Bay Venues Ltd

- Strategic Review

Confidential Report to Tauranga City Council

Status: Commercial in Confidence 28 September 2020

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Introduction

1. This report is the result of a strategic review of Bay Venues Ltd (BVL) considering aspects of the governance, management, organisations and ownership model of the Council Controlled Organisation (CCO). The report assesses the current context of the organisation within the Tauranga City Council (TCC) family and identifies and discusses issues with the current arrangement. Based on this analysis three options are provided in relation to the future provision of the services currently provided by BVL. These options are then evaluated in order to provide Council with a recommended approach.

Background

2. Bay Venues is a Council Controlled Organisation which owns and/or operates a range of facilities and associated activities and functions within Tauranga on behalf of the Council. The Council established Bay Venues Limited (BVL) in July 2013 by amalgamating Tauranga City Venues Limited and Tauranga City Aquatics Limited. Bay Venues was then amalgamated with its holding company, Tauranga City Investments Limited on 1 July 2014.

3. In establishing the CCO, the Council applied the following set of principles to the policy decision making:

    - operate in an entrepreneurial manner
    - run the business in an efficient manner
    - manage and invest in the assets in a way that maintains and enhances them into the future
    - operate in a manner that does not fiscally disadvantage the Council
    - generate an ongoing decrease to the overall ratepayer contribution to these activities.

4. The rationale was to achieve operational efficiencies and grow revenue through new service offerings, improve financial sustainability and reduce the reliance on rates funding over time. BVL is Council's largest CCO, managing twenty-four Council facilities, and operating venue-based businesses and services. The following table sets out facilities and activities managed and provided by BVL, separated into funded networks (those which receive funding from the Council) and unfunded networks (those which are operated on a commercial basis or on other third-party revenue streams).

Funded Networks	Non-Funded Networks
Community Aquatic Network • Baywave Pool • Greerton Pool • Otumoetai Pool • Memorial Pool	**Aquatic Network** • Mount Hotpools **Programmes Network** • BaySwim • Sports Leagues and Centre Run Programmes • Little Splashes Childcare[1]

[1] The Baywave Early Childhood Centre is in the process of being closed. Its last day of operation is 9 Ocotber 2020.

Community Centre Network	Indoor Sports Network
Community Centre Network • Arataki Community Centre • Papamoa Community Centre • Papamoa Sport and Recreation Centre **Community Hall Network** • Greerton Hall • Bethlehem Hall • Tauriko Hall • Welcome Bay Hall • Matua Hall • Waipuna Pavilion • Elizabeth Community Centre • The Cliff Road Building **Community Indoor Sports Network** • Queen Elizabeth Youth Centre • Memorial Hall • Memorial Pool • Mount Sports Centre • Merivale Action Centre • Aquinas Action Centre • Trustpower Baypark Arena – 6 Court	**Indoor Sports Network** • The UoW Adams Centre of High Performance • Trustpower Baypark Arena – 3 Court • Clubfit **Events Network** • Trustpower Baypark Arena Suites • Trustpower Baypark Stadium, Lounge Pavilions & Fields • Bay Catering • Bay AV • Bay Events • BayStation

5. The facilities that BVL operates are important to Tauranga. In the year to 30 June 2019 2.11m visits were made to BVL facilities and BVL venues hosted 60 regional or national indoor sporting tournaments and 26 regional or national aquatic tournaments. BVL led activity programmes engage large numbers of adult and senior citizens and also have very strong targeting and use by children and young people.

6. The BVL business includes a mix of commercial operations (what the Council refers to as ‘Business Outputs’) and community facilities and services (‘Community Outputs’). In many cases activities undertaken as part of each type of ‘output’ are delivered within the same facility.

7. The Council’s Enduring Statement of Expectations (ESE) for BVL sets out different expectations for the two categories of outputs. For Community Outputs (also referred to as the funded network), BVL is expected to:

   - ensure accessibility for all
   - maintain and enhance community access
   - maintain levels of service.

8. In the provision of Business Outputs (unfunded network), the Council’s stated expectations are:

   - operate its business in an efficient and effective matter
   - health and safety

- asset management
- an appropriate and diverse range of programmes and services.

9. The operation of these two very different categories of outputs side by side can, and at times has, caused a lack of clarity in relation to primary purpose, expectations and priorities. During a 2019 rewrite of the ESE what was regarded as the appropriate focus for the business was clarified:

> *"BVL's purpose as a whole is to provide a service to the community on behalf of Council rather that to operate a business for profit."*[2]

10. The ESE attempts to provide further clarity by stating that the organisation is required to operate in a financially prudent manner and produce an operating surplus overall. Consistent with this, BVL employs a financial target which focuses on EBITDA across the funded and non-funded networks. The ESE goes on to state, however, that the operating surplus generated from the commercial aspects of the organisation:

> *"will go some way towards offsetting the potential deficit generated by the community activities."*[3]

11. While these statements provide clear guidance from the perspective of expectations, it does not necessarily provide an optimal or clear framework within which operations can be managed effectively and efficient. This concern is discussed in more detail in the next section of this report.

12. The organisation is governed by a seven member board appointed by the Council. In terms of its relationship with BVL the council expects the business to:

    - present a unified public front on issues that affect both Council and BVL
    - be aware the Council has interests that are wider than BVL
    - be cognisant of wider Council policy issues as part of their decision making
    - be aware of the potential implications of BVL-specific issues on the Council and/or its balance sheet
    - be cognisant of the demands of accountability and transparency placed on councillors by their electors
    - have no surprises communication (both ways).

13. Alongside the setting of expectations, as shareholder of BVL, the Council also exercises the following functions:

    - appointing and removing BVL directors (including chair and deputy)
    - approving medium to long-term strategic direction
    - developing short term annual priorities (through the Letter of Expectation)
    - commenting on and approving the Statement of Intent
    - monitoring board performance
    - ensuring the prudent use of public money
    - protecting public assets managed and owned by BVL

[2] Enduring Statement of Expectations for Bay Venues Ltd, 2019 pg. 1

[3] Enduring Statement of Expectations for Bay Venues Ltd, 2019 pg. 2

- ensuring BVL does not make decisions that could have significant adverse implications for future Council funding.

14. Since the establishment of BVL in 2013, three independent reviews have been completed into varying aspects of the company; the Symes review (2017), the Pederson review (2020) and the Mueller review (2020).

15. While all three reviews have identified a variety of successes and opportunities, a common theme is evident: **an ongoing strategic tension that results from trying to balance efficient community service delivery with the current need to maximise commercial returns for the shareholder, in the absence of clear strategic direction.**

16. At the Tauranga City Council Finance, Audit & Risk Committee meeting of 12 May 2020, it was resolved that the Chief Executive:

    "engage with the Board of Bay Venues Limited regarding the implementation of a review that prioritises the strategy and alignment of Tauranga City Council and Bay Venues Limited, to understand the role of Bay Venues Limited, including the governance, management, organisation and ownership structure."

17. This report and its recommendations are the result of that strategic review.

Process

18. In undertaking this review and reaching recommendations the following process was undertaken:

    - review of relevant Council and BVL strategic documents, plans and policies
    - review of Council reports regarding the establishment and operation of BVL
    - review of previous reports resulting from independent reviews of BVL and the CCO model
    - a series of interviews (17) with elected members, Council management and BVL directors and managers – a list of those interviewed is included as Attachment A.
    - presentation and feedback on draft report.

Organisational and Financial Performance

19. Table 1 shows the reported Statement of Comprehensive Revenue and Expenses for BVL for the years ending 30 June 2014 to 30 June 2019.

