

Hart District Council

Leisure Management Options Appraisal
A Final Report
August 2009

Table of Contents

1	Executive Summary	01
2	Introduction and Background	10
3	Service Overview	15
4	Management Options	22
5	Identification of Key Financial Issues	45
6	Conclusions and Recommendations	48
7	Disclaimer	50

Table of Appendices

- 1 The National Picture
- 2 Financial Model Version V

Section 1

Executive Summary

1 Executive Summary

- 1.1 Strategic Leisure was commissioned by Hart District Council (HDC) to undertake a 'high level' management options appraisal for the management of the Council's directly managed leisure facilities. The purpose of the appraisal is to evaluate the management options available to the Council and to make recommendations in relation to the most appropriate option.
- 1.2 The Council currently manages two leisure centres, Hart Leisure Centre and Frogmore Leisure Centre
- 1.3 The scope of this options appraisal is as follows:
- To review the existing service delivery within HDC for sport and leisure management
 - To identify existing models of service delivery in the public sector, and assess their advantages and disadvantages
 - To identify which of the available models may offer an appropriate way forward

	Issues identified
Dual use agreements	<ul style="list-style-type: none"> • Currently very vague and would have to be formalised if any externalisation. • Centre Managers currently work more on a series of gentleman's agreements rather than being formally adhered. • Fear would be that any redrafting of the dual use agreements with the County Council would put the District in a worse off position.
Support services	<ul style="list-style-type: none"> • Support services costs are currently high. • The Council is currently in discussions with Capita to externalise finance, HR, and IT after discussions with BT's support arm fell through. • Any externalisation of these elements will have an impact on the decision to outsource leisure.
Human resources	<ul style="list-style-type: none"> • HR has recently experienced outsourcing – revenues and benefits was outsourced last year. This went reasonably well. • Single status was completed last year which involved the re-grading of some staff. This had a negative impact on revenue. • Currently about 150 staff working within leisure, not all FT, some casual. This amounts to about 40% of the Council's workforce • A two tier situation with casual staff as they did not go through evaluation. Other anomalies are the various instructors who are self employed and have an income share agreement • UNISON is the only union; however this is relatively insignificant at the leisure centres. Given the previous externalisation of revenues and the potential transfer of HR etc, externalisation of leisure not deemed to be a major issue. • Pensions – the council would probably be looking for Admitted Body status, as was the case with the previous externalisation • One of HR key services is to leisure. Leisure Centre Managers recruit staff and HR does all other HR related tasks. HR possibly transferred by summer, this could complicate matters as a 3rd party involved. • Payroll already transferred to Hampshire CC. • Looking for the managers of the centres to take on more responsibilities to enable the reduction in HR recharges. • Currently some streamlining of staff through natural wastage.
Legal	<ul style="list-style-type: none"> • The Council has entered into an agreement with Basingstoke and Deane for legal services, 20 lawyers in total, 3 based at Hart DC offices.

	Issues identified
	<ul style="list-style-type: none"> • Hart DC currently pay about £250k for legal services, a fairly rough apportionment to leisure would be based on number of case files relating to leisure • No procurement team within the authority – a large procurement exercise likely to be tendered out to private lawyers. • Initial legal view that there is a definite legal power for any transfer if only to a management contract.
Property	<ul style="list-style-type: none"> • Survey of Council's property portfolio conducted in 2006 and approved in 2008. Recommended that £2.8m required across all facilities, about half of this for leisure • It was agreed that this should be funded through revenue not capital, however next year this will be scrapped as revenue and be paid for by capital funding • The programme has been revamped and now only monies to be spent on urgent items, for leisure this means roofing and some other items. • About £500k left to spend on Hart Leisure Centre – still requires capital board approval. JE to provide details of capital programme. • If something is likely to generate income it is more likely to get through the capital programme. • Day to day maintenance dealt with by leisure centre managers. Contracts with external providers for M&E. Property only involved with leisure on an ad-hoc basis. • Property side does not have much involvement with leisure, not a major issue if leisure was externalised. 1 FT & 1 PT member of staff. PT close to retirement and FT could be redeployed elsewhere
Finance	<ul style="list-style-type: none"> • The authority is currently cash strapped and generally less wealthy than most authorities • Savings targets have been hit recently • NNDR savings have been secured for the next five years • £1.5 million budget hole – balanced budget 2009/10 • Council is likely to support capital investment if there is a detailed business case

Forms of Management for Public Sector Leisure and Cultural Services

1.4 The options evaluated are as follows:

- Option 1 In-house direct provision (plus a refocused option)
- Option 2 Private Sector Partnership
- Option 3 Non-Profit Distributing Organisation (NPDO)
- Option 4 Partnership with and Existing Trust

1.5 We have not assessed in any detail the option to cease providing the service. Whilst as a discretionary service, this is an option, it is not part of the brief for this study.

1.6 Similarly the option to dispose of the facilities as a going concern is also not considered a viable option. It is unlikely that the Council owns the freehold of facilities in any case and/or the County Council would in all likelihood object to the sale or assignment of the lease on a long term basis to a commercial operator. Furthermore the leisure facilities attract a subsidy and are in need of significant capital expenditure. They would not be an attractive property acquisition to a commercial operator at the best of times but in the current economic climate would be seen as a liability rather than an asset.

Advantages and Disadvantages of In-house Management

Advantages and disadvantages of In house Management

Advantages	Disadvantages
<ul style="list-style-type: none"> • Direct Council control and ability to influence and change service delivery 	<ul style="list-style-type: none"> • Opportunity for savings in revenue expenditure through increased income and operational efficiencies would rely on ability of in-house resources.
<ul style="list-style-type: none"> • Allows potential interaction and economies of scale between service areas 	<ul style="list-style-type: none"> • Any capital investment would rely on use of council capital and/or Prudential Borrowing which comes at an opportunity cost.
<ul style="list-style-type: none"> • Least disruption to services, no start-up costs incurred 	<ul style="list-style-type: none"> • More difficult to demonstrate Best Value due to lack of competitive process
<ul style="list-style-type: none"> • Able to budget and apply strict financial controls 	<ul style="list-style-type: none"> • No surety over future funding levels

Appropriateness of In house operation in Hart

- 1.7 As identified in table 4.1 Councils often decide to externalise the leisure service because the current in house operation is not performing and there is a perception that externalisation will significantly increase income and reduce expenditure due to a more commercially focused operation.
- 1.8 Our review of current performance has illustrated that both the Council's leisure facilities are performing well and there appears to be limited scope for improving income given the current capacity and utilisation of the centres. This would support the retention of the facilities in house.
- 1.9 The current economic situation is resulting in private sector organisations being very reluctant to tender for new contracts and this needs to be borne in mind. They will look to 'cherry pick' services where they feel there is scope to significantly improve the financial performance and therefore maximise profit. The relative economy, effectiveness and efficiency of the in-house service mitigates against this in this case.
- 1.10 A key driver for HDC is the need to spend capital to improve the leisure facilities and the limited resources currently at the Council's disposal. The need for capital may be such that if it can not be found in house will mitigate against an in house solution. However the availability of commercial sector capital is also severely limited at the moment and would be significantly more expensive than the use of public sector borrowing.

Advantages and Disadvantages of the Private Sector

Advantages and disadvantages of the Private sector

Advantages	Disadvantages
<ul style="list-style-type: none"> • New 'commercial' approach to management (entrepreneurial culture). 	<ul style="list-style-type: none"> • Some delegation of day to day control via the specification
<ul style="list-style-type: none"> • Competitive bidding process would be demonstration of Best Value and could realize increased revenue savings 	<ul style="list-style-type: none"> • Impact on central services personnel
<ul style="list-style-type: none"> • Opportunity to improve revenue situation. 	<ul style="list-style-type: none"> • Employee anxiety over transfer
<ul style="list-style-type: none"> • Access to development capital if required 	<ul style="list-style-type: none"> • Procurement costs, timescale and risks

Advantages	Disadvantages
<ul style="list-style-type: none"> • Surety over future funding levels 	<ul style="list-style-type: none"> • Potential dilution of the Council's objectives and policies
<ul style="list-style-type: none"> • Responsive service 	<ul style="list-style-type: none"> • Imperfect competition may lead to too few bids to realise best value
<ul style="list-style-type: none"> • Career opportunities for staff 	<ul style="list-style-type: none"> • Inability to attract tax-based savings

Appropriateness of Private Sector in Hart

- 1.11 In the case of HDC there does not appear to be potential for significant usage and income gains which negates one of the prime benefits of transfer of the operation to the private sector. In terms of the potential to reduce costs, our analysis shows that the centres are performing well. The only area of expenditure related to the facilities themselves where we feel that the costs could reduce in a private sector option is 'staffing'. We have reviewed the staffing structure and believe that there are opportunities to make savings. However it is important to note that TUPE would apply to any externalisation and it would take time for any operator to effect changes and have those changes reflected in any financial arrangement. Ironically it would be easier for the Council to review the staffing arrangements prior to any externalisation.

Advantages and Disadvantages of 'Hybrid Trusts'

Advantages and disadvantages of Hybrid trusts

Advantages	Disadvantages
<ul style="list-style-type: none"> • Tax-based advantages (NDR/VAT) 	<ul style="list-style-type: none"> • Market Capacity
<ul style="list-style-type: none"> • Potential savings are comparable with NPDO's 	<ul style="list-style-type: none"> • Can be complex legal, administrative and organizational structures
<ul style="list-style-type: none"> • Commercial sector expertise. 	<ul style="list-style-type: none"> • Partial loss of day to day control
<ul style="list-style-type: none"> • Access to capital. 	<ul style="list-style-type: none"> • Potential impact on central services personnel
<ul style="list-style-type: none"> • Good way of demonstrating Best Value via competitive process 	<ul style="list-style-type: none"> • Commercial focus unless effectively monitored
<ul style="list-style-type: none"> • More entrepreneurial and responsive approach 	<ul style="list-style-type: none"> • Start-up costs
<ul style="list-style-type: none"> • Potential Revenue effectiveness and surety 	

Appropriateness of Private Sector Hybrids in Hart

- 1.12 A Public Private Partnership with a company structured with a not for profit subsidiary could be advantageous for the Council because in addition to the benefits described in the private sector option above e.g. access to capital, such a partnership could yield further tax-based savings in relation to National Non Domestic Rate relief and possibly VAT concessions, subject to the structure of the organisation and partnership. These financial benefits could yield additional revenue to underpin Prudential Borrowing repayments.

- 1.13 The Council would need to satisfy itself that the particular model chosen was legally robust and would also need to understand where the risks lie should the financial status of hybrid trusts change. For example many of the operators are reluctant to assume the financial risk of future changes in rating policy.
- 1.14 Such a partnership would however not alter some of the fundamental concerns about a private sector partnership in this case e.g. the lack of real savings, the issue of support service duplication and complication, the dual-use arrangements and the cost of capital.

Advantages and Disadvantages of Leisure Trusts

Advantages and disadvantages of Trusts

Advantages	Disadvantages
<ul style="list-style-type: none"> • VAT favourable treatment of supplies of sporting services (NPDO must be 'principal rather than agent'). 	<ul style="list-style-type: none"> • Loss of democratic control (arms-length trust can only have up to 20% direct public sector representation)
<ul style="list-style-type: none"> • Will improve the Council's overall VAT position in relation to 5% partial exemption threshold 	<ul style="list-style-type: none"> • Trust may find it difficult to 'lever in' sufficient external capital and will still be dependent upon the Council for reinvestment in the assets
<ul style="list-style-type: none"> • Relief from National Non-Domestic rates (NNDR) (up to 85% can be saved subject to 80% mandatory relief and 20% top-up discretionary relief) 	<ul style="list-style-type: none"> • Potential fragmentation and disengagement from the Council
<ul style="list-style-type: none"> • Other Fiscal Advantages (favourable treatment in relation to Corporation Tax, Capital Gains Tax and Tax relief on donations) 	<ul style="list-style-type: none"> • Success depends on attracting and retaining quality 'Trustees/Directors'
<ul style="list-style-type: none"> • Capital Expenditure (ability to borrow / secure capital outside of local authority allocation and regulations) 	<ul style="list-style-type: none"> • Potential Impact on central establishment personnel
<ul style="list-style-type: none"> • Fits with Best Value (Partnership Arrangement) 	<ul style="list-style-type: none"> • Ability of TUPE to 'protect' employee benefits
<ul style="list-style-type: none"> • Ability /Opportunity to engage the local community through direct representation 	<ul style="list-style-type: none"> • Reversibility not guaranteed

Appropriateness of Establishing a New Trust in Hart

- 1.15 Establishing a new trust will in theory result in the same management team operating under a new name managing and operating the same facilities and services. If there were a need to drive the business forward with a more commercial approach then establishing a new trust will not necessarily resolve any weaknesses in the service because any management and operational issues will continue to be dealt with by the same team under a new guise but with less control and support from the Council. This will depend to some extent on the mix and strengths of external Board Members in a Company Limited by Guarantee model.
- 1.16 The main disadvantage of the Trust approach is that a new trust would not be able to generate any significant capital investment. The main advantage of this approach would be the access to charitable status and tax-based savings thus enhancing the revenue position.

- 1.17 On the other hand this option would enable an element of risk transfer arising from externalising the services. It would also generate tax-based revenue savings (that are probably more secure than a hybrid trust arrangement) and furthermore it would enable the service to remain as an integrated whole (if this was considered material).
- 1.18 We would have concerns about the Council deciding to establish a new trust in relation to procurement issues and the risk of challenge. A more detailed feasibility study would be required to demonstrate Best Value of this approach. We are not convinced that this could be achieved and the Council may have to go down the twin track approach which is costly and time-consuming

Advantages and Disadvantages of Existing Trusts

Advantages	Disadvantages
<ul style="list-style-type: none"> VAT favourable treatment of supplies of sporting services (NPDO must be 'principal rather than agent'). 	<ul style="list-style-type: none"> Loss of democratic control (arms-length trust can only have up to 20% direct public sector representation)
<ul style="list-style-type: none"> Will improve the Council's overall VAT position in relation to 5% partial exemption threshold 	<ul style="list-style-type: none"> Trust may find it difficult to 'lever in' sufficient external capital and will still be dependent upon the Council for reinvestment in the assets
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<ul style="list-style-type: none"> Fits with Best Value (Partnership Arrangement) 	<ul style="list-style-type: none"> Ability of TUPE to 'protect' employee benefits
<ul style="list-style-type: none"> Ability /Opportunity to engage the local community through direct representation 	<ul style="list-style-type: none"> Reversibility not guaranteed

Appropriateness of an Existing Trust in Hart

- 1.19 It is likely that there would be some interest from existing trusts even allowing for the current economic situation. If an open tender procurement process is undertaken, these organisations would not be excluded from expressing an interest. At that stage their ability to fulfil the Council's requirements would need to be evaluated objectively and against other potential partners.
- 1.20 If the Council were to consider this approach they would need to be very careful that they were not being used as a 'lifeboat' for an existing trust particularly at this time. They would also need to be certain that an existing trust had the skills and resources to manage the service in a sustainable way.

