Cabinet 1 August 2022	TOWER HAMLETS
Report of: James Thomas, Corporate Director of Children and Culture	**Classification:** Part exempt

Leisure Recommissioning

Lead Member	**Councillor Iqbal Hossain, Cabinet Member for Culture and Recreation**
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Wards affected	All wards
Key Decision?	Yes
Reason for Key Decision	Financial threshold and Significant impact on wards
Forward Plan Notice Published	6 May 2022
Exempt information	This report and/or its appendices include information that has been exempted from publication as the Monitoring Officer: • has deemed that the information meets the definition of a category of exempt information as set out in the Council's Access to Information Rules; and • has deemed that the public interest in maintaining the exemption outweighs the public interest in disclosing the information. The exempt information is contained in • Appendix 1 The exempt information falls into this category 3. Information relating to the financial or business affairs of any particular person (including the authority handling the information)
Strategic Plan Priority / Outcome	Priority 1: People are aspirational, independent and have equal access to opportunities Outcome 3: People access joined-up services whey they need them and feel healthier and more independent

Reasons for Urgency

This report needed to be updated to clarify specific aspects of the options set out within it and ensure that the full financial and legal implications of these changes had been properly assessed to provide the Mayor and Cabinet with the most complete information possible prior to a decision being made on which operating model to take forward.

The report cannot be delayed until a subsequent Cabinet as the existing contract for the operation of the Leisure Service expires on 30 April 2024. It has been estimated that it will take between 18-24 months to put any of the alternative models being considered in place to ensure the transition from the current to the future operation is as straightforward as possible. If the report was delayed until the next Cabinet, on 14 September, the programme would slip by six weeks, which would put achieving an efficient transition at risk.

Executive Summary

The purpose of this report is to set out for the Mayor and Cabinet the different options for running the Leisure Service in the future to inform a decision on which model should be taken forward. Officers recommend the use of an outsourced contract model for the delivery of the Leisure Service, as it is considered most likely to achieve a favourable transfer of operational and commercial risk. It is understood that the Mayor and Cabinet prefer to insource the service to provide greater direct control over its operational delivery, without the need to manage an intermediary and if this is the option pursued then officers will seek to run the service as efficiently as possible. In choosing to bring the service in-house the Council would be accepting the risk and potential need to subsidise the service if it did not achieve a financial surplus.

The Council will operate the service to benefit those hard-to-reach communities, such as BAME women and SEND children, to promote healthy living and wellbeing. These are groups who often suffer from chronic health conditions, including diabetes and heart disease, and a greater control of Leisure Service resources would enable the Council directly to encourage an increase in exercise, dietary improvement and mental and physical wellness in these groups.

The Council will seek to maximise the local economic and social benefits that result from control of an insourced operation, with the ability to create jobs, augment the talent-pool via training and employment schemes and removal of reliance on agencies and external staffing contracts. This should boost the local economy and provide opportunities to residents during a cost-of-living crisis.

The financial modelling undertaken indicates there is likely to be at least an initial shortfall that requires the Council to top up and subsidise the Service. The period of transition from now to the current contract's expiry on April 30, 2024, will be used to prepare for a changeover that is as smooth as possible and without serious issue. The Council will continue to manage the current contractor to ensure a good standard of delivery is maintained alongside this preparatory work, to ensure that both sides are working towards a smooth handover of the Service. In adopting an insourced model, the Council will seek to provide a more efficient Service.

Prioritising the mental and physical health of all residents is of even greater importance after the Covid-19 pandemic. The Council is fully committed to providing the means for all living and working in Tower Hamlets to have access to facilities that will allow them to play sport, join together as a community and stay healthy. This decision is, therefore, as much about public health as how we manage the leisure estate on behalf of residents.

The Leisure Service will, therefore, seek to engage with those who currently do not perceive the Council's leisure centres to be the appropriate venue to increase their activity. By ensuring the service is sensitive to the needs of Tower Hamlets' residents, the Council can actively improve the health outcomes of residents by creating both the opportunity to participate and encouraging that engagement. This could include reviewing whether the Council should support usage during the cost of living crisis by subsidising aspects of the service, although this report does not recommend specific options for doing so. This desire to improve residents' access to activities to encourage wellbeing would, of course, be the same under any of the options for managing the service going forwards.

The report also sets out the resources required to deliver the recommendation to put a new delivery model in place in Appendix 1a.

Recommendations:

The Mayor in Cabinet is recommended to:

1. Consider the initial options contained in the report and confirm which the Mayor in Cabinet wants officers to develop.

2. Note that consultation is required in relation to the options outlined in the report to develop them further and authorise officers to undertake this in parallel with other investigations.

3. Authorise funding for and the establishment of a project team to deliver these immediate works and the subsequent delivery of the option chosen.

4. Note the Equalities Impact Assessment set out in Paragraph 4.1.

1 REASONS FOR THE DECISIONS

1.1 The Council's Financial Regulations and Procurement Rules require Cabinet approval for the appointment of services over £0.250m and works over £5.000m. The estimated annual value of the income generated by the

Leisure Service contract is £9m based on the current estate.

2 ALTERNATIVE OPTIONS

2.1 If no action was taken, the contract would expire with no alternative operating regime in place. The Council would, by default, need to take over the management of the service and accept the associated financial and operational risks in full. It would need to appoint a full operating team and assume the existing contracts for all running costs and take on the employment of the staff under TUPE regulations.

