GVA

Brighton i360 Loan Restructuring Options

November 2018

1. Introduction

1.1 GVA Real Estate Finance (“GVA”) has been appointed by Brighton and Hove Council (the “Council”) to undertake a review of the senior loan arrangement between the Council and the Brighton i360 consortium, with a particular focus on the sustainability of the debt repayments due to the Council under the current loan structure. The Council is the senior lender to the i360 consortium having provided development finance to for the construction of the attraction. Since opening the attractions performance has not been in line with forecasts and as such the Council in performing its role as a commercial lender has instructed GVA to review potential restructure options.

1.2 This report follows on from our initial report in September 2018 which set out the potential options available to the Council in its capacity as senior lender to safeguard its investment and maximise its repayments under the loan agreement. The purpose of this report is to provide the Council with a shortlist of options that will need to be explored in further detail, to allow a definitive decision on the optimum course of action to be taken.

2. Background

2.1 The Council provided a senior development loan to the i360 consortium to undertake construction of the attraction between 2014 and 2016. At practical completion the loan outstanding was £36.2m, which was supplemented by a junior loan provided by the Coast to Capital Local Enterprise Partnership (the "LEP") totalling £4.06m. The LEP loan is due for repayment part way through the term of the Council's loan. The overall funding package included equity from shareholders and cost overrun loan agreements.

2.2 The Council element of the loan was provided through borrowing obtained from the Public Works Loan Board ("PWLB") and then on lent to the i360 consortium on a commercial basis. The source of the funding therefore places a liability on the Council to service the PWLB debt repayments. While the Council has the ability to manage its cash balance through wider treasury management, the repayments from the i360 consortium are ring fenced to make the PWLB loan repayments which increases the Council reliance on the returns generated from the loan arrangement.

2.3 As set out in our September 2018 report, the i360 operating performance has not been in line with original forecasts. This has resulted in cash shortfalls which have in turn led to the i360 consortium requesting that the Council defer the loan repayment due in June 2018. The Council agreed to this deferral and engaged GVA to analyse the anticipated future position of the loan.

2.4 GVA have received forecast cash-flows from the i360 consortium and have discussed these with the Directors. GVA have also discussed the LEP loan position with C2C's officers. The Council has appointed Leisure Development Partners ("LDP") to review the operational business plan of the attraction in order to forecast its potential future performance. This work will allow GVA to consider the course of action in respect of restructuring the loan.

3. Options considered to date

3.1 In our September 2018 report, we set out a number of different options available to the Council as senior lender to safeguard its investment and maximise its repayments under the loan agreement. The list of options which were considered are set out in the table below.

Table 1: Long list of options available

Do Nothing	The existing Council and LEP lending structure is retained.
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.
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 has been repaid.
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 would be for the Council as a result of continuing to support the asset rather than taking enforcement action).
Debt for equity swap	The Council agree to part of the loan being swapped for shareholding in the asset owning companies.
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.
Council sell their loan	The Council could market their loan for sale to a third party investor.
Buy out Junior Loan	The Council agree to purchase the LEP loan.
Council to restructure PWLB loans	The Council could restructure the existing PWLB loans, including taking out new longer term loans.
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 control

	expenditure and increase revenues.
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.

3.2 Since the options report, GVA has been working with the Council to shortlist the options based on the feasibility of the option and the commercial parameters that the Council needs to work within. GVA's analysis has additionally been informed by the discussions held with the i360 consortium, the LEP and the initial work undertaken by LDP.

LDP Business Plan Forecast

3.3 LDP has advised the Council on what a feasible business improvement plan could look like should a number of operational changes be made. As part of this, LDP has produced a profit and loss forecast which covers the period from 2018/19 through to 2025/26.

3.4 The business plan forecast indicates that the financial performance of the attraction could be improved through a c75% increase in visitor numbers over the next eight years where a more comprehensive marketing strategy is implemented. While this is a significant uplift in forecast visitor numbers from what is currently seen, it is a partly a reflection of the current under performance of the attraction against LDP's expected market penetration averages.

3.5 GVA has overlaid the forecast profit and loss of the attraction with the Council and LEP debt obligations. This analysis indicates that it is unlikely that the business will reach a level of operational profitability that will allow it to meet the Council loan obligations as currently set out, thereby necessitating a restructuring of these loan obligations.

3.6 As set out above the Council have their own debt obligations in respect of their PWLB borrowing. Any restructure of debt payments would need to ensure that the Council, as a minimum, receive sufficient loan payments from the i360 consortium to meet their own PWLB obligations without the need to subsidise these repayments from other Council activities.

