# Commercialisation of assets

## Bournemouth Christchurch and Poole Council

February 2022

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In particular, and without limiting the general statement above, since we have prepared this report for the benefit of the Client alone, this report has not been prepared for the benefit of any other local authority nor for any other person or organisation who might have an interest in the matters discussed in this report.

Our work commenced on the 8th of November 2021 and the report was completed on 22nd of November 2021. We updated the report on 16th February 2022 at the request of the Council for various information including but not limited to sensitivities and interest rate. We have not undertaken to update our presentation for events or circumstances arising after that date

In preparing our report, our primary source has been information received by the Client and representations made to us by management of the Client. We do not accept responsibility for such information which remains the responsibility of management. Details of our principal information sources are set out in page 5 and we have satisfied ourselves, so far as possible, that the information presented in our report is consistent with other information which was made available to us in the course of our work in accordance with the terms of our Engagement Letter. We have not, however, sought to establish the reliability of the sources by reference to other evidence.

# Glossary of key terms

| | |
|---|---|
| **BCP** | Bournemouth, Christchurch and Poole Council |
| **CPI** | Consumer Price Index |
| **CFADS** | Cashflow Available for Debt Service |
| **DSCR** | Debt Service Coverage Ratio |
| **DSRA** | Debt Service Reserve Account |
| **GBP** | Great British Pound |
| **GF** | General Fund |
| **ICMA** | International Capital Markets Association |
| **KPMG** | KPMG LLP |
| **NPC** | Net Present Cost |
| **NPV** | Net Present Value |
| **PWLB** | Public Works Loan Board |
| **SDLT** | Stamp Duty Land Tax |
| **SPV** | Special Purpose Vehicle |
| **VAT** | Value-added Tax |
| **WALL** | Weight Average Loan Life |
| **SDLT** | Stamp Duty Land Tax |

# 1 - Background

## Background

- This report is a follow up to the KPMG report dated September 2021, Commercial and Financial Options Structuring. That report sets out a range of potential commercial options for delivering capital projects, commercialising existing assets or disposing of Council assets.
- Bournemouth Christchurch and Poole Council ("the Council" or "BCP") wishes to further examine one of the options set out in the previous report, namely establishing a wholly owned subsidiary to purchase income generating assets from BCP using third party finance secured against those assets.
- We understand that BCP would like to improve the commercial performance of the Council's asset base.
- BCP has identified their current portfolio of Beach Hut assets as a suitable example to explore this further.

## Scope of work

- KPMG has been engaged by BCP to consider the potential structure and financing of the potential transaction. The scope of work covers:
    - Outlining BCP's preferred model, including details of fund flows and accounting treatment;
    - Reviewing materials provided by BCP in relation to their Beach Hut proposition;
    - Assisting BCP to undertake indicative financial analysis of the proposed financing of the Beach Huts; and
    - Suggesting ways to potentially enhance the business potential of the SPV.
- We note our commentary is limited due to the early stage of the considerations taking place by BCP.
- This report explores the potential deliverability of a structure, which may enable BCP to achieve its required service, operational and financial outcomes. The structure and concept will require additional work to develop further.
- We note that it is part of the Council's process to develop the business cases and the value for money cases which will guide its decision making. This report is not a business case or a value for money assessment.

## Information provided

- To assist KPMG in delivering the scope of work. BCP has provided the following primary sources of information:
    - Beach Huts Income and Expenditure – Historical (2015-2016) and forecast (2021 - 2025)
    - Beach Huts – Product type summary
    - Beach Huts – Book value

# 2 - Headlines

## Council owned SPV structure

- BCP are currently exploring various avenues to seek to improve the commercial performance of their assets. This entails seeking to maximise the efficiency of the assets, cost savings and increasing the potential income. We understand that the Council would like to explore a wholly or majority owned SPV structure to seek to deliver this agenda.
- The proposed structure that BCP wishes to explore entails BCP setting up an autonomous SPV that it will wholly or majority own. This SPV will then purchase BCP's assets at market value, based on independent valuation.
- The SPV will raise senior debt from a third-party to the extent the SPV can comfortably afford to repay that debt from cash flows generated by the assets in the future.
- The value of the senior debt raised less any amount used to fund transaction costs and cash reserves in the SPV will be paid to the Council as part payment of the purchase price.
- BCP could potentially recognise a Capital Receipt to the extent that the purchase price is paid in cash.
- To the extent that the value of the senior debt raised is insufficient to pay the purchase price in full, this will be recorded as a deferred capital receipt and the SPV will grant a subordinated shareholder loan to BCP, representing the amount owed to BCP but not yet paid.
- The SPV will then apply income generated from the assets towards operating and maintenance costs, corporation tax and debt service.
- Surplus cash after meeting senior debt service obligations will be returned to BCP as a combination of subordinated debt service (i.e., paying BCP the deferred capital receipt recognised on the initial disposal of the assets and the interest on that deferred capital receipt) and dividend or retained by the SPV for growth consistent with the Council's broader transformation and asset commercialisation agenda. Where there is third party minority interest, this party will be entitled to a share of distributions proportionate to their share.
- BCP may provide a partial guarantee of the income stream to the SPV. Where BCP provides a guarantee, BCP will charge a guarantee fee at a market rate to compensate for the limited risk taken.
- The chances of the guarantee being called will need to be sufficiently remote to conclude that there has been a 'true sale' of the underlying assets to the SPV. Ultimately this is a decision for the s151 officer and will need to be agreed with BCP's auditors.
- Once the senior debt has been repaid BCP will own share capital in an entity that owns the assets and is unencumbered by external debt. The Council can continue to trade the assets through the SPV or dissolve the SPV and take back the assets at this point.
- Our understanding is that BCP's proposed structure is in line with the updated CIPFA prudential code and the current capital finance framework and that BCP has discussed this with CIPFA. BCP is exploring this structure and financing arrangement as part of their commercialisation and local regeneration agenda and is identifying and quantifying the financial risks to the Council of the structure before deciding whether to implement it. Additionally, we understand that BCP has started to consider the governance processes it will need to implement to effectively manage and mitigate the risks associated with both the initial implementation of the structure (should BCP proceed with it) and the subsequent ongoing operations of the SPV.

