

Leisure Contract – Proposed Renegotiation

Summary: Sport & Leisure Management (SLM) known as Everyone Active has submitted a very positive financial offer to the Council for the remainder of the leisure management contract. Our consultants are involved in multiple negotiations of this kind and it is currently rare for operators to be offering to return to pre-Covid financial projections from April 2022 as the outlook for leisure centre operators and the recovery of market demand is highly uncertain. Considering these market factors, the offer of 'resetting' the agreement and utilising the extension to honour the original financial terms of the contract is a positive one. Indeed, by agreeing to lower their percentage margin and to increase the Council's share of any surplus to 60%, SLM is improving on the Council's original contract position as reflected by the increased average annual payment being offered to the Council.

Whilst an extension to the contract is part of the SLM offer, the extension is within the 5-year extension permitted within the original contract and the offer to fix out the management fee at a positive level for the Council over a longer period appears to be a good one at this stage as the Council will have guaranteed savings and SLM will begin taking the risk on the achievement of the financial figures being proposed. The position being offered is considerably greater than the current performance of the leisure centres and, whilst the opening of the Reef will undoubtedly assist SLM in achieving these figures, the offer appears to be a positive one from the Council's perspective.

Options

Option 1. To agree a 3-year extension of the contract with a management fee of circa £73k per annum paid to the Council

Option 2. To agree a 5-year extension of the contract with a management fee of circa £79k per annum paid to the Council

Option 3. To not agree to an extension at the current time.

Conclusions: The Leisure Contract is nearing the end of the third year of a ten-year contract. The contract took significant resource to procure and represented good value for money; it was not possible to foresee the impact that COVID19 would have on the performance of the contract when it was let. Agreeing to an extension of the contract is in accordance with current contract and transfers the financial risk back to the operator.

Recommendations: **Option 2: That Cabinet agrees to a 5-year extension of the leisure contract**

Reasons for Recommendations: To transfer the financial risk back to the operator with an improved financial reward over the length of the contract.

LIST OF BACKGROUND PAPERS AS REQUIRED BY LAW

(Papers relied on to write the report, which do not contain exempt information and which are not published elsewhere)

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Cabinet Member(s) Virginia Gay	Ward(s) affected All
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1. Introduction

- 1.1 The Council has been negotiating with its leisure management contractor, SLM (also known as ‘Everyone Active’), regarding the future financial position of the leisure management contract between the two parties.
- 1.2 Since the onset of the pandemic in March 2020, the Council has been providing financial support to SLM on an open book basis to ensure that SLM is not incurring losses on the contract (based on Change in Law provisions within the Contract). This has meant that the Council has funded the actual net deficit incurred in running the service after taking into account the income generated and expenditure incurred.
- 1.3 Whilst the leisure centres are currently operating and trading, the lockdown closures meant that a significant amount of income and participants/members were lost and the recovery back to pre-Covid financial performance is still on-going.
- 1.4 The Council desires to move out of this open book support arrangement and back to a position where SLM is guaranteeing a fixed financial management fee position for the Council and SLM is taking the risk on the financial performance of the contract. To this end, the Council has entered into negotiations with SLM to agree a position whereby SLM can begin taking the risk on the financial performance of the contract again.
- 1.5 The Council has received independent advice from FMG regarding the original leisure management contract procurement process to assist with the negotiations with SLM. FMG work with a number of other local authorities across the country and so have the ability to benchmark any offer to ensure the Council is getting best value. This paper sets out a review of the offer proposed by SLM.

2. Background

- 2.1 SLM's leisure management contract with the Council commenced on 1st April 2019. It was based on a fixed annual management fee payment to / from SLM as summarised in the **Table 2.1 in the Appendices**
- 2.2 The financial projections resulted in the Council paying SLM a management fee in years 1 and 2 and then SLM paying the Council a management fee from year 3 onwards. The average over the ten-year period was a payment to the Council from SLM of circa £68k per annum.
- 2.3 The above figures were based on the agreed assumption that the Splash would stay open until 30th November 2020 and the Reef would open on 1st December 2020. In reality, this was not achieved and Splash was closed early in February 2021 and the Reef did not open until 30th November 2021.
- 2.4 The lockdown which commenced in March 2020 and other subsequent shorter lockdowns and related social distancing measures have had a major impact on SLM's financial performance. The lockdown was classified as a change in law so the risk of the impact of this fell to the Council under the terms of the leisure management contract. As a result, the Council has been meeting the actual net cost of the service incurred by SLM for the period since March 2020 to date.
- 2.5 This has resulted in the Council subsidising the operation of the leisure centres to an estimated maximum level of circa £787k over the period March 2020 – March 2022. This amount would have been higher but furlough payments and a grant from Sport England has enabled SLM and the Council to mitigate some of the costs.
- 2.6 During the period since the lockdowns, SLM has been focusing on recovering the performance of the business. At this stage, it has not managed to recover to the pre-pandemic levels. To illustrate this, the first 7 months of the 21/22 financial year resulted in income generated of circa £569k and expenditure of £803k (after accounting for furlough claims) which resulted in a net loss to SLM of £234k for the period. These figures do not include the new Reef leisure centre which opened at the end of November and should help the financial performance of the contract recover.
- 2.7 It is clear that income is no longer close to the bid projections and, whilst SLM has reduced expenditure significantly, there is still a significant deficit on the contract (which the Council is currently funding). This is not an unusual position with the majority of Councils across the country in a similar position as the majority of leisure centres have not yet managed to return to pre-pandemic performance levels.