2.2 The Council could decide at this time to bring the management and delivery of the leisure service under its full control if it deemed this to be the main priority for the future management of the service. Insourcing does allow the Council to make changes to the management and operation of the leisure service without the need to vary a contract (if applicable, as not all changes would require a formal variation). It also allows the Council to prioritise its strategic objectives and action changes to these, placing greatest emphasis on how it can directly affect the operational performance of the service over other factors. This would, however, require the Council to accept the full financial and operational risks of running and maintaining the leisure centres and overseeing the daily operation of the activities within each centre, as set out in greater detail from section 3.10 onwards. In particular, the Council would be responsible for meeting the costs of running the estate and ensuring that any financial deficit was met, or costs reduced to provide a balanced budget. The financial analysis completed as part of the options appraisal process set out from section 3.13 onwards modelled that the insourcing option would make an annual deficit of £800k, based on a standard operating specification without significant subsidies to reduce prices or provide free access to some activities. As stated above, the Council could choose to accept the need to provide additional revenue funding in the short term (and approximately £1.3m of capital investment, common to all options) in return for greater control over how the service is delivered, what activities are undertaken, and how the leisure centres interact with and serve residents. In doing so, it would be important to acknowledge an understanding and acceptance of the risks that are intrinsic to adopting insourcing as the preferred model. The Council will, of course, aim to generate a surplus from operating the service efficiently, which could provide funding to reinvest in the service if realised. A more detailed analysis of the difference in risks between options is set out in section 5.7.

2.3 The Council could adopt an alternative delivery model, such as creating a wholly-owned subsidiary to operate the estate or establish a trust. This would be subject to some differences in how taxation rules apply compared to an insourced operation (being able to claim national non-domestic rates relief and reclaim VAT on income; please see section 3.18 for further details on the implications of VAT on each option) but would otherwise still require the Council to own and manage all risks associated with the operation of the leisure service.

2.4 The Council could also extend the existing contract with GLL, noting that it has already been extended twice, or decide to exit the delivery of a leisure service by either disposing of sites, developing them for alternative uses, or leasing them to a third party.

2.5 If it was decided to pursue the insourcing, LA Trading Company or Trust options, a further consultation would be required on that proposal.

3 DETAILS OF THE REPORT

The Current Estate & Contract

3.1 The Leisure estate consists of 7 centres (please see Appendix 2 for details). These are managed by GLL, trading as Better, through a contract originally set up in 2004, that will expire on 30 April 2024. This contract has already been extended twice, having originally been due to finish in 2019. The first extension was from 2019-22, the second to cover the period 2022-24. Although some sections of the contract have changed since 2004, it is now out of date and no longer fit for purpose given the commercial environment in which the Leisure Service operates, and the condition of the estate.

3.2 The Council needs to decide now how the Leisure Service will be managed in the future, as any of the options identified to replace the current contract will require at least 18 months to put in place and typically longer. The current contract expires in April 2024.

3.3 Leisure consultants were procured to assist the Council to examine how the service could be best managed in the future to meet the Council's strategic objectives. The outcome of that analysis is set out in section 3.18 onwards below. They have assisted many local authorities to identify, assess and select their leisure service management model, based on evaluating the local strategic aims, the financial position of the existing estate, and the opportunities for growth.

3.4 As part of their work, the consultants have undertaken a detailed analysis of how well the Council's leisure estate performs relative to other local authorities' facilities that they hold benchmark data for. This analysis is the basis of the appraisal of the financial benefits and risks of each of the options.

3.5 The overall leisure estate was in deficit in the financial year 2019/20, the last year that did not suffer major disruption due to the pandemic. Prior to that it had made a surplus for over a decade. The levels of use, mix of facilities, physical condition and financial performance of each leisure site differs considerably. As the financial data in Appendix 1b shows, only Mile End, York Hall and John Orwell Leisure Centres produced a revenue surplus in 2019/20. Although the Council's main focus has never been for the service to make a profit, this deficit was not the result of planned subsidies to encourage greater use of the Leisure Service. The reasons for this deficit are set out below:

- The contract was varied to extend it from 2019-22. The payment of a management fee by the Council to GLL was removed, in return for meeting an agreed proportion of GLL's head office costs for overseeing the Tower Hamlets contract; operating risk passed back to them. The impact of Covid from March 2020 onwards has impacted upon the financial performance of Tower Hamlets' leisure operation, in common with every other local authority. The current cost of living crisis, in particular rising energy costs, is also affecting the operation of leisure services nationwide.
- Centres with a balance of 'dry' and 'wet' facilities, such as Mile End, perform better financially as they attract more users relative to their size, and benefit from greater economies of scale for staffing, energy costs, etc. In comparison, the number of visits at St George's had been in steady decline, particularly after Poplar Baths reopened, and the small scale of its 'dry' side activities limited income to offset the high running costs of its pools. Centres with only 'dry side' facilities, such as Whitechapel, have a lower cost base but do not attract as many users as a full specification leisure centre.
- More than half the leisure centres are over 40 years old (York Hall, St George's, Tiller, Poplar Baths and parts of John Orwell), which can make these buildings more expensive and challenging to keep in good repair.
- There is a backlog of condition issues, with an estimated total cost of £11.3m needing to be funded over the next decade. This can affect usage both due to perceptions that the centre needs improving, and due to some facilities being unavailable when repairs have to be carried out. The current contract was set up as a full repairing lease, but some of the investment needed now is far greater in value and scale than a repair. £3m of capital funding was agreed by Cabinet in February 2022 to meet condition needs over the next 3 years, based on the priorities identified in the condition surveys. This funding has been included in the medium term financial strategy 2022-25.
- Minimising any deficit, or ideally generating a surplus, would make it more affordable for the Council to subsidise use of leisure centres. For example, specific groups could be targeted to enable health and wellbeing benefits to be maximised for residents who may be unable to meet the full costs of using the Council's leisure facilities. This assumes that achieving a balanced budget to provide the financial latitude to do so is a greater priority than subsidising usage independent of the estate's overall performance, or assuming greater control of the day-to-day operation of the Leisure Service.

