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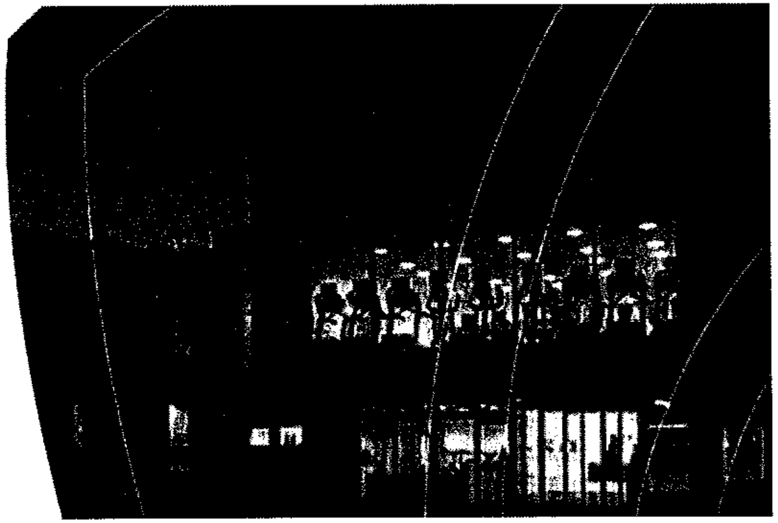
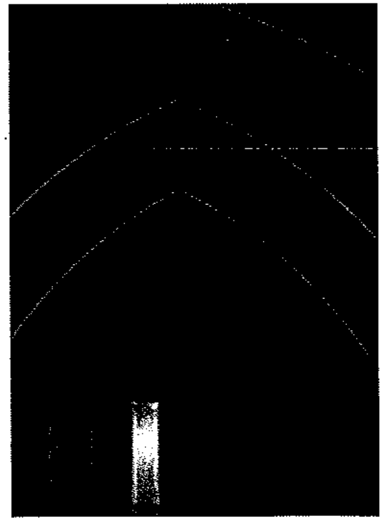
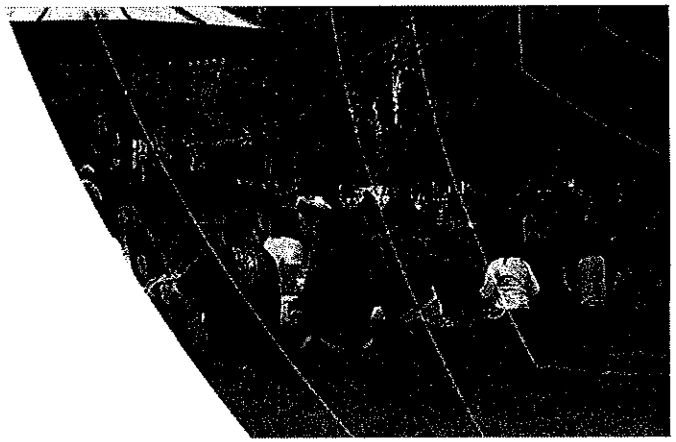
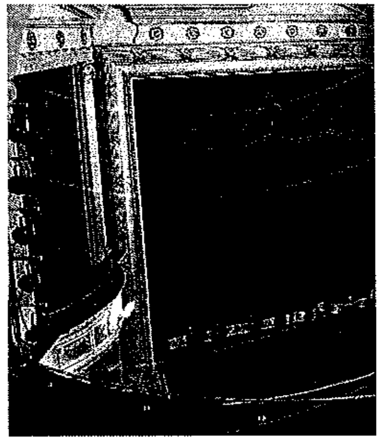
REDDITCH BOROUGH COUNCIL









Leisure and Culture Management Options Appraisal

Draft Report

Commercially Sensitive and Confidential

15 January 2015

The Sports Consultancy

Contents

1. Introduction

Background and Context

The Sports Consultancy ('TSC') was jointly appointed by Redditch Borough Council ('RBC') and Bromsgrove District Council ('BDC') to undertake an appraisal of the available management options for their leisure and culture facilities and services.

Together with a range of other Council services, RBC's and BDC's leisure and cultural portfolios are now part of a shared service, in a drive to achieve efficiencies and cost savings across the Councils.

The leisure and cultural facilities are all managed in-house, with the exception of (1) BDC's Dolphin leisure centre, which is outsourced under contract to Wychavon Leisure, a specialist leisure trust that also operates facilities on behalf of the councils of Wychavon and Malvern Hills, and (2) BDC's Artrix Theatre which is managed under contract on behalf of the Council by a charitable trust.

Against the background of the imperative make financial savings and to ensure a sustainable future for leisure and cultural provision, RBC and BDC are now exploring the feasibility of alternative management options. Whilst ensuring a financially sustainable future is a priority, the Councils would like to ensure that the management option can also deliver service improvement and benefits to local residents.

