POLICY, RESOURCES & GROWTH COMMITTEE	Agenda Item 97 Brighton & Hove City Council

Subject:		**i360 Loan Restructure**
Date of Meeting:		**6th December 2018**
Report of:		**Executive Director, Economy, Environment & Culture**
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Ward(s) affected:		**All Wards**

FOR GENERAL RELEASE

1. PURPOSE OF REPORT AND POLICY CONTEXT

1.1 This report sets out the professional advice the council has received regarding the restructure of the council's loan to the i360, and seeks agreement to a preferred way ahead.

1.2 The report also seeks agreement to take the actions necessary to enact those next steps. In addition it advises that the council continues working with the i360 Board to ensure the success of the attraction, with our advice showing that the i360 has the potential to deliver much higher visitor numbers. This is with a view to building on the successful impact the i360 has had on the city's profile and economy; as well as the positive impact it has had on the seafront.

2. RECOMMENDATIONS:

2.1 That the Committee notes the advice of GVA contained in Appendix 1 and agrees to defer the consideration of a formal restructure of the loan to the i360 until its meeting in October 2019.

2.2 That, during the period of the deferral of the restructure, the Committee agrees to the city council also deferring interest and repayment instalments necessary to ensure the sustainable operation of the i360, whilst ensuring that all available cash-flow after operating expenses is available to the service the Council's loan.

2.3 That the Committee agrees, subject to the performance tests referred to in recommendation 2.5, not to take default action at this stage in relation to the failure to hit the financial ratios set out in the loan agreement.

2.4 That the Committee agrees to defer £880,304.25 of the total payment due on 31 December 2018 (£1,492,304.25).

2.5 That the Committee delegates authority to the Executive Director, Economy, Environment and Culture and the Executive Director Finance and Resources in consultation with Group Leaders to determine the amount of the deferral in June 2019 and take all of the steps necessary to enact that deferral.

2.6 That the Committee agrees to officers monitoring key performance indicators, and that if these fall below the levels set out at section 3.17 then officers may, in consultation with the leaders of the party groups, opt to bring a report to an urgency PR&G Sub Committee, to consider further action including (but not limited to) any of the options set-out by GVA in their work to date.

3. CONTEXT/ BACKGROUND INFORMATION

3.1 A report sent to the 28th June 2018 Special PR&G meeting set out that the i360 opened to the public on 4 August 2016 and has since carried over 750,000 visitors. It has also generated approximately £2.4m net direct additional income for the council so far 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, that report also described that visitor numbers have been lower than anticipated and stood at the lower end of the long term financial viability modelled in the original business case. This meant that the i360 was not able to make the full anticipated 30 June 2018 payment to the city council of both the loan repayment and the margin. Since the June PR&G meeting visitor numbers in the second half of 2018 have continued to disappoint, being less than the revised visitor number forecasts that were made by the i360 at the time of that report. This is in keeping with a number of indoor attractions in the city, such as the Royal Pavilion, which actually suffered falls in visitor numbers despite it being a very hot summer.

3.3 PR&G committee agreed to defer £570k of the £1,492k due on 30 June 2018 until 31 December 2018. The basis for this is that the i360 paid the council £922k to enable the council to pay the PWLB the same amount in June. In doing so, the council also agreed not to take default action at that stage in relation to the failure to achieve the financial ratios set out in the loan agreement.

3.4 PR&G Committee were informed in June that a report proposing a long term restructure would come to this committee meeting in December 2018. An interim report to the 11th October PR&G Meeting set out that GVA had been appointed to advise on the loan restructure and included a report from GVA that listed a number of options open to the city council to restructure the loan. The work they had been asked to do included:

- Work Stream 1 – Analysing the current lending structure, understanding the stakeholder objectives and analysing the i360 Business Plan
- Work Stream 2 – Identifying a recommended loan restructure model
- Work Stream 3 – Implementation of the preferred restructuring option

3.5 In line with the state aid *Market Economy Operator Principle (MEOP)*, GVA have been asked to advise the city council in the same way that they would a private sector funder. This is to ensure that the city council is operating in the same way that a private funder would so that the council is compliant with state aid rules.

