

# Brighton & Hove City Council

## Culture, Heritage, Sport, Tourism & Economic Development Committee

## Agenda Item 31

**Subject:** Leisure Contract – Future Management Options

**Date of meeting:** 9<sup>th</sup> November 2023

**Report of:** Executive Director, Economy, Environment & Culture

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**Ward(s) affected:** All

**For general release**

### 1. Purpose of the report and policy context

- 1.1 Wealden Leisure Ltd trading as Freedom Leisure, manage the council's sports facilities pursuant to two contracts with the council, both on very similar terms. The current contract with Freedom Leisure commenced on 1<sup>st</sup> April 2011 in relation to the 7 leisure centres and 4 paddling pools, except Portslade Sports Centre. An additional contract with Freedom Leisure to manage Portslade Sports Centre commenced in 2016 to run concurrently with the existing contract. These two contracts are referred to as the Sports Facilities Contract.
- 1.2 Under the terms of these contracts, they have been extended twice; a three-year extension from 2021-24 (with associated renegotiated management fee) to take the service through the recovery period from the Covid-19 pandemic, and then another two-year extension from 2024-26 (with associated renegotiated management fee) in response to the impact of the utilities/energy crisis on the leisure sector and our operator. In both cases these extensions were to minimise the impact of the financial pressures created over recent years, allowing time for the market to recover and for the council to consider what future leisure provision is required and to be resourced before committing to new long-term contracts.
- 1.3 The current contract with Freedom Leisure is due to expire on 31st March 2026. The council therefore now needs to consider the most suitable management option for the future leisure contract. This report outlines these options and makes a recommendation as to the preferred option.

## **2. Recommendations**

*That the Culture, Heritage, Sport, Tourism & Economic Development Committee:*

- 2.1 Notes that the current outsourced leisure contract expires in March 2026.
- 2.2 Recommends to the Strategy, Finance and City Regeneration Committee that outsourcing the leisure contract remains the best option for the council's future leisure provision.
- 2.3 Agrees that officers should continue to explore the best route for delivering a new outsourced contract, ensuring the redevelopment of the King Alfred/West Hub is appropriately considered.
- 2.4 Agrees that officers will bring a report back to committee regarding detailed plans for outsourcing in March 2024.

## **3. Context and background information**

- 3.1 The council has an agreed Sports Facilities Investment Plan 2021-31 (SFIP). As part of this an options appraisal was undertaken by specialist leisure consultants FMG Consulting Ltd which recommended that outsourcing would deliver the best overall outcome for the council, including the lowest financial cost.
- 3.2 In light of the continued post-pandemic market recovery and significant change that has occurred in the leisure industry since the previous options appraisal was completed, external consultants Continuum Sport & Leisure Ltd were appointed to review the analysis and came to the same conclusion.
- 3.3 Two important new changes that have been factored into this review are: the changes to VAT and the context and timing of the future redevelopment of the King Alfred Leisure Centre.
- 3.4 In relation to the recent changes in VAT. HMRC have now accepted that the provision of leisure services by local authorities is a non-business activity (and therefore outside the scope of VAT). This therefore makes operating leisure services in-house more viable now.
- 3.5 The King Alfred Leisure Centre (KALC) will have a key influence on the overall financial viability of the leisure contract, both pre and post the proposed redevelopment of the centre. The current timetable for the redevelopment is still to be determined, as the council have yet to decide whether the new 'West Hub' leisure centre will be reprovided on the current site or at a new location. This decision is anticipated for Spring 2024.
- 3.6 As the new facility will not be complete at the time of any potential re-procurement exercise, careful consideration will be given as to how the council can provide certainty for any operator that this facility will come to fruition, and where it will be, otherwise they will cost in significant risk.