This report summarises the available options to help direct the Councils in terms of:

- the most appropriate scope of facilities and services to include
- likely financial savings available to the Councils over a 10-year period, taking into account operational improvements and any support service rationalisation, as well as VAT and NNDR savings
- potential for service improvement
- management and staffing
- legal framework and governance
- track record of the contractor market and strength of covenants
- council control and influence
- contractual documentation governing the agreement between the Council and contractor (e.g. legal agreement, service specification, asset management responsibilities matrix, performance management system)
- an implementation and cost plan
- likely appetite from potential service providers.

2. Overview of service

Scope of facilities – current portfolio

The Councils' respective portfolios encompass a mix of facilities and services across, indoor and outdoor, leisure and cultural, which are listed below. The combined cost of operating the facilities (including the management fee paid to Wychavon Leisure for the Dolphin Centre) is budgeted to be £5.3m in 2014/15, including support services.

In July 2014 BDC approved plans for a new leisure centre to be built to replace the Dolphin. The existing contract with Wychavon Leisure will effectively terminate when the current centre closes. Ideally, the contract for the new centre should be tendered as part a wider BDC/RBC portfolio. The management contract for the Artrix Theatre, however, does not expire until 2026 and is likely, therefore, to continue to be managed under a separate arrangement.

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Redditch specific

Abbey Stadium Leisure Centre
Arrow Vale Sports Centre (dual use)
Kingsley Sports Centre (dual use)

Palace Theatre

Forge Mill Needle Museum & Abbey Ruins

Pitcheroak Golf Course

5 Community Centres / Meeting Rooms

3 Parks (Arrow Valley, Overdale, Morton Stanley) & Open Spaces

3 Business Centres

Learning on-line

Common to both

Sports Development & Sponsorship

Arts Development

[illegible]

C2

Bromsgrove specific

Dolphin Leisure Centre (outsourced)

Artrix Theatre (outsourced)

Sanders Park and Open Spaces

Council House HQ (and cleaning)

Public toilets

Slide 6

C2 I have moved this to common to both. Redditch has 5 community centres and Bromsgrove has 2 (Spadesbourne and Amplett Hall)?
Chris, 14/01/2015

Cost of service

The budgeted net cost for 2014/15 of the service components for each portfolio is set out in the table below, listed in order of the net cost of the service (highest first):

2014/15 Budgets		
Redditch	Net Cost	% total
Parks, Open Spaces & Allotments	£1,042,696	37%
Management, marketing & support services	£626,439	23%
Palace Theatre	£211,280	8%
Forge Mill Needle Museum & Abbey Ruins	£172,664	6%
Community Centres	£155,025	6%
Sports Development & Sponsorship	£123,315	4%
Kingsley Sports Centre	£97,141	3%
Abbey Stadium	£87,607	3%
Playing pitches & changing rooms	£85,577	3%
Events	£57,410	2%
Arts Development	£47,270	2%
Learning on line	£34,426	1%
Arrow Vale Sports Centre	£29,720	1%
Pitcheroak Golf Course	£15,863	1%
Allotments	(£3,966)	
Total	£2,782,467	

C6

Slide 7

C6 Excludes the 8 community centres not part of John's portfolio
Chris, 18/12/2014

Scope of service – looking to the future

When assessing the most appropriate scope of a portfolio to outsource to a third party, we would recommend the facility and service portfolio represents a **coherent package** in order to confer opportunities for operational efficiencies and strategic benefits. A coherent package will be more attractive to the market, generate more interest, and ultimately put the Councils in a **better position to achieve best value from the contract**.

1. The **Leisure Centres** will form the core part of a portfolio of facilities outsourced to the market. Not only will these will generate the most interest from the market, they will provide the greatest opportunity for the Councils to achieve savings through operational efficiencies and driving additional income through higher usage numbers. BDC's Dolphin Centre is currently outsourced to Wychavon Leisure Trust but this will terminate upon the delivery of the planned replacement facility in [2017]. The prospect of a brand new leisure centre within the portfolio will maximise market interest in the operator market.

2. Bromsgrove's **Artrix Centre** is operated under contract by a specialist trust which is not due to expire until 2026. Whilst it would be reasonable to assume that the Artrix Theatre Trust could operate Redditch's **Palace Theatre** (currently operated in house) – and would recommend discussions are pursued to assess the feasibility of such – in the meantime, we would suggest that it forms part of the package to outsource as part of the wider portfolio. We should point out that whilst leisure operators do operate theatres on behalf of Councils, their experience here is still rather limited and they are likely to be keen to operate the theatre only if it is included with the other facilities, i.e. we cannot foresee it attracting much interest if let as a standalone contract, other than from specialist theatre operators.

3. RBC's **Pitcheroak Golf Course** generates income of less than £100,000 per annum. Whilst neither a review of the facility nor of competing golf courses has been undertaken, in the absence of any evidence to the contrary, we would expect this relatively low level of income to be enhanced by a specialist operator. Leisure operators such as SIV and MyTime are active in the public golf course operator market, and generally there is appetite to manage similar facilities. Further soft market test may well indicate that the Council is likely to achieve best value through separating the golf course operation from the rest of outsourced portfolio, but for the time being, we would recommend it forms part of the wider package.

