Brighton i360 Loan Restructuring Options

September 2018

1. Background

1.1 GVA Real Estate Finance (GVAREF) has been procured by Brighton and Hove Council to undertake a review of the structure of the loan provided by the Council to the Brighton i360 consortium for the construction of the i360. GVAREF are not advising Coast to Coast Capital who are the junior lenders with subordinated rights to the Council.

1.2 Between 2014 and 2016 Brighton Council provided the Brighton i360 Consortium with development finance in the form of £34m senior debt to construct the visitor attraction with interest accruing during the construction phase. At practical completion the loan value was £36.2m. Alongside the Council, Coast to Capital Local Enterprise Partnership (C2C LEP) provided additional £4.06m funding in the form of a subordinated junior loan.

1.3 The Council loan to the consortium is effectively made up of two parts:

- Annuity payments to cover interest and capital repayments due under the Councils borrowing from the Public Works Loan Board (PWLB)
- An interest margin of 3.75%

1.4 Since opening in 2016, the visitor numbers have not been in line with forecasts and as such the revenue generated has not at all times been sufficient to meet the semi-annual loan repayments to the Council. Prior to June 2018 the i360 consortium were able to make the repayments to the Council through the revenue generated by the attraction or in the case of December 2017 with additional equity being injected by the partners. However in June 2018 the consortium informed the Council that they would be unable to meet the entire payment required. The consortium made a payment to cover the PWLB element of the loan and the Council agreed to defer the Interest margin to the next payment date in December 2018.

1.5 We understand that a reservation of rights letter (in respect of the deferred interest and not charging default interest) has been drafted by the Council and their legal advisors and GVAREF has advised that this should be issued as soon as possible.

1.6 Based on the summer trading figures it is unlikely the i360 consortium will be able to meet their full loan obligations in December 2018 and as such the Council has begun to consider options on restructuring the current debt to ensure that their investment is protected. GVAREF have been asked to look at the debt restructuring options while Leisure Development Partners (LDP) have been commissioned to advise on improving the performance of the attraction.

1.7 While the Council loan is made up of two parts the minimum the Council require in order to avoid revenue pressures to the Council budgets is the PWLB element of the payment due. Therefore any restructuring options need to ensure that as a minimum the PWLB loan can be serviced in full. Furthermore the Council may have forecast the margin payable within their medium term financial strategy as income to help pay for services. If so any margin not payable would add an additional revenue pressure to the Councils budget.

1.8 This paper considers the wide range of options available but does not seek at this stage to make any recommendations and further work will be carried out in the coming weeks to narrow down the options before concluding on the optimum routes forward for the Council. This will include assessing any state aid implications of the options to ensure compliance to EU regulations.

2. Counterparties

2.1 In this section we have set out the Counterparties to the loan transaction and their respective positions at this stage on any restructuring options for the loan. The Counterparties in this loan investment are:

- Brighton and Hove Council
- Coast to Capital Local Enterprise Partnership
- Brighton i360 Consortium

Brighton and Hove Council

2.2 As set out above, the Council are the senior lender to the Brighton i360 with a loan of £36.2m due for full repayment by 2041.

2.3 The Councils interest in the success of the Brighton i360 is however twofold. As well as being a senior lender to the consortium in their function as local authority the Council have a vested interest in the securing the economic benefits that a successful tourist attraction will accrue for the local area.

2.4 Primarily the Council wishes to protect its financial interests with respect to the loan, ensuring that the principal loan repayment to the PWLB can be made on a semi-annual basis and the loan margin will be received as per the loan agreement. Where the full repayment cannot be made, the priority for the Council will be to ensure that the PWLB payment can be serviced with the margin potentially paid in a different profile.

2.5 The Council also wishes to minimise any further investment to be made under possible restructuring options and any restructuring options will need to be state aid compliant. While the Council have full step in rights as a the senior lender, this is not likely to be the Councils primary option, however should other options explored not be viable to protect their investment then this these rights may need to be enforced (subject to acceleration and enforcement advice from the Council’s legal advisors).

Coast to Capital Local Enterprise Partnership

2.6 The LEP is a junior lender to the Brighton i360 consortium and their loan is subordinated behind the Council's senior loan. Their loan consists of an Interest only (3.75%) element payable semi-annually with plus PIK (Payment in Kind) interest (11.25%) rolled up. There is a bullet repayment at the end of the loan for the principal amount and accrued interest. The principal is due to be repaid in 2021. There is no early repayment fee for the loan agreement.

2.7 As with the Council the LEP's desire is to protect their financial investment and ensure that the interest accrued to date and the principal amount due is repaid in full when the loan expires in 2021. The LEP as a junior lender does not have step in rights and ranks behind the Council's senior loan repayments. Given the LEP loan expires earlier, there is a more immediate risk of the financial loss occurring as a result of a default if the i360 are unable to repay the debt in full by 2021.

