

FREEDOM LEISURE CONTRACT VARIATION

1. RECOMMENDATIONS

- 1.1 That Cabinet recommend to Council the proposals set out in this report to vary the contract with Freedom Leisure to deal with the significant challenges presented by the unforeseen increases in energy costs, achievable via the incorporation of a mechanism for the Council to share the cost of utilities over and above the costs assumed in the bid.

2. INTRODUCTION

- 2.1 This report sets out a proposal to deal with a request from Freedom Leisure for the Council to offer support considering the significant unforeseen increase in energy costs.

3. BACKGROUND

- 3.1 On 18 June 2021, the Council entered into a contract with Freedom Leisure to run the Council's 5 Health and Leisure facilities commencing on 1 July 2021, for a term of 11 years (with an optional four-year extension). It is worthy of note that the contract years are not contiguous with the Council's year end accounting period, with 9 months of a contract year falling into one NFDC accounting year, and 3 months falling into the next. It is also worthy of note that the contract was signed before the commencement of the war in Ukraine and at a time when the subsequent significant increases in utilities costs could not have been foreseen.
- 3.2 Freedom Leisure is one of the UK's leading charitable and not-for-profit leisure trusts. They manage leisure and cultural services on behalf of over 25 local authority partners and operate more than 100 leisure and cultural venues across the country.
- 3.3 The extraordinary increase in utility costs nationally has had a particular adverse effect on the leisure industry. The sector is finding it extremely challenging to cover the huge energy cost increases and this is at a time when providers are still recovering from the fallout of Covid, which saw leisure facilities close with a slower than expected post Covid recovery.
- 3.4 Freedom Leisure, like many other in the industry, are experiencing these same challenges. Freedom Leisure first formally wrote to the Council in November 2022 to highlight the issues they were facing as a result of the exceptional costs of energy and to ask for a variation to the utility risk share within the contract with the Council taking the additional cost risk over and above bid levels. Freedom Leisure have provided a report, enclosed at Annex A, which explains the impact of the increased energy costs on the deliverability of the contract and the financial sustainability of the New Forest partnership as well as for Freedom Leisure as a group.
- 3.5 The contract between NFDC and Freedom Leisure allows for a 'Net Income Adjustment' calculation to take effect based on the year 2 outturn. Where financial

performance hasn't met the forecast bid position, resulting in the occurrence of a deficit, both parties share the deficit according to a staircase methodology, as summarised in table 1 below;

TABLE 1

	NFDC	Freedom
First £50k	80%	20%
Second £50k	60%	40%
Third £50k	40%	60%
Above £150k	20%	80%

- 3.6 The Net Income Adjustment did not anticipate such significant increases in utilities expenditure; conversely, it assumed a scenario based on utilities expenditure being stable, with the volatility expected within income, on the assumption that post-covid recovery may extend into year 2 of the contract.
- 3.7 Officers of the Council have been meeting regularly with Freedom Leisure to discuss the support that the Council may be able to offer specifically tailored to utilities, and this report sets out the recommendations of officers in this regard. The proposed support deals solely with the increase in utility costs as a result of unforeseen consequences relating to the Ukraine war and global influences, leaving the contractual Net Income Adjustment to support the other financial variations witnessed throughout year 2 of the contract.
- 3.8 Officers have taken expert legal advice on the matter and Appendix 1 to the report contains a confidential summary of the legal advice received from the Council's external legal experts, which is exempt information by virtue of Paragraph 5 of Schedule 12A of the Local Government Act 1972 (Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings). The public interest in maintaining the exemption outweighs the public interest in disclosing the information.

4. PROPOSAL

4.1 The Increase in utility costs due to unforeseen circumstance

- 4.1.1 Following a sustained period of stability in utilities pricing, Russia's invasion of the Ukraine, including global influences, resulted in a significant and unforeseen spike in gas and electricity pricing early in 2022.
- 4.1.2 In recognition of the significant increase in wholesale prices, the Government passed its Energy Bill Relief Scheme Regulations 2022 (known as the EBRs) in November 2022. Although this provided some relief as a result of lowering the wholesale unit price of gas and electricity by means of a discount directly reflected on utility bills, it didn't prevent consumers from seeing residual large increases when compared to previous billing and contract pricing.
- 4.1.3 There are 2 factors here that have been considered in the dialogue with Freedom Leisure;
- 1) the increase in utility expenditure during contract year 2 (covering 1 July 2022 – 30 June 2023); and

- 2) the forecast increase in utility expenditure expected over contracts years 3, 4 and 5.

