

<b>Subject:</b>	<b>i360 Public Funding Options</b>
<b>Date of Meeting:</b>	<b>10 May 2012</b>
<b>REPORT OF:</b>	<b>Strategic Director Place &amp; Director of Finance</b>
<b>Contact: Officer: Name:</b>	<b>Katharine Pearce Tel 29-2553</b>
E-mail:	katharine.pearce@brighton-hove.gov.uk
<b>Key Decision:</b> Yes	Forward Plan No: CAB29110
<b>Wards Affected:</b> Regency & seafront wards	

**FOR GENERAL RELEASE****1. SUMMARY:**

This report sets out public financing options for the i360 development and updates Members on issues of timing in relation to i360 and the wider regeneration of the seafront. It also provides an update on the very recent result of a Growing Places Fund (GPF) bid to the Coast to Capital Local Enterprise Partnership (C2CLEP). The report seeks authority from Cabinet for officers to enter into a negotiation with both the C2CLEP and Brighton i360 Ltd on preferred loan financing terms to unlock the project and enable development to commence in earnest to allow a projected completion by April 2014.

**2. RECOMMENDATIONS:**

That Cabinet authorise officers to:

- 2.1 Enter into detailed negotiation with Brighton i360 Ltd regarding loan financing terms under preferred prudential borrowing arrangements.
- 2.2 Draw up detailed loan financing and repayment terms under preferred prudential borrowing arrangements as set out in paragraph 3.12 of this report.
- 2.3 Enter into detailed negotiations with Brighton i360 Ltd and the C2CLEP on loan financing and repayment.
- 2.4 Report back to Policy & Resources Committee on 12 July 2012 setting out the outcome of negotiations on both 2.2 and 2.3 above.
- 2.5 Complete negotiations with the Brighton i360 Ltd regarding the underwriting of all reasonable expenditure necessary to complete negotiations and agreements required by the council to progress items 2.1 to 2.4 above (noting that Brighton i360 Ltd have accepted the underwriting in principal).

### **3. RELEVANT BACKGROUND INFORMATION/CHRONOLOGY OF KEY EVENTS:**

- 3.1 The i360 development is a private sector led £35m visitor attraction developed by the same team that delivered the London Eye. It was given a unanimous planning consent on 11 October 2006 and the proposal will be built in large part on land which is currently owned by the West Pier Trust. It is recognised that the i360 will create jobs, boost the conference and visitor economy of the city and the wider region and attract upwards of 800,000 visits per year. It provides the final catalyst to complete the seafront development strategy and therefore contribute to the wider economic resilience and development of the city. It is iconic in scale and design and will raise the profile of the city and the region on the national and international business, convention and tourism stage.
- 3.2 Following planning consent in October 2006 the project stalled in the wake of the 2008 financial crunch and the contraction in bank lending on such projects.
- 3.3 The project is at an advanced stage with construction contracts in place, advanced prefabrication underway and a detailed implementation plan, licences and some legal agreements already completed.
- 3.4 On 31 January 2012, in partnership with the Developer, the council submitted a bid to the Coast to Capital Growing Places Fund operated by the Local Enterprise Partnership (LEP). The bid was made to the LEP on the basis that there was a demonstrable market failure and that the scheme was a good fit with the requirements of the bidding criteria; namely to support projects offering sustainable growth which were able to move forward at pace and deliver significant regeneration benefits. The bid was for £3m.
- 3.5 The project bid has now been assessed by the LEP Investment Committee (25/04/12) and they have recommended the project be approved for the full amount of the bid. Details of the conditions of the funding will be reported back to Policy & Resources Committee after the Due Diligence process has been completed by the LEP's advisers Genecon.
- 3.6 The current capital funding situation for the i360, including the LEP funding, is outlined in detail in the financial section of this report.
- 3.7 **Economic Resilience & Regeneration**

The city council has continued to provide support to the i360 project for a number of strategic and financial reasons as outlined below:

- (i) The project provides a unique and financially sustainable visitor attraction at a key strategic location on the seafront with many spin off regenerative benefits for the wider area.