- 3.7 In addition, any delay to investment for delivery of the SFIP could mean there is little or no interest from the market or it could limit the council from negotiating a more preferable contract.
- 3.8 This report will not revisit each of the management options in detail but will provide a summary of the current state of the market and any significant issues or factors that the council needs to consider in making this decision on its preferred management option.
- 3.9 The following paragraphs provide details regarding why outsourcing remains the best option for the council's future leisure provision:

#### Outsourcing

- 3.10 The leisure market has recovered strongly from the pandemic with most operators reporting turnover back at or higher than pre-pandemic levels, especially the modern, more attractive facilities. This has been mirrored in Brighton and Hove with the operator Freedom Leisure moving back into a positive position in Q1 of 2023/24.
- 3.11 Many other authorities also chose to extend their existing contracts during the pandemic, which are now coming to an end, so there is the possibility of a number of other leisure management tenders coming to the market currently or in the near future.
- 3.12 The specialist leisure consultants currently appointed have indicated that all of the major leisure operators are currently active, including Everyone Active (SLM), Better (GLL), Parkwood, Places Leisure, Freedom Leisure and Serco Leisure.
- 3.13 There has been a small amount of consolidation in the market with some smaller leisure trusts becoming insolvent due to the pandemic and a few underperforming contracts being mutually terminated with the local authorities. Profit and overhead margins generally remain competitive at circa sub 10% of turnover, which whilst a positive outcome does mean that leisure operators are working on low margins and therefore have less appetite for risk (such as utility tariffs) and less capacity for investment in assets other than fitness equipment and kit.
- 3.14 Perhaps more relevant to Brighton and Hove, is that leisure operators are unwilling to take risks associated with the condition of buildings, including major plant and equipment.
- 3.15 There are many instances across the country of facilities closing in recent years due to major failures in fabric, structures and plant, with operators refusing to fund lifecycle works and/or seeking loss of income claims through insurers or local authority clients.
- 3.16 This risk is growing with Swim England research identifying more than 1,000 pools that have closed since 2010, whilst around 1,500 pools are in excess of 40 years old and coming towards the end of their economic life. This is

very pertinent to Brighton and Hove given the scale, age and condition of the leisure portfolio and highlights the need for major investment to secure a viable future for leisure provision in the city.

#### **4. Analysis and consideration of alternative options**

4.1 The specialist leisure consultants Continuum Sport & Leisure have supported the council in completing this review and analysis on the range of options. Continuum have extensive expertise in this area having led similar work for many other local authorities over recent years, as well as having a broader understanding of the market and leisure operators.

4.2 Set out below are the alternative options that have been considered, along with a statement about their suitability:

##### In-House Provision

4.9 A small number of leisure contracts have been brought back in-house including Lambeth, Wigan, Halton (in Cheshire) and Haringey.

4.10 A recent VAT Tribunal ruling against HMRC which determined that local authority leisure provision is a non-business activity and hence outside the scope of VAT, could well have a significant impact on the management of community leisure facilities.

4.11 In effect, it levels up the playing field for direct in-house provision versus external management by removing the requirement to charge VAT on the vast majority of leisure activities, providing a significant revenue gain for in-house operations.

4.12 Whilst the potential VAT gain can be compelling, there are substantial additional costs to be factored in when considering in-sourcing. These include:

- mandatory and discretionary NNDR relief which will be unavailable,
- all staff transferring would be harmonised onto local government pay and conditions (including Local Government Pension Scheme).

4.13 Of more significance is the loss of commercial focus and expertise and dedicated head office specialist support in sales, marketing, product development, IT, HR/Payroll which would be extremely challenging for a local authority to replace.

4.14 Even with modelling the financial impact of the VAT ruling, outsourcing remains the lowest net cost option, and more so for councils like Brighton and Hove, where leisure is already outsourced.

##### New Leisure Trust

4.15 The creation of a new local leisure trust was identified as an option in the original management options appraisal as part of the SFIP. Whilst this remains a popular form of provision, the number of such arrangements has

shrunk since the pandemic and very few leisure trusts have been established in recent years. However, cultural trusts have been established nationally and locally in the case of the Royal Pavilion & Museums Trust (RPMT).