20. BVL was successful in growing external revenue in the period 2014 to 2018, up 73% over the period. External revenue fell by 16% in 2019 as a result of a change to the partnership structure relating to Bay Dreams. Despite the loss in gross revenue the BVL Board has advised that the change in the Bay Dreams partnership structure increased the net return from the event to BVL by approximately $50,000.

21. BVL's revenue external growth has predominantly been the result of increased patronage, increased services and the creation of new commercial revenue streams/business units. In 2014/15 there were 1.7 million visitors to the BVL network. In 2018/19 there were 2.11 million visitors. The 2020 result will be challenging given the likely impact of Covid19.

Table 1: Reported Statement of Comprehensive Revenue and Expenses

	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Revenue						
User Revenue	11,418	13,177	13,867	17,782	19,900	16,641
Other Income	180	74	200	187	158	145
TCC Capital Funding	-	-	1,127	35	-	-
TCC Maintenance Funding					475	-
TCC Operational Grants	2,672	2,368	2,514	2,556	2,584	2,767
TCC Depreciation Grants	855	-	-	-	-	-
TCC Debt Servicing Grant	2,911	1,451	520	520	520	520
TCC Renewal Funding	-	-	2,023	3,053	3,133	2,437
Total Operational Revenue	**18,037**	**17,070**	**20,251**	**24,133**	**26,770**	**22,510**
Expenditure						
Employee Expense	7,347	7,239	7,598	9,819	10,203	11,440
Administrative Expense	1,426	936	1,105	1,244	1,222	1,242
Consulting and Governance Expense	476	571	405	510	1,033	636
Operating Expense (incl. COGS)	5,446	6,925	6,453	7,823	9,853	5,415
Repairs & Maintenance Expense	638	813	638	676	700	704
Joint Venture Commission	49	46	41	25	-	-
Rehabilitation Expense	-	-	-	-	-	204
Finance Costs	2,435	2,522	533	636	676	715
Depreciation & Amortisation Expense	4,391	4,325	5,264	5,822	5,925	6,256
Total Operating Expenditure	**22,208**	**23,377**	**22,037**	**26,555**	**29,612**	**26,612**
Surplus / (Deficit) before Tax	**(4,171)**	**(6,307)**	**(1,786)**	**(2,422)**	**(2,842)**	**(4,102)**
Income Tax Expense/(Benefit)	665	1,686	171	398	1,570	882
Surplus/(Deficit) after Tax	**(3,506)**	**(4,621)**	**(1,615)**	**(2,024)**	**(1,272)**	**(3,220)**
Other Comprehensive Revenue and Expense						
Gain on Property, Plant & Equipment Revaluation	-	11,242	-	-	10,310	-
Tax on Revaluation	-	(3,148)	-	-	(2,799)	-
Total Comprehensive Revenue and Expense						
	(3,506)	**3,473**	**(1,615)**	**(2,024)**	**6,239**	**(3,220)**
Total External Funding	11,598	13,251	14,067	17,969	20,058	16,786
Total TCC Funding	6,438	3,819	6,184	6,164	6,712	5,724
% of Total Revenue from TCC	35.7%	22.4%	30.5%	25.5%	25.1%	25.4%

22. A significant part of the growth in BVL’s external revenue has been the development of Bay Dreams. Whilst BVL has taken steps to reduce its risk and exposure to this event by

restructuring the original partnership and moving to a venue hire arrangement, the revenue it earns from this event is still material. If, for whatever reason, this event does not survive the economic conditions associated with Covid19, BVL will experience a further loss of revenue.

23. Opportunities to further grow revenue were explored through the interviews undertaken for this review. A consistent theme in the interviews was that a number of BVL venues were approaching capacity. This means that the revenue growth that can be achieved through the existing configuration of the network is slowing. This would be consistent with what can be expected of a maturing business with limited scope for on-going capital investment. The BVL Executive and Board have identified opportunities for new activities. These tend to require capital investment, and are inherently commercial in their nature. For a council with very limited capital it has been difficult to prioritise scarce capital to support commercial activity.

24. Over the period 2014 to 2018 operating costs have increased by 33%, before falling by 10% in 2019 (the year in which external revenue fell by 16%). Other than in 2019 operating costs have increased at a lower rate than revenue growth. Clearly some elements of BVL's costs, and event related costs in particular, are variable and scale up or down with the level of activity. Underlying this the operating costs for most of the network will inevitably continue to increase at least along the apparent trend, with the risk being that underlying operating costs will increase at a faster rate as the network continues to age.

25. Over the period 2014 to 2019 the funding from TCC was reconfigured, reflecting different approaches to the support provided to BVL to fund the operations of community facilities and the renewals and maintenance of the facilities. Total funding from TCC varies from year to year, but is generally around 25% of total revenue.

26. Despite the growth in external revenue that BVL has achieved, in all years it has made a deficit before tax. Indeed, the only years in which BVL has not made total loss are those years in which there has been a revaluation of property. Over the period 2014 to 2019 the after tax revaluation gains total $15.6m. Over the same period the deficit after tax totalled $16.3m.

27. The headline commentary through the BVL annual reports celebrate growth in use and the growth of external revenue. The commentary reflects the balanced scorecard of measures agreed with the Council. This emphasis on non-financial measures was repeated through the interviews conducted as part of this review. People are understandably proud of the growth in utilisation that has been achieved. However, this headline focus belies a business that is tenuous and has not ever made a either a before tax surplus, or an after tax surplus (excluding property revaluations). This situation will be made worse as BVL venues approach capacity and opportunities for revenue growth become more limited.

28. BVL's balance sheet shows consequences of the on-going financial challenges that the company faces. Following the introduction of $49.2m of shareholder capital in 2015 BVL had at 30 June 2015 non-current liabilities totalling $17.4m made up of borrowings of $7.5m and deferred tax of $9.8m. By 30 June 2019 non-current liabilities had grown to $24.3m, comprising $14.7m of borrowing and deferred tax of $9.6m. Over the same period retained earnings have deteriorated from -$16.5m to -$22.5m. The company's on-going operating losses are accumulating debt that the business (as currently configured) has no prospect of ever repaying. Or put another way, Council is in effect funding the non-commercial activities

undertaken by BVL through a growing loan to BVL rather than through the provision of direct and explicit funding for the provision of services.

Current Context

29. The issues discussed here were raised during the interviews undertaken as part of the review and have been touched on in the previous reviews undertaken. They provide important context for considering the future of BVL.

Commercial Sustainability

30. As stated in the previous section, while BVL has delivered significant external revenue growth it has never made a profit before tax and the growth in revenue was done from a low base and with spare capacity within the network. As the business comes up against capacity constraints, and without significant capital investment or commercial reinvention to replace lower margin activities with higher margin activities, revenue growth can be expected to soften and eventually stagnate.

31. At the same time, the business has experienced steady and consistent increases in operating costs. Again, this is to be expected and does not represent a criticism of BVL management. In the absence of a fundamental and/or structural reconfiguration of the business, costs can be expected to continue to increase at or around the historic rate. If anything, as the network ages, and usage grows closer to capacity, the rate of cost growth may in fact increase.

32. Taken together, BVL appears to be at the stage of its life cycle where questions of its commercial sustainability need to be considered. In addition to its very challenging operating environment, capital investment from TCC is restricted. Debt-funded investment is constrained by the borrowing limits of the Council (and other pressures and demands on such funding), rather than the state of the BVL balance sheet and the potential return from new commercial ventures.

33. The reviewer's conclusion is that the current business model, with the current level of council contribution is not sustainable.

