# Leisure Services Delivery Guidance

## Appendix 14: private capital funding sources

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Whilst there's no indication that the appetite for private capital investment has diminished following the Covid-19 pandemic, users of this document are encouraged to explore their specific local situation or contact Sport England to discuss the latest information.

# 1 PRIVATE SECTOR FUNDING FOR SPECIFIC FACILITIES

## 1.1 Funding Solutions for Design, Build, Finance and Operational Support Agreements

1.1.1 There are currently organisations within the sector who offer alternative, competitive funding arrangements by working in close partnership with major financial institutions that specialise in structured finance solutions in support of public sector leisure developments.

1.1.2 The funding can be used in conjunction with other funding sources such as reserves, capital funding or 3rd party grants and can encompass a variety of risk transfer profiles.

1.1.3 Competitive funding can be arranged that is bespoke to the requirements of each specific project, with amortisation periods that range from 10 years to 20 years.

1.1.4 Financial borrowing levels can be flexible and the organisations involved promote that funding can be delivered at public sector borrowing rates not commercial borrowing rates.

1.1.5 The structured finance solution can potentially meet immediate investment needs of the facility but can also incorporate all future planned investment requirements of the facility during the term of the contract.

1.1.6 There are a number of potential service providers and each organisation will have their own form of funding solution which should be assessed on their own merits. Legal contracts and template documentation have been developed by providers to assist the process.

1.1.7 The funding support can provide can sit within a number of contractual structures including:

- Design, Build and Finance
- Design, Build and Finance with Operational Support
- Operational support services can be provided to the local authority (or its appointed trust or 3rd party operator)
- Design, Build and Finance with Full Operation
- Full operational services provided by the project partner
- Strategic Leisure Development Partnerships
- A long term partnership arrangement (incorporating some of the above structures) to bring the various multi-disciplined processes required to deliver a successful project together under one contract.

1.1.8 The range of services that would be available under such a partnership arrangement can include (but would not be limited to): initial survey of existing leisure stock; demographic analysis of local market to establish needs and demand; competition analysis; concept designs; costed feasibility studies and risk analysis; detailed business planning; funding options appraisal; planning; design and build, long term operational support and all future planned investment requirements.

# 2 KEY FEATURES OF A DESIGN, BUILD, FINANCE AND OPERATIONAL SUPPORT AGREEMENT

2.1.1 Unless additional funding sources have been identified (i.e., capital, grants, reserves etc.) then 100% of all project development costs can be provided within the funding facility on a turnkey basis, thereby ensuring that no additional funding resource or contribution is required from the local authority.

2.1.2 Depending on the individual arrangements, the investment in the facility can be unsecured in relation to formal legal interest or charge on the land and building. However, in order to ensure that funding is delivered at public sector borrowing rates, secured structured finance facilities may be used to fund the investment which are then serviced from the future commercial revenues generated by those facilities.

2.1.3 A typical project agreement provides for the following key investment elements:

- Stage Payment facility through to practical completion
- If required, an income protection scheme can be developed to compensate for any loss of revenue suffered by the local authority during the development phase
- Post practical completion - a repayment holiday can be included, if required, to permit the facility to re-open and build up its revenue streams again prior to any repayments falling due
- Planned equipment replacement programmes will ensure that specified equipment is replaced at least every 5 years (or as and when agreed)
- Planned facility refresh programmes will ensure that specified elements of the facility are refreshed or replaced at least every 5 years (or as and when agreed)
- The investment may be amortised over the agreed term and with agreement from the local authority, can also include periodic refinancing breaks throughout the contract term to provide flexibility to re-profile the investment model if required by increasing or decreasing the investment balance outstanding or by increasing or decreasing the remaining amortisation period
- In the event that a project agreement with funding is terminated early, step in and step-out arrangements are put in place in the agreement for the benefit of the local authority and the funder that would enable the local authority to continue to operate the facilities and to service the investment from the revenue streams generated by the facility thereby maintaining the integrity of the self-financing business model.

**2.2 Self-Financing Business Model**

2.2.1 Working within any prescribed financial objectives, the partner works with local authorities to deliver leisure facilities that are capable of financing themselves through the future revenue streams that the facility will generate.

2.2.2 An important feature of this sustainable approach is to ensure that any financial modelling undertaken is comprehensive and incorporates not just the immediate investment needs of the facility but also the future investment needs in terms of replacement equipment and facility refresh programmes and other planned investment strategy decisions.

**2.3 Flexibility**

2.3.1 The long-term funding solutions provided, embrace the flexibility required by not only incorporating all known planned investment decisions but by also engineering into the financial model scope for contingencies or alternative investment strategies to be implemented at a later date.

2.3.2 The funding solutions can provide the ability (should circumstances permit) to repay capital early thereby reducing the burden on the revenue budget of the facility in future years. Alternatively, additional capital sums can be drawn down if required should additional unforeseen investment be required. Where additional capital is required the funding model can also be modified to ensure that repayment profiles remain within budget by extending the facility beyond the initial agreed term.

### 2.4 Whole Life Cost Funding Solutions

2.4.1 The whole life cost approach can include the initial design; build and fit out investment; a planned equipment replacement programme for the duration of the contract term; a planned facility refresh programme for the duration of the contract term; a wide range of operational support services that may be required for the facility; and also the potential to add an optional contingency fund to cover unforeseen investments that may be required from time to time, together with the flexibility to react to changing circumstances mid-term by increasing or decreasing the level of investment required.