- (ii) A visitor attraction at this location on the seafront will draw an estimated 600,000 to 1,000,000\* visitors a year, and this will generate upwards of £5m per annum in additional spend in the area. This in turn will offer a very urgently needed boost to businesses in Preston Street and beyond who currently suffer higher than average vacancy rates and reducing footfall and many of which are struggling to survive the current recession.
- (iii) The i360 attraction will directly create at least 154 full-time equivalent operational and construction jobs. This will include a minimum of 3 management training scheme apprenticeships. The council's Economic Development Team have also reviewed all the data and estimated that the wider spin off job creation from the project will be in the order of 444 jobs.
- (iv) The indirect employment benefits will result from a number of factors such as the increase in tourism numbers, the letting out as new business units the currently derelict arches to the east and west of the i360, increase in business to Preston Street generally and also the boost to the wider city economy via conferencing and delegate spend – particularly from overnight visitors.
- (v) The council will receive an equivalent of 1% of ticket revenue from the project to complete the landscaping schemes to either side of the West Pier site and this in turn will create a more beneficial environment for business to flourish.
- (vi) Deliverability – the project has planning permission and there are no significant remaining logistical or legal issues to resolve. It is effectively ready to start on site within 2 to 3 months of funding being secured.
- (vii) The i360 project has always received much public and business support and has captured the public imagination. By operating all year round it will help to even out fluctuations in tourism revenue for the city; it will help deliver high value business tourism visitors such as conference delegates and will also raise Brighton & Hove's profile as a vibrant and modern city.
- (viii) The i360 team have been committed to exploring ways to ensure access to the attraction for all members of the community. In particular, they have committed, in line with the council's own policy, to provide concessions for local people by way of reduced ticket prices at certain times of the year and/or specific promotions for local schools and/or community events.
- (ix) The i360 will be constructed predominantly on land owned by the West Pier Trust (WPT) which is a not for profit charitable trust. The West Pier Trust are wholly supportive of the project, not least because it allows the reproduction of the spirit of the West Pier in a 21<sup>st</sup> Century form, but it also allows the WPT to use the rental income from their lease with the i360 to recreate aspects of the original West Pier in various forms: a permanent exhibition, a virtual interactive display, re-building of ticket booths and kiosk, preservation of original columns and the re-use of cast iron columns as part of a new archaeological garden.
- (x) The arches to the east of the site and those to the west have been in need of refurbishment for many years. Strengthening works are due

to take place within months to the western arches (October 2012) and the progression of the i360 will finally allow a robust business case to be made to fund the refurbishment of the interior of the arches to create new units which can be let to local businesses.

- (xi) The business case to refurbish the arches to the east of the site can then also be made. Between them, the newly refurbished arches will provide much needed jobs and business opportunities and will also deliver significant rental income and business rates directly to the council. Their improvement will also complete the regeneration of this important part of the seafront.
- (xii) At planning application stage the i360 project received an unprecedented amount of support locally and also from bodies such as English Heritage who fully endorsed the principle of a 21<sup>st</sup> Century pier at this location.

In the light of all of the above, council officers have been working pro-actively for several months with Marks Barfield Architects (MBA) exploring a number of different options to facilitate funding of the Brighton i360 project at minimal risk to the council. This has included a re-appraisal of all the key visitor and financial assumptions and those elements relating to other similar attractions in the UK and elsewhere.

Note:

3.7 (ii) Figures recently produced by AECOM as part of Due Diligence on Tourist Visitor Numbers for the i360.

