

Leisure Facility Capital and Decarbonisation Programmes – Consideration of additional funding

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Purpose of the Report

1. To update members on the delivery of two capital projects to ensure the Council's built leisure estate is fit for purpose for the next 14 years. Both projects will significantly reduce carbon emissions at Goldenstones, Wincanton Sports Centre and Westlands Sport and Fitness Centre in line with Corporate Objectives.
2. To request an increase in the capital budget in order to complete delivery of both programmes by end of 2022.
3. To seek approval to fund the increase required from additional grant income received and a virement from the Council's approved Corporate Capital Contingency Budget.

Forward Plan

4. This report appeared on the District Executive Forward Plan with an anticipated Committee date of 12th May 2022.

Public Interest

5. The contract for the operation of the Council's indoor leisure facilities in Yeovil and Wincanton and Chard was awarded to Wealden Leisure Limited (Trading as Freedom Leisure) for 15 years from 1st April 2021 until 31st March 2036.
6. As part of the contract award, the Council approved capital funding to enable Freedom Leisure to manage facility improvements at the Yeovil and Wincanton sites. Improvements include; increased studio provision, enhance gym facilities, improved reception space and catering, expansion of gym, new equipment along with significant works to upgrade or replace mechanical and electrical systems to maintain the facilities in good working order and reduce carbon emissions from the facilities in line with the Council's Environment Strategy and Council Plan objectives.



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7. Under the leisure contract, the Council receives a significant and increasing annual management fee income from the contractor from year three of the contract (which is financial year 2023/24).
8. This report seeks additional budget approval to cover a shortfall, largely arising from inflationary increases in tendered prices from subcontractors' quotes, to deliver the environmental improvement works.

Recommendations

9. That District Executive recommends that the Chief Executive:-
 - a) Agree an increase to the capital budget for the two projects of £1,646,468, using its delegated authority under part 3 of the Constitution (section 4.1) – as set out in paragraph 36 of this report. This would bring the combined total for both projects from £6,295,000 to £7,941,468 as shown in Table 2.
 - b) Agree a virement of £1,015,495 from the approved Corporate Capital Contingency budget (currently standing at £4m) into these two project budgets. District Executive can vire any budget amount over £100k from one individual budget to another as long as there is no overall impact on the total budget agreed by Council (Financial Procedure Rule 2.3 (h)).
 - c) Note that £630,973 of the increase proposed is eligible to be funded from PSDS grant the Council has already received and has not included in its capital-funding budget.
 - d) Agree to delay the PSDS works at Wincanton Sports Centre and accept the consequential funding implications as explained in paragraph 38.
 - e) Note that the Chief Finance Officer will seek agreement to approve these proposals with the other S151 Officers within the Somerset councils as required under the Finance and Assets Protocol.

Background

Public Sector Decarbonisation Capital Project – Leisure Sites

10. The Council approved capital expenditure of £2.8m in February 2021 for decarbonisation works but has been awarded up to £3.993m of Public Sector Decarbonisation Scheme (PSDS) funding. While a total of £3.993m is available, all schemes have to be signed off by the Government's delivery partner, Salix Finance to ensure they meet strict grant criteria. Any money not spent by end June 2022 will have to be returned.
11. It was originally envisaged that this funding would be used to reduce carbon emissions at 10 sites, but the scope has been reduced to the three leisure sites, as these will deliver the greatest reduction in carbon emissions. It was clear last autumn that the risk of continuing with the Council's original delivery partner was too great given the constrained grant deadlines, wide project scope, volatile market and significant financial risk of having



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to fund a wide portfolio of schemes if not complete by the original grant deadline of 31st March 2022 (now extended to 30th June 2022).

12. The Council's Property team will seek to pick up the majority of works not covered by PSDS grant via the Phase 2 Decarbonisation Programme (capital approved by the Council in February 22). These proposals will be delivered over a more manageable timescale.