4. RBC has a number of **Community Centres** across the borough, five of which are operated by the leisure service. BDC's community centre portfolio comprises Spadesbourne and Amphlett Hall. Together, these seven facilities generate around £120,000 of annual revenue in bookings. These potentially could fit well with the leisure and culture portfolio, providing venues for delivering activity and community programmes.

Scope of service – looking to the future

5. RBC's **Forge Mill Museum** is a venue of regional significance, showcasing the area's heritage of needle and fishing tackle industries. On the same site are the ruins of Bordesley Abbey and the visitor centre. Whilst the current level of income generated by the facility is modest, at less than £50,000 per annum, the physical infrastructure seems to be sound and it is reasonable to assume that additional income could be generated if it was operated on a more commercial basis outside of the Council, perhaps driving additional revenue through venue hire.

6. RBC operates a number of **Business Centres** in the borough which provide rentable space for local business and organisations to use for meetings, events, and office space. Again, if it could be demonstrated that these facilities allow a third party operator (which is likely to be a trust) to demonstrate a commitment to some kind of charitable objective along the lines of supporting local business and promoting employment, there could well be some tax advantages of including these in the wider portfolio for outsourcing. The centres currently generate almost £400,000 income per year.

7. RBC's and BDC's **Sports Development and Sponsorship** services together cost £560,000 per year to operate. Whilst as part of this study we have not explored precisely what the service delivers and cannot comment on whether this represents value for money, this is nevertheless a significant cost and outsourcing it together with the wider leisure portfolio may bring some opportunities for some efficiencies and cost savings. Also, keeping the sports development service as part of the same package as the physical leisure infrastructure is likely to make good strategic sense.

8. Likewise, the Councils' respective **Arts Development** services require significant resources to operate, costing a combined £400,000 per year. Again, we have not undertaken a review of the activities of the arts development service and are therefore not in a position to opine on whether the outcomes it delivers represent good value for money for the Council. It does seem sensible to keep the theatre operations and the arts development services together as a coherent package and so we would recommend that these form part of the wider portfolio for outsourcing.

Scope of service – looking to the future

9. RBC's net cost of operation is £2.8m. At £1.0m, **Parks and Open Spaces** represent the highest cost within the portfolio, accounting for 37% of the total budget. This service includes all grass cutting, hedge trimming, verge maintenance, allotments, and planting, all of which is undertaken by RBC's in-house Landscape and Grounds Maintenance team. As there is no material income generated by parks and open spaces it is likely that moving these to a trust will prove to be more expensive to operate than currently due to the treatment of VAT. This issue is covered in more detail later in this report, but broadly speaking, a Trust will be able to benefit from VAT savings on income, whereas a Council-operated facility's prices will be subject to VAT. Conversely, a Trust needs to pay VAT on its input costs, whereas a Council will be able to recover the VAT paid. So, as a rule of thumb, where income is low in proportion to costs, it will be more expensive for a Trust to operate that service than a Council. Similarly, where income is high as a proportion of costs, a Trust will be able to operate that service at a lower cost than a Council. There are likely to be few savings achievable through the trust benefiting from National Non Domestic Rate (NNDR) relief as there is little or no NNDR payable on these facilities currently. Moreover, there are very few leisure operators who have a demonstrable track record in delivering grounds maintenance services. We have been asked whether a trust would be in a better position to driver better commercial terms through contract negotiation a grounds maintenance contractor; this may well be the case, but if the trust is the principal client, the VAT it will pay for the service is likely to negate any gains made in a lower management fee. For these reasons, we would recommend exploring the option of the parks and open spaces service being separately outsourced to a specialist private operator, with the client relationship retained by the Councils.

10. The Councils have a number of **playing pitches** and **changing rooms** within their boundaries which generate modest levels of annual income. The grounds maintenance contractor is likely to be best placed to undertake the maintenance of the playing pitches as a combined package with the open space portfolio. We would question what a leisure/culture contractor could bring in terms of additional benefits to the Councils and would therefore suggest that they can achieve better value if these are packaged together with the open space and parks contract.

11. Similarly with **allotments,** it is difficult to see what additional benefits could be gained by transferring their management from the Council to a trust. Any gardening programmes a trust could run for particular target groups could still be delivered without the need to manage the allotments directly.

Scope of service – looking to the future

12. Within the parks there are several **cafés** which are managed under contract by private operators. Knowing the leisure operators as we do, and given the typically seasonal nature of the café operations, we would suggest that these would not form a key part of their operation and are likely to follow a similar strategy to the Council in seeking a specialist catering company to manage them on their behalf, rather than deliver the service directly. For this reason, the Councils are likely to achieve better value for money if they retain theirs current arrangement and manage the relationship with the café operators directly.

13. The **catering service** within the leisure centres, however, will be considered by leisure centre operators as a core part of the portfolio and they would therefore typically prefer to manage it directly themselves.