## Beach Hut proposition

- BCP has identified its portfolio of Beach Hut assets as one which provides opportunity for commercialisation given the strong demand for the assets and positive market drivers. This report uses this portfolio as an example to set out potential cash flow and accounting impacts of BCP selling its Beach Hut assets into a subsidiary structure.
- We understand from the Council that there are important stakeholders and beneficiaries to the Beach Hut assets including BCP Futureplaces Ltd (Council owned), site owners such as the Meyrick Family and Cooper Dean and charities relevant to the foreshore. As such, BCP could explore a Limited Liability Partnership ("LLP") structure to incorporate the other stakeholders. This may bring additional commercial benefits such as access to additional assets, greater co-operation with relevant stakeholders and access to expertise in commercialising assets.
- Based on the high-level analysis of the Council's assumptions, we consider that the Beach Hut cash flow could be sufficient for BCP to benefit through a capital receipt of:
    - **£50.0m** based on a **wholly owned limited company** that is wholly owned by the Council, with a financial guarantee provided by the Council up to 67% of income.
    - **£56.9m** with an **LLP structure** that is 80% Council owned and 20% by other stakeholders to the transaction. This assumes that the third party is a Council owned entity and as such the distributions would remain within the Council group. This analysis would need to be updated to reflect the assets and investment an external third party could bring to the LLP when more information is available.
- The increased capital receipt from using an LLP structure is largely driven by the increased debt capacity of the SPV due to tax being paid by the partners in that SPV rather than the entity itself (and therefore excluded from debt coverage calculations).
- The limited company option introduces additional transaction costs and corporation tax into the structure with an NPC of **£24.4m** (using the PWLB rate as a discount rate). The main driver of this is corporation tax payable by the SPV.
- Under the LLP option this NPC of additional costs reduces to **£7.1m**, primarily due to less corporation tax being payable. Only high-level tax assumptions have been made at this time and specialist tax advice will be needed to understand any tax risk associated with this option. There would need to be a robust commercial rationale for the structure other than saving tax.
- There may be opportunity to further enhance the income or drive financial efficiency from the assets either through increased provision, better management, or better pricing strategies. It is possible that implementing the commercial structure set out improves the ability to do this and offsets the additional cost. Further consideration of this is needed for BCP to make the value for money case for the transaction.
- We note that the output from BCP's proposed scenarios for interest rate and inflation sensitivity can be found in Appendix 3.
- We estimate the potential transaction could take roughly six months to implement.

# 3 - Commercialisation and Council owned SPV structure

## Introduction

– In this section of the document, we provide an outline of the commercialisation rationale of the Council and an overview of the proposed SPV structure. The proposed SPV structure is a wholly owned SPV with 100% share capital held by BCP.

