Report of the Strategic Director of Place to the meeting of Executive to be held on 10 October 2017.

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Subject:

Future management options for Sport and Culture services.

Summary statement:

The report will consider the findings of a study undertaken to determine the most suitable future management option for the council's sport, leisure and cultural facilities.

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Portfolio:

Environment, Sport & Culture

Overview & Scrutiny Area:

Regeneration

1. SUMMARY

The report will consider the findings of a study undertaken to determine the most suitable future management option for the council's sport, leisure and cultural facilities.

2. BACKGROUND

An options appraisal report has been prepared which examines the future management of sport and culture in Bradford Council in the context of ongoing severe reductions in government funding for the council. This work follows a council budget decision to examine the potential savings from the creation of a culture company and a separate Executive decision to examine future management options for sports facilities.

Following a procurement process specialist consultants Winckworth Sherwood were appointed to complete the options appraisal for the future management of Culture and Leisure.

The report considers the following five options:

Option 1 In-house / status quo
Option 2 Outsourcing to local authority controlled company (LACC)
Option 3 Outsourcing to a mutual or co-operative
Option 4 Outsourcing to Not for profit distribution organisation (NPDO)
Option 5 Open competitive tender to private or voluntary sector

This summary of the options should be read in conjunction with the detailed financial analysis contained in the Winkworth Sherwood (WS) Options Appraisal Report.

2.1 Option 1 In-house / status quo

(WS report page 23) Advantages of the in house option include the Council retaining control of the facilities and thus being able to spread their overheads. There would be easier strategic integration between the Council and health bodies, promoting health and wellbeing. And staff employment would continue within the local authority, which is perceived as more comfortable for staff than any of the alternatives.

Disadvantages

The disadvantages of the in house option include that all risk remains with the Council.

Deficit-financing of sport and culture services is a risk and any discretionary services may become subject to further financial stringency. The Council has resolved to find significant savings.

Whilst most of the options predicate retention by the Council of some structural maintenance obligations, the status quo involves a 100% commitment which could place strains on the Services if inadequate funds are allocated for this purpose.

Overall there is a risk that facility closure or service cessation may be required with the consequential impact and risks.

2.2 Option 2 Outsourcing to local authority controlled company (LACC)

(WS report page 24) Many local authorities are transferring services to their own controlled companies following the pattern adopted with the creation in housing authorities of "arm's length management organisations".

Advantages

The advantages of the LACC is that although it is controlled by the Council, it would be independent of it and would therefore be able to trade and operate with some freedom within its own budget.

Under the recent Public Procurement Regulations, the Council can agree terms for the provision of the services direct with the LACC rather than advertising the opportunity generally, by virtue of the LACC being classified as a Teckal company. However, the LACC could not undertake more than 20% of its business to third parties by turnover.

If the LACC proved successful through catalysing the entrepreneurial spirit in the Council's Staff, the LACC could develop into a more formal externalisation, such as an NPDO or Voluntary Competitive Tendering ("VCT") but this has procurement implications.

The staff are likely to TUPE transfer to the LACC with all the obligations arising there from.

The LACC could seek discretionary non-domestic rates ("NNDR") relief on some or all of the facilities (resulting in up to a 50% saving to the Council on the relief granted), although the position after the anticipated 2020 changes to NNDR may affect this percentage saving.

It may be possible to obtain VAT exemption on sports charges for the LACC on obtaining approval from HMRC.

Disadvantages

The disadvantage is that the LACC would require continuing subsidies (to be negotiated) as there are no automatic savings arising from transfer, as NNDR relief would be discretionary. The LACC would be unable to opt for charitable status. Additionally the financial operation of the LACC as a wholly owned subsidiary of the Council would be reportable to Companies House within the respective annual accounts of the Council.

2.3 Option 3 Outsourcing to a mutual or co-operative

(WS report page 25) A mutual or co-operative would be an entity owned by and operated for the benefit of its members. Thus, a co-operative would be solely Council employee-owned and managed at strategic level by its board and a mutual could be both Council staff and/or community-owned and managed. This may also involve TUPE transfer of staff.

Advantages

The advantage is that as a single focused body with significant staff participation, it could catalyse Council staff who would own (in the case of a co-operative) and run the Services and facilities.

There have been a significant number of successful mutuals created to take over and manage a wide variety of local authority services and these have been both charitable and non-charitable.

Knowledge of the Council's services by the new mutual or co-operative would give employees an important sense of ownership in decision-making.

Mutual or co-operative could benefit from Regulation 77 of the Public Procurement Regulations, to permit the contract for the Services reserved for mutuals and co-operatives.