Contribution to Well-being and the Relevance of Financial Targets

34. The fundamental reason that councils operate community facilities is to contribute to the well-being of their communities. This reflects part of the core purpose of local government *"to promote the social, economic, environmental, and cultural well-being of communities in the present and for the future".*[4]

35. The well-being of communities reflects many things; the physical and mental health of its members, the health and sustainability of the environment that sustains it, the opportunities for social engagement and the social cohesion of the community are all relevant considerations. Financial performance is only one of the contributors to the overall well-being of a community.

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[4] Local Government Act 2002, Section 10(1)(b)

36. BVL currently operates to a mix performance metrics which reflect the use of facilities and a number of financial metrics. The interviews for this review suggest that BVL has a strong focus on EBITDA (earnings before interest, tax depreciation and amortisation) growth across its overall network - both funded and non-funded. It is questionable whether such a highly specific commercial metric is helpful in this context, given the complexity of the expectations the organisation faces, and the priority given to provision of a service to the community. To put this another way, a network-wide EBITDA target incentivises activity, which is potentially, and at times necessarily, inconsistent with advancing the priority well-being outcomes expected of it by council.

37. To illustrate, in a facility near capacity utilisation, maximising higher-margin non-funded usage would be consistent with growing EBITDA (due to higher entry prices than community activity, but the same level of fixed cost). In a situation, however, where increased commercial activity is achieved at the expense of community-based use, the financial target is being delivered at the expense of the business's actual objectives. While this issue would be less acute in venues with spare capacity, it still has the potential to come into play, particularly when both activities want to use the facility at the same time.

38. Regardless of the option chosen in relation to the future provision of services and facilities, there is a need to ensure that the objectives and expectations under which the entity operates are accurately and meaningfully reflected in financial targets and that the contribution of the network of facilities to the well-being of the community is explicitly considered.

Conflicting Business Objectives

39. BVL is an entity facing two very distinct sets of business objectives, those related to its Community Outputs and those to its Business Outputs. Under the ESE, BVL is required to both *"operate in a financially prudent manner and is intended to produce an operating surplus" as well as "to provide a service to the community on behalf of Council rather than to operate a business for profit"*. While the statement goes on to clarify that the latter community objective takes precedence, the practical reality is that the expectations sit uncomfortably alongside each other. While one is identified as primary, the secondary commercial expectation exists, along with an expectation it be advanced.

40. Irrespective of the stated priority in the words of the ESE, the practical reality of relatively fixed annual council contributions for the community good outcomes means that commercial objectives have to take precedence for BVL, or it will fail as a business.

41. The manner in which the expectations are set, and the organisational drivers associated with them, creates an ambiguous focus for the entity and a lack of a clear operating or governance framework. This lack of clarity and alignment detracts from, and weakens, the capacity of the commercial model to deliver efficiency, effectiveness and quality outcomes (in terms of either of the conflicting expectations).

42. Typically, and appropriately, a commercial model is about capturing the value of a business discipline and focus being applied to the delivery of commercial services where there is a view that this cannot be delivered to the same extent by more traditional council provision models. With BVL structured so that the delivery of commercial value is secondary to community service delivery, the potential of achieving, long term, the marginal benefits of a commercial model are, at least, dampened, at worst removed. It is for this reason that post settlement Iwi organisations recognised the importance of separating the delivery of

commercial returns from the application of those returns to social and community outcomes in their organisational structures. Similarly, it is the public policy rationale behind the State-Owned Enterprise (SOE) model.

43. An approach to public policy which is designed to generate commercial returns to subsidise, or increase, funding for community services is entirely justifiable and, where properly implemented, appropriate. It is questionable whether the current BVL model and associated organisational structures, however, is the optimal, or even a sustainably effective, method of delivering this.

Contribution to Expenditure Prioritisation

44. Increasingly councils operate in financially and fiscally constrained environments, and this is particularly the case in terms of local authorities grappling with the challenges associated with high levels of population growth. In such an environment, robust and coherent expenditure decision-making and prioritisation are crucial. If a local authority is to deliver the highest level of service and contribution to the well-being of its communities it must focus on the big-picture aggregate totals, as well as the line by line justification for expenditure, and its relative priority.

45. The current funding model for community facilities and some services, resulting from the BVL arrangements, means that a portion of the activity funding is effectively hypothesized (i.e. as commercial returns from BVL must be used to subsidise the provision of community services). There can be entirely appropriate public policy justifications for hypothecation, but in their absence the funding mechanism simply provides a barrier to optimal expenditure decision making (by skewing relative prioritisation). This can take the form of relatively too much funding being applied to an activity, or too little, depending on the details of the funding arrangement. While there is a logic to the current arrangements in terms of the funding of community facility activities, this does not necessarily translate into a defendable public policy case. In fact, hypothecating revenue, alongside funding settings which result in decreasing real and per-usage council funding is, if anything, inconsistent with the policy objective of improving, or even maintaining, the quality and quantity of community facilities and services.

46. As is noted above, the commercial imperatives for BVL drive it to identify commercial opportunities that provide a return on investment but require capital investment. It is understandably difficult for a council to prioritise this activity when it can't fund all of the activity it needs to in order to support growth and statutory compliance for core public good activities.

Fixed Council Funding

47. The Council funding model on which BVL is based is structured around a relatively fixed level annual council contribution. In effect, this acknowledges the public good nature of the services and facilities the entity provides. Setting funding at a fixed nominal rate results in reducing real and per-usage funding. The principle behind this policy is that it provides BVL with strong incentives to improve business performance across its non-funded network, in order to grow the funding available for application in the funded aspect of the business.

48. While incentivisation can be a powerful policy tool, the flip side of this arrangement is that where non-council revenue can't be grown, which could occur for a range of reasons, including the unavoidable, it is the users of the facilities, communities, who are ultimately

impacted. In effect, decisions on funding levels have the potential to be the consequence of factors unrelated and largely irrelevant to the issue of what the appropriate level of funding for community services is.

49. Given the long-term loss-making position that BVL has been in and the accumulating debt to council, one of the core questions that arises is whether the current levels of council funding and the expectation for BVL to behave commercially simply creates unrealistic expectations that cannot be met.

Commercial Relationships

50. Commercial activity, by its very nature involves taking risks in order to derive a return. It is not always the case that entirely appropriate commercial risks are acceptable within a public sector environment when public money is at risk. This is, in fact, a key reason why councils establish trading organisations. It is arguable whether the BVL CCO-model creates sufficient space for the full potential of commercial and entrepreneurial benefit to be captured by the Council or its business. On a similar basis, the nature and detail of commercial relationships will not always be consistent or as tight as those required by the public sector. Again, this is not a criticism of either approach, simply a result of different imperatives, and objectives. Associated with this, a difficulty with the CCO-model is the potential for commercial relationships to arise which are outside the comfort and expectations of the parent council. This potential will increase as commercial challenges increase and the necessity to drive the business harder is heightened. As a general observation, the greater the commercial pressure on a CCO, the more likely it is that it will take risks that the council would not countenance or accept.

Conflicting Venue Use

51. Related to the issues canvassed earlier in relation to clarity of focus, the ability for BVL to operate effectively is further constrained by its necessity to operate both commercial and community services out of the same venues and the capacity of the venues. Compromises between objectives are inevitable when decision making over the allocation of space and time between commercial and non-commercial activities sits within an entity with unclear and mixed objectives, and challenging financial bottom lines. The compromises will not necessarily be consistent with advancing either sets of objectives. Again, this will impact on the ability of BVL to deliver on any of the expectations they face and to operate effectively in either sphere.

52. While conflicts of this nature would remain under a model where community services are delivered separately from those of a commercial nature, greater clarity of expectations would be achieved under such an approach, as would a clearer linkage of decisions to objectives. Under a separated approach, those making decisions on the nature and level of community services would have direct and unambiguous responsibility for those decisions and outcomes. Further, they would be made within an organisation whose core business includes getting close to, understanding and working with communities.

