

Cabinet

25 January 2011



**Management Options Appraisal Phase 1:
Setting up of a Charitable Trust to
Manage the Council's Sport, Leisure,
Cultural and Library Services**

Key Decision NS/05/2011

MTFP Ref: NS 20.1

Report of Corporate Management Team

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Services**

Purpose of the Report

- 1 To set out details of the Management Options Appraisal undertaken to establish the most suitable option(s) available for the future management of a range of services including:
 - Sport and Leisure facilities and services
 - Museums
 - Libraries
 - Outdoor learning centre at Middleton-in-Teesdale

The services are presently managed by Neighbourhood Services, Adults Wellbeing & Health and Children & Young People's Services.
- 2 The report seeks an 'in principle' decision from Cabinet for the potential transfer of some, or all, of these services to a Non-Profit Distributing Organisation (NPDO) subject to further work to establish the best option for the Council whilst agreeing a project plan and milestones to deliver this project.

Background

- 3 The Council's Medium Term Financial Plan (MTFP) includes a number of savings proposals linked to the Management Options Appraisal (MOA) process. The principle aim of the MOA being to identify future management arrangements best suited to providing optimal value for money, whilst still meeting the Council's strategic priorities.

- 4 The services originally included within the scope of the project were Sport and Leisure Services (Neighbourhood Services) and Cultural and Library Services (Adults, Wellbeing and Health). The scope was subsequently expanded to also include Outdoor Learning Centres (Children & Young People's Services).
- 5 The total assumed MTFP savings linked to this project are £865,897; consisting of £615,897 within the Neighbourhoods proposals (NS20 - £369k in 2012/13; and £247K in 2013/14); and £250,000 within the Adults Wellbeing and Health proposals (AWH 10 and 23 – all assumed in 2013/14). All savings targets are based on the 80% savings against the current National Non-Domestic Rates costs to the Council as the new trust would qualify for 80% charitable rate relief (further details provided in sections 21 -26).
- 6 As the services under consideration in this report have cross cutting elements which impact all residents, visitors and businesses, the Council's vision around an Altogether Better Durham provides a key driver for adopting a new service delivery model for Sport and Leisure, Culture and Libraries. The changes under consideration link very strongly to the Council's priority themes of Altogether Wealthier; Altogether Healthier and Altogether Better for Children and Young People. Increased participation in sport, leisure, culture and libraries factor heavily in delivering improved physical and mental wellbeing.
- 7 Having facilities which are accessible and well maintained also factor in the Council's drive for an Altogether Greener Durham; and offering diversionary activities also plays a key role in the Altogether Safer priority theme. The Council Plan's commitment to deliver savings whilst remaining committed to service improvements provides an opportunity for the Council to consider the most appropriate service delivery model which will allow a key focus on improved services whilst exploring innovative ways in which to market and provide value for money services in these areas
- 8 Underpinning the priorities and outcomes set out in the Council Plan are three service specific strategies relevant to the service areas within the scope of the MOA namely; Inspire and Transform: Cultural Strategy for County Durham 2010-2013 (approved by Cabinet 16/06/10), Durham County Council: Sport and Leisure Service Strategy 2010-2013 (approved by Cabinet 02/03/11); and the draft library strategy for County Durham (also to be considered by Cabinet on 25th January, 2012). These key documents outline the challenges faced by these services and highlight the importance of modernising service delivery. Electronic copies of these key strategies are available on the Council's website and hard copies have been deposited within the Members' Library.
- 9 To assist development of the MOA, specialist independent advisors, Winckworth Sherwood, were appointed by the Council in April 2011. They have carried out a wide range of interviews with Officers, Elected Members (including the Leader and Deputy Leader) and key partner stakeholders. Winckworth Sherwood have also reviewed and analysed extensive financial and other relevant information provided by the Council, producing a report detailing their findings. The following terms of reference/assessment criteria were developed to assist in the evaluation of the options available, with the best option being one that would:

- offer the most economically advantageous option to the Council (in terms of delivering existing and future MTFP savings requirements);
- provide a sustainable, robust business model;
- provide the potential to secure capital and revenue from external sources;
- improve community involvement in services;
- deliver the priorities and objectives set out in Inspire and Transform: Cultural Strategy for County Durham 2010-2013; Durham County Council: Sport and Leisure Service Strategy 2010-2013; and the draft library strategy for County Durham, maintaining continuing involvement in service delivery;
- sustain and where possible improve upon the quality of the services under consideration to customers.

10 The scope of the project includes the following services from three service groupings:

Neighbourhood Services: Sport and Leisure Services:

- Directly managed indoor leisure facilities (15)
- Directly managed outdoor leisure facilities, including the Riverside facility, cricket centre, play pitches, parks and allotments (3000+ plots)
- Indoor leisure facilities presently operated by:
 - A local 'Trust' – Leisureworks (3 indoor facilities in addition to broader sports and arts services within the Derwentside area)
 - A National private contractor – Leisure Connection (2 indoor facilities within the Easington area)
- Sports development – club, coach and volunteer development; health interventions; holiday activities; partnerships and community engagement
- Events management
- Countryside services including 3 country parks, 150km of railway paths, 23 nature reserves.

Adults, Wellbeing and Health:

- Libraries (39 public libraries, including Bishop Auckland Town Hall and a mobile library service)
- The Gala Theatre
- The DLI Museum and Durham Art Gallery
- Killhope Lead Mining Museum
- The Arts Team – service team covering arts for social and economic impact, including BRASS and filming friendly

Children & Young People's Services:

- Outdoor Learning Centre at Middleton-in-Teesdale

- 11 The total net revenue cost of these services is £23.730m comprising gross expenditure of £33.041m and gross income of £9.311m. Excluding management and support costs and capital charges, net direct expenditure on these services is £17.474m. The Services collectively have circa 5 million visits and employ approximately 500 members of staff. The current budgeted costs associated with each service grouping are given below.

Table 1: The 2011-12 budgets for the service areas

| | Neighbourhood Services | Adults, Wellbeing & Health | Children & Young People Services | Total |
|------------------------------|-------------------------------|---------------------------------------|---|----------------|
| | £000's | £000's | £000's | £000's |
| Service Related Direct Costs | 12,216 | 11,292 | 129 | 23,637 |
| Contract Costs | 3,148 | - | - | 3,148 |
| Management & Support Costs | 1,611 | 350 | - | 1,961 |
| Capital Charges | 3,064 | 1,222 | 9 | 4,295 |
| Total Expenditure | 20,039 | 12,864 | 138 | 33,041 |
| Income | (5,886) | (3,353) | (72) | (9,311) |
| Net Expenditure | 14,153 | 9,511 | 66 | 23,730 |

Notes:

- i) The Net Direct Service costs (Service Related Direct Costs + Contract Costs – Income above), less MTFP savings requirements to the Council, would form the basis of the annual contract payment to any outsourced service model;
- ii) Capital Charges would be retained within the Council as the Council retains ownership of all facilities in all of the models considered under the MOA;
- iii) There would be elements of the management and support costs that would be subject to TUPE and therefore potentially included in the annual contract payment under an outsourced model, whilst other remaining areas would need to be reviewed / challenged further. The opportunity exists also to establish Service Level Agreements with the external provider (usually established on a tapering basis) for the Council to continue to provide support services to it and for it to access Council systems / infrastructure.

Potential Delivery Options

- 12 The MOA considered the following service delivery options (further details of the nature of each option are given in Appendix 2):
- a. Retaining the current arrangements for services, ie status quo;
 - b. A private sector partnership, without a pocket/hybrid trust (or Voluntary Contract Transfer (VCT));

- c. Utilising an existing Non-Profit Distributing Organisation (NPDO). This option is commonly referred to as a 'Trust';
- d. Establishing a (NPDO) for some facilities/services;
- e. Establishing a (NPDO) for the entire portfolio;
- f. Creating a Community Interest Company;
- g. A mixed economy of different delivery options.