- 4.16 However, the Public Contract Regulations published in 2015 restricts the ability of local authorities to establish new leisure trusts to provide services without running some form of competitive procurement exercise.
- 4.17 There would be a risk, therefore, albeit low, of legal challenge if the council was to set up a new trust and award it a long-term contract without a running a procurement exercise.
- 4.18 Under a procurement exercise it is unlikely that any newly established leisure trust entity would pass the pre-qualification stage, due to the lack of operating experience or financial resources.
- 4.19 An alternative approach for deploying a new leisure trust would be to establish arrangements as a property transaction which would sit outside the Public Contract Regulations. This has commonly been done where the venues do not require any financial support and can operate in commercial terms, such as golf courses and art venues.
- 4.20 In reality, very few multi-site leisure operations have been set up in this way, as local authorities would want a service specification and contract in place if agreeing long term arrangements. Leisure trusts set up in this way are therefore more common for single site facilities where a rent can be generated or where a service specification is deemed unnecessary.
- 4.21 A new leisure trust by its nature would carry risks in terms of finances and operations. It will have a lack of reserves so the first years of trading would likely require continued support from the council until investment streams are established.

#### Local Authority Trading Companies

- 4.22 This is an approach whereby local authorities can continue to set up a local not-for-profit trading entity without having to go through a competitive tendering exercise.
- 4.23 Local Authority Trading Companies (LATCs) have been set up for a range of services and increasingly in the last few years to deliver leisure and cultural services. These tend to be most successful where the entity is given the commercial freedoms to be innovative and operate efficiently, supported by an experienced and capable management team and board.
- 4.24 LATCs can claim VAT benefits from delivering sport and leisure services as a charitable activity in the same way as leisure trusts, however they cannot be charitable as they are controlled by a local authority and hence cannot benefit from the 80% mandatory NNDR relief. Instead they have to rely on

local authorities granting discretionary rate which has to be fully funded by the authority and is unlikely to be any more than 20% relief.

- 4.25 Ideally with LATCs there needs to be sufficient scale of operations to provide economies of scale. If they are only single authority operations then the costs of the management team and back office support function can be a considerable proportion of turnover. Within this review, there were no examples of LATC's operating across multiple authorities within the leisure sector currently found.
- 4.26 Similarly, as referenced with leisure trusts, a new LATC would carry significant risks in terms of finances and operations: lacking reserves and financial robustness, which would require continued support of the host authority in the first trading years.

#### Joint Ventures

- 4.27 Continuum have indicated that they are unaware of any such ventures being established in recent years whereby a leisure operator has gone into a joint venture with a local authority.
- 4.28 This could be because it can be complicated to establish and to agree an approach to equitably apportioning risk. If the leisure operator is carrying most of the risk, which they are best placed to manage, then there are likely to be more appropriate management models available, for example traditional outsourcing.
- 4.29 A joint venture structure may also cause legal issues around securing benefits from VAT exemptions and NNDR relief if it is not deemed to be a charitable entity.

#### Analysis

- 4.30 The table below shows the high-level appraisal of the management options considered which has been informed by data from the current leisure contract and adjusted to reflect the view of the current market. Elements included in the financial analysis were; predicted sites surplus for 2023/24 (which takes into account estimated ongoing maintenance costs), the income growth expected in future years, managing costs, Local Government terms and conditions, VAT adjustment, employer pension adjustment, NNDR payable, collection fund saving, overheads and profit. From this, a revised net surplus/deficit has also been calculated and factored in.
- 4.31 The figures are presented in the table below to indicate the difference between the various options. Outsourcing is showing as zero as the baseline position – note this doesn't reflect any level of subsidy that may be required for this option.

	A – Outsourcing	B – In-House	C – LATC	D – New Leisure Trust	E – Joint Venture
Difference between options	0	-£1,576,372	-£702,318	-£433,364	-£373,066
Rank	1	5	4	3	2

- 4.32 The table indicates that outsourcing remains the lowest cost option. The gap between these various options has closed (since the previous options appraisal was completed in 2021), although the gap between outsourcing and others does remain substantial and material alongside consideration of the other operating risks.
- 4.33 A new outsourced contract based on the current facilities might require a payment/subsidy each year if the current level of energy costs continue. These have more than doubled to £1.34m in 2022/23 and the ongoing repair and maintenance requirements and risk.
- 4.34 The projected contract cost highlights the importance of the council's investment plans in generating increased income and reducing costs, which would enable a future contract to deliver a surplus payment to the council.
- 4.35 Alongside this, the business case currently being developed for the new West Hub (replacement for King Alfred Leisure Centre) will also have an impact on the projected finances of any future management contract (including any extension), as well as the timing of when to procure any new arrangements.