## Commercialisation

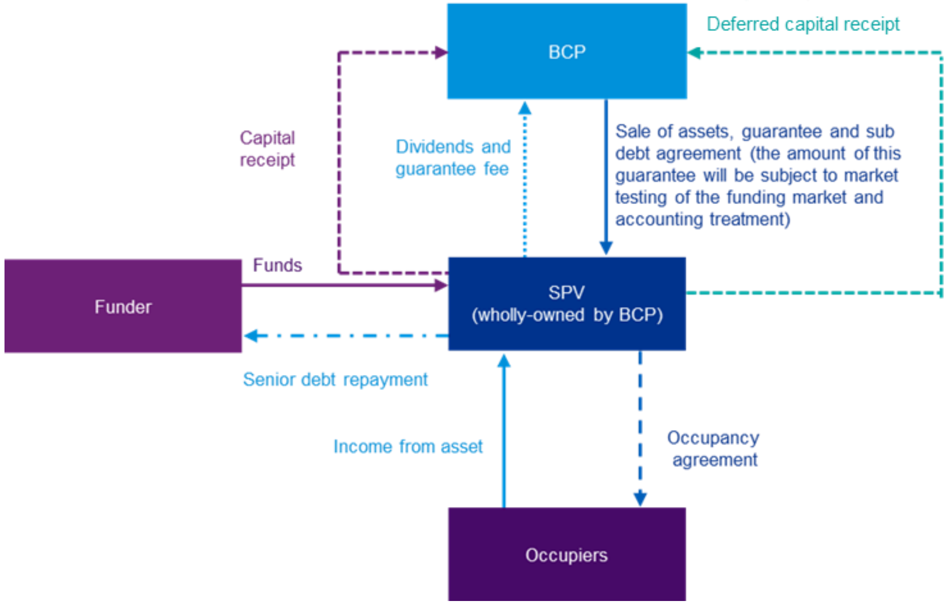
– BCP has income-generating assets that it currently manages. BCP wishes to explore commercialisation opportunities for these assets to seek to maximise their efficiency, cost savings and income potential. This commercialisation opportunity could involve setting up wholly or majority owned entities that will trade with a degree of autonomy within agreed parameters set by its Board. As such, it could create more time for BCP senior management to focus on core activities and a more nimble commercial organisation to exploit asset potential.

– As part of the commercialisation agenda, we understand from BCP that it is exploring various options including:

  - Increasing the rent of some of its assets to increase income;
  - Increasing the number of assets on some of its sites for example sites with Beach Huts; and
  - Exploring various projects with third parties to increase income.

## Structure diagram

*Figure 1 - Structure diagram*




## Overview

– BCP will set up an SPV that it will wholly or majority own.

– The SPV will have its own management team and governance arrangements, which will include decision-making arrangements. As such, the SPV will be autonomous of BCP's day to day operations but remain subject to BCP strategic oversight.

- The SPV will purchase BCP assets at market value to demonstrate value for money.
- The SPV will fund its purchase through:
  - raising long term senior debt from a third-party funder; and
  - a subordinated shareholder loan (deferred capital receipt) to BCP for the difference between purchase price and the amount of senior funding.
- When the sale takes place, BCP will recognise a Capital Receipt to the extent that the purchase price is paid in cash, i.e. for the value of senior debt raised less any transaction costs paid for by the SPV less any proceeds used to create cash reserves in the SPV.
- The SPV will apply income generated from the assets to:
  - Pay the operating and maintenance costs of the assets, including any costs of running the SPV and management overhead;
  - Making interest and repayments of the senior debt;
  - Making interest payments on, and funding the repayment of, the subordinated shareholder loans (deferred capital receipt) from BCP;
  - Distributing any surpluses to BCP as dividends (where they would score as revenue income) or retaining them in the SPV to fund the future business plan.
- To give further security to the senior external funder, BCP may be able to provide a partial guarantee of the income stream to the SPV. The extent of this guarantee is likely to be limited (e.g. a last loss guarantee mechanism) so as not to impair the incentives and external market discipline imposed on the SPV to optimise income generation. Where a guarantee is provided by BCP it is envisaged that BCP will charge a guarantee fee at a market rate to compensate for the limited risk taken.
- We expect senior funders will require the SPV to maintain a Debt Service Reserve Account (cash collateral held by the SPV to provide a buffer if there is any shortage of income in a period).
- Any repayments on the subordinated loan, payment of guarantee fees and distribution of dividends will be subject to financial covenant agreements with the funder, which are likely to include Debt Service Cover Ratios ('DSCR') and potentially an asset cover ratio. The DSCR is the ratio of a Project's cash flows available for debt service ('CFADS') to its senior debt service obligations.
- The SPV and funders to it (which include both third party senior debt and subordinated shareholder loans (deferred capital receipt) provided by BCP) will be subject to the risks related to the operation and income generation of the asset.
- On repayment of the third-party debt in 20 years BCP will have ownership of the SPV with no debt secured against it. Should it wish to at this point it could dissolve the SPV and take back ownership of the assets or continue to operate them through the SPV.

# 4 - Accounting considerations

## Introduction

- Only the Council and specifically its s151 officer can, in consultation with its external auditors as required, determine the accounting treatment appropriate to a specific transaction based on the facts and circumstances of that transaction at the time is it entered into.
- We set out below, for consideration by the Council, our views on the potential accounting treatment of the transaction described on pages 7 & 8. This is the potential accounting treatment by BCP in its single entity accounts under ACOP and the Capital Finance Regulations as they are currently understood to apply.

## Capital expenditure and borrowing

- As the SPV (even though a wholly owned subsidiary of the Council) would be a separate entity, under the prudential regime – which applies only to the transactions which the Council is required to record in its own single entity accounts – there is likely to be no capital expenditure or borrowing incurred by BCP (as the external borrowing and acquisition of assets is instead undertaken by the SPV, rather than the Council).
- Therefore, capital expenditure by the SPV on acquiring assets, and the external borrowing it undertakes to do so, will potentially not fall to be capital expenditure by the Council.

