

Cabinet Report	7	
Date:	23 February 2021	
Report Title:	Freedom Leisure Covid-19 impact: further ongoing support requested to maintain the business and contract	

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 as summary of which is set out at 2.17.

Phase I Support – March 2020 lockdown and leisure centre closure:

- 2.5 Following the change in law and the necessity to close leisure centres on 23 March 2020, 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
Total:	£277,668

Phase II support – reopening following lockdown

- 2.7 On 24 July 2020 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 2020 opening hours were extended, but still do not match pre-Covid levels.
- 2.9 On 29 June 2020 Cabinet agreed a **Phase II** [support package for July – September 2020](#) consisting of;
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|--|------------------------|
| Deferred management fees payable to FDC: | £112,680 |
| Financial support; an interest free relief payment on terms set out at 3.4 up to the value of: | <u>£200,000</u> |
| Total: | <u>£312,680</u> |

Phase III support; October 2020 – March 2021

- 2.10 On 21 October 2020 Cabinet considered and agreed a third phase of support for Freedom. This package again deferred the management fees due, as well as providing financial support to match the expected leisure operators business trading account from the contract between FDC and Freedom Leisure;
- | | |
|--|------------------------|
| Financial support: an interest free relief payment on terms set out at 3.4 up to the value of: | £284,748 |
| Deferred management fees: | <u>£225,360</u> |
| Total Phase III support (6 months) | <u>£510,108</u> |
- 2.11 Since the Phase III support agreement there have been significant changes across the UK as a result of the second Covid-19 surge. Fenland was fortunate to sit in a low tier until Christmas, meaning that Freedom could continue to operate the facilities on behalf of the Council safely. Unfortunately, however, since Boxing Day all leisure facilities in the District have been closed due to the National Lockdown.
- 2.12 The closure and the continued Job Retention Scheme has meant that costs for the facilities are relatively fixed – albeit higher than the initial lockdown (due to seasonal heating costs) - and are expected to exceed the support levels agreed in October by Cabinet by approximately £41,000. This change in circumstances has increased FDC's costs by 14% of this period.

Government Support

- 2.13 The Council has received four payments totalling £1.8m from Government to support all costs incurred due to Covid 19.
- 2.14 Additionally, Government has set up an Income Compensation Scheme for Councils. FDC is able to claim under this scheme for a proportion of the income losses related to the Freedom Leisure management fee. 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**. This equates to 71.6% of what we expected to receive in this financial year.

- 2.15 Government has also set up the National Leisure Recovery Fund (NLRF) that is accessible to Councils whose leisure services are provided by a third party – in the manner that Freedom does for FDC.
- 2.16 The notional amount that FDC has been offered for this scheme is £210,000. FDC has completed the application in the sum of **£221,000**, being a sum calculated by MHCLG’s spreadsheet as a realistic and sustainable grant required for the period December 2020 to March 2021. FDC awaits the results of the grant application.
- 2.17 Total support agreed by Cabinet for Freedom for financial year 2020/21 consists of:
- | | |
|---|------------------------|
| Phase I support | £277,668 |
| Phase II support | £312,680 |
| Phase III support | £510,108 |
| Less: | |
| Income support grant (confirmed) | (£322,763) |
| NLRF grant (application in progress) | <u>(£221,000)</u> |
| Total support in place for 2020 / 21: | <u>£556,693</u> |

The £556,693 is repayable by Freedom once the terms at 3.4 have been reached.

Note: Due to the NLRF Grant this sum is now lower than the annual expectation agreed by Cabinet in October 2020. This should be considered in the context of the NLRF grant being in the application phase, with funding unsecured at this point.

2020 / 2021 Financial Reconciliation

- 2.18 As we approach year end, a full reconciliation of the costs of supporting Freedom are becoming clearer. Freedom runs about 2 months behind when reconciling their accounts. However, given that costs for February and March are relatively fixed (i.e. costs are fixed and income is near zero due to closure), the Council and Freedom are working together to reconcile the year as a whole. This information will be presented to the Portfolio Holder for Finance and Portfolio Holder for Leisure , highlighting the full year’s impact of the pandemic on the service when compared with the original Leisure Operators Base Trading Account for this current year, and reported in future Cabinet reports as necessary

Phase IV Support: April – June 2021

- 2.19 The current lockdown situation and the lack of any knowledge regarding the outcome of the lockdown and when facilities may reopen and even what reopening may look like, means that our estimates for support for Freedom in April – June 2021 should be considered as ‘best guess’ estimates at this time. No work has been carried out nationally regarding the consequences of the third national lockdown on the leisure sector. Indeed, the NLRF scheme was based on supporting the leisure sector in December – March 2021 and had to go ahead without consideration of the lockdown due to the format of the scheme being implemented in mid-December.
- 2.20 It should be further highlighted that the usual boom and post-Christmas rush for leisure and fitness has passed, and with it the opportunity to gain new members.
- 2.21 Cabinet is asked to view the projected financial support for April – June 2021 with caution. Officers will work with Freedom to review the situation on a regular basis,

usually 6 - 8 weeks in arrears and should material financial issues arise, consultation will take place with the Portfolio Holders for Finance and Leisure.

Expected Phase IV support requirements

2.22 Income levels will remain low in this period, although the overall impact of the lockdown is unknown. The Council is certain that Freedom will be unable to pay a management fee, so once more these fees will require deferment.

2.23 Financial support is likely to be in the region of the requirements of Phase II support, given the season. Freedom has estimated the support funding required at £169,690. However, given the degree of uncertainty, it would be prudent to allow the Phase II figure of up to £200,000 to be agreed, with an open book approach in order that FDC pays only what is necessary in our legal agreement with Freedom. This is summarised as follows:

Deferred management fees payable to FDC;	£112,680
Financial support; an interest free loan up to the value of	£200,000
Total:	£312,680

2.24 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.

2.25 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 Phase IV financial relief to Freedom Leisure set out in these recommendations.
- 3.2 FDC defers the monthly management fee of £37,560 per month for April 2021 – June 2021, at a cost to the Council of £112,680, repayable in accordance with the terms set out at paragraph 4 of these recommendations and noting some of these monies may be recoverable through the Government's Income Compensation Scheme for Councils, should this scheme continue in 2021/22.
- 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 3.4:

An interest free loan up to the value of:	£200,000
Deferred management fees:	<u>£112,680</u>
Total Phase IV support:	£312,680

These costs are an estimate based on the information available at the time of despatch.

- 3.4 Repayment of the £312,680 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.

- 3.5 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
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Background Papers	2020 Cabinet Reports NLRf application pack Confidential: Freedom Leisure modelled income and expenditure Confidential: LOBTA - Leisure Operators Base Trading Account

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 has been 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 21 Council clients, all have supported the business in Phase I (closure) and Phase II (reopening) of the Covid crisis in broadly a consistent manner, and this has continued in Phases III and IV.
- 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 IV 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 IV 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 21 Councils who have a contract with Freedom Leisure. Financial relief packages have been agreed with each of the 21 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, however Freedom have confirmed that all 21 contractors continue to support them financially.
- 6.7 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:

- 6.8 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.
- 6.9 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.

- 6.10 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.
- 6.11 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.
- 6.12 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.