Evaluation of Delivery Options

- 13 Officers, working closely with the external advisors, have considered in detail the features of the seven different delivery options above.
- 14 Some of the delivery options considered have complex technical and legal characteristics, requiring lengthy explanations. An overview of what each of these would entail, together with the advantages and disadvantages of each and the assessment against the six criteria set out at paragraph 9 is attached at Appendix 2.
- 15 Whilst the following sections of this report consider each of the six assessment criteria and highlights the merits of the various delivery options relevant to each, it is recognised that the financial implications of each option are paramount to fulfilling the wider ambitions of the MOA project. The MOA has clearly demonstrated that the only delivery models able to provide the financial aspirations of the project are those which can secure charitable status and subsequently take advantage of the significant savings that arise from National Non-Domestic Rates (NNDR) relief of 80% and potentially from Value Added Tax (VAT) exemptions. These options are essentially those associated with the use of a Non-Profit-Distributing-Organisation (NPDO), commonly referred to as a 'trust' (options c d and e in paragraph 12 above).
- 16 Taking into account the findings of the detailed MOA and advice from the independent specialist advisors, the recommendation is that the Council should progress one of the NPDO options (i.e. c, d or e)

Non-Profit Distributing Organisation (NPDO)

- 17 A NPDO is a non-profit distributing organisation. This means that as an organisation it cannot distribute any surplus or profit it generates, rather it is restricted to reinvesting its resources to furthering its objectives. In other words, any surplus **must** be used to re-invest in service provision. The key advantages of a NPDO are set out below;
 - All profits to be reinvested in NPDO's business within County Durham (the exception to this being if a NPDO from outside the County is engaged)
 - VAT exemption from sporting and related facilities
 - Single focused body with unitary purpose
 - Opportunity for community involvement in the management of the NPDO
 - Ability to harness the various "Friends Of" organisations to enhance volunteering, fundraising and community initiatives

- Potential to access private finance for improving and enhancing any of the facilities
- A new NPDO would be the only option which would potentially involve a buy-back of any services from DCC
- A NPDO could benefit from the pooled experience of staff currently working within the portfolio, an external body and/or Leisureworks if they merge with the NPDO
- A new NPDO would be “owned” by those committed to County Durham and the delivery of the services
- A NPDO can borrow to invest and improve the facilities outside the local government finance requirements
- A new NPDO could become a strategic partner of the Council and take a leading role in the Durham Cultural Partnership
- This governance model has a proven track record and can develop collaborative working at regional, national and international levels
- Range of fiscal advantages including exemption for corporation tax, opportunity for corporate sponsorship and donations utilising gift aid, plus use of Charitable status to claim mandatory rating relief (80% of the current NNDR costs).
- Greater access for National Lottery funding which is increasingly being directed away from local authorities.
- County-wide NPDO will offer opportunities to attract contracts from commissioning bodies in public health through both arts and physical activity.
- Access to other sources of funding for charities not available to the public sector from national charitable foundations.

18 The key disadvantages of a NPDO are set out below:

- Regulation by the Charity Commission, although this is also seen as an advantage in the public service provision arena.
- Reversibility, as the assets of a charity can only be used for the charitable purposes of that charity or transferred to another charitable body for similar purposes. Therefore bringing the service back in house may prove difficult.
- The trustees of a charity cannot be controlled by any outside organisation or body albeit they will need to respond to the legitimate interests of their funders.
- Potential difficulty recruiting trustees with suitable experience and calibre coupled with the considerable obligations upon them.

19 Whilst the above sets out the general advantages and disadvantages of delivery through a NPDO, the following sections consider this model against the six specific assessment criteria identified earlier in this report.

Criterion 1: Economically advantageous

- 20 As noted above there are some clear and certain immediate financial benefits arising within the NPDO model, whereas others (eg impact on central management and support costs not subject to TUPE) require more detailed consideration over the coming months. The key headline savings are associated with NNDR and VAT implications, explored in detail below.

Financial Implications: NNDR:

- 21 Mandatory rating relief of 80% is available on property that is wholly or mainly used for charitable purposes and occupied by an institution or organisation established for charitable purposes. In this sense, only the NPDO options could be certain of achieving NNDR charitable rating relief.
- 22 Some other models (the pocket / hybrid trust options) currently also gain this relief but this has been subject to challenge by the Charities Commission and there is considerable concern that this will not continue to be available in the medium term, albeit that those organisations benefitting from this continue to explore its availability.
- 23 Local authorities have discretion to grant additional relief to NPDO's in respect of all or part of the remaining 20%, although Durham County Council's Discretionary Rate Relief Policy (approved by Cabinet on 11 November 2009) does not provide for this discretionary top up relief.
- 24 MTFP savings associated with this project were premised on the savings likely to be achieved through mandatory NNDR relief and should be viewed as the main opportunity to achieve cost savings certainty. The assumption therefore is that the NNDR savings would be top-sliced from any contract payment to a NPDO, with the Council benefitting from this relief at the expense of the NPDO. The following table shows the current NNDR budgets and expected savings from the NPDO model.

Table 2: NNDR costs and savings in the NPDO model

| | 2011/12 Budgeted full NNDR Costs | NPDO Saving @ 80% |
|----------------------------------|--|----------------------|
| | £ | £ |
| Sport & Leisure | 760,280 | 608,224 |
| Culture | 79,430 | 63,544 |
| Libraries | 267,765 | 214,212 |
| Teesdale Outdoor Learning Centre | 2,000 | 1,600 |
| TOTAL | 1,109,475 | 887,580 |

- 25 As noted earlier, the MTFP includes saving requirements totalling £865,897 (£615,897 Sports & Leisure, £250,000 Libraries and Culture) from the MOA. This is broadly in line with the savings expectations under the NPDO delivery model.
- 26 It should be noted that the NNDR savings identified above only relate to the buildings directly managed by DCC, rather than those presently run by Leisureworks and Leisure Connection. Both these organisations are in receipt of the mandatory rate relief currently, with this being reflected in the contracts with these organisations.

Financial Implications: VAT:

- 27 There are significant VAT benefits associated with NPDO options. In Sport and Leisure, and Culture and Libraries, transfer to a charitable NPDO would mean that the majority of fees and charges will be VAT exempt, allowing, if Members approved this approach, the NPDO to charge the same fees as previously without having to pass on VAT to HM Revenues and Customs; essentially gaining 20% of all fees not previously exempt. The two main streams of income that could deliver a VAT gain would be sporting activities and cultural admissions.
- 28 Offset against any VAT gain from income, a NPDO would be unable to reclaim any VAT on the expenditure associated with the income that is no longer subject to VAT. In practice, the VAT-able expenditure is normally less than the income and therefore a net gain is made. Other delivery options would not have this facility available to them, as it is only available to charitable organisations. Consequently, there is little potential VAT gain in transferring to any of the other options.
- 29 As can be seen from Table 3 below, the VAT position associated with NPDO options has the potential to provide significant additional benefits. A number of assumptions have had to be made in this analysis, but officers, working with the advisors and with in-house VAT officers, have determined that the potential net VAT gain may be in the region of £454,013, based upon an output tax VAT gain of £1,070,990 and a non-recoverable input tax VAT loss of £616,977.
- 30 Taking the financial benefits of NNDR relief and VAT gains into account there is a clear case for choosing either the Existing or New NPDO option. In terms of how these savings compare to the MTFP requirements across the various service groups, the following table summarises the key headline figures.

Table 3: Impact of NNDR and VAT against MTFP requirements by service area

| | Net VAT (Benefit) / Cost to NPDO | NNDR Benefit to NPDO | Estimated Net NPDO Savings | MTFP Savings Target | Variation (Over) / Under |
|----------------------------|---|-------------------------------------|---|------------------------------------|---|
| | £ | £ | £ | £ | £ |
| Sport and Leisure Services | (447,748) | (608,224) | (1,055,972) | (615,897) | (440,075) |
| Cultural Services | (82,776) | (63,544) | (146,320) | (250,000) | (38,087) |
| Library Services | 72,445 | (214,212) | (141,767) | | |
| Outdoor Learning Services | 4,066 | (1,600) | 2,466 | - | 2,466 |
| Total | (454,013) | (887,580) | (1,341,593) | (865,897) | (475,696) |

- 31 Whilst it is clear that the savings from NNDR and VAT alone suggest an efficiency that is £475,696 in excess of MTFP targets, future work relating to issues around client monitoring costs (there will be a need for an effective client function to oversee what would be one of the largest NPDO's in the Country); potential additional management and support costs/overheads that the NPDO would need; "profit" margins / contingencies; and commissioning costs will need to be carefully considered. The final variation amount will also

be affected by the specific services that are included in the transfer (see paragraph 44). Whether the additional capacity / resource above will be required to fund the future vehicle or can be declared as a further saving will be a key issue at phase two of the MOA project. It is, however, clear that savings identified within the current MTFP could be achieved with a degree of certainty through furtherance of the NPDO option.

- 32 In transferring the proposed portfolio out to a NPDO it would be further anticipated that other planned MTFP savings identified against out-going services would be embodied within any such arrangements. This would essentially mean that the level and profile of funding to the new entity would reflect not only the savings associated with the MOA project but all related MTFP savings. Not only would such an organisation be better placed to deliver these savings but the Council would achieve greater certainty through its contractual arrangements with the new body.

Criterion 2: Sustainable Business Model

- 33 Maintaining the status quo is not considered a sustainable option, with the current financial pressures making the continuation of the current level of services within scope unsustainable, leading undoubtedly to a reduction in both service standards and levels if retained in-house.
- 34 Other delivery options do not offer the same benefits of reinvestment provided by a NPDO; a NPDO will be required to re-invest 100% of its surpluses back into the service, whereas other models will need to compete with other priorities. The MOA concludes that savings presented through the NPDO option(s) present a more sustainable solution for service delivery over the short, medium and longer term. As NPDO's have the ability to produce surpluses for re-investment into the services, this strengthens the sustainability of this model.