Some "mutuals" could achieve charitable status in limited circumstances and thus may gain the advantages of a charitable NPDO.

Disadvantages

The disadvantages or risk is that if the co-operative is unable to obtain charitable status, it would not be able to benefit from NNDR relief and may have difficulty obtaining VAT savings. In these circumstances there would be no other financial benefits available to a co-operative.

2.4 Option 4 Outsourcing to a new NPDO set up by the Council

(WS report page 25) An NPDO is a non-profit distributing organisation. This means that the organisation's profits cannot be distributed but must be reinvested by the organisation to improve service provision.

The overriding consideration when evaluating the alternative models is the difference between the charitable and non-charitable NPDO models.

Advantages

The main advantages include NNDR savings, involving net saving to the Council of 50%, assuming both mandatory and discretionary relief are granted.

There would be VAT savings on sporting charges currently paid to the Council by customers.

Potentially moving to a NPDO could resolve possible ‘partial exemption’ risks relating to VAT (see section 3.1).

The NPDO would be a single focused body with a unitary purpose. It would provide the opportunity for community involvement in the management of the NPDO.

The NPDO would also have potential to access private finance for improving and enhancing any of the facilities if no funding is available by way of prudential borrowing from the Council.

Charitable status would also have a range of fiscal advantages including exemption for corporation tax and opportunity for gift aid on donations and some entrance fees, opportunity for corporate sponsorship and donations, and greater access to National Lottery funding.

There are certain other sources of funding for charities not available to local authorities, such as charitable giving involving gift aid and charitable trusts and foundations who will only grant fund other charitable entities. Staff would TUPE transfer to the NPDO.

Disadvantages

There are a number of disadvantages which should be borne in mind including some affecting only charitable NPDOs.

Most significantly there would be a loss of direct Council control. Although there would be greater community involvement with an NPDO, continuing involvement by the Council would require the Council to appoint nominees to the board of any new entity. The number of Councillors on the board would be limited and could not exceed 20% of the overall board.

Any non-charitable or trading activities, such as tourism and the markets, would have to be undertaken through a non-charitable subsidiary.

2.5 Option 5 Open competitive tender to private or voluntary sector

(WS report page 27) Outsourcing through a competitive tender to private sector / voluntary sector, VCT (Voluntary Competitive Tendering)

The VCT arrangement could take various forms with the Council selecting a contractor who would either enter into a contract which resembled the now defunct compulsory competitive tendering (“CCT”) or enter into a contract involving a “pocket” NPDO to access some of the NNDR savings.

The two options have some similarities and are discussed separately below.

In the case of VCT there would be no in-house tender. The use of a negotiating process would ensure that the contract could generate the best deal for visitors to the facilities or the Council in the longer term and the contract length could be determined by the Council.

The end result would be that responsibility for the management of all or part of the services would transfer to the private sector and that the staff would transfer under TUPE. The contract would contain all the standard provisions associated with documents of this kind and there is likely to be a significant payment by way of a management fee to the contractor by the Council in the light of the current deficit, taking into account potential savings as a result of the transfer.

As there is not a contractor that could manage the entire portfolio the contract would have to be let in multiple lots. This would impact upon the set up costs if the Council was to complete multiple separate tendering exercises, involving an elaborate procurement process and significant professional advisers' fees and officer time. In addition, the residual monitoring costs would be high with a range of contractors and the inevitable loss of synergy, which is now enjoyed.

Advantages

Most of the short term risk passes to the private operator.

There should be no adverse impact upon the Council's 5% input VAT threshold, although this will depend on the lease arrangements.

Private sector contractors would be able to access funding immediately and the amount of funding would be dictated by the length of the management contract.

The Council could share "super-profit" on any success with the contractor.

Disadvantages

In view of the range of facilities, a number of contractors would need to be involved and there would be a complex client/contractor relationship with potential problems should any contractor fail.

The set up costs of the Council's client side operation would be large and the tender documentation would be both expensive and time consuming to prepare.

In the case of a truly private sector company, the venture would be solely profit-driven and a desire for increased profits may interfere with the integrity of the Services.

The contractor would be seeking a 20/25% return on any capital injection and a 10% management fee based upon turnover. This would impact upon the financial benefits to the Council as any capital funding would reduce or eliminate any prospect of a service fee.

Lease of the facilities to the private sector operator and operation of the contract would represent the only involvement of the Council in the future management of any services outsourced. This lease would have to stipulate in some detail the investment requirements and repairing obligations as well as the Council's income expectations.

