

<b>Subject:</b>	<b>Brighton i360 update</b>		
<b>Date of Meeting:</b>	<b>28 June 2018</b>		
<b>Report of:</b>	<b>Executive Director Economy Environment &amp; Culture</b>		
<b>Contact Officer:</b>	<b>Name:</b>	<b>Mark Ireland</b>	<b>Tel:</b> 01273 292705
	<b>Email:</b>	<a href="mailto:mark.ireland@brighton-hove.gov.uk">mark.ireland@brighton-hove.gov.uk</a>	
<b>Ward(s) affected:</b>	<b>All</b>		

## **FOR GENERAL RELEASE**

Note: The special circumstances for non-compliance with Council Procedure Rule 3, Access to Information Procedure Rule 5 and Section 100B(4) of the Local Government Act 1972 (items not considered unless the agenda is open to inspection at least five days in advance of the meeting) were that discussions with both the i360 Board and LEP had not been concluded to release the report on time and a decision has to be made before 30 June 2018 otherwise the i360 company will be in default of the loan agreement with the Council.

### **1. PURPOSE OF REPORT AND POLICY CONTEXT**

- 1.1 At a Special Policy & Resources Committee on 6 March 2014 Members agreed that the council could loan the i360 a maximum sum of £36.222m at the relevant Public Works Loan Board (PWLB) interest rate plus a margin of 3.75% to reflect market risk at that time. In the event the full loan facility was used by the i360.
- 1.2 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 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. The i360 is due to generate a further £32.7m over the next 24 years from the margin charged on the loan, 50% of the business rates income and a 1% share of ticket revenue from the S.106 agreement.
- 1.3 The i360 may have acted as a catalyst for other major new developments and investment not just in the immediate vicinity of the i360 but across the city. For example since the i360 has opened, redevelopment deals valued at over £250m at Circus Street and Preston Barracks have been concluded and work has begun on both sites, the Grand Hotel multi-million pound refurbishment and the creation of a new lane as part of the redevelopment of the Hannington's estate by Redevco. Around the i360, the public realm has been transformed, the arches now offer a wide ranging shopping and dining experience and Preston Street has been revitalised.
- 1.4 However, visitor numbers have been lower than anticipated and now stand at the lower end of the long term financial viability modelled in the original business case. This report sets out:

- A review of the performance of the i360 to date and its impact upon the seafront.
- Action taken already by the i360 to reduce costs, increase visitors and introduce new revenue generating activities.
- Further proposals by the i360 to boost visitor numbers and revenues.
- Proposals to respond to the anticipated default on the 30 June 2018 and enter negotiations to secure a long term restructuring.

## **2. RECOMMENDATIONS:**

2.1 That the Committee:

2.1.1 Notes the financial and commercial performance of the i360 to date.

2.1.2 Notes the action so far taken by the i360 to reduce costs, increase visitor numbers and increase revenue generating capacity.

2.1.3 Agrees to defer £570,007.73 of the £1,492,304.25 due on 30 June 2018 until 31 December 2018 on the basis that the i360 will pay the council £922,296.52 to enable the council to pay the PWLB the same amount on the same day.

2.1.4 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.

2.1.5 Notes that representatives of the council, LEP and i360 Board will meet regularly to discuss a long term restructuring of the loans and that a further report will be brought to PRG Committee on 6 December 2018.

2.1.6 Authorises the Executive Director Economy, Environment & Culture, in consultation with the Executive Director Finance & Resources, to commission a specialist commercial adviser to provide advice and options to the council for a long-term loan restructuring and advise on whether those proposals meet the market economy operator principle.

2.1.7 Authorises the Executive Director Economy, Environment & Culture, in consultation with the Executive Director Finance & Resources, after discussion with the i360 Board, to procure additional support (such as a commercial advisor with specialist experience of visitor attractions) for the i360 management and Board to help them improve the financial performance of the i360.

2.1.8 Allocates a sum of £50,000 from the Strategic Investment Fund to meet the costs of the recommendations at 2.1.6 and 2.1.7.

## **3. CONTEXT/ BACKGROUND INFORMATION**

### **Brighton i360 performance**

3.1 Brighton i360 Limited have produced a detailed report which is included as a confidential appendix 1 to this report because of the commercial sensitivity of some of the content. The report covers the financial background, benefits to the city, challenges to the business so far, 2017 business restructuring, the present

financial situation and their initial debt restructuring proposals. One of the appendices to their report includes a wide range of supportive statements from businesses and organisations across the city.