Leisure Centre Improvements Capital Project

13. The Council approved £3.495m capital in April 2021 for centre remodelling and energy efficiency/partial decarbonisation works, and essential mechanical and electrical replacements proposed by Freedom Leisure in their contract tender submission. Just under £1million of this budget was originally earmarked for decarbonisation and energy efficiency measures.
14. The PSDS grant has enabled the scope of decarbonisation works at the leisure sites to be broadened in order to fully decarbonise Goldenstones and Wincanton Leisure Centres which Freedom Leisure fully supports, although some of the decarbonisation measures will not be covered by the PSDS grant. Consequently, the two capital projects have now become interlinked and delivery of both elements is being managed by Freedom Leisure but steered via a joint project board. The amended project scope has caused significant delay to Freedom's original capital improvement schemes which has had an impact on the Leisure Capital budget due to factors such as increased design costs and cost inflation. Freedom Leisure could reasonably have expected to be in contract for the leisure capital works by August 2021 with delivery fully complete by end March 2022.
15. The delivery of the leisure capital project is fundamental to Freedom Leisure delivering on their 15 year contract business plan set out within confidential appendices to District Executive and Full Council on 15th April 2021. A significant reduction in scope would therefore potentially reduce the amount of management fee income Somerset Council (the new council) would receive from Freedom Leisure.

Report Detail

Reason for budget shortfall position

16. Table 1 below shows the budget shortfall position in respect of both projects as of 31st April 2022 following tender returns. Both will cost more to deliver than anticipated due current market conditions.
17. It is possible that Value Engineering could further reduce the expected cost of delivering the leisure capital works, but this is unlikely to be significant.
18. PSDS grant funding is available to cover all expected PSDS costs incurred up to the end of June 2022. Any aspect of PSDS work delivered after this date (excluding commissioning and equipment expected but not delivered by this date) would not be eligible for PSDS funding and would therefore have to be funded by the Council if District Executive agreed to continue with the PSDS project at the three leisure sites.



Table One – Current shortfall in the approved 2022/23 capital budget

	PSDS	Leisure Capital	Combined figures
Approved capital budget	£2,800,000	*£3,495,000	£6,295,000
Increase to fund best case tender returns	£980,973	£630,495	£1,611,468
Contingency to cover latent defects	£0	£35,000	£35,000
Capital Budget needed to complete	£3,780,973	£4,160,495	£7,941,468
Shortfall in Budget	£980,973	£665,495	£1,646,468

*Contingency funding for contract compensation events or late project delivery of £95,950 has been included

PSDS Project

19. The expected cost of delivering the full scope of works now exceeds the approved budget by nearly £980,973.
20. Mechanical and Electrical is a particularly volatile sector at this time, due in no small part to pressures placed on it by PSDS demands. Inflated steel prices also contribute to the additional higher than expected costs. Market indices do not predict a reduction in relevant supply costs in the short term.
21. In addition, £300k of the increase arises from the costs of the contractors delivering at an accelerated rate (overtime and weekend working) to meet the grant deadline.
22. The project manager and SSSC officers believe that the majority of the decarbonisation works can be delivered within budget by the end of June 2022 in line with grant conditions. However, it should be noted that there is still a risk of not meeting the grant deadline as there is now no buffer within the delivery programme for slippage and no further scope for project acceleration.
23. The project board continue to press for an extension on the use of the grant funding until September in order to minimize the financial risk to the Council and to allow civil engineering works required adjacent to King Arthurs School, Wincanton, to take place during school holidays when there would be minimal impact for the school during the GCSE exam period. However, at present it should be assumed that a further extension will not be granted by Salix Finance/ The Department for Business, Energy and Industrial Strategy (BEIS).
24. If there is no movement on the grant deadline, it is proposed that the contractors will deliver all disruptive works and the labour elements at Wincanton after June, while the school is either closed or exams are finished. We have therefore taken a prudent approach and assumed that if District Executive agrees to this proposal PSDS grant is unlikely to be used in funding this element of the programme and that this would be a cost to the Council (see Financial Implications section of the report).
25. The PSDS contractors also estimate that a small amount of insulation works may also not be complete at Goldenstones by end of June but this has been taken into account in the financial implications.

Leisure Capital Budget

26. The expected cost of delivering the full scope of works now exceeds the approved budget by nearly £700,000. Around 80% of the increase above pre-tender estimate is in respect of Energy/Capital Mechanical and Electrical (M&E) particularly at Goldenstones and Wincanton for lighting works and air handling units.
27. In addition to the funding shortfall arising from the tender prices received, there may be additional capital costs, which are identified in the project risk register, that the Council would need to fund if they were realised (largely related to concealed defects). It is proposed that District Executive includes a contingency sum of £35k in the budget increase sought. This amount represents 10% of the total value of possible risks identified in the Project Risk register. This would be in addition to the £95k contingency already in the agreed capital budget, which has been approved to help mitigate any costs arising from late delivery of the programme.