## Minimum Revenue Provision (MRP) / General Fund impacts

- If the Council is not deemed to be undertaking capital expenditure or borrowing in its own right, it will not be required to make an annual MRP charge, nor will it incur interest costs on borrowing in its, General Fund ("GF").

## Capital receipts considerations

- Three objectives need to be met if the Council were to record capital receipts:
    - The Council must demonstrate that it has actually disposed of the underlying assets such that it is, under proper practices, required to derecognise the assets from its own single entity balance sheet (i.e., achieve a "true sale" to the SPV);
    - That were the Council to acquire the assets disposed of itself, that such an acquisition would fall to be capital expenditure; and
    - The consideration on the disposal of the assets must be in the form of cash. Under the Capital Finance Regulations only when cash is received, on the disposal of capital assets, can the Council recognise available capital receipts.

## Achieving a "true sale"

- To achieve a "true sale" of the assets to the SPV the Council must demonstrate both that (i) it has transferred substantially all the risks and rewards incidental to the ownership of the assets to the SPV (i.e., that it is the SPV which benefits from the economic flows associated with those assets and can control them); and (ii) that the Council has not reabsorbed those risks and rewards through other means.
- The key risks and sources of reward associated with the assets to be transferred to the SPV is likely to be around (i) rental income; (ii)

- maintenance and lifecycle costs; (iii) residual value of the assets and the income arising on the disposal of some of the assets.
- Under the proposed transaction it will be the SPV, rather than the Council, which will be substantially exposed to these risks and rewards in that it will be the SPV (and through it, its external funders) that will take the risk:
  - On variations in both gross income and net income after deducting the costs incurred by the SPV on maintaining the assets and meeting its obligations to users of the assets; and
  - On the residual / market value of the underlying assets. This reflects that the Council, as a single entity, will not have the right to re-acquire the assets at a nominal or undervalue at a future point. Instead, it is intended that the disposal will not contain any rights for the Council to reacquire the assets from the SPV (but should such rights be granted to the Council they will only be exercisable at an independently established market valuation).
- In this context the potential provision by the Council of a limited guarantee to the SPV is not considered to dilute the extent to which the risks and rewards inherent in the underlying assets are transferred on their disposal to the SPV. This reflects that the guarantee – which as considered further below would be to reimburse the SPV's external funders where net income fell below a certain threshold (the threshold at which the Council's guarantee might be triggered is unknown, However, it has been assumed to be in the order of 50% to 70% of expected net income depending on the amount raised) – will operate on a "last loss" basis. This means that it is the SPV (and its external funders) which bears any losses which might occur from all reasonably expected fluctuations in net income; and the Council's guarantee can only be called after all cash reserves and other income sources the SPV are exhausted or otherwise or otherwise inadequate to meet the debt service requirements of the SPV's external funders.
- Whilst subject to more detailed modelling of the variability of the net income streams over time of the assets to be transferred to the SPV, the "last loss" basis of the potential guarantee mechanism and the high threshold at which it is expected to apply would imply that the guarantee is only likely to be triggered in remote (or at least highly unlikely) circumstances. Accordingly, it would be reasonable to conclude that the guarantee (if offered) would not substantively dilute the transfer to the SPV of the risks and rewards of ownership of the underlying assets.
- In light of the above, we consider it likely that the proposed structure would achieve a "true sale" of the underlying assets to the SPV.

### Would the acquisition score as Capital if undertaken by the Council?

- As described by the Council the assets to be disposed of to the SPV, could be treated as capital expenditure by the Council if it is acquired by the Council.
- This reflects that they would be (i) expected to be treated as a resource from which future economic benefits are expected to flow; and (ii) held by the Council for either the purposes of their service potential or income generating ability for a period of more than 1 year. As such they would be expected to be treated as either Property, Plant & Equipment, or Investment Properties under proper practices, and thereby fall to be capital expenditure for the purposes of the Capital Finance regulations.
- In light of the above, we consider that the acquisition of the assets by the Council could be treated as capital outlay.

### Is cash received?

- As currently proposed by the Council, the consideration received by the Council will likely consist of both cash and a deferred capital receipt in the form of the acceptance by the SPV of the obligation to repay a loan (and associated interest) to the Council. The proposed transaction assumes that the deferred capital receipt, in the form of a loan payable to the Council, will rank lower than the borrowing undertaken externally by the SPV to fund its payment of the cash component of the consideration payable to the Council on the transfer of the assets.

– Only that element of the consideration received in cash by the Council will score as available capital receipts. The Council would only need to recognise capital receipts in respect of its loan to the SPV, when and to the extent that the SPV repays the principal of that loan. The extent to which the consideration is in the form of a long-term loan repayable to the Council will be treated as Deferred Capital Receipts (which will not be an available resource to the Council to fund capital expenditure).