### **3.8 Current funding position for the i360**

The project requires total investment of approx. £35m of which the project team have raised £18m equity funding, some of which is subject to the balance of funding being secured. The team have sought bank finance for the remaining balance of funding of £17m. The continuing huge uncertainty in the money markets has meant that bank funding is impossible to secure for this kind of project without additional security on offer. The team do have an offer from a high street bank to provide £6m funding as part of a consortium of lenders, but this would require council guarantees to be put in place. The council will derive direct and indirect financial benefits if the scheme is completed and successful (these are set out in paragraph 3.12) and can also achieve a commercial return on any financial support it offers. The project can only proceed to completion whilst the current financial conditions persist with additional financial support from the council and the LEP. Various options to provide this support and the risks and rewards entailed have been considered and these are set out in paragraph 3.14 to 3.17.

### **3.9 Construction costs**

The construction costs are estimated to be just under £26m and a further contingency provision of 5% is made in the full investment budget. The £35m investment budget also covers fees, fit-out costs, operating costs between financial close and opening, development costs and rolled up financing costs. The development costs of £3.3m that have already been

incurred to get the project to this stage include the purchase of the steel and have been funded by the equity investors.

Construction and development will be managed through an overall single turnkey construction contract. A number of risks have been identified that may impact on the overall capital costs of the project and strategies to mitigate or minimise each risk have been identified. Some of the key strategies are:

- A fixed price contract from the contractor.
- Any changes to the specification resulting in increased costs will be met by the equity investors.
- As part of the agreement between Brighton i360 Ltd and the main contractor a £5m performance bond (guarantee) has been included in the contract to ensure delivery on time.

### 3.10 i360 Financials

The financial assumptions were independently reviewed in October 2011 by the Economics Team at AECOM, a worldwide professional technical and management support services firm. They have looked at the attendance and financial projections and have concluded that the i360 should achieve just under 800,000 visitors in its first year of operation and an operating profit of approx. £6.7m per annum.

The attendance forecasts vary between a high forecast of 1m and a low forecast of 600,000. The table below shows the estimated profit that would be achieved if visitor numbers and the amount each visitor will spend are lower than anticipated, for example if visitor numbers are 10% lower than anticipated at 720,000 and income per visitor is 10% lower than anticipated then the profit forecast will be £5.4m in year one.

**Forecast Operating Profit in Year 1**

Assumed Visitor numbers	800,000 (Base Case)	720,000	600,000 (Low forecast)	480,000
Total Assumed Income per Visitor (Including VAT)	Forecast Profit £ million	Forecast Profit £ million	Forecast Profit £ million	Forecast Profit £ million
Base Case	6.7	6.0	5.0	4.0
Base Case less 10%	6.0	5.4	4.5	3.6
Base Case less 25%	5.1	4.6	3.8	3.1
Base Case less 40%	4.1	3.7	3.1	2.5

The operating profit needs to be sufficient to meet the costs of the debt finance. These are estimated to be approx. £2.5m in interest and provisions for loan repayment on a £17m debt. The operating profit is therefore sufficient to meet these costs even if visitor numbers fall significantly below the low forecast and income per visitor is 40% below the base case. The debt interest and repayment charges will be met before any dividend is paid to the equity investors.

### 3.11 **Due Diligence**

Finance officers have reviewed the business case and AECOM reports in detail discussing and testing assumptions with the i360 team and undertaking key sensitivities to ensure the financial modelling is robust. A full financial audit will be undertaken using appropriate financial and property advisers as part of the due diligence process prior to Policy & Resources Committee in July and the business case will be included in the papers for that Committee.

### 3.12 **Financial benefits to the council from the i360 development**

The potential financial benefits to the council once the i360 is operational come directly from the scheme and from the knock-on effect to other local businesses.

#### *Direct financial benefits:*

- S106 revenue payments will be triggered generating an annual income share of 1% of gross ticket revenues worth an estimated £70,000 per annum. This will enable £1.76m investment in the surrounding seafront filling the gap in the seafront redevelopment as detailed in paragraph 3.7 (v).
- From April 2013, as part of major changes to local government finance the council will also receive a significant share of any growth in business rates. The i360 development is expected to pay approx. £120,000 per annum potentially from early summer 2014.