Brighton i360 Consortium

2.8 The Consortium is made up a number of shareholders. The consortium operates the attraction internally and there is no third party operator currently on board. The consortiums primary objective is to continue to operate the attraction while improving the business plan. Alongside this the consortium is looking for the debt burden to be reduced to avoid default and have put forward their preferred options in this regard which was reported to the Councils Cabinet in June 2018. The current shareholders are reluctant to bring in a 3rd party equity investor which would dilute their interests and control.

3. Options

Current Position – Do nothing scenario

3.1 While the Council is exploring debt restructuring options, it is important to understand the current base case and the expected financial impact of the status quo. The Brighton i360 consortium has set out a revised business plan which forecasts the expected revenue and costs from July 2018 up to December 2043. This business plan sets out the 3 potential scenarios in relation to visitor numbers, with a base case, middle case and best case sensitivity. It should be noted that GVAREF has not made an assessment around the validity of these figures, which is a something that will be covered as part of the LDP work stream.

3.2 GVAREF have taken the current loan structure, repayment profiles and the revised business plan to model the potential shortfall in the debt repayments that the consortium has to make. The tables below set out the forecast to June 2021 of what the cash shortfalls would be for the consortium based on an expected visitor numbers on their business plan scenarios. Where a payment is not made in full, we have rolled that forward to the next period for the purposes of this analysis. The priority of repayments assumes that the Council interest is repaid first, followed by the LEP interest and then Council principal repayment.

Table 1: Indicative Cashflow Position - Forecast Visitor Numbers: 360,000

	31/12/2018	30/06/2019	31/12/2019	30/06/2020	31/12/2020	30/06/2021
Council Receipts	(1,680,001)	(790,999)	(1,401,892)	(610,639)	(1,483,368)	(646,128)
Expected Repayment	2,062,312	1,874,615	2,575,920	2,666,333	3,547,997	3,556,934
Shortfall/Surplus	**382,311**	**1,083,616**	**1,174,029**	**2,055,693**	**2,064,630**	**2,910,805**
PWLB	922,297	922,297	922,297	922,297	922,297	922,297
PWLB Shortfall	**-**	**131,298**	**-**	**311,657**	**-**	**276,168**

Table 2: Indicative Cashflow Position - Forecast Visitor Numbers: 412,400

	31/12/2018	30/06/2019	31/12/2019	30/06/2020	31/12/2020	30/06/2021
Council Receipts	(1,680,001)	(790,999)	(1,661,556)	(790,998)	(1,760,258)	(843,115)
Expected Repayment	2,062,312	1,874,615	2,575,920	2,406,668	3,107,974	2,840,019
Shortfall/Surplus	**382,311**	**1,083,616**	**914,364**	**1,615,670**	**1,347,715**	**1,996,904**
PWLB	922,297	922,297	922,297	922,297	922,297	922,297
PWLB Shortfall	**-**	**131,298**	**-**	**131,298**	**-**	**79,181**

Table 3: Indicative Cashflow Position - Forecast Visitor Numbers: 453,640

	31/12/2018	30/06/2019	31/12/2019	30/06/2020	31/12/2020	30/06/2021
Council Receipts	(1,680,001)	(790,999)	(1,991,667)	(934,789)	(2,120,481)	(1,000,022)
Expected Repayment	2,062,312	1,874,615	2,575,920	2,076,557	2,634,072	2,005,895
Shortfall/Surplus	**382,311**	**1,083,616**	**584,253**	**1,141,768**	**513,591**	**1,005,872**
PWLB	922,297	922,297	922,297	922,297	922,297	922,297
PWLB Shortfall	**-**	**131,298**	**-**	**-**	**-**	**-**

Note: Revenue split between the June/December revenue not available therefore we apportioned based on current available numbers - 70%/30% Dec/June respectively.

3.3 Due to the seasonal nature of the attraction the revenue projections fluctuate with higher revenue available to service the debt in December than in June. Under the base case visitor forecast provided by the i360 consortium, it can be seen in table 1 that over the next 3 years there is a shortfall in all periods, with the deferred payments each period causing the payment gap to increase significantly. Based on the estimates the cash shortfall payable to the Council would be c£2.9m at June 2021. The payments in December of each year cover as a minimum the PWLB repayment required in that period, while paying the Council an element of the Margin. However the June payments are not sufficient to meet either the PWLB or Margin,

3.4 In table 2 with a visitor forecast of c412,000 the overall payment shortfalls continue but a slightly lower level than the base case. At June 2021 the cash shortfall payable to the Council is forecast to be c£2m. The payments in December of each year cover as a minimum the PWLB repayment required in that period, while paying the Council an element of the Margin. However the June payments once again are not sufficient to meet either the PWLB or Margin.

