

LEISURE CENTRE REOPENING

REPORT OF: Assistant Chief Executive
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Wards Affected: All
Key Decision Yes
Report to: Council
Wednesday 19th August 2020

Purpose of Report

1. To outline the impact of the Covid-19 crisis on the Council's contract with Places Leisure (PL) and provide information and advice about how the risks and costs associated with this can be managed in order to enable the Council's leisure centres to reopen on 1st September 2020.

Recommendations

2. **Council are recommended to agree the following:**
 - (i) **That the negotiated costs associated with the enforced closure of the Council's leisure centres and their reopening as outlined in paragraphs 31 and 36 and the exempt appendix to this report, are noted;**
 - (ii) **That the mechanism for supporting PL to reopen the leisure centres and manage the costs to the tax payer (as outlined in paragraphs 38 to 43) is agreed;**
 - (iii) **That the costs to this Council resulting from this unprecedented set of circumstances be funded from the General Reserve and reported regularly to Members in the usual way; and**
 - (iv) **That the Council agree to remove Clair Hall from the contract with PL (paragraphs 48 to 55 refer).**
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National Context

3. This report focuses on the impact the Covid-19 crisis has had on the leisure sector in general and the specific issues for this Council. It recommends a way forward that will enable the District's well used leisure centres to open again (with Government required restrictions) and explains why significant financial support from this Council is necessary to enable this to happen.
4. This is a complex matter and there are some risks that Members must clearly understand and balance against the (understandable) desire to enable our centres to open again.
5. The Government required all leisure centres to close from midnight on 20th March 2020. It enabled them to open again from 25th July providing they comply with Covid Secure guidance. This places significant restrictions on the way centres can operate in order to facilitate social distancing and cleaning requirements.

6. Nationally there are a wide range of arrangements in place under which councils like Mid Sussex provide leisure centres. A few still run facilities in house, but the majority work with specialist leisure providers. The structure and size of these providers varies enormously and includes Trusts, charities, community interest companies and private operators.
7. Similarly, the contractual relationships between councils and these providers varies too. As a consequence of this, the impact of the enforced closure of facilities as a result of the Covid-19 crisis, has varied significantly and this in turn, has meant that the Government has struggled to find mechanisms to support the sector through this crisis.
8. Some councils still subsidise their leisure providers, some operate on a profit share basis and others (like this Council) receive a management fee from their providers in return for having the right to operate council-owned leisure facilities. This latter option involves providers taking most of the operational risk and in return having comparative freedom to operate facilities in accordance with their specialist knowledge of the sector and changing customer requirements.
9. The public leisure sector has considerable variation, but there are some common characteristics. This sector often operates on very low margins (1 to 5% income relative to contracts); it is reliant on income for cash flow; often has very limited reserves and can find it difficult to access borrowing.
10. In the light of the manifestation of some of these characteristics and following the enforced shutdown, the Government has made some interventions in order to try to assist councils and their operators.
11. It issued two Procurement Policy Notes (PPN) 02/20 and 04/20 which strongly encouraged councils to work with providers to ensure service continuity during and after the crisis. They included advice on supporting suppliers with cash flow and with payments (where appropriate).
12. Later, the Secretary of State for Local Government announced support for councils that were experiencing significant reductions in their income as a result of the crisis. Members will recall that this included a commitment that the Government would fund 75p in every £1 of income lost (after the first 5%). The Government has clarified that in addition to supporting loss of income (like car parking, planning fees etc), this scheme will also cover management fees paid by leisure providers to councils.

Situation in Mid Sussex

13. Many Members will recall that in July 2014, Mid Sussex entered into a contract with Places Leisure (PL) to operate its leisure centres and halls for 15 years with an option to extend for a further 5 years (until 2034). The contract requires PL to pay an annual management fee to the Council of £1.4m in return for running the Council's three leisure centres, halls (Clair Hall and Martlets, latter now closed), Mount Noddy, and the splash pad (Victoria Park) and paddling pool (Cuckfield).
14. The contract gave responsibility for utility costs and all reactive, planned maintenance and capital works on the leisure centres to PL. The halls were not included in the full repairing aspect of the contract because of their age and use profile.
15. This Concession Contract was let following the Council's Contract Procedures and EU Procurement Rules.