#### *Indirect financial benefits:*

- There is the potential for further growth in business rates from private investment in new businesses and existing business expansion generated by the increased number of visitors particularly in those areas close to the i360.
- The council-owned Regency Square Car Park is located very close to the i360 and car parking income is also likely to increase.
- The council owns the seafront arches either side of the i360 most of which do not generate any income as they need investment to bring them back into use and the business case for investment is not currently sustainable. Road strengthening works are due to be carried out in October 2012 on the arches west of the i360. Development of the i360 will almost certainly make the investment in internal refurbishment of these arches for final letting viable. It will also support the case for refurbishment of the eastern arches. The eastern and western arches will then become a significant source of additional

revenue to the council, as they have along other parts of the seafront, generating business rates income and greater income from lettings.

### 3.13 **Bidding for Growing Places Funds from the Coast to Capital Local Economic Partnership (C2CLEP)**

The council made an initial bid of £3m investment from the £23m Growing Places Fund allocated to the C2CLEP. The bid was approved by the Board on the 25 April 2012 subject to due diligence and agreement of terms. As part of the terms, the LEP will expect to receive a commercial return on their investment and early repayment of their investment (over 3 years after construction) into their revolving fund so that they can support other schemes. As potentially the senior debt funder, the council will need to negotiate all the terms with Brighton i360 Ltd and the LEP. The investment by the LEP will reduce the funding gap to £14m and similarly reduce the risk exposure of the council.

### 3.14 **Options**

The i360 team includes GVA Financial Consulting who have been employed to advise Brighton i360 Ltd on financing options to help secure funding for the project. GVA have worked on a wide range of projects and have experience of the accounting and legal requirements necessary to successfully deliver council support on a number of schemes including projects with the London Boroughs of Croydon and Brent. Council officers have worked closely with GVA to identify the different ways in which council support could help finalise the funding package for the i360.

3.15 The options available to the council are as follows:

#### **Preferred Option:**

1. The council provides debt funding to the project for the balance outstanding. The analysis shows that this option is roughly equivalent in risk to the other options but provides much more security and the potential for a significantly greater return.

#### **Other Options:**

2. The council uses its cash balances as security against the debt repayments with the debt provided by a bank or similar organisation.
3. The council provides security by taking a sub-lease from the debt provider, usually a pension fund, and then grants a sub-lease to the operator. Debt repayments take the form of rent paid by the operator to the council, and then by the council to the funding pension fund.
4. The council provides a guarantee to the funding bank or similar organisation of the capital and/or revenue payments from the project.

Appendix 1 sets out a summary assessment of each option covering the financial outlay and impact, security available to the council, risk of financial loss and the financial return. If it is agreed by Cabinet, it is

therefore recommended that officers negotiate terms with Brighton i360 Ltd on the basis of the council providing debt funding. The following sections provide more information on what is entailed.

### 3.16 Council provides debt funding

The council would act as a bank entering into a loan agreement with Brighton i360 Ltd. The legal powers to do this are covered in the legal implications of this report and the council would use its borrowing powers under the Prudential Code for Capital Finance, where the council must be able to demonstrate that the borrowing is affordable. Any decision to take up this borrowing will not impact upon any future borrowing decisions on other schemes, which will be considered separately on their individual merits.

