



SOUTH
KESTEVEN
DISTRICT
COUNCIL



Culture and Leisure Overview and Scrutiny Committee

Tuesday, 18 June 2024

Report of Councillor Paul Stokes
Deputy Leader of the Council and
Cabinet Member for Leisure and
Culture

LeisureSK Ltd – Update on Actions Requested by Cabinet

Report Author

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Purpose of Report

To provide an update to the Committee on the progress made with the actions requested by Cabinet in relation to LeisureSK Ltd, including an update on the leisure management options appraisal which is being undertaken.

Recommendations

That the Culture and Leisure Overview and Scrutiny Committee:

- 1. Notes the progress made on the actions agreed by Cabinet on 18th January 2024 and requests any further information that is required at this stage.**
- 2. Agrees to receive a further report providing detailed information on the results of the leisure management options appraisal at a future meeting.**

Decision Information	
Does the report contain any exempt or confidential information not for publication?	Appendices One, Three and Four to this report are not for publication by virtue of paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 – financial information
What are the relevant corporate priorities? (<i>delete as appropriate</i>)	Connecting Communities Effective Council
Which wards are impacted?	All Wards

1. Implications

Taking into consideration implications relating to finance and procurement, legal and governance, risk and mitigation, health and safety, diversity and inclusion, safeguarding, staffing, community safety, mental health and wellbeing and the impact on the Council's declaration of a climate change emergency, the following implications have been identified:

Finance and Procurement

- 1.1 The cost of providing the Council's leisure service is significant, both in terms of the management fee paid to LeisureSK Ltd, and the costs associated with maintaining three aging leisure facilities. Under the current arrangement with LeisureSK Ltd the Council pays the company a management fee which equates to the difference in the expenditure incurred by LeisureSK Ltd and the income the company has been able to generate.
- 1.2 Due to the increased costs incurred in financial year 2023/24 it was necessary for the Council to allocate additional budget to cover the management fee payment to LeisureSK Ltd. Most of the increased costs incurred related to higher than budgeted utility costs (both in terms of tariffs and consumption), and the impact of irrecoverable VAT on the company.
- 1.3 Based on the budget and business plan provided by LeisureSK Ltd a management fee payment of £446,672 has been built into the Council's budget for the current financial year, 2024/25. Subsequently LeisureSK Ltd have been tasked to provide a recovery and mitigation plan to ensure the management fee requested is sufficient and demonstrates a positive cash flow position.

Completed by: Richard Wyles, Deputy Chief Executive and s151 Officer

Procurement

- 1.4 Should the Council wish to proceed with the procurement of an external leisure management contract the process would be subject to the 2015 Public Contract Regulations. A request for information was publicly advertised in order to gauge market interest, a total of five companies responded positively which indicates there is a good level of market interest.
- 1.5 A procurement of this nature would be a significant undertaking for the Council and expert advice and support can be provided by Welland Procurement as part of the Council's ongoing relationship with them. In addition, specific consultancy advice would be required from a specialist organisation to ensure that the Council maximises the tender opportunity through the development of a robust Procurement Strategy.
- 1.6 The timeline for a potential contract procurement needs to take account of the significant amount of work which is required prior to the launch of the tender. In addition to the development of the Procurement Strategy, a leisure specification will need to be developed which sets out the Council's vision for the leisure service and identifies the outcomes the Council is seeking. This, together with a draft contract and leases for the individual leisure facilities, will be required to be available when the tender opportunity is launched.

Completed by: Helen Baldwin, Procurement Officer

Legal and Governance

- 1.7 It is the remit of the Culture and Leisure Overview and Scrutiny Committee to work alongside Cabinet Members to assist in the development of policies and scrutinise decisions in respect of the Council's leisure service. This includes the performance of LeisureSK Ltd.

