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| Subject: | Brighton i360 Loan Restructure |
| Date of Meeting: | 5th December 2019 |
| Report of: | Executive Director, Economy, Environment & Culture |
| Contact Officer: Name: | Max Woodford |
| Email: | max.woodford@brighton-hove.gov.uk |
| Ward(s) affected: | All Wards |

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

- 1.1 This report sets out the positive economic impact that the BAi360 has had on the Brighton & Hove visitor economy, but acknowledges that the attraction has not had the expected level of visitor numbers meaning it has had to defer paying its debt obligations to the council in full. The report sets out that performance is being actively addressed by the management and proposes a restructure of the debt.
- 1.2 The report also proposes that a loan from Coast to Capital Local Enterprise Partnership [‘the LEP’] is ‘novated’ to the city council (at no cost to the council) and is included in the loan restructure. ‘Novation’ in this case means that the debt is passed from one body to another – i.e. the debt must be repaid to the city council and not the LEP. The report also acknowledges that a previous repayment received by the council was paid in error as it should have gone to the LEP, and so recommends that sum is repaid to the LEP and the amount recovered as an outstanding debt that the i360 owes the city council.

2. RECOMMENDATIONS:

- 2.1 That the committee notes the economic and social impact benefits the BAi360 has had on the city’s visitor economy as set out at 3.1 and in the report at Appendix 1.
- 2.2 That the committee agrees to Coast to Capital Local Enterprise Partnership novating their Growing Places Fund loan of £4.06m and grants delegated authority to the Executive Director Economy, Environment & Culture to agree the terms of the novation agreement, enter into that agreement and take any other steps necessary to effect the novation.
- 2.3 That the committee acknowledges that £312,000 of loan repayment from BAi360 was paid in error to the city council and agrees to repay that money to Coast to Capital Local Enterprise Partnership whilst noting that it is a debt owed to the Council by the i360.

- 2.4 That the committee agrees to the loan restructure principles as set out at 3.16 and delegates authority to the Executive Director Economy, Environment & Culture and the Executive Director Finance & Resources; in consultation with the Members' Working Group as set out at 2.6, to negotiate a revised loan agreement to cover both the principal loan and the novated LEP loan based on those restructure terms and enter into any legal agreements necessary to effect that restructure.
- 2.5 That the committee notes that the restructure cannot take place until early in the new year and agrees to defer up to £ £880,304.25 of the total payment due on 31 December 2019 under the loan agreement; and agrees not to take default action at this stage in relation to the failure to hit the financial ratios set out in the loan agreement.
- 2.6 That the committee agrees to establish a new permanent Members' Working Group, in accordance with the terms of reference at appendix 2, to oversee the city council's relationship with the BAI360. This will include agreeing future business plans and receiving regular updates on performance.
- 2.7 That the committee agree to officers procuring ongoing advice on the visitor attraction market to help inform the process of agreeing the annual business plan.

3. CONTEXT/ BACKGROUND INFORMATION

- 3.1 The i360 opened to the public on 4 August 2016 and has since carried well over one million visitors. Appendix 1 is a copy of a report recently commissioned by the i360, which sets out the strong economic and social impact the Brighton i360 has had, already contributing £89.6 million to the Brighton & Hove economy. By the time the £36.2 million loan from the city council and the £4.0 million LEP loan, that were invested to fund its construction, are repaid in 2041, the i360 will have contributed £640 million to the city's economy. This represents a return of £15.90 for every £1.00 of public sector investment. It has also generated direct additional income for the council which has been or will be reinvested in the seafront; in particular in the landscaping of the council owned land around the i360, contributions towards the refurbishment of the Madeira Terraces and festoon lighting along the seafront.
- 3.2 However, recent reports to this committee have noted that visitor numbers have been lower than anticipated; and in particular they were lower than forecast through 2018, in keeping with a number of indoor attractions in the city, such as the Royal Pavilion, which suffered falls in visitor numbers despite it being a very hot summer. This meant that the i360 has not been able to make in full the last three six-monthly payments to the city council of both the loan repayment and the margin.
- 3.3 Previous PR&G committees have agreed to defer a total of £2.792m, with the deferred sum being rolled into the principle loan amount. No debt has been written off – it has been capitalised instead.