There are a number of issues the council will need to take into account should the council agree to provide debt funding to Brighton i360 Ltd:

- **Legality** – Section 5.1 of this report sets out the powers that the council may use in order to provide debt financing.
- **State Aid** – In order to comply, the council must consider all aspects within the terms and conditions of what would be normal commercial practice when making the loan.
- **The length of the loan** – Initial discussions have indicated that a loan over approximately 12 years is required, i.e. for the construction period plus 10 operational years. Earlier repayment may be possible through refinancing and the council will need to ensure that refinancing clauses within the loan agreement protect its financial return.
- **Security of loan and interest payments** – It is imperative that the debt financing is repaid over the period agreed between the parties. The council will secure the loan over the assets and revenues of the company. This is standard commercial practice and ensures that repayment of the loan together with all interest and other charges are fully met in preference to equity holders receiving a dividend.
- **Funding** – In order for the council to lend to the company it will need to borrow funds from the financial market (i.e. the PWLB or other commercial lender). The council will be responsible for repayment of the loan and interest payments. The borrowing will form part of the limit set annually by full Council and the amount outstanding will create a liability on the council's balance sheet. The Prudential Code requires the council to ensure all borrowing is affordable, prudent and sustainable. Failure by Brighton i360 Ltd to repay debt and/or interest in a timely manner will result in the council using other resources to meet the requirements of the Code.
- **Accounting** – The council will need to ensure that all aspects of the proposal are properly reflected in the accounts and conform with current codes of practice. The prudential indicators required by the Prudential Code and approved annually by full Council will reflect the terms of the new borrowing, whilst the annual Treasury Management



Policy Statement also approved by Members will include measures for the raising of the new debt and the planned repayment.

### 3.17 **Benefits and risks**

The council will recover all fees and charges associated with organising the loan, covering the full costs of council time and ensuring comparability with the wider commercial marketplace.

State Aid rules mean that the council must charge the going commercial rate on the loan. In determining the rate to charge Brighton i360 Ltd, the council will take into account the cost to the council of borrowing the funds plus a premium to reflect the commercial risk that a project of this nature necessitates and the on-going costs in administering the loan. The risk premium is estimated to generate a net return to the council on a £14m loan of approx. £0.5m per annum. This should in the early phases of the project be set aside as a contingency to cover off potential risks, but as the project progresses and income streams are established (and thereby reducing risk) it can be released into the budget. Members will need to determine how this money will be used, but an option would be to set up an investment fund which would support projects designed to help the poorest and most vulnerable in the community.

The principal financial risk is repayment of the loan and payment of the loan interest. The payments will be met from the operating profit and the table in paragraph 3.10 shows a range of sensitivities on the key variables, which show that even a 40% reduction in visitors and income would still enable sufficient profit (£2.5m) to be made to more than cover the anticipated debt payments. As the project progresses the debt payments could also be secured against guaranteed income streams from, for example, marketing, naming rights and catering concessions. Brighton i360 Ltd will provide a list of potential sponsors for the council to approve before detailed negotiations take place with sponsors. At this early stage it is estimated that the income streams from sponsorship and concessions could exceed £1m per annum. The council would also secure the loan through a combination of the following securities:

- **First Charge** – taken over the land and buildings which form the primary security for the loan. This would be registered against the property title in the land registry.
- **First Floating Charge** – taken over moveable assets including vehicles, moveable equipment, furniture and cash, which is less secure as items can be sold.
- **Step-in-rights** – provides the lender with the ability to take over construction/operations of the development or business if there is a default under the loan (e.g. a failure to pay interest or capital).
- **Interest on Insurance Contracts** – the lender has their interest noted on insurance contracts both during construction and operation.

### 3.18 **Negotiation issues**

In order that the debt financing is not classified as State Aid the council must treat the arrangement with Brighton i360 Ltd to be E.U. State Aid compliant. Consequently, the council will need to negotiate with the company on the following issues:

- **Interest rate / risk premium** – In arriving at an interest rate a commercial funder would take into account a number of factors – (a) the opportunity cost of not having the funds available for other investments/projects, (b) a premium to reflect the risk the funder was taking in advancing the funds to the company, (c) a margin to reflect any on-going costs associated with the loan.

The major area for negotiation will be the level of premium over and above the council's cost of borrowing. It is highly likely that any commercial funder would view the project as high risk on the grounds that the company has been set up specifically to build and operate the facility and therefore has no commercial track record.