Completed by: James Welbourn, Democratic Services Manager

2. Background to the Report

- 2.1 The Council's Corporate Plan (2024 – 2027) contains a vision for South Kesteven to be 'A thriving District to live in, work and visit'. This is underpinned by a commitment to invest in a sustainable leisure and cultural offer, and to provide excellent, value for money and financially sustainable services.
- 2.2 The Council's leisure contract arrangement with LeisureSK Ltd commenced on 1st January 2021, the contract being for a maximum term of five years, this being an initial contract term of two years with the provision to extend for a further three years.

- 2.3 The contract was initially extended until 31st March 2024 and subsequently further extended via an Officer Delegated Decision (See Background Papers) until 31st December 2025. This is the maximum period by which the contract can be extended and therefore a new arrangement will need to be in place by 31st December 2025. In line with the contract terms and conditions the arrangement can be terminated prior to the contract end date by providing six months' notice.
- 2.4 At a meeting of the Culture and Leisure Overview and Scrutiny Committee held on 9th January 2024, the Members present received a report which detailed the level of management fee requested by LeisureSK Ltd together with a business plan for financial year 2024/25. The management fee request and business plan were not supported by the Committee who subsequently made the following recommendation:

That the Culture and Leisure Overview and Scrutiny Committee recommend to Cabinet "A vote of no confidence in the Board of LeisureSK Ltd".

- 2.5 Prior to the meeting of the Culture and Leisure Overview and Scrutiny Committee held on 9th January 2024, the Council had received a request for an urgent in year payment from LeisureSK Ltd, the payment being required to resolve cashflow issues and enable staff to be paid. In response to this request and the vote of no confidence, the Leader of the Council read out a statement detailing a series of tasks to be undertaken to provide assurance on the performance of LeisureSK Ltd and to identify alternative management arrangements. These tasks were subsequently agreed at a meeting of Cabinet held on 18th January 2024.
- 2.6 The remainder of this report provides an update on progress on each of the tasks set, these being:
- A) To request Officers to write to LeisureSK Ltd to request a mitigation and recovery plan for the financial years 2023/24 and 2024/25 in response to the management fee request with a view to seeking the level of management fee being requested reducing further for 2024/25.
 - B) To request that the Cabinet Member for Leisure receive regular detailed budget forecast reports from LeisureSK Ltd between now and the end of the financial year 2023/24.
 - C) To request an urgent independent assessment of the business plan and profit and loss account for the financial years 2023/24 and 2024/25 and propose any corrective action or mitigations which can be undertaken.
 - D) To initiate an independent assessment of the existing governance model and operational financial management controls to ensure that they are fit for purpose and effective.

E) To note that an independent review of the VAT and taxation implications is underway.

F) To ask the Council's S151 Officer to undertake a review of the financial information, including a review of the Board minutes and level of financial support being provided to LeisureSK Ltd, and to recommend to Cabinet any corrective actions that may be required.

G) In the medium term to accelerate the options appraisal for the future delivery model of SKDC's Leisure Services including insourcing and full market testing by tender with leisure providers. This to be undertaken in the shortest of timelines.

A) Mitigation and Recovery Plan

2.7 An initial Recovery and Mitigation Plan was provided to the Council by the Board of Directors for LeisureSK Ltd for financial year 2024/25. Subsequently a further Recovery and Mitigation Plan has been requested to ensure the management fee payment allocated will be sufficient, and to provide assurance on the cash flow position.

2.8 In addition the Leader of the Council has written to the Chairman of LeisureSK Ltd seeking assurance that the revised recovery and mitigation demonstrates how the £153k overspend in financial year 2023/24 will be repaid to the Council. Furthermore, the Leader has requested confirmation that the Council will be the sole beneficiary of any savings resulting from recent investment into pool covers and additional energy saving initiatives.

B) Cabinet Member to Receive Detailed Budget Information

2.9 The Cabinet Member for Culture and Leisure now attends all LeisureSK Ltd Board meetings. As such all paperwork, including reports and financial information, are provided and there is provision for the Cabinet Member to raise any issues or concerns at the Board meetings.

