AGENDA ITEM NO. 6

LEISURE FACILITY IMPLEMENTATION - PROCUREMENT OPTIONS

Committee: Leisure Facility Working Party
Date: 26th February 2009
Author: Chief Executive

1.0 ISSUE

1.1 Recommended option for the procurement of the construction and management of the proposed leisure facility.

2.0 RECOMMENDATION

2.1 Members are requested to recommend to Community Services Committee that:

(i) Council directly procures the construction of the proposed leisure facility as detailed in paragraph 4.2 and in Appendix 1.

(ii) the procurement process for the appointment of service provider be deferred to enable benchmarking and evaluation of a trust option for the management of the facility.

3.0 BACKGROUND/OPTIONS

3.1 The Working Party on 3rd December 2008 resolved to defer the agreement of the project to enable the Council's consultants, Strategic Leisure, to review procurement options in the light of the current economic downturn. Specifically, Strategic Leisure would re-examine whether the preferred route of 'Design, Build, Operate and Maintain - DBOM' or 'Design, Build, Fund and Operate-DBFO' is still appropriate in the light of market conditions.

4.0 ARGUMENTS/CONCLUSIONS

4.1 Strategic Leisure have now completed their review and their briefing note is attached as Appendix 1. Their recommendations are summarised below:

- the disadvantages of an integrated single contract approach are exacerbated in times of economic difficulty;

- there are relatively small number of consortia who are active in the market place even in times of economic buoyancy and there is growing reluctance of these consortia to bid for integrated projects;

- this increased reluctance to bid is due to a number of interrelated factors, specifically; the costs and risks of preparing a DBOM/DBFO proposal (circa £250,000); reluctance for consortia to take a risk for every aspect of the
development and ordinarily, a consortia would establish a Special Purpose Vehicle to develop the facility which are dependant on Banks or related partner;

- the separation of the design and construction of the facility would be the more appropriate option for the procurement at the current time;

- there are three options available to the Council in directly procuring the construction of the facility, specifically traditional route, Design and Construct and Design and Build. The advantages/disadvantages of each option are detailed in the report and should be considered in the light of the Planning Update report.

4.2 The procurement of the service provider will therefore be separate from the construction of the facility although the Council will wish for the successful provider to make a capital contribution to the fit out of the facility.

4.3 The recommended procurement process outlined in para 4.2 will be less complex and shorter in duration. This will enable consideration of the feasibility of developing a case for a newly established East Cambridgeshire trust to formulate a proposal for the operation of the facility and provide a benchmark for the assessment of best value. This route may provide opportunities for cost savings and partnership and co-operation with existing trusts.

4.4 The recommendations detailed in para 2.1 have been reflected in a revised timetable, which is included as Agenda Item No. 8.

5.0 **FINANCIAL IMPLICATIONS**

5.1 The financial implications of the proposed facility are detailed in Agenda Item No. 11 under exempt matters.

6.0 **APPENDICES**

6.1 Appendix 1 - Interim Report - Form of Procurement of New Leisure Centre, February 2009.

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**Background Documents**

Leisure Facility Working Party, 3rd December 2008 - Agenda Item No. 7

Community Services Committee 22nd March 2007 Agenda Item No. 5 (Exempt)

15th May 2007 Agenda Item No. 5

**Location**

Room 103

The Grange

Ely

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Form of Procurement for New Leisure Centre
Interim Report
February 2009
## Table of Contents

1 Introduction 01  
    Background 01  
    Discussion of Key Issues 01  

Alternative Forms of Procurement 02  
- Operator Procurement 03  
- Management Options 03  

Summary 04  
Recommendations 04
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Background

1.2 The feasibility study into the provision of new sport and leisure facilities in Ely undertaken by Strategic Leisure identified the need for a new leisure centre to replace the existing Paradise Sports Centre and Swimming Pool. The optimum site was identified as a location on the edge of the City adjacent to and incorporating the existing EOSA facilities.

1.3 The need for a wide-ranging public leisure facility including wet and dry and indoor and outdoor facilities was identified through a market assessment and an independent assessment of need. The development is seen as complementary to and a catalyst for the Master Plan for Ely. The likely capital cost of the leisure facilities (incorporating replacement facilities for EOSA is on the region of £11.5-13m. The site which has been acquired by the Council (land adjacent to EOSA) is capable of supporting other commercial enabling development including a five a side football centre and a hotel/restaurant. At the time of the feasibility study demand from operator/developers was identified through a soft market test for all of these facilities. It was felt that the two enabling developments should be procured separately from the public leisure facilities and that any capital receipt of future rental income streams could be used to part fund the new leisure facilities. This opinion has not changed.

