



## **APSE Briefing: Commercialisation and COVID-19: Impact on income generation**

**To all APSE members: England, Wales, Scotland and Northern Ireland**

### **Key issues**

- Commercial income is often essential to council and service budget
- Much of this income will be reliant on on-going trading, fees and charges, which may be seriously reduced during the COVID-19 lockdown
- Investment income may also be impacted as the value of shares and assets for investment decrease
- There are questions as to the application of the Furlough scheme on commercial activity as a means to recover losses

### **1. Introduction**

Income from fees and charges has long been an established source of additional revenue for local councils. Since 2010 onwards there has been a steep increase in reliance upon such measures to support depleted council budgets. According to the National Audit Office (NAO) Government funding for local authorities fell by an estimated 49.1% in real terms from 2010-11 to 2017-18 which equates to around a 28.6% real-terms reduction in 'spending power'. This is also supported by APSE's own financial analysis, [with research conducted with NPI](#), which shows the serious impact on frontline neighbourhood services of budget reductions.

As a result of these budget pressures many local authorities explored different ways to manage these reductions including reducing spending on services, rationing certain services and looking for other savings and sources of income. These sources of income include commercial trading for profit, using assets and investments to generate income, and in some cases offsetting service costs by using fees and charges; in many case this has involved a revised approach to fees and charges, reflecting more realistically the cost of providing services, where it is permitted to levy a fee or charge. There are different arrangements in place in different UK administrations which govern approaches to trading and charges, assets and investments.

For England the NAO data suggests that local authorities have grown external interest payments, by 31.4% to £707 million from 2013-14 to 2016-17, and growth in trading profits, grew by 15.6% to £358 million. Across all non-social-care service areas as a whole, income from sales, fees and charges increased from 16.1% to 21.9% as a share of total spend. Therefore, there are good reasons to be concerned about the impact on local authority budgets from COVID-19, where there is clearly a reliance on ongoing income generating activities, which may have slowed, or stopped altogether, as a result of the restrictions placed on society as a result of the pandemic. Some areas of concern include: -

- **Income from Assets and Investments** – This is where councils have invested to generate, for example, rental income from commercial property or invested in other assets, to generate interest payments, or share dividends, with the value of such investments potentially decreasing as a result of the expected post-pandemic economic downturn.
- **Income from contractual or service level agreement related work** – This income could be from the sale of school meals, hire of a venue or park for a wedding or a festival, or an on-going maintenance contract for buildings or roads for example. The client may be another council, another public body, a private business or an individual person, for example a local resident. This would also include gym membership fees which are not chargeable given councils are unable to offer access to the leisure facilities during the lock-down.
- **Income from fees and charges and selling bespoke services** – This will often be related to services such as car parking, but it could also relate to ad-hoc 'sales' such as consultancy support on construction or highways contracts to developers, handyperson services, gardening schemes to residents, garden waste charges or other arrangements, or sales of advertising spaces.

## 2. Local Government Finance and COVID-19

Whilst the Chancellor initially pledged an additional £1.6BN to support councils, in their response to COVID-19, a further £1.6BN was pledged on 18 April taking the total to £3.2BN. An extra £300 million for the devolved administrations was also pledged as part of the announcement, with £155 million for Scotland, £95 million for Wales and £50 million for Northern Ireland. However, there is as of yet little clarity on additional support to councils who are set to lose significant sources of additional income. Indeed, so far councils have been asked to record the additional expenditure related to COVID-19 so that this can inform Government, but losses as a result of COVID-19, such as those from income generation through commercialisation, appear to fall out of the scope of current thinking, in supporting local council revenues.

For the purposes of assets and investments it is long understood that the value of these can go up as well as down. Given recent concerns from MHCLG on this type of investment, and the reform of PWLB, and the prudential code issues, it is unlikely that Government(s) would be

sympathetic to losses in this area. In any event in respect of assets and investments the potential for losses will need a much longer-term assessment, and will clearly be impacted by how far any post-pandemic economic downturn is felt, and how quickly the values of assets and investments can be recovered. However, in other areas such as contractual/SLA income and the income raised through fees and charges it is important to consider how losses might otherwise be mitigated or recovered.