The Leisure Strategy

3.6 Whatever option is chosen for how the Leisure Service is run in the future, there is an existing basis for structuring the specification and offer to residents, which has been used to inform this report, both with regard to the operating contract model and the investment strategy in the estate. The

Council’s Leisure Offer strategy is set out in Appendix 5. The overarching vision is to:

“*Enable and support local people to live healthier and physically active lives using leisure centres that provide affordable and accessible programmes, activities and events for under-represented groups that would benefit most from being physically active*”.

This vision has been developed into the Physical Activity & Sport Strategy, approved in December 2019, which highlights four priority areas:

1) Developing Young Interest
2) Driving Health Change
3) Shaping Places & Communities
4) Physical Activity & Sport as a community engagement tool

Further information is included in Appendix 5 on how each of these priority areas could be continued, where relevant, or further developed better to deliver each as effectively as possible. For example, within the Developing Youth Interest area, the Council may wish to consider offering free or subsidised swimming for young people before noon during school holidays. This, and the other suggestions in the Leisure Offer paper, is theoretically deliverable within any of the management options considered in this report. A decision is not needed at this time on the specifics of practical initiatives to meet the strategy, as these will undergo further development and costing prior to being included in the detailed specification for the future delivery of the Leisure Service and can be presented to Cabinet for approval once drafted.

3.7 The Leisure Offer also sets out that the key objectives of the development of the Leisure Service strategy is to deliver:

- A contract that meets the strategic aims of the Council.
- A leisure contract that operates with a robust financial position, aligning services to increase the physical activity levels of those residents that would benefit most doing so.
- A contract that is public health outcomes focused, with a holistic approach across the borough that is not specific to health interventions.
- A contract that ensures leisure centres are affordable and accessible to the residents that need them most.
- A contract that enables the refurbishment and redevelopment of the borough’s leisure assets ensuring that they are best in class.

3.8 The Council carried out a consultation from 15 November 2021 to 12 January 2022 inclusive on its proposed approach to improving the Leisure Service and its facilities. A total of 331 responses was received – 316 online or by completing a paper version of the consultation questions, and the remaining 15 provided comments by email including 8 audio files (not full answers to all questions). The report on that consultation is attached as Appendix 4b and is summarised in section 5 below. The Council has since engaged with a wide range of local stakeholders to gain their views on how the service could operate going forwards, and where investment would be most valued.

Recommended Leisure Estate Management Contract Model

3.9 The Council needs to decide how the Leisure Service will be managed once the existing contract with GLL expires on 30 April 2024. This decision needs to be taken promptly as it will take 18 months to 2 years to put an alternative management contract model in place.

3.10 There are, however, several options that need to be considered to test how well they would meet the Council's specific needs. Several of these increase control over the day-to-day operation, via a Trust, Local Authority Trading Company, or full insourcing (as Lambeth and Southwark recently decided to do). One, the joint venture model, is a more complex variation of outsourcing.

3.11 Officers have examined this range of options to provide the Mayor and Cabinet with sufficient information to consider all the potential ways of managing the Leisure Service. This includes their strategic, operational and financial implications. The full list is set out below (more detail is available in Appendix 3):

- Outsource the delivery of the service to a third party operator.
- Insource the delivery of the service within the Council, as part of an existing directorate.
- Set up a wholly owned subsidiary of the Council (a Local Authority Trading Company), to run the estate at 'arm's length'.
- Set up an independent trust (e.g. a charitable trust, or a Public Service Mutual).
- Create a joint venture with a third party or parties, which could include other local authorities and/or one or more private sector providers. This option has been discounted as it would take longer to negotiate than the other options and there is also no evidence that other parties would be keen to establish a joint venture in the midst of the cost of living crisis, nor that it would be in line with Tower Hamlets' requirements, aims and objectives. It is also, therefore, very likely that creating a joint venture would take longer than 2 years from a standing start.
- Sell off the leisure centres and associated facilities. This assumes that all the leisure centres would close. This option was discounted immediately for that reason.
- Enter into a long-term lease for the buildings in the estate. This assumes that all the leisure centres would cease to operate. This option was also discounted immediately for that reason.
- Extend the existing contract – it was assumed that this would only be considered to bridge a relatively short period between the end of the current contract and the start of a new arrangement if it was impossible to put this in place to start on 1 May 2024. It would not, by definition, improve the current service or its financial sustainability.

3.12 To provide an objective analysis of the pros and cons of each option, officers worked with specialist Leisure consultants to identify how to measure how well each model would deliver benefits for residents, be financially sustainable and meet the Council’s strategic objectives. This options appraisal scored each against key criteria, with 40% of the total score for financial performance, and 60% for how well they met operational and strategic aims. It was assumed that each option would run for a ten year period before being reviewed.

3.13 The financial scoring assumes that achieving a balanced budget is a key aim of the service and assesses the ability of each option to delivery that outcome based on the experience of operating similar models elsewhere and the structural differences between them. For example, an outsourced service working within a robust contract and performance regime should lever the greatest benefit from the expertise of the operator, while ensuring that the income from the service and the risks attached to achieving a given level are shared in an appropriate way. Typically, the operator would be required to hit a specified level of use and income as part of the contract performance regime. If it fails to do so the profit it would expect to make would be reduced both contractually and as a direct result of its failing to generate sufficient visits by residents. The consultants procured by the Council have developed a financial model based on both the performance of the existing leisure estate (factoring in the positive impact of a new leisure centre on the St George’s site), and comparators from other local authorities for each of the options being considered.