### 2.5 Financial Model and Business Case Affordability

2.5.1 The financial modelling can look at the total planned investment needs of the facility over the term of the project agreement and convert that long term investment requirement into a pre-agreed fixed month sum spread over the term of the contract that can be serviced from the revenue generated by the leisure facility.

## 3 PRIVATE CAPITAL FINANCE

3.1.1 The opportunity to attract Private Capital Finance (PCF) to augment and provide an alternative to more established avenues of funding capital schemes for the local authority leisure market has emerged during the last few years. This financing approach has been used by local authorities in other sectors and for non-leisure projects, but the market has not previously offered this in relation to leisure.

3.1.2 Private sector funder confidence has grown following a period of change in the efficiency and financial sustainability of the local authority leisure sector. The interest from private investors has been attracted on the following basis:

- Strong business performance of projects creating sufficient surplus for the repayment of the loan from revenue generated
- The willingness of local authorities to underwrite repayments
- The involvement of Sport England in the assessment of and support of projects (Sport England project support is available for any local authority project regardless of the source of funding, Public Works Loans Board (PWLB), capital receipts or private capital finance).

3.1.3 Whether the PCF route is an attractive option will be a matter for each local authority. The interest rate offered will be low but above that of PWLB, so in circumstances where no other factors come into play then PWLB will be the most likely route of funding. However, there are circumstances which may mean that the marginal increased cost of borrowing is offset by other factors. In such cases PCF may be a viable alternative worth exploring.

### 3.2 VAT Exemption Criteria

3.2.1 Following the European Court of Justice decision in the London Borough of Ealing, local authorities are able to treat certain supplies of leisure services as exempt from VAT. There has not yet been any proposed change to UK legislation which leaves a position where local authorities can choose whether to adopt the exemption or continue to tax leisure services.

3.2.2 HMRC have, however, been clear that where the exempt option is chosen, the local authority will be required to maintain that approach i.e. it will not be allowed to switch and change as and when it suits.

3.2.3 The benefit of adopting the exemption is clear - local authorities can retain all of the income from the relevant leisure services which translates into a 20% increase in income without increasing the cost to the end user. As well as adopting the position going forwards, many local authorities have also made retrospective claims. However, the exemption does come with a downside. As a result of the exemption, there is greater pressure on the local authority's partial exemption position which if breached, results in a significant irrecoverable VAT cost, in some cases outweighing the benefit altogether.

3.2.4 PCF loan rates are above the PWLB loan rate. However, this is can be mitigated to a degree by the Private Capital Loan being amortised over the course of the loan period, together with the VAT opportunities. The loan is likely to be over a 25-40 year period, though this can be negotiated on a local basis and will affect the interest rate.

3.2.5 It is envisaged that the loan repayments will be made from the trading surplus generated at the facilities, with the local authority underwriting the repayments (this is no different to the risk and responsibility arrangement with a PWLB loan).

3.2.6 Sport England will not be party to or provide any advice on any legal agreement between the local authority and the private finance provider, and it will be the local authority's responsibility to undertake due diligence separately from the Sport England grants process. In addition, the funders will need to see that the underlying business model is sound as part of the process.

## 4 DEVELOPMENT PARTNER APPROACH

### 4.1 How it works

4.1.1 A "Development Partner" approach allows for the co-ordination, shaping and scoping of capital investment project delivery, managed and co-ordinated by one party from conception to completion. This would include the initial scoping and outline business case that can then be used to determine the affordability of a project based on business feasibility.

4.1.2 Once outline feasibility has been established, the development of detailed building design can be undertaken. This can be achieved using a staged approach up to and including final project costs. The flexibility of this approach allows for open book value engineering during design development, to deliver an affordable and deliverable project that is directly related to the available capital and revenue budgets.

### 4.2 Benefits of a Development Partner approach

4.2.1 The Development Partner approach has a number of key benefits when compared to a traditional procurement route. It offers the opportunity to work in partnership with identified industry experienced architects and building contractors to ensure 'buildability' and affordability advice from the outset. This approach also offers access to an extended supply chain of industry specific suppliers with the buying power associated with an established, experienced and regular leisure developer. This together with access to the latest industry innovations and case studies enables delivery of a relevant, future proofed and sustainable facility.

4.2.2 Using a staged approach, a project can be worked up to a position of "cost certainty", including all the detailed design, building cost estimates and equipment provision, taking into account the identified affordability parameters. Early architect and contractor engagement is a particular benefit as it allows schemes to be developed with price confidence and buildability assured from the outset. Once a final scheme is agreed and costed, cost and delivery risk can be wholly transferred to the Development Partner.

4.2.3 In summary, project delivery from scoping through to completion is co-ordinated by the Development Partner. This includes detailed building design, construction and fit out supply and logistics. The client has one point of contact from which to manage all aspects of a development and the comfort of transferring cost and delivery risk to the Development Partner.

### 4.3 Procuring a Development Partner

4.3.1 A Development Partner could also be procured using a traditional procurement route. As with the traditional procurement route for a construction project, this process can also take significant time to complete, thus incurring not only significant tender costs but also the potential of additional building inflation costs.

4.3.2 The alternative to this is to use a pre-procured Framework route.