3.2 After detailed discussions with both the i360 Board and the LEP it was proposed that more time is needed to consider and analyse both the proposals set out in Appendix 1 and other restructuring options.

3.3 The actual capital construction costs including rolled up interest and costs of finance were 7.4% higher than expected, however, all the overspend was met by additional contributions from the equity shareholders. The cost overrun was largely due to the higher costs of the base building and immediate landscaping of the West Pier Trust owned land where the costs had not been finalised at the start of the contract and a provisional sum had been included. There were also some additional costs associated with unexpected underground obstructions when the main sewer was diverted around the site.

<b>Table A: Capital construction costs</b>	Forecast £ million	Final £ million	Variation £ million
Senior loan from the council	36.2	36.2	-
Junior loan from the LEP	4.0	4.1	+0.1
Equity from shareholders towards funding	6.0	9.3	+3.3
Total	46.2	49.6	+3.4

3.4 The original median visitor forecasts anticipated over 800,000 in the first year and just over 700,000 thereafter. However the 2014 Policy & Resources report stated that the i360 would generate sufficient cash to pay the PWLB loan costs and the council margin if visitor numbers were 440,000 or more and just the PWLB loan costs if visitor numbers were 332,500 or more.

3.5 The attraction opened on 4 August 2016, just over a month later than originally anticipated, and despite adverse weather and some well publicised technical hitches, has now been open for over 22 months. It meant that the very financially lucrative operational month of July was lost which has had an ongoing detrimental impact on cash flows. It became apparent that operating the ride every 20 minutes was not only technically unfeasible but detrimental to customer experience. The subsequent extension of ride times by cutting the number of rides to every 30 minutes only potentially impacts upon visitor numbers on the busiest of days. Although it was anticipated that weather would play an important role in visitor numbers it has proved to be critical particularly at weekends and school holidays. The i360 Board have recognised the need to develop strategies to boost numbers on poor weather days.

3.6 Visitor numbers in the first full year of operation were just over 500,000 but have subsequently declined with the annual total for the second year of operation based on current performance is likely to be in the 350,000 to 400,000 range. The i360 has so far continued to make full payments due to the council but a further cash injection was required from the shareholders to ensure these

payments were made in December 2017 and to cover some unexpected one-off costs.

- 3.7 As initially happened at the London Eye, a number of different technical issues have arisen since opening causing some stoppages but most related to software programming and sensors. These have had an impact on visitor numbers but although minor problems do arise these are quickly resolved with no or minimal impact on visitors.
- 3.8 The i360 has directly created 116 new jobs on site of which 75% live locally. It is a living wage employer and does not offer zero hours contracts. There is an apprenticeship scheme in place and training opportunities are available for all staff.
- 3.9 The i360 has so far won 19 awards from a wide variety of organisations. Visit England said it was “a triumph of innovation” and RICS said it was “an innovative project that has created an iconic landmark on a famous British seafront”.
- 3.10 In the first year of operation free tickets were given to all state school children in the city and free tickets are given each subsequent year to primary year of entry children. Over 20,000 have so far taken advantage of this offer. Ticket price discounts of 50% are also offered to local residents at off peak times as well as discounts in the restaurant, shop and for friends and family. The i360 has supported or partnered a wide range of charities and charity events including the Rockinghorse Charity, Paddle Round the Pier, Wembley to Soweto foundation, Martlets Snail Campaign, the Trust for Developing Communities, Chestnut Tree House Charity, Team Domenica, Save Madeira Terraces, Argus community awards and the launch of the Mayor’s Charity Bike ride.
- 3.11 The council has already benefited directly from the following cash payments made by the i360 so far:

<b>Table B: Council net income received</b>	<b>£</b>
Arrangement fees	543,300
Utilisation fees	417,330
Margin received on debt payments made so far	1,282,268
Retained business rates 49% of 2016/17 and 2017/18 payments	201,790
<b>Total direct surplus</b>	<b>2,444,688</b>
*Margin (currently £570k) due every 6 months	

- 3.12 The surplus has funded the i360 landscaping works, a £1.1m contribution to Madeira Terraces, festoon lighting along the seafront and a small part of the general fund budget from the retained business rates. There have been other indirect financial benefits from increased rents and business rates from the adjacent seafront arches and increased business rates from businesses that have expanded in the vicinity such as the 25% increase in covers at The Regency fish restaurant. Income from the Regency Square car park has increased by over £0.25m or 22.5% in the year since the i360 opened although an element of this increase is due to increased parking charges. The council also receives over £5,000 per annum in sitting out licences. Further S106 funding of 1% of ticket revenues will be paid by the i360 from November 2018 annually part

of which will be used to initiate local projects and part to repay the loan on the council i360 landscaping works.

