

<b>Cabinet Report</b>	<b>5</b>	
Date:	<b>21 October 2020</b>	
Report Title:	<b>Freedom Leisure Covid-19 impact: further ongoing support requested to maintain the business and contract</b>	

## 1. Summary

For Cabinet to consider a further request for financial assistance from Freedom Leisure in line with the Council's leisure contract.

## 2 Key Issues

- 2.1 In December 2018 Freedom Leisure, a charitable trust, took over the operation and management of the Council's four leisure centres with a 15-year agreement.
- 2.2 This arrangement, after Hudson Leisure Centre capital costs and gym equipment replacement costs, has saved FDC £351,000 p.a. Additionally, a staff review of contract management staff as a result of the new Freedom contract added £49,000 p.a to the annual savings, equating to a total of £5.6 million of savings over the life of the contract.
- 2.3 The first 15 months of the contract proceeded better than either partner, the former FDC staff in the centres and leisure centre customers could have hoped for. Customer feedback, as well as customer and income growth, demonstrates that Freedom has been doing a very good job on the Council's behalf.
- 2.4 As with any business, Freedom is dependent on income and cash flow to manage the business. As a large organisation, they have capacity to absorb market conditions and respond in a more agile manner than a Council might. The business is, however, dependent on income from paying customers therefore following the significant impact of Covid 19, the Council has provided a series of support packages in line with the Council's leisure contract

### Phase I Support – lockdown and leisure centre closure:

- 2.5 Following the change in law and the necessity to close leisure centres on 23 March, all income to Freedom became negligible. The contract between the Council and Freedom Leisure required that FDC supported Freedom financially in these types of situation and therefore the Leader agreed on behalf of Cabinet an initial support package on 1 May 2020 to fund costs that could not be further mitigated whilst the centres were closed and deferral of the management fee that Freedom usually pays to FDC on a monthly basis. The management fee is to be repaid in years 5-15 of the contract.
- 2.6 The Phase I support package (April-June 2020) consisted of:

Deferred Management Fees	£112,680
Cash support (paid)	£164,988
<b>Total:</b>	<b>£277,668</b>
- 2.7 On 24 July Government changed the law allowing leisure centres to reopen. Facilities have been run in a Covid Secure manner, following Government and industry advice with strict cleansing and social distancing requirements in place. These measures

meant a reduced customer experience when visiting the facilities as well as a significant reduction in capacity of all facilities.

- 2.8 In Fenland, due to reduced demand, costs have been kept low by reducing opening hours. On 5 October opening hours were extended, but still do not match pre-Covid levels.
- 2.9 UKActive, the leisure trade body, developed a report published 28 May 2020 modelling expected attendance levels following opening. Their predictions were between 35% and 40% reduction on 2019 levels, with a rapid recovery to just below 2019 levels when social distancing is lifted.
- 2.10 On 29 June Cabinet agreed a [support package for July – September 2020](#) consisting of;
- |   |                 |
|---|-----------------|
| Deferred management fees payable to FDC;  | £112,680        |
| Financial support; an interest free loan up to the value of<br>(still to be paid, awaiting reconciliation with actual costs and income) | £200,000        |
| <b>Total:</b>   | <b>£312,680</b> |
- Total Phase I and Phase II support: £590,348**

### Government Support

- 2.11 The Council has received two payments totalling £1.1m from Government to support costs due to Covid 19.
- 2.12 Additionally, Government has set up an Income Compensation Scheme for Councils. FDC has claimed £91,350 for April to July 2020 under this scheme for a proportion of the management fee losses experienced from Freedom. The expected total claim to this scheme relating to lost management fee revenue payable by Freedom Leisure by the end of the financial year will be **£322,763**.