Summary of Management options

- 1.21 An in-house solution is the status quo and it can be demonstrated that they are performing economically, effectively and efficiently. We do not believe that an external organisation would manage the service any better. They may be able to access tax-based savings but much of this would be swallowed up in support services, profit margins, start-up costs etc.
- 1.22 The big question mark about the in-house option is the ability to raise capital. The Council could use Prudential Borrowing to fund capital but would need to demonstrate an ability to fund the re-payments. Whilst the private sector could inject capital, the current market conditions do not bode well for a private sector partnership or for a partnership with an existing trust. The cost of capital would be higher in an externalised service.
- 1.23 There are advantages and disadvantages of retaining services in-house but in this case the advantages may outweigh the disadvantages particularly when considering the complexities and risks of reviewing the dual use arrangements and the current move to externalise support services..
- 1.24 A partnership with a private sector operator has a number of merits. Firstly through so-called hybrid trust structures access to tax-based savings can be obtained although the risks of these structures need to be evaluated carefully. These revenue savings can be used to underpin Prudential Borrowing repayments although in this case these would not be too significant and a proportion would accrue to the County.
- 1.25 External capital funding can be levered in through a partnership with a private sector organisation. It should be noted however that this capital will need to be repaid through the lifespan of the contract and is more expensive than the use of in-house capital.
- 1.26 The main disadvantage of the private sector approach is the current market conditions. A potential advantage is the potential improvement of the Council's VAT position especially if capital is spent on the leisure facilities.
- 1.27 The option to establish a new Trust to operate the service also has some merit. The main disadvantages are that the Council will lose control over the service to a greater degree than under a private sector contract and there will be limited opportunity for external funding. Therefore although a new trust would yield some revenue savings associated with National Non Domestic Rates and VAT concessions, a new trust would not be able to access significant capital or bring about cultural change in service delivery. It is unlikely that the Council could set up a new Trust without some form of more detailed Best Value assessment. Start-up costs would also be significant.
- 1.28 Other existing trusts currently operating outside Hart would probably be interested in a partnership with the Council but Strategic Leisure doubt whether they would be capable of delivering any major capital investment and there would be significant concern over their primary focus and operating priority.
- 1.29 It can be seen therefore that all forms of management have relative advantages and disadvantages. The importance of these will depend on ones 'frames of reference' as well as the Council's financial position, political opinion and corporate priorities. The next section of the report identifies some of the key issues in Hart that will influence the choice of the optimum form of management

Key Issues in Hart

- 1.30 This high level management options appraisal has highlighted some key issues in Hart. These are summarised below.
- **Effectiveness of current operation:** The leisure centres are performing well based on a number of benchmarks and performance indicators. The Quest scores indicate an effective operation and the net cost of the service is very low compared with other in-house local authorities.
 - **Opportunity for savings limited:** The efficiency of the in-house operation minimises the opportunity to generate savings from an externalised option.
 - **Dual-use Arrangements:** The agreements with the schools and County have been 'interpreted' over the years. There are many Gentleman's arrangements in place and most of these are in the District's favour. Any externalisation will need to be associated with a review and firming up of the agreements. This may increase the net cost of the service to the District and therefore reduce the potential savings.
 - **Savings to accrue to the County:** In any case a proportion of any savings arising from an externalisation would be due to the County under the current arrangements e.g. a proportion of any NNDR relief. Savings would need to be weighed up against the loss of direct control.
 - **High cost of support services:** When benchmarked against other local authorities and in particular other forms of management, the cost of support services attributed to the leisure centres is high. This is not unusual in a relatively small 'shire' District because proportionately there are fewer service departments against which these costs can be charged. Externalising the leisure management function would not reduce these costs (unless there was a commensurate reduction in overheads) because there would be no personnel on the TUPE list. Therefore costs would be duplicated.
 - **Out-sourcing of support services:** The Council is in the process of addressing the support services issue by outsourcing a number of administrative functions. Looking to externalise the leisure management service simultaneously may cause some complications.
 - **Relatively high staffing costs:** Having said that the net cost of the service is low, there is one area where we feel that savings could be made. Staffing levels are higher than we would expect particularly at a management/supervisory level.
 - **Need for capital investment:** The leisure centres are in need of investment to keep them up to customer expectation. Some of this investment is needed to maintain the fabric and structure of the facilities, some to refurbish and enhance the ancillary facilities such as changing rooms and some to create additional income generating facilities. The ability to fund this capital will be crucial. The Council is strapped for cash but can use Prudential Borrowing if it so chooses.
 - **High cost of external Capital:** One way to secure this investment would be to partner with a commercial sector company (a leisure trust option would not be likely to yield capital). However the cost of this capital is typically 10-15% which is significantly higher than public sector borrowing.
 - **Current market conditions:** There is evidence that fewer commercial sector companies are bidding for work in the current economic climate. Those that are have started to be much more risk averse and are applying much higher margins. Given the economic nature of the in-house approach we do not feel that there is scope to make significant revenue savings particularly when allowing for part of the savings to accrue to the County and to retain a client function.
 - **Synergy with other leisure facilities:** There are some existing outdoor sports facilities and the potential for more and better ones to be provided adjacent to the Hart Leisure Centre. Strategic Leisure believes that these should be integrated with the management of the leisure centres.
 - **Start-up resources and costs:** Any externalisation will be draining on the Council's time and resources. It is clear that there is insufficient expertise and time available to manage a significant externalisation. Setting up a leisure trust from scratch would cost at least £100k and an externalisation to a commercial contractor at least £50k. We do not believe that this can be justified at this time when the benefits of an external approach are so uncertain.

Conclusion

- 1.31 **In the case of Hart District Council and taking all relative factors into account we believe that the advantages of retaining services in house outweigh the disadvantages, at least for the time being.**
- 1.32 **Given the existing effectiveness of the service, current market conditions, the impending externalisation of support services and the risk of increasing the net cost through reviewing dual-use arrangements, Best Value may be served at least in the short term by retaining services in-house. The Council should consider in more detail the opportunity to invest in the leisure facilities through prudential borrowing and make some adjustments to the way services are delivered in-house before re-considering an externalisation.**

Recommendations

- 1.33 Strategic Leisure makes the following recommendations to Hart District Council in relation to the options for the management of leisure facilities;
- 1.** That the leisure management service remains in house (for the foreseeable future) and at least pending the out-sourcing of support services
 - 2.** That the Council undertakes a review of the staffing levels at the leisure centres
 - 3.** That the Council undertakes a feasibility study into the ability to extend the income generating capability of the leisure facilities and to refurbish them through a self-financing capital scheme

Section 2

Introduction and Background

2 Introduction and Context

Introduction

- 2.1 Strategic Leisure was commissioned by Hart District Council (HDC) to undertake a 'high level' management options appraisal for the management of the Council's directly managed leisure facilities. The purpose of the appraisal is to evaluate the management options available to the Council and to make recommendations in relation to the most appropriate option.
- 2.2 The Council currently manages two leisure centres, Hart Leisure Centre and Frogmore Leisure Centre. Hart Leisure Centre is seen as the 'flagship' leisure facility in the District providing both wet and dry facilities and is located adjacent to the Calthorpe Park School.
- 2.3 Frogmore Leisure Centre is a dual-use facility co-located with Frogmore Community School providing dry facilities such as health and fitness provision and a 4 court sports hall.
- 2.4 Although a discretionary service, there is recognition at a corporate and political level that the sport, leisure and cultural services play a key role in delivering the Council's corporate objectives. The Council is keen to explore the management options available in order to make an informed decision about the future delivery of leisure services.

Scope

- 2.5 In order to assess the best option for the service there is a need to consider all options even if some are easily discounted. There are a number of options open to the Council in relation to the future management of the sport and leisure service. These are set out below:
- **Retention of In-house Management**
 - **Cessation of the service**
 - **Selling off of the assets**
 - **Leisure Trust**
 - **Existing Trust**
 - **Establishment of New Trust**
 - **Private Sector Partnership with:**
 - **Pure Commercial Company**
 - **So-called 'hybrid' trust**
 - **Mixed Economy of the above**
- 2.6 The scope of this options appraisal is as follows:
- To review the existing service delivery within HDC for sport and leisure management
 - To identify existing models of service delivery in the public sector, and assess their advantages and disadvantages
 - To identify which of the available models may offer an appropriate way forward

Our approach

- 2.7 Strategic Leisure has been involved in advising local authorities on leisure management issues for 20 years. During that time we have assisted over 40% (circa 200) of Councils.
- 2.8 We have completed over 50 management options appraisals and been retained by many to implement a full range of solutions including:
- Re-focusing of the in-house service
 - The development of a new Trust
 - Entering into a partnership with an existing trust
 - Public Private Partnership (PPP)
 - Private Finance Initiative (PFI)
- 2.9 We are one of the few organisations that have this experience and that is truly independent. Based on the above we feel well qualified to comment on the 'state of the industry' and how this relates to the options for Hart District Council. The following options appraisal has been carried out independently and objectively. An assessment of the current 'external market' is included at Appendix 1.
- 2.10 The approach taken to the 'high level' options appraisal has been as follows:
- Site visits to Hart & Frogmore Leisure Centre
 - Consultation with key internal stakeholders
 - Review of existing service delivery and performance
 - Identification and assessment of available options for service delivery in the public sector
 - Identification of key Issues e.g. property, financial, legal, personnel, support functions, capital and revenue implications
 - Assessment of the most appropriate option for Hart DC

Evaluation Framework

- 2.11 Strategic Leisure has developed a model for use in evaluating management options in recognition that it is both a complicated and sensitive process. This approach has been successful in achieving the required outcomes and has been adopted by a number of local authorities.
- 2.12 The assessment matrix is presented below and illustrates the key issues to consider across a range of criteria. The matrix provides a framework to enable the different management options to be evaluated according to the relevant situation in Hart.

Criteria	Key Questions / Areas of investigation
Service Quality /Levels	<p>This criteria relates to the quality of service provided by the various options.</p> <ul style="list-style-type: none"> • How good will the service be under each option taking into account things such as quality standards? • What other similar services have been successfully operated? • Results of benchmarking? • Results of consultation / user satisfaction? • Health and safety
Provision of Opportunity / Influence & Control	<p>This criteria relates to the degree to which the Council can impact on and make changes to policy and day to day service delivery</p> <ul style="list-style-type: none"> • How important is the service to the Council? • How important is retention of control of the service?

Hart District Council
Leisure Management Options Appraisal

Criteria	Key Questions / Areas of investigation
	<ul style="list-style-type: none"> • What is the impact / consequence of each option assessed on the extent to which control is retained?
Investment Capital	<p>This criteria refers to the need for the Council to invest in the service and the relative importance of this in relation to the other criteria</p> <ul style="list-style-type: none"> • What is the ability of each option assessed to deliver the level of capital required? • What is the cost of investment? – cost of private sector capital will be higher than that of public sector borrowing
Revenue Implications	<p>This criteria reflects the net cost of the service under each option – day-to-day costs rather than capital.</p> <ul style="list-style-type: none"> • Is the current subsidy level viewed as an issue? • Are costs perceived (by providers and users) as being high? • Which option has the potential to operate the service with the lowest subsidy • Are tax-based savings available, significant and sustainable
Risk / Sustainability	<p>This criteria looks at the level of risk of each assessed option and long term implications</p> <ul style="list-style-type: none"> • What is needed to ensure year on year improvement to the service? • Are there risks with the assessed option relating to medium and long-term service delivery? e.g. lack of investment, lack of innovation • Are there “hidden” or additional costs in setting up certain options? • Future demand risk • How will each option maintain physical assets?
Staffing and Personnel	<ul style="list-style-type: none"> • How will each option affect staff? - not just staff delivering the service but central staffing • Economies of scale / central support services • TUPE, pensions, two-tier workforce guidelines etc
Legal Issues	<ul style="list-style-type: none"> • Are there any particular legal issues associated with each option
Timescale & procurement	<ul style="list-style-type: none"> • There are timescale implications of pursuing some options also potential additional costs if external assistance is required
Property Issues	<ul style="list-style-type: none"> • The ownership of the services will be affected by the option chosen • Leases/license • Future investment and risk

2.13 This framework formed the basis for the consultation exercise with key stakeholders, which will be discussed in the next section and has influenced the conclusions and recommendations.

Context

- 2.14 Hart is situated in North East Hampshire, it is easily accessible from the M3 and A30, and is well regarded for its unspoilt rural villages and the River Hart. Hart covers an area of 215km² of which 84km² is green wooded area. The district's communities are largely affluent; however, there are pockets of deprivation in both rural and urban areas.

Demographic and Socio-Economic Factors

- 2.15 It is important to consider the demographic and socio-economic characteristics of Hart as they have a significant influence on the demand characteristics for participation in sport and leisure activities. Hart's demographic profile is summarised below:
- Hart's current population is 91,700 (ONS: Revised 2004 based population projections); this is expected to increase to 98,000 by 2019
 - 62.4% of Hart's population are of a working age (compared with 62.2% which is the average for Great Britain) (Nomis)
 - 86.5% of Hart's population are economically active (compared with 78.8% which is the average for Great Britain) (Nomis)
 - Car ownership within the District is high; only 8.82% of households did not own a car compared with 26.84% the average for England (ONS)
- 2.16 Unemployment in the region is low and average income is high, Hart is ranked 349 out of 354 Local Authorities on the income measure of the Indices of Multiple Deprivation Scale. Hart is considered to be an affluent area and based on the average deprivation scores of its constituent LSOA's Hart was ranked 354 out of 354 Local Authorities.

Hart Leisure Strategy (2007)

- 2.17 HDC is currently reviewing its leisure strategy which is a key reference document for the undertaking of this study and recommendations made.
- 2.18 The existing strategy published in 2007 provides a strategic direction for the future provision of leisure facilities and services in the district on identified local need and prioritised demand. The strategy encompasses the provision of public commercial, education and voluntary sectors, in terms of facilities and services.
- 2.19 The main aim of the Leisure Strategy is to provide a co-ordinated approach to the future planning, resourcing, investment and delivery that will enable the provision of a range of quality and accessible facilities, services and opportunities, meeting the leisure, sport and physical activity needs of the District's communities, which contribute to an overall improvement in peoples health and quality of life.
- 2.20 The main objectives for leisure provision identified within the strategy are to:
- Ensure everyone in the District has access to quality 'community' sports and leisure facilities and services, including swimming pools, sports halls and other facilities such as fitness training equipment and an all weather training area, plus arts and sport development opportunities
 - Ensure effective spatial distribution and deals with any issues of under provision
 - Maximise access to existing leisure facilities
 - Ensure that private facilities (including commercial and voluntary sector) complement public facilities and vice versa, and that they are encouraged through partnership to be open to all
 - Locate facilities in the areas of greatest need
 - Integrate facility provision with suitable transport initiatives and public transport networks
 - Reflect the development of effective local partnerships for provision
 - Ensure future provision is appropriately resourced and managed

Hart District Council

Leisure Management Options Appraisal

- Make a bid to the football foundation in regards to the development of a synthetic turf pitch at Hart Leisure Centre
- 2.21 It is crucial that any future management vehicle is able to reflect and embrace the Leisure Strategy objectives.

Section 3

Service Overview

3 Service Overview

Introduction

- 3.1 This section looks at the District's leisure service in more detail and reviews the current performance of the Council's leisure facilities from both a financial and usage perspective.
- 3.2 The Council currently operates the following leisure centres:

Hart Leisure Centre

- 3.3 Hart Leisure Centre is a large wet and dry centre located in the town of Fleet. The Centre was built in 1978 and has had various elements added over the years. The facility is subject to a dual use arrangement with Calthorpe Park School (Hampshire County Council). The Centre contains the following facilities:
- 25m x 6 lane pool with spectator seating
 - 13m x 8m learner pool
 - 4 court sports hall
 - 80 station health and fitness suite
 - 2 studios
 - 6 squash courts
 - Multi purpose rooms.
- 3.4 The facility benefits from offering a 'complete' leisure package and there is limited competition within Fleet. There is a Fitness First centre in Fleet, however there is no pool at this facility and membership rates are higher than at Hart Leisure Centre.
- 3.5 The town of Fleet is also experiencing a growth in population to the extent that there is insufficient capacity at Hart Leisure Centre to accommodate swimming lessons. Much of this growth will take place in the vicinity of the leisure centre. Accommodating increased demand in the future is a key consideration.
- 3.6 The Centre achieved a QUEST score of 72% in May 2008, QUEST being the UK's Quality Scheme for Sport and Leisure. This is a very commendable performance.