53. Similarly, the commercial entity would be able to develop a clear understanding of the constraints their operations face and would be able to focus their efforts more exclusively on maximining their effectiveness and profitability within them. The level of certainty could be further enhanced by the development and negotiation of a mechanism, such as a facilities

partnership agreement, which clearly set out the principles behind, and reality of, facility availability.

Depreciation

54. Under the current framework the Council fully rate funds for the depreciation of BVL's community assets and makes an annual grant payment for renewals. This results in a quite confused financial picture in relation to the actual financial performance of BVL. A normal business would need to generate sufficient operating surpluses to deal with depreciation and the on-going capital expenditure associated with the renewal of assets. BVL is not a normal business in this regard.

Crowding Out of Private Sector

55. The potential crowding out of private sector investment was a risk that was clearly identified during the public policy process to establish BVL. It has also been considered subsequently during both regular and independent reviews. For services where the provision relies on the ownership of a facility, such a risk is minimal and has been managed. It is a different case when business functions have been developed which feed off the core services provided. For instance, the catering, audio visual and Club Fit business units represent commercial activity which could be provided by the private sector and funded by private investment. In this instance, the commercial opportunity was created because of the public investment in the facility, but the CCO subsidiary taking those opportunities does, by definition, crowd out potential private sector involvement. Whilst there remains significant competition in the market for fitness centres, including multiple competing gyms, the incentives for BVL to identify and take on more commercial activity associated with its facilities will increase as the commercial pressures and challenges discussed above intensify. As the pressure grows the potential for real crowding out may arise.

Cost of Governance

56. The 2018/19 Annual Report shows that the directors fees for the year were $257,000 with a further $76,000 in audit costs and $17,000 of tax advice costs. The simple and immediately obvious annual cost of operating the BVL as a CCO separate from council is therefore around $350,000 per annum. Governance costs are part and parcel of capturing the benefits achievable through the application of any form of a commercialised model of delivery (which is what CCOs represent). Such costs are a justifiable and worthwhile investment where the structural arrangements deliver material benefits (in terms of innovation, commercial edge, revenue generation, efficiency and cost containment) that exceed the specific costs that the model generates.

57. The strong external revenue growth achieved over the period 2014 to 2018 demonstrates significant value to the council and community. With the on-going loss making position of the business, and its scope to drive on-going improvement limited and subject to increasing constraints (without significant capital expenditure or commercial reengineering), it is questionable as to whether this cost can continue to be justified.

Board Skills Mix

58. The Board of BVL is highly experienced and accomplished, and has done a consistently good job fulfilling its governance obligations within the framework they are required to operate. The board does however appear to have a very strong commercial background in its make-up.

59. The Council appoints the directors of BVL. The Council has a board skills matrix that reflects the need for a mix of directors with commercial and non-commercial community backgrounds. Despite this, from the insights gained from the interviews for this review, it would appear that when making board appointments the Council consistently favours commercial experience over knowledge and skills developed through experience working within and servicing communities.

60. While a very strong commercial board would be entirely appropriate for an entity with an exclusive commercial focus, it may not be so appropriate for an organisation which has as its primary focus the delivery of community services. To the extent that the board may not at any time have the mix of skills and experience necessary to best address its conflicting commercial and non-commercial objectives, the council is responsible, and the council has the authority to change the situation. If BVL is to retain its dual focus, further work to consider the best mix of skills on the board would be important.

BVL Submission

61. In addition to the review interviews with the BVL Chair and management, the BVL Board provided an unsolicited six-page submission. A copy of this submission has been included as Attachment B.

62. The submission reiterated the historical performance of BVL using data consistent with that used to describe their performance earlier in this report. Specifically, the BVL Board highlighted that over the five years from 2015-2019:

    - hours of use have increased by 22,084 hours, from 80,916 to 103,000
    - number of visits has increased by 420,000, from 1.69 million to 2.11 million
    - customer satisfaction has increased from 86% to 88%.

63. Next, the Board's submission focused on the value and, what it refers to as, additionality delivered by the BVL CCO model. In relation to this the submission noted the creation of commercial revenue streams from facilities which it did not believe that TCC could capture in-house.

64. The submission calculated that an additional $1 million of net profit a year is necessary for BVL to provide the required level of community subsidy without additional Council funding – what it referred to as achieving a break-even position. In relation to this the Board raised the question of whether this level of additional profit is a realistic target for BVL, or aspirational in nature. The Board stated it's view that it was important for the review to take a position on this question.

65. In the reviewer's opinion, the framing of this question, in fact, clearly illustrates the key issues that have been identified in terms of the existing BVL model. That is, what are clearly strategic commercial decisions are reliant on prerequisite non-commercial considerations (the level of,

and fees associated with, community services), rather than being able to be made on a standalone and entirely commercial basis. It is this latter approach that would be appropriate for an entity operating under an effective commercial model.

66. In relation to the direct question raised by the Board (how realistic it is to achieve an additional $1 million of net profit?), however, for the reasons discussed in the context section, we do not consider this a realistic target given the maturing of the BVL business and its asset base. An attempt to achieve the target would likely require capital investment in the facilities, at a level that would be difficult for the Council to justify. In addition, it would require the commercially aggressive pursuing of new and additional commercial activities. This would create issues from a public policy point of view both in terms of acceptable levels of risk to be taken by a public sector entity and in relation to crowding out of the public sector.

67. The growth opportunities available to BVL are canvassed in the next section of the Board's submission. It notes involvement in the Ministry of Education's 'Free and Healthy School Lunches' programme. The submission estimates a net profit of $1 million would be achievable by being successful in securing contracts for less than half of the 22 schools the Ministry has identified as being of interest in the Western Bay, Whakatane and Tauranga area.

68. The submission also cites the University of Waikato Adams Centre of High Performance as an *"example of a significant project that demonstrates agile thinking".*

69. The submission then identified what the Board sees as the advantages of operating the BVL CCO model, specifically:

- industry specific expertise in business to consumer (B2C) and business to business (B2B) relationships
- industry specific expertise that makes BVL highly effective operating, growing and planning for the future of facilities
- the ability to add value to the facility by cross-selling, up-selling or utilising core services cross the entire network
- facilities are part of the wider city network
- a specific and dedicated governance focus.

70. Finally, the Board recommends an option in terms of the mix of facilities and assets under its control which would result in BVL's operations being optimised. Specifically, this would involve the removal of "community share facilities", community halls and community centres from their portfolio and the addition of the campground and marine precinct.

71. In addition, they suggest that this portfolio restructuring needs to be complimented by greater shareholder direction in relation to:

- guidance for commercial business units operating in the same market as the private sector
- clarification around areas where BVL and TCC have collective responsibilities including planning for further community facilities and events.

72. The reviewer believes that these recommendations are captured in the options set out and assessed in the subsequent sections of this report.

What Other Councils Do

73. All New Zealand territorial local authorities grapple to some extent with the provision of community facilities, how to best fund and operate them, and the boundaries between the public good outcomes that they support and the commercial opportunities that they enable. Across the local government sector there are a range of ownership, operational and funding models that have emerged. With Bay Venues, however, Tauranga would appear to be something of a unique outlier.

74. The core reasons for having community facilities are all about community well-being. Community halls, sporting venues, cultural centres, swimming pools and events centres exist to facilitate social interaction, and participation in sports, recreation and cultural events. They are part of the fabric of society, supporting healthy lifestyles, and building social cohesion, inclusion and well-being. They are not commercial assets that generate a financial return on investment. Parks and reserves are just as much a part of the fabric of community facilities as community halls. No council that the reviewer is aware of operates its core parks and reserves as part of a CCO.