3.5 Finally table 3 sets out the cashflow position forecast based on the most optimistic of the visitor numbers. Even at this level of visitors, the overall cashflow shortfall is significant and in at June 2021 it is forecast to be c£1m. However in this scenario there is only one period where the Council would not be able to service its PWLB payment based on the receipts from the i360 and that occurs in June 2019.

3.6 It should be noted that this analysis does not seek to calculate the default interest that the Council are entitled to charge the i360 consortium as per the original loan agreement. This would further increase the level of payments due to the Council and become an added debt burden to the consortium. It should also be noted that the Council should take advice from its legal advisors to confirm the relative repayment priority between the Council and Coast to Coast Capital under the financial agreements.

3.7 Critically, there is also a pinch point in June 2021, which is when the LEP loan becomes repayable in full. The i360 consortium will either have to find cash within the business to repay that debt (which based on the forecasts will not be available) or refinance the debt. In the current time it is unlikely that there will be sufficient value in the attraction to enable a successful refinance and therefore the overall debt package for the i360 may not sustainable going forward. GVAREF advise that LDP consider the value of the i360 attraction in the open market at key points in the future, this will enable GVAREF to consider the ability for a sale or refinance to repay the outstanding loan facilities.

3.8 Below we have outlined a number of options that are available to the Council when considering a restructure of the debt. We have included the do nothing scenario as option 1 however as set out above this option is not feasible within the confines of the forecast performance.

3.9 The options below should not be seen as standalone options and the likely preferred solution will be a combination of these options. A combination of measures to drive performance and ease the burden of debt on the consortium will need to be packaged to ensure that the i360 operation is sustainable in the long term and the Council's loan is able to be repaid.

3.10 The Council will need to consider the options with reference to their objectives, which at this stage we understand to informally include:

- Secure full loan repayment
- Maintaining the ability to service the Councils PWLB Loan
- Re-incentivise equity holders
- Minimise Reputational Risk
- Work in tandem with Coast to Coast Capital to minimise political fallout. This objective is outside GVAREF's control in advising the Council as senior lender.

3.11 The Council will need to agree the objectives when considering the preferred option. While some of these are competing objectives a balance will need to be established when assessing the preferred way forward.

	Restructuring Options	Advantages	Disadvantages
1.	**Do Nothing** The existing Council and LEP lending structure is retained.	• Equity promoter is motivated to maximise the returns from the asset. • Minimal Council intervention required.	• Initial modelling shows that revised business plan is insufficient to cover interest due as well as PWLB in all periods • Deferred (and thus rolled-up) interest exacerbates long-term problem. • Repayment of loan at risk.
2.	**Equity promoters (i360 consortium) invest additional equity into i360** The Council could request, or require as part of a loan restructure, the equity promoters investing additional cash or assets to either support the repayment of the loan or interest payment.	• Equity promoters have so far shown a willingness to contribute and work with the lenders. • Council receive the upfront capital repayment outstanding and debt or interest is paid. • Minimal changes to existing lending structure.	• LEP loan remains in place and can affect future repayments. • Likely to be a short term solution. • Reputational risk to the council. • Shareholders need to have cash or other assets to invest.
3.	**Restructure interest payments** The Council could agree to reduce or restructure the interest payments. There are variants to be considered: • Reduce interest rate to sustainable level (i360 promoter's proposal). • Defer interest due until cash-flow can sustain payment, either through waivers or "Payment In Kind" interest. • Agree stepped interest rate, with an increase in rate once the LEP loan repaid being most obvious.	• Keeps equity promoter motivated to maximise returns from the asset. • Minimal changes to existing lending structure.	• May require Councils senior position to be subordinated. • Future non-performance could result in subsequent default. • Council PWLB loan payment gap will be reduced. • Ideally LEP would agree to similar structure. • Repayment of loan at risk.
4.	**Upside Agreement** The Council could agree to restructure the interest payments in return for a share of any future equity returns. This would be structured as a fee which would be payable based on a future sale of the asset (part of the uplift in value	• Simpler to arrange than taking actual equity stake. • Having an upside agreement could return more to the council than originally agreed. • Promise of future equity return could allow the council to restructure the current	• Less control than taking actual equity stake. • No guarantee the asset will generate equity returns in the future. • If interest rate is reduced, reduction in immediate returns. • LEP loan remains in place.

