Environment & Climate Change

Report of: Corporate Director Homes & Neighbourhoods

Date: 15 December 2023

Ward(s): All

Subject: Leisure Contract Inflation Uplift Report

1. Synopsis

1.1. Under the terms of the Leisure contract with GLL there is an inflationary uplift taking effect in April each year, that is applied to annual rental that GLL make to the Council and the management fee payments that the Council makes to GLL.

1.2. This is based on that April's Consumer Price Index as published in May of each year.

1.3. During the previous years of the contract this has always been around 1 or 2% so a fairly modest amount that has been absorbed into the contract. However, last year inflation was running at a much higher and unprecedented level and the CPI for April 2022 was at 9.1%

1.4. GLL said that to apply the full inflationary amount to the rental payment would have created a financially unsustainable position and proposed a compromise of 4% uplift, this has risen from an initial offer of 2% through negotiation. This was agreed by CMB on 28th February 2023 and was being taken for a Key decision thereafter, however the Corporate Director left and officers delayed this whilst managing the Sobell consultation.

1.5. The contract also has an energy collar to share the risk of rising energy prices on a 50:50 split, this is based on a base utility consumption from 14/15 and the proposal is to change this to 21/22 to provide a more balanced share of that risk.

1.6. The report sets out the case for a partial waiver of the contract condition and accepting a lower inflationary uplift than the contract allows for but also to adjust the energy collar calculation to reduce the energy risk share pressure on the Council.

2. Recommendations

2.1. To note the financial implications of a partial waiver of the inflation uplift and adjustment to the energy collar for 2022/23.

2.2. To note the legal basis for a partial waiver of the contract term.

2.3. To note the broader financial pressures and issues impacting the overall financial model of the Leisure Contract

2.4. To agree to partially waive for financial year 2022/23 the contract requirement on inflationary uplifts, to accept a 4% inflationary uplift to the annual rent paid by the contractor and management fee and an adjustment of the energy collar calculation to base it on 21/22 consumption levels, not 14/15 consumption levels.

3. Date the decision is to be taken:

3.1. 15th December 2023

4. Background

4.1. The Leisure contract with GLL is a 15-year contract that expires at the end of March 2029. The contract pays an annual rent to the Council and the Council pays a management fee to GLL for certain activities which results in a net positive contribution to the Council. The annual rent provides a net income to the Council. The details of this are contained with the Exempt appendix.

4.2. The contract has been through a particularly difficult financial period with Covid and lockdowns which has resulted in the Council having to provide a significant level of financial support to GLL through the form of deferred rent. The service returned to a full contract position on the 1st of July 2022 having paid half the rental value for the April to June period. Prior to this the Council supported GLL with a deferred rent position through the lockdown and re-opening period, with GLL only under an obligation to pay rent for the period from 1st April 2020 when in a surplus position, with the deferred sum payable should the contract return to a surplus position.

4.3. The contract contains an inflationary uplift clause that lifts the base rental and management fee positions by CPI set at May of each financial year. This is structured to always be in the Council's favour as the rent paid by GLL is significantly more than that of the payment made by the Council. Having been at relatively low levels for the previous seven years of the contract since 2014 when the contract began, inflation this year is at the historic high of 9.1%. The financial implications of the inflationary uplift at 9% are set out in exempt appendix.

4.4. GLL have stated that this would create an unsustainable financial pressure on the contract and push it into financial deficit to the point that it would become unsustainable. They argue that this is unprecedented and could not be reasonably foreseen, this is also compounded by utilities increase and the broader impact of cost of living rises. During the previous years of the contract CPI has been at the following levels.

2014/15	0%
2015/16	-0.1%
2016/17	0.3%
2017/18	2.7%
2018/19	2.4%
2019/20	2.1%
2020/21	0.8%
2021/22	1.5%

So, the average inflation level over the last 8 years of the contract has been 1.2%. On this basis this is clearly an exceptional year and would not be reasonably foreseen or budgeted for.

4.5. In deciding whether it is a reasonable or fair offer to accept the 4% inflationary uplift accepting that this is 5% below inflation there are a number of broader factors that need to be taken into account. The first is the financial model of the contract. This has built into the contract a presumption that the contract will achieve a level of growth and that the annual rental payments increase over the life of the contract. This rise is not a consistent one but sees a significant uplift in the final 4 years of the contract. The details of this are set out in 1.6 of Exempt Appendix 1. This is also in the context that this contract offers very good value for the Council and is probably better than any other public Leisure contract, certainly in London and probably nationally.

