Important Considerations for Local Authorities Considering Alternative Leisure and Cultural Service Management Models During the COVID-19 Crisis

1. Introduction

1.1. Public leisure and cultural services are provided by a diverse mix of service management models (models) across the UK, some are managed in-house by Local Authorities and some are outsourced, run by organisations under contract and / or a lease(s). Irrespective of how Local Authorities have arranged to provide their leisure and cultural services, it is accepted that COVID-19 has put Local Authorities in a critical financial position and supplementary funding is required to reopen, recover and sustain their leisure /cultural facilities and services.

1.2. In some cases this is leading Local Authorities with outsourced models to consider the relative value of an alternative model, either because outsourcing has not proved to be free from risk and / or because there is a perception that this will assist the Local Authority to optimise net costs and service outcomes during the reopening and recovery phase, and then to sustain the service going forward. Local Authority considerations for alternative models moving from an outsourced model are usually an in-house managed service, establishing a new Local Authority Trading Company (LATC) or moving to an existing LATC (should one already exist).

1.3. This advice note is intended to support Local Authorities and their Leisure and Cultural Trust partners with strategic decisions regarding alternative models when discussions are prompted during the COVID-19 crisis. It sets out the key considerations, risks and cost implications, including the headline economic, social and contractual facts and considerations for retaining the existing Leisure / Cultural Trust model. It also covers the recommended steps to take should the move to an alternative model be the option decided upon by the Local Authority.

2. What are Trusts and what are the key characteristics of the Trust management model?

2.1. Leisure and Cultural Trusts (Trusts) are incorporated either as Companies Limited by Guarantee with charitable status, Community Benefit Societies with charitable status, Community Interest Companies (CIC's) or Charitable Incorporated Organisations / Scottish Charitable Incorporated Organisations. Trusts currently provide around 50% of the leisure service provision in the UK (including the overwhelming majority in Scotland) and most Trusts are members of Community Leisure UK.

2.2. Trusts do not distribute profits or surpluses to a third party, for example shareholders, they use all profits or surpluses to cross subsidise and reinvest in services and communities. Trusts contribute to and deliver across communities, providing safe havens and spaces, they help and support and develop other local civil society organisations and stakeholders to continually improve services to deliver social value and to tackle inequalities.

2.3. The model delivered by Trusts is commonly known as the Trust Model. This model aims to achieve a focus on engaging communities in decision making, it brings robust but relatively streamlined governance resulting in agility and speed of decision-making to respond to market conditions and opportunities, and it unlocks access to charitable funding streams, tax and NNDR savings to benefit the Local Authority partner and the local community.

3. As part of a strong collaborative national network facilitated by Community Leisure UK, Trusts are continually developing their effectiveness and efficiency. This largely includes:

3.1.1. Increasing service delivery across local policy areas to assist Local Authority partners e.g. supporting the delivery of health, social care, education and employment services.

3.1.2. Diversification to support Local Authority partners, including libraries, museums, theatres and children's centres.

3.1.3. Leveraging their charitable purpose, e.g. successfully bidding for grants and commissions, often in partnership with other third sector organisations with aligned strategic objectives.

3.1.4. Capital and service development opportunities to increase commerciality e.g. gym and leisure attraction facility investments.

3.1.5. In some instances sharing support services with, or merging / partnering with other Trusts by mutual consent.

4. What is currently happening?

4.1. By the time all leisure and cultural facilities are permitted to legally reopen across the UK, services will have experienced four to six months of zero income, and they are set to experience an extended period of reduced income due to capacity reductions because of social distancing measures and the need to build back customer confidence before demand for services returns to pre COVID-19 levels. The financial circumstances of Trusts is compounded because they are not eligible for the vast majority of Government backed financial support schemes and they are most at risk because they are charities, societies or community interest companies (with a public benefit asset lock) and as such do not distribute profits. Also contract margins are low (between 1% – 5% of income relative to contracts) and due to their charitable objects and contractual requirements, any financial surplus generated is invested back into services.