### Expected Phase III support requirements; October 2020 – March 2021

- 2.13 Leisure centres in Fenland are open with paying customers attending. Revenue is, as expected, about 30% – 40% lower than 2019 levels. It appears that income has plateaued at this level. Increased opening hours from 5 October are expected to increase revenue but have a negligible effect on the bottom line due to corresponding costs. However, this approach will help the business retain customers in the short term. Business growth will only be back to 2019 levels **when social distancing measures are lifted**, potentially in Q2 or Q3 of 2021.
- 2.14 Indications from Government are that social distancing will remain in place until March 2021. This being the case there will be no income recovery back to 2019 levels until after that date and, as anticipated, a further support package is required for Freedom Leisure.
- 2.15 The Job Retention Scheme ends in October, replaced with a Job Support Scheme (JSS). Early indications from Freedom are that the JSS may be applicable to the business, but the costs of using it may not be beneficial in all cases. Freedom may need to consider a combination of approaches in the coming months to ensure that the business remains viable.
- 2.16 Within the Fenland contract, Freedom provided an Active Communities offer. Given the financial context, it was felt more important to focus on the core leisure centre business and not incur additional costs. This means the Fenland contract no longer has an active communities officer, however this can be reviewed once the business is back to a pre-Covid position. Fortunately, FDC has a successful, community focussed Active Fenland

team carrying out this sort of work getting people across Fenland more active and healthy.

- 2.17 This situation means that there will remain a significant financial gap within the Freedom contract. Without the Council's continued financial support, the contract between Freedom Leisure and Fenland District Council is unlikely to remain viable and the Council would need to explore alternative options to deliver leisure services, all of which have their own financial challenges.
- 2.18 The Phase III support package contained within this report is for October 2020 – March 2021. The support package can be provided within the terms of the Contract and should not give rise to concerns under The Public Contracts Regulations or in breach of the general prohibition against State Aid.
- 2.19 It should be noted that recovery back to previous income levels will only occur AFTER the removal of social distancing measures. If such measures continue to be left in place, further financial support for Freedom Leisure should be anticipated in financial year 2021 / 2022.
- 2.20 The Council has been proactively lobbying the government through the LGA, District Council Network, District Council Treasurers, and local MP Stephen Barclay to highlight the financial difficulty that the leisure sector is facing and the financial impact on Councils to support their local facilities. FDC's understanding is that the Department for Culture, Media and Sport continues to consider proposals to put to Treasury and MHCLG regarding potential future funding to Local Authorities, in addition to the £1.1 million coronavirus support already received by FDC.
- 2.21 Fenland has a contract with Freedom Leisure that is in the second full year of a 15-year contract. The significant efficiencies and savings that the contract has allowed FDC are expected to return during its term, with the lifting of social distancing requirements.

### 3 Recommendations

#### It is recommended that:

- 3.1 Fenland District Council ("FDC") provides the financial relief to Freedom Leisure set out in these recommendations.
- 3.2 FDC defers the monthly management fee of £37,560 per month for October 2020 – March 2021, at a cost to the Council of £225,360, repayable in accordance with the terms set out at paragraph 3.6 of these recommendations and noting some of these monies are recoverable through the Government's Income Compensation Scheme for Councils .
- 3.3 FDC continues to support Freedom Leisure on an open book basis by providing them with an interest free loan payable monthly up to the amounts set out below and repayable in accordance with the terms set out at paragraph 3.6:

<b>Total cash support:</b>	<b>£284,748</b>
<b>Deferred management fees:</b>	<b><u>£225,360</u></b> (para 3.2)
<b>Total Phase III support:</b>	<b>£510,108</b>
<b>Total Phase I &amp; II support:</b>	<b>£590,348</b> (para 2.10)
<b>Less Income compensation support</b>	<b><u>(£322,763)</u></b> (para 2.12)

**Total proposed Freedom Leisure cost to FDC in 2020/21: £777,693**

- 3.4 These costs are an estimate based on the information available at the time of despatch. The new Job Support Scheme's applicability or possible impact is not factored into these costs. Additionally, UKActive is putting together another report on the current state of the leisure industry. This report is expected to give further information regarding expected recovery profiles in the coming 6 months.
- 3.5 Repayment of the £510,108 described in paragraphs 3.2 and 3.3 of these recommendations shall become payable through an annual deduction of 75% of any profit generated in excess of the levels predicted in the LOBTA (Leisure Operators Base Trading Account). This is a change from the current 50/50 profit share and will be subject to the performance of the business over the contract period.
- 3.6 The Monitoring Officer and s.151 Officer are authorised to put in place all necessary arrangements to give effect to the agreed recommendations to include entry into the necessary legal arrangements and expenditure of the amounts described from existing budget provisions.