Options available to the District Executive

28. **Option 1** - Freedom Leisure's project management believe further savings can be found through value engineering to reduce a small proportion of the expected shortfall. This would involve removing any elements of the project that did not have any impact on the delivery of Freedom Leisure's business plan, measures such as refurbishment of some M&E items rather than complete replacement.
29. Had there not been significant delay to this project caused by the Council's PSDS project, Freedom Leisure would have picked up the excess capital costs. Therefore under this option it would be proposed that the shortfall in budget would need to be funded by the Council.
30. **Option 2** – Freedom Leisure could retender the leisure capital works and this may bring the works back in under budget. However, this would cause further delay to the delivery of their business plan (around 12 weeks), and there is no guarantee that a better price could be achieved given the current unpredictable market conditions. It is also becoming urgent that works proceed so that aging gym equipment at Wincanton in particular can be replaced and provide the offer that customers expect from a modern leisure centre.
31. The Building Cost Information Service (BCIS) have forecast a 6.9% increase in construction/capital equipment costs across 2022, therefore a delay of one quarter could create an approx. 1.7% or c£60k price rise, which would offset any perceived benefit of tendering. Additionally, given the current market, the project cost consultants have advised of a low success rate in terms of identifying tenderers of sufficient quality who are willing to go on a tender list for this type of complex refurbishment project therefore this option is considered high risk.
32. **Option 3** – the Council could choose not to provide further funding for the leisure capital scheme and Freedom Leisure would have to deliver what they could within the existing approved budget. At present it has not be determined what elements would have to



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come out, but it is anticipated that such a reduction would significantly hamper their ability to deliver their business plan and this in turn is likely to have an adverse impact on the new Council's revenue budget for the next 13 years. The precise impact can only be determined once it is clear what would need to be removed from the project, but it is anticipated that this could result in a reduced return to the Council in years 3-15 of the contract in the order of £197k pa. This figure takes into account expected income reduction and additional costs for repairs & maintenance.

33. Freedom Leisure has already looked at the impact of removing elements from each scheme but it has concluded that this approach could deliver three fairly poor schemes. Therefore, if this option is selected, Freedom Leisure's preference would be to significantly scale back the planned improvements at Wincanton Sports Centre. The proposed scheme would be replaced with a very limited redecoration programme, essential M&E works and replacement of the fitness equipment. The planned improvements to the reception, catering offer, fitness suite, and creation of a new dedicated spin studio would be lost.

Financial Implications

Capital Budget

Table Two – Capital budget requirements and proposed financing

	PSDS	Leisure Capital	Combined figures
Approved capital budget	£2,800,000	£3,495,000	£6,295,000
Increase to fund best case tender returns	£980,973	£630,495	£1,611,468
Contingency to cover latent defects	£0	£35,000	£35,000
Proposed capital budget	£3,780,973	£4,160,495	£7,941,468
To be funded:			
- PSDS grant	-£3,430,973	£0	-£3,430,973
- Prudential Borrowing	-£350,000	-£4,160,495	-£4,510,495
Total	-£3,780,973	-£4,160,495	-£7,941,468

District Executive Approvals needed	PSDS	Leisure Capital	Combined figures
Approved capital budget (Council 28/02/22)	£2,800,000	£3,495,000	£6,295,000
Increase budget (to be funded by PSDS grant)	£630,973	£0	£630,973
Virement of capital contingency budget	£350,000	£665,495	£1,015,495
Proposed capital budget	£3,780,973	£4,160,495	£7,941,468

34. If the recommendations of this report are agreed, the overall capital budget will increase by £1,646,468 from that agreed by Council at its meeting on 28/02/2022, from £6,295,000 to £7,941,468.

35. There remains the risk that expenditure maybe higher than that shown in Table Two relating primarily to slippage on the programme and latent defects. A contingency amount of £130k is included within the proposed budgets shown in Table Two for these.