14. We note that the scope of the Leisure and Culture department encompasses responsibility for management of **the Council House** for Bromsgrove (the local authority's head office) as well as the district's **public toilets**. There appears to be no obvious fit between these facilities and the leisure and cultural portfolio and we would question whether there is any operational or strategic rationale for these to remain within the package in the future.

Scope of service – recommendations for the future

With the benefit of the feedback from the leisure operators, and our experience in procuring similar facilities, we would recommend that the package of facilities and services to be considered for outsourcing – whether to a new trust or an existing operator – contains the following to ensure the Councils are in the best position to secure best value and service improvements:

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Redditch specific	Common to both	Bromsgrove specific
Abbey Stadium Leisure Centre Arrow Vale Sports Centre (dual use) Kingsley Sports Centre (dual use)	Sport Development & Sponsorship	Dolphin Leisure Centre (new)
Palace Theatre	Arts Development	Museum & TIC
Forge Mill Needle Museum & Abbey Ruins	Events	
Pitcheroak Golf Course	Management, Marketing & Support	
3 Business Centres	Community Centres	

Those facilities that currently form part of the leisure and culture portfolio but should be considered for exclusion for an outsourced package are the parks and open spaces, playing pitches (which we would recommend be managed by the grounds maintenance specialist and packages with the bookings system and maintenance of the pavilions), allotments, public toilets, BDC's Council House, learning on line, and volunteering coordination.

3. Potential management options

Potential management options

The potential management options available to the Council are listed below:

1. Continued in-house management
2. External Delivery via outsourcing
    a) Leisure Operator / Existing Trust (10 to 15 year contract)
    b) Creation of New Leisure Trust (typically 15+ year contract)

This section provides a general overview of each option, highlighting their advantages and disadvantages.

In house management

- Under the option of continued in-house management, the Councils continue to be responsible for the operation of the facilities and services. We recognise that BDC already outsourced two facilities under contract – the Dolphin Leisure Centre and the Artrix Theatre- but the majority of the combined portfolio under review has remained in-house.
- Under this scenario, the Councils employ all staff and retain all income, expenditure, and buildings maintenance risks.
- There will be continued reliance on the central support functions within the Council, such as legal, accounting, and human resources.
- The Councils **benefit** through retention of total strategic and operational control of the services, and retain relationships with other local authority services. Whilst continuing on this basis will save on avoided set-up and procurement costs, there are some **key disadvantages** that are relevant in assessing the viability of this option, as set out in the following table.

In house management

Advantages and disadvantages of in-house management versus outsourcing to a specialist operator.

Advantages	Disadvantages
Councils retain total strategic and operational control of the services	No revenue savings from NNDR relief or VAT (achievable under the option of outsourcing to a Trust)
Councils retain relationships with other local authority services.	No risk transfer relating to management or maintenance
Avoids set-up and procurement costs	No contracted long term operating savings achievable
	Limited opportunity to achieve wider council savings
	No additional specialist management expertise and ideas brought in
	Limited career opportunities within leisure and limited development of leisure staff
	Retention of slower local-authority decision making processes , impeding development opportunities and reaction to market forces
	No entrepreneurial incentives to improve the service
	Councils have other strategic priorities competing for funding
	The future of the service is not enshrined in a legally binding contract which could threaten its longer term sustainability.

Outsourcing to existing trust

- If the Councils were to outsource the management of the portfolio to the market, there are likely to be two different types of organisations bidding, both of which will benefit from the tax advantages of a trust set-up:
    1. Existing charitable trusts,
    2. Private sector organisations with their own trust structures (hybrid trusts)
- The distinction between these two types of trusts has become rather blurred and therefore their differences are not immediately obvious. Moreover, the benefits each can bring to the Councils, as the client, are indistinguishable. Under both options a trust would contract with the Councils under the following indicative terms:

    1. over a fixed term, typically between 7-15 years
    2. taking on the risks and responsibilities of income and costs
    3. offering an annual contracted management fee (which will either be a payment from the trust to the Councils, or from the Councils to the trust, depending on the net cost of operating the portfolio)
    4. delivering the services under an output specification and performance management system, ensuring the Councils retain some level of control over the scope and quality of service delivery. The Councils will need certainty over the future scope of their service and this is only possible with a robust contract document.
    5. the Council would lease the facilities to the operator
    6. sharing the risks and responsibilities of facility maintenance, with the Councils typically retaining the responsibility for the structure of the buildings
    7. employment of the staff and their terms and conditions would be transferred from the Councils to the operator under TUPE.

- Crucially, an external operator will not be reliant on the Councils' support services as it will have its own IT, marketing, HR, accounting and legal functions to support the outsourced service. This will allow the Councils the opportunity to assess the viability of any additional head office savings, which could be substantial (around £800,000 in this case).

Outsourcing to existing trust

- Where the private sector hybrid and charitable trust models differ is around the ability of the former to achieve the same degree of NNDR and VAT benefits.

    1. A charitable trust will be able to access **greater** NNDR relief (this is covered in more detail in the financial modelling section later in this report
    2. A charitable trust will be able to achieve savings through VAT relief which are not available to hybrid trusts at all.

