

<b>Cabinet Report</b>	<b>Agenda item 11</b>	
Date:	<b>15 July 2021</b>	
Report Title:	<b>Freedom Leisure - Covid-19 impact and Fenland District Council Support</b>	

## 1 Summary

For Cabinet to review the support put in place for Freedom Leisure as a result of the Covid crisis and to agree financial support for the period July – September 2021.

## 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 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 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.
- 2.4 Leisure centres have reopened and performance is more positive than expected – but still below pre-Covid rates. This has a detrimental impact on income levels.
- 2.5 FDC has some grant funding from the National Leisure Recovery Fund available for Q2 of 2021/22 and this may be used to fund operational cost shortfalls. However, it may not be used to fund the management fee deferral of £114,000 for Q2 of 2021/22.
- 2.6 19 July changes to social distancing regulations should allow the complete opening of leisure facilities and see an increased rate of income improvement within the leisure centres.

## 3 Recommendations:

### It is recommended that:

- 3.1 Fenland District Council ("FDC") provides the Phase V financial relief to Freedom Leisure set out in these recommendations.
- 3.2 FDC defers the monthly management fee of £38,000 per month for July 2021 – September 2021, at a cost to the Council of £114,000, repayable in accordance with the terms set out at paragraph 3.4 of these recommendations.

- 3.3 FDC continues to support Freedom Leisure on an open book basis by providing financial support from the remaining NLRG grant. The current estimated cost of operational support for the period is £47,178.
- 3.4 Repayment of the £114,000 described in paragraph 3.2 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
Report Originators	Phil Hughes, Head of Leisure Services Carol Pilson, Corporate Director Peter Catchpole, Corporate Director Amy Brown, Chief Solicitor
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Background Papers	2020/21 Cabinet Reports NLRG application pack  Confidential: Freedom Leisure modelled income and expenditure Confidential: LOBTA - Leisure Operators Base Trading Account

#### 4 Reconciliation and summary of support provided to Freedom Leisure from April 2020 to June 2021

##### 4.1 Phase I Support; April – June 2020

Deferred Management Fees	£112,680	
Grant support	<u>£164,988</u>	
<b>Total Phase I support</b>		<b>£277,668</b>

##### 4.2 Phase II support; July – September 2020

Deferred management fees	£112,680	
Financial support; interest free loan	<u>£163,902</u>	
<b>Total Phase II support</b>		<b>£276,582</b>

##### 4.3 Phase III support; October 2020 – March 2021

Deferred management fees	£225,360	
Financial support	<u>£69,962</u>	
<b>Total Phase III support</b>		<b><u>£295,322</u></b>
<b>Gross support 2020/21</b>		<b><u>£849,572</u></b>

#### Government Support

- 4.4 The Council has, since March 2020, received four payments totalling £1.859m from Government to support additional spending pressures due to Covid 19 (with a fifth tranche of £0.634m expected in 2021/22).
- 4.5 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 total claim to this scheme relating to lost management fee revenue payable by Freedom Leisure by the end of the financial year will be **£321,139**, compared with the expected annual management fee of £452,880, This leaves the Council £131,741 short of the original 2020/21 budgeted income expectations from Freedom.
- 4.6 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. FDC has received **£224,418** from the NLRF – this sum must be split across 2020/21 and 2021/22 in order that reopening of facilities is supported in the current financial year.

#### 2020/21 Financial Reconciliation

- 4.7 The total support agreed by Cabinet for Freedom for financial year 2020/21 consists of:

Phase I support	£277,668
Phase II support	£276,582
Phase III support	£295,322
<b>Less:</b>	
Income support grant	(£321,139)

NLRF grant	<u>(£69,962)</u>	
<b>Net total support 2020/21</b>		<b><u>£458,471</u></b>

#### **Phase IV Support: April – June 2021**

4.8 Cabinet agreed the following support:

Deferred management fees payable to FDC:	£114,000	
Financial support (estimate)	£62,857	
Less:		
Income support grant (estimate)	(£80,670)	
NLRF Grant	<u>(£62,857)</u>	
<b>Estimated Net Phase IV support (April-June 2021)</b>		<b><u>£33,330</u></b>

**Net Total support April 2020 – June 2021** **£491,801**

4.9 The NLRF payments made up until the end of June 2021 leaves FDC with a grant balance of £91,599.

4.10 It should be noted that the Government's income compensation scheme has been extended for only Q1 of 2021-22. At this time no extension due to the extended Covid recovery roadmap has been forthcoming.