### **3. What about contractual issues?**

There are a number of issues which will impact on commercialisation matters, including any that involve contractual issues between the council providing a service to another body in order to generate income; for example the hire of a wedding venue with catering services or the hire of a park to allow a third party to host an event, such as a festival or concert. In these circumstances' councils may face challenging legal issues, as well as the loss of income, or indeed claims that may go beyond the loss of income.

***The following matters are therefore worthy of further consideration though APSE would always advise councils to take appropriate legal advice from their solicitors or other such qualified persons: -***

#### **Contract Frustration**

Essentially the idea of contract 'frustration' stems from the English common law doctrine whereby a 'frustrating event', means that the parties to the contract are no longer able to carry out their contractual obligations to one another and therefore the contract is in effect terminated. This will typically be argued where performing the obligations under the contract, through no fault of the parties to the contract, will be impossible or where continuing to carry out the contractual obligations would be illegal. So, for example the hire of a venue for a wedding gathering, where in effect this would not comply with the new emergency regulations debarring social gatherings. However, attention must be given to the details within the contract because the courts are usually reluctant to set aside a contract without good reason. So, if the hire agreement allows the parties to agree an alternative date – even if this is more expensive or not in the commercial interests of the parties involved – it would not necessarily mean that the contract could be set aside. However, as COVID-19 is a very unique situation it would need all the factors in a particular circumstance to be explored. It may well be that the circumstances of COVID-19 would allow for a stronger argument for 'frustration' to be argued.

#### **Force Majeure**

A further option for consideration would be where a contract includes an express 'Force Majeure' clause. The parties to a contract cannot imply that they are subject to a 'Force Majeure' provision – it must be evidenced within the contract itself as a specific clause. It is worth noting that a Force Majeure provision does not automatically enable the parties to the contract to end the contract all together. It may allow for adjustments as to how the contract is

performed – so for example a change to the date by which a contract must be performed or to otherwise vary the terms of the contract. In the case of commercial contracts the 'Force Majeure' clause may define certain events as 'acts of God or 'natural disasters' or 'government acts' and they may also state that these lists are not exhaustive – this would allow for exceptional events to be considered as being within the scope of treating that event as a 'Force Majeure'. So, in the case of COVID-19 this would provide some scope to argue the point in a non-exhaustive list due to the nature of the pandemic. It is also worth noting that the exceptional event was the only cause for the contract not to be performed – in layman's terms 'Force Majeure' cannot be used as an excuse for a contract that would have failed for other reasons.

In any event the contracting parties who do rely upon 'Force Majeure' need to take all reasonable steps to limit the impact of the exceptional event. In the case of councils this should also be considered in the context of the wider impact on council budgets. At the moment, as detailed above, there are no guarantees that losses from sources of income would be covered by the additional COVID-19 funding being made available to councils. It would therefore be good practice in any circumstances to ensure losses are minimised. This may be, as used in the example of a wedding venue and catering hire, to offer the delivery of the event on an alternative date.

### **Reviewing or renegotiating a contract**

Renegotiation of a contract or other arrangement might be an option if the parties are willing to do so (or it is provided for under the contract) which could allow for changes to be made. For example, amending the dates or the method of delivery to enable the agreed obligations to be fulfilled or set aside or postponed.

As an alternative to formal legal disputes between the parties many contracts will also provide for dispute resolution and if the parties are unable to agree a route between them, they could rely upon this option – this will often be a recognised industry body able to suggest an arrangement between the parties.

### **Insurance provisions**

Some losses incurred may be covered by insurance arrangements. The ability to rely upon any insurances should be considered but, again in practical terms, you may need to prove that you have not exacerbated any claims by failing to take appropriate action.

## **4. What about Service Level Agreements or more ad-hoc sales to residents or other clients?**

As with contracts many council services may find they are unable to deliver essentially commercial arrangements as a result of COVID-19. This may be particularly problematic for services that are sold to schools or other public bodies. In many cases these arrangements are reflected in Service Level Agreements. Payments for example on school meals, may be made by the schools to the council catering service based on the numbers of school meals provided.

