



Cabinet

17 March 2021

Report of: Councillor Alan Pearson - Portfolio Holder for Housing and Communities

Leisure Centre Contracts

Corporate Priority:	Excellent services positively impacting on our communities
Relevant Ward Member(s):	All
Date of consultation with Ward Member(s):	N/A
Exempt Information:	<p>This report contains exempt information and is not for publication in accordance with Paragraph 3 and 5 of Part 1 of Schedule 12A of the Local Government Act 1972. Further details can be seen in legal advice contained within the report.</p> <p>Paragraph 3: Information relating to the financial or business affairs of any particular person (including the authority holding that information).</p> <p>Paragraph 5: Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings.</p>
Key Decision:	Yes
Subject to call-in:	Yes

1 Summary

- 1.1 Melton Borough Council is committed to providing good quality leisure facilities for the long-term health & wellbeing benefit of residents within the Borough. The position has been complicated by the ongoing impact of COVID19 on the Leisure industry and the Council's legal obligations to its leisure providers following the government imposed restrictions during the pandemic.

- 1.2 In September 2020, Cabinet considered a report detailing current operating conditions in light of COVID19, and the options available to the Council for new leisure contract arrangements in light of the pandemic and the expiry of the leisure centre contracts at Waterfield Leisure Centre (WLC) and Melton Sports Village (MSV). Cabinet noted the interim support given to the Leisure Operator, Sports Leisure Management (SLM), during initial closure & remobilisation periods by the Council.
- 1.3 Cabinet delegated to Officers the negotiation of a deed of variation to the end of the financial year 2021/22. The total support for the period April 2020 to March 2021 was agreed to be capped at £478k representing the waiving of the management fee (£250k) and the underwriting of the estimated net costs incurred during this period (£228k) and;
- 1.4 Cabinet also authorised negotiation to extend the contracts for Waterfield Leisure Centre (WLC) and Melton Sports Village (MSV) for a period of 2 years, on the basis of seeking no less favourable contract terms (including car parking arrangements), with the terms for the proposed extension to be considered and approved through formal decision by Cabinet.
- 1.5 This report confirms the proposed terms of the contract extensions resulting from those negotiations and recommends to Cabinet the extension of the contracts.

2 Recommendations

That Cabinet:

- 2.1 **Note the decisions taken to date in respect of the interim support provided to the Leisure Operator, Sports Leisure Management (SLM) during closure & remobilisation periods, and the Deed of Variation agreed for the period September 2020 to March 2021.**
- 2.2 **Approve the extension of the contracts for Waterfield Leisure Centre (WLC) and Melton Sports Village (MSV) for a period of 2 years, on the basis of the contract terms detailed in the report and the financial information in Appendix A.**
- 2.3 **Delegate authority to the Chief Executive, in consultation with the Leader of the Council, to finalise and enter into any contract / property documentation necessary to affect the extension within the parameters set out in this report.**
- 2.4 **Approve further work to be undertaken on:**
- 2.4.a **the options around the Council's offer to residents in respect of leisure services from April 2024**
- 2.4.b **an options appraisal of Council-owned leisure sites in the context of the Council's Corporate Asset Management Strategy**
- 2.4.c **the recommendations from 2.4.a and 2.4.b to be submitted for Cabinet's consideration in February 2022.**

3 Reason for Recommendations

Note the decisions taken to date

- 3.1.a The government enforced closure of leisure centres affected the viability of SLM to generate any revenue to cover the costs of the period of closure.

- 3.1.b The government's guidance was that local authorities should act to ensure leisure operators at risk are in a position to resume normal contract delivery once the outbreak is over and, by implication, seek ways of providing support. Public sector outsourcing contracts such as the two leisure services contracts typically include a provision to apportion the cost risk of specific ("qualifying") changes in the country's laws. This means that contractors do not have to include a risk premium for these changes in their pricing which the public sector would pay even if that risk does not materialise. On balance these clauses result in better value for money for the public sector, however if the risk does materialise – as has been the case with the various Coronavirus Regulations in force since March 2020 – then the public sector bears the cost. These clauses provide that SLM should be put in a "no better and no worse" position that it would have been in (looking at each contract's financial model) had the Qualifying Change in Law not taken place.
- 3.1.c Both of the Council's contracts with SLM entitled SLM to claim (where a "Qualifying Change in Law" event has taken place):
- a) relief from obligations under the contracts; and
 - b) adjustments to the Management Fee.
- 3.1.d Varying the agreements avoided the risk of costly litigation should the Leisure provider sought to pursue a breach of contract claim against the Council if support had not been provided.