3. Options

- 3.1 After several rounds of discussion and negotiation with SLM, a final proposal has been received regarding the potential to move back to a fixed position whereby SLM is guaranteeing the financial performance of the contract. The key features of the offer are as follows:
 - The open book arrangement will end and SLM will revert to taking the risk on the financial performance of the contract from 1st April 2022;

- The service will be delivered in line with the originally agreed leisure management contract;
 - The extension clauses in the contract are utilised with offers put forward for a 3 year and a 5-year extension (the contract allows for up to a 5-year extension);
 - SLM will reduce its budgeted margin from 3.5% of income (as agreed in the original leisure management contract) to 3% of income;
 - If any additional surplus is generated on an annual basis, the contractual arrangement of a 50:50 share will be amended to a 60:40 share in the Council's favour in order to help the Council recover some of the losses it has incurred since the start of the pandemic.
- 3.2 SLM has offered a fixed management fee profile with a 3-year extension as summarised in **Table 3.1 in the Appendices**
- 3.3 SLM have offered a 3-year contract extension with the intention of having a full 10 years of operation from 1st April 2022 (in line with the original contract length). It can be seen that SLM is requesting a management fee payment from the Council in 22/23 of circa £151k but that, from 23/24 onwards, it will begin paying the Council a positive annual management fee. The average payment to the Council over the remaining 10 years of the contract will be an average annual payment to the Council of £73k.
- 3.4 This is a very positive offer considering that the performance of the leisure contract over the first 7 months of 21/22 was a deficit of circa £234k and there is no guarantee of the rate of recovery of the leisure centres' financial performance over the coming years.
- 3.5 SLM has also offered a fixed management fee profile with a 5-year extension as summarised in the table below. This offer was submitted because Council officers requested to understand the implications of extending the contract by its full amount (5 years) rather than just the 3-year offer tabled by SLM. See **Table 3.2 in the Appendices**
- 3.6 It can be seen that the profile of the payments offered for years 4 to 13 are exactly the same as the 3-year extension offer and that the payments in years 14 and 15 reduce slightly to circa £105k per annum. This is because of additional equipment replacement costs included for the Reef as a result of the slightly longer contract period. The average payment to the Council over the next 12 years would be circa £78.6k per annum. This is an improvement on the 3-year extension offer because the positive performance in the later years of the contract is retained over the extra 2-years and therefore the annual average payment increases.
- 3.7 **Table 3.3 in the Appendices** compares the original 10-year management fee offer from SLM to the revised offer it has made for the next 10/12 years.
- 3.8 When comparing the original contract against the revised contract offers put forward by SLM, it can be seen that the revised offers are very positive, particularly when the current operating loss is taken into account. In the first 7 months of 21/22, the leisure centres made an operating loss of £234k. Over the course of the whole financial year, the loss is likely to be even higher. Despite this, SLM is proposing to turn this position around so that the Council

pays a management fee of circa £151k in 22/23 and then gets paid a management fee by SLM for the remainder of the contract (in line with the original contract). This realignment of the financial position will be challenging for SLM to actually achieve and yet they are willing to move back to a position of full risk transfer to them from April 2022.

- 3.9 The original contract with SLM involved an average annual payment from SLM to the Council of circa £68k per annum over the ten-year period. Now three years into the contract, SLM is proposing to pay the Council an average of circa £73k per annum (with a 3-year extension) or circa £79k per annum (with a 5-year contract extension). Considering where the current operating performance of the leisure centres sits, this appears to be a very positive offer from SLM.

4. Summary

- 4.1 SLM has submitted a very positive financial offer to the Council for the remainder of the leisure management contract. Our consultants are involved in multiple negotiations of this kind and it is currently rare for operators to be offering to return to pre-Covid financial projections from April 2022 as the outlook for leisure centre operators and the recovery of market demand is highly uncertain. Considering these market factors, the offer of 'resetting' the agreement and utilising the extension to honour the original financial terms of the contract is a positive one. Indeed, by agreeing to lower their percentage margin and to increase the Council's share of any surplus to 60%, SLM is improving on the Council's original contract position as reflected by the increased average annual payment being offered to the Council.
- 4.2 Whilst an extension to the contract is part of the SLM offer, the extension is within the 5-year extension permitted within the original contract and the offer to fix out the management fee at a positive level for the Council over a longer period appears to be a good one at this stage as the Council will have guaranteed savings and SLM will begin taking the risk on the achievement of the financial figures being proposed. The position being offered is considerably greater than the current performance of the leisure centres and, whilst the opening of the Reef will undoubtedly assist SLM in achieving these figures, the offer appears to be a positive one from the Council's perspective.

5. Recommendations

That elected members consider the following options:

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| Option 1. | To agree a 3-year extension of the contract with a management fee of circa £73k per annum paid to the Council |
| Option 2. | To agree a 5-year extension of the contract with a management fee of circa £79k per annum paid to the Council |
| Option 3. | To not agree to any extension, and re-procure the contract |

4. Implications and Risks

Without an agreed renegotiated contract there is a risk to the Council of contract failure or contractual claim is increased. In the event of contract failure then the Council would be left with no one running the activities covered by the contract leading to an increased reputational risk both with the public in terms of performance of Leisure Services and with any future bidders for the contract.

5. Financial Implications and Risks

Should the Council decide to accept this revised offer, the financial risks would be transferred back to SLM.

6. Sustainability

There are no identified sustainability issues arising from this report.

7. Equality and Diversity

There are no identified equality and diversity issues arising from this report.

8. Section 17 Crime and Disorder considerations

There are no identified crime and disorder issues arising from this report