Criterion 3: Potential to secure capital and external funds:

- 35 All options have increased scope / capacity to secure external revenue and capital resources not open to the Council. Whilst private sector contractors are undoubtedly not best placed to access many of the main grant distributor's funds, such as National Lottery, they do have the potential to provide a capital financing facility. There are a number of examples whereby this sector have provided significant investment into facilities but in all instances this is reflected back through the contractual arrangements. It is unlikely that this way of financing would prove cheaper than prudential borrowing already available to the Council. It is also evident that many of the funders of revenue initiatives, ie Sport England, are increasingly more reluctant and in some instances prohibited from distributing their resources to commercial organisations.
- 36 NPDOs on the other hand are well placed to secure grants, as many distributors will only distribute to charitable organisations. Although National Lottery allocations to sport and the arts are to increase, access to these funds is becoming increasingly restricted to a point that even local authorities will find it difficult to apply. NPDOs, with charitable status, therefore, should prove more successful than any of the other options.

Criterion 4: Improved Community Involvement

- 37 For private sector related options it is anticipated that the relationship with the Council would be a transactional one specifically determined by the nature and scope of a contract specification. Management of the organisation would be expected to be through the corporate body. Whilst different organisations will take differing views on establishing 'friends of' or 'service user' groups, the relationship in terms of governance and influence would be expected to be more remote with a private sector operator.
- 38 NPDO options would need to establish a Board of Trustees, where they did not already exist, and this would be required to attract membership from a wide range of community representatives. This would assume that a NPDO organisation would work with, and be closer, to the community. A NPDO from outside the County may, however, already have an established Board and would not be bound to include local members. Establishing a new NPDO would, in addition, allow the authority to determine the rules and basis of operation as it was developed and could therefore be prescriptive about community engagement.

Criterion 5: Delivering Durham County Council strategic objectives and maintaining continuing involvement.

- 39 In considering the transfer of Cultural, Library and Leisure Services to a NPDO, one concern may be the level of influence the County Council will have on the new entity. Given the importance attached to these services as contributors to the well-being of the area, some level of assurance that the activities of any new entity remains in the influence, although not the control, of the local authority will need to be given. Such an influence over the proposed kind of organisation is acceptable provided the independence of the NPDO is not fettered.
- 40 Such influence can be exercised in four ways: through Council Board membership; through the landlord/tenant relationship; through grant / contract funding; and through managing the relationship.

In selecting options there is a clear need to ensure that the Council's objectives are aligned with those of any new organisation and that the performance criteria provides formal links to their achievement. This should provide a clear foundation and motivation for success. Many NPDOs report that by better alignment and a faster, more responsive decision-making structure, the ability to make significant contributions to corporate aims is improved. More formally, the governance arrangements of any new entity would need to be satisfactory. These would need to be put in place and where the organisation is a charity this is a legal requirement. Such a requirement would take the form of a Board on which Council Members would have representation.

The key functions of any board would be to:

- act as the guardians of the organisation;
- make decisions about policy and strategy;
- act as the final point of accountability;
- monitor, supervise and control the organisation.

Criterion 6: Sustain/improve service quality

- 41 The use of surpluses is the main consideration. Whilst other options will have a requirement to generate greater surpluses these will essentially be for the purposes of profit. NPDOs will need to seek to generate surpluses but these will be used solely for re-investment into the service. Such re-investments should make a significant contribution to sustaining and improving the quality of services on offer. The ability to generate surpluses would need to be built into the business case of any option. Whilst in this report only savings emerging directly from the change in delivery model are given, it would be anticipated that any new entity would further develop financial savings and generate a greater surplus. This would result from:
- An ability to provide a more integrated and branded service: the ability to integrate services would be significantly increased by a single operator. In particular the economies of scale would benefit programming, ticketing and booking arrangements. In addition, a single focussed organisation would have the opportunity to develop a single, strong or cultural brand within the County;
 - An increased focus on accessibility and usage of the services: a more integrated and branded service would be able to increase usage and participation through a more efficient and focused marketing effort.

Other Material Considerations Associated with the Preferred NPDO Option

Service Scope

- 42 The MOA has indicated that all services identified in paragraph 10 should be within the scope of any transfer. More detailed work, however, is required at phase 2 to determine whether there is a strong enough business case for all these services to transfer to a NPDO.
- 43 There is some concern that the scale of any proposed entity may be such that the benefits associated with a single focus may be diluted. At the same time a number of areas have been identified as potentially not providing the same degree of obvious synergy.
- 44 The initial conclusion is that work continues on the basis that services should be considered within two broad groupings namely; Primary Services, those most likely to transfer to a NPDO and Secondary Services, those which are secondary considerations, and for which it may be prudent to give some further consideration to their inclusion in the early stages of phase two. These general categorisations have been developed based upon initial indications upon service synergy, financial contribution and disengagement issues. Services falling within the two group are as follows;
- a. Primary Services for transfer
 - i. Directly managed leisure facilities
 - ii. Leisure facilities currently managed by Leisureworks and Leisure Connection on behalf of the Council
 - iii. Library Services
 - iv. Gala Theatre

- b. Secondary Services for transfer
 - i. Sports Development Services
 - ii. Arts Development
 - iii. Outdoor Sport and Leisure Services
 - iv. Museums
 - v. Outdoor Learning Centres
 - vi. Countryside Services

Procurement

- 45 The recommendation of this report is to transfer the management and operation of the leisure and culture portfolio to either an existing or newly established locally based NPDO. The Authority is however required to consider the procurement issues associated with this decision. The portfolio is made up of Part B services. Under the Public Procurement Regulations there is no need to advertise these services nor carry out a competitive tender exercise. However, case law in this area has highlighted the principles of the Treaty of Rome and there is an underlying expectation in the body of case law that for contracts outside the provision of the regulations, advertising of such contracts may be required to comply with those principles.
- 46 Whilst we are advised that it is unlikely that there is an operator in another European member's state or possibly within the UK with sufficient knowledge, expertise and capacity to manage and operate this complex and challenging portfolio of services, this cannot, however, be definitively ruled out.
- 47 It is, therefore, recommended that even where the NPDO option is the approved way forward, that the Council undertakes a soft market testing exercise to determine appetite and test value for money. Clearly any operators expressing an interest in the contract will have to satisfy the Council's overriding objectives for the service as well as meeting financial and operational requirements, which will be stated expressly in any advert or resulting PQQ. The timescales are tight, although this process can be run concurrently with the furtherance of the preferred NPDO delivery model.

HR Issues

- 48 As a general rule the transfer of any services to an NPDO would trigger Transfer of Undertakings (Protection of Employment) Regulations 1981 ("TUPE"). In such a case all employees essentially dedicated to the Services within the scope of the exercise would transfer on existing terms and conditions and there would be no break in their continuity of service. This would include any revised terms and conditions that are subject to single status proposals.

The position for other employees involved with the facilities/services included in the transfer exercise, but effectively working within other service areas eg. support service functions, would depend on their individual circumstances, and in some cases they may also be subject to TUPE arrangements.

- 49 Any organisational change will, of course, be of concern to staff. The services under consideration have been subject to considerable uncertainty in recent times and it is imperative that any future management options prioritise employee concerns. A transfer of the services to a new NPDO may have considerable benefits to employees as the new organisation would be a focused entity which would enhance management stability and employee security moving forward.
- 50 TUPE Regulations place a legal requirement on both transferor (the Council) and transferee (the new NPDO) to formally consult with affected employees, and their representatives, in relation to the implications of any transfer exercise, and indeed the Council's Change Management protocols facilitate this process when a TUPE scenario has been agreed. However, in this complex and large-scale exercise it is important that early identification of, and engagement with, those employees who are likely to be affected by the proposals takes place in relation to how any 'in principle' decision may affect them. Therefore, having identified those employees who will essentially make up the potential TUPE list, a detailed employee and Trade Unions communications plan will need to be implemented which will allow for full, meaningful and timely engagement ahead of and throughout the transfer process.
- 51 Assuming the Council enters into a contract with a NDPO to carry out functions previously carried out by the Council, and staff have their employment compulsorily transferred from the Council to the NDPO, the NDPO will have to provide the transferring employees with either continuing access to the Local Government Pension Scheme (LGPS) or access to a broadly comparable pension scheme.
- 52 In practice, the expense of setting up and maintaining a 'broadly comparable' scheme makes it very probable that the new organisation would become an 'admitted body' employer in the Durham County Council Pension Fund (part of the LGPS). The Council and the new organisation will have some options when establishing the new organisation as an admitted body in the Pension Fund; the main choices are set out in Appendix 3.