Inflation is also likely to be high next year as well which would continue to compound the pressure on the contract and make it financially unsustainable. GLL have stated that they would like to see an agreement that sets a limit on CPI to a maximum level to prevent the rent climbing to levels that are completely unviable and to prevent future negotiations having to take place. There is a logic to this as prices cannot be raised constantly by inflation at that level as people simply would not be able to pay the increased prices, however this report does not address future years. This is going to be an issue for future years but not to the extent that it currently is as there is a degree of optimism that inflation will fall. The latest Office for Budget Responsibility estimates for inflation in the Autumn Statement are 7.4% for 23/24, 0.6% for 24/25 and -0.8% for 25/26. Given the uncertainties at the moment it is proposed that we consider this on an annual basis and keep under review.

4.7 Under the contract the energy price fluctuation is shared 50/50 between GLL and LBI. This is calculated by a Utility Collar.

Utility Collar Calculation	
(A - B) x C	A = Utility Rate at Review Date
2	B = Base Utility Rate (31/3/15)
	C = Base Utility Consumption (31/3/15)

This considers consumption as well as cost with GLL having 100% of the consumption risk with the risk share on price. GLL has reduced electricity consumption by around 21% and gas by 15% since the base 2015 position. In terms of energy cost risk share this benefits GLL with the 50% share based upon the base utility unit cost which pushes a greater proportion of the risk to LBI.

This is the first year of the contract that this clause has had to be used and so is the first time that the Council has had to contribute towards the energy costs of the service. This is therefore a new cost that had not been budgeted for and so reduces the overall level of rental contribution that the Council receives.

The financial impacts of this are shown in 1.7 of the Exempt appendix.

4.9 In addition to energy prices there are also increases in the staffing costs and real living wage and increases in the cost of all materials and foods and services. An example is the cost of chlorine that has risen from £196 in 2019 to £516 per tonne this year, an increase of 163%.

5. Implications

5.1. Financial Implications

5.1.1. The financial implications are set out in detail in the exempt appendix of this report.

5.2. Legal Implications

5.2.1. The Legal implications are set out in detail in the exempt appendix of this report.

5.3. **Environmental Implications and contribution to achieving a net zero carbon Islington by 2030**

5.3.1. Although there are no direct environmental implications as a result of this decision, the broader context of increasing utility prices means that there is a huge incentive on GLL as the operator to minimise consumption wherever possible to reduce costs which will also reduce carbon emissions. A range of new house keeping measures have been put in place alongside an investment in energy control measures. These have reduced consumption by about 20%. GLL have also implemented a winter operating programme that has reduced pool operating hours at very low demand periods. This will save approximately £6,500 per week.

5.4. **Equalities Impact Assessment**

5.4.1. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

5.4.2. An Equalities Impact Assessment is not required in relation to this report, because the decision does involve any changes to services or operations and there is no impact on residents or staff. It is a financial decision only.

6. Conclusion and reasons for recommendations

6.1. Contractually the Council is in a strong position to enforce the terms of the contract and implement the 9% CPI uplift if it so desires.

6.2. At the same time, the contract is facing unprecedented pressures that were not foreseeable when the contract was signed, as is the Council.

6.3. From a partnership perspective of seeking to work together to deal with the challenges that both parties are facing then a sharing of the pressures would be a reasonable position to adopt.

6.4. The long-term viability of the contract is an important one for the Council to protect given its value and worth. To retender the contract would see a significant drop in income to the Council and to bring the service in house would be a very expensive option (estimated to cost at least £2million, which is a net shift of circa £6m and places trading risk back onto the Council) that we have reviewed previously to agreeing the support to GLL through lockdown.

6.5. The Council has developed options with GLL to improve the product offer to significantly improve the contract position through the agreed improvements to Sobell and Ironmonger Row Baths. These options have the potential to put the contract into a surplus position. 100% of any surplus would come to the Council to repay the deferred rent support through the lockdown period.

Appendices:

- Exempt Appendix

Background papers:

- None

Final report clearance:

Signed by:

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Date: 15/12/2023

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