4.2 1) The increase in utility expenditure during year 2 of the contract

- 4.2.1 The yearend accounts covering year 2 of the contract show a gas and electricity overspend of £785,864 as against the originally budgeted (3% indexed) gas and electricity budget of £489,641.
- 4.2.2 Freedom Leisure has instigated several mitigating actions, including the reduction of pool temperatures, the temporary closure of Sauna / Steam facilities, and fees and charges adjustments, reflecting on CPI.
- 4.2.3 Despite these mitigations, and a successful grant from Sport England to support the utility overspend (further info in para 4.2.5), there is a residual gap between the budgeted position, and the actual spend (whereby actual spend = Gas and Electric spend net of Sport England grant), to the end of June 2023 (contract year 2).
- 4.2.4 Through a contract variation, officers recommend Freedom Leisure absorb the first 10% of the increased utilities costs, when compared to their year 2 bid assumption (3% inflation adjusted), reflecting a reasonable risk tolerance on utilities, and propose a share arrangement for the overspend beyond this 10%. The proposed share is then 50% NFDC / 50% Freedom Leisure. Based on the year 2 outturn figures this equates to;

TABLE 2

	Bid Position £	Actual Outturn £	Variance £
Gas and Electric (net of Sport England grant)	489,641	1,234,336	744,695
Freedom Leisure to absorb first 10% above bid;			48,964
Balance to be shared 50 / 50;			695,731
NFDC Share			347,866
Overall Freedom Leisure Share			396,829

- 4.2.5 It should be noted that the Council (in Partnership with Freedom Leisure) has been successful in obtaining support funding from the Government's Swimming Pool Support Fund (£20M cash fund to support community pools with their increased costs). This income has been deducted from the gross Energy Spend, thus reducing the Council's share accordingly for the fiscal period that ties in with the grant (impacting contract years 2 and 3).

4.3 2) The forecast increase in utility expenditure expected over the next 3 years of the contract

- 4.3.1 Officers recommend Freedom Leisure absorb the first 10% of the increased utilities costs, when compared to their year 3,4 and 5 bid assumption (3% inflation adjusted), reflecting a reasonable risk tolerance on utilities, and

propose a share arrangement for the overspend beyond this 10%. The proposed share is then 50% NFDC / 50% Freedom Leisure.

5. PROCUREMENT CONSIDERATIONS

- 5.1 The contract was awarded pursuant to a public procurement carried out under the Public Contracts Regulations 2015 (the PCR). Any variation of the contract therefore needs to take place in accordance with the PCR.
- 5.2 Regulation 72(1)(c) provides that modifications can be made to public contracts where:
- the need for the modification has been brought about by circumstances that a diligent contracting authority could not have foreseen;
 - the modification does not alter the overall nature of the contract; and
 - any increase in price does not exceed 50% of the value of the original contract.
- 5.3 In this case, officers are satisfied that the grounds for reliance on Regulation 72(1)(c) are met. The modification is necessary due to significantly increased energy prices that could not have been foreseen by the Council at the time it signed the contract in order to ensure that the contract remains deliverable without a reduction in service levels/changes to service delivery for the remainder of the contract term. Officers have noted that Freedom Leisure has carefully considered ways it can seek to mitigate the impact and that a variation to the contract in some form will be necessary to avoid significant risk of future service delivery failure. The utilities risk share mechanism that has been agreed in principle with Freedom Leisure is flexible and will therefore limit additional payment to the minimum necessary to ensure that the impact of energy costs is managed. The variation will not alter the overall nature of the contract, and the increase in payment from the Council will not exceed 50% of the value of the contract.

6. FINANCIAL IMPLICATIONS OF RECOMMENDATIONS

- 6.1 The Council's budget for 2022/23, which covers the majority of year 2 of the contract, included a £475,000 contingency (the headroom above and beyond the annual savings associated with the operational review already built into the General Fund budget) to take account of the contractual Net Income Adjustment, and other potential financial matters arising. The 2022/23 accounts allowed for 9/12ths of the estimated Net Income Adjustment based on figures available over the yearend period. A further £400,000 was placed in a provision and will now be used to fund the Council's contribution towards the year 2 utility payment. The Net Income Adjustment payment balance applicable to NFDC FY 23/24 (3/12ths) will be funded from the equivalent 2023/24 contingency.
- 6.2 The expected financial contribution from NFDC as a result of the proposed contract variation over the next 3 years will be covered by the budgeted contingency. Through the additional contractual income, due from Freedom Leisure in years 3, 4 and 5 of the contract, the Council can still make the intended top-up to the Leisure Maintenance budget, to fulfil our landlord maintenance responsibilities.

7. CRIME & DISORDER IMPLICATIONS

7.1 There are none directly associated with this report.

8. ENVIRONMENTAL IMPLICATIONS

8.1 There are none directly associated with this report, however it is worth noting that the Council continues to work with Freedom Leisure on matters that will reduce energy consumption at the Leisure Centres. A recent example can be cited as the replacement of the end-of-life gas boilers at New Milton Leisure Centre, being replaced with more energy efficient air-source heat pumps.

9. EQUALITY AND DIVERSITY IMPLICATIONS

9.1 There are positive equality and diversity implications for the community in the provision of leisure facilities across the District. The services provided improve the health and wellbeing of residents, take into account those with particular characteristics and play an important contribution to the District's social wellbeing.

10. PORTFOLIO HOLDER COMMENTS

10.1 Community, Safety and Wellbeing

As good partners, it is only right that NFDC should both acknowledge and help to address the significant challenges presented by the unforeseen increases in energy costs for Freedom Leisure.

10.2 Finance & Corporate Services

The contract, including the proposed variation, continues to provide value for money for both the Council and our residents and without which, under previous arrangements the full cost of the unforeseen energy increases would have fallen solely to the Council.

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Background Papers:

Public documents

Exempt information (legal advice)