- 3.4 On these previous occasions when the Council agreed to defer payments, it also agreed not to take default action in relation to the failure to achieve the financial ratios set out in the loan agreement.
- 3.5 The Council has instigated work to consider restructuring the loan in the long term to protect the council's position and maximise the returns on the loan payment. Avison Young (formally GVA) were appointed to work on financial modelling with a view to arriving at a preferred recommendation for restructuring the loan. They produced an initial report which was noted by Committee in December 2018. However, without a better understanding of the BAi360's plans to turn around its performance – and the visitor numbers that might support – Avison Young were not able to recommend a restructure option to the December 2018 PR&G meeting. Likewise, they were not able to advise whether the city council should step in to take control of the i360. They did advise that stepping in is not necessarily the option that would result in the city council getting the largest amount of its money back as it could immediately result in a write down of the value of the asset.
- 3.6 For this reason, PR&G Committee decided in December 2018 that the city council should defer any loan restructure until after the summer season of 2019 to take a view on the steps the i360 Board were taking to improve visitor numbers. The committee decided that officers should return with this report to agree the shape of a loan restructure following the summer.
- 3.7 The December 2018 PR&G report also set out that the city council had appointed visitor attraction specialists LDP to look into the existing and potential commercial performance of the attraction and to advise on whether the i360 is taking all available steps to maximise income and enable it to meet its obligations to the council under the loan agreement. LDP found that the attraction was underperforming in key market sectors, and that this could be attributable to a lack of marketing spend. If the i360 were to be performing at the expected level for an attraction of this type, and therefore having the expected degree of market penetration, then it should be achieving visitor figures of 433,204 by 2020/21 and 486,419 by 2021/22. This level of visitor number would enable the i360 to pay all of the PWLB element of its loan from 2021/22.
- 3.8 For this reason it was it was also recommended that the i360 be set a number of key performance indicators to show that the board has considered both the advice of LDP and is enacting its own plan for a turnaround in visitor number. These KPIs included:
- Marketing spend should be on target to reach 8% - 10% of revenue over the year.
 - A clear marketing strategy for the effective spend of that budget should be in place and be delivered.
 - Visitor numbers should remain on target to hit 364,860 by the end of the 2019/20 financial year.
 - The i360 Board should show an ongoing commitment to ensuring it has the relevant skills and experience sitting around the table.
- 3.9 As set out in the previous PR&G report, the i360 Board has addressed the suggestions in the LDP report. The improved management team and focus on performance has resulted in many metrics showing improvements. During the

Spring and early Summer season there were significantly improved visitor numbers, with over 14% more visitors in the period April to July. However, this year from the start of August through to November has seen very poor weather, which has negatively impacted on the visitor number growth. It has to be acknowledged that the BAI360 is an attraction that is weather dependent, whoever manages it. Despite this, it has been consistently evidenced throughout the last few months of poor weather that when the attraction is compared to days where there was similar weather to last year it is performing very well, which suggested that awareness amongst visitors has grown substantially over the past 9 months. Examples during September where the performance vs last year was very strong on specific days include:

10th Sept +54%

13th Sept +21%

15th Sept +24%

17th Sept +68%

19th Sept +54%

21st Sept +83%

- 3.10 In addition other figures showed strong performance despite the weather. A joint ticketing arrangement with the Pavilion and the Sea Life Centre has also been promoted. The [Brighton Explorer](#) offers 35% off these key all-weather city attractions. In September their yield (average ticket price) was £12.50, versus a budget of £12. This demonstrated that despite the poor weather they are managing the pricing strategy well and not reverting to deep discounting that could damage the business in the long term. This helps maintain a better gross profit and has ensured an admissions income from January to September that is up by 6.5% despite the challenging weather in the peak summer holiday period. They are also controlling their operating costs well, which came in on budget for September and are showing a saving year to date of £22,000 vs budget and £83,000 vs last year. They are managing to do this while remaining a Brighton Living Wage employer. Their operating profit before depreciation and financing costs in the year to date at the end of September (so a period of 3 months) is showing at £769,687, which is £153,277 up on last year.
- 3.11 Part of the work Avison Young has done has been to look at whether it would be in the council's financial interest to exercise its step-in rights under the present loan agreement and take control of the attraction. Their report sets out several reasons why such action would not be advisable, and the advice is that the council should seek to avoid enforcement options. The asset benefits from sponsorship and maintenance arrangements that could be terminated as a result of an insolvency or step-in by the city council, and there would be a loss of value to the asset that is likely to be worse than restructuring the loan. Furthermore, as the directors of the i360 are operating the asset in way that substantially meets the requirements of the city council and are being co-operative, there is currently no clear rationale to pursue an enforcement strategy. The advice from Avison Young is the same as they would give to a commercial lender in similar circumstances, which gives the city council a degree of reassurance that it is in compliance with State Aid laws.
- 3.12 At the time the i360 was built, the main funder was (and remains) the city council. However, the LEP also loaned the attraction £4.06m from its Growing Places Fund as it recognised the economic and regeneration value to the city region's

economy. The LEP loan is mezzanine funding: i.e. it is a second- ranking lender with subordinated rights and protections than the city council, but that higher risk is reflected with a higher level of interest payable on the LEP loan. The LEP loan is due to be repaid in 2021. The attraction does not have sufficient cashflow to repay on that date. However, for the LEP the loan has fulfilled its main economic and regeneration purpose by delivering the new attraction to the city region, and the LEP do not need to continue to retain an interest in the asset. They have therefore proposed that the LEP loan that is repayable to them is granted (via novation) to the city council. 'Novation' means that a contract (in this case the loan agreement) is passed from one body to another, but the terms of the contract remain the same. The city council would then be able to restructure this loan on such terms as it wishes (subject only to minimal restrictions imposed by the LEP). This transfer of the loan would be at no cost to the city council – i.e. the city council can collect the loan without needing to repay the money to the LEP.

3.13 Avison Young have advised on the costs and benefits of the city council receiving the novated LEP loan. Their advice is that the proposed transaction will consolidate the interest of a third-party stakeholder under the control and ownership of the city council and the transaction would entitle the city council to additional upside above its current level of debt. It would also remove the impending cashflow issue of the LEP loan becoming repayable in the near future. For these reasons they state that the city council would be advised to conclude this transaction with the LEP

3.14 Unconnected to the transfer of the main LEP loan, the LEP has raised an issue that they should have been paid an amount of £312,000 towards the LEP loan. The city council has taken legal advice on this, and the view is that the LEP were due to receive that payment, and while the city council acted in good faith in taking the payment, it could be regarded legally as being a unilateral amendment to the inter-creditor agreement as we have received funds from BA i360 which were due to the LEP under the terms of that agreement. The LEP require this money as it is budgeted within the financial year. For this reason it is proposed that the city council pays the money it received in error to the LEP. That money is still due from the i360, but now becomes payable to the city council rather than the LEP, so it is proposed that the sum is added back into the overall principal loan amount payable from the i360 to the city council.