3.14 The financial element of the options appraisal has, therefore, been set at 40% of the total score (comprised of 30% of marks for relative financial performance, and 10% for the transfer of commercial risk) to provide a clear assessment of each option’s net fiscal performance. In this context, ‘commercial risk’ means that the operator would be responsible for ensuring, for example, that the number of visits to leisure centres was sufficient to cover the cost of running the Leisure Service from that estate, unless the Council had agreed to subsidise some aspects of that service. If the income from a falling number of visits did not meet running costs, the operator would be responsible for the funding gap, not the Council. As set out above, the financial scores were derived using a database that contains information on multiple contracts, allowing the relative performance of different options that are already operating to be used as the basis for this evaluation. Given the current uncertainty over future energy and other operating costs, and the potential reduction in discretionary spend by residents in response to the cost of living crisis, officers have sought to ensure that the financial implications of each option are presented clearly. If, however, the Council was to prioritise the ability to adjust strategic priorities and adapt the service accordingly, then greater weight could be given to the non-financial factors if the Council was willing to reduce the scoring for financial risks.

3.15 The full list of criteria is shown in the table below, with the relative weightings for each category. These weightings were agreed collectively by the project team for this workstream, based on an evaluation of the generic priorities for any option (for example, ‘will it provide an adequate service?’), through to local priorities (such as, ‘will it be possible to change the way the service works over time?’). The full options appraisal scoring, including all the assumptions made, is attached as Appendix 3 (the financial scoring is set out in Appendix 1c).

Category	Criteria	Weighting
Financial Factors		
Cost	***Extent of Council responsibility for/exposure to:***	**30%**
	Income generation	
	Economies of scale for key costs, including utilities	
	Salary levels (not relating to LGPS)	
	Overhead management costs	
	Profit	
	VAT treatment	
	Non-National Domestic Rates (NNDR)	
	Pension liabilities	
Risk transfer (commercial)	***Extent to which the Council has ownership of or influence over key risks:***	**10%**
	Day-to-day operations (e.g. costs resulting from unavailability of areas of a building)	
	Change of customer demand	
	Local competition	
	Change in law affecting operation/cost/ facility specification	
	Utility cost (tariff) changes	
	Utility cost (consumption) changes	
	Uninsured risks	
Operational Factors		
Service delivery	***Relative ability of each model to:***	**30%**
	Deliver the Council's current strategic objectives for next 10 years	
	Work with other Council departments, e.g. Public Health, Parks, etc.	
	Deliver excellent customer service	
	Meet the Council's net zero objectives	
	Increase participation in the most economically and sustainable way	
	Engage with the most vulnerable groups within the borough	
Operational flexibility (for Council)	***Ability to adapt to changes to the service within the period***	**20%**
	Opportunities for cross-Council initiatives, e.g. joined up IT solutions across leisure/IDEA stores	
	Extent to which arrangement protects service in long-term (10 years)	
Risk transfer (operational)	***Extent to which the Council has ownership of and influence over key risks:***	**10%**
	Health and safety	
	Managing, recruiting and retaining staff	
	Planned preventative maintenance, including compliance checks	
	Investment to improve the estate	

3.16 The full financial analysis is not included in the public section of the report, as a decision has not yet been made on which leisure service management model to take forward. If the outsourcing option was selected, the data within that analysis would provide potential bidders with information that may prejudice the Council's ability to achieve the best possible value for money outcome. It does, however, show that outsourcing should deliver the best financial outcome from the service, compared to the other options. The table below shows the high level summary of the financial analysis, and the difference between the options:

Average cost per annum over 10 years

	Outsource	**In-House**	**LATC**	**Trust**
Income	£11.904m	£10.929m	£11.337m	£11.337m
Costs	£9.877m	£10.352m	£9.490m	£9.490m
Net Position	£2.027m	£0.578m	£1.847m	£1.847m
Additional Revenue Costs	£0.710m	£1.399m	£1.071m	£1.071m
Final Position p.a.	**£1.317m**	**-£0.821m**	**£0.776m**	**£0.776m**
Gap vs. Outsourcing	**£0m**	**-£2.138m**	**-£0.541m**	**-£0.541m**
One off costs (set up)	£0.15m	£0.84m	£0.45m	£0.45m

3.17 The key financial differences between the models are summarised below:

- Outsourcing/LA Trading Company/Trust:
  - The operator can reclaim a significant proportion of VAT on income (typically 85-90%), which an insourced operation can, in theory, do but would potentially prejudice the Council's overall ability to reclaim Exempt VAT costs. Please see 3.18 for more details on this specific issue.
  - The operator can claim relief on national non-domestic rates (NNDR) that the insourced operation is unable to do.
  - The operator may choose to use a different pensions regime to the LGPS (especially for an outsourced contract) that reduces personnel costs.
- Outsourcing:
  - The operator is likely to have access to a specialist, regional or national supply chain that can generate economies of scale for some costs, e.g. pool chemical supply, specialist equipment service contracts.
  - The operator will benefit from experience and expertise from other projects it runs, as another form of economy of scale.
  - The operator will, however, charge a proportion of its head office costs to reflect this.
  - A management fee may be payable to the operator, depending on the contract form used. It is currently assumed this will not be the case.