2.10 However, at the recent LeisureSK Ltd Board meeting held on 22nd May 2024, the Cabinet Member and Council Officers present were asked to leave the meeting whilst the Board considered the revised Recovery and Mitigation Plan as it was appropriate that this issue was for the Board's consideration only.

C) Independent Assessment of the Business Plan for LeisureSK Ltd

2.11 Sports and Leisure Consultancy were commissioned to undertake an assessment of the original budget and business plan for LeisureSK Ltd for financial year 2024/25. The report on their findings is provided at **Exempt Appendix One**.

2.12 The key findings from the review are:

- An additional £78k of expenditure was identified which had not been included in the budget.
- It may be possible to offset the expenditure which had been omitted as the cost of utilities is forecast to reduce and additional savings will be generated from the energy saving initiatives being introduced to the leisure centres.
- The LeisureSK Ltd 2024/25 budget and business plan forecasts increased income and reduced expenditure, meeting these targets will be challenging in the current economic climate where costs are increasing, and customer spend is being squeezed by the cost of living crisis.
- Income projections for memberships and swimming lessons demonstrate increased levels of uptake but no modelling has been undertaken to demonstrate latent demand or how price increases may impact uptake.
- The staffing budget appears to be low which may be a potential risk in terms of having enough qualified staff to run the services and activities.
- The business plan does not include the lifecycle and capital maintenance costs which fall to the Council, therefore it does not provide a holistic view or demonstrate the true costs of running the three leisure centres. This is important to note when considering alternative management options.
- Overall LeisureSK Ltd attendance has not returned to pre-pandemic levels. Furthermore, they are performing less well compared to the national average. For example, LeisureSK Ltd fitness income is at 68% of pre-pandemic levels compared to the national average of 100%.
- As a small company the capacity of LeisureSK Ltd to drive income by innovation and programming is limited. Larger national operators are generally better placed to drive higher levels of income and benefit from expenditure savings resulting from economies of scale.

D) Independent Assessment of the Governance Model and Financial Controls

- 2.13 There have been difficulties in securing independent support to undertake an assessment of the governance model for LeisureSK Ltd and the financial controls in place.
- 2.14 A scope of works was developed which resulted in a quote being received in the sum of £17.5k, which is a significant cost for a backward-looking assessment. There remains a commitment to undertake an independent assessment and other avenues are being explored, including a review being undertaken by the Chartered Institute of Public Finance and Accountancy (CIPFA).
- 2.15 In the meantime the Financial Regulations for LeisureSK Ltd have been examined to ensure they are fit for purpose. These arrangements mirror the Council's own Financial Regulations and can be found at **Appendix Two**.

E) Independent Review of the VAT and Taxation Implications

- 2.16 Confirmation has been received from the Council's tax advisors, PS Tax, that LeisureSK Ltd have been accounting correctly for irrecoverable VAT. Furthermore, under the current governance arrangements between the Council and LeisureSK Ltd, there is no way to mitigate this cost.

F) Review of Financial Information and Board Minutes by s151 Officer

- 2.17 The s151 Officer was provided with a pack of information which included the LeisureSK Ltd Board meeting minutes and the financial information which had been provided to the Board over the past twelve months.
- 2.18 Following a thorough review of the information provided, the s151 Officer has confirmed that the information presented to the LeisureSK Ltd Board, including the monthly financial budget monitoring information, has been thorough. This information detailed the projected overspend from an early position in financial year 2023/24, and as a result the s151 Officer has raised no concerns around the information provided, rather how it has been interpreted and used by the Board of Directors.