Loan Restructure

3.15 The report from Avison Young into the suggested form of the loan restructure looks at options, focused on attracting appropriate return for the additional risk involved in continuing to support the business. It considers how a commercial lender would approach the issue, as that is necessary to avoid the restructure being at risk of being determined to be State Aid . The main principles of a commercial lender would be to:

- Maximise repayment/minimise loan write off
- Receive payments as quickly as possible
- Reflect additional risk, potentially through an upside agreement
- Introduce controls to ensure cash is available to service debt obligations and management are delivering the agreed business planis that the proposed that the restructure takes the following form:

3.16 The report's proposal is therefore in the following form:

- That the council and i360 agree a business plan as part of the loan restructure with this being reviewed as a minimum every year. The business plan will include a target Net Operating Income (NOI). The NOI will be after reasonable expenses to allow the i360 to continue to operate and deliver the business plan.
 - There is a full 'cash sweep' of NOI going to the city council. i.e. the i360 retains enough cash to continue to operate as a solvent entity and meet obligations around marketing etc, but that any money left over each year automatically goes to the city council to service the debt. As the attraction performs better in future years, this would mean the council gets paid off more quickly than the original loan envisaged.
 - Some form of arrangement would need to be in place for the city council to have more control over the account where all of the i360 income and expenses are managed. This control would allow the council to ensure that only agreed expenses are being released from the account with full NOI being available to pay down the loan. The council would also have full visibility and access to the i360's day to day accounts.
 - To provide a commercial incentive to the directors (who are also shareholders of BAI360) to perform, any Net Operating Income over and above the business plan is shared 60%/40% (Council/Shareholders). This share of excess NOI will give the council a return above the current loan payments, for continuing to support the operation. If there is no commercial incentive for the directors to make any profit at all then it would be less likely they would perform effectively, meaning the council would be less likely to see the debt repaid.
 - Failure to hit certain thresholds in the business plan would carry implications. For example, if they are more than 20% short of the business plan NOI, then that would mean they are once more in default.
 - There would be an arrangement fee to cover the council's costs in this process, as well as fees for prepayment of the loan above the restructured loan payments profile.
- 3.17 Due to the slow nature of the turnaround process, the poor weather since August and the additional money that the board is investing into marketing, the cash flow situation at the BAI360 means that there will need to be a deferral of an element of the December 2019 payment, which is payable before the terms of the final restructure can be agreed. The exact figure deferred cannot be set until the end of December as this is an important month with Christmas income yet to have come in. The i360 expect to be able to match last December's payment of at least £612,000 on the 31 December. Officers therefore propose setting this as a minimum payment, with more to be paid if available. This would therefore require a maximum deferral of up to £880,304.25.
- 3.18 The proposed restructure requires an ongoing strong working relationship with the i360. In particular, the city council will need to agree the business plan every year and then monitor performance against that business plan. There will be a need for officers to continue to involve members in this process. It is therefore

suggested that a new permanent Member's Working Group is set up to give members a chance to have oversight of this process. The proposed Terms of Reference of the working group are at Appendix 1, but in summary the group would:

- Be consulted on the final detail of the loan restructure agreement.
- Be consulted on the business plan every year.
- Receive reports on the performance of the attraction every six months.
- Offer a 'critical friend' role to the management of the attraction about performance.

It is also likely that the city council will need to procure experts in the visitor attraction industry to offer some light touch advice every year on the existing market and to help to agree the business plan.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

- 4.1 The city council has also commissioned Avison Young to advise on the options around undertaking any step-in and taking control of the asset, as we would be able to do under the terms of the funding agreement. This report states that step-in would not be advisable for the reasons set out above at 3.11.
- 4.2 The proposed loan restructure follows a detailed options appraisal process, also carried out by Avison Young.

5. COMMUNITY ENGAGEMENT & CONSULTATION

- 5.1 The i360 has received a wide range of supportive statements from local businesses, charities and other organisations. Businesses have focussed on the beneficial impact on tourism to the city and the improvements made to a previously run-down part of the seafront.
- 5.2 The council is due to receive 1% of ticket sales in perpetuity to spend on local initiatives with about 25% of this sum allocated to fund part of the landscaping works and discussions continue with local organisations about how to spend the remainder.