- The split between in-house and external leisure facility management is broadly 50:50 in the UK. The proportion of facilities externalised is expected to continue to grow for the foreseeable future due to:

    - Competing budgetary pressures of local authorities
    - Growing realisation that **it secures the long term future** of its leisure service (under contract) and is more financially sustainable than in-house management
    - Allows Council to make savings in support services as operators provide their own established and specialist back office function.

Outsourcing to existing trust

- Whilst there are some –primarily strategic and control-related - advantages of in-house operation, there is good reason for the growing numbers of Councils turning to outsourcing of their services. The advantages and disadvantages of outsourcing are set out in the table below:

Advantages	Disadvantages
Contracted cost savings are available to the Council through a lower management fee, achievable by operators through VAT and NNDR savings, as well as increased income and cost efficiencies.	Reduced control and day to day influence from the Council
Council transfers income and cost risks over to the operator. If the operator fails to achieve these, the Council's savings are not in jeopardy.	Support service costs are spread over fewer services
Brings significant specialist management expertise to the service	Requires funding and resources for the initial procurement process (and fro any retendering)
Council is more likely to invest in new facilities if there is the guarantee of annual operational cost savings. Also, the operator can bring additional capital finance to fund revenue generating schemes.	Weakens link with other local authority providers (although as increasing numbers of local authorities are outsourcing, this is becoming less relevant).
The quality and performance of the service is benchmarked against similar facilities across an operator's portfolio. Poor performance is identified more readily and addressed swiftly and appropriately.	
The operator has a single focus – operation of leisure and culture facilities and services – and is not distracted by	
Enshrines the service in a contract and protects the portfolio ultimately for the benefit of the community. All the Council's service requirements are stipulated in the contract, allowing protection of certain prices and user groups.	
Faster decision making – avoids the typically time-consuming processes of the public sector.	
Allows further savings to be generated by reducing the Council support services function (marketing, HR, finance, legal etc) – as these will no longer be supporting the outsourced service	

Setting up a new trust

- The Councils could instead choose to set up their own trust to operate the portfolio. There are a number of different social enterprise models available that the Councils could elect to set up, all of which have very subtle differences. These models all fall under the banner of **Non Profit Distributing Organisations:**

  1. Industrial & Provident Society
  2. Company Limited by Guarantee
  3. Unincorporated Charitable NPDO
  4. Limited Liability Partnership
  5. Charitable Incorporated Organisation
  6. Community Interest Company

- The **Industrial & Provident Society,** and the **Company Limited by Guarantee** models are the most appropriate for the Councils to consider. Both offer the advantage of achieving the VAT and NNDR benefits.
- For a range of reasons (the *key* ones listed below), the other four models are unlikely to be appropriate for the Councils to consider:
  - ⊗ *Unincorporated NPDO - Trustees will be* ***personally liable*** *for the performance of the trust*
  - ⊗ *Limited Liability Partnership - Does not benefit from VAT or NNDR savings*
  - ⊗ *Charitable Incorporated Organisation - No public record of liabilities and so CIO's will struggle to borrow money. Also, the model is new and untested for leisure and culture services.*
  - ⊗ *Community Interest Company - No VAT benefits and NNDR relief is discretionary only. Also, the assets cannot be transferred back to the Council in the event a CIC fails.*

Setting up a new trust

- So, whether the Councils decide to set up an IPS or a CLG, the charitable trust model it uses is likely to have the follow advantages and disadvantages **compared to an existing established trust:**

Advantages	Disadvantages
More opportunity for community and staff involvement in the management of the business	Greater reliance (at least in the short to medium term) on Council's support services
Management team are more likely to understand the existing business from the outset, the market and demographics of the user catchment	Reliance on a single contract, which is likely to persist in the longer term as it struggles to offer competitive commercial proposals for other contracts compared to the established operators.
Typically closer working relationship with the Council	If the Trust fails it is likely that the Councils will have to step in to support it financially (in the absence of contracts with other local authorities to support the business). The Councils can therefore effectively be held to ransom by the Trust
Focus on a single contract by the management team will avoid distractions from other clients	Weak financial covenant compared to the larger established trusts and it may struggle to raise capital for investment
Closer relationship with local groups, organisations and stakeholders	Effective transfer of risk from the Councils will be limited due to the weakness of a new trust's financial and operating covenant
Offers a political "compromise" or half-way house between in-house and outsourcing	No track record of operating the service without the support of the Council
More responsive to local needs and closer to local strategic partners	A top heavy head office in relation to the bigger, more established trusts. Purchasing power will be weaker and they struggle to offer competitive management fees. They tend to be significantly more expensive than larger trusts.
	No new management expertise or new ideas as management team typically comes from the Council officers
	Fewer opportunities for staff promotion and career development
	Process to set up a new NPDO can be lengthy, complex and expensive, and is more likely to be in this instance due to the involvement of two Councils rather than just one