**Overall conclusion: Capital Receipts considerations**

– If the Council will dispose of assets to the SPV under a "true sale" in return for both cash consideration and a deferred capital receipt in the form of the acceptance of a loan obligation, the Council would be required to recognise capital receipts to the extent it has received cash consideration. This reflects that the prudential regime applies only to the Council's single entity (rather than group) accounts and that therefore cash consideration arising on asset disposals, even to a wholly owned subsidiary, would score as capital receipts (as the acquisition by the Council of those assets would score as capital expenditure). The extent to which the consideration is in the form of a loan repayable by the SPV to the Council would be treated as Deferred Capital Receipts.

– Moreover, s21(3) of the Local Government Act 2003 requires that, in the event of conflict between statutory provisions and proper practices, that the statutory provisions (namely that capital receipts are recognised in respect of the cash consideration) will prevail.

It is noted for completeness that whilst the Council's single entity accounts will show available capital receipts (and deferred capital receipts) on the sale of these assets to the SPV, the group accounts, if s21(3) of the LGA 2003 is deemed not to apply to that disclosure note, would show a different level of available capital receipts reserve as transactions between the Council and its wholly owned SPV are required to be eliminated on consolidation.

## Proper purpose considerations

– It is assumed that the Council is recognising available capital receipts on the disposal of assets to its wholly owned SPV to the extent that the SPV pays cash consideration for those assets, which the SPV would fund by way of external borrowing. This requires the Council to consider whether the transaction is for a proper purpose (i.e., that it is not solely a device to generate available capital receipts funded by way of external debt).

– Whilst this is a matter on which the Council will need to satisfy itself, our current understanding is that the motivations for undertaking the transaction is for commercial and strategic reasons. The generation of available capital receipts is incidental to that core purpose. This reflects that:

  - The primary driver of BCP's proposed structure is the Council's strategic desire, as part of its wider transformation programme, to introduce significantly greater commerciality to its utilisation of assets and thereby increase the level of income and service benefits generated by its extensive asset base;
  - The SPV is a mechanism by which to collate those assets with scope for income and service benefit optimisation. BCP expect the SPV to grow and complement the Council's wider place making agenda over time; and to this end
  - The SPV is likely to, within a robust overall governance and oversight framework which the Council will design and implement, have meaningful autonomy of action and greater flexibility to take rapid and market focussed decisions. This autonomy will be reflected in the SPV's Board of Directors and the management team which over time run it on a day-to-day basis; and
  - The use of external funders to support the SPV is seen by the Council as not only a mechanism by which to introduce sharpened commercial disciplines but also to financially insulate the Council's other activities from the SPV (as well

as reinforcing the SPV's autonomy) as substantially all the reasonably foreseeable risks and rewards associated with the assets are borne by the external funders.

- Whilst a matter for the Council to conclude on, the current understanding of basis of BCP's proposed structure would suggest that it is driven by a proper purpose and that the generation of available capital receipts is incidental to that purpose.

## Other accounting considerations

### Treatment of the guarantee (if provided)

– The guarantee is likely to fall to be a financial guarantee (as defined by IFRS 9) as it is assumed it will require the Council to reimburse the lender specified amounts if the SPV fails to meet its obligations under a debt instrument.

– The Council would be required to calculate a loss allowance for the guarantee which will be a charge to the GF, net of any premium income earned by the Council from providing the guarantee (it is assumed that the Council would charge the SPV a 'market' premium for the guarantee).

– The loss allowance would reflect the Council's risk weighted assessment of the likelihood of it being required to make payments under the guarantee to the lender (which as noted above is currently considered to be very low on the basis of the current understanding that the guarantee will operate on a "last loss" basis).

### Treatment of loan between Council and the SPV

– A portion of the consideration provided by the SPV on the disposal of assets is in the form of the acceptance by the SPV of a loan obligation to the Council which will give rise to a financial asset and deferred capital receipt on the Council's balance sheet.

– The Council will need to account for its financial asset (loan to the SPV) under IFRS 9, on the amortised cost basis. This will require the Council to review the loan (and any balance for unpaid interest at the year-end) for impairment and make an appropriate Expected Credit Loss (ECL) provision. In this context it should be noted that:

  - Any increase in the ECL arising on the principal would not be expected to be a charge to the GF as the loan balance represents a deferred capital receipt (and the original asset disposed of was fully funded through capital resources). Any provision required in respect of unpaid interest would however be a charge to the I&E account; and
  - Interest income on the loan (measured on the effective interest rate method which we would be expect to be the same as the nominal interest rate of the loan – as the loan is expected to be at a commercial rate consistent with the wider purpose for establishing the SPV and disposing of certain assets to it) will be credited to the I&E when earned. To the extent that the SPV has not paid interest due by the year-end, the Council will recognise a financial receivable for the amount due.

# 5 - Beach Hut proposition

## Introduction

- This section of the report discusses our findings on the indicative amount of third-party debt that the SPV could raise based on the estimated income generated (the "Project" and the "Transaction") by BCP's Beach Huts and related land interest (the "Assets") and the associated capital and revenue flows to the Council if implemented.
- To inform our analysis, we have reviewed the following information sent by BCP:
  - Beach Huts Income and Expenditure – Historical (2015-2016) and forecast (2021 -2025)
  - Beach Huts – Product type summary
  - Beach Huts – Book value

## Key assumptions

This sub section states the key assumptions which were provided by or agreed with the Council. We have extrapolated the figures over a likely debt term to get an indication on how much capital the SPV could raise.