COVID-19 has effectively led to school closures and therefore, with the exception of some on-going free school meal provision, the income ordinarily generated from sales is lost.

There is a prima facie argument for viewing these types of arrangements through a different prism to that of hard contract terms. A unique factor within council trading or charging arrangements is that the 'income' or 'profits' generated are essentially 'profit for a purpose'. Any additional money raised is used to support council budgets, and ultimately public services. Alongside this the council services will often be highly regarded because it is recognised that the council as a provider is less risky than other providers, is well regarded, and trusted to deliver the goods or services to their clients. There are strong reputational reasons why councils have good relationships with their clients. Many councils enter into commercial arrangements or other income generation arrangements, using Service Level Agreements, with other public sector clients such as schools, as well charging or contractual arrangements with residents and local businesses, or in some cases arrangements operating across boundaries with other councils, so many will be reluctant in these difficult times to reach for hard-nosed legal solutions.

Indeed, taking too harsh a view of a client who is no longer able to accept a service or goods, may be very damaging to the long-term relationships with clients built up often over many years. Therefore, consideration could be given to: -

- **Reviewing arrangements** – could the goods or services be delivered at a different point in time by mutual agreement between the parties? What are the flexibilities available to the parties?
- **Renegotiation of an arrangement** – again if the parties are willing to do so could changes be made to dates or the method of delivery or to otherwise set aside or postpone the agreed goods or services?
- **Is there scope for mutual agreement between the parties for any retainer or alternative work arrangements?** This will help to support resilient services post the pandemic. For example, the council caterer is engaged to provide welfare catering / free school meals in the community in place of jeopardising a traded service. It is worth noting that some councils have paid retainer payments to their own suppliers in order to ensure services can be resumed as soon as possible once normality returns.
- **Insurance provisions** – As with contracts can any losses be recovered through insurances?

## **5. What about non-contractual or more ad-hoc income arrangements?**

Many councils rely on ad-hoc sales or income from fees and charges. For example, car park income which will drop as a result of the closure of shopping centres, and public car parks or closure of parks facilities which may lead to a loss of income from cafés or other sales such as licence or franchise arrangements. In addition, some services are sold to the public as additional services; such as a handyperson service – which may have been suspended due to

social distancing. There is also an issue with fees generated from membership income from gyms and leisure provision.

In many of the above scenarios the money may not be recoverable and this will mean a substantial loss from service budgets. In these scenarios APSE is suggesting that recovery plans and reviews need to be considered now alongside ensuring proper record keeping of the anticipated budget income against the revised figures.

This will be important from a departmental /service budget angle because income projections are heavily embedded into service budgets. This means that in many cases central resourcing will already have been reduced to align with income predictions, pre-COVID-19. Accordingly, whilst good record keeping will not ameliorate the losses, it will at least mean that the changes within budgets are explicable to the council Treasurer. This will also help in the on-going calls for a fair settlement on the impact of COVID-19 on council budgets.

## **6. Could traded services or Teckal companies rely upon Furloughing workers?**

A number of APSE member local councils have raised various issues around the application of the Furlough scheme to those areas whereby the funding for staff is sourced through income generation such as gym fees, or the sale of school meals services, both within and outside of their local authority boundaries. The matter is also complicated when considering the position of Teckal trading companies – where up to 20% of income may be derived from non-council sources and those councils where significant income is sourced through, for example, municipal airports.

The Government's Furlough scheme states in respect of public sector organisations: -

### ***“Public sector organisations***

*The government expects that the scheme will not be used by many public sector organisations, as most public sector employees are continuing to provide essential public services or contribute to the response to the coronavirus outbreak.*

*Where employers receive public funding for staff costs, and that funding is continuing, we expect employers to use that money to continue to pay staff in the usual fashion – and correspondingly not furlough them. This also applies to non-public sector employers who receive public funding for staff costs.*

*Organisations who are receiving public funding specifically to provide services necessary to respond to COVID-19 are not expected to furlough staff.*

*In a small number of cases, for example where organisations are not primarily funded by the government and whose staff cannot be redeployed to assist with the coronavirus response, the scheme may be appropriate for some staff.”*

Therefore, the scheme appears to allow staff to be furloughed where wages are not otherwise covered by the public sector budget but are instead covered by external sources of income.