16. Members were deeply involved in the process, with the (then) Leisure and Community Scrutiny Committee overseeing every step in the process. The Council used guiding principles and its leisure strategy to provide a policy framework for the procurement. These included requirements to maintain and enhance service quality, increase participation levels, develop services and opportunities to improve wellbeing, reduce the Council's exposure to risk and cost and enhance opportunities to invest in the facilities.
17. The procurement took place at a time when the market was extremely competitive. It attracted strong interest from a wide range of providers and when the Council awarded the contract in February 2014 it fulfilled all the Council's key requirements and delivered an annual management fee that was extremely competitive. It was then and continues to be a central plank of the Council's financial strategy as the income over the lifetime of the contract is very significant.
18. Since the contract was let the Council has worked effectively with PL. Key performance indicators are considered in detail by Members quarterly and demonstrate a positive picture. In addition, the capital investment so important to the success of leisure facilities, has been secured. To date the Council has invested £1.9m in centre improvements and this has leveraged £4.8m investment in the facilities from PL. This total investment of £6.7m since the contract was let has seen very significant improvements to facilities in all three centres.

Impact of the Coronavirus Act and its Regulations on the Contractual Position

19. As outlined above, the contract with PL is a concession contract. It gives the service provider the right to exploit the service and make money from third parties. The contractor takes the operating risk (encompassing demand or supply risk, or both), in addition they are exposed to any fluctuations in the market.
20. Along with many other councils across the country this Council's contract is based on the Sport England template. As such it includes a Clause which is triggered in the event of a Qualifying Change in Law (QCIL). As confirmed in the Government's Procurement Notes, the instruction to close the centres on 20th March 2020 triggered this Clause; although it seems quite unlikely that the Clause was drafted with the circumstances of a global pandemic in mind.
21. In the event of a QCIL, the contract either requires the Council to work with the contractor to leave them in a 'no better, no worse off' position, with a duty on PL to mitigate the losses in the event of a complete closure, or to activate a force majeure clause. Activating the force majeure clause could result in the contractor terminating the contract, in which case the Council would also be liable for redundancy costs, unless it takes on the leisure staff itself or relets the contract to a new provider.
22. Looking nationally again for a moment, the implications of this are significant. Current estimates suggest that the enforced lockdown of leisure centres, combined with the restrictions imposed on reopening, could cost local authorities nationally over £1.5bn. For many, this is the single biggest financial impact of the coronavirus pandemic, and work is ongoing across the sector to lobby Government on this matter.
23. As the Government has indicated that the Coronavirus Act and its Regulations constitute a Qualifying Change in Law (QCIL), it appears that the Council's obligation to provide financial support to the contractor is triggered. However, the level of support is not prescribed in the contract, and as a result officers have been in extended negotiations with PL over what is reasonable.

24. In recognition of the complexity of this set of circumstances, the Government, through Sport England is supporting Councils by funding expert consultants to work with contractors and Councils to reach agreement. This Council has availed itself of this support and retained specialist advisors to support its negotiations with PL.
25. The negotiations have been ongoing throughout May, June and July. They have been tough and taken many twists and turns. However, officers and the Council's advisors are now of the view that they have reached an end point and the priority is now for Members to carefully consider the cost to the Council (and tax payers of Mid Sussex) of both the enforced closure period and reopening. These must be balanced against the desire to reopen these well used facilities, albeit with significant restrictions on their operation in order to ensure a safe environment for users.
26. This is a difficult issue because the cost implications of the QCIL are significant. As outlined above, the Council relies heavily on the annual management fee (£1.4m) from the contractor to support its direct service provision. Therefore, to lose this fee and move to a position of having to provide significant financial support to PL is very difficult to accommodate; not least because the Council's other sources of income have also been hugely impacted by the Covid-19 crisis.
27. However, as outlined above, the Government's Scheme to support councils experiencing loss in income will assist in the 2020/21 financial year. Importantly though, the Government has made clear that its scheme only applies to the 2020/21 financial year. Therefore, if the current situation extends into 2021/22, the impact on the Council's financial position will be significant.
28. Members need to carefully consider these matters and the related risks.
29. The impact of the QCIL means the Council needs to consider two areas:
 - (a) Closure costs; and
 - (b) Costs of reopening.

Closure costs

30. After tough negotiations and some regrettable delays in producing the necessary information, officers and their advisors have been able to undertake a line-by-line analysis of PL's claim for the costs associated with enforced closure of the centres since March 2020.
31. The conclusion of this is that total closure costs are **£943k** (March to August) (subject to final reconciliation). This is in addition to the Council forgoing the Management Fee (£120k per month).
32. A more detailed analysis of this is provided in the exempt Appendix.