No NNDR or VAT savings (unless using a pocket NPDO).

No scope to spread the Council's central overhead costs as the private contractor would employ its own staff and charge for the expenditure. Also the contractor would not wish to utilise any of the Council's other services.

Depending upon the nature of the private sector operator, staff terms and conditions may be adversely affected despite the provisions of TUPE.

VCT with pocket NPDO

A number of private sector operators have created wholly-owned charitable or non-charitable NPDOs to take leases/licences of the facilities to attract discretionary NNDR relief. In the case of one contractor, a free-standing or independent charitable NPDO is created locally with local/community board members who then employ the contractor to manage the facilities on their behalf. However, although these arrangements are widely used, there are misgivings about providing discretionary NNDR relief to a wholly-owned subsidiary of a private sector with-profit entity.

This latter arrangement would need to take into account the relevant legislative provisions. The facilities would be leased to the new NPDO which would then take transfer of the staff under TUPE, perhaps jointly with the contractor.

In practice, some private contractors using pocket NPDOs have some local representatives on the board.

VCT to existing NPDO

Increasingly local authorities are tendering out their facilities to existing NPDOs who are, in practice, competing effectively with the private sector.

NPDOs are thus creating structures to undertake local management transferring the facilities either to locally-based NPDOs within a group structure or generally contracting direct with the local authority.

Whilst, unlike the with-profit sector, there are some existing NPDOs managing a whole range of services, such as those at Wigan, Peterborough and Rochdale, we do not detect any appetite for new commitments of this nature.

Advantages and disadvantages of VCT to existing NPDO

The factors relevant to the VCT arrangements would equally apply to this option, except that:

An existing NPDO has no shareholders and will not therefore regard pursuit of profit as a key ingredient.

The existing NPDO would however be expecting a return on their involvement and would not seek to utilise any of the Council's other services.

Existing NPDOs are unlikely to create a designated Bradford District NPDO and would take the management contract direct.

2.6 Consultant's Main Findings

Based on the financial analysis and other considerations the consultant's recommendation is that the Council sets up an NPDO (Option 4).

The report shows potential savings resulting from the transfer to trust which are in three blocks;

- increased income
- efficiency
- savings from national non domestic rates (NNDR)

3. OTHER CONSIDERATIONS

3.1 A CJEU decision on VAT handed down on 13th July in relation to a claim by Ealing Borough Council may have far reaching consequences for all Local Authority Sport and Leisure operations. This change could also result in the cost of the new build facilities taking the Council over its partial exemption VAT limit. Mitigating actions to avoid incurring irrecoverable VAT will need to be considered.

3.2 The options review needs to be considered along side work that is ongoing within the council's current plans. Over the next two to four years the Council has planned capital investment totalling more than £50m. This work includes refurbishment at St George's Hall, the construction of two new sports facilities and investment in cemeteries and crematoria. At the same time the Council is committed to multi-million budget savings. These strategies and actions will result in more people taking part and at the same time reducing costs in sport and leisure and in other service areas.

3.3 EU public contracts regulations changes effective from 2016 significantly amended the arrangements for selecting or appointing contractors for local authority services. This means that the direct award of a contract to an in house NPDO could potentially be problematic. It is possible that there may be further changes to procurement regulations arising post "Brexit".

3.3 Impact on Potential Savings

The Consultant's report shows potential savings resulting from the transfer of all Council culture and sport services to a trust.

The savings are in three blocks;

- increased income
- efficiency
- savings from national non domestic rates (NNDR)

Based on the report findings the savings from NNDR are smaller than the efficiency and income increases. NNDR savings are low because rateable values are low and it is only these NNDR that cannot be achieved without going in to a trust.

The Council could potentially achieve some of the efficiency and income savings over the next two to four years without transferring to trust. The benefits of the NPDO/Trust could be reviewed once some of the transition work has been completed.

Retaining the in-house option for the time being would require the Council to:

- Review investment priorities and take risks similar to those that the private sector would take to optimise financial performance

- Consider changes to the operating arrangements at each facility to reflect changing leisure time expectation

- Introduce innovative marketing and promotion techniques

- Contemplate restructuring the services under review whether or not capital investment is required or forthcoming (this may well involve a disposal of sites and/or further creation of community libraries, for instance)

This process will achieve the majority of the required savings over the next 4 years and making structural adjustments to the service prior to considering an operational partner will help with the speed in achieving the changes.

The recommendation in this report to continue with the existing in house operation for the time being is based on the implication on the savings and in particular the recent legal change regarding VAT.