- **Repayment period / tranches** – A commercial bank would require certainty over the profile of debt repayments (i.e. instalments) and interest payments and would expect these to be incorporated within the company's final business case to evidence that repayment is achievable. The bank would impose a number of key ratios that are designed to keep the revenues within the company and place restrictions on dividend payments to shareholders. These ratios ensure the company retains sufficient funds to meet its operational and debt financing liabilities.
- **Security over revenues /assets** – A commercial funder will require security over all revenues and assets sufficient to meet the outstanding debt and interest payments. The council will seek similar security in addition to "step-in" rights discussed below.
- **Step-in rights** – In a worst case scenario whereby the i360 company is unable to attract sufficient numbers to generate revenue to meet interest payments, a commercial funder would protect its investment by exercising "step-in" rights that could range from a change in the company's management structure, a new company being selected to run the facility, or in the worst case scenario, running the company directly until the loan has been repaid and all interest paid.
- **Phasing of injection of shareholder funds** - The council will seek to reduce its exposure to risk during the construction period by negotiating with Brighton i360 Ltd and the LEP about the timing of the payment of their funding contributions. The shareholders have indicated that they would prefer funds to be injected on a pro-rata basis from the outset.

### 3.19 Timing

Timing of the project is a key consideration in relation to funding decisions on the i360:

- (i) Arch strengthening works are due to start on site in October 2012 to the west side of the West Pier. This will cause some level of disruption to the seafront (although this will be largely contained off road).
- (ii) Arch strengthening to the east of the West Pier may (subject to final funding confirmation) be progressed towards the latter part of the current financial year (in March 2013 onwards).
- (iii) Works to the Regency Square Car Park will be completed in summer 2012 which will allow for improved traffic management from Regency Square and improved crossing points for pedestrians.

If a funding solution is found for the i360 by July 2012 it will be able to start on site at the same time as the planned construction works to the seafront arches. By programming the i360 to start construction alongside these works, the total time period for disruption on the seafront can be significantly minimised and the most disruptive work for the public can be timed to take place within the winter months.

## 4. CONSULTATION

- 4.1 A Risk Workshop was held in February 2012 with the MBA team and their Employers Agent and key officers.
- 4.2 Extensive public consultation took place on the i360 project as part of the Planning Application in 2006. The project received much public and business support. A copy of the planning reports can be viewed on the council's website [Planning Application Sub Committee 11 October 2006].
- 4.3 It is also proposed to set up a consultative group to agree final recommendations for the landscaping proposals. Terms of Reference will be reported back in July.

## 5. COMPLIANCE ISSUES – LEGAL/FINANCIAL & OTHER IMPLICATIONS:

*Legal implications/statutory framework:*

- 5.1. Section 2 of the Local Government Act 2003 enables the council to do things which are likely to achieve the promotion or improvement of the economic, social or environmental well-being of their area. The previous council administration considered a proposal to support the i360 using these wellbeing provisions and the option of a council guarantee to support bank lending. Under the previous Government's guidance on wellbeing, it was considered that the term "promotion of economic, social or environmental well-being" was sufficiently broad to include cultural well-being generally, and in the case of the i360 it would appear that all three elements – economic, social and environmental - would be satisfied. The

statutory provision is broad enough to enable the council to act as a funder of this project without the need to set up a special purpose vehicle (SPV).