This may be considered to include those within a charging or traded service scenario (with or without a trading company arrangement). A further scenario would be where staff wages are met not from the main council budget but from, for example, gym membership fees in the case of Leisure services. Additionally it is worth considering if external income is sourced from receipt of specific funding that relates to the numbers employed, such as a discrete investment grant. The prospect of recovering staff costs in areas which rely upon non-public funding should therefore be considered. However, the Government has made clear it would expect the maximum use of public sector staff in responding to COVID-19.

Furloughing some staff out of a council workforce that is otherwise remaining in work is both sensitive and potentially controversial. Consideration would therefore need to be given to the following matters: -

- How would furloughing staff in income generating services (or wholly owned trading companies) be reconciled with wider council policies towards staff provision under COVID-19? With some possible exceptions staff costs may only be partially made up of external income.
- There is still a requirement to adhere to fair treatment principles in the selection process of those who may be considered to be furloughed and in their consent.
- Care would need to be taken to again ensure fair treatment in pay terms. For example if public sector staff may be fully funded on 100% pay, even if remaining at home where home working is not possible, it would be difficult to justify to staff who are formally furloughed to be offered just the 80% that could potentially be recovered from Government, whilst working for the same employer (including Wholly Owned Companies who may be considered a comparator employer).
- Furlough funding would need to be reconciled on employee costs so as to avoid duplication i.e. those considered not to be 'primarily funded' by Government
- In the case of staff working across boundaries – with income derived from a neighbouring authority consideration would need to be given as to how such payments, for the purposes of the Furlough scheme, could be considered to be non-public sector funded and therefore fall within the scope of the scheme when they are derived from another public body.
- In the case of Teckal companies there are further complexities whereby clearly the primary funding ( and controls ) would emanate from the contracts for works funded by the parent council, and, where it may be difficult to determine, which if any members of staff were dedicated to external trading which, under Teckal, is limited to 20%.
- Any approaches to furloughing staff in income generating roles should be considered corporately, and in line with financial and HR management protocols, and reporting arrangements. Ideally this should also involve trade union agreement to the proposals.

## APSE Comment

The potential loss of income in commercial areas may need different solutions in the short, medium and long term. APSE would suggest that a headline analysis of income losses, by income category, and options for recovery or damage limitation should be undertaken as soon as is reasonably practical. It is also worth considering the need to review and revise income projections as well as ensuring plans are in place to remobilise income generating services, including supply chains and client communications.

It is highly likely that commercialisation plans and projections will need to be thoroughly reviewed. It may be possible in many areas to recover income once the lock down period is over and 'normal' activities resume. However, equally the passage of time may mean that the income ordinarily generated will be lost, for example even once shopping centres re-open it is unlikely that losses on, say car park, income could be thoroughly recovered if months of normal trading is effectively lost.

Whilst the £3.2BN package of measures to support councils is therefore welcome much uncertainty remains as to how these sums will be allocated, with priorities to deal with COVID-19 expenditure clearly necessary, and whether or not in any event funds would be available, and in any case sufficient, to cover income losses.

APSE Solutions is able to offer support online to commercial managers both through reviews, critical friend services and providing expert specialists in procurement and contracts. To enquire about this support contact Andy Mudd on [amudd@apse.org.uk](mailto:amudd@apse.org.uk). In the case of municipal energy schemes, including reviews of existing project work, APSE Energy is available to support energy managers or climate change managers through these issues. Contact Phil Brennan [pbrennan@apse.org.uk](mailto:pbrennan@apse.org.uk)

[APSE's commercialisation network](#) remains open for support to APSE Members through network queries and advice. An online facilitated network meeting to discuss the issues raised in the briefing will be arranged shortly using Microsoft teams – as well as uploads onto the APSE Website post that event. If you are interested in receiving an invitation to online events please email [mbaines@apse.org.uk](mailto:mbaines@apse.org.uk).

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