4. FINANCIAL & RESOURCE APPRAISAL

The report shows potential savings resulting from the transfer to trust or NPDO which are in three blocks:

- increased income
- efficiency
- savings from national non domestic rates (NNDR)

Other factors were taken into account including the impact of Pensions, VAT, insurance and taxation. The table below summarises the level of subsidy needed for a Bradford NPDO according to the analysis from Winckworth Sherwood (WS). WS conclude that by setting up a NPDO the client side costs would reduce by £3.5m over five years.

SUMMARY OF NPDO	2016/17	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	Total
	£'000	£'000	£'000	£'000	£'000	£'000	£'000
Rates		-£507	-£507	-£507	-£507	-£507	-£2,535
Tax		£123	£123	£123	£123	£123	£615
Management		£260	£185	£185	£185	£185	£999
Cost efficiencies		£0	£0	-£696	-£1,378	-£2,046	-£4,119
Internal investment in services		£0	£0	£696	£1,378	£2,046	£4,119
Income Increase		-£466	-£942	-£1,669	-£2,418	-£3,190	-£8,684
Set up	£150						£150
Reserve		£0	£400	£0	£0	£0	£400
Total	**£150**	**-£590**	**-£741**	**-£1,868**	**-£2,617**	**-£3,389**	**-£9,056**
Annual subsidy	£17,348	£16,607	£16,457	£15,329	£14,580	£13,809	£94,130

A number of assumptions underpin the analysis, however. The key assumption is that a Bradford NPDO can increase income on a par with benchmarked performance of 3 comparable NPDO's.

It is important also to note that the systems governing VAT and NNDR have changed significantly. Government initiatives have moved toward local authorities to being permitted to retain 50% of locally collected business rates with an extension to 100% being considered although a final decision has not been made. The VAT system is subject to changes in treatment arising from case law. Recent developments especially regarding charging for sports activity are relevant to the Council's decision. Further consideration of the options should consider the prevailing and future systems for NNDR and VAT.

5. RISK MANAGEMENT AND GOVERNANCE ISSUES

There are risks arising out of the implementation of the proposed recommendations in that the required budget savings may not be achieved. The achievement of the required budget savings will be reviewed as part of the ongoing financial and project progress.

6. LEGAL APPRAISAL

If the in-house arrangement continues for the proposed two to four years, while the Council undertakes planned transitional work, some disadvantages of the 'in-house' option described in the consultant's report could materialise in that time. These disadvantages may reduce if planned transitional work intended to generate savings and income is sufficiently effective. Consequently there are no immediate legal issues that arise from implementing the proposed recommendations.

7. OTHER IMPLICATIONS

7.1 EQUALITY & DIVERSITY

There are no equality and diversity issues arising out of the implementation of the proposed recommendations.

7.2 SUSTAINABILITY IMPLICATIONS

There are no sustainability issues arising out of the implementation of the proposed recommendations.

7.3 GREENHOUSE GAS EMISSIONS IMPACTS

There are no carbon footprint and emissions from other greenhouse gasses issues arising out of the implementation of the proposed recommendations.

7.4 COMMUNITY SAFETY IMPLICATIONS

There are no community safety issues arising out of the implementation of the proposed recommendations.

7.5 HUMAN RIGHTS ACT

There are no human rights issues arising out of the implementation of the proposed recommendations.

7.6 TRADE UNION

There are no trade union issues arising out of the implementation of the proposed recommendations at this stage.

7.7 WARD IMPLICATIONS

All wards.

8. NOT FOR PUBLICATION DOCUMENTS

Winckworth Sherwood Options Appraisal report is exempt under Paragraph 3 (Financial or business affairs) of Schedule 12A Local Government Act 1972 (as amended).

9. OPTIONS

The options considered in this report are:

Option 1 In-house / status quo
Option 2 Outsourcing to local authority controlled company (LACC)
Option 3 Outsourcing to a mutual or co-operative
Option 4 Outsourcing to NPDO
Option 5 Open competitive tender to private or voluntary sector

10. RECOMMENDATIONS

Note the findings of the report, advantages and disadvantages of options and that the NPDO is seen as the preferred option.

That clarification is sought on VAT and NNDR as legislation and guidance is developed by central government

That the internal programme of change is implemented

That option 4 “Outsourcing to an NPDO” be re-examined once the Council has completed its own planned transitional work, likely to be in the latter part of the coming four-year period

11. APPENDICES

Winckworth Sherwood Options Appraisal report is exempt under Paragraph 3 (Financial or business affairs) of Schedule 12A Local Government Act 1972 (as amended).

12. BACKGROUND DOCUMENTS