be able to transfer significant risk of the operation to the operator, in the long term. Whilst risks in situations like Covid 19 are unlikely to be transferred there is the opportunity to transfer risk of normal operational fluctuations.	• There may be a lack of continuity in delivery of services as a new operator is appointed • There will be a need to transfer all assets and data from Operators, which may become complicated if the Contract is terminated • There may not be any operators willing to bid for a contract and if there are then they are unlikely to take any risk on the contract (at least in the short term) • It is unlikely that any new operator will deliver a better financial position.

Option E – Closing Centres

Advantages	Disadvantages
• The Council potentially would remove all costs associated with operating the venues and could target alternative use for the sites if they considered a long term closure of the Centres.	• There would be no leisure provision in the Council, which could deliver reputational damage to the Council, either in the short term as other Centres open up or if Centres closed in the long term then this could impact on people's health and wellbeing. • A short term closure could result in additional costs such as potential redundancy costs or reopening costs as a result of rehiring staff • A long term closure would likely mean that there would be additional costs associated with frustrating the contract, including redundancy costs and other potential breakage costs

1.4 As a result of the advantages and disadvantages set out above there are a number of specific issues which will influence any decision the Council make, particularly in the short term, which include

- Staff Costs and TUPE

  It is likely that in any of the options that staff will be subject to TUPE either immediately or when the Centre reopen. It is likely that the only circumstances where TUPE wouldn't apply would be if the Council permanently stopped the services.

- NNDR Relief

  Currently Operators claim NNDR relief on the Centres. Under Option A this would continue, as it would under Option D, assuming the new operator was a charity or not for profit organisation.

  Option B would not be able to claim this relief as the Centres would be directly operated by the Council.

  There is the potential to claim this relief through Option C. Whilst it is unlikely that any LATC could claim charitable status due to it being controlled by the Local Authority, it could still be granted discretionary relief due to it being a not for profit company involved in the delivery of recreation and sport.

- Operating Market

  The current operating market for Leisure Centres is suffering similar issues to Operators with the impact of Covid 19 and the majority of operators are seeking release from contractual obligations and also amendments to their management fees for the future contract.

  There is a focus from operators on their existing contracts and the Council may find that depending on when they seek to procure a new operator, that there is a lack of operators willing to bid for the contract. Although currently operators are still keen to bid for contracts.

  The other key issue for operators will be the timescale for procuring new partners which typically would need to see a period of 3 – 6 months for an operator procurement for what in effect would be a short term contract.

Assuming that any financial support provide by the Council to Operators is based on the current market position, then it is unlikely that any alternative operator will deliver a better financial position.

- Data Transfer & Equipment

  There will be a need and a requirement for Operators to transfer data (such as membership/suppliers/etc.) to the Council to enable the facilities to be operational once the facilities are able to open again.

  This is likely to be a challenge if the approach is through a termination of contract position and the transfer of data and assets may be problematic, unless a mutually agreed position is reached between the Council and Operators.

- Control & Governance

  Options B and C are both effectively directly controlled by the Council and decisions can be made on the service operation. It should however be recognised that any decisions to change the service may have cost implications.

  Options A and D would typically be controlled through a specification which enables the Council to control prices and other aspects of the specification, such as programming and opening hours and how the Centres are used. In return the Council will pay or receive a fixed management fee. Any changes in the specification potentially have a cost implication but the Council can make changes in the same way they can to the service under Options B & C.

- Risk

  Whilst in all options the risks associated with the current situation (or similar situations) are likely to be broadly similar, in that any costs are likely to fall on the Council or central Government, and there are differences in the risk positions for the options during normal operation. This assumes that any agreement reached with Operators is broadly in line with an open book approach which is on market.

  Options B and C mean that effectively the Council pick up any risk of over or under performance in terms of the operation as the net position will impact on the Council's finances directly. Although with Option C there may be the opportunity to move deficits and surpluses between financial years.

  Options A and D provides the opportunity for the Council to transfer the operating and financial risk to the operator and agree a fixed management fee. It should however be recognised that the appetite for risk amongst operators may not be as great as it was before the Covid 19 crisis.

1.5 The other key issue will be the timescale by which any of the options commence with Operators no longer operating, including:

- Options B, C & D would all take time to implement and are likely to result in a short term continued closure of the Centres, this is likely to be between 3 – 6 months.

- Option E can obviously be immediate (whether short term or long term) but may take time to resolve the issues with the contract being frustrated.

1.6 A key issue for the Council will be to consider whether they wish for the service to continue or not and we consider the financial implications below.

The financial implications for the alternative options are summarised below in terms of the key principles, although there are certain costs which are difficult to project without further discussions with Operators (such as redundancy costs).

- Assuming that the costs requested by Operators are in line with the market and operating on an open book approach, then the net operating costs for Option B – D will be similar in terms of income and expenditure.
- For each of Options B – D there will be additional costs that have to be incurred including
    - Set up costs – there will be costs which the Council will have to incur through either establishing a LATC or procuring an operator or establishing a departmental structure for in house
    - Additional NNDR costs in the case of Option B (In house)
    - Build-up of income – if the contract is frustrated then access to membership database from Operators and other customer data may be difficult, which will mean that effectively the income achieved is likely to be less than that achieved by Operators
    - Income levels – for Option B & C the in house operations will mean that the Council is unlikely to benefit from the commercial approach to income from Operators and other operators
    - Additional staff costs could potentially be incurred in Options B & C as the staff harmonisation with Council staff may result in staff access to pension and changes to terms and conditions
    - The lack of a market for alternative operator may mean that Option D is such that the Council has to risk share and is unlikely to achieve any better arrangements
- For Option E (short or long term closure) it is likely that the key costs that will be incurred will be redundancy costs of staff and also any other breakage costs (this could include loss of profit for Operators) if the contract is frustrated. Any short term closure would also mean that the future recruitment of staff and re-establishing the contract would be more costly.
- A long term closure of the Centres would allow the Council to consider alternative uses for the sites which could generate revenue if sold for development. However set off against this would be the future management fees the Council would receive once the market is back to normal.

1.7 It is clear from the analysis that Options B – D (continued operation of the venues) are likely to be more costly than supporting existing Operators, assuming that the agreement reached with Operators is in line with the market and does not include unnecessary costs.

1.8 The Council would potentially have the opportunity to reduce its costs through a long term closure of the facility, but this would be dependent on future development of the sites.