Appendix 1

Financial Analysis

Executive Summary of Business Case Report Prepared By Ernst & Young

Executive Summary

Introduction

A number of Scottish local authorities have utilised charitable Leisure Trusts as a tax efficient vehicle for delivering community leisure services. The not-for-profit structure provides opportunity for operational, VAT and business rate efficiencies and allows savings to be reinvested to improve services.

In the case of West Dunbartonshire Council ("the Council") a number of services from different departments would be aligned under the Leisure Trust ("the Trust") to capture synergies in the utilisation of assets and staff. The structure also has the potential to increase accountability and focus for the services transferred and should benefit the wider community through enhanced service provision and lower operating costs.

Improving the provision of leisure services is key to enhancing the health and well being of the residents of West Dunbartonshire as statistics tell us that the area suffers very high levels of poor health coupled with unhealthy lifestyles.

The delivery model

The Trust will be incorporated as a private company limited by guarantee by way of an application to the Registrar of Companies. The Council will be the sole member of the Trust with ultimate control over its activities. Subsequently, an application will be made to the Office of the Scottish Charity Regulator ("OSCR") for charitable status, which would be a key element of deriving tax efficiencies from the structure. Current proposals will see the responsibility for the operation of the Council's three leisure centres, seven halls and eleven community centres transfer to the Trust under a lease agreement. The Council would retain ownership of the properties. It is also proposed that the operation of a number of other services and related initiatives would transfer to the Trust, for example, Sports Development and Active Schools.

The Trust requires a number of back-office and support services to be provided and for the initial three year period from establishing the Trust on 1 April 2012 these would continue to be provided by the Council under Service Level Agreements ("SLA").

An SLA will also be put in place for the delivery of repairs and maintenance services by the Council for halls and community services whilst the Trust will carry out its own property repairs in relation to the leisure centres.

Gas and electricity represent a significant ongoing cost for facilities and there are significant VAT benefits to energy costs remaining the responsibility of the Council. This will be reflected in the lease agreement between the Council and the Trust.

Capital repairs and improvements to existing facilities would also rest with the Council. However, the efficiency of the Leisure Trust structure provides a source of funds for capital investment.

Financial analysis

The Trust has the potential to make operational efficiency savings when compared to the way services are currently operated. However, for reasons of prudence the current financial model of the Trust is largely based on the historic revenues and operating costs of services being transferred from the Council. The financial model assumes no asset rationalisation at this time or staff restructuring and excludes potential capital developments, such as a proposed new £15 million facility at Clydebank Waterfront.

The structure allows for exemption from National Non Domestic Rates (“NNDR”). This represents an annual cost saving to the Trust of £0.631 million (in 2012/13 prices). However this includes 80% mandatory relief and 20% discretionary relief awarded by the Council. In providing the discretionary relief 25% of this cost must be met by the awarding Council, with the remaining 75% met by the National Non Domestic Rates Pool. This would reduce the comparable net NNDR benefit to £0.600 million(in 2012/13 prices).

The VAT analysis indicates that the creation of the Trust will generate a VAT benefit of £0.099 million in 2012/13; however, the structure does offer the potential of a more advantageous VAT position in the future should income be increased, due to the likes of concession and pricing reviews or lower VAT-able operating costs arising from efficiencies.

Taking these savings into account, the financial modelling indicates the ongoing operations continue to return a deficit over the first three years. This deficit would be deemed to be the cost of providing the Council’s leisure services on behalf of the Council. Consequently the Trust would charge this cost to the Council in the form of a management charge. The quantum of the deficit to be funded through the management charge is shown in Table A below, together with other Council cashflows associated with the Leisure Trust:

Table A – Cashflow summary

	Year 1 2012/13 £’000	**Year 2 2013/14 £’000**	**Year 3 2014/15 £’000**
Leisure Trust operating income	2,460	2,501	2,542
Leisure Trust operating expenditure	(6,816)	(6,808)	(6,808)
Net cash outflow from operations – Management Charge payable by Council	(4,356)	(4,307)	(4,266)
Utility payments retained by Council	(734)	(734)	(734)
Repairs & maintenance costs retained by Council	(95)	(95)	(95)
Element of discretionary NNDR relief funded by Council	(31)	(31)	(31)

Trust SLA payments receivable by Council	249	248	248
Total cashflow from Council	**(4,968)**	**(4,921)**	**(4,880)**

Note: The tables presenting the results of the financial analysis are presented in nominal terms. In line with WDC budgetary protocol, indexation has been applied at 2% for lets and admissions, 0% for other income categories and 0% for all expenditure.

Source: Ernst & Young LLP

The table projects a management charge of £4.356 million in year 1, reducing to £4.266 million in year 3. The overall financial position illustrated in Table A contributes to an improved position for the Council when compared to the existing delivery model. Table B provides for the purposes of comparison the overall costs that would be associated with the existing model:

Table B – Projected results of the current delivery model

	Year 1 2012/13 £'000	**Year 2 2013/14 £'000**	**Year 3 2014/15 £'000**
Cashflows under existing model			
Operating income	(2,320)	(2,357)	(2,396)
Operating expenditure	7,801	7,801	7,801
Net deficit	(5,481)	(5,443)	(5,405)
Cashflows under Leisure Trust model	(4,968)	(4,921)	(4,880)
Improved position for Council	**513**	**523**	**526**

In line with WDC budgetary protocol, indexation has been applied at 2% for lets and admissions, 0% for other income categories and 0% for all expenditure.

