APPENDIX 2

PERTH & KINROSS COUNCIL

23 FEBRUARY 2022

PH20 Project: Summary of Outline Business Case

Report by Head of Culture & Community Services/Project SRO

PURPOSE OF REPORT
This report summarises the Outline Business Case for PH20 to support Council's consideration of the wider capital report. The latter includes an officer recommendation to proceed with the current preferred option for PH20, at an indicative cost of £85-90m.

1. BACKGROUND

1.1 In February 2019, Council instructed development of a Strategic Business Case (SBC) for the PH20 project to replace Perth Leisure Pool (PLP) and Dewars Centre (DC), allocating £0.5m towards this development work. Financing the replacement of these aging facilities has always been a huge challenge alongside other capital pressures. Market conditions for leisure have changed dramatically since PLP/DC opened in the 1980s, and no publicly funded leisure facilities operate without significant public subsidy albeit there are wider economic and social returns on investment. Major capital grant programmes for public leisure facilities have all but disappeared. The business case for PH20 is, therefore, not founded solely on the financial case but the wider economic, community and health benefits it will deliver for residents and visitors to Perth and Kinross.

1.2 A SBC scopes out a project. It sets out the strategic need and appraises market conditions; scopes project objectives and benefits and appraises a long list of options to identify which option will best deliver the objectives/benefits. An OBC is about planning project delivery. It tests the preferred option in more detail and carries out further appraisal if needed. A Full Business Case develops the financial and commercial case further as the project moves from procurement to delivery stage.

1.3 The strategic case for change to support PH20 can be summarised as follows:

- Pre-Covid over 400,000 people used PLP and DC facilities annually of which 300,000 live in Perth and Kinross.
- The facilities deliver key economic, educational, community and health benefits for residents and visitors, particularly the day visitor market for Perth.
- The current facilities are nearing end of life: £1.7m has been spent on essential repairs and maintenance since 2021/22 plus work to repair Perth Leisure Pool following floods in 2020.

- Their combined operating deficit of £790,000 pa is projected to grow by over 50% by 2023/24.
- Flood mitigation work following catastrophic floods at PLP in 2020 is needed, estimated at £1m.
- The facilities are also a major constraint on our ability to meet 2030/2045 carbon emissions reduction targets.
- The links between sport, physical activity and public health/health improvement are stronger, particularly in light of Covid-19.

1.4 The PH20 SBC was completed in April 2021 and approved by the Council's Strategic Investment Board. Elected member briefings were held in September 2019, February 2020 and September 2021 on the proposed accommodation schedule for a preferred option as it developed during the SBC stage.

1.5 The accommodation schedule for the preferred option was designed to maximise income from key facilities which generate or can grow significant income whilst cutting running costs through more efficient building design. It comprises:

- Large leisure water
- 25m traditional pool with movable floor enabling more efficient/flexible programmes
- 12.5x8.5m teaching pool with movable floor
- Gym/group fitness facilities (3 studios)
- Bowling – 6 lanes
- Ice – 8 lanes
- Health spa
- Family/play facilities (soft play, clip n'climb)
- Flexible conference space
- Café

1.6 In October 2021, the outline cost plan from HubCo for the preferred option was reported to Council as £70m. Council instructed the SBC should be developed to Outline Business Case (OBC) by February 2022; and for all viable funding routes to meet capital and revenue consequences of PH20 to be explored. Additional questions were raised by members about VFM at October Council, therefore an independent review of the HubCo cost plan in the SBC was carried out at OBC stage.

1.7 The remainder of this report summarises key findings from the OBC, prepared by Thomas & Adamson Property Consultants and the PH20 Senior Officer Group which is a joint PKC/Live Active Leisure team. External advice was also commissioned from EKOS/Integratis leisure consultants (market appraisal) and Jones Lang LaSalle (funding options).