75. The most common models for the ownership, funding and operation of community facilities are:

- **Council ownership and in-house operation**
  This is by far the most common model for the provision of community facilities. It is simple, straight forward and aligns the ownership and management of the facilities with the council's broader community well-being outcomes and asset management capabilities. This form of ownership and operation recognises the fundamentally public good nature of community facilities.

  Where councils seek to bring a higher degree of focus or some more commercial discipline to the operation of particular facilities it is common to establish an internal business unit for that facility that has its own cost centre and financial transparency. This is how the Auckland Regional Council managed Mt Smart Stadium prior to amalgamation in Auckland. The stadium was owned by the council, supported by the Regional Parks team to ensure that it had all of the asset management and compliance focus that was necessary, but was structured as a business unit with an advisory board able to provide advice and expertise on commercial matters.

- **Community ownership of some facilities with some Council funding**
  This is more common in rural communities where facilities have been developed by local groups and are owned and managed by trusts. There are, however, a significant number of this type of model in urban areas. Charitable trusts have frequently been used as the entity to drive the development of community facilities in order to secure funding from lotteries grants or regional trusts for which councils are not eligible. In this model it is common for councils to contribute to the initial development of facilities, but to have little influence over their design and whether or not that are the best option for meeting the needs of the community. Frequently the council contribution to these facilities includes the pepper-corn lease of council reserve land.

  The general experience of this form of community facility ownership is that while it is possible to secure grant funding to build facilities, it is very difficult to get grant money to support either their operation, or renewals and maintenance. This frequently results in pressure for on-going council funding to support operating losses and to maintain the facilities. In these circumstances councils tend to have little scope to influence the nature of the activity and rely on the capability of the trustees to operate them effectively. There are a number of instances where councils have had to intervene and take on ownership of facilities from community trusts which have failed.

- **Council ownership with a commercial lease**
  This is a common model used to support the effective operation of community facilities where the council has little expertise and the nature of the activity is inherently commercial. This model is most frequently used for the operation of camping grounds / holiday parks.

  Most of these commercial leases are structured to provide incentives for the operator to drive commercial revenue and either leave the ownership and renewals responsibility with the council, or they provide a framework for tenant improvements geared to quite long-term lease arrangements. There are frequently issues over the treatment of improvements at the end of lease terms, or where the level of service provided is not what the council expected, or where the tenant leaves assets to run down before the end of a lease period.

- **Council ownership with a commercial operating contract**
  This model is used to support the effective operation of community facilities where the activity is specialised and the council has little expertise. While it is still comparatively rare for councils to contract out the complete operation of community facilities, this model is most frequently used for the operation of swimming pools. Most of these commercial operating contracts are structured to provide some incentives for the operator to drive commercial revenue and leave the ownership and renewals responsibility with the council. Key points of tension in these relationships include, the service levels provided, distinguishing between routine maintenance and major renewals, and balancing commercial and community well-being / use objectives.

- **Council ownership with some form of partial tendered concession to operate from the facilities**
  This is a common model used to generate revenue from commercial activity associated with a part of a community facility. This can include: the commercial lease of space within a pool complex to operate a gym or a café, the rights to operate a swim school within a pool complex, or the right to use a part of a park or reserve for events, or the rights to deliver catering or audio visual services within a venue.

  This model is commonplace and provides a convenient and simple way to separate community and commercial objectives without crowding out the market. This approach can incentivise commercial revenue generation within specific contractual boundaries. It is often used in large venues to isolate the venue owner from the costs of maintaining delivery capacity which is infrequently used (i.e. core catering staff).

- **CCO ownership and operation of regional and substantially commercial facilities**
  Auckland Council has a portfolio of community facilities that operate across all of the models noted above and has key regional facilities with significant commercial

revenue grouped in a single CCO. Regional Facilities Auckland (RFA) manages the Auckland Art Gallery, the Auckland Zoo, Mt Smart Stadium and the Aotea Centre and related performance venues. None of these venues are fully commercial but each of the venues by themselves are larger than BVL. All other Auckland Council community facilities are owned and operated by the council, with a range of operating contracts and commercial and community group tenancies, some of which continue to reflect the legacy of the eight prior councils in Auckland.

Since RFA's establishment in 2010 there have been on-going debates over the amount of council funding required to support it, most notably over the funding for the Art Gallery, and the future of Mt Smart Stadium and the related debate over the future of Eden Park (which is owned by a separate standalone Trust). There have also been significant concerns over the level and nature of commercial risk associated with becoming a promoter in order to drive activity within venues. A recent review of Auckland CCOs has recommended merging RFA with Auckland's tourism and economic development agency ATEED.

The only other example that the reviewer is aware of where a council created the sort of mix of facilities that is operated by BVL within a CCO, is the Queenstown Lakes District Council CCO Lakes Leisure Ltd. In addition to managing the Queenstown Events Centre, Lakes Leisure Ltd managed community halls and parts of some reserves (events centre sports fields). The joint management of reserves resulted in complex, overlapping and unnecessarily expensive service contracts. The management of community halls resulted in the extension of commercial catering and security arrangements to venues where the majority of users sought to do self-catering for their activities. The CCO was ultimately wound up and its activities brought back in house as part of a broader review and rationalisation of council activities. One of the factors that contributed to the council decision to wind up the CCO was a dramatic increase in user charges for community halls which was part of what was required by the CCO to remain commercially viable. The increase in user charges was a clear demonstration of the conflict between the commercial imperatives of the CCO and the community well-being objectives of the council.

76. The most common model for managing community facilities across local authorities is to operate them in house as a core part of council activity. Depending on the size and nature of the facilities councils also use a number of contracts for service, or commercial tenancies to drive commercial revenue objectives within council owned and operated facilities. Where community facilities like halls are held at arms-length from council they are generally owned by local community charitable trusts and not in commercial structures.

77. Community facilities are, by their very nature **not** commercial undertakings. Where facilities like stadiums are operated on a commercial basis the stadium operators do very well if they can generate sufficient revenue to make an operating surplus. Generally New Zealand stadiums do not generate sufficient operating surpluses to fund depreciation or periodic renewals.

78. Tauranga City's BVL is unusual in the New Zealand local government context both because of the large number of small scale community assets held in a commercial structure, and the overall quite modest size and limited truly commercial scale of the undertaking.

Options Identification

79. While this review was not commissioned as a review under Section 17A of the Local Government Act 2002, it makes sense to canvas the range of matters that the council would need to consider under that part of the Act.

80. In a Section 17A review *"A local authority must review the cost-effectiveness of current arrangements for meeting the needs of communities within its district or region for good-quality local infrastructure, local public services, and performance of regulatory functions."*[5]

81. A Section 17A review must also:

"… consider options for the governance, funding, and delivery of infrastructure, services, and regulatory functions, including, but not limited to, the following options:

(a) responsibility for governance, funding, and delivery is exercised by the local authority:
(b) responsibility for governance and funding is exercised by the local authority, and responsibility for delivery is exercised by—
  (i) *a council-controlled organisation of the local authority; or*
  (ii) *a council-controlled organisation in which the local authority is one of several shareholders; or*
  (iii) *another local authority; or*
  (iv) *another person or agency:*

(c) *responsibility for governance and funding is delegated to a joint committee or other shared governance arrangement, and responsibility for delivery is exercised by an entity or a person listed in paragraph (b)(i) to (iv).*[6]

82. Of the options that must be considered under Section 17A quite a number can be rejected with little consideration.

83. There has historically been little appetite for joint ownership and management of community facilities between Tauranga City Council and Western Bay of Plenty District Council. It is clear that Western Bay residents use and benefit from the facilities provided by Tauranga City, and to a lesser degree the reverse applies. However, Western Bay's community facilities are significantly remote from those currently operated by BVL. They do not form a contiguous network, and they provide for a different mix of community activities and service quite different communities. For these reasons it is considered unlikely that Western Bay of Plenty District Council would be interested in, or derive benefits from a CCO that manages and operates community facilities in which both Tauranga City and Western Bay were shareholders. Indeed, the inability of Tauranga City to resolve the issues associated with the balance between community outcomes and commercial objectives would be made considerably more complex by adding in the community facilities of Western Bay. The same issues would apply to a joint committee established by Tauranga City and Western Bay to oversee community facilities.