Leisureworks and Leisure Connection

- 53 Leisureworks has a long-term contract with the Council (until 1 June 2042) inherited from a previous constituent authority (Derwentside District Council) for the operation of 3 leisure centres and 2 Arts Venues. In recommending a single new or existing NPDO, it is clear that the transfer of Leisurework's engagements, assets and business into a single NPDO would be beneficial, given that:
- Leisureworks have trustees already skilled in this key strategic role and some could be invited onto the new wider NPDO Board, subject to resolving conflicts of interest;
 - There are potentially additional savings possible through a reduction in overhead costs for a new enlarged NPDO, building on the existing infrastructure within Leisureworks;
 - The opportunity to combine the Gala Theatre/Cinema and the two facilities managed by Leisureworks would significantly enhance the performing and visual arts service offer within County Durham.

- 54 Leisureworks have been consulted throughout the MOA process and have responded in relation to the various options under consideration. Not surprisingly, their preferred option would be to have the entire portfolio transferred into them. This may have some benefits worthy of further exploration at phase 2. They have also indicated that where any other option with the exception of, the creation of a new County wide NPDO, is preferred they would wish to remain running their existing portfolio under their current contractual arrangements. In such a situation the Council would need to be minded of the contractual relationship that currently exists with Leisureworks.
- 55 Leisureworks have, however, indicated that should the Council determine that it wishes to create a new NPDO it would be supportive and would wish to work with the Council with the intention of facilitating a merger with the new entity. This would not preclude Leisureworks from engaging in any future procurement process or being the vehicle for the development of a single County Durham NPDO.
- 56 Leisure Connection are a private sector provider who currently run and manage the Council's leisure facilities at Peterlee and Seaham. The existing contractual arrangement, instigated by the former Easington District Council, runs until June 2013. It is anticipated that these arrangements would continue for their full term, albeit that the management of this arrangement could be transferred to any new NPDO until a decision to terminate or renew the contract is made in 2013.

Corporate Issues

- 57 The Council's Cultural, Library and Leisure services have a significant role in the quality of life and health and wellbeing of people who live, work in or visit the County. All facilities under consideration are used by local residents and visitors; and the latter have a major impact upon the economy of Durham. In addition, there are a number of consequential impacts that the outsourcing of all the services to a NPDO could have upon the Council's infrastructure, in particular its central management and support services.
- 58 Corporate Capacity: It is assumed that the Council would wish to retain a strong corporate "client or commissioning" role after transfer. The Council will, therefore, need to ensure it retains sufficient capacity, skills and experience to effectively manage the relationship with what would be one of the largest and most complex NPDO's in the country. The nature and scope of this resource will be developed in phase 2 through consideration of the Council's specific requirements and from a range of visits to Authorities who have already established similar arrangements.
- 59 There will also be the need to carefully consider / address potential impacts on central support services in order to manage and balance the relationship with a new NPDO.
- Whilst this may not have an immediate impact on the overall cost to the Council, as it will take a little time to restructure and determine these sums, savings beyond those identified within this report should be achievable.
- 60 It is common practice for newly established NPDOs to purchase support services from their sponsoring authority, particularly in the early years. This would be within the powers of the Council, subject to ensuring that a new

NPDO was designated as a public body under the Local Authorities (Goods and Services) Act 1970.

However, it is normally provided on a tapering basis, with the level of reliance on the Council (and recharges into it) reducing over a period of time. Careful consideration of fixed costs elements within any SLA's will need to be a key feature of the financial modelling at phase 2. The purchase of services from the Council would be unlikely from existing NPDOs

VAT Partial Exemption Issues:

- 61 There are a range of VAT exempt activities currently carried out by the Council relating to the services currently included in scope for transfer. The recovery of input tax (amounts recovered on vatable expenditure) on expenditure relating to the generation of this income is permissible, providing in totality across the Council this does not exceed 5% of total input tax recovered by the Council. Breaching this threshold results in the Council having to repay **all** VAT recovered in generating exempt income, not just the sums above the 5% threshold.
- 62 The Council's partial exemption threshold in 2010/11 (ie 5% of all input tax recovered) was £2.454m. The Council's Partial Exemption calculation for 2010/11 shows that the Council currently operates comfortably within the threshold.
- 63 The externalisation of a large number of services has the potential to have a negative effect on the Council's Partial Exemption calculation. The MOA Project Team have had support and input from VAT specialists in Resources and have taken advice from the Council's VAT advisors in this regard.
- 64 With regards to the services which are potentially being transferred, where the exempt percentage of activity undertaken is greater than 5%, then the input tax associated with that cost centre is currently having a negative impact on the Council's VAT Partial Exemption position. Advice from colleagues in Resources is that removal of these services would have a positive impact on the Council's VAT Partial Exemption position and would reduce the risk of the Council exceeding its 5% VAT de minimis limit.

Grant Funding

- 65 Positioning the particular range of services outside the local authority has the potential to be strategically advantageous as the Council's commissioning role increases. Of particular interest is the in-sourcing of the public health function from 2012 and the wide range of functions sport and leisure services provide in this area; GP referral and cardio rehabilitation, together with a wide range of physical activity developments. An externalised NPDO would provide a more transparent relationship for commissioning services than an internal service would.

Legal Considerations

- 66 DCC has a number of powers through which it can manage or outsource the services and facilities within the scope of the MOA. The key powers, which include an ability to provide grant aid, are given in Appendix 1 of this report.

Future Project Costs

- 67 If the Council is minded to pursue the development of an NPDO, there will be a number of costs that will be incurred in establishing such an organisation. It is estimated that these costs will be circa £200k. These costs would need to be accommodated from within the cash limit reserves held by the service groupings involved in the MOA project.
- 68 There would be two main elements to these costs associated with advice and support in developing a service delivery or business plan for the new entity and those incurred for legal work in procuring and establishing the entity. For example the following documents would need to be developed and enacted to bring an NPDO into existence:
- Service Delivery Plan
 - Transfer Agreement
 - Funding Agreement
 - Rules
 - Support Service Agreements
 - Building Leases
 - Admissions Agreement (Pensions)

Conclusions and Next Steps

- 69 It is important that Members are aware of the scope of making an 'in principle' decision to transfer services into a charitable NPDO so that there is an appreciation of what is being committed to and what further information is to be provided, prior to a full decision to transfer being made.
- 70 In the first instance, acceptance of the recommendations of this report do not commit the Council to the transfer of services at this stage. What this report seeks is a clear steer as to the Council's aspirations and intent thus allowing detailed information, based specifically on the preferred arrangement to be prepared, for future consideration. Members may, if not fully satisfied, at a future date decide not to proceed with a transfer and reconsider its MTFP proposals.
- 71 Subject to an 'in principle agreement', officers will prepare information on which a decision as to whether to transfer services into a charitable NPDO can be made. In order to make that decision, detailed information relating to transfer arrangements will need to be given. These will be contained within a Service Delivery Plan that will form the main proposal from any new entity for the provision of services.

In addition, it will be necessary to satisfy the Council that arrangements for staff, legal issues and corporate impact matters have been adequately dealt with, together with the confirmation of financial savings. This information, together with the Service Delivery Plan, will form the basis of a future report.

It would be proposed that a Members seminar also be held in relation to the Service Delivery Plan, prior to it being presented to Cabinet.

- 72 The phase 1 of the MOA concludes that the Council establishes a charitable NPDO or transfers its services into an existing NPDO. The Council's in-house services, together with those managed through Leisureworks, at their discretion, should form part or all of the new arrangement. This will require the Council and Leisureworks to work collectively to consider the detailed implications of such a move before any transfer is undertaken. This will represent a significant amount of work for both parties. It is, therefore, recommended that a framework be put in place through which all issues can be considered and communicated including the exact form and legal structure of any new NPDO
- 73 Consideration to the Leisure Connections contract would also be addressed in phase 2 of the project.
- 74 In order to progress matters a Project Board has been established of relevant senior officers and portfolio-holders. This group will oversee the development of any future work on the project.