3.7 In considering the LDP business plan forecast it is likely that the i360 will not be able to make sufficient payments to achieve this until 2022/23. GVA's analysis estimates that the shortfall against cumulative PWLB obligations is likely to be in the region of £3m. Indeed GVA understand that there is a likely shortfall against the payment due at the end of December 2018. From 2023/24 the operational cashflows are forecast at a level where the i360 debt repayments would at least be sufficient to meet the PWLB loan obligations.

3.8 Furthermore, it should be noted that while GVA are not providing advice in relation to the LEP loan, the term of the LEP loan expires in 2021. As such a significant repayment liability will need to be met by the i360 consortium at that point. It is currently unclear how the i360 cash-flows will meet that debt repayment though as set out above the LEP loan in junior to that of the Council.

Options Discounted

3.9 The LDP forecast business plan and the financial analysis undertaken by GVA helps to significantly refine the options available to the Council. As a result the following options have been discounted at this stage.

Table 2: Options discounted

Do Nothing	The Council acting as commercial lender is obligated to act in a manner that a market participant would and doing nothing would not protect the investment that has been made.
Equity promoters (i360 consortium) invest additional equity into i360	From our discussions with the i360 consortium, it has been made clear that the ability of the existing shareholders to provide additional funding is extremely limited. The Council is however recommended to ensure that this suggestion has been fully evidenced.
Debt for equity swap	At this stage it is considered that there is insufficient value in the business to be able to convert the debt into equity. GVA's analysis also shows that any future equity value would likely be insufficient to compensate the Council for undertaking this restructure to support the i360 consortium. Furthermore a debt for equity swap would result in an immediate write down in the loan amount on the Councils balance sheet.
Equity promoters (i360 Consortium) arrange refinance of Council loan	It is unlikely that any commercial lender would refinance the Council loan due to the insufficiency of the forecast business plan to support loan repayments and the lack of commercial appetite to lend to this sector.
Council sell their loan	As above, there would be limited interest to purchase the Council loan. Any sale achieved would likely be on a heavily discounted basis, which would require the Council to write off a significant part of the loan.
Buy out Junior Loan	While this option would enable the overall debt package to be consolidated and restructured on the basis of a lower repayment schedule, the Council would be required to invest additional money as well as increase its exposure to an underperforming operation
Council to restructure PWLB loans	This is unlikely to be financially attractive to the Council given the early repayment fees associated with the PWLB agreement. Furthermore it would extend the life of the PWLB loan resulting in an extended risk exposure for the Council.

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4. Shortlisted options for detailed consideration

4.1 This leaves the Council with four options for more detailed consideration:

Table 3: Shortlist of options available

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 has been repaid.
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 would be for the Council as a result of continuing to support the asset rather than taking enforcement action).
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 control expenditure and increase revenues.
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.

4.2 The LDP business plan forecast and GVA analysis shows that the Council loan is unlikely to be fully repaid in its current structure. The Council under these circumstances, in order to comply with state aid regulations, should act as a commercial lender would do.

4.3 In this situation a commercial lender would consider the following principle objectives:

4.3..1 Maximise the repayments received under the loan agreement in order to minimise any loan write-off.

4.3..2 Receive these repayments as quickly as possible.

4.3..3 Receive payments which reflect the risk profile of continuing to lend to a business experiencing difficulties and compensation for continuing to support it.

4.3..4 Introduce controls that ensure all cash is available to service debt obligations and that the lender receives full information about the performance of the business.

4.4 In order for the Council to fully appraise how it achieves these principle objectives, it is recommended that further detailed consideration is given to the four options identified above. This analysis should focus on the financial and operational implications of each of these options. GVA have focussed on loan restructuring options and now recommend that the implications of enforcement are considered by the Council.

5. Further recommendations

5.1 The Council acting as a commercial lender, in this situation, should seek to maximise recoveries from their loan arrangements in the quickest timeframe possible. In order to understand the optimal route to achieve this the Council would be reasonably expected to explore in detail the remaining options in that context before settling on a preferred option to take forward. In order to carry out the appropriate work to analyse the shortlisted options further GVA understand that the Council will be requested to agree to a further deferment of debt repayments from the i360 consortium.

5.2 GVA also understand that there have been discussions considering allowing the i360 consortium to retain cash to reinvest in the business to help implement certain strategies that could improve the business. GVA would recommend that until an agreed way forward is agreed by the Council, that the Council ensure all available cash-flow after operating expenses is available to the service the Council loan. This may require the Council to consider which operating expenses are business critical and those that are not. GVA would not therefore recommend that the payment due is fully deferred nor cash made available for business improvement strategies until the implications of this expenditure are fully known.

5.3 GVA would recommend that the Council seek legal advice to protect their rights and understand enforcement implications. This may include issuing a reservation of rights letter and charging default interest on the deferred payments. It is apparent that for a business experiencing distress, third party creditor action could quickly result in serious solvency implications which it is recommended the Council now fully understand and are in a position to react to.

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