4.2. Outsourced leisure and cultural service operators are reliant upon ongoing income from customers and members to operate with management fee payments either to or from the Local Authority based on the balance between income and expenditure. During the enforced COVID-19 closure period (lockdown), operators have continued to incur costs with no ongoing income with which to service the costs. Reopening means income can begin to be reintroduced, but only at levels significantly below pre-COVID-19 levels due to social distancing / capacity restrictions and reduced levels of demand linked to customer confidence levels. At the same time, the reopening of facilities and phasing out of Government support schemes (i.e. the furlough scheme) will result in higher costs for operators.

4.3. Trusts have used various financial levers to cover their costs, including using their reserves, arranging bank overdrafts, applying for Government backed loans and requesting payment holidays. Trusts' average monthly payroll is £378,000 and average monthly utility and energy costs are £44,000. With no income receipts being taken throughout this period, it has had a serious impact on the financial sustainability of the leisure and cultural service sector as a whole. The recovery period could take 12 months or longer to return to the pre COVID-19 levels of business, depending on the length of closure and social distancing restrictions to service capacity, therefore, in many cases Trusts are under threat of insolvency.

4.4. Given this position, outsourced leisure and cultural service operators are seeking financial support from their Local Authority partners to subsidise the lockdown costs and to provide ongoing financial support during the reopening / recovery period. This is likely to see the costs of operation increase above pre-COVID-19 levels with significantly curtailed revenue generating potential for an uncertain period possibly lasting over 12 months as stated earlier. It should be noted that costs of the recovery period could be higher than the lockdown period regardless of the model adopted by a Local Authority. Thus, a change in the model will not be sufficient to address all of the potential costs of recovery, and in most cases the costs of the service during recovery under an alternative model will be higher than an existing external leisure operator.

5. What alternative management options are available to Local Authorities?

5.1. A good relationship will mean the Local Authority can work with their operating partner i.e. Trust, adopting transparent accounting to determine both the lockdown and recovery plan. However, there may be situations where a Local Authority's relationship with its operating partner is such that the operator cannot be supported and becomes insolvent and / or the operator chooses to withdraw from the contract due to a lack of financial support inorder to protect its interests.

5.2. Alternatively, as stated earlier, the Local Authority may wish to assess the relative value of an alternative model to its current arrangements. Given that undertaking a procurement would take at least 14 months and incur significant costs (circa £150-200k) and management resources, there are typically two immediate options without the need to undertake a competitive procurement process; either bringing the service in-house or into a LATC, assuming the service is to continue. The LATC option may involve establishing a new LATC or expanding the scope of an existing LATC if one already exists in the Local Authority domain. Moving the service under an existing LATC is a strategy for the Local Authority that can provide the time necessary to undertake a comprehensive options appraisal to determine the future model for the service.

5.3. Other options, which may be available, are asset transfers for some sites or a joint venture company if a suitable partner can be found; or where another leisure provider is operating in the area, it may be possible to novate the contract to them given the relaxation of procurement rules. However, these options may be limited in the current crisis as operators are currently focused on managing the risks associated with their existing contracts and are unable to spare management capacity.

6. What are the key considerations and implications of the alternative management options?

6.1. For Local Authorities that have a Trust or other outsourced leisure service model, there will be direct and indirect financial risks and consequences that the Local Authority will need to carefully consider in relation to their current and future leisure service, if they are contemplating an alternative model, which could result in a net overall cost to the Local Authority.

6.2. There could be costs incurred to TUPE transfer staff back to the Local Authority, absorb pension liabilities and cover potential redundancy costs; the Local Authority will also not indirectly benefit from tax concessions available to Trusts. Key considerations are explained in more detail below (paragraphs 6.2.1 - 6.2.8).

6.2.1. **Set up and mobilisation costs and resources -** Bringing an outsourced service in house or transferring it to a new or existing LATC would require significant internal resources to establish the relevant systems and procedures for the management of the service.

6.2.2. This would include human resources and TUPE transfer management, IT systems and licenses, operational systems and policies, health and safety policies and procedure, maintenance and utilities management systems, sales, marketing and communications development, finance and administration systems and project management.

6.2.3. In the case of a new LATC, there would also be additional resources required to establish governance policies and additional legal costs. Depending on the scale of the service these initial resources would equate to circa £125k – £250k. A minimum of three months would typically be required for the orderly transfer of a leisure service and with COVID-19 related restrictions, this could require more time.