Wards Affected	All Wards
Portfolio Holders	Cllr Chris Boden, Leader of the Council and Portfolio Holder for Finance Cllr Sam Clark, Portfolio Holder for Leisure
Report Originators	Phil Hughes, Head of Leisure Services Carol Pilson, Corporate Director Peter Catchpole, Corporate Director Amy Brown, Chief Solicitor
Contact Officers	Paul Medd, Chief Executive <a href="mailto:paulmedd@fenland.gov.uk">paulmedd@fenland.gov.uk</a> Carol Pilson, Corporate Director <a href="mailto:cpilson@fenland.gov.uk">cpilson@fenland.gov.uk</a> Peter Catchpole, Corporate Director and Section 151 Officer <a href="mailto:petercatchpole@fenland.gov.uk">petercatchpole@fenland.gov.uk</a> Phil Hughes, Head of Leisure Services <a href="mailto:phughes@fenland.gov.uk">phughes@fenland.gov.uk</a> Amy Brown, Chief Solicitor <a href="mailto:abrown@fenland.gov.uk">abrown@fenland.gov.uk</a>

Background Papers	<p>Urgent Decision Notice and Supporting Documents 1/5/20</p> <p>Cabinet Report June 2020</p> <p>Cabinet Office; Procurement Policy Note – Recovery and Transition from COVID-19. June 2020</p> <p>UK Active Covid Impact Report June 2020</p> <p>Freedom Specific customer information from UK Active Survey</p> <p>September 2020 Freedom Leisure letter to FDC regarding financial outlook</p> <p>Confidential: Freedom Leisure modelled income and expenditure</p> <p>Confidential: LOBTA - Leisure Operators Base Trading Account</p>
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#### **4 Pre-Covid Financial Summary**

- 4.1 Expected income for 2020/21 for the Fenland leisure centre contract was budgeted at approximately £3.5m - an average of just under £300,000 per month. Staffing costs are around £149,000 per month.
- 4.2 Freedom Leisure pays the Council a management fee of £450,717 p.a. (£37,560 per month).
- 4.3 Savings from Freedom's operation and management of the leisure centres are approximately £400,000 p.a. with 14 years left of the contract to run this equates to £5.6m in savings for FDC over that period, when compared with the previous in-house management and delivery costs.

#### **5 Key Issues; Covid19 Business Impact**

- 5.1 The impact of Covid19 on the leisure sector was profound and immediate. Customers were unable to attend due to the change in law. Freedom furloughed most staff. Income during closure was negligible.
- 5.2 Independent leisure operators have written to clients requesting support. Across the District Council's Network approximately £305m was required by Councils to support leisure service Covid costs up to October 2020. Sport England is reporting a deficit in excess of £1bn across the sport and physical activity sector. Of Freedom's 20 Council clients, all have supported the business in Phase I (closure) and Phase II (reopening) of the Covid crisis in broadly a consistent manner.
- 5.3 FDC's contract with Freedom includes a change of law clause stating that in the event of a change in law, Freedom should be in a position that is no better and no worse as a result of such a change. Government guidance forms part of this contract clause, meaning that FDC is obliged by the contract to provide Phase III support during the Coronavirus crisis.
- 5.4 It was anticipated that further financial support may be required following the initial reopening period of leisure centres. Once income levels are back to original contracted levels or legal restrictions on business operations are lifted, the Council would then expect to see the management fee back to its original contracted level. Unfortunately,

these restrictions on business operations (Covid Secure ways of working and social distancing) have not been lifted and it is likely they will remain in place for the next 6 months.

- 5.5 It is proposed that the Phase III financial support package between Freedom and the Council is structured as a long-term loan unless and until the current contract is varied so that;
- When income performance levels reach those agreed in the original LOBTA, profit generated above the LOBTA level will then be shared 25:75, with the Council receiving the larger share as the loan repayment of Phase II support monies (including deferred management fees) and the deferred management fees from Phase I.
  - Should the support payments loan (including deferred management fees) be settled prior to the end of the contract, the contract shall revert to the original profit share mechanism.
- 5.6 It should be noted that the Council is keen to regain the financial support identified in this report using this mechanism. However, the Council recognises that repayment levels are uncertain due to the nature of future income levels, determined by customer demand and due to the fact that the profit share only applies after the contracted profit has been taken by Freedom.