	would be for the Council as a result of continuing to support the asset rather than taking enforcement action).	interest rate.	• Repayment of loan at risk.
5.	**Debt for equity swap** The Council agree to part of the loan being swapped for shareholding in the asset owning companies.	• Portion of loan that is swapped for equity will not carry an interest rate and thus reduce cash-flow burden on asset. • The council becomes a shareholder in the company and can have a seat at the table to have role in taking operating decisions. • Council has access to future profits above and beyond the amount of the loan (depending on the terms of the swap). • Potential for preferential shares to ensure first right to dividends.	• No guarantee of any returns under equity portion. • Added council resources required to be an active shareholder. • Council may need to consolidate shareholding within its group accounts. • Current shareholders stake diluted which they may not be receptive to, especially where valuation of shareholding today may show this being minimal. • LEP loan remains in place however this option could also apply to the LEP should this be acceptable to them. • Repayment of loan at risk, albeit reduced due to lower loan amount.
6.	**Equity promoters (i360 Consortium) arrange refinance of Council loan** The Council could require the equity promoters to refinance their loan with a third party lender.	• New lender would repay existing Council outstanding debt which could be used to repay the PWLB loans. • No future revenue risk will be borne by council.	• Nature of asset and level of loan vs. valuation may mean limited lenders available to refinance loan. Realistically, raising finance on a distressed asset will mean the Council may have to settle for a lower price than the loan amount. • LEP loan creates issue for new lender. • Council forgo future interest payments. • May be costs associated with breaking PWLB loans. • If buyout at less than loan amount then Council revenue pressure for remainder of PWLB loan.
7.	**Council sell their loan** The Council could market their loan for sale to a third party investor.	• New owner of loan would part repay Council outstanding loan. • No future revenue risk will be borne by council.	• Council likely to have to accept a discount to current loan amount outstanding. • LEP loan creates issue for new lender. • Council forgo future interest payments

			which could otherwise help to support revenue budgets. • May be costs associated with breaking PWLB loans. • If buyout at less than loan amount then Council revenue pressure for remainder of PWLB loan.
8.	**Buy out Junior Loan** The Council agree to purchase the LEP loan.	• LEP loan could be bought at a discount, or option value, Council then receives the full amount of both loans over an extended term if the asset becomes successful. • Council has significant control over the lending structure. • The Council could then consolidate the loans into one structure. • Council could buy the distressed loan at a discount	• Council increases its exposure to an underperforming asset. Repayment of loans at risk. • Immediate capital expenditure required to purchase the loan. • LEP may not want to exit the loan.
9.	**Council to restructure PWLB loans** The Council could restructure the existing PWLB loans, including taking out new longer term loans.	• Council could reduce the level of interest required to be paid under the PWLB loans by taking out a new longer PWLB loan. • Reduced periodic payment for i360 consortium but over a longer period.	• To restructure the length of the PWLB loan is lengthening the Council's risk profile and the Council takes all the risk. • Repayment of loan at risk. • May be costs associated with breaking PWLB loans.
10.	**Consensual 'enforcement'** The Council agree with the equity promoters that it takes more control over the asset with a view to increasing revenue and value of the asset. This might include: • Requirement for the consortium to appoint a new operator. • Operator to drive the performance targets with the board being more strategic • Agreeing a revised business plan to	• i360 Consortium consensually agree to appointing new operator. • Council take more control to drive performance – not through actual shareholding but a contractual obligation to have sight of operator reporting. • Value of asset likely to be higher than under enforcement scenario. • i360 consortium retain 'strategic' control and therefore are more incentivised, however the Council has the ability to approve board structure through business planning process	• Reputational risk of "repossession" and implication for sponsorship deal and land leases. • Ability to enhance revenue or value uncertain. • Additional costs and Council resource. • All partners to work together. • Less control than enforcement action. • Valuation uncertainty at present. • Market for asset on a sales scenario is uncertain.

	control expenditure and increase revenues	• Restructuring of loan could be dealt with in tandem.	
11.	**Enforce Security** The Council appoint a third party property or accountancy firm to take control of the asset with a view to trading or selling the asset.	• Council have full control (within restrictions of security provided and insolvency process) to drive performance or sell asset. • Ability to put in place a new operator and board members.	• LEP intercreditor provisions to be considered. • Reputational issues. • Costs associated with third party property or accountancy firm. • Market for asset on a sales scenario is uncertain. • Distressed sale of asset likely to result in lower value.

4. Next Steps

4.1 The Council will need to consider the options set out and agree which options will be taken forward for greater consideration. These options will then need to be worked up in more detail from both a quantitative and qualitative basis.

4.2 Detailed state aid legal advice will also need to be taken during the process of agreeing on the preferred options as it will be important that the Council is able to demonstrate that any restructuring option taken forward is market facing or at least evidence that the decisions taken are credible ones that a commercial entity in a similar situation would take.

4.3 Some of the options will need an assumption to be made around the valuation of the asset. This will help to conclude whether certain options are feasible to consider. The Council may want to consider either a formal valuation or a proxy valuation through the work that LDP are currently undertaking.

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