

Decision Pathway – Report Template



PURPOSE: Key decision

MEETING: Cabinet

DATE: 05 November 2019

TITLE	Hengrove Leisure Centre: Parkwood Community Leisure conversion to Lex Leisure Community Interest Company (CIC)		
Ward(s)	<i>Hengrove and Whitchurch Park</i>		
Author: Guy Fishbourne	Job title: Sport & Physical Activity Development Manager		
Cabinet lead: Cllr Craig Cheney	Executive Director lead: Jacqui Jenson		
Proposal origin: <i>Other</i>			
Decision maker: Cabinet Member Decision forum: <i>Cabinet</i>			
Purpose of Report:			
<ol style="list-style-type: none"> The purpose of this report is to inform cabinet of a proposal presented to the Council by Parkwood Leisure that involves them terminating their current leisure subcontract at Hengrove Leisure Centre, to Parkwood Community Leisure, and replace it with a new leisure subcontract to Lex Leisure CIC. The new CIC will benefit from VAT and NNDR relief and consequently provide an annual payment of £76,000 plus VAT to the Council 			
Evidence Base:			
<ol style="list-style-type: none"> Hengrove Leisure Centre was built under the Private Finance Initiative (PFI) and has been operational for 7 years. The Councils contractor (Bristol Active Limited (BAL)) operates and maintains the facility and is contractually bound to continue doing so until 2037. This sits outside the scope of the current Everyone Active contract (which includes six other sites) and Jubilee pool which expires in March 2022. Parkwood Leisure has put a proposal directly to BCC to terminate their current leisure subcontract to Parkwood Community Leisure, and replace it with a new leisure subcontract to Lex Leisure. Lex Leisure is a Community Interest Company (CIC) that has been established to build upon the legacy of two successful Paralympic games in London and Rio, the Invictus Games and other sporting events that have helped to inspire persons with physical, mental or health related inequalities to be physically active. Lex Leisure seeks to operate leisure venues on a commercial basis with a view to generating a surplus that can be used for its principal objective of supporting those who are disabled, physically or mentally or who require support or bespoke care plans to stay physically active The Lex Leisure Board offer grants to local community groups and clubs/organisations. This will be implemented at Hengrove. The offer of grants will reflect the principles and priorities of the CIC encouraging applications from disadvantaged and disability groups/individuals. This proposal sees Lex Leisure being entitled to retain 0.75% of sales turnover (currently £25,000) which would be used towards an annual small grants pot for Bristol applicants to bid in to. A further 0.75% of sales turnover will be contributed by Parkwood Leisure Limited amounting to an overall annual small grants pot which equates to 1.5% of the annual sales turn over. 			

7. The Lex Board of Directors will meet on a quarterly basis during which a review and allocation of grant applications is made. Branded grant application forms & criteria plus promotional material outlining the opportunity and the process will be available. This will be displayed within the centre and details shared on their website.
8. There will be the opportunity for members to be a part of the grants process but at this stage the detail is still to be confirmed. However, the final decision on the grant allocation must rest with the Lex Board.
9. Lex Leisure CIC is structured as a private company limited by guarantee and as such is able to attract external funds and grants from industry, commercial organisations and other bodies to support the delivery of community based programmes, targeted towards their key user groups and target audiences. It also benefits from VAT and NNDR relief.
10. The proposal will provide Bristol City Council with a £33,000 one off payment in Year 1 (2020 calendar year), which is the final amount net of legal fees and costs of transfer, and a set fee of £76,000 (+ VAT) indexed annually and payable from year 2 (2021 Calendar Year). This figure (£76,000) represents a 53% split of the financial CIC operating benefit projected. This annual income over the rest of the contract term (18yrs) will add up to over £1.3 million in savings for the Council.
11. The Council's PFI Contractor Bristol Active Limited (BAL) will receive 7% (£10k) per annum.
12. Any residual benefit (40% in year 1) will be retained by Parkwood Leisure Limited as they carry the full income risk in this proposal. The sum to the Council is guaranteed and indexed ensuring whatever the trading position of Parkwood Leisure Limited, the benefit to the Council is not at risk. The proposal requests the Council to waive any benchmark until 2025.
13. All of the mechanisms in the current PFI contract will remain the same including the profit share arrangement. In this way the risk profile is unchanged and does not impact the authority or the PFI Contractor (Bristol Active Limited) other than to provide an additional indexed annual payment.
14. All staff would transfer from Parkwood Community Leisure to Lex Leisure under TUPE retaining all of their current terms and conditions. There would be no change to any terms and conditions of employment, hours of work or pension arrangements.
15. There will be changes required to the Project Agreement and lease to reflect the change of subcontractor to Lex Leisure, and the SPV bank and funders will require their own legal advice and due diligence on the change.
16. The proposal will be legally captured by a direct agreement between the Council and Parkwood Leisure Limited, avoiding the need for a deed of variation to the main contract. The principle reason why the direct agreement approach is suggested is the bank's objection to amending the main project agreement using the change control procedure on the basis that :
 - (i) the current scenario doesn't actually constitute a change for the purposes of the project agreement and so wouldn't allow that mechanism to be used and
 - (ii) more commercially neither the Bank nor BAL will accept the risk of the VAT savings being channelled through the PFI SPV

Officer Recommendations:

1. That subject to the satisfactory completion of financial and legal due diligence, authority is delegated to Executive Director: People (in consultation with the Cabinet Member for Finance, Governance and Performance) to support Parkwood Leisure in the conclusion of the transfer from Parkwood Community Leisure to Lex Leisure, including the completion of all necessary legal documentation.

