



**Report to: Policy and Resources Committee, 6<sup>th</sup> September 2022**

**Report of: Corporate Director - Operations, Homes & Communities**

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**Subject: FREEDOM LEISURE CONTRACT UPDATE – RISING COST PRESSURES**

**1. Recommendation**

**That the Committee:**

- 1.1 Notes the contents of this report and in particular the increased costs faced by Leisure Operators across the UK linked to inflation and energy supply;**
- 1.2 Approves financial support up to a maximum value of £255,000, to be taken from the Business Rates Risk Reserve, to cover additional energy costs for the period 1<sup>st</sup> October 2022 – 31<sup>st</sup> March 2023, to be paid monthly in arrears via a fully open-book process; and**
- 1.3 Notes that a full options appraisal and recommendations for operations and future funding will be presented to the Committee as part of the budget-setting process.**

**2. Background**

- 2.1 In 2016, the Council awarded a 10-year contract to Freedom Leisure to operate Perdiswell Leisure Centre, St Johns Sports Centre, Nunnery Wood Sports Complex, and the Active Communities Sports Programme.
- 2.2 Freedom Leisure (Wealden Leisure Ltd) is a not-for-profit leisure trust; the contract is built on a partnership arrangement approach, with the Council, in normal operating circumstances, receiving an annual management fee.
- 2.3 To support Freedom Leisure through the 3 periods of COVID-19 lockdown when the Council's 3 Leisure Centres were closed and during those periods when demand was returning, the Council provided financial support to maintain a public leisure offer across the City. The level of support provided by the Council amounted to £810,000 over the two years. This included £220,000 provided through Sports England's National Leisure Recovery Grant to help support leisure service providers address the impact of loss of business. The Council, in turn, received £410,000 compensation from the Government, for loss of income which partially offset the lost management fee. The transactions are summarised in the table below and were managed by way of regular open book account meetings with payments in arrears by agreement.

	2020/21 (£000)	2021/22 (£000)
Annual Management fee reduction to Freedom Leisure	450	140
Income compensation received by City Council from DHLUC	(330)	(80)
Financial support grant payment to Freedom Leisure	220	0

- 2.4 For 2022/23 the council budgeted to receive a full annual management fee of £473,000. Demand was continuing to return to pre-pandemic levels and ongoing discussions with Freedom Leisure through winter and spring did not raise any significant issues that would indicate the need to deviate from this position.
- 2.5 Prior to setting the 2022/23 budget, Council approved a new set of Freedom Leisure Fees & Charges in November 2021 which were applied on 1st January 2022 and resulted in an average increase of around 3%. This proposal was developed in August 2021 when inflation was running at 3.2%. Actual inflation was running at 4.9% by January 2022.
- 2.6 Regular liaison meetings have continued and, in early summer 2022, Freedom Leisure raised concerns around increases in energy costs. As a result, it was highlighted in the Quarter 1 Financial Monitoring Report presented to this Committee in July 2022, that the management fee due to be received in respect of Leisure Services was forecast to be £124k lower than budget. This is the combined effect of reduced income and increased costs.
- 2.7 Furthermore, in June 2022, Freedom Leisure expressed their intention to submit an in-year proposal in respect of their fees & charges. The impact that this would have on customers was discussed and it was agreed to pursue a fees and charges review in line with the normal budget timetable, with reports coming to Communities Committee, Income Generation Committee and Council as part of budget setting for 2023/24, rather than request a specific fee increase outside of the budget cycle.
- 2.8 There are two elements to the potential cost impact: general inflation and rising energy costs. The impact of each element is considered separately below.

#### Inflation impact

- 2.9 If inflationary forecasts are accurate, it is likely that the future fees and charges review will indicate that increases in the region of 13-15% could be expected. Members may wish to acknowledge that in the current financial climate, a single annual review of fees and charges is not sufficient in enabling a business to manage its budgets efficiently. To this end, further reviews of fees and charges will be received during 2023 whilst the economic situation remains dynamic.
- 2.10 Rising inflation and other economic pressures, while affecting Freedom Leisure's costs also has an impact on customer demand. Therefore, it is necessary to revisit Freedom Leisure's overall best- and worst-case scenario net operating position, having regard to the management fee owed to the Council and their own forecasted outturn position. Having this information enables the Council to consider whether there is a need to provide further financial support in order maintain access to public leisure services for our residents and customers.

2.11 The latest forecasted position (not including additional energy costs) is included in the table below. The best-case scenario is for the Council to receive a management fee of £536,284, with the worst-case scenario leading to a management fee being received of £264,321. In the event that the best-case scenario were achieved, the Council would expect to recover the whole amount of £536,284. This would represent £63k compensation for lost income in prior years.