6.2.4. **Future operational costs -** A high proportion of Local Authorities have outsourced the operation of their leisure facilities and services to achieve operational savings that an outsourced service can typically offer, both through a lower cost base and higher levels of income generation.

6.2.5. Transferring to an in-house or LATC model would most likely have significant additional cost implications for the service, both during the initial COVID-19 recovery phase and thereafter, resulting from:

6.2.5.1.1. **Less efficient tax recovery** – depending on the Local Authority's de minimis limit, an in-house service may not be able to recover VAT relating to exempt supplies. Even if the in-house service can initially gain VAT recovery this could change in the future depending on the Local Authority's overall VAT position. Essentially the Local Authority will take the risk on VAT recovery.

6.2.5.1.2. **Additional NNDR costs** – an in-house or LATC operation typically will not qualify for NNDR relief which will result in an additional cost to the Local Authority (variable depending on the rate of business rate retention at the Local Authority).

6.2.5.1.3. **Increased employee costs** – moving to an in-house model with Local Government terms and conditions and access to the Local Government Pension Scheme (with employer contributions of over 15%) can add significantly to employee costs, proportionally the highest cost for the service.

6.2.5.1.4. **Lower levels of income generation** – independent operators are more commercially astute, able to diversify and maximise income, which in the case of Trusts can then be used to cross-subsidise their charitable work. They bring sector specific marketing and sales experience coupled with dedicated management expertise and organisational agility, with a capacity for risk taking and innovation.

6.2.5.1.5. **Higher procurement costs** – in-house services can result in reduced buying power compared with multi-contract leisure operators and operators accessing industry specific consortia supply and service procurement arrangements.

6.2.6. **Allocation of risk –** Another key driver for many Local Authorities that have outsourced their leisure and cultural services has been the transfer of operational and commercial risk away from the Local Authority. Whilst the need to provide financial support demonstrates that some risk is ultimately retained by the Local Authority, once services are able to recover to a steady operational state, it will be possible to transfer the majority of this risk back to the external leisure provider. This level of risk transfer does not exist with an in-house or LATC model.

6.2.7. **Re-procurement implications –** In the event that the operation of a Local Authority's leisure and cultural services were brought in house for an interim period with the intention of procuring a new outsourced operator in the medium term, there would also be significant long term financial implications to both cover the costs of the procurement event and also with regard to establishing a new incoming service delivery partner. A new operator would most likely have to develop income from a lower income and customer base than would otherwise have been the case. Expenditure in the early years of the contract would also be higher due to the transfer of staff under TUPE to the Local Authority and being placed under Local Government terms and conditions.

6.2.8. **Service disruption –** The transfer of the leisure and cultural service to an alternative model under these circumstances would have a high level of service disruption risk. Under the circumstances, the time required to ensure a smooth and managed transfer of the service is unlikely to be available. Similarly, equipment (i.e. gym equipment), IT systems and information relating to existing customers may not be transferred from the existing operator. Services may be forced to cease for an interim period whilst new systems are established. Significant disruption to the service resulting in the loss of customers would be a substantial risk.

6.3. The higher cost and support cost base of LATC or in-house service management options, and the reduced capacity to generate income and drive innovation is likely to result in substantially higher overall subsidy levels during a recovery period than under an outsourced operator. For a Local Authority with a number of facilities this could equate to £ hundreds of thousands of additional subsidy each year. There is also a significant cost to the community, as the services are likely to remain closed until arrangements can be put in place to reopen, at a time when Local Authorities will have many other demands on their time and finances and statutory services will have to take priority.

7. Termination of the contract with a Trust by mutual agreement

7.1. Should, after endeavours to protect and retain the existing model, the Local Authority request a "termination of the contract by mutual agreement" Trustees have duties and responsibilities, both under the Companies Act and the Charities Act. Trustees must be satisfied that termination of the contract is in the best interests of the Company and it will enable it to better fulfil its charitable purposes. This is a non default termination. Such termination should not, therefore, prejudice the Company in any way and, in particular, impact on its ability to continue to fulfil its charitable purposes. On this basis, it is incumbent upon the Local Authority to set out in more detail its proposals for the mutual termination of the Contract.