84. The only scope that Tauranga City would have to transfer responsibility for community facilities to another local authority would be to transfer them to the Bay of Plenty Regional Council. Whilst legally possible, there is little reason to believe that the regional council would

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[5] Local Government Act 2002 Section 17A(1)

[6] Local Government Act 2002 Section 17A(4)

agree to such a transfer. The regional council does not own or operate similar community facilities and accordingly would need to develop the expertise and capability to do so. Given the nature of Tauranga City's existing parks, reserves and facilities capacity it is most unlikely that a transfer of the responsibility for BVL's community assets to the regional council would result in a more cost-effective way of meeting the needs of the Tauranga communities than either the status quo, or transferring the activities of BVL back into Tauranga City Council. It is equally implausible to consider that establishing a joint committee of Tauranga City and the Bay of Plenty Regional Council would deliver more cost effective outcomes than other options. The only obvious advantage of transferring this activity to the regional council would be that the regional council is not financially constrained in the way that Tauranga City Council is.

85. Whilst there may well be individual activities within the BVL's portfolio that could be sold or taken to the market as a concession to operate, the whole of the portfolio is not a viable commercial undertaking. It is intended to deliver significant and on-going community well-being outcomes. This means that it is not practical to consider options that involve the transfer of the activities to another person or agency (Section 17A(4)(b)(iv)).

86. Based on the issues discussed above, there are three potential options in terms of the future provision of the facilities and services currently provided by BVL. The options have been developed at a high level to enable a principles-based assessment to be undertaken, as opposed to a much more granular consideration of design details. If an option was to be considered further, detailed structural, financial and operational analysis may be required.

Option 1 – Enhanced Status Quo

87. This option broadly involves a continuation of the current operational and governance arrangements. Based on the findings of this review the option would, however, be strengthened by a number of proposed enhancements from current practice:

- Development of clear KPIs, fully and accurately aligned to the expectations and objectives of the organisation, and consistent with the prioritisation of those objectives.

- A review of council funding to ensure that the levels and mechanisms realistically provides for the on-going and sustainable provision of community facility-based services in line with the community's expectations as well as the on-going commercial viability of the commercial network.

- Rebalancing of the skills matrix of the Board to align it with the nature of the services provided by BVL and the priorities in terms of the expectations placed upon it.

Option 2 – Stronger Commercial Focus

88. This option would involve a restructure of the existing BVL business to more tightly and directly focus it on its commercial activities, expand its non-funded portfolio and move non-commercial assets and services back into direct council management. In broad terms, this would involve moving the management of halls, community centres and community pools into the Council. As appropriate, external management contracts could be tendered under this option to enhance delivery. To the extent that these facilities impact on the ability of BVL to provide their commercial services, usage agreements would be negotiated with the Council

in order to provide certainty to both BVL and those managing community usage of the facilities.

89. In addition, to bolster the BVL commercial portfolio, and to potentially increase the value derived from Council's marketable assets, this option would also involve transferring management and responsibility of additional commercial assets into BVL - specifically, campgrounds and the marine precinct. A new ESE would need to be developed and it would need to include a clear expectation of BVL to return an annual dividend to the Council, reflecting a reasonable return on its equity. The Board skills matrix would also need to be reviewed to ensure that it has the mix of skills and expertise necessary to deal with the new mix of assets and activities.

90. As with option one, this approach would be complimented by the development of clear and appropriate KPIs, along with a review to determine appropriate and sustainable levels of funding of community services under the new model. Such a review would most appropriately be undertaken within the 2021 Long-term Plan (LTP) to enable expenditure prioritisation against other demands.

Option 3 – In-House with Commercial Sales/Leases

91. Option 3 involves the disestablishment of BVL. Delivery of the facilities and services currently managed and provided by the CCO would, in the first instance, be taken inhouse within the Council. To provide for the continuation of the Council's events focus, a clear and innovative events strategy would need to be developed (again, this would most effectively be achieved through the 2021 LTP). As with option two, this approach would, as appropriate, involve the tendering of management contacts to enhance delivery.

92. In addition, what are effectively "busines units" currently operated by BVL (or from within Council) are packaged up for either sale (with tenure and/or time specific contracts to enhance value) or lease. These assets / operations could include:

    - Holiday Park (currently owned by Council)
    - Bay Swim
    - Clubfit
    - Audio visual business
    - Catering business.

93. Again, this option would need to be complimented by the development and setting of clear KPIs (including in relation to the events strategy) and a review, through the 2021 LTP, of funding levels required to deliver a sustainable and quality facilities network.

Options Analysis

94. In this section the advantages and disadvantages of each of the options set out above are assessed in order to inform the basis of a recommendation to Council on a preferred option.

Option 1 – Enhanced Status Quo

Advantages	Disadvantages
• Minimal change and disruption. • Communities know and understand the model and form of delivery. • Institutional knowledge, capacity and experience maintained. • Retention of brand equity • Avoid restructuring costs, both financial and in terms of lost focus. • Avoid the public, political and media challenges associated with driving major change.	• Questions about commercial sustainability remain. • Continued issues in rationalising conflicting objectives and operational pressures. • Potential inability to invest in renewals and network development to the extent necessary to mitigate commercial sustainability risks. • Continued, and likely increased crowding out of private sector activity and investment. • Continued high governance costs to achieve a relatively insignificant offset to the cost of delivering community facilities.

Option 2 – Stronger Commercial Focus

Advantages	Disadvantages
• Community services delivered closer and with more direct accountability to the community. • A rebalancing of the use between commercial and community activities • Ability to prioritise community facilities expenditure alongside and on the same basis as other council priorities. • The actual cost to council of managing a sustainable network of community facilities will became both obvious and transparent. • Ability for BVL to focus exclusively and unambiguously on commercial operations and outcomes. • Brand equity maintained and potentially, overtime, enhanced. • Enables the Council to address the contribution to community well-being across the non-commercial commercial facilities.	• Costs of restructuring including financial costs as well as uncertainty and organisational distraction (TCC and BVL). • Potential loss of institutional knowledge, capacity and experience. • Commercial sustainability questions will remain in relation to mature revenue streams and increasing costs. • Need to invest in upgrading facilities to strengthen commercial potential remains a challenge. • Issues associated with conflicting use of facilities will remain and, in fact, could be heightened. • Community confusion and uncertainty about what is delivered, by who and on what basis. • Potential exposure to public, political and media challenges associated with driving major change.