Frogmore Leisure Centre

- 3.7 Frogmore Leisure Centre is a dry facility located on the outskirts of Yateley and was built in 1995. The Centre is subject to a dual use agreement with Frogmore Community School (Hampshire County Council). The usage pattern is slightly different to that at Hart Leisure Centre with the School given more usage of the facility. The Centre comprises of the following facilities:
- 4 court sports hall
 - 70 station health and fitness suite
 - 2 studios
 - 4 squash courts
 - Multi purpose rooms.
 - 1 full size STP.
- 3.8 Given its location Frogmore Leisure Centre is more susceptible to competition with the facilities at Camberley within easy access for local residents.
- 3.9 In February 2006 the facility experienced an electrical fire which caused the facility to be closed for a period of time.

- 3.10 The Centre achieved a Quest score of 75% in July 2008. Again this is a very commendable performance and reflects a high standard of management.

Facility condition

- 3.11 An important factor to consider if the service were to be outsourced is the condition of the existing buildings. A condition survey was carried out for Hart Leisure Centre in 1999, however this was 10 years ago and any external provider would want more certainty over the condition of the buildings before entering into any contract.
- 3.12 Condition surveys for both centres would therefore need to be carried out should any form of externalisation be the preferred option. This would have obvious cost implications.
- 3.13 Based upon the available information it is estimated that there is in the region of £500k required to be spent on Hart Leisure Centre to remedy a number of identified issues. We understand this expenditure has not yet been approved by Cabinet.

Current usage

- 3.14 Usage over the last 3 years at both sites is represented in tables 3.1 and 3.2 below:

Table 3.1 Hart Leisure Centre 3 year usage figures

	2005/06	2006/07	2007/08
Wetside	210,050	197,520	204,858
Dryside	192,773	99,163	183,555
Health and fitness	89,282	82,071	83,070
TOTAL	492,105	378,754	471,483

- 3.15 There was a significant reduction in throughput between 2005/06 and 2006/07. The main reduction was in sports hall and squash court usage due to refurbishment of these areas. Throughput recovered to just below 2005/06 levels by 2007/08. Throughput levels are high for this type and size of facility.
- 3.16 Health and fitness usage has fallen slightly since the Fitness First was built in Fleet. This is not unusual. Many facilities experience a peak 'honeymoon' period until usage levels settle at a plateau level.

Table 3.2 Frogmore Leisure Centre 3 year usage figures

	2005/06	2006/07	2007/08
STP	63,037	112,059	138,380
Dryside	111,142	100,031	102,740
Health and fitness	117,601	101,553	119,218
TOTAL	291,780	313,643	360,338

- 3.17 The centre has continued to experience increased usage over the 3 year period. This growth is predominantly due to the STP facility. Usage of the indoor facilities was affected by the fire in February 2006. Again these figures represent high occupancy levels.

Current performance

- 3.18 It is useful to establish a baseline performance for the facilities to allow a level of comparison with similar facilities and to identify any potential areas for improvement. Benchmarking is, however, generally regarded as being fraught with difficulties. This tends to be compounded in the case of leisure because of a number of factors:
- No two leisure or sports centres are the same
 - No two catchment areas are the same
 - Local authorities have different objectives in relation to financial and social performance

Hart District Council

Leisure Management Options Appraisal

- Methods of collecting vary considerably.
- 3.19 Nonetheless it does provide some degree of comparison and for the purpose of this study we have utilised our database of performance measures from over 100 management options analyses, competitive tendering exercises and business review projects, to compare the performance of leisure facilities.
- 3.20 The evaluation has been conducted on the basis of the 2007/8 actuals. These have been utilised instead of set budgets due to the accuracy of the achieved figures and throughputs compared against projections. The actuals therefore represent a better guide to future performance.
- 3.21 A description of the key performance indicators used is outlined below:
- The **gross recovery rate** is a relationship between income and expenditure and therefore indicates in percentage terms the proportion of all expenditure costs that are recovered by the income generated
 - **Gross subsidy per user** performance indicators, identify the total cost of providing the service per user. It is the relationship between the identified deficit / surplus and the total number of customers attending the facility
 - **Net spend per user**, is the average amount each visitor to the centre spends at the facility
 - **Staffing as a % of income**, is the relationship between total staff costs and the amount of income in percentage terms
 - **Support Costs as a % of income**, this indicator indicates the level of central support charges (Payroll, Audit, HR etc) as a percentage of total income. Best practice in private and established trust sector identifies a level of between 3 and 6%.

Table 3.3 Leisure Centre Key Performance Indicators (2007/08)

Site	Gross Recovery rate	Gross subsidy per user	Net spend per user	Staffing as a % of income	Support Costs as % of Income
Hart LC	81.2%	£ -0.75	£3.22	55.4%	8.5%
Frogmore LC	69.8%	£ -0.85	£1.97	65.1%	11.3%

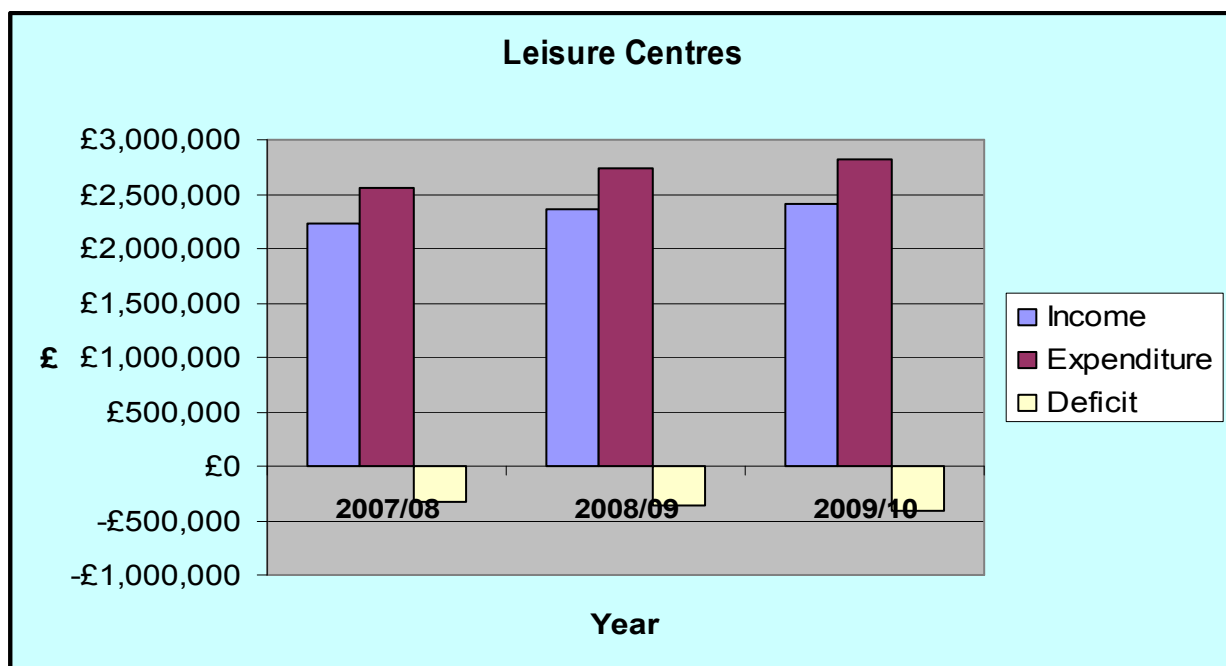
- 3.22 **Recovery Rate**; The two facilities perform relatively well considering their age in terms of recovering their costs through the income they attract, despite the relatively high central support costs. Notably Hart LC outperforms Frogmore LC by almost 12%.
- 3.23 **Gross Subsidy per User**; the gross subsidy per user is also relatively low for the two centres with Hart LC outperforming Frogmore LC despite the greater scale and scope of facilities and activities on offer to the community.
- 3.24 **Net Spend per Head**; The net spend per head is high at the facilities. This would indicate that the prices charged for activities are in line with customer demand.
- 3.25 **Staffing as % of Income**; Staffing as a percentage of the income received is a key indicator. The staffing indicator at Hart Leisure Centre is competitive when compared to both the private sector and similar “in house” facilities; the private and trust sector will aim for a figure between 50% and 60% dependent upon the facility mix. Frogmore Leisure Centre is less efficient achieving 65%.

Hart District Council Leisure Management Options Appraisal

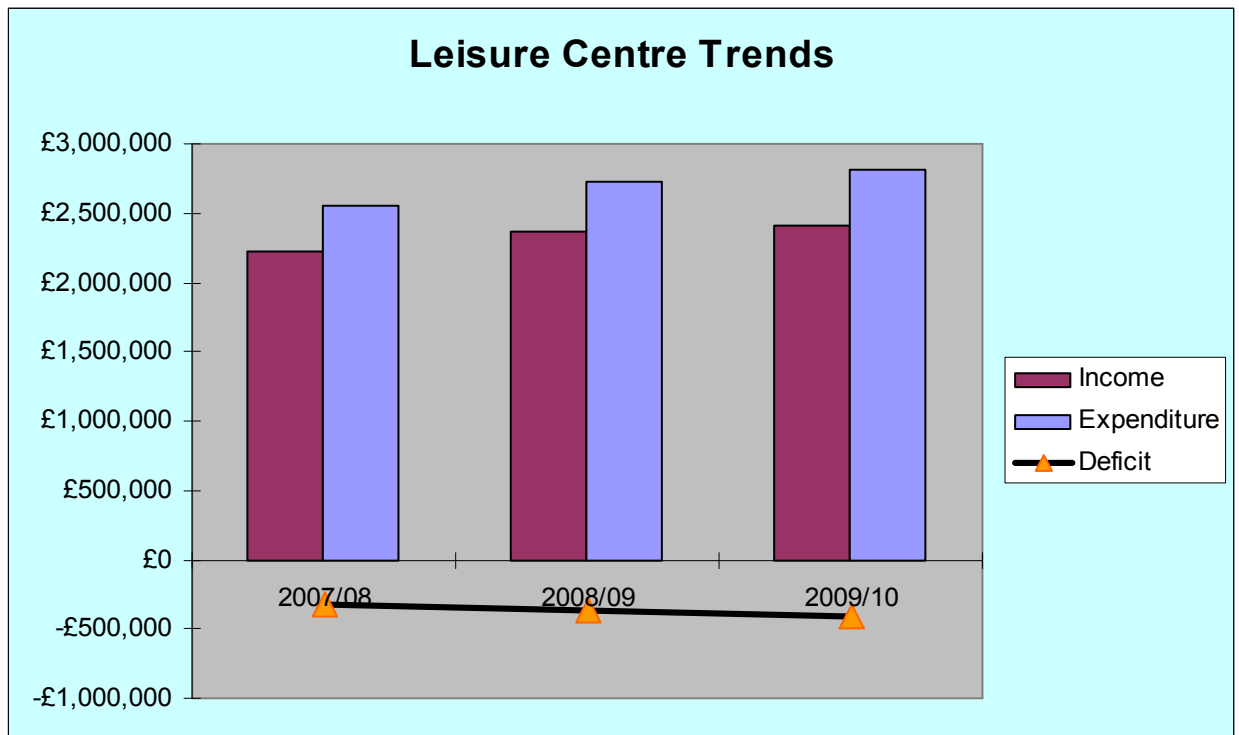
- 3.26 The high cost of **central support costs** as a percentage of income is an issue affecting the overall performance of the centres. All sites are significantly above best practice figures for the private or voluntary sectors and there are now many local authorities who would realise a figure between 3 and 6% of income.
- 3.27 There appears to be some potential to reduce the overall cost to the Council by reducing the cost of support services. (The financial model we have used to assess the different options does not assume any savings at this stage). We would also suggest that there is scope to look at staffing levels across both sites with a view to improving the financial performance.

Financial Appraisal

- 3.28 The graph below identifies the income/expenditure figures for the leisure facility service based upon 2007/08 actuals and set budgets for 2008/09 and 2009/10.
- 3.29 Income has been projected to increase by 9.86% in 2008/09 and by 5.63% the following financial year. Revenue expenditure has been projected to increase by 7.13% in 2008/09 and by 3.21% the following financial year. Gross expenditure has been projected to increase by 11.74% and 13.77% over the same periods.



3.30 The following graphical representation below identifies the projected trends of the two facilities:



Consultation

- 3.31 Consultation was undertaken with a number of Council officers to examine whether there would be any particular issues relating to the future management of the Council's leisure facilities. Officers with an interest in Leisure, Property, Legal, Finance and Human Resources as well as those involved in the day to day operation of both facilities were consulted.
- 3.32 Those areas which were discussed and the issues identified are highlighted in the table below:

Table 3.1 Hart Management Options consultation findings

	Issues identified
Dual use agreements	<ul style="list-style-type: none"> • Currently very vague and would have to be formalised if any externalisation. • Centre Managers currently work more on a series of gentleman's agreements rather than being formally adhered. • Fear would be that any redrafting of the dual use agreements with the County Council would put the District in a worse off position.
Support services	<ul style="list-style-type: none"> • Support services costs are currently high. • The Council is currently in discussions with Capita to externalise finance, HR, and IT after discussions with BT's support arm fell through. • Any externalisation of these elements will have an impact on the decision to outsource leisure.
Human resources	<ul style="list-style-type: none"> • HR has recently experienced outsourcing – revenues and benefits was outsourced last year. This went reasonably well. • Single status was completed last year which involved the re-grading of some staff. This had a negative impact on revenue. • Currently about 150 staff working within leisure, not all FT, some casual. This amounts to about 40% of the Council's workforce • A two tier situation with casual staff as they did not go through evaluation. Other anomalies are the various instructors who are self employed and have an income share agreement • UNISON is the only union; however this is relatively insignificant at the leisure centres. Given the previous externalisation of revenues and the potential transfer of HR etc, externalisation of leisure not deemed to be a major issue. • Pensions – the council would probably be looking for Admitted Body status, as was the case with the previous externalisation • One of HR key services is to leisure. Leisure Centre Managers recruit staff and HR does all other HR related tasks. HR possibly transferred by summer, this could complicate matters as a 3rd party involved. • Payroll already transferred to Hampshire CC. • Looking for the managers of the centres to take on more responsibilities to enable the reduction in HR recharges. • Currently some streamlining of staff through natural wastage.
Legal	<ul style="list-style-type: none"> • The Council has entered into an agreement with Basingstoke and Deane for legal services, 20 lawyers in total, 3 based at Hart DC offices. • Hart DC currently pay about £250k for legal services, a fairly rough apportionm • No procurement team within the authority – a large procurement exercise likely to be tendered out to private lawyers. • Initial legal view that there is a definite legal power for any transfer if only to a management contract.