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36. District Executive has delegated authority, under part 3 of the Constitution (section 4.1), to increase the capital budget if the decision is urgent, is required to deliver the agreed corporate plan, and if the increase is less than 5% of useable reserves. The decision also has to be reported to Council in the Annual Budget and MTFP report and to Audit Committee in the Annual Outturn Report. The proposals meet the delegation conditions as follows:
- The Chief Finance Officer can confirm that the increase in budget sought is less than 5% of useable reserves.
 - The two projects are key elements in delivering priority 1 in our Corporate Annual Action Plan, namely: to accelerate action to adapt to and mitigate the effects of climate change which includes reducing the Carbon footprint of the authority and enhancing the natural environment.
 - The decision is urgent, as there is a need to agree the tenders received and to get into contract in order to deliver as much of the PSDS project by the grant deadline. In addition, any delay may increase the tender prices already received given the current inflationary market.
 - The decision is also urgent in order to agree that the Council is prepared to accept the risk of funding any agreed expenditure not spent before the grant deadline. The S151 Officer was required to give such assurance to Salix Finance on the 28th April 2022 as part of the grant conditions. This assurance was given in consultation with the relevant Portfolio Holders and the Senior Leadership Team. The rationale for giving this assurance is:
 - That this is a key agreed corporate project.
 - It is vital to meet grant conditions to continue to secure the funding awarded, particularly since much of the eligible expenditure for grant funding is already committed.
 - The financial risks are currently assessed as being relatively low (currently at £350k arising from delaying the Wincanton works).
 - Any further increases in the budget required are able to be funded from the corporate capital contingency budget without any unbudgeted consequences (see below).

Funding of the Capital Budget

37. It is currently estimated that £3,430,973 (or 43%) of the capital expenditure will be funded from PSDS grant funding with the remainder being funded through prudential borrowing.
38. The full grant awarded to the council is £3,993,000 but it is unlikely we can spend or commission the full amount before the grant deadline. In addition, if District Executive agrees to delay the works at Wincanton then SSDC will not be able to use PSDS grant for this element of the programme (£350k including Goldenstones) unless the grant



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deadline is extended. Table Two assumes that these schemes will not spend by the grant deadline and will therefore need to be funded by SSDC from prudential borrowing.

39. If the grant deadline were to be extended until the end of September then unallocated PSDS grant (of £1.193m) could be used to cover some of the energy works currently expected to be funded by SSDC through prudential borrowing.
40. It is proposed that District Executive agrees to vire £1,015,495 from the corporate capital contingency budget (approved by Council at £4m) into these capital projects, as shown in Table Two above. This amount is 25% of the contingency budget, which would leave £2,984,505 remaining for possible requests later in the year for other projects in the agreed capital programme.
41. The prudential borrowing required to fund the corporate capital contingency budget is already included in the Council's overall capital funding plan approved by Council in February 2022

Revenue Budget Implications

42. The capital expenditure and funding proposals described in the above paragraphs will not, at this point in time, have an additional impact on the Council's approved revenue budget as the financing costs of funding the overall corporate capital contingency budget through prudential borrowing have already been included in the agreed 2022/23 revenue budget.
43. As explained elsewhere in the report, there remains the risk that not all of the eligible expenditure we have assumed will be grant funded will be spend by the grant deadline. If this happens then the increase in expenditure would be a further call on the corporate capital contingency budget or would need to be funded via an increase in prudential borrowing, with the consequential increased financing costs charged to the revenue budget.
44. As at the date of writing this report, £1,059,440 of the eligible expenditure for PSDS grant funding (of £3.993m) is spent and £2,338,868, or 68%, is contractually committed.
45. The financing charges arising from borrowing to fund the corporate capital contingency fund have been included in the revenue budget with the assumption that the Bank of England Bank Rate is 1%. At its meeting ending on 4 May 2022, the Monetary Policy Committee (MPC) voted by a majority of 6-3 to increase the Bank Rate by 0.25 percentage points, to 1%. Those members in the minority preferred to increase the Bank Rate by 0.5 percentage points, to 1.25%. The markets and financial commentators expect further increases during this year.
46. Any further rise in the Base Rate may require additional revenue budget to set aside a provision for this increase. The situation is complicated however by Local Government Reorganisation, the fact that any increased need to borrow is often initially met by use of available cash resources (internal borrowing) rather than by entering into external loan agreements, and the need to take a longer-term approach to financing borrowing needs (indebtedness) than just the one year remaining for SSDC as a separate organisation.