3.6 The October PR&G report also advised that Leisure Development Partners had been appointed to advise on the existing and potential commercial performance of the attraction; 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. This advice was intended to inform the preferred restructure option.

3.7 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.

3.8 The final LDP report at Appendix 2 has made the following comments relating to the current performance of the i360:

- Primary market penetration (i.e. visitors from the local area) for the first year was very strong at 8.6%, but this has dropped away as would be expected due to the 'champagne effect.' Market penetration for the larger secondary market (visitors up to 2 hours drive away) has been less strong as this is a very large catchment with a lot of competition, including London. As such market penetration overall hasn't been poor, but if it were to improve a little in the secondary market then it could drive a lot of growth in visitor numbers.
- They state they would expect marketing spend to be between eight and ten percent of revenues, whereas it was a six and four percent during the first two years of operation. This is identified as a major area for focus to drive higher visitor numbers – particularly in the underperforming secondary market.
- The report identifies that steps have been taken to manage costs, and there is scope to take this a little further, but the implication is that the focus should be on driving revenues up rather than costs down.
- The entrance price is broadly right, and the i360 has a relatively high yield (i.e. the spend per capita as a % of the lead price). A high yield can be seen as a sign of success but could also indicate an opportunity to bring further visitation with attractive discounts at periods of low demand.

3.9 These factors, at least in part, explain the failure of the i360 to achieve the budgeted-for visitor numbers. However, the report does consider that 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.

3.10 LDP's report advises on a number of steps the i360 should take to improve visitor numbers, and forecasts a potential growth in visitor numbers up to a more sustainable level in 2021. These steps include:

- The most important recommendation is that the marketing spend is increased considerably to enable greater reach into the secondary market. In general they would expect marketing spend to range from 7 to 14 percent of revenues. For a newly established attraction of scale they would expect to see around 10 percent of revenues being spent on marketing. Cost cutting measures have in fact reduced it to less than four percent, far too low for an attraction trying to establish itself. The decline in marketing spend has probably contributed to the decline in visitor numbers and without a significant increase in marketing spend, alongside sound strategy, that a turnaround will not be achieved.

- Whilst in general they believe the admission price to be about right, LDP recommend testing price sensitivity and customer feedback on the experience with some primary research.
- As mentioned above, yield is relatively high, which can be a positive indicator. However, given the relatively high lead price and price sensitive nature of some visitors LDP feel that careful yield management will be necessary as the attraction matures. It is likely that some yield will need to be sacrificed in future to make significant attendance gains.

3.11 The advice from LDP therefore paints a positive picture about the potential visitor numbers the attraction can drive. If the predictions are accurate, and the i360 implemented the recommendations above and were able to achieve the visitor numbers expected of an attraction of this type, then the restructure options would be clearer. This is because there would be an income stream that was capable of paying off at least the PWLB element of the loan, ensuring the city council is better placed to recover it original investment and as much of the total loan value as possible.

3.12 The i360 Board have also been considering their own options for driving a turnaround of performance, independent of the work being done by LDP. The board have taken steps to appoint David Sharpe as an interim Executive Director. David Sharpe is a former Managing Director of the London Eye and has decades of experience leading business and operations at major London attractions. His appointment brings significant knowledge and experience to the attraction. Once he has appointed a new general manager David Sharpe will step up to bring his experience and knowledge to strengthen the Board of the i360.

3.13 The steps the i360 Board are proposing include:

- They have also identified an underspend on marketing as being a problem. They are working on a revised and refocused sales and marketing plan with an increased marketing budget to improve the visitor volume to the attraction. A consultant has been appointed to assist with this.
- They will work with the other tourism partners including major attractions in the city, Visit Brighton, Tourism South East UK Inbound and the Tourism Alliance to promote the i360 and Brighton. They will develop improved value offers that would include more than one attraction at an attractive discount.
- They will be improving website sales and particularly their pre-booking performance to drive more online sales, gaining commitment from the visitor and combating some of the issues around bad weather days.
- They have already done work around staffing costs, including looking at structure and recently introducing annualised hours for the operational team, allowing flex of their payroll costs around the high and low season in 2019 to ensure they are more efficient and have the right ratio of staff to visitors at peak and low season.