- The contract will include a payment mechanism, using key performance indicators (KPIs) to measure compliance with the specification. If the operator fails to meet those KPIs it could be financially penalised. A new contract will provide the Council with the opportunity to define 'on market' terms for the payment mechanism.
- One off set up costs of £150k incurred by the Council in re-procuring the service, e.g. pre-procurement document preparation.

- Insourcing:
  - There should be negligible costs for any 'head office' input to the operation, unlike in the other options. This is, however, a relatively small annual cost.
  - National Non-Domestic Rates relief is not available to Local Authority-run leisure services but can be claimed within other options.
  - It is more complicated for the Council to reclaim VAT either in the same way as the other options, or to the same extent. The position on VAT was challenged in the context of leisure service delivery in 2017 by the London Borough of Ealing. Although it won the case, reclaiming VAT on income from the leisure service may impact upon the Council's overall VAT position. It is understood, therefore, that most local authorities do not assume a VAT benefit equivalent to other options when assessing insourcing. Please see section 3.18 for more details.
  - The Council would need to enrol all staff in the LGPS. This has cost implications but offers substantive benefits to those employees.
  - The income levels for an insourced operation are reduced partly due to the inability to reclaim VAT on 'sales', but also due to the initial impact of setting up a new operation without the benefit of an operator's broad experience of running the same.
  - The Council carries all commercial and other financial risk, e.g. if the levels of use at each leisure centre fall income will also decline, but fixed costs will still need to be met. The Council will be responsible for all such cost increases.
- Insourcing/LA Trading Company/Trust:
  - The operator would need to employ new senior staff to provide effective leadership and operational management to the service, as GLL's existing senior team would not transfer to the future operation. This is an additional cost both in terms of recruitment and ongoing employment and is calculated to be a greater total cost than for an outsourced contract due to the loss of economies of scale from such staff overseeing multiple local authority contracts for a third party operator.
  - Risk transfer varies slightly across each of these options, but (as set out under the insourcing bullet above) the Council will be unable to transfer as much risk as it can through an outsourced contract with a specialist leisure provider. The only exception to this is likely to be energy costs, given these are rising at recently

unprecedented rates, so that the Council is likely to need to consider retaining a far greater proportion of this risk than it might even a year ago, although the financial cost of this is likely to be common across all models.

- One off set-up costs: for each option, there are costs that the Council will incur to establish the model effectively. These are greater for the insourcing, LA Trading Company and Trust options as the Council would need to fund the purchase of items such as uniforms, IT systems, branding, etc., that a specialist leisure operator would provide all or much of. These costs have not been included in the financial element of the options appraisal.
  - Outsourcing: costs of £150k incurred by the Council in re-procuring the service, e.g. officer time for pre-procurement document preparation.
  - Insourcing: costs of £835k to cover the cost of new IT systems, officer time uniforms, branding, website, facility due diligence, and consultancy support (HR, legal, technical), etc. A contingency of £100k has also been included to cover any additional costs that cannot be confirmed at this stage.
  - LA Trading Company/Trust: the one-off costs for these options are broadly the same. Costs of £450k are estimated for either, to cover officer time, branding, website, etc.

3.18 VAT treatment for local authority-run leisure services: as referred to above, the treatment of VAT on income for an insourced leisure operation has implications for its overall financial performance. From the early 1990s until 2017, an in-house leisure operation could not reclaim VAT on income. A charitable trust or LA trading company typically could reclaim 75% or more of the VAT on income, thus in effect boosting its sales. The London Borough of Ealing challenged this position and was ultimately successful at the Court of Justice for the European Union (CJEU) in 2017 in establishing that local authorities could reclaim VAT. There is, however, a risk from doing so: to safeguard the Council’s continuing ability to recover all the exempt VAT it incurs on its costs, it needs to ensure that the level of VAT on expenditure it incurs in relation to VAT exempt supplies remains under 5% of all Input Tax it incurs in a year. The 5% level is set by HMRC as the level of Exempt VAT costs that can be reclaimed each year as a proportion of all the VAT the local authority incurs as costs. Although this covers VAT on costs, not on income, any Input VAT on costs which can be shown to support the VAT exempt income areas will be set against that 5% threshold. For example, capital improvements to a leisure centre would be VAT costs that contribute to improving income. If the Council exceeds that 5% input VAT on costs figure, it risks losing all the value of recovering that VAT. This may be a greater value than the income that is gained through the leisure service no longer paying VAT on ‘sales’, so that there is no advantage in seeking to reclaim the latter. Given that it is understood some local authorities have chosen not to pursue a reclaim on in-house leisure income to avoid prejudicing the 5% threshold on Exempt VAT costs, the financial analysis of the insourcing option assumes VAT is paid on income. If insourcing is selected as the option to take forward it is recommended that further work be undertaken to understand the implications of reclaiming VAT, or not, in this context on the whole Council VAT position.