Option 3 – In-House with Commercial Sales/Leases

Advantages	Disadvantages
• Commercial relationships managed consistently and in-line with Council expectations, including expectations relating to probity and risk. • Provides scope to rebalance activity between commercial and community uses across the whole network of council facilities. • Ability to realise efficiencies in the management and operation of the entire network of community facilities. • Reduced governance costs and complexity. • Opportunity to structurally address usage conflict issues. • Reduced potential for crowding out of private sector activity and potentially a catalyst for an increase in private investment. • Potentially generate gains on sale to invest in facilities upgrades. • Enable a comprehensive consideration of the levels of service needed to support the well-being of the Tauranga community. • Enable a comprehensive, across the board review of council facilities, in a manner consistent with council's overall strategic imperatives and priorities and desired levels of service. • Community services and facilities delivered closer and with greater accountability to communities. • Ability to prioritise expenditure on the development and operation of community facilities alongside, and on the same basis, as other council priorities. • The actual cost to council of managing a sustainable network of community facilities will became both obvious and transparent.	• Costs of restructuring including financial costs as well as uncertainty and organisational distraction (TCC and BVL). • Potential loss of institutional knowledge, capacity and experience. • Potential for community confusion and resistance. • Perceived failure of the BVL model and questions about the organisation's performance. • Loss of brand equity. • Weakening of existing commercial relationships. • Reduced focus on commercial outcomes within facilities. • Potential exposure to public, political and media challenges associated with driving major change. • Likely loss or reduction in commercial revenue due to greater emphasis being placed on community activities.

Conclusion

95. This report is the result of the review of the BVL CCO model commissioned by TCC. The review included in-depth interviews with a number of those involved in the governance and operations of BVL, consideration of the previous review reports and other desktop research. From this, a range of issues associated with the current approach and structures were identified and analysed from a public policy perspective. As a result, three future delivery options were developed and assessed.

96. Based on the assessment of these options, on balance it is the view of the reviewer that option three represents the optimal and preferred way forward. That is, wind up BVL bringing its activities in-house within council and alongside that packaging up stand alone, commercially viable business units for sale or lease.

97. It is acknowledged that this recommended option would involve significant transitional disruption and up-front cost, but the reviewer considers that the long-term benefits justify this. In particular, this option best provides the basis for the Council to consider the entire network of community facilities, identify the level of service that the community needs, and prioritise and plan for the development of community facilities alongside all other Council activities and priorities. It is also the option that provides the Council with the best opportunity to understand the trade-offs between commercial and truly non-commercial activity across the entire network of facilities and make decisions on allocation to different uses and users to deliver the best overall outcomes for Tauranga and the biggest impact on the well-being of its residents.

98. Whichever option is taken, any future arrangements involving a CCO would necessarily, and beneficially, be accompanied by:

    - Development of clear KPIs, fully and accurately aligned to the expectations and objectives of the organisation, and consistent with the prioritisation of those objectives.
    - A review of council funding to ensure that the levels and mechanisms realistically provides for the on-going and sustainable provision of community facility-based services in line with the community's expectations as well as the on-going commercial viability of the commercial network.
    - Rebalancing of the skills matrix of the Board to align it with the nature of the services provided by BVL and the priorities in terms of the expectations placed upon it.

Attachment A – Interviewees

The strategic review process involved extensive interviews with Tauranga City Council (TCC) elected members, Council officers, and BVL directors and managers. Specifically, the following people were interviewed:

Mayor Tenby Powell	
Cr Jako Abrie	
Cr Larry Baldock	
Michael Smith	Chair, BVL
Keith Tempest	Director, BVL
Marty Grenfell	Chief Executive, TCC
Gareth Wallis	GM Community Services, TCC
Paul Davidson	GM Corporate Services, TCC
Anne Blakeway	CCO Manager, TCC
Jeremy Boase	Strategy Manager, TCC
Mohan de Mel	Treasurer, TCC
Kathryn Sharplin	Finance Manager, TCC
Mark Smith	Spaces & Places Manager, TCC
Justine Brennan	Chief Executive (Acting), BVL
Adam Ellmers	Chief Financial Officer, BVL
Tina Harris-Ririnui	Venues & Programmes Manager, BVL
Ervin McSweeney	Commercial Manager, BVL

Attachment B – BVL Submission

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Monday, 24th August 2020

Mr Peter Winder
peter@mcgredywinder.co.nz

Dear Peter

Board Input into Bay Venues Ltd Strategic Review

Further to our meeting earlier in August, conducted as part of your review of Bay Venues Limited (BVL), I'm writing to provide some further information for your consideration. As the majority of the individual directors of BVL didn't have the opportunity to be interviewed directly by you for the review, the Board felt it appropriate to provide its collective thoughts for your consideration into the process.

Purpose & Performance

1. The defined purpose of BVL is ***to be the kaitiaki of community facilities. To enhance quality of life through community facilities and the experiences we provide in them.*** This purpose statement underpins our strategy and action and has been endorsed by TCC annually through our Statement of Intent process.
2. BVL have a proven track record in terms of delivering on its purpose and achieving targets. This is evidenced by the year-on-year improvements in financial and non-financial targets. Results of our key financial and community outcomes over the previous 5 years from 2015 to 2019 (discounting FY20 which was significantly impacted by COVID related facility closures) shows significant improvement:
   - Hours of use has increased by 22,084 hours from 80,916 to 103,000
   - Number of visits has increased by 420,000 from 1.69m to 2.11m
   - Customer satisfaction has always been high but has also increased from 86% to 88%
3. BVL has a strong track record of achieving targets and demonstrating continuous improvement.

Additionality & Value

4. Whilst BVL has performed consistently since inception, we support the opportunity this review presents to consider if there are other models Tauranga City Council (TCC) could consider that would provide efficiencies in performance and outputs.
5. When considering alternative models, we believe it is important to consider what additionality the current BVL model provides to TCC. BVL drives significant revenue from the community assets/facilities that are manged within the portfolio by applying a robust commercial lens to the organisation. It is unlikely that TCC could achieve the same commercial outcomes if the assets were managed within Council.
6. It is expensive to operate community facilities in a way that ensures they remain affordable for the community to access (through low entry fees) and affordable to ratepayers (through a relatively

static rate subsidy). At an operating cost level, it costs around $3.4m to run BVL's funded network of community facilities. $2.7m of this cost is covered by Council (through the rate funded operating grant), leaving an operating loss of $680k in the funded network[1]. This operating loss is offset through commercial revenues generated from other activities within the BVL portfolio, therein reducing the ratepayer burden.

7. An aspirational level of profitability for BVL is not simply achieving the target (of a positive contribution from the non-funded network) but to grow profitability to a level that presents a breakeven position across both the funded and non-funded networks. To achieve this position, BVL needs to generate an additional $1m of net profit (after depreciation and debt servicing on assets purchased by BVL).

Breakeven vs Profit?

8. If BVL were to consistently generate an additional $1m of profit per annum, this would provide the necessary cashflow required to operate the existing community facilities in the portfolio at a subsidised rate for residents of the city, without drawing on any additional funding requirements from TCC (other than the cost of assets already under ownership). To achieve this, BVL would need to execute new projects and initiatives in order to offset the growing cost of running community facilities.
9. If the breakeven position above represents the utopia TCC is seeking, it becomes critical for this review to ascertain whether the additional $1m profit is merely aspirational or a realistic target (to then be supported by a BVL business growth strategy). To this end it is notable that net revenue has increased by 32% over the last 5 years from $17m in FY15 to $22.5m in FY19,[2] which is evidence that the commercial activities initiated and delivered by BVL are moving in the right direction.