6. CONCLUSION

- 6.1 The BAi360 has been a catalyst for regeneration, both on the seafront and in the wider city and will be into the future, no matter what happens with the way the attraction has been financed. It has had a strong positive impact on the city's visitor economy while also delivering new funding streams that the city council would not otherwise benefit from. It is an iconic structure that has quickly become a key part of Brighton & Hove's global brand and imagery. In the report at Appendix 1, the Executive Chairman of Tourism South East, Mark Smith comments that "*Brighton i360 has helped raise the profile and awareness of Brighton and the South East region on the worldwide tourism stage. It has attracted over one million visitors in less than three years and has repositioned Brighton & Hove as a resort with modern attractions to complement the rich traditional heritage of this dynamic city.*"
- 6.2 Strong steps have been taken towards turning around the financial performance of the attraction, which have seen improvements this year, despite very poor

weather in much of the peak season. However, a full turnaround will take some time to get in place, and the existing loan needs to be restructured both to give time for this to happen, but also to give the city council opportunity to be paid back at the earliest possible opportunity and to potentially benefit from any upside in improved performance.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

- 7.1 The original loan to the BAi360 included the principle, rolled up interest during construction, and arrangement fees totalling £36.222 million. The loan was planned to be repaid on an annuity basis to the 30 June 2041 including a market rate of interest, resulting in 6 monthly payments of £1.492 million which includes both capital repayment and interest.
- 7.2 The city council has agreed to defer £2.792m of the payments due since June 2018 whilst options for the future relationship and recovery of outstanding debt are explored. The total outstanding debt as at 30 June 2019 as a result of these deferrals is £37.366 million. However, of the payments received by the city council since June 2018, £0.312 million is due to be paid to the LEP and therefore the outstanding debt will become £37.678 million once this amount is paid.

| | Opening Principle Debt | Interest due | Payment | Closing Principle | Deferred (cumulative) |
|------------|-------------------------------|---------------------|----------------|--------------------------|------------------------------|
| | £'000 | £'000 | £'000 | £'000 | £'000 |
| 30/06/2017 | 36,222 | 1,184 | -1,492 | 35,913 | - |
| 29/12/2017 | 35,913 | 1,173 | -1,492 | 35,594 | - |
| 29/06/2018 | 35,594 | 1,163 | -922 | 35,835 | 570 |
| 31/12/2018 | 35,835 | 1,152 | -612 | 36,375 | 1,450 |
| 28/06/2019 | 36,375 | 1,141 | -150 | 37,366 | 2,792 |
| | | | | | |
| LEP Adj | 37,366 | - | 312 | 37,678 | 3,104 |

- 7.3 A restructure of the debt with the BAi360 is expected to provide the best financial outcome for the city council. The restructure principles are set out in paragraph 3.16 and assume no debt is written off. The restructure will be based on an agreed business plan for the attraction demonstrating that future net revenues will be sufficient to repay the city council. This approach is expected to mean that there will be lower payments initially resulting in the outstanding debt increasing, but with greater payments in the future, the debt reduces more rapidly. This proposal is not without risk as it relies on continuous financial improvements over the next 2 years driven by improvements to patronage and controlling costs. Evidence to date suggests that financial improvements are already taking effect

but substantial improvements are still required. The proposed scrutiny by external consultants and the members working group will be critical in ensuring the restructure is viable.