8. Steps to take should the move to an alternative model be the only option

8.1. A communications strategy should be agreed with the Local Authority which should include a joint agreed statement to provide all possible assurances to key stakeholders during the period of transition, with particular regard to employees and customers.

8.2. A schedule of structured meetings should be included to address the key commercial issues to be discussed and agreed between the parties, at the earliest opportunity. During this period, should the Local Authority have Board nominees they should be asked to withdraw / stand down due to the potential conflict of interest for those individuals. Elements that will need to be discussed and agreed are as follows:

- 8.2.1. The consultation process for employees with regard to TUPE and the responsibility for any such redundancy costs for employees who are at risk as a result of the Local Authority's decision.
- 8.2.2. The compensatory payment for any undepreciated capital expenditure relating to any investment that the Trust has made in the facilities.
- 8.2.3. The timetable for the exit and handover of the services, a minimum of 12 months is realistic given the prevailing COVID-19 pandemic circumstances i.e. considering the Local Authorities capacity and the Trusts focus on remobilising services after a prolonged period of lockdown.

9. Conclusion

9.1. The delivery of a Local Authority leisure and cultural service by a Trust needs to be assessed in line with the unique circumstances required to deliver the contract and service specification. Local circumstances will differ and Local Authorities are best placed to decide their own approach to these services. However, in all cases a partnership focused approach between Local Authority and operator is the best way of securing positive outcomes for the community. To be encouraged is the consideration of the long term implications of the unprecedented COVID-19 crisis on the leisure and cultural sector as a whole, and how partners can best stand together to ensure the resilience of community facilities and services.

9.2. The overall cost of transitioning from the existing model will likely be much greater accounting for delays, disruption and added to this, the likely increased long term financial costs and potential negative impact upon the desired strategic outcomes for the service. Coupled with this, there is no doubt that Local Authorities have and will continue to be under exceptional financial pressures, this is why, during this unprecedented COVID-19 crisis, considering changing the model is not advised as a prudent option over capitalising on the existing leisure service delivery partner relationship and prioritising operational stability during the crisis.

9.3. Assuming, despite the uncertainties, the costs of lockdown can be successfully mitigated during the reopening period, the Local Authority can work with their incumbent delivery partner to share risks and agree a long term plan to reimagine and sustain the service. By stabilizing the financial position over the short term, the contractual relationship with the incumbent delivery partner can be redesigned by mutual consent to create a sustainable long term solution that will best deliver the strategic objectives required by the Local Authority.

9.4. It is therefore recommended that Local Authorities seek every possible opportunity to work with their incumbent Trust delivery partner to agree a financial solution before contemplating moving to another model. Should Local Authorities believe it absolutely necessary to consider alternative models, a comprehensive options appraisal including a cost / benefit analysis should be carried out maintaining a positive and transparent approach between the incumbent delivery partner, the Local Authority and involvement of any relevant third party i.e. consultants.

ABOUT COMMUNITY LEISURE UK

Community Leisure UK is a members' association for organizations who deliver public leisure, sport and cultural services across the UK. Commonly called Trusts, members are registered Charities, societies or community interest companies (with a public benefit asset lock), often working in partnership with Local Authorities. Community Leisure UK currently represents 110 Trusts who operate over 3,800 facilities across the UK including gyms, swimming pools, sports halls, theatres, town halls, libraries, museums and cinemas (58% of members deliver cultural services and facilities, which equates to 1,100 cultural assets). With over 100,000 staff and over 17,000 volunteers, Community Leisure UK members served 233 million customer visits last year generating a combined turnover of over £2 billion. Community Leisure UK members work locally to develop community place based services and solutions with partners, they reinvest all profits in wellbeing and supporting communities. Community Leisure UK is Fair Tax certified and a member of Coop Group, Charity Finance Group and Social Enterprise UK. Community Leisure UK champions and protects the leisure and cultural service delivery model provided by Trusts (known as the Trust Model) by enabling networking and knowledge sharing with peers and external stakeholders.