- 5.2 The Localism Act 2011 gives a general power of competence which enables the council to do anything that a competent individual can do provided that it is not otherwise restricted by legislation. In other words, it changes the old presumption that "the council cannot do it unless expressly empowered" to the new presumption that "the council can do it unless expressly restricted or prohibited". This power includes lending money, although it may be necessary to set up a SPV if commercial activity requirements in the Act are considered to have been triggered.
- 5.3 When the Localism Act came in to force this provision was not of immediate effect. However, it was intended that when it did come into force, the wellbeing provisions in the 2003 Act would be repealed. However, the general power was brought in to effect earlier than planned and the wellbeing provisions have not yet been repealed. It may be considered prudent to assume that the 2011 powers will be relied on, but this can be clarified in the counsel's opinion referred to below, which will be referred to in the follow up report referred to in recommendation 2.4.
- 5.4 Provided that any loan made to Brighton i360 Ltd is at commercial rates there would be a strong argument that no commercial advantage or market distortion has arisen, which would support a finding that there would be no State Aid implications.
- 5.5 So as to ensure compliance and probity in relation to this project, if the recommendations in this report are agreed it is proposed that counsel advice is also sought to confirm the appropriate use of powers and any State Aid implications.
- 5.6 The Big Wheel at Daltons Bastion, Madeira Drive will be given appropriate notice as required by the terms of the lease and licence from the council.

Legal officer consulted: Bob Bruce

Date: 17/04/12

*Financial Implications:*

- 5.7 The detailed financial implications are covered within the body of the report. The council will need to incur costs to enter into negotiations and to start drafting the agreement documents to ensure all the key negotiations points are identified. These costs are likely to cover the costs of counsel's opinion and the appointment of specialist legal, property and financial advisors to protect the council's interests. All of these costs will be fully reimbursed from the project and relevant provisions have been made within the business case. Brighton i360 Ltd have accepted in principle to underwrite all reasonable costs incurred prior to the loan agreement being signed. This would ensure that the council is not left to pick up costs if the loan agreement does not proceed.

Finance officer consulted: Mark Ireland

Date: 17/04/12

*Equalities Implications:*

- 5.8 An Access Statement accompanied the planning application and demonstrated a very clear understanding of the issues, setting out an approach to inclusive design judged to be the right approach by the Access Officer.

*Sustainability Implications:*

- 5.9 The operating company for the i360 will become a member of the Green Tourism Business Scheme and will promote environmental awareness and sustainability. Staff will be trained to reduce waste and conserve energy and resources. Energy use for the i360 will be sourced from a renewable supplier and supplemented by wind turbine energy on-site.

*Crime & Disorder Implications:*

- 5.10 Sussex Police Community Safety Branch commented at the planning stage: "The proposed development will enhance the location considerably, providing a safe and secure environment. The applicant has made a commitment to seek approval under the police initiative 'Secured by Design' which shows absolute commitment to policy QD7 of the Brighton & Hove Local Plan".

*Risk and Opportunity Management Implications:*

- 5.11 Council officers have been developing a risk & opportunity register which has applied the council's approved Risk Management Strategy methodology and has considered "*the effect of uncertainty on objectives*" in respect of this project and that "*an effect is a positive or negative deviation from what is expected*"<sup>1</sup>. There are some direct links to risks contained in the council's Strategic Risk Register. Detailed opportunities and risks presented by this project will be reported to Policy & Resources Committee in Part 2 in July 2012 and it is proposed that a briefing session is held with key Members prior to the July Committee meeting.

*Corporate / Citywide Implications:*

- 5.12 The Risk & Opportunity Register directly relates to corporate and city-wide implications and these will be addressed as part of the above.

**6. EVALUATION OF ALTERNATIVE OPTION(S):**

- 6.1 These are set out in the main body of the report (3.15).

**7. REASONS FOR REPORT RECOMMENDATIONS:**

- 7.1 These are set out in 3.8 in the report.

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<sup>1</sup> The definitions of Risk from the International Standard for Risk Management (ISO 31000)

## **SUPPORTING DOCUMENTATION**

### **Appendices:**

Appendix One: Summary of security, risks and rewards of each approach

### **Documents in Members' Room:**

- Planning Report 2006/07

### **Background Documents:**

- Planning Report 2006/07



**Summary of security, risks and rewards of each approach**

This appendix looks at the financial impact of each of the 4 options listed and assesses the potential risks and rewards if the council was to proceed with that option. The appraisal is considered from a financial stand-point and based on the exposure to any potential loss and any potential returns to the council. It does not consider the wider social and economic merits of the scheme detailed in the body of the report.