- 3.13 Performance of the shop has been below target but has improved through the second year of operation as improved design and layout has been implemented and knowledge has been gained about the product lines that sell well. However, the Sky-Bar has operated consistently above target and the decision to open the Sky-Bar all day has meant that overall income has been higher than expected despite the reduced visitor numbers. The catering concession is operated by Centreplate and total income has also been well below projected levels and customer feedback has been patchy. Following a refurbishment of the restaurant and changes to the management team income levels have improved and 80% of visitors rate it excellent or very good.

#### **Action taken by the i360 during the year**

- 3.14 As soon as it became apparent that visitor numbers would be lower than expected action was taken to improve the financial performance of the attraction. Since Steve Bax started as Executive Director of the i360 last summer he has:
- Thoroughly reviewed and restructured all the operational and back office functions delivering ongoing savings of more than £450,000 per annum. It should be noted that operational and technical staffing costs increased after opening to reflect initial demand so savings achieved mean that the number of posts now reflects the original business plan.
  - Reviewed and tightly controlled all expenditure.
  - Reviewed and renegotiated where possible all external supplier contracts resulting in annual savings of £40,000.
- 3.15 New initiatives have been introduced to boost visitor numbers. For example a “kids go free” promotion in February not only boosted numbers by 36% but increased revenues by 8% and an experiment with “sky dining” in early March was a huge success and has been added into the diary with the next 2 events already fully sold out. Abseiling from the i360 pod known as the iDrop was launched by a charity event in April. The event raised almost £50,000 to help Rockinghorse buy a specialist X-ray machine for premature babies at the Trevor Mann Baby unit in the Royal Sussex County Hospital. The iDrop will operate before normal opening times at weekends and is expected to generate a new income stream of about £24,000 per annum.
- 3.16 A new website has been launched to improve the customer experience and make it easier to buy tickets online. A significant joint investment was made with the catering contractor in the restaurant which has improved the ambiance and takings. A new ice cream concession for sales on the outside terrace for busy days has been signed.

#### **Further Proposals by the i360 to boost visitor numbers and revenues**

- 3.17 There are a number of new initiatives which are intended to increase visitor numbers to over 410,000 per annum include:
- A partnership offer with Govia Thameslink starting in the summer.

- Working closely with the Universities of Sussex and Brighton on graduate packages, student discounts and a student's night on a Monday.
- Developing closer links to the conference trade and developing conference packages.
- Developing offsite ticket sales potentially at Brighton Railway Station and / or close to the sea end of West Street.

3.18 A successful and financially sustainable i360 could generate about £32.69m for the council over the next 24 years bringing the total net cash benefit to just over £35m.

Table C: Income source	£ million
Margin on the loan	26.79
50% of Business Rates	4.84
1% of ticket sales – S.106 agreement	1.06
Total	32.69

### **Proposals to respond to the anticipated default**

3.19 The terms of the loan agreement were agreed by Policy & Resources Committee on 6 March 2014. The key terms of the Loan Agreement are set out below:

- A loan facility of £36.222m which was fully drawn down.
- The loan would be for 25 years from the opening of the i360 (i.e. it would be repaid by 2041).
- The i360 would pay the council arrangement and utilisation fees of just under £1m.
- The i360 would pay the council the full costs of servicing the PWLB every 6 months on 30 June and 31 December each year can be met so that the council is never out of pocket.
- The i360 would pay a commercial margin of 3.75% on the loan to the council at the same time the PWLB payments are made.

3.20 To date the i360 has made all payments due to council in full and on time, however, this has required an additional cash injection from the shareholders in order to make the full December 2017 payment.

3.21 Due to lower than anticipated visitor numbers, the i360 will not have sufficient cash to make the payment in full on 30 June 2018 and a further cash injection from the shareholders will be required to pay the council sufficient funds to allow it to make the PWLB payment. If the proposals contained in this report are agreed by the council the shareholders have agreed to make an additional cash contribution, currently estimated to be about £400,000, before the end of June. This will enable the PWLB element, £922,296.52 of the £1,492,304.25 total payment due on 30 June 2018, to be made. This will bring to nearly £1m the amount the shareholders have invested since funding the capital cost overspend. However, there will not be sufficient cash available to meet the remaining £570,007.73 due on 30 June causing a loan default.