Source: Ernst & Young LLP

The analysis highlights a projected improved financial position for the Council of £0.513 million in year 1 rising to £0.526 million by year 3. This is before asset and operational efficiencies are identified and taken into account.
The reasons for the improved positions are set out in Table C:

Table C – Net savings of the Leisure Trust model

	Year 1 2012/13 £'000	**Year 2 2013/14 £'000**	**Year 3 2014/15 £'000**
Savings			
NNDR relief	600	600	600
VAT savings on revenues	140	143	146
Additional costs			
Additional Leisure Trust costs	(186)	(179)	(179)
Irrecoverable VAT	(41)	(41)	(41)
Net improved Council position	513	523	526

In line with WDC budgetary protocol, indexation has been applied at 2% for lets and admissions, 0% for other income categories and 0% for all expenditure.

NNDR relief reflects 80% mandatory charitable relief and 20% discretionary relief, of which 25% would be funded by WDC.

Source: Ernst & Young LLP

Capital investment requirements

There is a requirement for significant reinvestment in the building assets used for the delivery of leisure services to ensure they are fit for purpose and do not adversely impact on the delivery of services. In particular the halls and community centres are generally in poor physical state and this contributes to the very low utilisation of these facilities by the local communities.

We understand that asset condition surveys have been carried out by the Council's in-house team and identify a capital investment requirement of £3.1 million in halls and community centres and £2.8 million related to the leisure centres, with an anticipated level of expenditure for the leisure centres as set out in Table D below. The minimum annual spend required for the halls was not available at the time of the preparation of this report.

Table D – Capital investment requirement

	Year 1 £'000	Year 2 £'000	Year 3 £'000
Total	**350**	**350**	**241**

Source: West Dunbartonshire Council

An underlying presumption of this business case is that the Council will carry out this element of investment and this could be funding in part via the savings generated by the new Trust structure.

In addition to the above, it is anticipated that £0.13 million required for the formation of a new office within the Alexandra Community Centre may be funded through the Council's Modernisation Fund.

Summary

The proposed Leisure Trust structure offers the potential for tax efficiencies that will positively impact on operating costs with some £0.600 million of annual savings from exemption from business rates anticipated in 2012/13 (net of Council cost of discretionary relief). The prudent assumptions applied for VAT analysis lead to a VAT benefit of £0.099 million in 2012/13, and the structure offers further potential savings if income from sports participation is increased and/or operational costs savings are made. Efficiencies could be realised from the alignment of services currently delivered across a number of Council departments and from increased accountability and focus on the management and operational of leisure services provided under the Trust structure.

Next steps

There are a number of key financial issues that will need to be focussed on in the time leading up to the transfer of assets and immediately post-transfer. These include:

- **Real estate rationalisation** – We understand that a number of the halls have been subject to discussions regarding potential transfer to community ownership; however, the exact nature of such transfers is still to be determined.

- There is also the question of the proposed £15m development of a new facility at Clydebank Waterfront. The preferred position will need to be identified and the financial impact of this on the Leisure Trust and its management charge analysed.
- **Capital investment requirements** – The reinvestment programme identified to ensure that the assets used for the delivery of leisure services are fit for purpose and the extent to which it can be funded from the savings generated by the implementation of the Leisure Trust model will need to be reviewed and a position agreed.
- **Concession policy** – The concession policy employed by the Leisure Centres currently provides free swimming concessions to 80% of the centres' customers. Once the Leisure Trust Board is formed it would be in a position to review this model. Financial analysis of the effect of any change to concession policy will be required to understand the impact on the Leisure Trust's revenues and, in turn, the management charge payable by the Council to the Leisure Trust.
- **Pricing policy** – Similarly, the pricing policy employed for the use of the leisure services, its implication and impact of revenues will need to be analysed and agreed.
- **Leisure Trust cost efficiencies** – As agreed with the Council, this business case has employed prudent assumptions based on the current leisure service position and a steady state position rolled forward into the early years of the Leisure Trust's operation. However, one of the key advantages of the Leisure Trust is to provide a single entity body with responsibility for leisure services in West Dunbartonshire, which could realise efficiencies and improved services from the alignment of services and from increased accountability and focus. The efficiencies that could be achieved by the Leisure Trust will have a direct impact on the level of management charge payable by the Council and we will analyse the effect of anticipated efficiencies when these are available in order to provide the Council with a clear view of the expected management charge requirements of the Leisure Trust.
- **Ongoing tax and VAT analysis** – As the transfer progresses and the legal documentation is drafted, care will be required to ensure that the appropriate applications are made to and agreements reached with HMRC to achieve an efficient VAT and tax solution.
- **Leisure Trust financial position** – The detail of how the Leisure Trust will be funded, financed and implemented will need to be confirmed. Each of the above issues will influence the financial position and requirements of the Trust and analysis that draws all of these elements together will be required in support of the final business case.
- **Confirm costs retained by the Council** – The services retained by the Council and profile of associated costs will need to be confirmed in order to ensure that the Council has an understanding of the total costs of the Leisure Trust model.

We can work with the Council and the Leisure Trust shadow Board to analyse these issues and propose solutions that will be both beneficial to the Council and put the Leisure Trust in a strong position as it takes over responsibility for these key leisure services for West Dunbartonshire.