Contract Extensions

- 3.1.e The extension of the contracts provides some certainty for leisure provision in the Borough and the financial position up until March 2024. The Council has negotiated provision to enable it to recoup the support it has provided to SLM during the Coronavirus pandemic by way of a profit share agreement. Recovery of such support relies on profits being generated by SLM.
- 3.1.f The Council is acting in line with guidance and procurement regulations – see below at 5.1.e et seq.
- 3.1.g If the Contracts are not extended, there is a risk that any procurement exercise undertaken during the current pandemic will be fettered by the uncertainty in the leisure industry. Leisure providers are not in a position to bid for new contracts or provide competitive financial proposals due to the uncertainty of footfall and other business pressures resulting from Covid 19.

Further work on options around leisure delivery and best use of Council assets

- 3.1.h The extension allows the Council to consider the future leisure offer to residents of the Borough within the context of a changed environment for the industry in the post-Covid era.
- 3.1.i An options appraisal will demonstrate a Best Value approach to the best use of Council-owned assets in the context of the future leisure offer.

4 Background

COVID19 Context & Leisure Sector Response

- 4.1.a The Coronavirus pandemic is unprecedented and has required the Council and Leisure operator to work in partnership to address issues quickly and resolutely.
- 4.1.b All other local authorities across the County who outsource their leisure provision have found themselves in similar positions.
- 4.1.c The Council have been in regular communication with other Districts within Leicestershire throughout the Coronavirus pandemic and have been supported by Leicestershire & Rutland Sport & Sport England in creating, where possible, consistency to Leisure Operator requests in line with central government guidance wherever possible.
- 4.1.d The Council received funding from Sport England to appoint specialist consultants FMG to support and provide guidance to the Council in regards to Leisure Operator requests and the consultants compiled a report outlining the impact of leisure facility closures and remobilisation. The support provided guidance on the level of financial and other support the council should be providing at this time to the leisure operator.
- 4.1.e There is a high degree of uncertainty within the Leisure Market at present, with COVID disrupting operators. This will naturally have an impact on any potential procurement exercises and this report also provides members with options which are reflected in the commentary provided to minimise the impact to the Council and the provision of its leisure offer.
- 4.2 The UK government issued guidance to local authorities and other public bodies who have outsourcing contracts or concession arrangements. In short, the government's guidance is that local authorities should act to ensure suppliers at risk are in a position to resume normal contract delivery once the outbreak is over and, by implication, seek ways of providing support. Councils seeking to apply the guidance would be acting rationally and properly in public law terms. In light of the COVID-19 pandemic, various Councils including Melton Borough Council had been approached individually during this uncertain time for assistance in helping the Contractor (SLM) to remain viable during the enforced closures of leisure centres.
- 4.3 The Council was one of the first in Leicestershire to remobilise leisure sites in a phased reopening (fitness suite & group exercise) from the 25th July 2020, and the swimming pool from the 1st August 2020.
- 4.4 **Deed of Variation**
- 4.4.a The Change in Law provisions in both of the Council's contracts with SLM (clause 43 of the Waterfield Contract and clause 47 of the Sports Village Contract) **entitled** SLM to claim:
- a) relief from obligations under the contracts; and
 - b) adjustments to the Management Fee,
- where a Qualifying Change in Law event has taken place.
- 4.4.b Given these clauses, to both stabilise the financial position and provide for certainty for all parties, Cabinet agreed in September 2020 to enter into a Deed of Variation with SLM, on the following basis:
- 4.4.c that the terms of the Variation were based on applicable Government guidance covering social distancing requirements and the Council's own financial viability;

- 4.4.d that the net costs incurred by the leisure provider for the remobilisation period are underwritten, subject to a cumulative cap of 10% above the full Forecast Deficit per month; and
- 4.4.e that the management fee paid by SLM to the Council for the period September 2020 to March 2021 be waived should the net financial position indicate this is required.
- 4.4.f Appropriate contractual letters of variation and support were entered into on:
 - a) 28 April 2020 covering 01 April 2020 to 30 June 2020
 - b) 23 July 2020 covering the period from 01 July 2020 to 31 August 2020
 - c) 04 December 2020 covering the period from 01 September 2020 to 31 March 2021