- 3.22 Officers met with the council's external commercial legal advisors to consider the options open to it in response to the anticipated default and have concluded that the best option is to defer the payment of £570,007.73 due on the 30 June until 31 December 2018 to allow time for further engagement with the i360 Board and the LEP in relation to a long term debt restructuring. It is proposed that the council will not charge interest estimated at £10,700 on the deferred payment.
- 3.23 The council is working closely with the LEP who have a subordinate loan. They have indicated that they are committed to supporting the i360 in the long term and are also prepared to spend the next few months engaging with the council and the i360 to find a long term solution in relation to their loan which secures the long term viability of the i360. It is proposed that representatives of the council, LEP and i360 Board will meet regularly to discuss a long term restructuring of the loans and that a further report will be brought to PRG Committee on 6 December 2018.
- 3.24 To comply with the existing loan agreement, the i360 needs to provide the council with financial data every 6 months that demonstrates that the performance of the business as expressed by 3 accounting ratios means that debt can be repaid as planned. The data for June 2018 will show that at least one of the accounting ratios will not be met, meaning that default can be triggered. In order to enact the proposal to provide further support to the i360, Committee needs to be content not to take action in regard to this default.

#### **Performance reporting and additional support**

- 3.25 The council already receives daily visitor numbers and is represented at the monthly Board meetings in an observation role. Using the information from these sources regular performance reports currently prepared for senior officers will be shared at Leaders meetings so that they are kept fully informed.
- 3.26 The council is required to protect its investment and act as a commercial investor faced with this situation would. Firstly it is proposed that the council appoints a specialist commercial adviser to provide detailed advice and options for a long term council loan restructuring. Secondly, discusses with the i360 Board the provision of appropriate additional support for the i360 management and Board to help them improve the ongoing financial performance of the i360 such as a commercial advisor with specialist experience of visitor attractions. It is not known how much this will cost but it is recommended that £50,000 is set aside from unallocated Strategic Investment Fund resources following the receipt of £50,000 from the Circus Street Project.

#### **4. ANALYSIS & CONSIDERATION OF ANY ALTERNATIVE OPTIONS**

- 4.1 The alternative response to the anticipated default on the 30 June would be to:
- Accelerate the council term loan or place it "on demand". Given the current financial position of the i360 this would be of little benefit.
  - Freeze the Borrower's bank accounts. Again this would be of little benefit because there is very little cash in these accounts.
  - Enforce the security which the council has.

4.2 If the council and the LEP did agree to enforce the security over the project (as they are entitled to do whilst an event of default is continuing) then they could:

- Enforce the security over the shares in the Borrower and sell them to a third party, using the proceeds of the sale to repay their outstanding loans (plus expenses of enforcement). The value that the shares would realise would depend upon the market's perception of the ability of the project to generate income. Although the council has a degree of freedom in relation to a sale, there would need to be a formal process in order to maximise recovery. The proceeds would be used firstly to repay the council loan then the LEP Loan, and finally the shareholders/junior loan note holders.
- Enforce the security over the assets of the Borrower. This would entail more of a piecemeal approach – akin to cherry-picking certain assets (e.g. the lease, the benefit of certain operational contracts, the main assets) and, as above, the proceeds of the sale would be used to repay the outstanding loans. Here, the expenses of enforcement would be considerably higher. The proceeds would be used firstly to repay the council loan then the LEP Loan, and finally the shareholders/junior loan note holders.
- Appoint a receiver to run the company in place of the existing directors. This would allow the council and the LEP to "take charge" of the company, replace management and tender out the operation of the i360 to a new company. The general powers of a receiver are set out in schedule 1 to the Borrower's security document. However, it is worth noting that the i360 is largely self-operating – i.e. it employs its own staff and terminating staff employment contracts would be expensive.
- As an alternative to appointing a receiver the council could use "step in rights" conferred under the security documents. These rights are set out in Schedule 1 to the Borrower Debenture and very broad. Typically, commercial lenders would not step in directly largely because, notwithstanding the purported protections against liability that are contained in the Borrower Debenture, a lender who steps in and operates the project may be liable to compensate affected parties (e.g. the LEP and other creditors) for loss suffered if they were negligent.

4.3 The council has been advised by its external legal advisors that such enforcement is a "last option" for commercial lenders and this step is not recommended. Officers continue to have confidence in the board and its proposals to increase visitor numbers. Enforcing its security would cause significant damage to the attraction at a critical point in the year.