Setting up a new trust

- In common with any NPDO, the new trust will not be able to distribute any profits or surpluses to shareholders or a third party; instead all surpluses must be reinvested in the direct delivery of the trust's charitable objectives.
- As set out above, the Councils options are realistically limited to a choice of two NPDOs: Industrial and Provident Society (IPS) and a Company Limited by Guarantee (CLG), the characteristics of which are set out below:

Industrial and Provident Societies (IPS)

1. Limited liability, registered under the IPS Act 1965
2. Needs to be a bona-fide cooperative society or for the benefit of the community
3. Regulated by the Financial Conduct Authority
4. If formed for charitable purposes, it will be exempt and enjoy the benefits of other charities despite not needing to register with the Charity Commission (including VAT ad NNDR benefits
5. Each member of the IPS has one vote. This dilutes the control of a local authority

Company Limited by Guarantee (CLG)

1. Legal entity incorporated under the Companies Act 1985
2. It does not issue shares, instead requiring members of the company to contribute a (typically nominal) sum
3. Enjoys VAT and NNDR benefits
4. Regulated by the Charity Commission and subject to the requirements set out in the Companies Act (which allows it to changes its own rules to meet the needs of the business
5. Directors are the Trustees and are responsible for compliance with Charity Commission and Companies Act

A new trust will typically have 10-12 board members and the influence of the Councils is limited to 2 members. In this case, therefore, BDC and RBC would be limited to one board member each. The rest of the board is typically made up from local representatives with their role being to ensure the trust is operating in line with its charitable objectives.

Council control and contract documentation

- Fundamentally, the Council will be able to retain as much control as it needs whether its service is operated by an existing trust or a new one, whilst ensuring that the contract attracts sufficient interest from the market and delivers the Council's target savings. The typical controls retained include:
  - Availability of facilities
  - Scope of services
  - Core prices (for certain activities such as swimming)
  - Protected users / target users
  - Contracted asset management obligations

Key contract documentation

- **Legal Agreement** between the Council and the operator sets out the terms and conditions of the contract, including default and termination provisions
- The **Service Specification** sets out the nature and scope of service to be delivered.
- The responsibilities for asset management (maintain, repair and replace) are agreed at the outset through an **Asset Management Responsibilities Matrix**. The Council typically takes responsibility for the structure of the facilities, latent defects, and any significant items of plant and machinery.
- The standard of service is governed by a **Performance Management System** which sets monthly and annual performance standards that the operator should achieve. If these are not achieved, penalty points are incurred. If penalty points breach an agreed threshold for set periods, the operator will be in default of the agreement and Council can terminate the agreement.

Procurement

- Whether the Councils ultimately choose to pursue the option of setting up their own trust or contracting with an existing operator, it will be important to demonstrate that the recommended option provides best value, and this is only achievable through selecting your operator through a competitive procurement process.
- However, most Councils who have set up their own trusts seem to have chosen to ignore the fairness, openness and transparency that a well-managed competitive procurement process provides. The difficulty here is the obvious conflict of interest a council has in evaluating the responses of third parties when it has already chosen to pursue the option of setting up its own trust (and have committed to the considerable associated set-up costs).
- As part of the detailed management options appraisal, we would suggest that procurement options be considered in consultation with your legal advisors.

Set up costs and timetable

- The lead-in time and set up for each option will depend on the necessary requirements the Councils will need to put in place.
- Procuring a management contract via a competitive tendering process to an existing operator typically takes 12 months and will cost the Councils around £75,000 in advisory fees. This will require the drafting and agreement of a contract, property leases and a specification, and will require the Councils to follow a competitive tendering process to ensure it achieves best value.
- Setting a new trust could take around 18 months and could cost up to £200,000 in legal, procurement and accounting advisory fees. This could be significantly reduced depending on the complexity of negotiations; however, given that there will be two Councils involved in the set up, it is likely that this will bring with it complexities that may introduce additional costs and require more time to deal with. The longer lead-in time is typically necessary for the creation of a new legal entity with the Charity Commission as well as the recruitment of senior management staff and trustees, drafting of company documents, logos, procuring of business support systems, and setting up a head office.
- The fees set out here really are just guidelines and whether the Councils decide to use their own legal services to procure the contract or whether it uses external advisors at all. Where the Councils use their own legal resource, the costs could reduce by around £50,000 in setting up their own trust.

Legal implications

TUPE and Pensions

- Under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (referred to as TUPE), the rights of existing employees transferred from one employer to another are protected, allowing them to retain the same terms and conditions with continuity of employment.
- New employers are therefore obliged to provide a broadly comparable pension scheme for existing employees. This is either through their own pension scheme, or via the existing Local Government Pension Scheme, which the new employer can join as an admitted body.
- The Council can specify whether the pension scheme is to be open or closed to future new employees.

Property leases

- Typically, the Council's assets will be transferred from the Council to the new operator under a lease agreement, granting them exclusive use of the facility to carry out their contracted services. The lease will co-terminate with the management contract.

4. Financial implications

Current cost of the service

- For the purposes of showing the potential financial implications of outsourcing the portfolio, we have used 2013/14 budget data as a base. This is due to the relative completeness of this data set, compared to 2013/14 actual performance and the 2014/15 budget.
- The 2014/15 budgeted cost of the package of facilities and services we recommend be outsourced together is set out below. The detail behind this is attached as Appendix 1.