	Issues identified
Property	<ul style="list-style-type: none"> • Survey of Council's property portfolio conducted in 2006 and approved in 2008. Recommended that £2.8m required across all facilities, about half of this for leisure • It was agreed that this should be funded through revenue not capital, however next year this will be scrapped as revenue and be paid for by capital funding • The programme has been revamped and now only monies to be spent on urgent items, for leisure this means roofing and some other items. • About £500k left to spend on Hart Leisure Centre – still requires capital board approval. JE to provide details of capital programme. • If something is likely to generate income it is more likely to get through the capital programme. • Day to day maintenance dealt with by leisure centre managers. Contracts with external providers for M&E. Property only involved with leisure on an ad-hoc basis. • Property side does not have much involvement with leisure, not a major issue if leisure was externalised. 1 FT & 1 PT member of staff. PT close to retirement and FT could be redeployed elsewhere
Finance	<ul style="list-style-type: none"> • The authority is currently cash strapped and generally less wealthy than most authorities • Savings targets have been hit recently • NNDR savings have been secured for the next five years • £1.5 million budget hole – balanced budget 2009/10 • Council is likely to support capital investment if there is a detailed business case

Summary of Service Overview

3.33 The analysis of current performance and the consultation exercise has flagged the following issues with relation to future management of the Council's leisure facilities:

- **Effectiveness of current operation** – the current facilities appear to be performing well and it is difficult to see a change of operating vehicle significantly improving the revenue position across the two sites
- **Dual-use Arrangements** – the existing agreements are currently not detailed enough if the Council were to outsource their facilities. A more detailed dual use agreement would need to be drawn up, which could have cost implications, plus it could see the Council potentially losing out to the school/county on a number of issues
- **Out-sourcing of support services** – the outsourcing of a number of the Council's support services will have implications if the Council wished to outsource leisure.

Section 4

Management Options

4 Management options

Forms of Management for Public Sector Leisure and Cultural Services

- 4.1 This section of the report deals with the options available for the management of local authority leisure and cultural facilities and services. Each option is presented in turn with an analysis of its appropriateness for scope of facilities provided by HDC. The options evaluated are as follows:
- **Option 1** In-house direct provision (plus a refocused option)
 - **Option 2** Private Sector Partnership
 - **Option 3** Non-Profit Distributing Organisation (NPDO)
 - **Option 4** Partnership with and Existing Trust
- 4.2 Reference should be made to Appendix One of this report which identifies the current position of the external operator market. This is a market that has seen significant changes in recent years and there are likely to be further changes in forthcoming years due to number of factors including the consolidation of the market place due to the recession and the demise of a number of leisure trusts for the same reason.
- 4.3 We have not assessed in any detail the option to cease providing the service. Whilst as a discretionary service, this is an option, it is not part of the brief for this study. In any case it is not considered a realistic option because of the significance and importance of the service in political and social terms. Furthermore in this case the Council has a formal dual-use agreement with the County Council and would not be able to withdraw from its obligations without serious consequences.
- 4.4 Similarly the option to dispose of the facilities as a going concern is also not considered a viable option. It is unlikely that the Council owns the freehold of facilities in any case and/or the County Council would in all likelihood object to the sale or assignment of the lease on a long term basis to a commercial operator. Furthermore the leisure facilities attract a subsidy and are in need of significant capital expenditure. They would not be an attractive property acquisition to a commercial operator at the best of times but in the current economic climate would be seen as a liability rather than an asset. We are not aware of any public leisure facilities that have been sold to a private company except where the use has been changed to some other form of development e.g. housing or retail.

Option 1 - In-house Service Delivery

- 4.5 Under CCT (Compulsory Competitive Tendering) legislation, it was not possible for Councils to provide leisure centre management services (except exempt facilities e.g. dual use and di-minimus services, under £100k) unless it had won the contract to do so in open competition with the private sector. Most other leisure and cultural facilities and services were never subject to CCT. This legislation has now been repealed (January 2000) and has been replaced by Best Value and more recently the requirements of CPA (Comprehensive Performance Assessment) and CAA (Comprehensive Area Assessment). These additional changes have not change the requirement of seeking best value for council services. No local authority facilities or services are exempt from Best Value.
- 4.6 Therefore, Councils can operate all sport leisure and cultural facilities and services in-house under Best Value. This presupposes compliance with the rigors of Best Value itself and in particular, a management options appraisal that demonstrates that the in-house option is the most advantageous, measured in terms of economy, effectiveness and efficiency.
- 4.7 The criteria for evaluating the three E's in relation to sport, leisure and cultural services include many issues such as the quality of service, the imperative to make revenue savings, the need for capital investment, the impact on the Council as a whole etc. A robust and objective appraisal of the options against the criteria must be carried out to justify the final choice.

Hart District Council

Leisure Management Options Appraisal

- 4.8 The in-house option must demonstrate how it can fulfil the Council's objectives (e.g. capital investment in facilities, revenue savings and improved service delivery). It must be demonstrably the most economic, efficient and effective method of service delivery using objective and 'robust' criteria set and defined by the Council. For example, this could mean achieving, demonstrating and maintaining a position within the upper quartile of comparable services through continuous improvement and annual efficiency gains. In other words, Councils can not simply choose the in-house option for political reasons.
- 4.9 There are particular circumstances that make retaining an existing in-house service delivery (as opposed to externalising the service) more appropriate. This option is more justifiable if:
- Customer satisfaction is high
 - An existing in-house service provider meets local and national targets/standards
 - Revenue performance is demonstrably in accordance with the three E's
 - There is no supply market for the service
 - The cost of externalisation, or of attracting an alternative supplier of the service is high, and perceived to exceed the benefits
 - The service is "high profile" and there is a substantial impact on the Council if the service fails
 - There are benefits associated with an integrated approach that would be lost through a whole or part externalisation
 - There is no need for large capital investment and/or the Council has the ability and commitment to allocate funding through its own capital programme or Prudential Borrowing.
- 4.10 Clearly, the converse applies and there are certain circumstances that mitigate against the in-house option. These factors include:
- A poor existing service when benchmarked against comparable facilities and service providers
 - Low levels of corporate and political support for the service
 - The need for significant capital investment and a lack of willingness or ability to fund those from public sector sources
 - Significant external interest in the opportunity
 - The potential for tax-based savings not available through in-house service delivery particularly NNDR and VAT benefits
 - A service that is already 'packaged' in such a way that it lends itself to externalisation
 - A service that is already operated externally and complications associated with bringing it 'back in-house'
- 4.11 The situation in Hart is that the service is currently managed in-house. An evaluation of this option in relation to HDC is discussed later in the report.

Advantages and Disadvantages of In-house Management

Table 4.1 – Advantages and disadvantages of In house Management

Advantages	Disadvantages
<ul style="list-style-type: none"> • Direct Council control and ability to influence and change service delivery 	<ul style="list-style-type: none"> • Opportunity for savings in revenue expenditure through increased income and operational efficiencies would rely on ability of in-house resources.
<ul style="list-style-type: none"> • Allows potential interaction and economies of scale between service areas 	<ul style="list-style-type: none"> • Any capital investment would rely on use of council capital and/or Prudential Borrowing which comes at an opportunity cost.
<ul style="list-style-type: none"> • Least disruption to services, no start-up costs incurred 	<ul style="list-style-type: none"> • More difficult to demonstrate Best Value due to lack of competitive process
<ul style="list-style-type: none"> • Able to budget and apply strict financial controls 	<ul style="list-style-type: none"> • No surety over future funding levels

Appropriateness of In house operation in Hart

- 4.12 As identified in table 4.1 Councils often decide to externalise the leisure service because the current in house operation is not performing and there is a perception that externalisation will significantly increase income and reduce expenditure due to a more commercially focused operation.
- 4.13 Our review of current performance has illustrated that both the Council's leisure facilities are performing well and there appears to be limited scope for improving income given the current capacity and utilisation of the centres. This would support the retention of the facilities in house.
- 4.14 The current economic situation is resulting in private sector organisations being very reluctant to tender for new contracts and this needs to be borne in mind. They will look to 'cherry pick' services where they feel there is scope to significantly improve the financial performance and therefore maximise profit. The relative economy, effectiveness and efficiency of the in-house service mitigates against this in this case.
- 4.15 A key driver for HDC is the need to spend capital to improve the leisure facilities and the limited resources currently at the Council's disposal. The need for capital may be such that if it can not be found in house will mitigate against an in house solution. However the availability of commercial sector capital is also severely limited at the moment and would be significantly more expensive than the use of public sector borrowing.

Option 2 - Partnership with a Private Sector Operator

- 4.16 In the 20 years or so since the introduction of Compulsory Competitive Tendering, the private sector has become increasingly involved in the management of certain local authority leisure services (mainly leisure centres) through leisure management contracts and partnerships.
- 4.17 There are a few examples of integrated leisure management partnerships that encompass other services e.g. theatres etc but these are few and far between. Similarly there are other private sector contractors that operate municipal golf courses and there are a number of grounds maintenance contractors.

Hart District Council

Leisure Management Options Appraisal

- 4.18 Compulsory Competitive Tendering spawned a new breed of leisure centre contractor and a number of these companies have come and gone and more recently there has been consolidation through mergers and acquisitions. There are now a relatively small number of organisations operating in this sector and these have up until now been limited to UK-based organisations.
- 4.19 Strategic Leisure has advertised a number of these opportunities through European procurement journals and has never had any significant interest from other European countries. Appendix 1 of this report is a contemporary assessment of the main leisure management contractors.
- 4.20 The financial stability of the UK leisure management companies has been underpinned by the formation of strategic alliances with larger companies or merger and acquisition activity in the market place. Most of the main players are now part of larger organisations.
- 4.21 The market has matured into one dominated by five main leisure management organisations. With this improved stability and access to capital has come a hardening of attitudes with an increased focus on the bottom line. It is undeniable that there is an established private sector market for leisure centre management where a commercial return can be generated by increasing levels of income, reducing costs and receiving management fees from the Council to underwrite any remaining operational deficit. The current 'credit crunch' will inevitably impact on these organisations, their ability to borrow and their attitude to risk.
- 4.22 Compulsory Competitive Tendering legislation forced Councils to subject their facilities and services to competition and as a consequence a number did so reluctantly. This led to very prescriptive (and in some cases anti-competitive) specifications and adversarial client/contractor relationships. This proved counter-productive to both the Council and the operator and more importantly service users.
- 4.23 Fortunately the type of partnerships and the relationships are now (in the main) much better. Some of the main differences compared to a more traditional 'contracting' process are:
- In the first instance the Council will formulate its strategic vision for the service and develop a **partnership strategy and philosophy**, which identifies the needs of stakeholders in line with local and national strategies.
 - Potential suitable partners are short listed through a pre-tendering exercise (European Union Restricted process or Competitive Dialogue).
 - Potential partners are consulted on the partnering strategy and have an opportunity to 'influence' the tender documentation.
 - The client (Council) is much less prescriptive about the specific requirements but places the emphasis on the partner to demonstrate how the partnership objectives will be delivered.
 - The 'outcomes' of the partnering agreement become important rather than the 'inputs'. These are articulated in an 'output specification'.
 - The evaluation is less bottom-line driven but focuses on a balance between economy, effectiveness and efficiency i.e. Best Value, based upon the Council's stated priorities.
 - Final contractual arrangements are negotiated
 - The onus is put on potential partners to identify through 'method statements' how they intend to manage facilities /services and what measures/outputs will be achieved.
 - Partnerships tend to be between **10-15 years** depending on the level (if any) of capital investment required.
- 4.24 Modern leisure management partnerships can yield both operational and financial benefits to both Councils and leisure management contractors i.e. a mutually beneficial arrangement. To achieve this however both parties need to share a common vision and objectives and work together throughout the relationship to deliver the service within a performance management framework.
- 4.25 A survey carried out on behalf of the Leisure Management Contractors Association by Professor Peter Taylor of Sheffield University compared the performance of private sector companies against other forms of management using the Sport England National Benchmarking Survey. The report highlighted the following:

- In terms of cost recovery and net subsidy per user the private sector performed better than other forms of management
 - Levels of income generation were higher than other forms of management
 - Levels of utilisation were higher than other forms of management
- 4.26 The survey showed that private sector operators were capable of delivering an economic, effective and efficient service. A recent Audit Commission report also concluded that commercial sector partners on average provided the leisure management service for less revenue cost than a leisure trust and/or an in-house operation. Commercial sector companies achieve best value by more assertive marketing, the use of national branding and general efficiencies and economies of scale.

Key Sector Issues

- 4.27 There are a number of key issues facing the sector. These are summarised below:
- There are a relatively small number of private sector operators in the market thus levels of competition may be low, particularly as one operator is apparently not tendering at present and another appears to have some financial concerns. This leaves effectively only three viable bidding organisations
 - A number of these are looking to consolidate recent wins rather than seeking new opportunities
 - Many of the companies have the ability to invest capital but this comes at a cost much higher than the use of local authority capital typically 8-12% interest as opposed to approximately 4-5% through Prudential Borrowing
 - There is evidence that the main operators are getting more risk averse particularly in relation to things such as building maintenance, cost of utilities etc
 - Additional market consolidation would not be a surprise. This would further erode competition

Benefits of the Private Sector Approach

- 4.28 There are a number of potential benefits both to the partner and the Council of this approach providing that a mutually beneficial agreement is reached and an effective partnership flourishes. They have the potential to:
- Maintain a focus on leisure as their priority reason for existence
 - Invest with either new 'capital' or off their "bottom line"
 - Offer councils a uniform and holistic approach to service provision and a known level of financial commitment (deficit or surplus) achievable over a contract period thus securing a given standard for a set period of time
 - Bring the benefits associated with national brands
 - Operate at lower service delivery cost based upon a like for like comparison with an in-house provider due to the lack of operational constraints and economies of scale particularly in relation to support services
- 4.29 There are some potential difficulties with a private sector partnership approach and these can be summarised as follows:
- Falling foul of the regulations governing capital receipts and credit arrangements
 - Writing an over-prescriptive specification that stifles business enterprise
 - Failure to address the issues involved under the Landlord and Tenant Acts
 - Failure to address the importance of the partnership in the joint funding of projects
 - Failure to let the Partner carry out functions that they are best placed and capable of doing as part of any investment package
 - Letting a contract and then trying to retain management control
 - Prevailing market conditions resulting in 'imperfect' competition
 - Increasingly high levels of return sought by operators
 - Lack of focus on sports development and concentration on income generation