Timescales / Key Milestones

- 75 In working towards the establishment of a new cultural and leisure trust, there is a great deal of detail to be worked out and arrangements put in place. A detailed schedule has been drawn-up which suggests that a reasonable timeframe, subject to Members' approval, to transfer to a new entity would be autumn 2012.
- 76 Whilst a detailed project plan for establishing a NPDO is being developed the key milestones for the creation and the transfer of the services are seen as follows:

| Milestone/Decision | Target Date | Approval |
|--|---|----------|
| In principle decision to embark upon the NPDO project. | January 2012 | Cabinet |
| Commencement of Market Testing and Procurement | January 2012 | |
| Preparation of Service Delivery Plan | January to August 2012 | |
| Negotiations on documentation and grant-funding arrangements | February to August 2012 | |
| Negotiations on service level agreements | February to August 2012 | |
| Decision to transfer | September 2012 | Cabinet |
| Staff consultations and LGPS matters | January 2012 onwards | |
| Establish NPDO and charitable registration | Autumn 2012 | |
| Transfer | Date to be confirmed at September Cabinet | |

Recommendations and reasons

77 It is recommended that:

- (a) an 'in principle' decision to establish a charitable Non Profit Distributing Organisation as the preferred vehicle for those services outlined in Section 10 of this report is approved;
- (b) subject to confirmation of a non-contestable market from the existing NPDO sector, work to develop a new NPDO be progressed in-house;
- (c) further consideration is given to the inclusion of service areas identified in section 44b;
- (d) that both recommendations (b) and (c) are subject to a delegated decision of the Corporate Directors of Neighbourhood Services , Adults, Wellbeing and Health and Children's and Young People's Services, in consultation with their respective portfolio holders and in consultation with the Corporate Director of Resources and the Cabinet Member for Resources;
- (e) a further report is prepared, in relation to any final decision to transfer, in line with the schedule proposed in section 75 of this report.

Background papers

Durham County Council, Management Options Appraisal; Winckworth Sherwood 2011

Medium Term Financial Plan 2011/12 to 2014/15

Inspire and Transform: Cultural Strategy for County Durham 2010-2013 (approved by Cabinet 16/06/2011)

Durham County Council: Sport and Leisure Service Strategy 2010-2013 (approved by Cabinet 02/03/2011)

| | | |
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Appendix 1: Implications

Finance

The report identifies the achievement of significant savings, in-line with the Councils MTFP programme, for all services within scope. It also identifies additional efficiencies beyond this which will need to be considered in the development of a sustainable Service Delivery Plan for any future NPDO.

As part of the phase 1 MOA analysis, officers have carefully considered potential impacts on the Council's partial exemption position, whereby the Council is permitted to reclaim all the VAT on expenditure associated with VAT exempt activities, providing that the annual amount of VAT recovered on exempt activities does not exceed 5% of the total VAT incurred on expenditure. The Council carries out a calculation each financial year to confirm that the annual amount of VAT recovered in respect of exempt activities does not exceed 5% of total input tax incurred. This is called the Partial Exemption annual adjustment calculation. The total amount of input tax reclaimed in 2010/2011 was in excess of £47m, resulting in a 5% value of £2.35m. Should the 5% limit be exceeded, then the whole of the £2.45m would be due to HM Revenues and Customs and not just the amount by which the limit is breached.

Staffing

As a general rule the lease of any facilities to an NPDO would trigger Transfer of Undertakings (Protection of Employment) Regulations 1981 ("TUPE"). In such a case, all staff within scope would transfer on existing terms and conditions and there would be no break in their continuity of service. This would include any revised terms and conditions subject to single status proposals. The position for other staff involved with the facilities, but working with other services, would depend on their individual circumstances.

A list of all staff affected by these proposals has been identified. There are, however, currently 271 staff employed within the library service who would be affected by the move to a NPDO. However, the library service would transfer following the implementation of changes to the level of service that will be subject to consultation during 2012. If these changes are agreed there will be a reduction in the number of staff employed in the library service transferring.

The Service will work closely with representatives from the HR Team to ensure that all affected employees and the trade unions are fully engaged in the consultation processes associated with these proposals, and that the Council's Change Management protocols are adhered to in this regard.

Risk

A comprehensive risk assessment has been completed and all reportable risks are attached in Appendix 4

Equality and Diversity / Public Sector Equality Duty

An initial equality impact assessment has been undertaken and will be developed further if the proposal is approved in principle. Any potential impacts on service delivery and staff will be included in a final impact assessment to inform future decision making; essentially we would need to ensure that safeguards are in place to meet our responsibilities under the Public Sector Equality Duty alongside the general provisions of the Equality Act 2010

Accommodation

Whilst those services within the scope of this project currently run and manage a large number of buildings it is anticipated, at this stage, that the Council will enter into long term leases with any new entity. It is further envisaged that the Council will retain repair and maintenance responsibility. Although in phase two it may be determined that some elements of work, small works and repairs together with internal presentation issues, will pass to the new organisation(s).

In general terms, however, the Council will still need to make provision on both a revenue and capital basis for the upkeep of the buildings. So whilst in future there may be the opportunity for investment from the new organisation in relation to this, in the short term there will be no savings to be achieved from this area of expenditure; similarly there will be no additional cost either.

Crime and Disorder

None

Human Rights

None

Consultation

It is not anticipated that public consultation will be undertaken in relation to any transfer, as there would be no changes to the level of service, as a direct result.

Consultation with Members will be undertaken via the Overview and Scrutiny process together with Member workshops.

Staff consultation will take place in line with the management of change toolkit.

Procurement

Contained within the main body of the report.

Disability Issues

Any potential impact in terms of disability will be considered in the full EqIA developed to inform Phase 2 of the MOA.

Legal Implications

See Appendix 5

Appendix 2 : Potential Delivery Options Considered

The MOA has reviewed seven options, as follows:

- Status quo
- VCT
- Existing NPDO
- New NPDO with some facilities and services
- New NPDO with entire portfolio
- Social enterprise
- Mixed economy

The key features of each option are set out below:

Status Quo

This option assumes no change in the ownership or management of any service or facility so that Leisure Connection and Leisureworks would continue to manage their services in accordance with the respective contracts. In other respects, DCC would continue to manage and control the services and facilities as well as being financially responsible for them.

Outsourcing to a Private Contractor with or without Hybrid Trust (“VCT”)

Pure VCT arrangement

The VCT arrangement involves DCC seeking a contractor through the normal competitive tendering procurement route with key issues being as follows:

- use of a negotiating process to enable contracts to be signed with a contract specification setting out DCC’s aspirations for the services and facilities
- normal contract length of between 10 and 15 years
- staff would transfer to the private contractor under Transfer of Undertaking (Protection of Employment) Regulations 2006 (“TUPE”) although contractor may see to negotiate change
- the contractual arrangements would set out anticipated facility and service improvements (if any)
- the facilities would be leased to the VCT contractor or held by the contractor on licence
- the VCT contractor is responsible for national non domestic rates (“NNDR”) and gains no VAT advantage

VCT and Hybrid Trust

Many VCT contractors either wholly own or work closely with a voluntary body or non-profit distributing organisation (“NPDO”) often described as a “hybrid trust”. These organisations, through the VCT contractor, will manage the facilities along the lines of the existing Leisure Connection/Leisure in the Community Trust arrangements.

The principal advantage of the VCT/hybrid trust route is the ability to reclaim NNDR which involves 80% mandatory relief for a charitable trust and the potential for discretionary relief on the basis that the hybrid trust is an NPDO. The hybrid organisation would be wholly owned/controlled by the VCT contractor and there would be no opportunity for DCC involvement at board level or spreading of DCC’s overheads to the VCT contractor.

Outsourcing to an Existing Non-Profit Distributing Organisation

The essence of an NPDO is that its profits are not distributed (e.g. to shareholders) but are retained by the organisation for reinvestment in the business to further its objectives and improved the services or facilities. The other key features of an NPDO are:

- although the NPDO board would generally consist of volunteers with a range of skills, they will not necessarily have local involvement or knowledge
- contractual arrangements between DCC and the NPDO setting out the Council’s aspirations and anticipated facility and service improvements (if any)
- contract length of between 10 and 15 years which is conventional for VCT arrangements
- staff transfer under TUPE
- opportunity for mandatory NNDR relief for charitable NPDO
- savings due to VAT exemption on sport charges arising from the nature of the NPDO as a voluntary body – such exemption arises from EU directive and applies to sporting charges only
- the facilities would be leased to the NPDO direct or held by the NPDO on licence.

In the case of an existing NPDO DCC would undertake a procurement exercise as for the VCT route with NPDOs competing against private contractors. As most of the existing free standing NPDOs are registered with charitable status, they will be able to take advantage of savings in NNDR by virtue of mandatory relief and VAT exemption on sports charges. As with the VCT/hybrid trust approach, there would be no opportunity for DCC involvement at board level or spreading of DCC’s overheads to the NPDO.