- Purchase price of assets: BCP has provided the book value of the assets. We note that to achieve the desired accounting treatment and meet the Council's best value requirements, the assets will need to be transferred at fair value. In the absence of a formal valuation of the assets, we have used a capitalisation method agreed by the Council to estimate the value of the assets. This will need to be replaced by a formal valuation if the Project is progressed. To provide a high-level estimate of the fair value we applied a net initial yield of 8% to the 2021 annual income of £5.4m. This results in a proxy for fair value of £67m which we have used in this report. The net initial yield of 8% reflects the non-prime purpose-built student accommodation in regional locations according to CBRE in Residential Investments Q3' 2021. We have used this yield since there are limited large scale transactions similar to the Beach Hut asset class. Additionally, the assets have similarities to student accommodation, such as a stable income stream, low operating cost base and a waiting list in most cases.
- Inflation: We considered various methodologies and sources for the inflation rate. Below we list some of these approaches
  - Difference between the index-linked gilt and fixed gilt: This suggests the market is forecasting inflation of between 3.8% and 4.0% over a 10-to-20-year duration.
  - Office for Budget Responsibility ("OBR") RPI forecast: The OBR provides forecasts for inflation. In the forecast as of 16th of February 2022, which covers the period until Q1 2027, RPI has a maximum rate of 5.43% and then stabilises in the latter years to around 2.8%. We calculated a compound average rate using the OBR forecasts for RPI. This results in a rate of approximately 3.47%.
- Since the assumption for revenue in this analysis is linked to inflation and the debt is fixed, high inflation is beneficial once debt is raised. We have therefore taken a conservative approach by using a rate of 2.9%. This is the CPI rate from the Office of National Statistics for the month ending September 2021, when we started the analysis. This is also close to the rate of the OBR forecast when inflation stabilises in the latter years of the appraisal period. We note that inflation movements can be volatile. As such, adverse movement of inflation could impact the output from the extrapolation of the Council's assumptions.
- Revenue forecast: BCP has provided a revenue forecast for 5 years which we understand assumes an increase in assets. For our

analysis, we increased the revenue for the year ending 2021 by an inflation rate of 2.9% for each year over 20 years.

- <u>Operating and maintenance cost:</u> We take a conservative approach by using the highest operating and maintenance cost as a % of income for the last three years. This results in an allowance of 7.4% of income for operating costs and 5.0% for maintenance costs. We have then applied an inflation rate of 2.9% for each year over 20 years.
- <u>SPV cost:</u> We have assumed an annual SPV cost of £100k and increased this amount by the inflation rate of 2.9%. This is a high-level allowance for the incremental cost of having an additional entity, to cover costs such as additional management time, audit fees, Directors fees, insurances.
- <u>Tax:</u> For corporation tax, a tax rate of 20% was applied simply to any annual surplus. Senior debt interest is deemed to be deductible but interest on subordinated debt payable to the Council is not. The tax rate increases to 25% from year 2 which is in line with the government's corporation tax increase to 25% from April 2023. Further detailed work on the tax computation will be needed ahead of implementation and this is a high-level allowance only at this stage.
- <u>Lease:</u> we have assumed the leasehold is of at least 99 years (and more likely 125 year+) and therefore represents a true disposal of land interest.
- <u>Discount rate:</u> We have used a discount rate of 2.62%, which is the PWLB 20-year annuity rate as of 16/02/22, instead of the HMT Green Book rate of 6.09% (nominal). The PWLB rate reflects BCP's cost of capital, and this rate is adjusted daily. The HMT Green Book rate is based on the economic concept of a Social Time Preference Rate. Given this analysis is a financial one and not an economic analysis, KPMG has agreed with BCP that the PWLB is a better measure for this purpose. The HMT Green Book rate has not changed in several years despite a reducing interest rate environment. We do note that using the HMT Green Book rate, the NPC analysis for the proposals would be more favourable.

## Debt assumptions

- This sub section states the key debt assumptions based on transactions in the market with some similarities.
- There are various debt instruments that are available to the SPV to raise the funding. For this report, we have assumed that the debt will be raised through a Private Placement ("PP") from the capital markets.
- Private placements are unlisted corporate securities including debt, offered directly to a limited group of institutional investors rather than via public markets. It is a form of raising debt from the capital markets. These instruments offer a few advantages over bank debt and some other capital markets instruments such as income strips. The advantages include the ability to structure the repayment to match the income profile of the asset and the option to hedge against inflation or not through index-linked or fixed rate debt.
- For the high-level review, we have assumed that the debt will have a fixed rate.