Service & Quality Implications of Private Public Partnerships

- 4.30 The selection of the right partner and the negotiation of mutually beneficial terms are the critical success factors. Modern private sector partnerships are far removed from CCT arrangements allowing greater scope for negotiation regarding length of contract, capital investment and operating parameters such as pricing and programming. Quality and service issues are particularly important to both the Council and leisure centre users. Any partnership documentation needs to be prepared thoroughly to reflect the level of service expected by all stakeholders balanced against affordability criteria.
- 4.31 Prospective partners should bid against the Council's requirements in a competitive situation. There may be a requirement for the partner to provide capital for investment in the service. The Council should choose the partner that most closely meets the Council's stated aims and objectives taking into account both cost and quality. Thus, service quality standards that are important to the Council can be protected, and indeed enhanced under a PPP arrangement. Unlike CCT, Best Value allows the Council to negotiate a true partnership that is prescriptive where the Council wants it to be e.g. concessionary pricing and more flexible where it is beneficial to the partner to maximise income e.g. length of contract, level of capital investment etc.
- 4.32 The extent to which the private sector can operate facilities more cost effectively than the other options described in this report is not an exact science and will depend on a number of factors including:
- The extent of private sector interest and competition
 - The relative efficiency of the current operation
 - The need for capital investment, the return on this investment, interest rates and length of contract
 - The extent to which the requirements of TUPE are exceeded e.g. Admitted Body status and pensions bond
 - The ability to make savings in support service costs and commensurate costs of private sector head office functions
 - Purchasing discounts and other economies of scale
 - The success of more 'aggressive' marketing and pricing and the ability to operate more entrepreneurially
 - Current occupancy and capacity at the centres
 - The flexibility of the contract, e.g. scope for price increases/ programming changes, etc
 - Contractor's profit margin
 - The future relationship between the two partners
 - Any changes that may occur to the private sector company during the lifetime of the contract
- 4.33 The externalisation of services to a private sector partner can bring benefits to the public sector. If the Council is unable to fund improvements from its own resources or via borrowing, it can be the best way to secure the capital necessary to deliver Council's objectives.
- 4.34 Care needs to be taken to structure the partnership in such a way as to avoid any capital investment being seen as a credit arrangement or affecting the Council's VAT position. Although assumptions can be made about the outcome of a PPP, the only way to truly 'test' this approach is through a competitive process. The cost of 'borrowing' commercial sector investment can however be prohibitively expensive.
- 4.35 The private sector option PPP is more viable when:
- An external market exists for services
 - There is a commonality in the services, activities and objectives between the Council and another organisation
 - There is an opportunity to share both risk and rewards
 - There is agreement between the Council and the other organisation on the level of accountability
 - There is a need for investment that the public sector cannot meet
 - The existing service is poor or lacks commercial awareness
 - There is healthy competition in the marketplace

4.36 The creation of a PPP is less suitable when:

- The timescale, direct costs and opportunity costs of letting a PPP/PFI contract outweigh the perceived benefits. This applies equally to both parties and should be considered in relation to the efficiency of current arrangements
- The Council has clear service aims and objectives it wants to achieve which may not be achievable through the involvement of other organisations (i.e. with additional aims and objectives)
- The service requires close control, management, specification and monitoring which could be lost through the involvement of an external partner
- There is an active supply market with viable alternatives which would greatly limit the impact or improvement that could be made through a partnership
- Where fragmenting the services from other related services can be proven to be detrimental
- A small portfolio of facilities/services reduces the likelihood of private sector interest due to a lack of economies of scale

Advantages and Disadvantages of the Private Sector

Table 4.2 – Advantages and disadvantages of the Private sector

Advantages	Disadvantages
<ul style="list-style-type: none"> • New 'commercial' approach to management (entrepreneurial culture). 	<ul style="list-style-type: none"> • Some delegation of day to day control via the specification
<ul style="list-style-type: none"> • Competitive bidding process would be demonstration of Best Value and could realize increased revenue savings 	<ul style="list-style-type: none"> • Impact on central services personnel
<ul style="list-style-type: none"> • Opportunity to improve revenue situation. 	<ul style="list-style-type: none"> • Employee anxiety over transfer
<ul style="list-style-type: none"> • Access to development capital if required 	<ul style="list-style-type: none"> • Procurement costs, timescale and risks
<ul style="list-style-type: none"> • Surety over future funding levels 	<ul style="list-style-type: none"> • Potential dilution of the Council's objectives and policies
<ul style="list-style-type: none"> • Responsive service 	<ul style="list-style-type: none"> • Imperfect competition may lead to too few bids to realise best value
<ul style="list-style-type: none"> • Career opportunities for staff 	<ul style="list-style-type: none"> • Inability to attract tax-based savings

Appropriateness of Private Sector in Hart

4.37 In the case of HDC there does not appear to be potential for significant usage and income gains which negates one of the prime benefits of transfer of the operation to the private sector. In terms of the potential to reduce costs, our analysis shows that the centres are performing well. The only area of expenditure related to the facilities themselves where we feel that the costs could reduce in a private sector option is 'staffing'. We have reviewed the staffing structure and believe that there are opportunities to make savings. However it is important to note that TUPE would apply to any externalisation and it would take time for any operator to effect changes and have those changes reflected in any financial arrangement. Ironically it would be easier for the Council to review the staffing arrangements prior to any externalisation.

- 4.38 The other area where the current cost of the serviced is high is 'support services'. Again the opportunity to make any savings in this area from an externalisation is limited. Indeed there is potential for the costs to increase because it is unlikely that any support service staff would be on a TUPE list and yet these functions would be carried out by the private sector partner thus duplicating the cost unless the Council could make commensurate savings. We understand that the Council is currently negotiating a deal to externalise some support services and this process may be complicated by a simultaneous externalisation of leisure management.
- 4.39 Elsewhere in this report we have alluded to the dual-use arrangements. It is clear that the modus operandi of the leisure facilities includes a number of 'Gentleman's agreements' with the respective Schools. These would need to be defined in any contract specification and this may lead to additional costs or a worsening of the availability of facilities. In any case it would alert the County to the potential to share in any savings that may arise from any externalisation.
- 4.40 A Public Private Partnership could potentially be an effective way to generate additional capital investment, however it is worth remembering that the commercial sector partner would be looking for a return on that investment over the life of the contract. This return can only come from either service efficiencies, additional customer receipts or the management fee paid by the Council. Funding facility development through the public purse will be cheaper but this of course is conditional on those funds being made available. There is very little external public sector funding at present and the Council will need to use its own resources or borrowing powers.
- 4.41 The extent to which this option would be more cost-effective than an in-house solution could only be truly tested through a competitive procurement process. This in itself could cost circa £50k in external advice. Given the other factors referred to above we do not believe that would be a good use of tax payer's money.
- 4.42 A private sector company without a hybrid trust (discussed below) would not be eligible for the tax-based savings associated with a Non-Profit Distributing Body. This would further negate some of the potential revenue savings.

Private Sector 'Hybrid Trusts'

- 4.43 In recent times, there have been significant changes in the management of local authority leisure services particularly sports centres and swimming pools. Up until the introduction of CCT in 1988, only a few Councils operated leisure centres under any arrangements other than through in-house service provision. There were only isolated examples of local authorities managing facilities in partnership with private operators and one or two examples of leisure trusts.
- 4.44 After the introduction of CCT, a number of management 'buy-outs' of local authority leisure centres occurred and new privately owned leisure management companies/contractors were 'born'. Whilst these were initially formed to provide services for their 'host' local authority, they grew quickly by bidding and winning CCT leisure management contracts in other local authorities.
- 4.45 At the beginning of the 1990's, there were two main ways of operating local authority leisure centres: in-house via a DSO, and under a CCT contract with a private sector operator. CCT only applied to certain types of facilities and contracts were for a specific length of 5-7 years. Few contracts involved capital investment.
- 4.46 In 1993 Greenwich Leisure was formally incorporated. This was the first of a new tranche of leisure trusts (although Harlow Leisure Centre has been operated by a trust since 1965). The 'Greenwich model' became the third main way of operating local authority leisure facilities. Greenwich was quickly followed by other local authorities that established arms-length organisations independent from the Council. The not-for-profit status of these separate companies (either Limited by Guarantee or Industrial or Provident Societies) enabled them to obtain tax-based advantages (NDR and VAT) not available to local authorities or private sector companies. The trust model became the preferred way of managing leisure centres for many local authorities.

- 4.47 In 2000 Best Value replaced CCT and this legislation had a more profound impact on leisure centres than CCT ever did. The trend to externalising services continued because, through Best Value reviews, local authorities had to evaluate the optimum way to deliver services based on economic, effectiveness and efficiency criteria. Given the tax-based savings available to not-for-profit organisations, it became increasingly difficult to justify in-house service delivery and furthermore the trust was considered by many local authorities to be the ‘lesser of two evils’ when compared to the ‘big bad’ private sector.
- 4.48 There is a certain irony in that a Council can actually exercise more control over a private company via a contract than it can over an independent trust, as a number of Council’s have found to their cost.
- 4.49 Nevertheless, to ensure the evenness of the ‘playing field’, private sector companies needed to reduce the advantage that trusts had and the concept of the so-called ‘hybrid’ was born. The idea of the hybrid is basically to structure the private sector company, or the relationship between the company and the local authority in such a way as to qualify for mandatory and/or discretionary rate relief and in some cases VAT concessions through the use of a not for profit company or subsidiary. By structuring their organisations in this way, private sector companies could offer Council’s the benefit of the tax savings and the ability to secure capital investment and a more ‘commercial’ approach to the operation, and thus remove the financial advantage gained by trusts.
- 4.50 Many local authorities were concerned about the transparency of the arrangements and, whilst ‘legal’, there were concerns about the sustainability of the solution and the risks associated with such a new business model. The recent versions of the hybrid are becoming more sophisticated, simpler in structural terms and easier for local authorities to understand than the prototype hybrids.
- 4.51 Although many of these arrangements are in existence, there is still no guarantee that they won’t be subject to legal challenge.
- 4.52 An example of the ‘next generation’ hybrid works as follows; the council participates in the establishment of a trust ‘vehicle’, with not for profit objectives, this organisation is granted a lease and beneficial occupation on a leisure building. Through this mechanism the trust receives mandatory 80% rate relief. The trust company then enters into a performance based management contract with a private sector operator with the tax-based savings being passed back to the Council. The private sector company manages the service as an ‘agent’ to the trust company.
- 4.53 All five leisure management operators have now established variations on the above theme, however Parkwood are very reluctant to offer their version as they see the establishment of these NPDO’s have an inherent risk.
- 4.54 These new ‘models’ overcome many of the issues associated with original ‘hybrid’ models but considerable concern exists about the ability of some of the models to obtain charitable registration. Strategic Leisure is aware that one such hybrid has applied for Charitable Status with the outcome pending. This particular model has however received a letter from the HMRC confirming that it is an ‘exempt charity’.
- 4.55 It is possible therefore to ‘mix and match’ the private sector and charitable routes. This can result in additional financial benefits (tax-based) over and above the purely commercial operation; however organisational structures and relationships can be complex and risky.

Advantages and Disadvantages

Table 4.3 – Advantages and disadvantages of Hybrid trusts

Advantages	Disadvantages
<ul style="list-style-type: none"> • Tax-based advantages (NDR/VAT) 	<ul style="list-style-type: none"> • Market Capacity
<ul style="list-style-type: none"> • Potential savings are comparable with NPDO’s 	<ul style="list-style-type: none"> • Can be complex legal, administrative and organizational structures

Advantages	Disadvantages
<ul style="list-style-type: none"> • Commercial sector expertise. 	<ul style="list-style-type: none"> • Partial loss of day to day control
<ul style="list-style-type: none"> • Access to capital. 	<ul style="list-style-type: none"> • Potential impact on central services personnel
<ul style="list-style-type: none"> • Good way of demonstrating Best Value via competitive process 	<ul style="list-style-type: none"> • Commercial focus unless effectively monitored
<ul style="list-style-type: none"> • More entrepreneurial and responsive approach 	<ul style="list-style-type: none"> • Start-up costs
<ul style="list-style-type: none"> • Potential Revenue effectiveness and surety 	

Appropriateness of Private Sector Hybrids in Hart

- 4.56 A Public Private Partnership with a company structured with a not for profit subsidiary could be advantageous for the Council because in addition to the benefits described in the private sector option above e.g. access to capital, such a partnership could yield further tax-based savings in relation to National Non Domestic Rate relief and possibly VAT concessions, subject to the structure of the organisation and partnership. These financial benefits could yield additional revenue to underpin Prudential Borrowing repayments.
- 4.57 The Council would need to satisfy itself that the particular model chosen was legally robust and would also need to understand where the risks lie should the financial status of hybrid trusts change. For example many of the operators are reluctant to assume the financial risk of future changes in rating policy.
- 4.58 Such a partnership would however not alter some of the fundamental concerns about a private sector partnership in this case e.g. the lack of real savings, the issue of support service duplication and complication, the dual-use arrangements and the cost of capital.

Option 3 - Non-Profit Distributing Organisation (NPDO), Leisure Trusts

4.59 In this section we illustrate the characteristics, advantages and disadvantages of the leisure trust option.

SPORTA and Key Sector Issues

4.60 SPORTA is the national association that represents leisure trusts. It has around 100 members but not all leisure trusts are represented. A survey carried out by Leisure Net Solutions in 2005 on behalf of SPORTA with returns from 60 of the member trusts highlighted some interesting and pertinent facts:

- The average turnover of a leisure trust is now £4.6m giving the sector as a whole an estimated turnover of £460m. (Strategic Leisure would question this as it is likely that some of the smaller trusts would not have completed the survey due to a lack of resources). Our own experience is that the average is smaller than £4.6m. The turnover figure will undoubtedly include the grant given by the local authority. Nevertheless it is still a significant size
- 57% of leisure trusts only operate 1 contract
- The number of leisure trusts actively seeking additional contracts has increased as trusts seek to spread their overheads
- Leisure trusts are experiencing a weakening financial position. This has been particularly evident in the last three years with 24% of trusts describing their financial position as either weak or very weak
- Leisure trusts are finding it increasingly difficult to recruit and retain employees with 86% saying that this was either difficult or very difficult. This is an industry-wide problem due to the relatively low levels of remuneration and the transient nature of the workforce
- Leisure Trusts do not usually have large funds to invest and some find it difficult to raise capital due to the lack of assets they own for security and a short track record of profitable trading. They are usually dependent on Councils for a large proportion of their revenue

4.61 Strategic Leisure believes that the factors described above means that the 'honeymoon' period for many trusts is over. Most trusts have only been formed in the last few years and it is now that local authorities are expecting levels of grant to be reduced and for investments to be made. It is difficult to obtain data on the level of funding received by trusts in the form of local authority grants. The table below shows examples of grants and local authority grants for some of the bigger existing trusts:

Trust	Turnover 2004/5	LA Grant	%
Fusion (Southwark)	6,453,000	1,725,000	27
Valley Leisure	3,600,000	362,000	10
Stevenage	6,540,000	1,030,000	16
Wealden (Freedom)	4,500,000	825,000	18
Hertsmere *	7,000,000	0	0
Tameside Trust	5,149,000	1,924,000	37
Average	4,912,480	869,429	18

this level of grant does not include the Council cost of maintaining the facilities.

4.62 There have been some high profile failures recently including Bristol which involved 12 sites, LB Merton, North Wiltshire DC. In the case of Bristol, the Council brought the service back in-house temporarily and has now subjected the service to competitive tender resulting in the award of preferred partner status to a commercial operator with a hybrid trust structure. Chiltern Leisure Trust got into difficulty and the Council has now entered into a partnership with another trust, Wycombe Leisure. Other failures include, e.g. Kettering Community Leisure Ltd, Sutton Community Leisure, East Herts. Leisure Trust, Enfield Leisure Centres Ltd.

- 4.63 There have been a number of industry consultation papers (ODPM / PwC and BISL) issued in 2006 that have raised the issue of leisure trusts. Essentially these are questioning the sectors ability to generate capital funding and the equity of the tax-based savings available to trusts but not to private sector contracts. It is too early to tell what impact, if any, these discussions will have.

Theoretical Considerations of Leisure Trusts

- 4.64 The theoretical issues surrounding this option are complex and are set out below in summary form only.
- 4.65 The establishment of a NPDO (trust) involves the Council participating in the formation of an arms-length company. The 'trust', (either a registered or exempt charity) must be independent from the Council and the relationship is characterised by influence rather than control. Once established the NPDO operates the services on behalf of the Council and is usually given an annually negotiated grant and a 'co-terminus' lease on any premises for which it assumed operational responsibility. Removing the service from direct Council control and subject to having charitable objectives, there are some financial advantages to managing services in this way. The financial benefits must be seen in the context of other advantages and disadvantages as described in this report. The paragraphs that follow set out the main characteristics of a NPDO.