## **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 Despite the lower than anticipated visitor numbers the i360 has been a major revenue generator with over £12m gross income and £3m net operating profit achieved to date before financing costs are taken into account. The council needs to respond to the anticipated default and engage in dialogue with the LEP and the i360 to agree loan restructuring which secures the future of the i360 in the long term thereby protecting the council's investment. A further report will be brought to Policy, Resources & Growth Committee on 6 December.

## **7. FINANCIAL & OTHER IMPLICATIONS:**

### Financial Implications:

- 7.1 Under the proposal contained in recommendation 2.1.2, the council will receive sufficient funds from the i360 on 30 June to ensure loan repayments to the PWLB are met.
- 7.2 In order to protect the financial interests of the council additional specialist advice is required to ensure that all the options for loan restructuring can be thoroughly explored, financially evaluated and considered before one of them is recommended for implementation. By deferring part of the loan repayment until December this gives time for an adviser to be appointed and work through the options with council officers, the i360 Board and the LEP. Critical to the future financial success of the i360 is boosting current visitor numbers and help should be given to achieve this aim by the provision of appropriate additional support such as a commercial advisor with specialist experience of visitor attractions on an ongoing basis. In the current year the one-off loan restructuring work and the commercial advisor can be funded from unallocated Strategic Investment Fund resources of £50,000. The cost of providing commercial advice beyond 2018/19 needs to be factored into the loan structuring discussions and funded by income received from the i360.
- 7.3 Financial analysis shown in appendix 1 shows that based on existing visitor numbers the i360 should generate enough cash over the life of the loan to meet all the loans costs due to the council but it would be tight. Reliance on the visitor numbers being maintained as a minimum represents a financial risk to the council. The continued focus of the i360 to boost visitor numbers and revenue and the potential restructuring of the loan agreement will help to mitigate this risk and council oversight of performance will be crucial in managing the risk. Ultimately if agreed payments are not made to the council then the council has step in rights to take over the running of the attraction or can enforce the other options shown in section 4 of this report.
- 7.4 As part of the 2017/18 budget, £0.050m per annum of the margin was earmarked to fund seafront festoon lighting and maintenance. Additionally, £0.050m pa was earmarked to meet existing commitments relating to the landscaping works around the i360. Therefore these resources will not be available until margin payments resume and this shortfall may therefore need to be taken into account in budget projections for future years.

- 7.5 The additional business rates generated from the attraction and increased parking income from Regency Square Carpark have been included in the council budget assumptions.

*Finance Officer Consulted:* David Kuenssberg

*Date:* 25/06/18

Legal Implications:

- 7.6 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. The council is taking external legal advice and they have confirmed that the proposed course set out in this report is a course of action which a commercial investor would be likely to take. They have confirmed that, at this early stage, it would be highly unlikely that a commercial investor would take any of the options (set out below) to enforce the security as this would be highly unlikely to achieve a full repayment of all amounts due to the council. Instead, commercial lenders would take whatever course of actions open to them which would be likely to result in an eventual full recovery of all amounts owed, even when this means deferring payments due. The council may need to revisit the options described below in the future.
- 7.7 In summary, these options are for the council to enforce its security over the shares in the i360 and sell them to a third party, using the proceeds of the sale to repay as much of the outstanding loans (plus expenses of enforcement) as it can; to enforce the security over the assets of the i360 and follow the same sale action; or to appoint a receiver to run the company in place of the existing directors in order to try to recover its debts. The council has the option to exercise those rights directly, without appointing an administrative receiver. However, our external legal advice is that commercial lenders would invariably appoint a receiver to act their behalf due to the potential liabilities that a receiver may incur.
- 7.8 If the parties are able to agree long term restructuring of the loan then this will have to conform to the MEOP. Officers will ask the specialist commercial adviser to confirm in a written report that the recommended restructuring proposals would meet the MEOP test with as much certainty as reasonably possible. This will enable the council to robustly defend any challenge that the restructuring amounts to state aid.

*Lawyer Consulted:*

Alice Rowland

*Date:* 25/06/2018

Equalities Implications:

- 7.9 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 necessarily 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 wage contracts. There is an apprenticeship scheme in place and training opportunities for staff at all levels of the organisation.

Sustainability Implications:

- 7.4 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 will provide 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:

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

**SUPPORTING DOCUMENTATION**

**Appendices:**

1. British Airways i360 Limited – Restructure Proposal – Exempt Category 3

**Documents in Members' Rooms**

None

**Background Documents**

None