G) Options Appraisal for the Future Delivery Model for the Leisure Service

Leisure Centre Maintenance

- 2.19 Prior to assessing the options available to the Council for the future delivery of the leisure service an assessment of the repairs and maintenance liability resulting from the leisure centre building condition surveys has been made. Under the current contract arrangement with LeisureSK Ltd the Council is responsible for all repairs and maintenance over £500, and the replacement of items of plant or equipment which are at end of life.
- 2.20 Building condition surveys were undertaken on the leisure facilities in financial year 2022/2 to identify the anticipated spend required to maintain them over a 30-year period. Items identified were categorised A to D, those rated D being either a health and safety issue or requiring urgent attention, through to A which were non-urgent repairs or areas requiring redecoration.
- 2.21 **Exempt Appendix Three** provides detail on the spend profile for the Council's leisure facilities, including the Stadium at Grantham. The costs identified are for category C and D items only and do not include any provision to enhance the leisure facilities. The figures identified relate to works which, if not completed, would pose a significant compliance issue, or risk the continuing operation of the leisure centres. In addition, the figures do not include any grant funded works, ie. those being funded by the Swimming Pool Support Fund Phase II.

- 2.22 The current leisure contract arrangement with LeisureSK Ltd sets out the repairs and maintenance responsibilities of the company and the Council. There is provision within the contract for the company to approach the Council with a loss of income claim should repairs not be undertaken in a timely manner and this subsequently impacts income generation, or if maintenance works require a full or partial closure of a facility.

Management Options Appraisal

- 2.23 In assessing the options available for the future delivery of the Council's leisure service, the following options have been identified:

- Insourcing the leisure service
- A further contract arrangement with LeisureSK Ltd
- An 'Agency Agreement' with LeisureSK Ltd
- Securing an external provider

Insourcing

- 2.24 A costing exercise has been undertaken to identify the likely financial impact of an insourced leisure service using the projected outturn management fee for financial year 2023/24 and the actual expenditure incurred.
- 2.25 **Exempt Appendix Four** provides details on the savings which would be achieved by delivering the leisure service in-house, together with the additional costs, the most significant of which would be the payment of the business rates and additional salary and pension costs for the staff.
- 2.26 Given the significant cost implications this option has been discounted.

New Contract Arrangement with LeisureSK Ltd

- 2.27 As detailed in paragraph 2.3 the current contract with LeisureSK Ltd cannot be extended further and a new arrangement will need to be in place ready to commence by 1st January 2026.
- 2.28 Should the preferred option be a further contract arrangement with LeisureSK Ltd then it will be necessary for the Council to enter new contract and leasehold arrangements with the company.
- 2.29 A new contract arrangement with LeisureSK Ltd does afford the Council some advantages in terms of flexibility, especially in relation to the prioritisation and timing of any maintenance works. As with the current arrangements, LeisureSK Ltd would continue to receive business rate relief.

2.30 However some of the disadvantages of this arrangement include the following:

- The Council would remain liable for a management fee payment which represents the difference in expenditure and the income the company has generated. As experienced in financial year 2023/24, any deficit resulting from lack of performance or increased costs is passed to the Council.
- The company would continue to incur a significant amount of expenditure in terms of irrecoverable VAT.
- The company is unable to draw on wider expertise and economies of scale that benefit larger leisure companies.

Agency Arrangement with LeisureSK Ltd

2.31 An option is being explored which could facilitate a new type of arrangement with LeisureSK Ltd which would facilitate LeisureSK Ltd acting as the Council's agent. This arrangement is a new emerging model which is being explored by other authorities who have a local authority trading companies managing their leisure facilities and follows a ruling in March 2023 that in-house leisure services are able to provide activities at zero VAT rating but are then able to reclaim the VAT on the related costs.

2.32 Under an Agency Model, the services of LeisureSK Ltd would be retained, although a new contract would have to be entered into before December 2025. LeisureSK Ltd would collect income as the Council's agent, all income passing straight to the Council rather than the company. LeisureSK Ltd would then invoice the Council for the expenditure incurred in generating this income by way of a service fee.