Tax Based Savings Available to a Leisure Trusts

- 4.66 A NPDO has an opportunity to benefit from tax based savings arising from:
- The relief (75-85% depending on the model, constitution and Council policy) from National Non-Domestic Rates (NDR) only available to a NPDO
 - The difference in the VAT treatment of supplies of sporting services by the NPDO and the Council
- 4.67 The financial schedules included as appendices identify the detailed financial implications. There are no reductions proposed at present in the Council's support cost calculation. This is because the level of savings can only be determined following a Council wide review. However given the level of support costs at Hart there should be some scope for a minimum 25% saving on the support costs. This would require some renegotiation with the departments concerned and could apply to other forms of management as well.
- 4.68 There is significant start up and ongoing costs for a new NPDO in terms of support costs. Year one costs would include the legal and other advice required for establishing the new NPDO estimated currently at about £120k to £150k. This would be a one off cost but needs to be taken into account when calculating the first year savings.
- 4.69 A recent issue that may affect the figures is the recent case considered by the Court of Session in Scotland, which considered the VAT implications of leisure centre membership schemes. HMRC's view is that unlimited access to all leisure facilities in a leisure centre, typically in return for a monthly or annual payment, is liable to VAT at the standard rate. Many leisure trusts across the Country operate a similar scheme where they package different activities under one membership. If a scheme offers facilities or activities that would all - if supplied individually - be exempt, the supply of the package is also exempt. However if included in the package are activities that would normally have VAT applied then HMRC and the recent case confirms that VAT applied if there is unlimited access to all leisure facilities in a leisure centre, typically in return for a monthly or annual payment. The upshot of all of this is that the VAT benefits attributable to the membership element may be at risk if not structured correctly and in a tax efficient way. Specialist VAT advice would be necessary when setting up the NPDO to ensure the most tax efficient model is used. However, Strategic Leisure believes that this scenario can be mitigated by carefully structuring the final NPDO model and the treatment of VAT of the membership scheme.

Form of Trust

- 4.70 Two main types of NPDO have been used in the recent transfers of local authority-owned sport and leisure facilities:
- Industrial and Provident Society (IPS)
 - Charitable Company Limited by Guarantee (CLG)
- 4.71 In the last few years there has been a significant shift away from the IPS model in favour of the CLG model.

Charitable & Non-Charitable Industrial and Provident Societies (IPS)

- 4.72 An IPS is a society registered under the Industrial & Provident Societies Act 1965. It is a body corporate with limited liability.
- 4.73 A Society qualifies for registration under the 1965 Act if it is within either of the two classes permitted to be registered set out in Section 1 of the 1965 Act. The Act stipulates that “it is a society for carrying on an industry, business or trade (including dealing of any description with land) whether wholesale or retail and (i) it is either a bona fide co-operative society or (ii) the society is for the benefit of the community and there are special reasons why it should be registered under the Act rather than as a company under the Companies Act”. The Financial Services Authority (formerly the Registrar of Friendly Societies) administers Industrial and Provident Societies.
- 4.74 An Industrial and Provident Society formed for charitable purposes may be deemed to be an “exempt” charity and therefore enjoy the fiscal advantages available to charities. It is not necessary for an exempt society to register with the Charity Commissioner. If it does, it will not be subject to the Commissioner’s power of supervision over registered charities but will be subject to the statutory requirements for charities.
- 4.75 A non-charitable society can have a significant degree of employee involvement in the running and management of the society at Board level although recent legislation is likely to alter this. Under current arrangements employees can have seats on the trust Board of an IPS whereas they are precluded from having a seat on the Board of a registered charity.
- 4.76 An IPS that is not a registered charity is only entitled to discretionary rate relief which places the onus on the Council as rating authority. This can lead to complications.

Company Limited by Guarantee

- 4.77 It is considered that the company regime offers greater flexibility than other regimes and companies are able to change their rules to meet changing needs more simply than other types of vehicles.
- 4.78 A company can be established very quickly. Once incorporated, the Memorandum and Articles of Association must then be forwarded to the Charity Commission for registration. This can be a time consuming process.
- 4.79 A provision relating to dissolution and application of assets on dissolution will be provided for in the company’s Memorandum of Association.
- 4.80 One of the key disadvantages of a Charitable Company Limited by Guarantee is that it will inevitably involve compliance with company law as well as charitable law. It therefore, requires a greater degree of sophistication in its administrative arrangement than required for other NPDO options. The directors of the charitable company, as the principal decision making body, are the charitable trustees and are responsible for the proper administration of the charity in the same way as charity trustees of other forms of charity. In addition, trustees must comply with their duties as company directors under the Companies Act.

- 4.81 One of the main advantages of the Company route with charitable status is the eligibility for mandatory rate relief at 80%. The disadvantage is that employees can not have voting rights on the Board.

The Employment Implications of Transfer

- 4.82 The Transfer of Undertakings (Protection of Employment) Regulations 1981 and the Acquired Rights Directive 77/187 will ensure that staff employed wholly or mainly within the economic entity are transferred to the NPDO with all employment rights intact. Recent case law has involved the variation of terms and conditions of employment post transfer.
- 4.83 Any changes in conditions of employment should relate to economic, technical or organisational reasons and should not be for reasons relating to the transfer.
- 4.84 An additional issue that has developed in recent years is the impact of the Best Value Code of Practice on the Handling of Workforce Matters. The Code of Practice on Workforce Matters (Circular 3/2003) sets out an approach to workforce matters in public sector service contracts which involve a transfer of staff from the public sector organisation to the service provider, or in which staff originally transferred out from the public sector organisation as a result of an outsourcing are TUPE transferred to a new provider under a retender of a contract. In essence this is the prevention of a two tiered workforce when contracting out local authority services. The provision of the Code should apply equally to a new trusts as it would to any external private operator or indeed existing trust. The requirements of the Code should be included in any contractual arrangement.

Pension Rights

- 4.85 One of the major concerns of staff will be remaining within the Local Government Superannuation Scheme. A trust can apply to become an admitted body to the Local Government Superannuation Scheme under the 1936 Admitted Body Regulations (as can private sector operators). This is not covered by TUPE but is covered by the Code on Workforce matters and the Council will need to form a view on this. There may be a financial implication of this in terms of pension guarantees and bonds.

Central Services

- 4.86 The NPDO will wish to be responsible for the provision and procurement of its own support services including financial services (accountancy, payroll, debtors, creditors, banking, insurance etc), legal services, Human Resource Management and ICT. The NPDO may wish to deliver these support services through a combination of directly employed staff and out-sourcing services such as legal support on an 'as and when required' basis. It is possible to phase any disengagement from the local authority through the negotiation of Service Level Agreements.
- 4.87 However, a factor the Council will have to consider is the impact on the Council's central support services under any externalised option. No additional savings have been factored into the financial model for any reductions in the Council's central service function. This can be seen as an additional saving if the Council decides to maximise the potential saving by externalising the leisure service.

Relationship between the Trust & the Council

- 4.88 The relationship between the NPDO and the Council will be regulated in a number of ways:
- Through the building leases
 - By the payment of an **Annual Grant** linked to satisfactory performance of the conditions contained within the **Funding/Management Agreement**
 - **By Participation** by elected members and or officers of the Council in the **Board of Management** of the NPDO (see below)

Hart District Council

Leisure Management Options Appraisal

- 4.89 Through the Landlord and Tenant relationship it will be necessary for the Council to grant a term of years sufficient for the NPDO to demonstrate security of tenure to an external funder to enable development or refurbishment to take place. In addition, funding bodies sometimes require security of tenure in excess of twenty-one years when considering applications for significant capital works.
- 4.90 It is important for the Council to accept that a long lease of say between 15 and 25 years is desirable so as to give the new entity some stability. It is important to note however that this effectively commits the Council to this length of arrangement thus removing much of the discretion that exists at present. It also commits the trust to long leases which it may not want to take on unless condition surveys warrant that the buildings will survive that long!
- 4.91 By exercising Landlord's powers under the leases to the various premises, the Council can ensure that use of the buildings is restricted to that contained within the lease.

Grant Funding

- 4.92 The award of an annual grant will enable the Council to exercise significant influence over the NPDO, by virtue of its dependence on grant-aid for a large proportion of its annual income. The Council will be able set through the funding agreement parameters that it will require the Trust to meet in return for the grant funding. The Council should be aware that this arrangement is not the same as having a contract, it will not be possible for example to issue default points against failure to perform. There is also the possible reaction from the trust that it resents being beholden to the Council. In extreme cases the trust may become financially independent from the Council and this changes the 'balance of power'.
- 4.93 Providing a grant is a complex legal area with significant case law. One legal firm that set up trusts for Councils advocate a maximum 3 year funding agreement, which they admit is a risk given that Councils can only issue a grant in the financial year concerned. The funding agreement is in effect indicative and in many cases not tested in terms of robustness. The setup costs of the new trust may be considered grant aid therefore the spectre of State Aid becomes relevant. By not agreeing a longer term funding arrangement linked to Council objectives etc the trust is at real risk of the Council arbitrarily reducing its grant and putting it at risk in terms of sustainability. If the Council decides in principle to pursue the new Trust option, the advice is to undertake a detailed feasibility with specialist legal advice to determine the most robust legal model.
- 4.94 A recent development has been the issue that the granting of discretionary rate relief could contravene EU State Aid regulations, which generally prohibit government subsidies to businesses. In their 2002 Guidance, the ODPM state that relief from taxes including non-domestic rates can constitute State Aid and that billing authorities should bear this in mind when granting discretionary rate relief. The ODPM go on to say that rate relief for charities and non-profit making bodies is not normally considered to be State Aid because the recipients are not in market competition with other businesses but that if the charities or non-profit making bodies are engaged in commercial activities or are displacing an economic operator or have a commercial partner, rate relief could constitute State Aid. The trigger for State Aid, in these circumstances, is approximately £63,000 to any one business over 3 years.
- 4.95 The law on State Aid is exceptionally complex and is still developing. Strategic Leisure is not a legal practice and these comments should not be considered to be legal advice. However, the Council should consider its rate relief policies in light of EU State Aid regulations if it adopts one of these models. It should be appreciated that many other local authority policies in this area grant of discretionary rate relief to charities and non-profit distributing organisations. We understand that there is no settled case law on this matter and a number of other local authorities have granted rate relief to hybrid trusts and others in similar circumstances to those envisaged in this report.
- 4.96 In most cases a grant given by the local authority to the NPDO enables the Council to exercise 'influence' over the NPDO by virtue of the new entity's dependence for a significant proportion of its annual income from grant aid. The NPDO will need to have similar objectives to the Council i.e. the equitable provision of quality pay and play opportunities to the whole community and it would be reasonable to expect such a partnership to be mutually rewarding.

- 4.97 Strategic Leisure has been involved in developing such documentation with the most recent example being the arrangement between Tameside MBC and the Tameside Sports Trust.
- 4.98 The documentation would need to:
- Develop shared objectives between the NPDO and the Council
 - Monitor the contribution of the NPDO of the Council's strategic leisure objectives.
 - Monitor the financial performance of the NPDO
 - Develop consultation methods on issues relating to variations of service and policy development
 - Share the findings of market research to shape future programmes and services
 - Monitor focus sports and target groups as part of a sports and community development programme
 - Ensure the provision of performance information to enable the Council to demonstrate Best Value and make the required statutory performance indicator returns. In addition, the Council may wish to build certain safeguards into the relationship including:
 - Control over prices charged by the NPDO (e.g. by including an annual index above which prices should not rise). However, this will be required to be drafted very carefully as it may prejudice the VAT position of the NPDO
 - Limit the activities of the NPDO to a geographical area to avoid unnecessary diversification and expansion
 - Ensure that any concessionary access scheme is maintained by the NPDO to ensure social inclusion
 - An effective process of communication, monitoring and reporting should ensure that the Council has early warning of any financial or trading difficulties that may emerge with the new NPDO

New Trust and Procurement Issues

- 4.99 There is significant concern within the contracting leisure management market that local authorities maybe setting new trusts without establishing whether it is the best value option. Anecdotal evidence suggests that a number of private sector organisations are considering challenging Councils that pursue this option without "testing" the market. The argument is based on two separate areas, the first relates to the State Aid issues as highlighted previously, the second on EU procurement law.
- 4.100 In terms of transparency and openness and in the interest of best value, it is difficult to argue against an open procurement to identify an external operator to manage the Council's leisure service as this option removes any ambiguity and or preconceived ideas about on option or another. The vast majority of options appraisals undertaken by Strategic Leisure have identified that an open procurement route is the preferred option for a variety of reasons, e.g. transfer of risk, revenue savings, access to capital, and sometimes improvements in service quality. There are instances where the development of a new trust has been adopted but this is always against the backdrop of overwhelming financial benefits, relatively low levels of external capital required, (as trusts are limited in terms of accessing capital for investment) and the transferring service is performing well. These have also been undertaken before the risk of challenge issue has become more evident. Strategic Leisure is not aware of any challenges to date, but the risk should not be ignored and if the Council does indeed decide to pursue the new trust option then it should only do so following a detailed feasibility study where specialist legal advice is obtained on both the state aid and EU procurement issues.
- 4.101 There is no equivocal answer to whether the Council is able to set up a new trust without exposing the service to the wider market. There are risks and part of the answer is that it will depend on the legal risk, the resolve of the private sector in challenging any decision and how risk averse the Council is.
- 4.102 One significant issue is that if a new NPDO is to be considered alongside other options there are further procurement issues in that how can an organisation that doesn't exist be included on any Council shortlist as it cannot be assessed using the normal short listing measures.
- 4.103 We will in the next few paragraphs describe how the twin tracked approach can be achieved.

- 4.104 As a first step the Council should determine what resources it has in house and whether there is the capacity and expertise to complete the project. If there is a need to obtain some external assistance then this should be identified at an early stage and the recruitment of advisers undertaken as a first step so that an agreed methodology and project plan can be developed. The external advice for the procurement project is likely to include project management, specialist legal advice, leisure advice, and VAT specialists. Most of these areas equally apply to the shadow trust, e.g. legal advice, VAT advice.
- 4.105 It is recommended that there is a clear separation of roles between the Council and the shadow trust and if considered appropriate a set of rules agreed that will determine the conduct during the process and to avoid accusations of collusion.
- 4.106 There should be a project team for the procurement project and a separate team for the trust project. The shadow trust will require some support both in terms of developing their legal model and their business plan. They will be required to develop their bid in line with the Invitation to Tender and behave like any of the external bidders. There will be a requirement at some point to appoint shadow trustees and for the new organisation to be set up as a company limited by guarantee. There is no need to do this until there is some certainty that they will be the preferred bidder.
- 4.107 The procurement project will follow a traditional procurement path in that expressions of interest will be invited from the wider market, a shortlist will be developed, a suite of tender documents developed and the shortlisted organisation invited to submit their responses to the Invitation to Tender. These submissions will then be evaluated and a preferred bidder identified. There will then be negotiations with the preferred bidder to reach an acceptable agreed agreement. If the preferred bidder is the new trust then the new organisation can be formed and final agreement reached.
- 4.108 Again this is an untried model but one designed to protect the Council from future challenge. The Council may deem this unnecessary and that the risk of any successful challenge be mitigated.