5 Main Considerations

5.1 Contract Extensions

- 5.1.a The Council owns both the WLC & MSV sites. A leisure operator was procured to manage the sites on behalf of the council to deliver leisure services to residents. SLM were the successful leisure operator acquired in October 2011.
- 5.1.b In March 2020 officers began looking at the contracts and requirements for a formal procurement process for both the Waterfield Leisure Centre (WLC) & Melton Sports Village (MSV) Contracts because the contracts were due to expire in March 2022. This was impacted by the enforced government closures in light of the Coronavirus pandemic and staff resources being diverted to assist with the Council's response.
- 5.1.c Consequently, officers sought to clarify the options available in the circumstances.
- 5.1.d Regulation 72(1)(c) of the Public Contracts Regulations permits an extension of up to 50% of the value of the contract where that variation is necessary due to "unforeseen circumstances" without a new procurement process where:
 - a) the need for modification has been brought about by circumstances which a diligent contracting authority could not have foreseen;
 - b) the modification does not alter the overall nature of the contract;
 - c) any increase in price does not exceed 50% of the value of the original contract or framework agreement.
- 5.1.e The Procurement Policy Note (PPN) 02/20 published by the Cabinet Office confirms that the Covid-19 pandemic constitutes such an unforeseen circumstance:
<https://www.gov.uk/government/publications/procurement-policy-note-0220-supplier-relief-due-to-covid-19>.
- 5.1.f The Council has had a positive relationship with SLM over the course of the current contract, during which SLM have met the council KPI's for attendance across the leisure sites.
- 5.1.g Procurement for a new contract at this time is high risk, due to the coronavirus pandemic impact and the uncertainty of the leisure market currently so the proposal is to extend both contracts for a period of 2 years.
- 5.1.h For the service contract for Melton Sports Village which has a duration of four years starting on 01 March 2018, the Council will seek to rely on the "unforeseen circumstance"

in regulation 72 of the Public Contracts Regulations 2015, which allows a variation of up to 50% of the value of the contract which provides for an extension of up to a further two years.

5.1.i The service contract for Waterfield is a 10 year and 6 month contract which has a built-in provision for extending it for up to 5 years (clause 3.2). Extending this contract for 5 years is permitted since it forms part of the original contract which was subject to an open procurement process. The recommendation is to extend this contract for a period of 2 years. The two years will allow time for a strategic assessment, not only of the leisure industry and what approach the Council needs to take in the future, but an appraisal of the sites as a Council asset with the potential for alternative use. The current contracts work in tandem with property leases and new leases will be granted for the extension periods if approved.

5.1.j The other options considered by officers were:

a) Procurement for a new Leisure Contract at expiry of current contracts:

- i) It is unknown whether the Council will achieve a better commercial and financial offer in terms of leisure services at the present time due to the volatility in the industry. In the context of the Coronavirus pandemic, the demand post lockdown recovery may present a limited appetite in the leisure operator market for new contract opportunities. In addition, there are capacity implications to undertake a formal procurement process at the present time with officers having to deal with the response and recovery resulting from the pandemic.
- ii) The Council may not be able to recoup costs they have supported SLM with during the Coronavirus pandemic if a new leisure operator is chosen.
- iii) Financial Offers from leisure operators would be significantly diminished or with financial caveats, owing to the lack of confidence in the leisure market.
- iv) For the above reasons, this option has been discounted and the option proposed provides the Council and the Leisure Operator (SLM) more time to understand the long term implications of COVID19 on the Leisure Sector and recouping the costs incurred by the Council.

b) Extend both Leisure Contracts for the maximum period, in line with clauses in current contracts; and undertake one procurement exercise for both sites after 2 years for different contract lengths, to synchronise contracts.

- i) This would result in one contract being extended for 5 years (WLC) and the other for 2 years (MSV) which would cause issues for the council when procuring a new provider.
- ii) This option would also result in the Council having to manage two different operators for a period of 3 years which may prove difficult and provide a difference in service provision at the two sites.
- iii) This may require cancelling the contract with current Leisure Operator if a new Leisure Operator is appointed to deliver the new contract. This would have financial implications for the Council.
- iv) There may also be limited appetite in the leisure operator market for a new contract, with varying contract lengths over two sites.
- v) For the above reasons this option has been discounted

- c) **Extend both Leisure Contracts for the maximum period, in line with clauses in current contracts; WLC for 5 years & MSV for 2 years; and procure for each site at the end of their respective contracts – synchronising at time of procurement.**
- i) WLC is the more profitable of the two sites. The benefit of this option is the Council could look to recoup any costs they have supported with SLM during the Coronavirus pandemic, with a profit share agreement over a 5 year contract extension rather than 2 years.
 - ii) The downside is the Council took a decision previously to synchronise both the WLC & MSV contracts, as there was limited appetite to tender by leisure operators for individual leisure sites in such close proximity to one another.
 - iii) The lack of synchronisation could affect the tenders/financial offers received for leisure sites at each contract expiry.
 - iv) This option is not cost effective as it requires two procurement processes and there may be limited appetite in the leisure operator market.
 - v) This option also may present conflicts between Contract Management, if there were different leisure operators at each leisure site.