## **6 Options and Risks**

- 6.1 Members agreed prior to the outsourcing process that they wished leisure centres to continue to run in each town.
- 6.2 Freedom is providing the service of managing the leisure centres on Fenland's behalf, but this arrangement it is very much a partnership. Whilst Freedom Leisure is an expert in this field, it is important for both organisations to work collaboratively to achieve the common objective of reinstating and continuing to improve leisure services.
- 6.3 If Freedom fails, then FDC's short term costs will increase by at least £500,000 p.a. and FDC would be taking back the health and safety risk, staff management, accountancy and payroll functions, administrative functions and human resources of over 100 staff. Staff restructures took place in back office teams to reflect leisure being outsourced. These additional costs would have to be added back into the FDC budget to support any in-house change. It will not be possible to find an alternative provider of the Service at short notice.
- 6.4 Should Freedom fail, FDC will not realise the £500,000 per annum of savings over the outstanding period (14 years) of the contract. FDC's current MTFS highlights the requirement to find £1.1m in savings by 2024/25 as well as consideration of the added uncertainty of Covid 19, fairer funding, new homes bonus and business rates retention. If the Freedom contract ceases and Members decide to continue to deliver the current level of leisure service provision to the community, bringing the service in-house will add an additional revenue cost of around £500,000 per annum to the Council.
- 6.5 Further to paragraph 6.4, should Freedom fail and the planned savings of the Freedom contract are not possible, the Council may need to reconsider the strategic approach to leisure centre provision in Fenland. Such a review may mean that the current level of provision across the four towns would need to be re-visited, reflecting the financial challenges.
- 6.6 Fenland District Council is one of 20 Councils who have a contract with Freedom Leisure. Financial relief packages have been agreed with each of the 20 Councils for varying periods of time and values commensurate with the value and length of the

respective contracts. Similarly to FDC, each other Council is also keeping the circumstances of support under review and to an extent, the success of any individual Council's contribution is contingent upon the support being given by others. This remains a potential risk factor, with Officers monitoring the situation.

- 6.7 Freedom has taken £2.8m income across all sites nationwide since reopening at the end of July. The budgeted expectation prior to Covid was £6.8m. Income across the organisation is at 41% of budget levels.
- 6.8 FDC has recently received a letter from the Freedom Leisure MD and this is appended in the Appendix. This letter further highlights the uncertainty in the leisure industry, given the ongoing restrictions expected to remain in place for the next 6 months.
- 6.9 Due to the unprecedented nature of the current situation and the overall fragility of the industry at this stage in recovery process, the Council faces inevitable risks whatever decision it takes.

### **Contractual Options Appraisal:**

- 6.10 If FDC withdraws its support to Freedom it will be in breach of contract entitling Freedom to give notice and claim any associated penalties. In addition, FDC will face the financial costs of the service brought back in house or retendered.
- 6.11 If FDC itself serves notice under the contract there would again be financial implications associated with assuming responsibility for the service or retendering, together with a penalty of up to 12 months loss of opportunity payable to Freedom.
- 6.12 If the Council attempts to negotiate a reduction in the currently proposed relief package such that only partial support is provided, it will impact on the services that can be delivered and would therefore put Freedom in a disadvantageous position in terms of re-establishing its competitive position in the market and ultimately the level of profit required to offset the payments made.
- 6.13 If the Council provides the relief package on the terms identified, due diligence suggests that this will put Freedom in the best possible business position to recover over the coming year. Nevertheless, it is acknowledged that there remains a possibility that trends will not evolve as expected which could result in a requirement to remodel the proposed operational model and / or ultimately to revisit the relief package. Of all the options however, this is the one which provides Freedom and the Council with the best opportunity to work towards the realisation of the originally predicted savings and programme of improvements originally planned for the benefit of our community.
- 6.14 In conclusion, whilst we remain in a position of uncertainty, a further relief package will provide an opportunity to maintain the status quo until more informed decisions can be made about the future of the leisure industry following the relaxation of the restrictions and as people adjust to the new normal. Whilst it is recognised that the recommendations have a significant budgetary impact, every effort will be made to recoup the costs through government funding and as part of the proposed amendments to the contract by way of loan repayments. It also avoids the wider implications of taking the leisure centre service back in house where the effect would be evident not only in budgetary terms but also potentially in relation to the level of service that could be provided.