Participation on the Board of Management

- 4.109 The issue of control over any newly created NPDO is often key to a Local Authority. The relationship between the Council and the NPDO will be characterised by influence rather than the Council controlling a majority of the voting rights in the NPDO.
- 4.110 It is possible for the local authority to participate in the direct management of any model in-so-far as the basis of involvement is subject to the provisions of Part V of the Local Government and Housing Act 1989, the Local Authorities (Companies) Order (S1 549).
- 4.111 For these reasons the Council is unlikely to be able to hold more than 20% of the 'voting power' on the Management Board. Those holding 'voting power' would include: serving members and officers from the sponsoring authority; ex-members who have left the Council within the preceding four years and members and officers from other local authorities.

Conflicts of Interest

- 4.112 In serving as trustees or as Directors on the Board of Management of a NPDO, Councillors are required, both under company law and charity law, to act in the best interests of the NPDO and not the local authority, which has nominated them to the Trust. It is for reasons of conflict of interest that a number of recently created trusts do not have public sector representation on their Boards of Management.

The Trust & Community Involvement

- 4.113 A NPDO has the opportunity to attract and recruit a diversity of skills and perspectives to add value to the management of the organisation. These skills may come from service users, nominated representatives, the sporting, business and educational sectors (particularly given the dual use commitments) or trust staff (depending on the chosen entity).
- 4.114 Externalisation of service to a NPDO can be a viable option where there is evidence that:
- An existing in-house service delivery is effective, since these are the staff who will manage and operate the trust
 - There is a clear client / contractor split and the service is relatively easy to quantify within a supply contract
 - There is a lack of interest from the private sector to bid for the service. there are clear benefits of using the market which outweigh the costs of the exercise
 - There are tax-based advantages to external organisations that do not apply to the public sector
- 4.115 This option is less viable when:
- Tax-based savings are not significant when compared with the cost of establishment and loss of control
 - The current in-house service provider is struggling
 - Service aims and objectives go beyond value for money (i.e. not just cost / quality)
 - The service is difficult to specify, monitor and package into a suitable contract
 - Where the service is dynamic and where short/medium term change would be precluded by a long term arrangement
 - The scale of the operation would make it difficult to attract suitable trustees and for significant economies of scale to be generated
 - The service is already externalised

Advantages and Disadvantages of Leisure Trusts

Table 4.3 – Advantages and disadvantages of Trusts

Advantages	Disadvantages
<ul style="list-style-type: none"> • VAT favourable treatment of supplies of sporting services (NPDO must be 'principal rather than agent'). 	<ul style="list-style-type: none"> • Loss of democratic control (arms-length trust can only have up to 20% direct public sector representation)
<ul style="list-style-type: none"> • Will improve the Council's overall VAT position in relation to 5% partial exemption threshold 	<ul style="list-style-type: none"> • Trust may find it difficult to 'lever in' sufficient external capital and will still be dependent upon the Council for reinvestment in the assets
<ul style="list-style-type: none"> • Relief from National Non-Domestic rates (NNDR) (up to 85% can be saved subject to 80% mandatory relief and 20% top-up discretionary relief) 	<ul style="list-style-type: none"> • Potential fragmentation and disengagement from the Council
<ul style="list-style-type: none"> • Other Fiscal Advantages (favourable treatment in relation to Corporation Tax, Capital Gains Tax and Tax relief on donations) 	<ul style="list-style-type: none"> • Success depends on attracting and retaining quality 'Trustees/Directors'
<ul style="list-style-type: none"> • Capital Expenditure (ability to borrow / secure capital outside of local authority allocation and regulations) 	<ul style="list-style-type: none"> • Potential Impact on central establishment personnel

Advantages	Disadvantages
<ul style="list-style-type: none"> • Fits with Best Value (Partnership Arrangement) 	<ul style="list-style-type: none"> • Ability of TUPE to 'protect' employee benefits
<ul style="list-style-type: none"> • Ability /Opportunity to engage the local community through direct representation 	<ul style="list-style-type: none"> • Reversibility not guaranteed

Appropriateness of Establishing a New Trust in Hart

- 4.116 Establishing a new trust will in theory result in the same management team operating under a new name managing and operating the same facilities and services. If there were a need to drive the business forward with a more commercial approach then establishing a new trust will not necessarily resolve any weaknesses in the service because any management and operational issues will continue to be dealt with by the same team under a new guise but with less control and support from the Council. This will depend to some extent on the mix and strengths of external Board Members in a Company Limited by Guarantee model.
- 4.117 The main disadvantage of the Trust approach is that a new trust would not be able to generate any significant capital investment. The main advantage of this approach would be the access to charitable status and tax-based savings thus enhancing the revenue position.
- 4.118 On the other hand this option would enable an element of risk transfer arising from externalising the services. It would also generate tax-based revenue savings (that are probably more secure than a hybrid trust arrangement) and furthermore it would enable the service to remain as an integrated whole (if this was considered material).
- 4.119 We would have concerns about the Council deciding to establish a new trust in relation to procurement issues and the risk of challenge. A more detailed feasibility study would be required to demonstrate Best Value of this approach. We are not convinced that this could be achieved and the Council may have to go down the twin track approach which is costly and time-consuming.

Option 4 - Partnership with an Existing Trust

- 4.120 Another option for the Council to consider would be to negotiate with an existing trust. It would also be possible to allow other leisure trusts to bid for the partnership 'contract' through a competitive tendering process.
- 4.121 Until recently there was a growing number of existing trusts looking to expand their domains beyond the local authority where they were originally established. A number of Leisure Trusts have secured contracts in other local authority areas. These include Aquaterra (Bath), Carlisle (Allerdale), Hertsmere (Three Rivers and Milton Keynes), Wycombe (Chiltern), Fusion (Tunbridge Wells and Croydon) and Hastings (Freedom Leisure) to name a few. The number of Trusts seeking other contracts has been affected by the current economic crisis. Not surprisingly these organisations are looking to consolidate rather than grow.
- 4.122 One trust that has been particularly good at securing additional contracts is Greenwich Leisure Limited (GLL). GLL is an Industrial and Provident Society formed in 1993 which describes itself as 'leisure's most successful social enterprise'. The company employs around 3,000 people and operates 65 facilities mostly on behalf of London Boroughs (Barnet, Camden, Ealing, Greenwich, Hackney, Hammersmith and Fulham, Newham, Sutton, Tower Hamlets and Waltham Forest). GLL also operates facilities in Reading and Epsom and Ewell and Crystal Palace on behalf of Sport England, a facility previously operated by Leisure Connection.
- 4.123 To put this in context, GLL is about the same size as three of the main private sector operators (Parkwood, 65 sites, SLM 60 sites, and Serco 65 sites). It is without doubt the biggest operator of public sector leisure facilities in Greater London. It is possible that GLL may be interested in Hart District Council as they already manage a facility in Reading.
- 4.124 Community Leisure Services (CLS) is a charitable company that was originally linked to DC Leisure (the private sector company referred to in the previous section) but is now independent.
- 4.125 CLS is unique in being a member of both LMCA and SPORTA. The company operates 11 sites on behalf of five local authorities including Chorley, City of Lincoln and Abingdon but has seen a dramatic decline in the number of facilities managed in recent years.
- 4.126 At first the process of trusts bidding for contracts outside their home patch may appear unusual. It is however similar to the process that occurred following the original CCT legislation in 1988 when the new commercial companies emerged. Some DSO's conducted successful management buy-outs, of these some were more successful than others and sought to expand with the benefits of economies of scale (increased purchasing power, etc).
- 4.127 The process with NPDO's is somewhat similar with one significant difference. The benefit to the private sector of expanding is that there is potentially a bigger dividend for shareholders. As a non-profit making organisation NPDO shareholders cannot benefit financially as a dividend can be taken. Therefore the question to be resolved is which organisation benefits from such an arrangement, the host or the new partner organisation? The motives of the 'predatory' trust need to be considered carefully. Is it about growing a business to share overheads, spreading the not for profit 'gospel' for philosophical reasons or is it just empire building or a 'lifeboat' for a failing trust?
- 4.128 There are varying degrees of contractual arrangement that can apply ranging from one trust simply supplying support services, to a concession contract won in a competitive situation to a new 'umbrella' trust with a new local Board and a full repairing lease arrangement.

- 4.129 A relatively new trend is for an existing trust to minimise the risk to their host arrangement, is to offer a model that means the setting up of a new local trust. The model is that the Council's services will be delivered by a dedicated stand alone charitable company by guarantee within the organisation's wider company group. What this means is that the bidding company is an existing company in the group but final contract is a new company which does not exist and cannot be evaluated. It can have no trading record, its accounts cannot be evaluated, its precise legal structure and its membership, director/trustees and its memorandum and articles of association cannot be established.
- 4.130 This is an intrinsically risky legal model. The risks can be mitigated if instead of the Contract being in the name of the new subsidiary it is actually in the name of a company with a well established track record, sound financial viability, operational capacity and technical competence and capacity which are criteria normally included within council's contract procedure rules. If the new company is a subcontractor of the company with capacity and financial viability etc then providing the Contract is drafted appropriately then the main Contractor is liable for all of the actions of the subcontractor and is liable to ensure that the Contract is properly delivered. This is the model put forward by the private sector operators with a "hybrid trust" model.
- 4.131 By all means not all existing trusts adopt this model but it is one that is gaining favour amongst trust organisations as it limits their exposure and liability.
- 4.132 There are a number of issues to consider including:
- Experience of operating facilities
 - Benchmarked ability to deliver economic, effective and efficient services
 - Security of tenure in 'host' authority
 - Financial standing and sustainability
 - Robustness of proposed model
 - Ability to invest
 - Pensions arrangements and security of employment for those transferring
 - Constitutional arrangements such as the extent of representation of the Board
 - Compatibility of systems and procedures and operating philosophy.

Advantages and Disadvantages of Existing Trusts

Table 4.4 – Advantages and disadvantages of Existing Trusts

Advantages	Disadvantages
<ul style="list-style-type: none"> • VAT favourable treatment of supplies of sporting services (NPDO must be 'principal rather than agent'). 	<ul style="list-style-type: none"> • Loss of democratic control (arms-length trust can only have up to 20% direct public sector representation)
<ul style="list-style-type: none"> • Will improve the Council's overall VAT position in relation to 5% partial exemption threshold 	<ul style="list-style-type: none"> • Trust may find it difficult to 'lever in' sufficient external capital and will still be dependent upon the Council for reinvestment in the assets
<ul style="list-style-type: none"> • Relief from National Non-Domestic rates (NNDR) (up to 85% can be saved subject to 80% mandatory relief and 20% top-up discretionary relief) 	<ul style="list-style-type: none"> • Potential fragmentation and disengagement from the Council
<ul style="list-style-type: none"> • Other Fiscal Advantages (favourable treatment in relation to Corporation Tax, Capital Gains Tax and Tax relief on donations) 	<ul style="list-style-type: none"> • Success depends on attracting and retaining quality 'Trustees/Directors'

Advantages	Disadvantages
<ul style="list-style-type: none"> • Capital Expenditure (ability to borrow / secure capital outside of local authority allocation and regulations) 	<ul style="list-style-type: none"> • Potential Impact on central establishment personnel
<ul style="list-style-type: none"> • Fits with Best Value (Partnership Arrangement) 	<ul style="list-style-type: none"> • Ability of TUPE to 'protect' employee benefits
<ul style="list-style-type: none"> • Ability /Opportunity to engage the local community through direct representation 	<ul style="list-style-type: none"> • Reversibility not guaranteed

Appropriateness of an Existing Trust in Hart

- 4.133 It is likely that there would be some interest from existing trusts even allowing for the current economic situation. If an open tender procurement process is undertaken, these organisations would not be excluded from expressing an interest. At that stage their ability to fulfil the Council's requirements would need to be evaluated objectively and against other potential partners.
- 4.134 If the Council were to consider this approach they would need to be very careful that they were not being used as a 'lifeboat' for an existing trust particularly at this time. They would also need to be certain that an existing trust had the skills and resources to manage the service in a sustainable way.

Summary of Management options

- 4.135 In this section of the report we have dealt in some detail with the management options available to the Council in the context of the need for continuous improvement in service delivery, the need to make revenue efficiencies and the requirement for ongoing investment in enhanced facilities.
- 4.136 An in-house solution is the status quo and it can be demonstrated that they are performing economically, effectively and efficiently. We do not believe that an external organisation would manage the service any better. They may be able to access tax-based savings but much of this would be swallowed up in support services, profit margins, start-up costs etc.
- 4.137 The big question mark about the in-house option is the ability to raise capital. The Council could use Prudential Borrowing to fund capital but would need to demonstrate an ability to fund the re-payments. Whilst the private sector could inject capital, the current market conditions do not bode well for a private sector partnership or for a partnership with an existing trust. The cost of capital would be higher in an externalised service.
- 4.138 There are advantages and disadvantages of retaining services in-house but in this case the advantages may outweigh the disadvantages particularly when considering the complexities and risks of reviewing the dual use arrangements and the current move to externalise support services..
- 4.139 A partnership with a private sector operator has a number of merits. Firstly through so-called hybrid trust structures access to tax-based savings can be obtained although the risks of these structures need to be evaluated carefully. These revenue savings can be used to underpin Prudential Borrowing repayments although in this case these would not be too significant and a proportion would accrue to the County.
- 4.140 External capital funding can be levered in through a partnership with a private sector organisation. It should be noted however that this capital will need to be repaid through the lifespan of the contract and is more expensive than the use of in-house capital.
- 4.141 The main disadvantage of the private sector approach is the current market conditions. A potential advantage is the potential improvement of the Council's VAT position especially if capital is spent on the leisure facilities.