To consider the debt capacity of the structures at a high level, the debt assumptions are based on transactions with similar characteristics in the market and initial discussions with BCP include:

*Table 1 - Debt assumptions*

| | Definition | BCP guarantee |
|---|---|---|
| Tenor | Number of years to pay the senior debt back | 20 years |
| Repayment profile | The profile under which debt is repaid and whether it is repaid in full over the tenor of the debt or will need to be refinanced in the future. | Repaid in full over the debt term with an amortisation profile to hit the Debt Service Cover Ratio. |
| Transaction cost | Transaction costs are cost related with executing the financing transaction. This includes legal fees, financial advice, etc. These costs will be reimbursed by the funder at financial close. | 800k |
| Inflation hedging | Private placements be structured as fixed rate, index linked or combination of both. | Fixed |
| Debt Service Cover Ratio | This is the ratio of a Project's CFADS to its debt service obligations. | 1.5x |
| Debt Service Reserve Account ('DSRA') | DSRA provides for some cash (enough to meet the next debt service payment, generally 6-12 months) to be set aside to provide liquidity and secured in favour of lenders | 6 months |
| Guarantee fee | A guarantee fee is the amount charged for BCP providing a guarantee to the SPV. We have assumed that this is the difference in margin between the guarantee and no guarantee debt option equivalent. In this case 1.25%. | 1.25% |

– Pricing: The all-in rate for a private placement transaction typically consists of:

  – Reference rate: Long term debt transactions (over 10 years) such as private placements are typically priced with reference to the underlying gilt rate. We have used the relevant gilt rate for the corresponding Weighted Average Loan Life ("WALL") period. This in line with common practice.

  – Credit margin / spread: This reflects the additional project risk over risk-free rates. Since there are limited transactions comparable to this one in the market, we have used the spreads for recent Local Government private placement transactions to determine the guaranteed debt margin. We have used social housing, tourism and student accommodation bond yields to inform the spread for the non-guaranteed option.

– We note that the pricing offered by private placement providers could vary depending on their risk appetite for the transaction. A soft market testing will be required for the deliverability of the structure and the pricing. The indicative debt pricing is as follows. These figures are expressed as a percentage over gilts.

*Table 2 - Pricing*

| | BCP guarantee | No guarantee |
|---|---|---|
| Market comparable range | Gilt + 0.95% -1.40% | Gilt + 2.10% -2.90% |
| All in price | Gilt + 1.25 % | Gilt + 2.50 % |

– Subordinated debt (deferred capital receipt): Sub-ordinated debt is debt that ranks after senior debt for interest and repayment. For the proposed structure, the SPV will have to purchase the assets from the BCP at a purchase price which represents its fair value. As such, a sub-debt from BCP to the SPV will be required to make up for the difference between purchase price and the amount of senior funding. In our analysis, we have priced the sub-debt at 3.00% above the all-in rate of the senior debt although this is indicative only and not material to the overall analysis at this stage.

Dividend: Based on the DSCR levels for the proposed transaction, taking into account the other assumptions, there will be a surplus after servicing the senior debt. This amount will be returned to BCP as a combination of the sub-debt repayment, sub-debt interest, guarantee fee and dividend.

## Financial Summary

- In this section of the report, we provide the outcome from our initial high-level analysis.
- This analysis assumes **no change in the income or operating cost assumptions** associated with the assets as a result of the structure and wider commercialisation activities – it considers the amount of debt that could reasonably be raised and estimates the additional costs that result from implementing the structure. This will need to be overlaid with the estimate financial benefits from better asset performance when available as part of a value for money assessment by BCP.
- We note that the provision of a BCP guarantee will have pricing benefits for the transaction. With a lower price, the SPV can raise more senior debt upfront.
- Table 3 shows the indicative pricing, upfront capital receipt to BCP and the maximum amount that the SPV could raise from the private placement market based on our assumptions.