	Redditch		Bromsgrove		Total	
2013/14 Budget total	£1,805,589		£1,210,644		£3,016,233	
VATable income (Council operation)	(£2,015,911)	78%	(£72,079)	45%	(£2,087,990)	76%
VAT exempt income	(£564,265)	22%	(£89,288)	55%	(£653,553)	24%
Income	(£2,580,176)		(£161,367)		(£2,741,543)	
Expenditure						
Service recharges	£47,558		£0		£47,558	
Staffing Costs	£2,176,613		£193,345		£2,369,958	
Utilities	£239,045		£0		£239,045	
Water	£91,349		£0		£91,349	
NNDR	£235,422		£29,193		£264,615	
Premises	£405,217		£20,000		£425,217	
Transport	£7,263		£0		£7,263	
Supplies & services	£746,698		£328,181		£1,074,879	
Dolphin Management Fee	£0		£370,650		£370,650	
Insurances & Licences	£42,165		£4,405		£46,570	
Cost of sales	£10,751		£0		£10,751	
Support services	£383,684		£426,238		£809,922	
	£1,805,589		£1,210,644		£3,016,233	

Trust option – VAT and NNDR

VAT benefits

- A Trust will be able to benefit from VAT savings on income, whereas a Council-operated facility's prices will be subject to VAT. So, for example, if the current price of a health and fitness membership at the Council-operated Abbey Stadium is £26 including VAT, the cost is made up of £21.66 + £4.33 (20% VAT). If the delivery of the service is transferred to a trust, it allows the total price of £26 to remain the same but all of it can be taken as income as it becomes VAT exempt. This additional income benefit converts to a better bottom line which the Council benefits from through a better management fee.
- Conversely, as a general rule a Council can claim back VAT on the costs of providing its services relative to the VAT it charges for its services. Our calculations indicate that the Councils currently charge VAT on 76% on its income. It can therefore claim back 24% (100% minus 76%) of the VAT paid in delivering those services. We have calculated that a Trust will charge VAT on 88% of its operational income and will therefore only be able to claim back 12% (100%-88%) of the VAT it pays in delivering its services. However, this proportion increases if the Trust charges a VAT-able management fee to the Council. Assuming this is around £2m, the exempt income percentage reducing to 46%, allowing the trust to claim back 54% (100%-46%) of the VAT on its input costs.
- Overlaying these assumptions to the financial modelling indicates a VAT benefit of £103,889 under a trust scenario, as set out in the table below.
- As this is such a complex and specialist area, we would recommend as part of the next stage that a VAT specialist undertakes a full review on the basis of the latest actual trading figures.
- Clearly, if a trust cannot claim back VAT on its capital expenditure to the same degree as a Council, it can have significant implications for the affordability of capital schemes. For this reason, it is usually sensible for Councils to fund any significant capital expenditure and benefit through the resulting improved management fee

VAT Calculations – Trust Scenario	
Taxable income	(£366,442)
Exempt income	(£2,730,060)
Total income	(£3,096,502)
Exempt percentage	88%
Irrecoverable VAT	£413,233
VAT benefit on income	(£354,958)
Net VAT (benefit) / cost	£58,275

Assuming VAT-able management fee charged to Council	
VATable Management Fee	(£2,000,000)
Taxable income	(£366,442)
Exempt income	(£2,730,060)
Total income	(£5,096,502)
Exempt percentage	46.4%
Irrecoverable VAT	£251,070
VAT benefit on income	(£354,958)
Net VAT (benefit) / cost	**(£103,889)**

Trust option – VAT and NNDR

VAT and management fee

- It is important to point out that only a contracted management fee attracts VAT. A grant payment is not subject to VAT and therefore will not confer the major advantage of enabling the grant recipient to increase the amount of VATable outputs and thereby increase its VAT recovery on inputs. In this case, the advantage of a contracted VAT-able management fee is around £200,000.
- Combined with the clear disadvantage to a trust of the lack of visibility of a grant – it is by definition not a clear contracted payment – we see no rationale for structuring the payment to the trust as such.

National Non Domestic Rates (NNDR)

- NNDR (or business rates) is a tax on non-domestic properties such as leisure centres, community centres, theatres, cafes and shops.
- Under the Local Government Act (1988) certain organisations are entitled to mandatory or discretionary relief from NNDR payment. Setting the level of discretionary relief – and the rules under which it can be claimed - is at the discretion of local authorities considered on a case by case basis.
- If a building is used wholly of mainly for charitable purposes, the building will receive 80% mandatory relief and up to 20% of discretionary relief In 2013, new NNDR legislation was introduced which effectively meant that any relief is funded 50%/50% between local and central government.
- In our modelling we have assumed that a trust will be able to secure 80% rate relief on the current NNDR costs, half of which will be funded by the Council. The current NNDR liability under Council operation is £264,615 per annum. This will reduce to £52,923 (80% relief, or a £211,692 saving) under a trust operation. However, as the Council will be funding half of the value of this relief, the ultimate net benefit to the Council will be £105,846 (50% of £211,692).