### **Financial Assessment**

- 6.15 Factors taken into account with the 6-month financial forecast:

- Since Freedom originally produced estimates in May 2020 there have been some significant changes which have impacted the figures including:
- Facilities being allowed by Government to reopen from 25th July and not 4th July. This has delayed the performance of the facilities by 1 month meaning the Phase II support is out of sync by a month.
- A 50% membership discount was offered in the first full month of operation (August) to reward members loyalty and to encourage retention for the rest of 2020-21
- Changes to social distancing rules and guidelines relating to indoor sports, catering etc, and confirmation of the UK Active COVID secure measures including additional cleaning, signage etc. This has impacted on the projected, modelled UKActive recovery profile.
- The announcement by the Prime Minister on 22 September, outlining that restrictions may be in place for 6 more months. This may affect customer and member confidence to return to the facilities.
- Freedom has experienced less income than predicted from casual income, catering and retail. This is a common theme across all Freedom contracts. Predictions from September are based on the actual casual income data from August.
- October is the last month of the Job Retention Scheme (JRS / furlough) scheme, so staffing costs will rise from this point. The replacement of the JRS with the Job Support Scheme (JSS) is less generous. Freedom is currently assessing if the business qualifies for the JSS and what the financial and practical implications are.
- October direct debit income is slightly lower than September's income. Leisure Centre income levels have plateaued with no significant increase expected in the remainder of the financial year.
- No lift in social distancing restrictions are considered within the timeframe for this report

6.16 The assumptions above and the previously expected performance of the contract has allowed the modelling of costs and income. FDC has reviewed Freedom's expected costs and cost assumptions and considers that the table below is a realistic financial model based on information available. Depreciation has been removed from this modelling.

6.17 The impact of the modelling on the expected budget for the Fenland contract is as follows:

	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21	Total
	Estimate	Estimate	Estimate	Estimate	Estimate	Estimate	
<b>TOTAL INCOME</b>	<b>140,138</b>	<b>144,736</b>	<b>139,070</b>	<b>163,220</b>	<b>171,391</b>	<b>174,689</b>	<b>933,244</b>
<b>TOTAL COST</b>	<b>155,135</b>	<b>174,376</b>	<b>172,883</b>	<b>182,360</b>	<b>181,511</b>	<b>183,104</b>	<b>1,049,369</b>
<b>SURPLUS/(DEFICIT)</b>	<b>- 14,996</b>	<b>- 29,641</b>	<b>- 33,814</b>	<b>- 19,139</b>	<b>- 10,120</b>	<b>- 8,415</b>	<b>- 116,125</b>
<b>Normal operation</b>	<b>27,714</b>	<b>18,770</b>	<b>1,188</b>	<b>35,717</b>	<b>42,516</b>	<b>42,717</b>	<b>168,622</b>
<b>Variation to normal</b>	<b>- 42,711</b>	<b>- 48,411</b>	<b>- 35,002</b>	<b>- 54,856</b>	<b>- 52,636</b>	<b>- 51,132</b>	<b>- 284,748</b>

6.18 It should be understood that this information is based on modelling of future income and costs, based on September performance, with October direct debit information also

considered. It is the best information on which we have to base estimates. Cabinet should be aware that there is a risk that these costs could be higher than anticipated.

- 6.19 FDC has an ambition to recover this Phase III support loan by entering into a variation to the original agreement as described in the recommendations. It should be noted that the Council is ambitious to regain the financial support identified in this report using this mechanism, but repayment is uncertain due to the uncertainty surrounding future income levels and customer demand.
- 6.20 Recent announcements by the Prime Minister have set out a 3 tier response for local areas. Those areas in Tier 3, Very High, namely the Liverpool City region at present have agreed locally to shut leisure facilities. If rates of infection in Fenland reach similar levels it is a possibility these same provisions may apply and Freedom leisure facilities will be required to close again.

## 7 Appendix – Freedom’s market expectations



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