- 7.4 In addition to the council's loan, the LEP have an outstanding loan to the BAi360 of £4.060million. The LEP are proposing to novate this loan to the city council at no cost. This proposal will facilitate the restructuring of the loan agreement with the BAi360 by simplifying the process to a bilateral arrangement; it will increase the notional outstanding debt the attraction has with the city council but this increase does not expose the city council to further financial risk. This restructure is in line with the expected actions of a commercial lender as advised by Avison Young and set out in paragraph 3.15.
- 7.5 The loan restructure is planned to be completed in the new year and therefore the council needs to agree to defer up to £880,304.25 of the December 2019 payment under the current loan arrangements to avoid a default.
- 7.6 The outstanding debt is funded from a combination of external PWLB loans and rolled up marginal interest. The PWLB debt repayments are £0.922 million every 6 months and the marginal interest forms part of the BAi360 reserve. This reserve increases as each payment becomes due however, given the financial position of the BAi360 and the amount of debt deferred, no new commitments can be made against this reserve until the debt restructure to recover all outstanding debt is agreed and there is evidence this is being delivered. The initial lower repayments have a negative impact on the city council's cashflow, but on the basis these payments will increase in the future, and the city council is not making commitments against the reserve, this impact is not material.

In addition to the loan, the ongoing viability of the BAi360 has a number of other financial implications for the city council. The city council receives a 49% share of the business rates from the attraction and potentially benefits from increased parking revenue from Regency Square car park.

Finance Officer Consulted: James Hengeveld

Date: 15/11/19

Legal Implications:

- 7.7 The options for enforcing the council's security were set out in the report which went to PR&G in June 2018.
- 7.8 Loan arrangements such as this comply with state aid law if they meet the market economy operator principle (MEOP) – sometimes also referred to as the market economy investor principle (MEIP). The council is required to act in a similar manner to a commercial investor in the same circumstances. The report from Avison Young confirms that their recommendation can meet the MEOP test. However, the Council will need to be able to show that the percentage of the net operating profit which is kept by the shareholders is the result of robust commercial negotiations.
- 7.9 It is lawful to defer the December 2019 payment in these circumstances as a commercial lender would be expected to take the same steps whilst putting in place a restructure.
- 7.10 In order to protect its position, the council will send a reservation of rights letter to i360 as it has in relation to previous deferrals. The Council continues to take

external legal advice in relation to the loan arrangements to ensure it complies with state aid law and to support the council to achieve the best commercial outcomes.

- 7.11 Although the LEP's primary claim is against the BAi360, our external legal advice is that the LEP have a strong argument that in accepting the (incorrect) payment the city council has agreed to an amendment of the payment order of priorities set out in the financing documents, which would be a breach of the city council's obligations and that in failing to ensure that the order of priorities is observed by BAi360 (or, more particularly, by acquiescing with the amendment to the order of priorities), the city council is in breach of the intercreditor arrangements between the city council and the LEP. The LEP therefore would have a strong case against the city council which, if it pursued its claim successfully, would enable it to recover its losses from the city council.
- 7.12 Permanent member groups (as opposed to 'task and finish' groups, set up on a time-limited basis) may only be established by the Policy and Resources Committee. The terms of reference of all permanent groups shall be approved by Policy & Resources and included in the Constitution.

Lawyer Consulted: Alice Rowland

Date: 07/11/2019

Equalities Implications:

- 7.13 The i360 is accessible throughout to people with disabilities and has improved access to the seafront lower promenade by the building of a new lift to the east. Unisex toilets are open to members of the public who are not using the centre or visiting the attraction. The i360 has introduced a range of concessions for local residents and free tickets for local schools. The i360 is a living wage employer and does not offer zero hour contracts. There is an apprenticeship scheme in place and training opportunities for staff at all levels of the organisation.

Sustainability Implications:

- 7.14 The report at Appendix 1 sets out some of the environmental strengths of the i360. It is a low energy user, with energy recovery when the pod is descending. The installation of heat pumps provides air heating and cooling in the pod and main building and provides an estimated 30% of the total thermal heating energy use. All electricity is purchased from renewable energy sources. Grey water and rainwater recycling has been included. Purchasing policies are based on sourcing environmentally friendly local products particularly the Sky Bar, café and restaurant.

Any Other Significant Implications:

- 7.15 All significant implications are dealt with in the body of the report.

SUPPORTING DOCUMENTATION

Appendices:

1. Brighton i360 Economic and Social Impact Report
2. Terms of Reference for Members' Working Group