#### **5 Proposed Phase V Support: July – September 2021**

- 5.1 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.
- 5.2 The recovery of the leisure sector from April onwards has been far more positive than initial modelling and financial projections. The Fenland contract with Freedom is doing particularly well, when compared across the other local authority contracts that Freedom manages.
- 5.3 The alteration to the Covid Recovery roadmap has had an impact; casual (pay and play) sessions such as swimming are still limited in capacity, gyms continue to run with a significant reduction in capacity and most significantly fitness classes are running at particularly limited capacity. Whilst social distancing in a leisure environment continues to impact on capacity and therefore customer numbers and income earned, the expected 19 July date to remove the final restrictions is imminent. On this date expectations are of another increase in the rate of recovery in customer uptake and subsequently income.

A summary of Freedom's contract performance in Fenland as at 21 June 2021 is as follows:

- 5.4 Learn to Swim is now running at 116% of pre-Covid levels. Pent up demand and imaginative approaches to using pools effectively has increased the number of pupils in the leisure centres swimming schools considerably in a short period of time.

- 5.5 Fitness direct debit memberships are running at 81% of pre-covid levels. This is typical across all Freedom contracts, with the wider leisure sector experiencing similar performance. Whilst membership recovery continues to move slowly in the right direction, the 19 July change in social distancing rules and the significant increase in fitness class capacity should see a faster rate of improvement for late August onwards.
- 5.6 Pay as you go swimming sits at 88%, reflecting both capacity changes and the current nature of the swimming experience.
- 5.7 Children's activities are significantly lower in terms of income than other core activities; no soft play parties are allowed and this has left this income line sitting at 32% of target. Whilst this performance is significantly affected this income is a small proportion of overall income which is dominated by memberships and learn to swim.
- 5.8 Whilst the overall recovery picture is positive, Freedom will still require some support from FDC in the coming months. As noted in 2.12, FDC has a balance of £91,599 from the Government NLRG grant. This funding will be used to cover operational cost deficits in the coming three months. Current estimates are a cost of £47,178 for this period.
- 5.9 However, NLRG cannot be used for the income lost from the management fee payments to FDC. This has been part-covered by the Government income support grant in the past. This grant ceases in June. This means that in the period July – September 2021 FDC will need to defer the full management fee for the period of **£114,000**. This will be recouped from Freedom on similar terms to previous management fee deferrals – by a larger share of any future excess profits that the contract may make.
- 5.10 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 Contractual Options Appraisal**

- 6.1 Cabinet should be aware that previous support made to Freedom was a contractual obligation. The continuing shortfall in Freedom's income is a direct result of the Covid 19 changes in law, and it is reasonable to argue that the change of law provisions in the contract do enable FDC's level of support to reflect the fact that Freedom's income will not return to pre-Covid levels immediately. There is a contrary argument that FDC has no obligation to support Freedom financially once the law has changed back to the pre-Covid law (i.e. no social distancing) – expected on 19 July. However, even if this were correct, FDC is not obliged under the contract to require this adjustment and there are sound commercial arguments not to do so in the context of FDC's relationship with a valued, long term partner – these are set out below and provide a good argument that FDC is acting in the same way as a private sector operator would in not adjusting the payments under the contract and thus there is no subsidy to Freedom.
- 6.2 To ensure that FDC maintains the long-term contract with Freedom and the future savings that this will accrue to the Council, as well as offering the potential to recoup the deferred management fees, an approach of continuing to support Freedom as a valued partner is recommended.

- 6.3 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.
- 6.4 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, the report recommendation 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.
- 6.5 In conclusion, whilst we remain in a position of uncertainty, a further relief package funded by the NLRF will provide an opportunity to push performance back above pre-covid levels as soon as possible. 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.