5.2 Terms of the extension

- 5.2.a In the September 2020 meeting, Cabinet agreed to negotiations on the contract extension on the basis of “no less favourable terms”, and requested the terms were submitted for Cabinet’s consideration. The key points of difference from the existing contracts are contained within the exempt appendix A.
- 5.2.b The financial forecasting in relation to these terms is provided in the financial comments section below and exempt Appendix A.

6 Options Considered

- 6.1 In addition to the options above the Council has the following additional option:
- 6.1.a Do nothing with the Leisure Contracts - this is not a recommended option, as will leave the Council with no leisure provision within the Melton Borough and no opportunity to recoup costs provided to support the enforced closures and remobilisation.
 - 6.1.b To commence procurement – as detailed above, not a preferred option due to the pressing timescales and uncertainty about the provision of leisure in the post-covid environment.

7 Consultation

- 7.1 There has been significant engagement from internal stakeholder service areas and in regards to understanding the implications of each recommendation.
- 7.2 The Council has engaged with Sport England, in which a funding grant was received to appoint FMG Consultants for their expertise in Contract Extension & Procurement Options.

- 7.3 External legal advice was given to understand implications of current contract clauses, state aid & changes in law.

8 Next Steps – Implementation and Communication

- 8.1 Subject to Cabinet Approval, the contract extension for both the Waterfield Leisure Centre (WLC) and Melton Sports Village (MSV) sites for a period of 2 years will be actioned.

9 Financial Implications

- 9.1 The total support for the period April 2020 to March 2021 was agreed to be capped at £478k representing the waiving of the management fee (£250k) and the underwriting of the estimated net costs incurred during this period (£228k). To the end of January 2021 the council has provided £183k in support to underwrite losses for that period from April 2020. The remaining months are likely to bring the total support in line with the capped amount of £228k. However, for the period December 2021 to the end of the financial year the Council has been successful in obtaining sport grant funding of £80k to help offset the losses in this period. Therefore the total impact overall including management fee support is estimated to be £398k.
- 9.2 The Council has received a total of £675k in funding from the Government for 2020/21 which is expected to meet additional costs of the Covid crisis and we have also claimed £178k from the income guarantee scheme in respect of the leisure management fee.
- 9.3 For 2023/24 the contract terms are to return to pre-covid management fee arrangement so is in line with the MTFS.
- 9.4 The overall costs of Covid19 including the leisure provision is being monitored and regularly reported along with the impact on the council's reserves and balances of any unmet costs and income loss.

Financial Implications reviewed by: Section 151 Officer

10 Legal and Governance Implications

- 10.1 The UK government has issued guidance to local authorities and other public bodies who have outsourcing contracts or concession arrangements. In short the government's guidance is that local authorities should act to ensure suppliers at risk are in a position to resume normal contract delivery once the outbreak is over and, by implication, seek ways of providing support. Councils seeking to apply the guidance would be acting rationally and properly in public law terms.
- 10.1.a **Underwriting costs:** guidance suggests that local authorities should act to ensure leisure operators are supported, whilst restrictions remain in place, until in a position to resume normal contract delivery.
- 10.1.b **Deed of Variation, Contract Extensions & Subsidy Control (formerly State Aid):** Provided that the variation (to the existing concession arrangement or contract) route is adopted in principle, state aid should not arise – though a claw-back should be included to deal with the provider being better off doing nothing compared to it operating the service. External legal advice has been sought on this point to ensure the Council does not fall

foul of any state aid rules. The proposals also align with PPN 02/20 and also PPN 04/20 which updated Cabinet Office guidance with a view to lockdown restrictions being lifted.