Financial modelling

- In creating a financial model to show the likely impact of outsourcing the portfolio to a trust (which looks at the option of creating a New Trust as well as contracting with an Established Trust) we have used the 2013/14 in-house budget cost as a basis for both.
- We have applied to both scenarios the "Year 0" benefits of the VAT and NNDR savings. Going forward, we have looked over a 10-year contract horizon and applied the likely reasonable assumptions that each is likely to commit to in pricing its contractual management fee.
- In order to show a management fee that is directly comparable to the current cost on a like for like basis we have made the following assumptions:

  1. Support services are shown "above the line" in the trust business plan. In reality, of course, these will not be incurred by the trust but will remain with the Council. However, generally speaking, as a new trust would typically be more reliant on the Council's support services going forward, there will probably be less scope to reduce the scale of these in-house costs when compared to an established trust (which will be typically entirely reliant on its own head office for HR, finance, legal and IT resources.
  2. We have used the 2013/14 budgeted management fee for the Dolphin Leisure centre. Although this is planned to be demolished and replaced, potentially at a nil ongoing operating cost, to model this could confuse the analysis and overstate the savings achievable by outsourcing compared to remaining in-house.
  3. 10 year contract term (although these have been historically longer for new trusts created out of Councils, we have used 10 years to allow for a like for like comparison to be made between the options).
  4. 5% profit . An operator will seek to make a profit out of each contract it secures. 5% seems to be the current market rate. This allows some headroom for any adverse performance or any unexpected changes in income or costs. Over and above this, operators will factor in a charge to cover central overheads (typically this is between 5% - 7.5% currently).

5. Options evaluation

Proposed evaluation criteria

PROPOSED EVALUATION MATRIX

RAW SCORES

		Evaluation Scores (max raw score 3)		
	Weighting	In-house	Existing Trust	New Trust
1 Level of Council influence	10.0%	3	1	2
2 Ability to transfer/manage risk	15.0%	0	3	2
3 Strength of financial covenant	15.0%	1	3	2
4 Potential for initial savings (NNDR and VAT)	12.5%	0	3	3
5 Potential for sustainable operational savings	15.0%	1	3	2
6 Flexibility for future asset strategy and adding add'l services	10.0%	3	1	2
7 Improvement in service delivery	12.5%	0	3	1
8 Scope for community partner involvement	5.0%	3	1	2
9 Scope for reinvesting surplus in service	5.0%	0	1	3

WEIGHTED SCORES

		Evaluation Scores (weighted)		
	Weighting	In-house	Existing Trust	New Trust
1 Level of Council influence	10.0%	10.0%	3.3%	6.7%
2 Ability to transfer/manage risk	15.0%	0.0%	15.0%	10.0%
3 Strength of financial covenant	15.0%	5.0%	15.0%	10.0%
4 Potential for initial savings (NNDR and VAT)	12.5%	0.0%	12.5%	12.5%
5 Potential for sustainable operational savings	15.0%	5.0%	15.0%	10.0%
6 Flexibility for future asset strategy and adding add'l services	10.0%	10.0%	3.3%	6.7%
7 Improvement in service delivery	12.5%	0.0%	12.5%	4.2%
8 Scope for community partner involvement	5.0%	5.0%	1.7%	3.3%
9 Scope for reinvesting surplus in service	5.0%	0.0%	1.7%	5.0%
Total score	100.0%	**35.0%**	**80.0%**	**68.3%**

9. Recommendations & Next Steps

Recommendations and Next Steps

- This report recommends that the scope of the facilities and services to be outsourced forms a coherent strategic package and one which an operator is most likely to be in a position to deliver best value to the Councils through a combination of service improvements and contracted savings.
- With best value as the primary objective, we would recommend *excluding* the management of the Council House, parks and open spaces (including cafes), public conveniences and the allotments. Including them in the package is likely to reduce the attraction of overall contract, thereby limiting competition. Whilst a single entity such as a newly established trust could operate these facilities, there seems to be no operational or strategic rationale for doing so.
- The financial modelling undertaken as part of this review indicates that average annual savings of over £780,000 could be secured if the package was competitively tendered to an existing established trust. This compares to just over £430,000 for a newly created trust.
- In reality, these savings could be greater once the replacement for the Dolphin Centre is factored in, and a more detailed understanding is achieved of what is included in some of the – significant – cost categories such as staffing, supplies and services, and property.
- On the basis of the technical and commercial evaluation criteria used within this appraisal, The Sports Consultancy would recommend the Councils pursuing the option of outsourcing the management of the portfolio to an existing trust rather than set up a new trust.
- Further scrutiny of the options should be undertaken, particularly to validate the VAT assumptions and analysis which we would recommend be overlaid on the 2013/14 actual performance, rather than the budget.
- Furthermore, regardless of which option the Councils ultimately choose to pursue, the scope for making future savings in support services should be explored further.