Newly created local NPDO with some facilities and services

This option assumes that some of the facilities and services would transfer to the NPDO and the remainder would continue to be run in house or through Leisureworks or Leisure Connection. For the facilities transferred to a newly created NPDO the key features would be:

- the new NPDO would only have locally based or community volunteers on the board including DCC elected members with a broad range of skills
- contract length of up to 35 years with break clauses which is conventional for NPDO outsourcing and reflects the Leisureworks arrangements
- staff transfer under TUPE
- opportunity for mandatory relief for charitable NPDO on transferred facilities only
- savings due to VAT exemption on sport charges and VAT payable on management fee

Newly Created local NPDO of Entire Portfolio

This option would involve transfer of all the facilities and services currently managed by DCC to one new NPDO with Leisure Connection managing their facilities under existing contracts subject to the issues raised below:

- locally based NPDO whose board would consist of locally based or community volunteers and DCC elected members with a broad range of skills
- contract length of up to 35 years with break clauses which is conventional for NPDO outsourcing and reflects the Leisureworks arrangements
- staff transfer under TUPE
- the NPDO is likely to be registered with charitable status and thus able to obtain mandatory NNDR relief on entire portfolio
- savings due to VAT exemption on sport charges and VAT payable on management fee

Social Enterprise (Community Interest Company) with opportunity for Private Shareholders

This option for a community interest company or CIC, was recently permitted under the Companies (Audit, Investigations and Community) Act 2004 which is likely to be the vehicle of choice where an entrepreneur wishes to invest in an enterprise managing a social business. The key features are:

- the private sector investor would not have control of the CIC and could only receive dividends capped at a rate dictated by HM Treasury
- all CICs incorporate an asset lock
- a CIC can never be charitable which thus affects its ability to obtain NNDR relief other than on a discretionary basis

In other respects a CIC involvement would follow along the lines for an NPDO. Appendix D sets out the issues for this type of vehicle.

Mixed Economy

This option would involve a process of selecting all of the facilities and services for one or more of the options referred to above with the likelihood of one or more NPDOs for some facilities, VCT contractor for those facilities where there is private sector appetite and the remainder continuing to be managed in-house.

Precedents

We have undertaken an overview of the precedents in respect of all the facilities and services in the light of these options. The matrix below has been scored on the basis that no known precedent is “x” and √s are used for known examples with √√√ being the most frequent.

| Facilities or Services | New NPDO | Partnership with existing NPDO | Private Sector contractor | Private sector with hybrid trust | Community interest company | Comments |
|---|----------|--------------------------------|---------------------------|----------------------------------|----------------------------|--|
| Indoor sport and leisure facilities | √√√ | √√√ | √√√ | √√√ | x | Sports and leisure facilities are relatively easy to transfer to NPDO or private contractor |
| Outdoor sport and leisure facilities including parks and allotments | √√√ | √√√ | √√√ | √√√ | x | |
| Sports development | √√ | √ | √ | √ | x | Transfer takes place alongside sport and leisure facilities to reflect synergy |
| Events | √ | √ | √ | x | x | Free-standing Events NPDOs are rare |
| Countryside Services | √ | √ | x | x | x | Little interest in such services from private sector although Hardwick Park would be the exception |
| Theatre | √√√ | √ | √ | x | √ | Many theatre NPDOs operate and there are a |

| Facilities or Services | New NPDO | Partnership with existing NPDO | Private Sector contractor | Private sector with hybrid trust | Community interest company | Comments |
|----------------------------------|----------|--------------------------------|---------------------------|----------------------------------|----------------------------|---|
| | | | | | | number of private sector management organisations who would be interested in the Gala Theatre |
| Museum, heritage and art gallery | √√√ | √√ | x | x | x | Many operating museum, heritage and art NPDOs but little interest from private sector |
| Libraries | √√√ | √ | √ | x | x | Three known private contractors currently managing libraries |
| Arts development | √√√ | √√ | √ | √ | x | Transfer takes place alongside arts facilities to reflect synergy |
| Whole Portfolio | √√√ | √√√ | x | x | x | Only NPDO approach could be appropriate such as those at Wigan, Peterborough and Bournemouth |
| Mixed economy | √√ | √√ | √√ | √√ | x | Outsourcing could be achieved in possibly two or three separate vehicles as indicated |

Advantages and Disadvantages of each option.

Status Quo

Advantages

- Control – DCC would retain control of the services and facilities and thus be able to spread their overheads subject to the existing contractual arrangements with Leisureworks and Leisure Connection.
- Staff – employment by a local authority (with pension provision remaining with the Local Government Pension Scheme (“LGPS”)) is perceived as more comfortable for staff than any of the alternatives.

Disadvantages

- Risk – remains with DCC and thus the public opprobrium if any of the facilities are forced to close through lack of investment or finance as the Council has already experienced on their leisure centre restructuring
- Accordingly, whilst DCC would maintain complete and direct control over the facilities (subject to the Leisureworks and Leisure Connection arrangements) and be able to spread their central overhead costs, all risks would remain with DCC and they would have to bear the full NNDR costs and the costs of VAT on sporting charges. In addition DCC staff morale may well be affected if no further significant investment is made.
- Disparate facility managers and service providers confuses customers, hinders successful partnership working and increases overheads.
- Capital Funding – access to HLF grants and charitable trust funding is increasingly difficult for local authorities and there is positive discrimination in favour of charitable entities.
- Revenue Funding – deficit-financing of the services is arguably a more serious risk for DCC, particularly where income generation is difficult or the public's interest is fickle particularly as the services being discretionary in nature are subject to disproportionate financial stringency.
- Maintenance of buildings – whilst most of the options predicate retention by DCC of some structural maintenance obligations, the status quo involves a 100% commitment which could potentially become greater if inadequate funds are allocated for this purpose.
- Some of the facilities will deteriorate with lack of investment following diminishing capital budget and reduced revenue funding as discretionary services. This may erode their customer base and give rise to health and safety concerns for some such facilities in the future.
- Need to consider new methods of meeting statutory duties which may give rise to potential closure of countryside sites with consequent risk of liability claims and/or grant repayments.
- Closure – this involves a risk for DCC's staff at any relevant facility or service.

The status quo option would require the Council to:-

- review their investment priorities and take risks similar to those that the private sector would take to optimise financial performance.
- consider regular changes to the operating arrangements at each facility to reflect changing leisure time expectations.
- consider significant re-prioritisation of its capital programme to permit some of the desirable expenditure on replacements and improvements (such prioritisation would probably be at the expense of statutory services and take place in addition to planned investment).
- introduce innovative marketing and promotion techniques, particularly to ensure both income generation and solid objectives are achieved/balanced.
- contemplate further restructuring of the services if capital investment was not forthcoming (this may well involve disposal of sites).
- the Local Government Act 2003 allows local authorities to borrow within “prudential” limits after appropriate public consultation against income from their assets. Whilst this might appear to benefit cultural and leisure facilities as one of the significant income-earners for the Council, this will depend upon DCC’s overall capital investment strategy priorities. The DCC Borrowing Strategy 2010/11 – 1012/13 indicates a cautious approval to its treasury strategy and mandatory services are likely to benefit from any prudential borrowing.

VCT

Advantages

- Most of the short term risk transfers to the private operator.
- 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.
- Whilst the relationship will be subject to one contract, and thus comparatively simple, there may well be three separate relationships.
- DCC could share “super-profit” on any success with the contractor.

Disadvantages

- In the case of a truly private sector company, the venture would be solely profit-driven and less likely to pursue participation in the health agenda or community engagement. There is little evidence of them embracing these issues when income generation and return on investment is perhaps higher on their agendas.
- Desire for increased profits may interfere with the integrity of some of the services and objectives for residents.

- The contractor would be seeking a 20/25% return on any capital injection and a management fee of well over 2.5% based upon turnover. This would impact upon the financial benefits to DCC 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 DCC's income expectations.
- No NNDR or VAT savings (subject to use of hybrid trust) particularly if the hybrid trust is non charitable when DCC does not provide discretionary relief. Even if a hybrid trust was used the NNDR risk would be borne by DCC.
- No scope to spread the Council's central overhead costs as the private contractor would employ its own staff and charge for the expenditure.
- Depending upon the nature of the private sector operator, staff terms and conditions may be adversely affected despite the provisions of TUPE.
- Lottery funding/grant aid may well be more difficult, particularly if the services are run by a privately-controlled entity.
- There might be less local loyalty from an entity running the facilities with no direct local connections.
- In view of the range of facilities and services, a number of contractors may need to be involved with a corresponding increase in monitoring arrangements on the part of DCC.
- There could be a complex client/contractor relationship multiplied by the number of contracts with potential problems following contractor failure.
- Less control over programmes at most facilities which would particularly affect the Gala Theatre.
- Significant procurement costs arising from desirability of possibly three separate contracts for the facilities and services. We estimate that these could amount to £1 million in legal and other consultancy fees.

VCT and Hybrid Trust

A number of private sector operators (such as Leisure Connection) have created wholly-owned charitable or (usually) non-charitable NPDOs to take leases/licences of the facilities to attract discretionary NNDR relief which DCC does not provide. However, although these arrangements are widely used, there are some misgivings about providing discretionary NNDR relief to a wholly-owned subsidiary of a private sector with-profit entity and the NNDR risk would remain with DCC.

This latter arrangement would need to take into account the legislative provisions as outlined in Appendix E. The facilities would be leased to either an existing NPDO or an NPDO created for this contract which would then take transfer of the staff under TUPE, perhaps jointly with the contractor.