- 4.142 The option to establish a new Trust to operate the service also has some merit. The main disadvantages are that the Council will lose control over the service to a greater degree than under a private sector contract and there will be limited opportunity for external funding. Therefore although a new trust would yield some revenue savings associated with National Non Domestic Rates and VAT concessions, a new trust would not be able to access significant capital or bring about cultural change in service delivery. It is unlikely that the Council could set up a new Trust without some form of more detailed Best Value assessment. Start-up costs would also be significant.
- 4.143 Other existing trusts currently operating outside Hart would probably be interested in a partnership with the Council but Strategic Leisure doubt whether they would be capable of delivering any major capital investment and there would be significant concern over their primary focus and operating priority.
- 4.144 It can be seen therefore that all forms of management have relative advantages and disadvantages. The importance of these will depend on ones 'frames of reference' as well as the Council's financial position, political opinion and corporate priorities. The next section of the report identifies some of the key issues in Hart that will influence the choice of the optimum form of management

Section 5

Identification of Key Financial Issues

5 Identification of Key Financial Issues

Capital Funding

- 5.1 It is acknowledged that there is a need to spend money on the leisure centres to maintain them effectively and to enhance the services on offer. The Council is strapped for cash and has limited capital to spend particularly on a discretionary function. The leisure facilities are performing well at the moment and levels of usage and income are high. This volume of people creates wear and tear on the buildings. The danger is that unless the investment takes place, the standard of facility and service will deteriorate and usage levels will fall. This will put pressure on the revenue account.
- 5.2 The Council could use Prudential Borrowing to fund investment but would need to demonstrate that the revenue implications of any borrowing could be accommodated. We believe that there is potential to expand the income generating potential of the centres, particularly Hart Leisure Centre and this would provide a commercial return sufficient to cover the cost of the non fee-earning expenditure such as repairs to the roof and improvements to the changing rooms. Clearly a more detailed feasibility study would be required to prove the business case.
- 5.3 As stated in the previous section, the establishment of a leisure trust or a partnership with another existing trust would not be a good vehicle for attracting external capital particularly in the current economic climate. These organisations have no assets against which to secure debt. There would be nothing to stop the Council using Prudential Borrowing to fund capital and having a contract with a leisure trust to operate the facilities. In this case the Council would be reliant on a third party to deliver the return on investment.
- 5.4 Again as stated in the previous section, the commercial leisure management contractors have a history of investing in community leisure centres particularly when a commercial return can be envisaged e.g. health and fitness facilities. However now is not a good time to secure this investment because many of these Companies are consolidating rather than expanding. Furthermore the cost of this capital is very high, typically 10-15%. This is significantly more than through Prudential Borrowing. It is possible to match public sector borrowing with private sector management.
- 5.5 Our conclusion is that it would be better for the Council to fund any capital investment, subject to the demonstration of a sustainable business case. **The issue of capital investment is therefore not a critical factor in determining the most advantageous management option.**

Revenue Implications of the Management Options – Financial Model

- 5.6 As part of this options appraisal, Strategic Leisure prepared a financial model which identified the potential savings and additional costs associated with the different management options. This model was discussed with the Council's financial officers. As a result of this discussion and the identification of some formulae errors a new model was prepared. This was subsequently amended a number of times and Version V is presented at Appendix 2. This uses the 2009/10 budget estimates as the starting point rather than previous years' outturn figures. The figures are based on a number of assumptions and as with all theoretical the results need to be treated with some caution. They form a piece of the jigsaw rather than the whole picture. In this case non-financial considerations and risks are as important.
- 5.7 In relation to the options involving private sector operators and existing trusts, the only way to really identify the financial position is to test the market as many variables come into play. The main assumptions used are as follows:
- The current net cost of the service has been identified and used as the benchmark against which other options have been assessed. The working papers are also set out in Appendix 2.
 - It is assumed that rate relief (80%) and VAT benefits could be realised through a new trust, an existing trust and a hybrid trust structure. We have allowed for the recovery of VAT where it applies and the partial exemption position of not for profit organisations.

Hart District Council

Leisure Management Options Appraisal

- It is assumed that a private contractor (with and without hybrid trust structures) would generate approximately 5% more income (this is based on recent experience of externalisations), reduce staff and other costs over time by 5% and support services by 10% (subject to the Council's treatment of residual support services).
- We have allowed for the additional costs associated with not for profit organisations such as higher support services, insurances etc. We have also allowed for a small build up of working capital
- We have allowed for realistic profit margins for private sector organisations as well as contributions to head office overheads.

5.8 The detailed financial model is set out in detail in Appendix 2. The table below presents a summary of the financial review of the facilities when applied to each of the potential management options available to the Council.

5.9 We have used the financial appraisal as part of the decision-making process rather than the sole determinant. The figures contained in the table are best estimates based on a number of assumptions. In relation to the options involving private sector operators and existing trusts, the only way to really identify the financial position is to test the market. Clearly this was not the remit of this study.

5.10 The table below is the outcome of an analysis of both leisure centres services.

Table 5.1 – The Outcome of an Analysis of both Leisure Centres Services

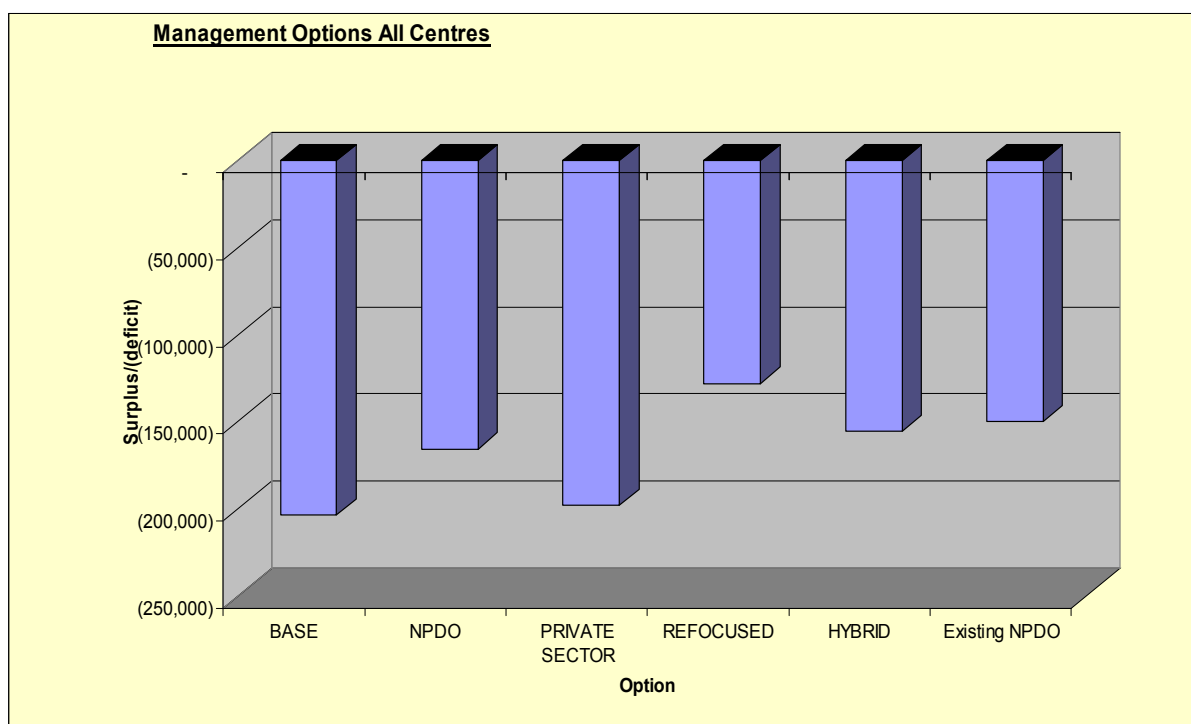
	BASE	NPDO	PRIVATE SECTOR	REFOCUSED	HYBRID	Existing NPDO
<u>Income</u>	2,405,500	2,616,758	2,525,775	2,425,216	2,525,775	2,682,177
TOTAL INCOME	2,405,500	2,616,758	2,525,775	2,425,216	2,525,775	2,682,177
<u>Expenditure</u>						
STAFFING	1,509,050	1,509,050	1,437,190	1,437,900	1,437,190	1,509,050
PREMISES	743,190	665,706	726,393	743,190	592,563	661,736
TRANSPORT	6,250	6,874	5,952	6,250	5,952	6,706
SUPPLIES	333,921	366,296	318,020	333,921	318,020	357,362
AGENCY SERVICES	41,310	45,342	39,343	41,310	39,343	44,237
SUPPORT SERVICES	205,370	205,370	164,296	186,700	164,296	164,296
FINANCING COSTS	-	-	-	-	-	-
PROFIT/RESERVES	-	52,335	189,433	-	189,433	134,109
Additional Support Costs	-	75,000	50,000	(50,000)	50,000	50,000
TOTAL EXPENDITURE	2,839,091	2,925,973	2,930,628	2,699,271	2,796,798	2,927,495
(SUBSIDY)/CONTRIBUTION	(433,591)	(309,215)	(404,853)	(274,055)	(271,023)	(245,318)
Assumed Saving		(124,376)	(28,738)	(159,536)	(162,568)	(188,273)

5.11 The graph below highlights the assessment of required subsidy based on the variant management options scenarios. It identifies that a refocused delivery of services could in theory realise an annual saving of £159k. To achieve this saving the service should focus on efficiency savings namely a 5% saving on staffing expenditure at both facilities, a 10% saving in recharges and a further £50,000 on additional support costs. We appreciate that the 2009/10 estimates already include a number of targets for savings and that achieving additional benefits may be difficult. The model shows that many of these savings would not be in relation to operational changes but more the allocation of recharges and support services.

Hart District Council

Leisure Management Options Appraisal

- 5.12 In regards to the other management options, contracting with an existing NPDO could save circa £188k per annum but this does not include start up costs or the cost to the Council of managing a future partnership e.g. a client function. Externalising to the private sector without a hybrid trust would not yield significant savings, circa £29k per annum. With a hybrid trust there is potential to save £162k. Again this does not include start up costs or client residual costs. The risks of this option need to be considered carefully.
- 5.13 The setting up of a new NPDO could realise savings of circa £124k p.a. but as staged above this is not seen as a sustainable model.
- 5.14 The graph shows the relative differences of the various options in terms of net subsidy.



- 5.15 This part of the report should be read in conjunction with the Council's financial officer's appraisal of the model. Some of the figures vary but not significantly and in the context of the assumptions used and the nature of the model i.e. its illustrative nature, the differences are not seen as material in terms of the conclusions. Indeed it is agreed that retention of the services in house represents the best value approach subject to the attainment of the savings.
- 5.16 The Council should not base its decision to externalise the service purely on the financial benefits that may be achieved as opposed to existing performance. The Council should also review what an externalised service will mean for the authority, and how overall service improvement will be achieved through the externalisation process and how continued investments will be funded over the longer term the criteria we have applied reflect this balanced approach.
- 5.17 It will be for the Council to decide whether the extent of savings that could be achieved through an externalisation is significant. Strategic Leisure feels that the economy, effectiveness and efficiency of the existing in-house operation is such that the scope for savings is less than in many other savings. Furthermore in this case the extent of savings could be reduced by reviewing the dual-use arrangements. It should also be remembered that whilst the savings identified would accrue to the public purse generally they would not all be derived by Hart District Council. For example the County would be entitled to its share of NNDR relief.

Hart District Council

Leisure Management Options Appraisal

- 5.18 The current market conditions may also adversely effect the generation of savings through an externalisation by impacting on the levels of competition. Having a relatively small number of interested parties in a risk averse marketplace is not conducive to the attainment of savings.
- 5.19 The Council would lose influence and control of the service if it were to externalise the service and yet we believe that the public sector is the best way to realise capital investment. The financial benefits of an externalisation in Hart are not compelling at this time. It may be better to implement any capital investment and make the operational changes first and then reconsider an external solution once the market conditions have improved. This will also give an opportunity for the out-sourcing of support services to take place and to assess any impact that this may have on an externalised leisure function.

Section 6

Conclusion and Recommendations

6 Conclusion and Recommendations

Key Issues in Hart

6.1 This high level management options appraisal has highlighted some key issues in Hart. These are summarised below.

- **Effectiveness of current operation:** The leisure centres are performing well based on a number of benchmarks and performance indicators. The Quest scores indicate an effective operation and the net cost of the service is very low compared with other in-house local authorities.
- **Opportunity for savings limited:** The efficiency of the in-house operation minimises the opportunity to generate savings from an externalised option.
- **Dual-use Arrangements:** The agreements with the schools and County have been 'interpreted' over the years. There are many Gentleman's arrangements in place and most of these are in the District's favour. Any externalisation will need to be associated with a review and firming up of the agreements. This may increase the net cost of the service to the District and therefore reduce the potential savings.
- **Savings to accrue to the County:** In any case a proportion of any savings arising from an externalisation would be due to the County under the current arrangements e.g. a proportion of any NNDR relief. Savings would need to be weighed up against the loss of direct control.
- **High cost of support services:** When benchmarked against other local authorities and in particular other forms of management, the cost of support services attributed to the leisure centres is high. This is not unusual in a relatively small 'shire' District because proportionately there are fewer service departments against which these costs can be charged. Externalising the leisure management function would not reduce these costs (unless there was a commensurate reduction in overheads) because there would be no personnel on the TUPE list. Therefore costs would be duplicated.
- **Out-sourcing of support services:** The Council is in the process of addressing the support services issue by outsourcing a number of administrative functions. Looking to externalise the leisure management service simultaneously may cause some complications.
- **Relatively high staffing costs:** Having said that the net cost of the service is low, there is one area where we feel that savings could be made. Staffing levels are higher than we would expect particularly at a management/supervisory level.
- **Need for capital investment:** The leisure centres are in need of investment to keep them up to customer expectation. Some of this investment is needed to maintain the fabric and structure of the facilities, some to refurbish and enhance the ancillary facilities such as changing rooms and some to create additional income generating facilities. The ability to fund this capital will be crucial. The Council is strapped for cash but can use Prudential Borrowing if it so chooses.
- **High cost of external Capital:** One way to secure this investment would be to partner with a commercial sector company (a leisure trust option would not be likely to yield capital). However the cost of this capital is typically 10-15% which is significantly higher than public sector borrowing.
- **Current market conditions:** There is evidence that fewer commercial sector companies are bidding for work in the current economic climate. Those that are have started to be much more risk averse and are applying much higher margins. Given the economic nature of the in-house approach we do not feel that there is scope to make significant revenue savings particularly when allowing for part of the savings to accrue to the County and to retain a client function.
- **Synergy with other leisure facilities:** There are some existing outdoor sports facilities and the potential for more and better ones to be provided adjacent to the Hart Leisure Centre. Strategic Leisure believes that these should be integrated with the management of the leisure centres.
- **Start-up resources and costs:** Any externalisation will be draining on the Council's time and resources. It is clear that there is insufficient expertise and time available to manage a significant externalisation. Setting up a leisure trust from scratch would cost at least £100k and an externalisation to a commercial contractor at least £50k. We do not believe that this can be justified at this time when the benefits of an external approach are so uncertain.

Management Options

In relation to Hart

Advantages of 'externalisation'

6.2 The Council really has two main options. The first is to retain the leisure management function in-house and the second is to externalise them. In this respect we do not believe that there is a rationale for setting up a new leisure trust and should the service be externalised we would suggest that a competitive tender process be followed to allow commercial leisure contractors and existing leisure trusts to bid for a contract. The advantages of an externalisation are as follows:

- Some revenue savings
- Transfer of risk
- Ability to focus on 'core' services
- Opportunity to 'streamline' support services
- Access to capital funding (high cost)

Disadvantages of 'externalisation'

- Revenue savings potentially small (and shared with HCC)
- Loss of control and influence
- Impact on 'externalisation' of support services
- Potential duplication of support services
- Start-up and residual 'client' costs
- Loss of synergy with other services
- Limited access to and high cost of external capital

Conclusion

6.3 **In the case of Hart District Council and taking all relative factors into account we believe that the advantages of retaining services in house outweigh the disadvantages, at least for the time being.**

6.4 **Given the existing effectiveness of the service, current market conditions, the impending externalisation of support services and the risk of increasing the net cost through reviewing dual-use arrangements, Best Value may be served at least in the short term by retaining services in-house. The Council should consider in more detail the opportunity to invest in the leisure facilities through prudential borrowing and make some adjustments to the way services are delivered in-house before re-considering an externalisation.**

Recommendations

6.5 Strategic Leisure makes the following recommendations to Hart District Council in relation to the options for the management of leisure facilities;

- 1 That the leisure management service remains in house (for the foreseeable future) and at least pending the out-sourcing of support services
- 2 That the Council undertakes a review of the staffing levels at the leisure centres
- 3 That the Council undertakes a feasibility study into the ability to extend the income generating capability of the leisure facilities and to refurbish them through a self-financing capital scheme

Disclaimer

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Forecasts and recommendation in any proposal, report or letter are made in good faith and on the basis of the information before the Company at the time. Their achievement must depend, among other things, on effective co-operation of the Client and the Client's staff. In any consequence, no statement in any proposal, report or letter is to be deemed to be in any circumstances a representation, undertaking, warranty or contractual condition.