2.33 This arrangement would enable the Council to reclaim the element of VAT that has previously been irrecoverable. However, as an emerging model this is currently untested and, should the Council wish to pursue this option then independent VAT and legal advice is required. In addition, the Council's external auditors would need to be satisfied with the proposed arrangements.

New Contract Arrangement with External Provider

2.34 The Council has the option to procure an external provider through a tender process which may produce a better financial outcome for the Council and provide a fixed level of management fee payment for the length of the contract (although this is typically increased annually by the Retail Price Index). An external provider may also be able to bring innovation to help shape the facilities and the activities offered to increase income, being able to draw on wider operational expertise, and benefit from economies of scale in terms of expenditure.

2.35 Due to the age and condition of the Council's leisure facilities there is a risk that contractors may not be interested in bidding for the contract without any significant

investment from the Council, or the risks associated with managing aging facilities may be priced into the management fee payment. In addition, as part of the contract arrangement, a maintenance schedule would identify the repairs and maintenance liabilities of the contractor and the Council, therefore the Council would be contractually obliged to undertake works at prescribed times or be subjected to loss of income claims.

2.36 A soft market test exercise was undertaken in November 2023 to establish appetite from the market for an external contract arrangement. The main feedback received was:

- Operators wanted a shared approach to maintenance risks, with the Council retaining responsibility for major lifecycle and structural aspects.
- Use of the Sport England utility benchmarking process was recommended with the operator taking the risk on consumption, and the Council retaining the risk on tariff increases.
- The use of the Sport England Model Contract was recommended as the basis for a contractual agreement with the Council.
- Operators suggested a minimum contract term of ten years with the potential to extend for a further five, although some were open to longer contracts.

2.37 As part of the soft market exercise no indicative management fee pricing was received. Should this be required then contractors would need sight of the condition survey information and access to a leisure specification which describes in detail the Council's requirements as to how the facilities should be managed.

2.38 Should an external contract be the preferred option, due to the complex nature of the procurement and potential costs, a Procurement Strategy will need to be developed to identify the optimum procurement route, the Council's financial expectations, and whether any investment can be provided to enhance the facilities. Legal support will be required to assist the Council in developing a leisure specification and contract, both of which will need to be provided at the launch of the tender opportunity. It is incredibly important to ensure the leisure specification and contract are robust as these would become the principal documents which govern the relationship between Council and contractor for the contract term.

2.39 The procurement of an external contractor would be a significant undertaking for the Council and timeline from launch of the contract opportunity to mobilisation of a new contract would take approximately sixteen months. This includes prescribed timescales as detailed in the 2015 Public Contract Regulations.

3. Key Considerations

- 3.1 This report provides an update on each of the tasks set by Cabinet and announced at the meeting of Culture and Leisure Overview and Scrutiny Committee held on 9th January 2024.

4. Other Options Considered

- 4.1 Members of the Culture and Leisure Overview and Scrutiny Committee have previously requested an update on the actions set out by Cabinet in relation to LeisureSK Ltd.
- 4.2 As part of the update this report provides information on the options which have been identified for the future management of the Council's leisure service.

5. Reasons for the Recommendations

- 5.1 The Culture and Leisure Overview and Scrutiny Committee is requested to note the progress made in relation to the tasks set by Cabinet and request any further information which may be required.
- 5.2 In addition the Culture and Leisure Overview and Scrutiny Committee are requested to consider the results of the leisure management options appraisal once this is completed.

6. Background Papers

- 6.1 Officer Delegated Decision regarding the extension of the contract with LeisureSK Ltd [here](#).

7. Appendices

- 7.1 **Exempt Appendix One** – SLC Review of LeisureSK Business Plan
- 7.2 **Appendix Two** – LeisureSK Ltd Financial Regulations
- 7.3 **Exempt Appendix Three** – Spend Profile for Leisure Buildings
- 7.4 **Exempt Appendix Four** – In-house Leisure Costings