2. PROPOSALS

Option 1: Preferred option – review of estimated capital cost

2.1 An independent cost review of the HubCo cost plan for the preferred option was completed by Thomas and Adamson. This shows the estimated £70m cost at that stage was reasonable. Construction inflation was excluded from the wider capital report to Council on 6 October 2021 but for the PH20 OBC, likely market inflation has now been factored in. The final tender price for the preferred option may increase by 20-25% or more by the time we reach financial close. This means the capital cost is now estimated at £85-90m including inflation allowance, contingency, client fees etc.

Option 2: Smaller 'core' option

2.2 Given this significant cost increase, the Senior Officer Group also examined what was achievable within the original indicative £70M cost envelope. A smaller core option, estimated at £67-70m**,** could provide these facilities:

- 25m traditional pool with movable floor
- 12.5x8.5m teaching pool with movable floor
- Ice – 8 lanes
- Family/play facilities (soft play, clip n'climb)
- Flexible conference space
- Café

The following would be <u>excluded</u>:

- Leisure water
- Bowling
- Health spa
- Gym/fitness offer. Bell's would remain the key location for LAL's main gym/fitness offer and is currently under development for this purpose

2.3 This smaller scale core option has not been developed to SBC or OBC stage. Outline capital costs and usage/revenue assumptions have been prepared for comparative purposes and are shown in **Table 1**.

2.4 A 'do minimum' option to refurbish the existing PLP and DC sites was also examined at SBC stage. This was discounted due to the construction risks inherent in refurbishing older facilities and the limited lifespan of these buildings; thus, limiting ability to grow usage, income, cut running costs and meet carbon emission reduction targets.

Review of usage & revenue assumptions

2.5 Usage, income and expenditure assumptions for the preferred option and base case/'do nothing' scenario were updated at OBC stage by EKOS/Integratis. This was done in light of Covid-19 impact on usage projections, and anticipated cost increases mostly attributed to rising staff and utility costs due to inflation/other factors. Usage, income and expenditure assumptions were also prepared for the smaller scale core option. These are also summarised in **Table 1**.

Table 1: usage, income and expenditure projections

Option	Projection SRC (April 21): Yr 1	Projection SRC: Yr 5	Projection OBC (Jan 2022): Yr 1	Projection OBC Yr 5
Preferred option - OPTION 1	**Usage:** 611,000 **Operating deficit:** 248,000	**Usage:** 611,000 **Operating deficit** 361,000	**Usage:** 563,000 **Operating deficit:** 598,000	**Usage:** 563,000 **Operating deficit:** 724,000
Smaller core option – OPTION 2	N/A	N/A	**Usage:** 323,000 **Operating deficit:** 662,000	**Usage:** 323,000 **Operating deficit:** 1,030,000
Base case/do nothing[1]	N/A	N/A	**2023/24**: **Usage:** 328,000 1,721,000	**2027/28: Usage:** 379,000 1,600,000

2.6 The ability of each option to reduce carbon emissions has also been assessed and is summarised in **Table 2**.

Table 2: Impact of each option on carbon emissions

Energy bills Co2 emissions	Current facilities (‘do nothing’)	Preferred option – OPTION 1	Smaller core option - OPTION 2
	Current: **£0.5M** annual energy bills Projected to rise to **£0.7M** in 2022/23 Current carbon emissions: 1,637tCO2 per year	**£420,000** reduction Reduction of 1370 tCo2 per year	**£490,000** reduction Reduction of 1440 tCo2 per year

2.7 These comparisons show:

- The preferred option still offers best potential to grow usage, income and cut running costs although the original anticipated reduction in operating deficit is no longer achievable due to Covid impact on usage and running costs.
- The smaller core option will help manage and contain running costs but will not generate the extra usage/income needed to achieve wider economic and community benefits. Swimming lesson capacity for example will be significantly curtailed.