- 10.1.c **Change in Law:** The adjustments to the Management Fee that SLM are entitled to claim are implemented through Clauses 56 (Waterfield) and 61 (Sports Village). Public sector outsourcing contracts such as the two leisure services contracts typically include a provision to apportion the cost risk of specific ("qualifying") changes in the country's laws. This means that contractors do not have to include a risk premium for these changes in their pricing which the public sector would pay even if that risk does not materialise. On balance these clauses result in better value for money for the public sector, however if the risk does materialise – as has been the case with the various Coronavirus Regulations in force since March 2020 – then the public sector bears the cost. These clauses provide that SLM should be put in a "no better and no worse" position that it would have been in (looking at each contract's financial model) had the Qualifying Change in Law not taken place. Therefore, under a strict contractual interpretation, SLM could bring a claim against the Council for a payment that compensates for all shortfalls in revenues (subject to SLM taking reasonable steps to mitigate its losses). It is therefore advisable for the Council to come to an agreed support settlement with SLM rather than risk a costly litigation which could result in a significant payment to SLM as well as payment of SLM's legal fees if the Court finds in SLM's favour.
- 10.1.d **Car parking** – the car park order may require a variation depending on the longer term agreement reached.

Legal Implications reviewed by: Monitoring Officer

11 Equality and Safeguarding Implications

- 11.1 The Coronavirus pandemic is a very human crisis. Individuals who have not been able to access or actively participate in their regular individual or group physical activities outside of their homes may, as a result of the restrictions, have been less physically active with longer screen time, worse diets and other associated factors resulting in the loss of physical fitness, weight gain and consequently widening the health inequalities gap. As well as the economic interests, the physical and mental health benefits of physical activity should therefore put the full remobilisation effort for Leisure facilities at the heart of recovery action.

12 Community Safety Implications

- 12.1 Availability of and participation in health and physical activity has a positive impact on community cohesion.

13 Environmental and Climate Change Implications

- 13.1 There are no implications to consider.

14 Other Implications

- 14.1 **Health & Wellbeing Implications:** Leisure services directly impact the health and wellbeing of users in a positive way, and ensure that users maintain an active healthy lifestyle.
- 14.2 **Procurement Implications:** If Cabinet recommends a formal procurement process, the Council will ensure it complies with the Public Contracts Regulation 2015 and the Contract Procedure Rules in terms of the process will be followed.
- 14.2.a The Council has a duty under the Public Services (Social Value) Act 2011 to have due regard to economic, social and environmental well-being in connection with public service contracts.
- 14.2.b Tenders for leisure service contracts will set out how they will meet the social value requirements, support the economy and reduce environmental impact.

15 Risk & Mitigation

Risk No	Risk Description	Likelihood	Impact	Risk
1	Not recouping costs provided to support SLM during closure/remobilisation in line with the Medium Term Financial Strategy	High	Critical	High Risk
2	Limited appetite by leisure operators if go out for procurement	Significant	Critical	Medium Risk
3	No Leisure provision or opportunity to recoup costs as a result of doing nothing.	Low	Critical	Medium Risk
4	Financial Failure of the leisure operator	Low	Critical	Medium Risk
5	Reputational Impact if no leisure provision is provided	Low	Critical	Medium Risk
6	Operations do not return to normal post April 2021 necessitating further ongoing financial support	Significant	Critical	Medium Risk
7	Normal operations delayed beyond April 2021 due to resurgence of Covid 19, lack of vaccination and imposition of increased social distancing on a regular basis	High	Critical	High Risk

		Impact / Consequences			
		Negligible	Marginal	Critical	Catastrophic
Likelihood	Score/ definition	1	2	3	4
	6 Very High				
	5 High			1,7	
	4 Significant			2,6	
	3 Low			3, 4, 5	
	2 Very Low				
	1 Almost impossible				

Risk No	Mitigation
1	The Council and SLM have proposed a favourable profit share agreement for the Council in the contract extension that is consistent with prudent assumptions in the Medium Term Financial Strategy.
2	Test the market prior to going out to procurement, and looking at other Councils who may have gone out for procurement during these unprecedented times.
3	Leisure provision is important service to support the Council's Corporate Strategy, so would want to support the service continuity.
4	The Council have provided ongoing support in line with government guidance to leisure operator to ensure that this does not occur.
5	The Council have proactively engaged in partnership with Leisure Operator to ensure remobilisation of leisure services occurred.
6	Work with SLM to encourage residents to return to the leisure sites.
7	This risk is mitigated by the work of Government and Public Health agencies

16 Background Papers

16.1 No background papers.

17 Appendices

17.1 Appendix A – Comparison Table: Current Terms and Terms of Extension and Exempt Financial Implications

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