Growth Opportunities

10. The Board of BVL attest there is clear potential to continue growing commercial revenues.
11. As an example, BVL is currently pursuing an opportunity to deliver meals as part of the *Free and Healthy School Lunches* ('FHSL') programme through Ministry of Education. This programme will provide a nutritious lunch to lower decile schools across NZ every day. The Bay of Plenty region has been targeted for the first phase of this programme expansion with 100 BOP schools joining the programme from Term 4 (ie October 2020). Bay Catering have responded to the Ministry of Education RFP and has identified 22 'schools of interest' across the Western Bay, Tauranga and Whakatane as potential clients for the FHSL programme. Successfully contracting with less than half of these school represents a projected $1m net profit return for BVL. This is considered a realistic and achievable projection, given that Bay Catering is one of only a small number of local providers with the capability to cater at the scales anticipated by the programme. Furthermore, this opportunity aligns to our strategy to achieve a greater level of resistance to COVID-19 related disruption and enable continued operations as an 'Essential Service'.

[1] Note the total overall loss across the BVL network after depreciation and debt servicing on BVL assets is $1m (Covid adjusted FY20 position).
[2] FY20 has been discounted as a result of COVID-19 disruption

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12. As the FHSL initiative has progressed rapidly following the interviews held as part of your Strategic Review, the Board wanted to take this opportunity to ensure you are aware of what would be a significant and material development for BVL.
13. Pursuing this time-bound opportunity is an example of the nimble and commercially focused Board and Management approach. It demonstrates one of the benefits to Council of having a CCO which can act swiftly to take advantage of fast moving opportunities, as well as demonstrating our ability to be agile and change direction to become more resilient to current and future impacts of COVID-19.
14. Another example of a significant project that demonstrates agile thinking would be the *University of Waikato Adams Centre for High Performance*. Since its' inception, the Adams Centre has been an incredible success story for the City, founded on the strength of innovative thinking and commercial partnerships, and enabled by the BVL CCO structure. This initiative has put Tauranga on the map as a centre of excellence for high performance sport and was the critical factor in NZ Rugby's decision to centralise their Olympic Sevens programme in Tauranga in 2018.

The BVL CCO Model

15. There are a number of notable advantages of BVL operating under a CCO model. As described above, fundamentally the CCO model allows BVL to generate greater revenue from community facilities than Council could achieve if operating as an internal cost centre. Further advantages include;
    - **Industry specific expertise in business to consumer (B2C) and business to business (B2B) relationships.**
      As a CCO, BVL is highly effective at holding and developing relationships with consumers and businesses who have high expectations around customer service and expect a commercial culture and environment. This is evidenced by our year on year improvements in customer satisfaction results since inception; and our ongoing partnerships with various commercial entities.
      Conversely Council is more effective at holding and developing relationships with ratepayers (B2R). For example, ratepayers and not-for-profit groups have expectations around usage of community facilities, based on the contribution they have already made through rates to support these facilities. Council is the appropriate body to hold the relationship with ratepayers in the City and to manage their expectations.
    - **Industry specific expertise that makes BVL highly effective at operating, growing and planning for the future of facilities.**
      BVL has a depth of industry specific knowledge and experience in the sport/recreation, aquatics and events sectors which is valuable particularly around health and safety, customer expectations and optimisation of facility management. This is evidenced by our results in customer satisfaction and asset management and the quality of input BVL has made into future facilities planning over recent years. The Adams Centre ideation and development is a demonstrable case in point.

- **The ability to add value to the facility by cross-selling, up-selling or utilising our core services across the entire network.**
  A large proportion of the 2 million plus visits to our facilities each year are made by single customers interacting with us in a variety of ways across different facilities/services within the network. Recent investments in our customer database enable us to track the journeys of each of customer and upsell/cross-sell according to their needs and preferences (i.e encouraging our pool users to become gym users).
  Another example of how we add value across the network is with Bay Catering. Bay Catering is required to operate at scale, to provide the level of service appropriate for events and functions in the Arena. BVL derive greater revenues and operating efficiencies from Bay Catering by offering their product throughout our facility network (i.e. through Cafes at various facilities).
  Furthermore, this cross-network approach allows BVL to employ staff who can work in different facilities and different jobs, effectively creating a pool of staff to utilise when required. This drives efficiency by reducing contract staff requirements and operating in a commercial manner across all facilities (community and commercial).
- **Our facilities are part of the wider City network.**
  Several of our facilities are operated using a city-wide network approach (e.g indoor courts).
  QEYC/Memorial, Mount Sports Centre and the Baypark Arena are operated as a network of court space across the city as opposed to individual centres. This allows us to best accommodate the needs of multiple user groups by moving bookings around the network. It would be detrimental and frustrating for users if the Arena and the various community courts were to be operated under different management structures.
- **Specific and dedicated governance focus.**
  The BVL Board of Directors have been appointed to lead the organisation, and demonstrate acumen, skills and expertise specific to the industry and operations of BVL. Having this clear and astute leadership, separate from the political machinations of Council, is a definite advantage of the CCO structure.
  Furthermore, an independent, skills-based Board that is appointed on a rotational basis enables longevity and consistency, as BVL is able to continue to pursue its long-term strategy outside the three-yearly local government election cycle. It also removes BVL from any potentially distracting political disharmony.
  It is unrealistic for Elected Members to provide the same level of specialist, quality focus and direction to the mix of activities in the BVL network; alongside the myriad of other issues facing the city. Council does however, retain ultimate control of the CCO through the guidance issued in the Enduring Statement of Expectations and SOI process.

Model Optimisation

16. The BVL Board and Management have considered the various assets within Council ownership that are in scope for this review and present the below analysis for consideration.

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17. Our analysis suggests the BVL operating model could be optimised by a slight change in the mix of facilities and assets, namely removing community halls, centres and community share facilities. To counter this reduction in managed assets, the analysis suggests the Campground and Marine Precinct could align into the BVL network and therefore could be further investigated.
18. We note that any recommendation for change to the mix of activities or the structure of the CCO would need to consider the full impacts (financial and operational) to the community, the shareholder and the customer.
19. The table below uses the current BVL CCO model advantages (noted above) to assess the mix of activities in the BVL stable.

Community Facility Types	Customer relationship	Specialist industry knowledge	Ability to add value through commercial activities	Benefits of the network realised?	Assessment
Community share Facilities	B2R	No	No	No	Remove
Community halls	B2R	No	No	No	Remove
Community centres	B2R	No	No	No	Remove
Community courts	B2R	No	No	Yes	Retain
Community pools	B2C B2R	Yes	Yes	Yes	Retain
Sub-regional pools MHP & Baywave	B2C B2R	Yes	Yes	Yes	Retain
Arena, Stadium & Pavilions at Baypark	B2B B2C B2R	Yes	Yes	Yes	Retain
Adams Centre	B2C B2B	Yes	Yes	No	Retain
Campground	B2C	Would need to develop	Yes	No	Add
Marine Precinct	B2B	Would need to develop	Yes	No	Add

20. In addition to altering the asset mix, we attest the CCO model would also benefit from greater shareholder direction around:
    - Guidance for commercial business units operating in the same market as the private sector

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- Clarification around areas where BVL and TCC have collective responsibilities including planning for future community facilities and events

Interestingly, these are also the key points picked up in the recent review of Auckland's CCOs which highlighted that "The council has the means to make two significant improvements to the model generally. One is to give CCOs clear strategic direction (which would enable them to translate the council's high-level plans into practical work programmes) and the other is to give CCOs guidance on how to strike a balance between commercial and public interests (which would eliminate a good deal of the criticism levelled at CCOs by the public)."

21. The Board consider there is merit in the CCO model being used as a vehicle to drive a greater level of collaboration with sub-regional partners; thus enabling access to funding for development of new community facilities. We would like to see this as an area for further investigation.

I thank you for the time and consideration given to incorporating the BVL Board's viewpoints into your review. Should you wish to discuss any of these points, I can be contacted on 021944280 or via email Michael.smith@hobec.co.nz

Yours sincerely,

Michael Smith
Chairman
Bay Venues Ltd