3.19 The criteria and weighting in the table above were used to assess each option in the list in 3.12 above, except for those to dispose of or lease the whole estate, which were discounted as not meeting the service delivery criteria in any way, and the joint venture option as it would take too long to put in place assuming suitable partners could be found. The option to extend the existing contract would (if used) be a short term measure, so has not been assessed. The final scoring is set out below, initially showing the 'raw' score, which represents the total scores awarded before weighting is applied, then showing the weighted score as a percentage, both for the total and the non-financial scores:

Option	Financial Raw Score	Non-Financial Raw Score	Total Raw Score	Total Weighted Score %	Non-Financial Weighted Score %
Outsourced contract	34	43	72	76%	67%
Full Insourcing	15	44	59	65%	65%
LA Trading Company	24	39	59	67%	60%
New Leisure Trust	26	40	62	69%	63%

3.20 The highest scoring option was, therefore, for an outsourced leisure contract, based on both financial and non-financial criteria. The insourcing option scored second on non-financial criteria once weighting was applied, but lowest for financial criteria. The Leisure Trust model is second on the total weighted score, and third on the non-financial weighted score. The LA Trading Company has the lowest non-financial weighted score, and third lowest overall weighted score. Officers have, therefore, recommended the outsourcing option based on the criteria set out in the options appraisal. It should, however, be noted that section 2 sets out the alternative options that the Mayor and Cabinet may wish to consider before making a decision on how the leisure service should be managed once the current contract with GLL expires on 30 April 2024.

3.21 The estimated timescales for delivering all of the options (including those not taken forward and scored) are summarised in Appendix 3c. The joint venture route is the slowest, with its total duration difficult to predict as it relies on finding suitable JV partners willing to create a new vehicle, and then procure a private sector partner. Delivery of the insourcing, trust and LA trading company options should progress at a similar pace. Each would require an additional consultation process to be completed in advance of their final confirmation. The outsourcing option has been assessed to be quickest to deliver as it follows the most defined process, a procurement, and both operator and local authority are experienced in it use.

3.22 Each of the options in 3.17 would require a Transfer of Undertakings (Protection of Employment) (TUPE) process (except for outsourcing if GLL was awarded the contract as it already employs all the affected staff). The insourcing, trust and LA trading company options would also require the recruitment of a new management team to oversee the whole estate, as the incumbent central team at GLL will not transfer.

4 EQUALITIES IMPLICATIONS

4.1 An Equality Impact Assessment is included as Appendix 4a. It addresses all of the issues set out within this report, including its recommendations. It is understood that a new consultation and Equality Impact Assessment would be required if the Council chose to insource the Leisure Service management contract as this option was not consulted on when the original consultation was undertaken, and it represents a material change to the way the service operates.

4.2 The Council's approval process prevents any proposal which amounts to discrimination from being implemented and any project that is likely to lead to differential impact is varied to mitigate the differential impact.

5 OTHER STATUTORY IMPLICATIONS

5.1 This section of the report is used to highlight further specific statutory implications that are either not covered in the main body of the report or are required to be highlighted to ensure decision makers give them proper consideration. Examples of other implications may be:

- Best Value Implications,
- Consultations,
- Environmental (including air quality),
- Risk Management,
- Crime Reduction,
- Safeguarding,
- Data Protection / Privacy Impact Assessment.

5.2 **Consultations**

The Council undertook a consultation on the proposals set out in this report, running from 15 November 2021 to 12 January 2022 inclusive. A total of 331 responses was received – 316 online or by completing a paper version of the consultation questions, and the remaining 15 by email including 8 audio files (not full answers to all questions). The report on the outcome of that consultation is attached as Appendix 4b. That consultation sought specific responses on the provision of leisure services in the south-west of the Borough. Given it has already been decided to build a new leisure centre on the St George's site, that content is not repeated here but can be found in the full consultation report.

5.3 Key points arising from that consultation are set out below (percentage and numbers are for answers to specific questions):

- 84% of respondents (267 people) agreed with most of the Council's vision for the future of its leisure facilities
- More than half disagreed that the current facilities meet their needs.
- 94% (297 responses) agreed that the Council should plan for significant investment in our leisure centres.
- 83% (261 responses) agreed that a network of leisure centres should be available within 20 minutes by public transport from where they live.
- 58% (183 people) disagreed with closing centres that are not used enough, or in a bad condition or losing money, while 28% (87 people) agreed.
- 90% (285 people) agreed that Community groups, sports clubs and volunteers should be supported to use open spaces, playing fields, community centres, schools, and colleges to bring leisure opportunities to people of all backgrounds, especially the most disadvantaged and/or least active.
- Respondents were able to provide comments within the consultation on specific issues. These are set out in detail in the consultation report. The following are highlighted as particularly pertinent to the recommendations of this report, when considered alongside the multiple choice responses set out above:
    - Multiple respondents asked for more women only sessions and expanded women only gym space.
    - Respondents called for better collaboration with local health services, including physiotherapy, community dietician and smoking cessation sessions, which could be delivered in Leisure Centres to improve health outcomes.
    - 123 respondents provided views on the Council Strategy, including a call for ambitious planning to match provision at Hackney's Britannia Leisure Centre, as well as for investment in the existing facilities, with specific references to Mile End. Others asked that there should be less strategic focus on pools, with a preference for a variety of accessible activities.
    - 140 respondents provided feedback on the existing operation of the leisure estate and their views of GLL's performance in particular. These comments will be considered by the Council's Sports and Physical Activity team as part of their management of the contractual relationship with GLL. These comments can be read in the full report attached as Appendix 4b.