3.14 Since the October PR&G report, GVA have been working on financial modelling with a view to refining the options presented in October down to a preferred single recommendation for restructuring the loan. However, in doing this work and consulting with LDP on the potential level of visitor numbers, it has become clear that, whilst GVA have been able to eliminate a number of options, they are not at this stage in the process able to recommend any options for restructuring the loan. Whilst the LDP report does suggest that ability to cover the city council's PWLB payments is achievable, GVA have to be mindful that the performance is not currently at that level. Without it being a comment on the i360's ability to turn performance around, they can only base their professional advice for a loan restructure on the figures as currently presented to them.

3.15 Therefore, because GVA are not able to recommend a restructure option at this stage, or that the city council should step in to take control of the i360. 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. The city council is also not looking to operate the i360, and so a public procurement would need to be run to find an operator, and it is not clear that an operator offers the best financial future for the attraction (see section 3.21, below).

3.16 For this reason, it is not recommended to either restructure or step in at a time when the visitor numbers are underperforming, and in doing so fix the value of the asset at a level lower than it would be once visitor numbers improve. This would therefore necessitate that the city council defers any loan restructure until after the summer season of 2019. In doing so it is proposed the city council will also defer any elements of loan payments in that period which the i360 is unable to make whilst remaining financially solvent. Officers will closely examine the accounts of the i360 to determine what sums are available for loan repayments in June 2019 and what sums have to be deferred.

3.17 Officers will continue to monitor performance of the i360 and its Board during the deferral period over the busy summer 2019 season, and they will bring a report in October 2019 to PR&G to update on performance and to restructure options at that stage. Furthermore, it is also recommended that the i360 is 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 include:

- Marketing spend should be on target to reach 8% - 10% of revenue over the year (to be monitored on a monthly basis)
- A clear marketing strategy for the effective spend of that budget should be in place, and should be monitored to show it is being properly 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. At least two board representatives should be experienced in the visitor attraction market.

3.18 If the i360 fails to meet these KPIs then it is proposed that officers, in consultation with the leaders of the party groups, could bring a report to an urgency PR&G Sub Committee, to consider further action including (but not limited to) any of the options set-out by GVA in their work to date.

3.19 It is clear that none of the options available to the city council are ideal, and the preference would be to achieve a restructure that gives certainty going forward. However, a restructure secured at a time when performance is poor would result in the council realising a reduction in the asset value. The LDP report and the i360 Board's plans show that there is a very real opportunity to lift the performance of the i360, and if it is performing along the lines that an attraction of this style should then it will be financially stronger by around 2021 and better placed to pay back the council's loan. A restructure then would be more favourable and secure the best chance of the council getting back as much of its original loan plus the best opportunity to secure some of the surplus that was predicted at the time of making the loan.

3.20 In the time that the restructure is deferred then any payments due and not paid will be rolled into the loan amount. Any restructure next year will need to account for the repayment of those missed payments. The i360 is predicting that at the end of December 2018 (when the next payment is due) it will be in a position to pay £612,000. The loan agreement requires the i360 to make a payment of £1,492,304.25 on the 31 December.

3.21 Officers have given consideration to requiring that the i360 Board bring in an external operator to run the attraction, and LDP have given a view on this as well the i360 Board having considered if it might be the best step for them to take. However, an operator without an ownership stake would not be incentivised to turn around the performance of the attraction and would take out 4% to 7% of revenue as a management fee that would affect profitability. LDP consider this issue in their report, stating "In our opinion there is merit in the new leadership carefully right sizing the team and streamlining operations and implementing a greater marketing budget and more effective marketing approach and we feel this should be worked through and the results assessed before taking the step to bring in a management company with an additional cost to the business."

3.22 Coast to Capital LEP have also invested £4m into the i360 through their Growing Places Fund. They constitute a secondary or 'mezzanine' funder without the same loan enforcement rights as the city council. GVA have only been appointed to advise the city council, but have been mindful of the repayment terms of the LEP loan when considering issues like future cash flow for the attraction. The LEP and the city council have made clear that they are both strategically aligned on ensuring the best outcome for the public purse and officers continue to engage with the LEP about how best to achieve this.