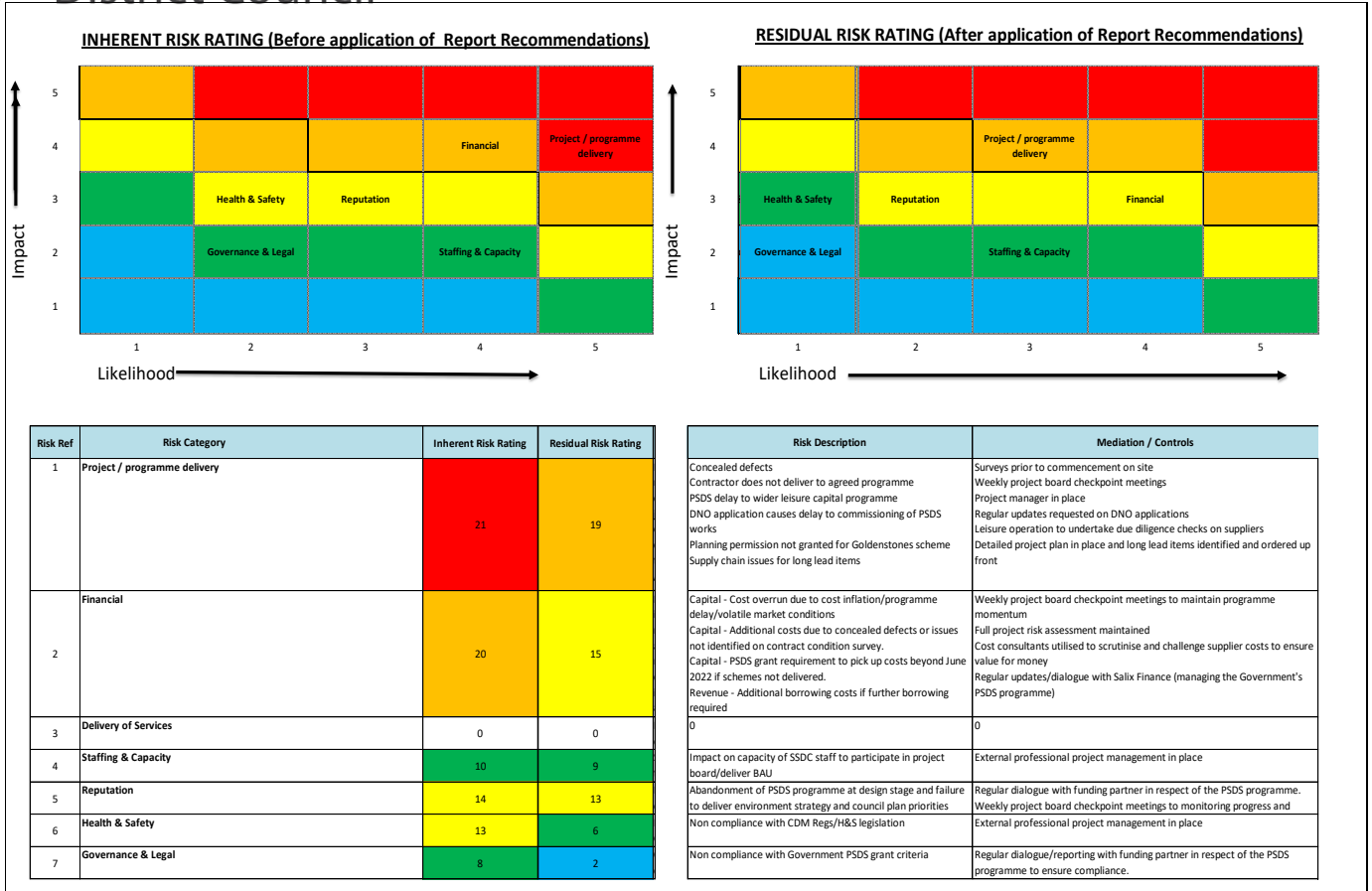
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47. Ultimately, the financing of the indebtedness arising from this project, as with all other projects in SSDC's capital programme that require Prudential Borrowing, will be a decision taken by the new Somerset Council as part of its first Treasury Management Strategy. This means it is difficult for the SSDC Chief Finance Officer to be explicit about any revenue budget impact that may arise from any further increase in Base Rate above the 1% provided for in SSDC's 2022/23 budget (and the 1.25% included in the indicative 2023/24 estimates).
48. District Executive has the option, as set out in paragraph 31, option C, to cap the Leisure Capital Improvement Budget to the amount already approved by Council: this would decrease the need to borrow (indebtedness) that would transfer from SSDC to the new Somerset Council.
49. However District Executive needs to note that if it does not agree to proceed with increasing the Leisure Capital Improvement Budget, Somerset Council is at risk of a reduced management fee income from Freedom Leisure of some £197k per annum, as advised by the contractor.
50. The additional cost of the financing charges arising specifically from increasing the Leisure Capital Improvement Budget have been calculated at £33,050 per annum (£22,140 for Minimum Revenue Provision (MRP) costs and interest charges of £10,910, based on an interest rate of 1%).
51. There is therefore a financial case to support the increase in the Leisure Capital Improvements Budget. It is however difficult to be exact about the financial benefits given the uncertainty over interest rates and the impact of capping the capital budget (Option C) on the management fee income.
52. The Chief Finance Officer will seek agreement to approve these proposals with the other S151 Officers within the Somerset councils as required under the Finance and Assets Protocol given that the increase in the capital budget required is over £1m – which is the limit over which approval is needed under the Protocol. An oral update will be given by the Chief Finance Officer at the District Executive's meeting.