1.4 At the time that the feasibility study was written the extent of any capital receipt from these commercial opportunities and any receipt from the Paradise site were not known. In making a decision on the preferred procurement route, it was envisaged that most, if not all, of the capital to pay for the new public leisure facilities could be found without the need for a significant capital contribution from a private sector partner.

1.5 In view of this it was felt that a Design, Build, Operate and Maintain (DBOM) procurement route would be the optimum form of procurement if there was no funding gap or a Design, Build, Fund (part) and Operate (DBFO) contract would be best if some additional funding was required from an operator. The fundamental principle of these procurement routes is that a single contract is let to a consortium that brings all of the skills and experience necessary to take the scheme through from start to finish. This approach differs from the more traditional approach to procuring a leisure centre where the design and construction of the leisure centre is done separately from the funding and subsequent operation. The market testing exercise confirmed that most of the main leisure management contractors would participate in this form of partnership. Indeed many had a recent track record of delivering leisure buildings in this way and had established relationships with architects, engineers and funders.

Discussion of Key Issues

1.6 The rationale for the integrated single contract approach is to simplify the tendering process from the client's perspective, to transfer the risks associated with the various components of the process and to take advantage of economies of scale e.g. by employing consortia with a track record of successful collaboration and where the operator has a vested interest in the functionality and quality of the design.

1.7 There are many advantages of this approach and in times of economic buoyancy this approach has been used successfully on many occasions. However there are also disadvantages some of which are exacerbated in times of economic difficulty.
1.8 The first main issue is that in terms of leisure facility development there is a relatively small number of Consortia (3-5) with the requisite experience of this form of procurement. To ensure that any procurement process is competitive it will be necessary to ensure that most if not all of these consortia are willing to bid. Our recent experience of competitive procurement processes leads us to suggest that this might not be realistic in the current market.

1.9 It is our recent experience from other tendering exercises that a number of the market players are becoming reluctant to bid for this form of leisure facility procurement. One of the main reasons for this change of heart is the cost of bidding for DBOM/DBFO contracts. The bid process requires the production of architectural designs that require significant site investigative work e.g. topographical surveys etc. Anecdotally the bid costs for a project on this scale can exceed £250k across the consortia. Bearing in mind that these costs will be incurred whilst there is a chance of being unsuccessful (i.e. at the bidding stage), this is a high risk particularly at this time. The second main reason why this approach is not a contractor’s preferred route at the moment is the transfer of risk to them for every aspect of the development and subsequent management. The main market players are becoming increasingly risk averse and many are in the hands of venture capitalists and large parent companies that are seeking to consolidate rather than take risks to expand. A further complication is that the Consortia whilst often led by a leisure operator look to establish a Special Purpose Vehicle (SPV) to develop the facility. Where there is a need to bring capital the SPV often includes a Bank as an equity or loan partner. There have never been many banks willing to get involved in leisure projects which they view as inherently risky but the current banking crisis has made this situation worse. It is likely that any bids received under this procurement route will include large premiums to cover for bid costs, risk transfer and high profit margins. There is a growing body of evidence to suggest that the total capital cost of a leisure facility under this form of procurement is more than under a more traditional approach because of the pricing of risk but also because all consortium partners are looking for their ‘slice of the cake’.

1.10 Clearly a DBOM would be more attractive to a consortium than a DBFO where some capital investment will be required. At this point in time it is still not clear how much capital the Council can put into this development and whether a funding gap will need to be plugged. Even if no capital contribution is needed, our recent dealings with the commercial sector have revealed a reluctance to become involved in this form of procurement simply because of the bidding costs.

Alternative Forms of Procurement

1.11 The alternative is therefore to separate the design and construction of the building from the future operation, management and maintenance. This is a more traditional form of procurement. Taking the design and construction aspect first, there are two main ways in which to procure a new leisure facility (with some variations on a theme).

1.12 The first option would be for the Council to employ an architect to design the facility and oversee its construction. They (in conjunction with other experts e.g. structural and Mechanical and Electrical Engineers) would prepare detailed drawings, obtain the necessary consents and prepare a tender for the construction of the building. The architect would manage the tender process, evaluate tenders, award the contract and then project manage the building process. This approach is often referred to as the ‘Traditional’ or Architect-led form of procurement. The common wisdom is that this form of procurement results in a high quality facility but often at a higher cost. Increased costs can arise from the building contractor suggesting variations to the design as the project proceeds.