4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS

4.1 The report to the 11th October meeting of the PR&G Committee set out a number of options for the loan restructure. The subsequent work done by GVA, in discussion with LDP, has resulted in those options being reduced down to the four options set out in their report.

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 i360 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. The payment that was deferred in June was of the city council's margin, i.e. the surplus the city council makes above and beyond the repayment of the principle element of the PWLB.

6.2 However, it is recognised that no options for the future of the financing of the i360 offer easy or guaranteed ways of protecting the public purse and ensuring payback of all money that the city council expected to derive from the i360 loan agreement. Work needs to be done to ensure the ongoing viability of the attraction so it can ensure that the public purse is not negatively impacted further. For this reason it is proposed that a partial deferment of payment of both the PWLB and margin elements is agreed and that the city council continues to work with the i360 to build the attraction's success.

7. FINANCIAL & OTHER IMPLICATIONS:

Financial Implications:

7.1 The council, like any market lender needs to take such action as required to recover the maximum debt outstanding. A number of options are being explored and this committee is being recommended to defer part of monies due for both the 31 December 2018 and 30 June 2019 payment dates whilst further work is completed to provide assurance of the ongoing viability of the attraction and its ability to make debt repayments in the future.

7.2 The original loan to the i360 included the principle, rolled up interest during construction and arrangement fees totalling £36.222m. The loan was planned to be repaid on an annuity basis to the 30 June 2041 including a market interest resulting in 6 monthly payments of £1.492m. The outstanding principle, including the £0.57m deferred in June 2018 is currently £35.835m.

7.3 The i360 are expected to make a payment of £0.612m on the 31 December 2018, a shortfall of £0.880m. At this stage it is not known the level of payment that could be made in June 2019.

7.4 In agreeing to defer payments the council will need to take a view on the likely recovery of all outstanding monies to date as part of the process of preparing the 2018/19 statement of accounts. Any impairment of this debt will need to be provided for within the councils overall financial position. At this stage it is not possible to reasonably estimate any impairment.

7.5 The outstanding debt is funded from a combination of external PWLB loans and rolled up marginal interest. The PWLB debt repayments are £0.922m every 6 months and the marginal interest forms part of the i360 reserve. The proposed payment shortfall of £0.880m in December 2018 and potential shortfall in June 2019 will have a marginal cashflow impact on the council reducing the council's investment income. Currently the council is achieving around 0.8% on is cashflow surpluses and reserves and therefore June 2018 and December 2018 deferments will lose a marginal £0.005m in investment income in 2018/19. Interest will be charged on deferred payments in line with the loan agreement to offset this loss.

7.6 The councils i360 earmarked reserve is currently £3.6m before the planned £1m + transfers in 2018/19 for the councils marginal interest. At present £1m of this reserve is earmarked to support the redevelopment of Madeira Terrace and £0.050m to support festoon lighting maintenance in 2019/20. No further commitments can be made against this reserve until a viable option to recover all outstanding debt is agreed.

7.7 The council committed £0.050m resources from the Strategic Investment Fund to support loan restructuring advice and specialist commercial advice. Any additional funding for advice beyond this allocation will be factored into restructure proposals and funded from 1360 income.

7.8 A further report on a potential restructure proposal is planned to be presented to this committee in October 2019 assuming the requirements under paragraph 3.17 are met.

7.9 In addition to the loan, the ongoing viability of the i360 has a number of other financial implications for the council. The 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: 27/11/18

Legal Implications:

7.10 The options for enforcing the council's security were set out in the report which went to PR&G in June 2018.

7.11 Loan arrangements such as this comply with state aid law if they meet the market economy operator principle (MEOP). The council is required to act in a similar manner to a commercial investor in the same circumstances. GVA have confirmed that "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."

7.12 In order to protect its position, the council has sent a reservation of rights letter to i360 in relation to the deferral in June 2018 and will send further letters in relation to the deferrals in December 2019 and June 2019 if the recommendations in this report are agreed. 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.

Lawyer Consulted: Alice Rowland *Date: 27/11/2018*

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 i360 is low energy use 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. GVA Report into Loan Restructure Options

2. LDP Report into performance of the i360 (redacted version to remove commercially sensitive benchmarking data)

Information in Members Rooms:

1. LDP Report into performance of the i360 (unredacted version)