**Assessment of each option based on £14m support from the council**

The options available to the council are as follows:

1. The council provides debt funding to the project for the balance outstanding.
2. The council uses its cash balances as security against the debt repayments with the debt provided by a bank or similar organisation.
3. The council provides security by taking a sub-lease from the debt provider, usually a pension fund, and then grants a sub-lease to the operator. Debt repayments take the form of rent paid by the operator to the council, and then by the council to the funding pension fund.
4. The council provides a guarantee to the funding bank or similar organisation of the capital and/or revenue payments from the project.

<b>Option</b>	<b>Financial outlay</b>	<b>Financial impact</b>	<b>Security available to the Council</b>	<b>Risk of financial loss</b>	<b>Financial return</b>
1	£14m from council borrowing under the prudential regime	The council is required to charge interest costs and (depending on the structure of the loan) loan repayments to the revenue account.	The council would get a first charge over the asset; the value of which when built is estimated to be in excess of £35m.	The council could incur financial loss from: <ul style="list-style-type: none"> <li>• Non repayment of the loan and interest on the loan;</li> <li>• Reduction in the value of the asset from £35m to below the outstanding capital value of the loan (£14m).</li> </ul>	The council, in complying with State Aid legislation will be required to offer the loan to Brighton i360 Ltd at a market rate, based on the financial strength of the project. This will be higher than the borrowing rate that the council can currently access from the PWLB and will result in a net income of approximately £0.5m each year for the council.



Option	Financial outlay	Financial impact	Security available to the Council	Risk of financial loss	Financial return
2	Requires the council to place £14m cash balances held by the council with the nominated lender (bank).	The council currently invests cash reserves and surplus cashflow balances with financial institutions as set out in the Annual Investment Strategy.	Any security held by the council would rank after the bank's charge.	The council is committed to cover any non-performance of the project, topping up any shortfall on the loan. Based on assessed bank rates this would be up to a maximum of £1.2m per annum.	The council may obtain additional interest from the cash lodged with the lender to reflect the funds at risk. In similar schemes this has been approximately 0.7% of the value held, and would equate to about £0.1m each year for the council.
3	No initial up front payment	The council must sign a lease agreement with the funder and commit to a long term contract, generally as a minimum 25 years. The council would then make annual lease payments to the funder which will increase each year in line with the Retail Price Index and enter into a sub-lease with Brighton i360 Ltd where the rent would be equivalent to the lease payments plus a margin.	Any security held by the council would rank after funders (normally a pension fund) security. The security to the council would be the lease agreement.	The council is committed to cover any non-performance of the project, topping up any shortfall from the i360 Company's rental payments potentially over a 25 year period.	The council should receive more in lease rental from Brighton i360 Ltd than would be paid to the funder to reflect the security given by the council over the funding. This would be the difference between the pension fund rate and State Aid rates and would be about £0.25m each year for the council.

Option	Financial outlay	Financial impact	Security available to the Council	Risk of financial loss	Financial return
4	No initial up front payment although there may be a requirement to set aside money within the accounts	Depending on the structure of the guarantee the council would have to assess whether this transaction constitutes a provision or a contingent liability in the accounts. If a provision is considered the most appropriate the council must assess the value of this provision and this must be charged to the revenue account in year 1. If the assessment of this provision reduces then the council write back elements of this provision to the revenue account.	Any security held by the council would rank after the lender's security.	The council is committed to cover any non-performance of the project, topping up any shortfall on the loan. Based on assessed bank rates this would be up to a maximum of £1.2m per annum.	The lender should charge a lower risk margin to reflect the guarantee over the funds offered by the council. This would entitle the council to receive payment equivalent to the reduction in the margin. In similar schemes this has been approximately 0.7% of the value held, and would equate to about £0.1m each year for the council.