- Both options will enable carbon emissions to be reduced by around 60-70% from current levels. PLP and DC currently generate around 15% of emissions from the PKC/ALEO estate: over 1.6m kg of carbon emissions annually.
- The 'do nothing' scenario will not enable us to manage/contain running costs or meet our 2030/45 carbon reduction targets. The current operating deficit will increase by more than 50% in the next 3 years despite some recovery in usage levels. The buildings are also highly likely to fail within the next 5 years.

Funding routes

2.8 Having reassessed the preferred option and investigated an alternative smaller scale option within the earlier £70m cost envelope, the OBC examined funding routes. The Council borrows from the Public Works Loan Board (PWLB) for most capital projects which allows key public infrastructure projects to be prudently financed.

2.9 Independent advice from Jones Lang LaSalle was obtained for the OBC to assess if other funding routes would provide better value in both the short and longer term. These are summarised in **Table 3**.

Table 3: summary of funding routes examined in the OBC

Funding option examined	Conclusion
Private finance to build PH20 Private sector owns the facility and leases back to PKC/Live Active Leisure ('income strip')	Won't be cheaper than PWLB. PKC locked into high rent charges for 40 years +
Private finance to procure and build PH20 via Scape/similar procurement route. PKC/LAL owns and operates	Won't be cheaper than PWLB. Typically, 6% compared to 1.5-2% via PWLB.
Private sector finances, builds and operates PH20, and subsidised by PKC to provide community services.	Unlikely to attract private operator as customer volume/turnover in P&K relatively low. Costs of change associated with reducing or ending LAL's current role as PKC sole operator.
Borrow from PWLB and cross-subsidise loan charges by commercial developments leased to 3rd parties – hotels, offices, retail etc	Insufficient market demand in Perth to generate enough income to make any real inroad on borrowing costs. This option has been examined at key stages prior to 2019.

2.10 The PWLB is therefore the proposed route to finance PH20 should Council approve it. However, the additional borrowing required will place additional revenue pressure on the Council. Modelled over a 40 year borrowing period:

- For the preferred option the average annual revenue pressure is **£3.9m** pa; and
- For the smaller scale core option, it is **£2.8m** pa.

2.11 Loan charges are lower in the early years of a project's lifetime and rise steadily each year, particularly in later years. As the annual charges are lower in the short-medium term, they can be managed by using the Council's Loan Charge Fund. To ensure we can meet these loan charges in the longer term, we need to build up the Capital Fund in the meantime. It is, therefore, proposed to increase the Loan Charges Budget incrementally by £150-200,000 per annum <u>every year, for 40 years</u>, from 2022/23. Our ability to borrow for other future projects will be impacted, and the Investment Blueprint will support good prioritisation and decision making for future investments in light of the PH20 commitment should Council approve it.

2.12 Key comparisons for the preferred option and a smaller core option are summarised in Table 4.

Preferred option – OPTION 1	Smaller core option - OPTION 2
• Capital cost: **£85-90m** • Projected usage: **562,000 pa** • Annual operating deficit: **£691,000 pa** (Yr 5) • Projected annual energy consumption: Reduced by **£420k**/1370 tCO2pa • Average annual loan charge: **£3.9m** • Annual addition to PKC's budget for capital borrowing: £200K each year	• Capital cost: **£67-70m** • Projected usage: **324,000 pa** • Annual operating deficit: **£744,000 pa** (Yr 5) • Projected annual energy consumption: Reduced by **£490k**/1440 tCO2 pa • Average net annual loan charge: **£2.8m** • Annual addition to PKC's budget for capital borrowing: £150K each year

2.13 If it proceeds, PH20 will be delivered in a fast-changing world, to which LAL's current business model will need to adapt. Significant business transformation will be required both to ensure business continuity whilst PH20 is under construction, and post-completion to fully realise project benefits. This scale of transformation for LAL will require support from the Council through our wider Transformation Programme. A review/reassessment of commissioning priorities and targets will be required to ensure the Council's investment in sport is balanced appropriately across Perth and Kinross: before, during and after PH20 comes on stream.

[1] Based on 5 year lifespan from 2021/22