5.4 **Risk Implications**

The risks that arise from the implementation of each option set out in 3.12 have been considered and financial risks quantified as part of the modelling undertaken for each, as set out in Appendix 1C. Their overall fiscal impact is reflected in the table in 3.17. The options appraisal process also considered operational risks as part of assessing each model. The option-specific risks are summarised below:

- **Outsourcing:**

    - The third party operator would be responsible for managing the majority of risks, financial and operational, across the leisure service.
    - For example, the operator would need to ensure that the service operated efficiently so that it covered costs through income and was thus able to deliver the service specification without recourse to Council funds under normal trading conditions.
    - For operational risks, the operator would manage the risk of staffing the leisure centres appropriately to meet the service specification. It would also be responsible for day-to-day maintenance of the estate and the availability of all facilities and equipment to meet the specification.
    - The risk of tariff increases on utilities costs has previously fallen to the contractor under Tower Hamlets' current contract. Given the unprecedented increase in these costs, the distribution of this risk between each party may need to be considered further.
    - The Council's management of risk in this context is:
        - To ensure a responsible and financially stable operator is procured.
        - The service specification is transparent, affordable and measurable, to allow performance to be assessed via an appropriate payment mechanism regime.
        - To use the contractual levers available to enforce the delivery of the service specification if necessary.
- **Insourcing:**
    - The Council would be responsible for all risks, financial and operational, under this model.
    - For example, should expenditure exceed income, the Council would need to fund the shortfall in the short term and either reduce costs or increase income in the medium to longer term. The Council will, of course, seek to maximise income and control cost to produce a surplus that could be reinvested in the service if realised.
    - The Council would need to ensure that its workforce was sufficient in scale and expertise to manage the estate and meet the service specification.
    - The transition from the current outsourced contract to an insourced contract risks destabilising the quality of the current operation, particularly if there is a major change in the personnel involved in the delivery of the leisure service and/or existing supply chains cannot be readily replaced to create a smooth transition.
    - The risk of utilities cost increases would sit wholly with the Council.
    - The Council's management of risk in this context is:
        - To ensure that the leisure service has the appropriate human, material and financial resources to deliver the service specification. In particular, the Council would need to identify and recruit the management structure required to ensure the estate has the operational and technical expertise to function effectively. This would need to take account of market rates for employing individuals of the requisite quality and experience.

        - To manage the process of transition by ensuring that a team is appointed with the requisite skills in sufficient quantity to ensure that the service is insourced as smoothly as possible to allow a successful transition.
        - To accept the need to fund any deficit in the trading performance of the leisure service and identify means of meeting its costs where no surplus is created.
        - To accept ownership of the broader operational implications of running the leisure centres, in particular health and safety and the systems and practices required to ensure incidents residents are safe whilst using our facilities.

- **LA Trading Company/Trust:**
    - The risk profile of both these models is very similar, so are treated as a single entity. In these options, the ultimate risk owner would be the Council, but the management and board responsible for the day-to-day operation of each model would 'own' the immediate response to risks.
    - For example, should the overall trading position of the organisation be worse than the agreed budget, the Council would expect that the management of a LATC or Trust would present a plan for bringing the service back in line with that budget. If it failed to do so, the Council would need to consider providing assistance within acceptable legal parameters or stepping in to take over the operation entirely.
    - Similarly, operational risks would be owned by the management and board of either model, with performance measured against a service specification. Failures to achieve that standard in the short term would definitely be the responsibility of the organisation. Ongoing failure may, again, lead to the Council needing to step in more formally to address underperformance.
    - It is considered very likely that, at least while energy costs are increasing so rapidly, the Council would need to manage the tariff risk on utilities costs for either option.
    - The Council's management of risk in this context is:
        - To ensure that, as either of these organisational structures were created, it would have the appropriate human, material and financial resources to deliver the service specification. In particular, the Council would need to identify and recruit the management structure required to ensure the estate has the operational and technical expertise to function effectively. This would need to take account of market rates for employing individuals of the requisite quality and experience. Once either body was fully operational it would assume this responsibility, subject to the Council remaining the 'lender of last resort' on financial issues.
        - To adopt a governance regime that provided either model of organisation with the requisite robust oversight to ensure it met the service specification in a safe, accountable and efficient way. This may include officers and/or members being

appointed to the board of either organisation, subject to complying with relevant statute.

- To monitor delivery of the service specification against a clear set of metrics that would allow the Council to identify and seek remedy for any shortfalls in service quality, financial performance, health and safety, etc.

5.5 **Best Value**

The Best Value duty requires the Council to, “make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectives.”

The relative financial performance of each option is set out in section 3.17 to 3.19, and set out in detail in Appendix 1c, and section 5.7 in respect of relevant risks. This establishes that outsourcing is the most economically advantageous option. This is, however, only one factor in assessing relative value for money and an assumption was applied that the service should achieve a balanced budget annually, whereas the Mayor and Cabinet may wish to consider investing revenue in the service to provide more affordable access to leisure activities and facilities.

The options appraisal also considered operational factors, as set out in sections 3.20-3.21 and Appendices 3a and 3b. These evaluate the relative efficiency of each option in achieving the Council’s objectives, as articulated in Appendix 5. The options appraisal identified outsourcing as the most effective model for meeting operational requirements, with insourcing a close second. The major difference is in the ability of the Council to change operational delivery at pace, without recourse to contractual changes (if required, as it is intended that the contract for an outsourced operation would include a mechanism for making such changes relatively swiftly).

The options appraisal took account of the benefits of risk transfer from the Council to another party and considered the benefits of the Council taking greater control of the delivery of the leisure service. If the latter criterion was given greater weighting, i.e. was considered a more important strategic priority than other factors, then insourcing would be likely to achieve a higher score relative to outsourcing on operational factors.

The cost model created to assess the options does identify that outsourcing should deliver the best fiscal performance and insourcing the least propitious if measured against existing assumptions. If, however, the Council’s priority was to exert the greatest possible control over the leisure service then insourcing would represent the most advantageous model. In choosing insourcing, the Council would need to ensure that the leisure service was operated in the most efficient way possible going forwards, financially and operationally, which would require the risk mitigations set out in section 5.7 to be applied. In particular, it would be essential to ensure that a suitably resourced and experienced transition team was in place to manage the change from the current contract to an in-house operation, and that the latter would have a management team capable of meeting the challenges of running the estate to meet the Council's objectives.