Corporate Strategy alignment:

1. Using our assets wisely, generating a social and/ or financial return. Raise money in a fair but business like way.
2. Supporting the organisational priority to be responsible financial managers and explore new commercial ideas.
3. Support the medium term financial plan.

City Benefits:

1. Efficient and effective service delivery.

Consultation Details:**Background Documents:** *NA*

Revenue Cost	<£76k saving per year	Source of Revenue Funding	External funding (Parkwood Leisure)
Capital Cost	£0.00	Source of Capital Funding	<i>N.A</i>
One off cost <input type="checkbox"/> Ongoing cost <input type="checkbox"/>		Saving Proposal <input type="checkbox"/> Income generation proposal <input checked="" type="checkbox"/>	

Required information to be completed by Financial/Legal/ICT/ HR partners:**1. Finance Advice:**

- 1.1 Hengrove Leisure Centre PFI has been operational for 7 years. The contractor built, operates and maintains the facility and is contractually bound to continue doing so until 2037. To assist with the affordability of the contract, the council injected £4m of capital into the project at the start, which was financed through prudential borrowing and that is being repaid at £161k per year for the duration of the contract. The finances of the contract for 2019/20 are summarised in **Table 1**.

Table 1: Expected costs on Hengrove PFI 2019/20 and sources of funding.

Component	Expected 2019/20 £'000
Prudential Borrowing costs	161
Unitary Charge (Fixed element)	2,813
Unitary Charge (Indexed to RPIx)	195
Utilities (Indexed to annual tariff changes)	431
Total costs	3,600
Funded from	
PFI Grant	-2,786
General Fund Budget	-662
Contribution from PFI Reserve	-152
Total income	-3,600

- 1.2 The PFI contract includes a leisure contract for the leisure operations at the facility. This is with Parkwood Leisure Ltd and they deliver the services through Parkwood Community Leisure (a non-profit distributing company (NPDO)). The leisure contractor is required to produce an audited income and expenditure statement each year which sets out the amount of any deficit or surplus that has been generated each year. A profit share arrangement is in place where any surplus up to 13% of the higher of expenditure or income for the year, is retained by the contractor. Between 13% and 17.5%, 70% is retained by the

contractor and 30% is provided to the Council. Beyond 17.5%, any surplus is shared 50:50. The latest income and expenditure statement, for the period to 31st March 2019 indicated a surplus of 4% (£0.116m on a turnover of £2.841m). To date, there has not been a year when the surplus amount has triggered any share for the Council.

- 1.3 The proposal from Parkwood is to switch their leisure operator from an NPDO (Parkwood Community Leisure) to a Community Interest Company (CIC) (Lex Leisure). A CIC uses surpluses for community purposes, and Lex Leisure indicate that this would be for access to sport and facilities for people with disabilities or health inequalities. From a financial perspective, delivery through a CIC has benefits in the cost of national non-domestic rates (NNDR) and how transactions are treated for VAT purposes.
- 1.4 The current arrangements through the NPDO already benefit from 100% rate relief on the facility, so there can be no improvement on that. The VAT arrangements are a combination of gains and losses, which represent a net gain. For income generation activities (eg subscriptions) where VAT is no longer chargeable, so, if charges to customers are the same, the current VAT element becomes real income. For some expenditure items, however, VAT incurred may no longer be recoverable from HMRC because the income that funds it is VAT exempt.
- 1.5 Officers have had specialist VAT advice and have concluded that the VAT status of the £3.429m payments to Bristol Active Limited for the unitary charge and utility costs is unaffected by the change of sub-contractor.
- 1.6 Parkwood Leisure has indicated that they estimate the net benefit to be £0.143m, as per table 2.

Table 2: Summary of net on-going annual financial benefit from switching to a CIC

Component	Estimated annual impact £m
VAT Benefit on Income	£0.416m
Irrecoverable VAT on expenditure	(£0.133m)
Other additional on-going costs associated with the new arrangements	(£0.140m)
Benefit to Share	£0.143m