This approach has some of the same advantages and disadvantages as the pure VCT model subject to the following:

Advantages

- Although the Council might retain a greater role in the management of the facilities through a free-standing NPDO private sector contractors usually control their hybrid trusts.
- The private contractor and/or hybrid trust would have greater freedom than DCC to access private finance and undertake investment in the facilities.
- NNDR savings for charitable entities and, subject to careful drafting, some potential for VAT savings.

Disadvantages

- There would still be an element of profit driving the process through the desire of the partner contractor to seek an appropriate return for its investment which would result in few funds for investment remaining within hybrid trust.
- DCC does not usually provide NNDR discretionary relief for non-charitable entities which affects viability of this option.
- No scope to spread DCC's central overhead costs as the private contractor would employ its own staff and charge for the expenditure.
- To date the private sector leisure contractors have been successfully managing local authority facilities by introducing investment, generating increased income and expanding usage of their facilities. However, this work has tended to be carried out under a commercial arrangement between the client and contractor with the local authority subsidising special entrance charges pursuant to its social objectives, and thus losing the opportunity for cross-subsidy benefits. Leisure contractors are increasingly required to take into account issues relating to community benefit, social inclusion and partnership. There is little evidence of them embracing these issues when income generation and return on investment is perhaps higher on their agendas.

Outsourcing to an existing NPDO

NPDOs are managing more leisure and cultural facilities than the private sector. Indeed increasingly local authorities are tendering out their facilities seeking interest for existing NPDOs who are, in practice, competing with the private sector although these NPDOs need to look for a “commercial” return on their management contracts.

NPDOs are thus creating group structures to undertake local management transferring the facilities to locally-based NPDOs within a group structure. In particular this has taken place widely throughout the UK and we have no doubt that there would be considerable interest in your facilities with more interest in some facilities (such as leisure) than others although this would only extend to your leisure centres. Leisureworks one of two of the nearby NPDOs would be interested.

However, we consider that as there are unlikely to be many NPDOs able to manage the whole portfolio (such as Wigan Cultural and Leisure Trust), DCC could be faced with letting up to three contracts with the attendant procurement costs.

Advantages

The outsourcing to an existing NPDO would provide all the advantages associated with the traditional VCT route and few of the disadvantages, thus:

- All profits would be reinvested in the NPDO's business although its overheads will be realised outside County Durham
- On the outsourcing DCC would be able to utilise the existing skills of the NPDO to facilitate the transfer although there would be less scope to spread DCC's overheads
- As a charitable entity the NPDO would be able to take advantage of the benefits that such status affords

Disadvantages

- The potential procurement costs associated with up to three separate contracts

The position of Leisureworks

Leisureworks (the trading name for Derwentside Trust for Sport and the Arts) run three former Derwentside DC leisure centres and two arts / culture venues on the basis of long (35 year) leases inherited by DCC together with a range of other services. We have discussed the potential options for Leisureworks if a new County-wide NPDO was created with both the Chair and Chief Executive and have received a helpful note from Leisureworks on their review of an earlier draft of this MOA.

The terms of the Leisureworks documentation anticipated a long term arrangement with an initial five year period expiring in April 2012. There are a number of termination provisions in their Funding and Management Agreement, principally arising on breaches of covenant although Leisureworks could opt to terminate the agreement in whole or in part. Although DCC could negotiate a termination of the arrangements with Leisureworks, we are not aware of any circumstances giving rise to termination as a result of breaches.

Consequently, Leisureworks could well seek to put in a formal proposal under any VCT involving an existing NPDO although we question if they would be able to undertake the management of such a significant portfolio, including libraries and museum, with a turnover approaching £27 million.

However, we consider there is a critical role for Leisureworks in any proposed new NPDO, as outlined below in paragraph 6.6.

Newly Created Local NPDO for entire portfolio

The key advantages and disadvantages of the NPDO model are set out below:

Advantages

- All profits reinvested in NPDO's business with County Durham
- VAT exemption from sporting and related facilities
- Single focused body with unitary purpose
- Opportunity for community involvement in the management of the NPDO
- Harnessing the various Friends' organisations to enhance volunteering, fund raising and community initiatives

- Potential to access private finance for improving and enhancing any of the facilities
- The new NPDO would be the only option which would involve a buy back of any services from DCC
- The NPDO would benefit from the pooled experience of staff currently working within the portfolio and Leisureworks if they merge with the NPDO
- The NPDO would be “owned” by those committed to County Durham and the delivery of the services
- The NPDO can borrow to invest and improve the facilities outside the local government finance requirements
- The new NPDO would become a strategic partner of the Council and take a leading role in the Durham Cultural Partnership
- This governance model has a proven track record and can develop collaborative working at regional, national and international level
- One new NPDO for the entire portfolio would hugely contribute towards regularising charging and cross-selling across the facilities and services

Additional Advantages through charitable status

- NNDR savings
- Range of fiscal advantages including exemption for corporation tax.
- Opportunity for corporate sponsorship and donations utilising gift aid.
- Greater access for National Lottery funding which is increasingly being directed away from local authorities.
- County-wide NPDO will offer opportunities to attract contracts from commissioning bodies in the public health area through both arts and physical activity.
- Other sources of funding for charities not available to the public sector from national charitable foundations.
- Possibility of saving tax by directing Newcastle International Airport to pass dividend direct to NPDO and thereby creating additional savings for DCC.

Disadvantages

- There are a number of “disadvantages” which should be borne in mind including some affecting only charitable NPDOs:
- Regulation by the Charity Commission although this is also seen as an advantage in the public service provision arena.
- Reversibility as the assets of a charity can only be used for the charitable purposes of that charity or transferred to another charitable body for similar purposes.

- The trustees of a charity cannot be controlled by any outside organisation or body and their discretion must not be fettered in any way.
- Potential difficulty recruiting trustees of suitable experience and calibre coupled with the considerable obligations upon them.
- Loss of direct Council control although there would be greater community involvement with an NPDO.

We expand upon the NPDO issues in Appendix C.

Social Enterprise or Community Interest Company

Advantages

- The key opportunity arises from the possibility of outside investment to create the social enterprise where the investor can achieve a modest return on shares dictated by HM Treasury. However, such a private or institutional investor may well have more interest in some facilities and not others due to the varied opportunities for income generation. This type of entity is particularly common in town centre management organisations and health service outsourcings.

Disadvantages

- A CIC can never be charitable and thus able to take the advantages afforded by such designation such as NNDR relief
- A CIC is better able to function with a single purpose facility or service which is income producing
- A CIC would have difficulties raising funding from other sources due to its non-charitable status
- The external investor would benefit from dividends on their shares limiting opportunity for reinvestment

We do not consider that the CIC option is appropriate for further detailed consideration from both a practical and financial point of view. CICs are a comparatively new social enterprise vehicle with no track record in the sport, leisure, culture and library area. Whilst CICs incorporate an asset lock, their non-charitable status does not render this governance model feasible from a financial point of view.

Mixed Economy

The adoption of a mixed economy approach to DCC's facilities will inevitably take into account the relative advantages and disadvantages of each option which will build upon the status quo where DCC already has outsourced leisure facilities under VCT with a hybrid NPDO (Leisure Connection) and leisure/cultural facilities to a local NPDO (Leisureworks). DCC could create one or more NPDOs for the services and facilities it currently manages or undertake VCT for one or more of them.

Disadvantages

These are significant:

- Little opportunity for economies of scale and combined marketing
- Confusion amongst residents and customers as to the service providers
- Considerable difficulty relating to health commissioning bodies
- Unhealthy competition between the wide range of providers for revenue and capital funding, trustees and charitable donations

This option is likewise inappropriate both in terms of the significant procurement and outsourcing costs but the uncertainty of establishing the financial savings in advance.

Consequently, it is not practicable to incorporate this option in the financial appraisal.