Reopening costs

33. PL have developed a model to forecast likely usage levels for all facilities in the light of the Government's guidance regarding social distancing. Clearly most expenditure is fixed and is required irrespective of whether the centres can operate at full capacity.

34. However, income is more difficult to predict. There are still a large number of unknowns regarding the trajectory of Covid-19, the speed with which lockdown measures will be eased, the public appetite for returning to leisure centres and the risk of local outbreaks. However, PL's assumptions and income modelling have been thoroughly scrutinised by officers and our expert consultant and are considered cautious but reasonable.
35. They assume all three centres reopen at the same time and that usage levels start low and build as customer confidence grows. They also take account of the Government's restrictions. Appendix A provides an overview of PL's current plans for which services will be available to the public, over which timescale.
36. These forecasts indicate a cost to this Council of approximately **£1.5m** to April 2021, assuming the restrictions currently in place.
37. Given the length of time the facilities have been closed, it will take PL two weeks to get the facilities and plant ready and undertake the work essential to public safety given the Covid Secure requirements. PL have decided to commence these reopening procedures at their own risk. This means that, if Members agree the recommendations in the report, all three leisure centres will be able to open on 1st September 2020.

Review and Monitoring Mechanism

38. However, given the very significant uncertainty governing both the progress of the virus, the current restrictions and possibly most significantly, customer behaviour, officers have negotiated a very flexible mechanism which should enable the Council and PL to respond to opportunities and risks as they emerge.
39. This mechanism involves the Council forward funding 75% of the anticipated costs for PL to open and run the centres on a month by month basis (based on PL forecasts). This will then be reconciled to actuals at the end of every month. This will be done on an open book basis. The negotiated position is that this mechanism is only agreed for the first 3 months; thereafter it is subject to review.
40. This should enable PL to open the Centres and operate and enable this Council to satisfy itself that the burden on the tax payer is being actively managed by PL. It is also flexible enough to take account of actual customer behaviour, use of the facilities (including income) and any change to restrictions (positive and negative).
41. Detail of the assumptions and costs, month by month are provided in the exempt Appendix to this report. The actual cost to this Council will obviously depend on the support the public gives to the facilities but, as outlined above, PL's estimates provide a reasonable starting point.
42. It is proposed that these arrangements are kept under active review. Officers are very mindful of value for money for the tax payer. If Members agree this mechanism at this point, it will be reviewed after three months and a decision made about whether to continue for a further three months, in consultation with the Leader and Portfolio Holder.
43. In the longer term, a proposed programme of work involving a strategic review of all the Council's long term contracts (in a post Covid-19 world) will enable opportunities to keep this contract under active review. This will be outlined in the Revised Corporate Plan for 2020/21 to be considered by Members shortly.

Management Fee

44. It is proposed that the Council forgoes any management fee payments that it was due throughout the enforced closure (March to opening), and for at least the first three months of reopening (at which point the issue would be subject to further review).
45. As outlined above, the Government's Income Scheme should enable the Council to claim some reimbursement for this budgeted income in the current year. Officers will maintain pressure on PL to uphold its contractual obligations to mitigate its costs and to flex service provision as customer preferences in a post Covid-19 environment become clearer.
46. There is a clear expectation that PL will work to ensure this significant support from the tax payer is reduced and eliminated as quickly as possible and that a return to the position where the Council starts to receive its management fee again, is achieved.

Insurance

47. The Council understands that PL has insurance for business interruption. However, Members will also be aware that this issue is currently being litigated through the High Court and at the time of writing, is unresolved. PL has accepted that the arrangements outlined above would be subject to a successful claim. Officers will keep this matter under review and should PL's claim be successful it will, of course, be built into the monthly review mechanism of managing the reopening of the leisure centres outlined above.

Clair Hall

48. The position for Clair Hall is quite different to that of the leisure centres. There is currently no clear indication for when venues like Clair Hall can reopen, but larger theatres appear to be planning for a very prolonged period of closure.
49. As outlined above, because of the age of Clair Hall and its low usage, it is included in the PL contract but at a cost to the Council (i.e. deducted from the management fee). In addition, the Council retains full repair and maintenance responsibility.
50. Clair Hall is not economically viable to run. It runs at a loss and assuming it can open at some stage in the future, social distancing requirements and other restrictions will make its viability even more challenging.
51. It was constructed over 50 years ago and is beyond its economic lifespan. The cost of maintaining and repairing the building over the next 20 years is estimated to be £1m. In addition, a new legal standard for minimum energy efficiency (MEES) commencing in April 2023, places a penalty on landlords who continue to let any buildings which have an EPC rating of less than E. This will certainly apply to Clair Hall and penalties for non-compliance are likely to be applied unless significant work is done to improve the building's energy efficiency.
52. Usage at Clair Hall has steadily declined over the last four years.
53. Therefore, given the significant uncertainty over when this facility can open again and its poor value for money for the tax payer, it is recommended that it is removed from the contract with PL at this time. This would relieve PL of some cost pressures and help with the overall affordability of opening the leisure centres and will need to be part of the agreement with PL.