- 1.7 Parkwood has provided a detailed account of how each of these figures has been calculated and the numbers are consistent with the explanations they have given.
- 1.8 The current arrangements have the leisure sub-contractor, Parkwood Community Leisure, as a Non-Profit Distributing Organisation. This means that there is, in effect, no profit, as any surplus is transferred as a fee to the contractor (Parkwood Leisure). The proposed arrangement would have Lex Leisure as sub-contractor instead. Lex Leisure would be entitled to retain 0.75% of sales turnover (currently £25k) which would be used for the community purposes indicated in the proposal. A further 0.75% of sales turnover will be contributed for community purposes by Parkwood Leisure Limited amounting to an overall annual small grants pot which equates to 1.5% of the annual sales turn over.
- 1.9 Parkwood have proposed that the Council receive 53% of the on-going benefit to share, but that be fixed at specific guaranteed sums, rather than percentages (£33k in 2020 calendar year, to take account of the one-off legal costs of introducing the CIC, and £76k plus VAT indexed each year thereafter). 7% of the on-going benefit would go to Bristol Active Limited (the PFI Special Purposes Vehicle) and 40% would be retained by Parkwood Leisure.
- 1.10 Parkwood have asked that the contractual requirement to benchmark the leisure operation be deferred to 2025 to give the operator 5 guaranteed years of operation. Benchmarking is due every five years and could be triggered by either party now. In effect, Parkwood are asking for this change instead of a full benchmarking exercise. Officers have insufficient information to estimate the likely outcomes from a benchmarking exercise, the outcomes of which cannot be known as it would be done independently of all

parties. Benchmarking is neither a quick, nor a straightforward, exercise and if the Council were to trigger a benchmark now, it would delay decisions on the Community Interest Company option.

1.11 The proposal appears to be financially attractive compared to the current arrangements where the Council is unlikely to be in a position to benefit from the profit share with current levels of declared surplus by the leisure operator. A profit share of £76k to the Council under the current arrangements would need profit overall to be around 20% of turnover, rather than the 4% achieved to 31st March 2019.

1.12 Much as the Council would wish to have a profit share arrangement which had a lower threshold for the Council to start to share any gains, this is a feature of the original PFI contract to which the SPV (on behalf of the shareholders of and the lenders to the PFI contractor) is very unlikely to give its consent.

1.13 Formal due diligence on this will be necessary before a final judgement is made.

Finance Business Partner: Neil Sinclair, 2nd October 2019

2. Legal Advice: The principal proposal would be captured in a new direct agreement between the council, Parkwood Leisure Limited (the 'Leisure Operator' under the PFI) and Parkwood Leisure Holdings Limited (the guarantor under the leisure contract with the SPV). The idea is to leave the risk profile and payment mechanism under the current PFI unchanged, and to replace the Leisure Operator's current sub-contractor with a more VAT efficient Community Interest Company (CIC) (Lex Leisure).

A deed of variation of the Hengrove Leisure Centre PFI Project Agreement would be required (e.g. changing references to the current leisure sub-contractor to Lex Leisure), but there is a consensus of view (including with the banks) that the amendments required would not constitute a formal "Change" to the Services. Likewise, the required amendments to the Project Agreement would not constitute a material / substantial change for the purposes of public procurement law. It follows that the changes could be agreed (subject to consideration of the financial, commercial and tax related risks and benefits, including the reasonableness of Parkwood's request to suspend benchmarking under the PFI for 5 years) without instigating the contractual change control mechanism (i.e. without bank approvals or certification etc), and without requiring a waiver of the council's procurement procedures. The banks, Parkwood / the SPV, as well as the council, will wish to carry out legal and technical due diligence on the direct agreement and related documents, but the process should be simpler and less costly than with a formal Change.

A high level table listing the proposed documentation has been provided by Parkwood Leisure and commented on. The documents are said to have been used previously by Parkwood on similar matters, and include documents that the council would not be party to. While the proposed contractual structure does not raise any particular concerns a full review, together with negotiation of the relevant contractual provisions, will be required in due course. A review would consider the key issue of what should happen (and who bears the cost / risk), if the CIC arrangement proves to be inefficient and will Parkwood seek to impose conditions on the guaranteed fixed payment other than where the VAT exemption is lost.

At this point in time, and provided that the council's technical and financial advisers can advise on the VAT / financial mechanisms in the direct agreement, it is felt that the proposal could be transacted using internal legal resource although a view will be taken on whether external expertise is required after the draft documentation has been provided for review.

Legal Team Leader: Eric Andrews, Team Leader, Legal Services 24/10/19

3. Implications on IT: There are no identifiable IT implications arising from this report

IT Team Leader: Simon Oliver – 24/09/19

4. HR Advice: The report proposes that Parkwood Leisure terminates their current leisure subcontract at Hengrove Leisure Centre to Parkwood Community Leisure and replace it with a new leisure subcontract to Lex Leisure CIC.

There may be TUPE issues between sub-contractors but none of the staff affected by this are Bristol City Council employees.

HR Partner: Lorna Laing 16/10/19

EDM Sign-off	Jacqui Jenson	7 th August
Cabinet Member sign-off	Cllr Craig Cheney	9 th September
For Key Decisions - Mayor's Office sign-off	Mayor's Office	7 th October

Appendix A – Further essential background / detail on the proposal	NO
Appendix B – Details of consultation carried out - internal and external	NO
Appendix C – Summary of any engagement with scrutiny	NO
Appendix D – Risk assessment	NO
Appendix E – Equalities screening / impact assessment of proposal	YES
Appendix F – Eco-impact screening/ impact assessment of proposal	NO
Appendix G – Financial Advice	NO
Appendix H – Legal Advice	NO
Appendix I – Exempt Information	NO
Appendix J – HR advice	NO
Appendix K – ICT	NO