Legal implications and details of Statutory Powers

The leisure operator contract does not oblige the Council to cover any additional capital for the leisure centre improvements beyond what is already approved. However, the leisure operator will almost certainly challenge the management fee payable given that they will not be able to fully achieve their business plan targets set out within their tender return.

Risk Matrix



Council Plan Implications

The effective management of the Council's leisure centres contributes to Council Plan aim to "improve health and reduce health inequalities" and to help the Council "to build healthy, self-reliant, active communities" by "Helping people to live well by enabling quality cultural, leisure, play, sport & healthy lifestyle facilities & activities".

The current Council Plan demonstrates the council's commitment to keep South Somerset green, clean and attractive and respond to the climate and ecological emergency. The first area of focus under this theme is to continue the delivery of the Environment Strategy action plan reducing our carbon emissions by 10% every year, to reach carbon neutrality by 2030.

Carbon Emissions and Climate Change Implications

The investment proposals put forward by Freedom Leisure as part of their contract tender expected to reduce emissions by 269 tonnes per annum. The increased scope of decarbonisation works utilising PSDS funding, is expected to reduce carbon emissions by 435 tonnes per annum in total across the Council's three leisure sites.

Equality and Diversity Implications



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<i>An Equality Impact Relevance Check Form has been completed in respect of the Proposal?</i>	Yes
<i>The Impact Relevance Check indicated that a full EIA was required?</i>	Yes
<i>If an EIA was not required please attach the Impact Relevance Check Form as an Appendix to this report and provide a brief summary of its findings in the comments box below.</i>	
<i>If an EIA was required please attach the completed EIA form as an Appendix to this report and provide a brief summary of the result of your Equality Impact Assessment in the comment box below.</i>	
Additional Comments	
<p>The EIA was developed by Freedom Leisure in collaboration with SSDC officers. The consultation findings with relevant user groups have been used to influence RIBA stage 4 designs. The EIA is based on the assumption that all improvements are delivered in line with Freedom proposals within their ITT documents. If the scope of the scheme is reduced due to a funding shortfall, there will be a requirement to revisit the EIA to update it.</p> <p>Some further consultation is expected to be undertaken with the LGBTQ+ community to ensure that the proposed changes do not have any adverse impacts, and inform any further reasonable adjustments that could be made.</p>	

Privacy Impact Assessment

- No new implications.

Background Papers

- South Somerset District Council – 25th February 2021 – 2021/22 Revenue & Capital Budgets and Medium Term Financial Plan
- South Somerset District Council – 15th April 2021 – Appointed Leisure Facilities Provider
- SSDC Environmental Strategy
- South Somerset District Council – 28th February 2022, Decarbonisation Programme Phase 2