Worcester Forecasts 22-23 BEST CASE (15.8.22) - Excludes Management Fee													
	April	May	June	July	August	September	October	November	December	January	February	March	Total
	Actual	Actual	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection
Perdiswell	30,125	13,819	- 10,032	- 70,114	- 36,092	- 4,017	40,423	42,571	22,830	55,561	63,270	298,108	446,451
St Johns	- 9,204	- 26,595	17,165	14,904	14,930	14,809	14,644	14,685	14,894	14,422	14,424	14,351	166,619
Nunnery Wood	7,870	- 4,599	- 7,687	- 5,037	- 2,736	- 3,162	1,853	458	- 3,793	6,805	6,439	- 25,196	- 28,785
Active Communities	- 5,790	- 3,983	- 5,934	- 3,978	- 6,720	- 4,695	- 4,270	- 4,887	- 4,082	- 4,614	- 4,324	5,279	- 48,001
Surplus/(Deficit)	23,001	31,832	- 6,488	- 64,225	- 30,618	2,935	52,649	52,827	29,848	72,174	79,808	292,542	536,284

  

Worcester Forecasts 22-23 WORST CASE (15.8.22) - Excludes Management Fee													
	April	May	June	July	August	September	October	November	December	January	February	March	Total
	Actual	Actual	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection	Projection
Perdiswell	30,125	13,819	- 10,032	- 83,143	- 50,404	- 23,029	16,498	18,352	1,403	30,478	36,721	272,032	252,822
St Johns	- 9,204	- 26,595	17,165	10,382	8,960	8,598	8,101	8,225	8,851	7,437	7,442	7,223	109,775
Nunnery Wood	7,870	- 4,599	- 7,687	- 7,035	- 4,848	- 5,621	- 760	2,000	- 6,013	4,314	3,913	- 27,809	- 50,275
Active Communities	- 5,790	- 3,983	- 5,934	- 3,978	- 6,720	- 4,695	- 4,270	- 4,887	- 4,082	- 4,614	- 4,324	5,279	- 48,001
Surplus/(Deficit)	23,001	31,832	- 6,488	- 83,774	- 53,012	- 24,747	19,569	19,690	159	37,615	43,752	256,726	264,321

### Energy cost impact

- 2.12 Freedom Leisure's current utility tariffs expire in September 2022 (gas) and October 2022 (electricity), and they have informed the Council that based on projected tariff increases it is likely that the additional costs in 2022/23 will be £252,036 (not including irrecoverable VAT). This is subject to change if the rates change in the next couple of weeks prior to entering into a new set of energy contracts.
- 2.13 The impact of the in-year increase in energy costs could be absorbed by a reduction in the Management Fee and reflected in the table above. However, for transparency it is proposed that the actual costs be offset by a transfer from reserves so that the impact of energy increases – which are subject to a separate contract regime – can be monitored separately from the impact of other inflation increases.
- 2.14 At a time when recovery is beginning to gain momentum, leisure providers are being hit hard by rising utility costs and the recent cost of living pressures on households which will adversely impact consumer confidence, throughput, and participation rates.
- 2.15 Freedom Leisure have asked the Council to consider providing further financial support to cover the increase in costs as set out within this report. The future impact of rising energy costs may be more significant. Freedom Leisure are facing increasing inflationary pressures that are adding to the running costs of the business and the scale of these were not built into the bid submission when the contract was let. Without some form of intervention from the Council, the operation of leisure services as currently delivered could be placed at risk.
- 2.16 The energy contracts to be re-let in September and October would normally be for a 4-year energy period. Freedom have indicated that the full-year additional energy costs are forecast to be up to a value of £506,000 per year above existing cost levels. To understand the full impact of these pressures it is necessary to undertake a detailed review of provision and understand the potential options for mitigating this impact ahead of budget setting for 2023/24 and the setting of the Medium-Term Financial Plan up to 2026/27.

### **3. Preferred Option**

- 3.1 Supporting the continued operation of our leisure centres in 2022/23 through direct financial support is the preferred option, particularly if it delays by several months any potential impact to residents through a revised set of fees and charges linked to inflation.
- 3.2 For future years, to undertake a detailed review of leisure services provision to determine the options for addressing the long-term impact of increasing energy costs.