Appendix 3 : Pension options

| Decision making body | Decision | Comments |
|-----------------------------|--|--|
| Council | Whether to transfer a share of Pension Fund deficit to the new employer | Transferring deficit will reduce the Council's requirement to pay deficit payments. However it will increase costs for the new organisation – these costs will presumably be passed back to the Council in some form. |
| Council | Whether to ask the new organisation to provide a Guarantee Bond (to protect the Pension Fund from additional costs in the event of the new organisation's insolvency), or (alternatively) to offer to guarantee the new organisation's pension liabilities | Insisting on a Guarantee Bond will increase overall costs. The actuary is likely to use more cautious assumptions when setting the employer contribution rate for an admitted body whose pension liabilities are not guaranteed by the Council. Offering a guarantee will mean the pension risk is retained by the Council. |
| New organisation | Will the new organisation operate a 'closed' pension scheme? – in other words, only the transferring members would have access to the LGPS, not any individuals who are subsequently employed by the new organisation. | A 'closed' scheme is the likely decision. Whilst it will result in a higher employer contribution rate, operating a 'closed' scheme will reduce long-term costs. In an 'open' scheme the Council would be unlikely to offer a guarantee covering pension rights of anyone joining after the transfer. |

Appendix 4 : Risk Assessment

| Risk Description | Potential Impact | Measures to mitigate the risk (if not already in place state implantation date) | Risk Owner |
|---|--|---|---|
| Risk 1 The chosen solution is not fit for purpose. | 1. Adverse impact on the area Masterplans. 2. MTFP Savings for Sport & Leisure are not achieved in 2012-2013 & Culture/Arts in 2013/2014 3. The quality of service delivery is reduced. 4. Reputational damage. | 1. Brief written by and approved by project Board/Sport and Leisure Management Team. 2. Project Initiation Document which lays out governance arrangements and Cabinet Report, this will be tracked by the Project Board and progress reported to Service Management Teams. 3. Winckworth Sherwood using appraisal tool. | Steve Lister |
| Risk 2 Project not adequately resourced | 1. Inability to meet requirements of existing partners. 2. Adverse impact on the Area Masterplans. 3. Major impact on pulling together the three services (not just Sport & Leisure). 4. MTFP Savings for Sport & Leisure are not achieved. 5. Decision based on inaccurate data/wrong assumptions. 6. The quality of service delivery is reduced Newco has inadequate resources to manage unforeseen liabilities. 7. Reputational damage | 1. Monitored by Project Board. 2. Milestones to be closely monitored by project team and reported to Project Board with early escalation of problems issues to Service Management Teams. 3. Issues log to be used to highlight problems and to be discussed at each project team and board meeting. 4. Project Board needs consider where budget for MOA, asset transfer issues and Implementation will come from. | Steve Lister; Ann Davison; Neil Hillier |
| Risk 3 Staff resistance | 1. Solution not delivered within timescale. 2. Three services do not reach consensus on preferred solution. 3. Lack of political appetite. 4. Inability to meet requirements of existing partners. 5. MTFP Savings for Sport & Leisure are not achieved. 6. The quality of service delivery is reduced. 7 HR issues, low staff morale. | 1. Outsourcing of sport and leisure services is common place the majority of Sport and Leisure Staff have some knowledge of and therefore less 'fear'. 2. This risk is more likely within Libraries Service. Employee terms and conditions covered by TUPE, Management Vehicle likely to be an admitted body to the LGPS. 3. Overall this risk is currently considered as possible however it is less likely for Sport & Leisure Services it should therefore be considered more carefully by Arts and Libraries. 4. Communication Plan, FAQ sheet for staff | SL; AD & NH |
| Risk 10 The solution is not delivered within the required timescale | 1. MTFP Savings for Sport & Leisure are not achieved, or there is slippage | 1. Project Management, PID, and project plan timelines to adhere to. 2. Project plan to be updated and agreed which ensure tracking of milestones | NSMT/HoS SL |
| Risk 12 Inability to attract the right quality of trustees if charitable status is selected | Flag as post project but may need to be highlighted at this early stage as it could inform future decision making. | 1. 'Job Description' and person spec to be approved at project board and NSMT | |
| Risk 13 Loss of strategic control, | 1. Adverse impact on the area Masterplans. 2. Major impact on pulling together three services. | 1. Ongoing communication to Cabinet | SL; AD & NH |
| Risk 17 The solution not sustainable because of lack of resources | 1. Reduction in service standards, potential liability claims. 2. New operation becomes insolvent. 3. Reputational damage | Joint report by HoS for S&L and services to NSMT regarding budget pressure | ND/SH |

Appendix 5:

Powers of Local Authorities to provide cultural and recreational facilities

- Section 19(1) of the Local Government (Miscellaneous Provisions) Act 1976 (“the 1976 Act”) provides that “a local authority may provide, inside or outside its area, such recreational facilities as it thinks fit”, including the power to provide:
- Indoor facilities dance studios.
- Premises for use of clubs or societies having athletic, social or recreational objects.
- Staff in connection with any such facility.
- Any ancillary facility such as parking spaces and food and drink counters, and also any equipment, supplies or other assistance required (Section 19(1) of the 1976 Act).

Section 19(3) provides that “a local authority may contribute by way of a grant or loan towards the expenses incurred or to be incurred by any voluntary organisation in providing any recreational facilities which the authority has the power to provide pursuant to Section 19(1) “For the purposes of this sub-section, the “voluntary organisation” means any person carrying on or proposing to carry on an undertaking otherwise than for profit, i.e. a NPDO.

Local Authority functions in relation to the provision of entertainment, arts and crafts, theatres, concerts and other such activities are contained in Section 145 of the Local Government Act 1972 (“the 1972 Act”). This Section empowers a local authority to provide these services itself or arrange for the provision of the services by a third party and then contribute towards the expenses of a third party or do anything necessary or expedient for the delivery of entertainment or the arts.

Conference centres and tourism are covered in Section 144 of the 1972 Act in similar terms and libraries and museums are governed by the Public Libraries and Museums Act 1964.

Section 7 of the 1964 Act states that “it shall be the duty of every library authority to provide a comprehensive and efficient library service”. “In fulfilling its duty ... a library authority shall in particular have regard to the desirability of ... securing ... by any other appropriate means”. Section 9 entitles the authority “to make contributions towards the expenses ... of any other person providing library facilities”. Local authority powers in respect of museums are contained in Section 12 of the 1964 Act and are far wider. They may “so all such things as may be necessary or expedient for or in connection with the provision or maintenance thereof”.

Under various provisions of the Public health Acts and the 1972 Act, local authorities may lease or purchase land for use as public walks and pleasure grounds and may support or contribute to the support of public walks and pleasure grounds provided by other bodies, including, for example, charitable trusts.

The National Parks & Access to the Countryside Act 1949 gives local authorities wide powers to take all action expedient for the presentation and enhancement of the natural beauty of public parks and open country. Further powers are conferred on planning authority under the Wildlife & Countryside Acts to give financial assistance to any person (or body) to do anything deemed conducive to attainment or natural beauty of parks.

Section 2 Local Government Act 2000 (“the 2000 Act”)

The promotion or improvement of well-being power contained in Section 2 of the 2000 Act provides sufficient powers to DCC to establish the NPDO, including incurring costs associated with its establishment.

- “Every local authority are to have power to do anything which they consider is likely to achieve any one or more of the following objects:-
 - A. *the promotion or improvement of the economic well-being of their area;*
 - B. *the promotion or improvement of the social well-being of their area; and*
 - C. *the promotion or improvement of the environmental well-being of their area.” (s.2(4))*

- “The power under Sub-Section (1) includes the power for a local authority to:-
 - A. *Incur expenditure;*
 - B. *give financial assistance to any person;*
 - C. *enter into arrangements or agreements with any person;*
 - D. *co-operate with, or facilitate or co-ordinate the activities of any person;*
 - E. *exercise on behalf of any person the functions of that person; and*
 - F. *provide staff, goods, services or accommodation to any person” (s.2(4)).*

Section 3 of the 2000 Act prohibits the Council from doing anything which it is unable to do by virtue of any prohibition or limitation on powers contained in any enactment and also places a restriction on the raising of money by use of the power.

Section 2(3) provides that when determining whether or how to exercise the power or well-being, a local authority must have regard to the community strategy prepared under Section 4 and clearly DCC’s strategies envisage the developments outlined in this study. Further, Section 3(5) requires that before exercising the well-being power, a local authority must have regard to any guidance issued by the Secretary of State. (section 2(3) will be repealed under the Localism Act 2011)

Guidance was issued by the Secretary of State in March 2001. Section 6 of the Guidance sets out the Government’s purpose in introducing the well-being power as “to reverse the traditionally cautious approach, and to encourage innovation and closer joint working between local authorities and their partners to improve communities’ quality of life.”

Section 111

Section 111 of the Local Government Act 1972, gives a local authority power to do anything (whether or not involving the expenditure, borrowing or lending of money or the acquisition or disposal of any property or rights) which is calculated to facilitate, or is conducive or incidental to the discharge of any of their functions.

Localism

Under the Localism Act 2011, The Council will have a general power of competence from 1 April 2012. This will permit all local authorities to undertake any activity which an individual can engage in subject to the proviso that it is not excluded by other legislation, does not involve charging for statutory services and does not provide tax raising powers. It is believed that this part of the act will be in force by April 2012

This new power will provide the vires for DCC after from April 2012 and commercial activities must be undertaken through a company or community benefit society.

Provision of Services to and from the New Body

Section 1 of the Local Authorities (Goods and Services) Act 1970 provides that a local authority may enter into an agreement with another local authority or “public Body” for the supply of goods and materials, the provision of professional or technical services or for the use of vehicles or plant.

Procurement

Dealt within the body of the report.

The powers and duties detailed above, would give the authority power to enter into the sort of arrangements being considered in this report.