5.6 **Crime Reduction**

Under Section 17 of the Crime and Disorder Act 1998, the Council is under a legal duty when exercising its various functions to have due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent crime and disorder in its area, including anti-social behaviour adversely affecting the local environment and the quality of life of residents, the misuse of drugs, alcohol and other substances and re-offending. This will be taken into account in the design development for any new or refurbished/remodelled leisure centres.

6 COMMENTS OF THE CHIEF FINANCE OFFICER

6.1 The financial analysis indicates that the outsourcing option would offer the best financial value to the Council. Core Budgets for Leisure facilities are currently budgeted with a net nil cost outsourced model through GLL and the re-contracting would offer the opportunity to make future budget savings or generate additional income. The significant impacts of the difference in VAT treatments have been detailed in the body of the report however taking this out of the modelling equations would still leave the outsource model in a favourable position. Further work will be required to review the VAT implications on the Council's partial exemption threshold.

6.2 The model takes account of business rates (NNDR) whereby an outsourced provider could claim charitable status relief for a majority of the rates and therefore reduce the cost of providing the service. The benefit of these reliefs would be partially reduced by the income loss for the Council from the decreased business rates of which the Council retains a share.

6.3 The costs of the external project team are currently unbudgeted and would require additional funding or redirection of current funding of £338k for this financial year and a further £405k for the 2023/24 Financial year. Funding would need to be requested through a growth bid in the MTFS or could utilise short-term non-ringfenced reserves. Internal staffing would be included in current budgets.

6.4 One off costs have been identified as £150k for outsourcing and £835k for insourcing. These costs would require additional budget (requested through the MTFS and/or reserves) and would be likely spread over the 2023/24 and 2024/25 Financial years as the new offer is rolled out at the beginning of 2024/25.

6.5 On current analysis the outsourcing option would give us an average annual additional £1.317m of available resource for council spend through income generation.

6.6 On current analysis the insourcing model would require an average annual growth of £821k in spend. This would require a growth bid to be added into the MTFS and agreed by full Council as part of the 2023-26 budget.

6.7 The figures provided are currently illustrative and final detailed growth or saving calculations would be required for inclusion in the Council Medium term Financial Strategy.

7 <u>COMMENTS OF LEGAL SERVICES</u>

7.1 The Council is not legally obliged to provide leisure services and facilities of this nature. However, it may do so if it wishes and in doing so the provision of such services and facilities is one of the Council's functions under the law.

7.2 S.3 of the Local Government Act 1999 requires the Council to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness. This Best Value duty applies to function referred to in 7.1 above. Both the insourcing option and the various outsourcing options are options that are legally permissible for the Council to pursue.

7.3 The legislation (and the central government guidance of which the Council must have regard) requires the Council to consult with stakeholders in the event that the Council is considering high level choices about how, as a matter of principle and approach the Council is going to deliver this legal function. The content of this report meets this threshold triggering the need for the Council to undertake further consultation whilst these proposals are still at a formative stage.

7.4 Following the consultation the Council is required to consciously consider the results whilst finalising any such proposal for the future of this function. Any such proposal may or may not be one of the two proposed options provided that that the conclusions drawn by the Council from the consultation are conclusions that a reasonable authority ought to be expected to make. Also, the consultation relates to the Best Value duty. However, Best Value is that which the particular council considers to be Best Value in the circumstances of that particular council and therefore, the Council has a relatively wide discretion when reaching conclusions about Best Value from the evidence shown from the Consultation.

7.5 The release into the public domain of the information detailed in Appendix 1 could have a significant impact on the business operations of the Council and the Council's existing supplier. This could leave the Council open to expensive legal claims or left in a weak commercial position in any related tender process. It is therefore in the public interest that the public is excluded from the information, and this outweighs the public's interest in knowing the information and withholding the information in Appendix 1 is lawful.

7.6 The Mayor is responsible for and has discretion to make decisions relating to the discharge of executive functions under the law and the Council's constitution. The leisure services function is an executive function. Therefore, the Mayor may make any decision other than those recommended.

7.7 It is conceivable that any changes from the previous shape of the leisure offer could affect people who have a protected characteristic for the purposes of the Equality Act 2010 disproportionately to those people who do not. Therefore, in the event of such changes that Council will have to undertake such actions as are reasonably necessary to understand the impact of such changes. This could include a further Equality Assessment or further consultation.

Linked Reports, Appendices and Background Documents

Linked Reports
- Leisure Investment Plan (approved at Cabinet on 09/02/2022)
- Physical Activity and Sport Strategy 2019-2024 (approved at Cabinet on 18/12/2019)

Appendices
- Appendix 1a – Resourcing Costs [Exempt]
- Appendix 1b – Fiscal Performance of the Contract FY 2019-20 [Exempt]
- Appendix 1c – Financial Options Appraisal Scoring [Exempt]
- Appendix 2 – Leisure Centre Details
- Appendix 3a – Options Appraisal Methodology for Management Contract Model
- Appendix 3b – Scoring for the Non-Financial Criteria
- Appendix 3c – Estimated Timetable for Delivering Each Option
- Appendix 4a – Equalities Impact Assessment
- Appendix 4b – Consultation Report
- Appendix 5 – Leisure Offer Paper

Background Documents – Local Authorities (Executive Arrangements) (Access to Information) (England) Regulations 2012
- NONE

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