### **4. Alternative Options Considered**

- 4.1 As set out in this report, a fees and charges review which would have resulted in a request to increase prices to customers was proposed. This has been discounted due to the impact that this would have on residents and visitors at a time when the Council has declared a cost-of-living crisis and is actively seeking to support those on lowest incomes. Furthermore, the timing of a potential increase would have coincided with the pool at Perdiswell Leisure Centre only having been open for a matter of weeks following a 3-month closure to replace floor tiles.
- 4.2 The provision of financial support to Freedom Leisure in the form of a reduction or a waiver of the management fee owed to the Council has been discounted as a full management fee has been budgeted as income in 2022/23 through until 2025/26 when the contract is due to expire.
- 4.3 At this point in time a temporary closure of one or more of the Council's three leisure centres has been discounted due to the overall net financial impact requiring further investigation. Temporarily closing one or more leisure centres would result in the reduction or failure to receive management fee that has been budgeted for and in addition there would be costs that the Council would be required to cover in keeping one or more leisure centres ticking over during the closure period. The combination of both these factors would need to be compared against the reduction in additional energy costs associated with a site.
- 4.4 The option of bringing the operation of leisure centres 'in-house' at this time has also been discounted as the increase in costs faced by Freedom Leisure would also be faced by the Council if it were the operator. Furthermore, the Council would be unlikely to benefit from the levels of tariff Freedom Leisure can, due to their purchasing power across multiple contracts and sites.
- 4.5 The installation of solar power generation at one or more of the centres to reduce reliance of energy from the National Grid is being investigated with conversations progressing about undertaking feasibility work in respect of Perdiswell Leisure Centre and its car park. Further options for energy efficiency measures will be considered as part of a wider review.

### **5. Implications**

#### **5.1 Financial and Budgetary Implications**

The report is recommending the provision of financial support up to a maximum value of £255,000 to cover the period 1 October 2022 – 31 March 2023. It is recommended that this is taken from the Council's Business Rates Risk Reserve.

The Reserve has an expected balance at March 2023 of £2.488m, subject to any other requirements for funding that arise during the year. As agreed under previous decisions of the Committee, a minimum balance of £1.4m is required on the Reserve to mitigate the risk of reduced income arising from the Government's planned business rates reforms due to take place in 2023/24. A withdrawal of £255,000 would leave a balance of £2.233m, although a further £0.4m is committed for 2023/24 as part of the Government's Covid-19 business rates risk-spreading scheme.

## 5.2 Legal and Governance Implications

Subject to approval of this report, financial support would be managed and provided on the same basis as during the COVID-19 Pandemic via a fully open-book arrangement with payments made in arrears.

There is no clear provision within the contract that is required to be triggered for this support to be put in place and the arrangement is very much in the spirit of the contract being a partnership arrangement.

## 5.3 Risk Implications

There is currently 1 corporate risk linked to the provision of leisure services. The first of these is a legacy of COVID-19 and is the risk to the viability of the operator due to reduction in demand. Freedom's projections have confirmed that demand has returned well (if not to pre COVID-19 levels yet) and the Worcester contract compares well nationally. This risk has therefore been classified as tolerable to date.

As the report has set out, however, the impact of rising energy costs is now threatening the existing arrangements for leisure services, which need to be reviewed accordingly.

## 5.4 Corporate/Policy Implications

The Worcester City Plan 2022 – 2027 makes it clear that Worcester aspires to be a healthy & active city where people should have the opportunity to be as fit and healthy as they can be by using all of Worcester's assets, from the swimming pools to our green spaces, to improve their wellbeing. Part of this is people using state-of-the-art fitness and leisure facilities provided by Freedom Leisure on behalf of the Council, to be active and healthy.

The Council wishes to help more people make healthier choices, more easily leading to an increase in sport and physical activity for all age groups through the wider sporting community, such as the Parkrun and grassroots sport.

There are no negative impacts as a result of agreeing to the recommendations in this report.

## 5.5 Equality Implications

There are no equality implications associated with this report.

## 5.6 Human Resources Implications

There are no human resource implications associated with this report.

## 5.7 Health and Safety Implications

There are no health & safety implications associated with this report.

## 5.8 Social, Environmental and Economic Implications

Subject to approval of this report there would be positive social, environmental, and economic implications.

Socially, sustaining the operation of the Council's three leisure centres and the active communities programme will benefit the health and well-being of our residents and users both physically and mentally.

Environmentally, the increase in energy prices to such an extent has added emphasis and pace to the commitment that was already in place to consider alternative power generation across the three centres. It will also drive the day-to-day operation to further consider how energy consumption can be reduced.

Economically, sustaining the operation of the Council's three leisure centres will ensure that locally-employed staff remain employed and furthermore will ensure that the leisure market remains competitive with a thriving public sector offer.

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**Background Papers:** N/A