54. The Council can consider the future of the site at some future point, the priority now being to agree a process for enabling the leisure centres to reopen.
55. The Redwood Centre is unaffected by the proposal to remove Clair Hall from the contract with PL.

Conclusion

56. This report outlines a basis upon which the Council can enable PL to reopen the District's leisure centres for public use (with restrictions to enable public safety).
57. Members need to carefully consider the considerable financial impact on the Council and tax payers of Mid Sussex of this and balance it against the importance of our well used leisure centres to local communities and the contribution they make to the wellbeing of our population.
58. The situation faced by the Council is shared by many others nationally. The impact of the Covid-19 crisis on our contractual position with PL is unprecedented.
59. Officers are comfortable that the negotiated mechanism for managing the costs to the tax payer on a monthly basis, will provide a sufficiently flexible way of ensuring PL make strenuous efforts to keep the cost to the tax payer at an absolute minimum. It will also enable constant pressure on PL to develop new and innovative ways of providing services that comply with Covid-19 restrictions but maximise income and customer choice.
60. For the 2020/21 year, the costs of the enforced closure and reopening of the leisure centres will need to be met from the Council's General Reserve. This is tolerable for the short term but is not sustainable in the long term. Members will be able to consider this matter, in the round, when they consider the Revised Corporate Plan for 2020/21 shortly.
61. If Members support the recommendations in this report and enable the centres to reopen (from 1st September 2020) they will be doing so in a very uncertain commercial environment. It is currently very unclear how customer preferences for using leisure facilities will be affected by the Covid-19 crisis or how the leisure industry will need to adapt to a post Covid-19 trading environment.
62. The Council will need to maintain careful scrutiny of this as the next few months progress. These matters will be reported to the Portfolio Holder and Cabinet as appropriate. The recommendation to remove Clair Hall from the contract will provide PL with more freedom to manage the challenging commercial environment.

Financial Implications

63. Members should note that this is the most significant aspect of our Medium Term Financial Plan (MTFP) pressure. Whilst the income protection scheme mitigates the worst of the income loss, it does not assist with the increased costs from the prolonged closure or the reopening where expenditure is in excess of forecast income for some months.
64. The effect of this is that those costs form part of a direct draw on the General Reserve – probably in the region of **£2.5m** in 2020/21.
65. Whilst this is within our financial capacity, and could be sustained over the short to medium term if absolutely necessary, at some point overall income and expenditure should be brought back into equilibrium to enable a balanced budget to be set.

Policy Context

66. This decision will enable the Council, in accordance with the requirements of the leisure contract, to reopen its leisure centres.

Other Options Considered

67. The Council could decide to not reopen the leisure centres. However, this would result in a loss of amenity for residents and would incur costs for the Council. A decision to not reopen could trigger a breach of the Council's contract with PL resulting in the termination of the contract. This would mean the Council would no longer have a provider to run its centres. In this situation the Council could choose to run the centres or to relet the leisure contract to another provider. Re-procurement is expensive and protracted with no guarantee that a provider would be interested given the risks of operating centres under the Governments current restrictions. If a new provider was secured there is no guarantee that the Council would secure as beneficial a contract as it currently holds with PL. The Council does not have the expertise or capacity in house to operate the leisure centres.

Risk Management Implications

68. There are commercial risks for PL in terms of trading in an uncertain environment; during the Covid-19 pandemic. How the public will respond to the centres reopening and how they will use them, is not fully understood at this point. In addition, the untested legal situation regarding the QCIL means the requirement for the Council to support PL (and for how long) is also unclear.

Equality and customer service implications

69. The purpose of an equality impact assessment is to determine whether it is likely that there would be a negative impact on any protected groups as a result of any service changes and if so to consider whether these can be mitigated or under the proposal should be changed or dropped. It is not considered that reopening the leisure centres would have a negative impact on any protected groups.

Other Material Implications

70. None

Background Papers

None