## 5. Conclusion

- 5.1 As per the analysis presented in section 4, the alternative options have been considered and reviewed. Based on the financial appraisal of each of the management options and risks associated with each, it is recommended that the council continues to outsource as it remains the most viable (best value and lowest risk) option for our future leisure contract.
- 5.2 Agreement of outsourcing being the council's preferred option, will enable officers to proceed with more detailed financial analysis and feasibility work to determine the best route for delivery.
- 5.3 This work must be able to take place over the coming months in order to provide sufficient lead-in time for any preparatory work required for any possible re-procurement exercise. An indicative timeline is below:

Project Initiation – Council approvals/governance established	Summer 2024
Prepare procurement documentation	Autumn 2024
Issue contract notice	Early 2025

Detailed proposals submitted and Evaluation	Spring 2025
Final proposals submitted	Summer 2025
Appoint preferred partner and finalise contract/legal documentation	Autumn 2025
Sign contract and leases	Early 2026
Mobilise new contract / contract commences	Spring 2026

## 6. Financial implications

- 6.1 There are no direct financial implications arising from the recommendations of this report. The analysis provided by Continuum Sport & Leisure Ltd continue to show outsourcing as the best option for the council's leisure contract. Delivering of the key capital projects along with consideration of the King Alfred/West Hub would allow for a more attractive leisure offer. Officer time in exploring the best route for delivery from March 2026 will be contained within existing Sports and Leisure budgets and any significant variations to budget will be reported as part of the council's monthly budget monitoring process. Outcomes including any required investment and revenue budget implications, will be considered and reported back to a future meeting of the committee.

Name of finance officer consulted: John Lack Date consulted (23/10/2023)

## 7. Legal implications

- 7.1 The range of options available to the council in relation to running its leisure services and the implications of each are summarised in the report. At the stage when a decision is taken to proceed with one option rather than another, Legal Services will support with advice on compliance with relevant legal requirements. For example, a new contract or a contract extension would need to comply with the Public Procurement Regulations 2015 and Subsidy Control Act 2022.

Name of lawyer consulted: Elizabeth Culbert Date consulted: 23/10/23

## 8. Equalities implications

- 8.1 The work to develop and implement a new leisure contract will include consideration of equalities as a key part of the process. The Sports Facilities Investment Plan (SFIP) outlines accessibility and inclusivity as a key principle for our investment, and through our new leisure contract we would want to ensure that our facilities and services are accessible, inclusive and provide everyone with the opportunity to be active and have good physical and mental health. The council wants its sport and leisure provision to appeal to and engage local communities, including marginalised groups.

## **9. Sustainability implications**

- 9.1 As indicated within this report, the long-term sustainability of our leisure facilities is key for the council and will be an important part of any future contract with an operator.
- 9.2 The council has made significant progress and investment in its facilities to improve the environmental sustainability of them (such as LED lighting, improved controls, thermal glazing and Solar PV), which will help to reduce the running costs for any future operator and make our assets more energy efficient in the long term.
- 9.3 Any wholesale improvements to the energy efficiency of the facilities and to support the council's 2030 carbon neutral agenda will need to be delivered by new facilities.
- 9.4 With any contract, operators will expect to see some shared risk with the local authority regarding energy costs which is often in the form of capping and or benchmarking.

## **10. Other Implications**

### **Social Value and procurement implications**

11.1 N/A

### **Crime & disorder implications:**

11.2 N/A.

### **Public health implications:**

- 11.3 The re-procurement of this leisure contract will be fundamental in ensuring our facilities are operated and managed in a way that will provide opportunities, reduce barriers and encourage more people in the city to be more active, more often.
- 11.4 The outcomes of the contract will align to relevant strategies (such as the Heath & Wellbeing Strategy and the new Sport & Physical Activity Strategy due to be launched in 2024) and targets in trying to reduce health inequalities and address other health priorities. For example, the Free Swimming scheme offered to children and young people under the age of 18 who are living or studying in the city.

## **Supporting Documentation**

N/A