1.13 The other main form of contract is a Design and Build. In this case the Council would initially engage with an overseeing architect or project manager who will develop a design to an early stage (RIBA Stage D rather than detailed drawings) and prepare an outline specification for the building. They will often then manage a tender process where contractors will bid for the design and construction of the building for a fixed price. The conventional wisdom is that this form of procurement is that the price will be lower but the quality may be poorer than a traditional approach. In this form of contract the architect or project manager originally engaged by the Council is often retained as Employer’s agent to monitor
the design and build process. Alternatively they can be ‘novated’ to the Design and Build contractor and will work on their behalf to ensure that the building is constructed in accordance with the agreed design criteria, specification and principles.

1.14 In the case of leisure buildings where there are very technical requirements e.g. swimming pools a ‘hybrid’ form of procurement has been used. This is known as the Development and Construct approach which effectively means that the architect is retained to work with the appointed design and build contractor beyond RIBA stage D to stage E and F. This means that there is a greater chance that the quality of the building will not be compromised and the technical requirements will be fulfilled by an organisation with the requisite expertise but at the same time the responsibility for cost overruns is still transferred to the main contractor.

Operator Procurement

1.15 Under the alternative forms of procurement described above the future operator of the facility (the leisure management contractor) is selected through a completely separate procurement process. It is helpful but not essential if the management operator is selected in time to influence the design and to ensure that the building is functional. This is often not possible because of the long lead in process.

1.16 Having separate contracts for the construction and management of the leisure facility enables the Council to set a capital budget for the construction of the building and negotiate a leisure management contract for the operation which is usually funded from future revenue budgets. This does not preclude a capital contribution from the operator for example to pay for the ‘fit out’.

1.17 One of the main advantages of separating out the design and construction of the facility from its subsequent management is that it opens up the opportunity to a much wider market. There are many more architects, project managers and design and build contractors than there are DBOM/DBFO Consortia. There is likely to be more competition for the opportunity especially in the current economic climate.

1.18 One of the downsides is that the Council and its advisers will need to complete a number of separate but linked procurement processes and this is a more complex and potentially time-consuming process.

1.19 In terms of the overall cost, it is difficult to be precise but in terms of professional fees the extent of costs will broadly be similar under each of the procurement options because the nature and extent of the tasks remains the same, but they will need to be paid to different organisations at different times. For example employing an architect under a traditional approach will need the professional fees to be paid directly and up front whereas under a DBOM/DBFO contract these will be accounted for within the overall management fee and therefore paid for over the length of the contract.

Management Options

1.20 A further advantage is that the leisure management contract can be for a shorter period of time because it is not linked to the design and construction. A DBOM/DBFO contract is usually for a period of at least 25 years to give sufficient time to ‘depreciate’ the initial investment. This is committing the Council to a single operator for a long period of time. Separating the two contracts means that the Council can negotiate a shorter management agreement with an operator and we would suggest around 10 years would be more appropriate.

1.21 In this case, there are a number of existing leisure operators in Ely including a number of Trusts and a private sector contractor. Subject to the demonstration of Best Value it would be possible to negotiate with one or more of the existing operators in partnership with East Cambridgeshire District Council rather than follow a competitive procurement process. This option should be considered before making a final decision on the leisure management contract and could provide a useful benchmark to inform the financing of the scheme. The Council will need to carry out an independent and objective management options appraisal which evaluates all forms of leisure management including the option for an existing
partner to operate the new leisure centre. This approach has been undertaken elsewhere. The Council will need to identify robust criteria and a framework for completing this review because any decision will be scrutinised internally and externally by both the appropriate regulators and the market itself.

Summary

1.22 The Council is seeking to provide new leisure facilities and will wish to procure these in the most cost-effective way whilst ensuring the best outcome from a design and functionality standpoint. Twelve months ago a recommendation was made to follow a single contract DBOM or DBFO approach. Since then the economic circumstances have changed and this has affected the enthusiasm of the market place for that form of procurement.

1.23 Alternatives exist which do not rely on a single consortium approach. All forms of procurement have advantages and disadvantages and much will depend on the Council’s approach to risk, the certainty of funding and additional soundings from the market.

1.24 Strategic Leisure suggests that it is appropriate to re-visit the procurement methodology given the current economic climate and that under the prevailing financial circumstances a more traditional approach could now be more appropriate.

Recommendations

1.25 Strategic Leisure would recommend that:

1. The Council adopts a procurement strategy that separates the design and construction of the facility from its subsequent management
2. The Council advertises for architects to assist the Council in a more traditional form of building procurement based on the Development and Construct approach
3. The Council carries out an independent and objective management options appraisal prior to embarking on a leisure operator procurement
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Table of Contents

1 Introduction 01
   Background 01
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Alternative Forms of Procurement 02
   • Operator Procurement 03
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