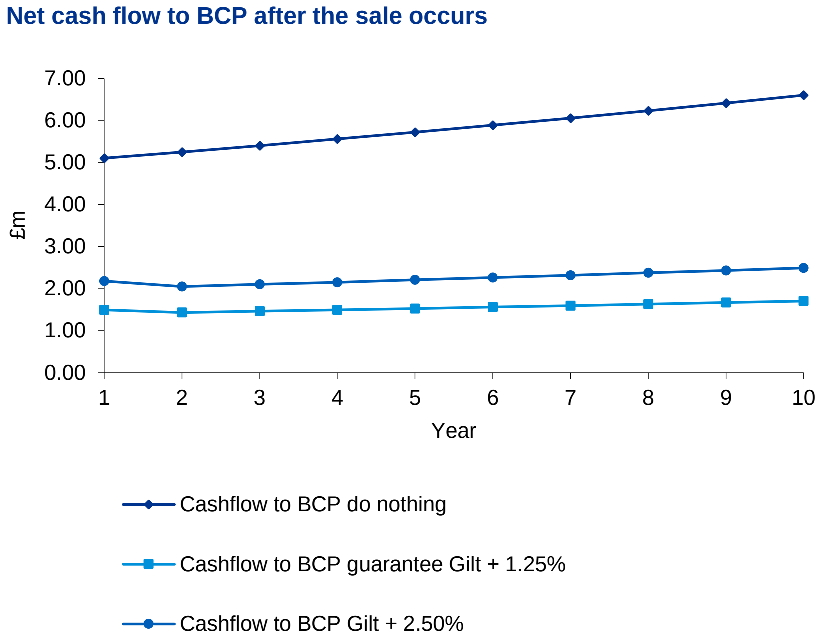
*Table 3 – Debt raise summary*

| | BCP guarantee | No guarantee |
|---|---|---|
| Pricing | Gilt + 1.25% | Gilt + 2.50% |
| DSRA prefund | £1.5m | £2.1m |
| Transaction cost | £0.8m | £0.8m |
| **Upfront capital receipt to BCP** | **£50.0m** | **£31.1m** |
| **Senior debt amount** | **£52.3m** | **£34.1m** |

*Source: KPMG analysis based on Council assumptions*

- Indicatively, a capital receipt up to £50.0m could be achievable if BCP provides a guarantee.
- Under this scenario, it is assumed that the Council would provide a guarantee equivalent to 67% of income and reach the view (and that view be agreed by the Council's external auditors) that a drop in income below 67% is sufficiently remote as not to cause the guarantee to be recognised as a liability.
- Comprehensive market testing will be required to test the deliverability of the guarantee.
- In Figure 2, we present the net cash flow to BCP after the sale occurs. This is cash distribution from the SPV to the Council (whether through guarantee fee, repayment and interest on subordinated debt or subordinated debt interest).
- Figure 2 shows that the do-nothing option of retaining the asset will generate the most annual net cash flow for BCP over the life of the transaction. However, this is due to not receiving an upfront receipt in time 0 from the sale of the assets and therefore not incurring transaction and interest costs.
- Once debt is repaid after 20 years the Council receive all net income through dividend in the standard BCP guarantee option.

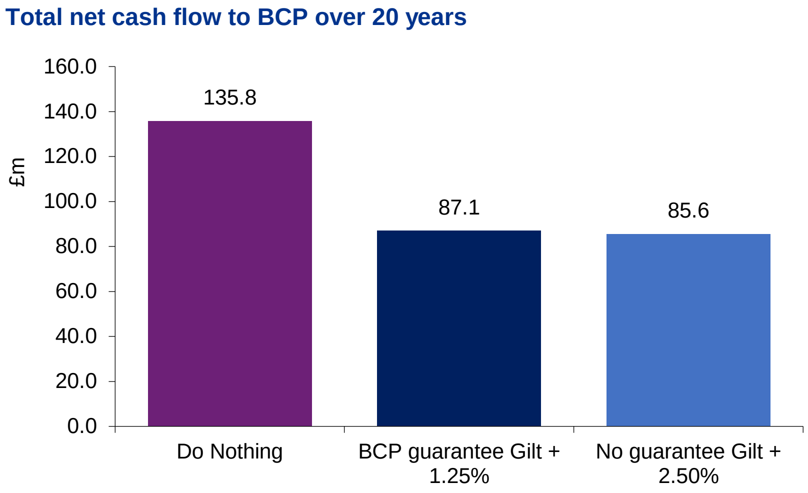
*Figure 2 - Net cashflows to BCP*




*Source: KPMG analysis based on Council assumptions*

- In figure 3, we provide the total net cash flow to BCP over the 20-year period. The chart shows that the BCP guarantee structure could potentially generate the most cash. This is mainly driven by the upfront capital receipt.

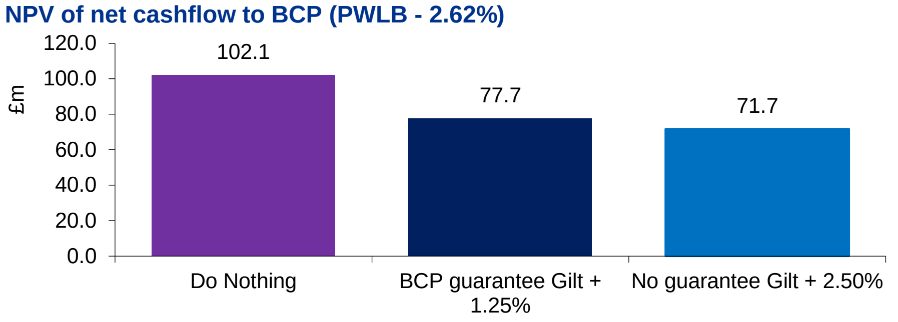
*Figure 3 - Net cashflows to BCP*




*Source: KPMG analysis based on Council assumptions*

- Assuming a base case scenario where BCP did not sell the assets to the SPV, we have calculated the NPV and compared it to the NPV of the net cash flows to BCP for all three scenarios. To derive the NPV, we have used a discount rate of 2.62% (PWLB 20-year annuity rate – 16/02/22). Figure 4 shows the NPV for the various scenarios.

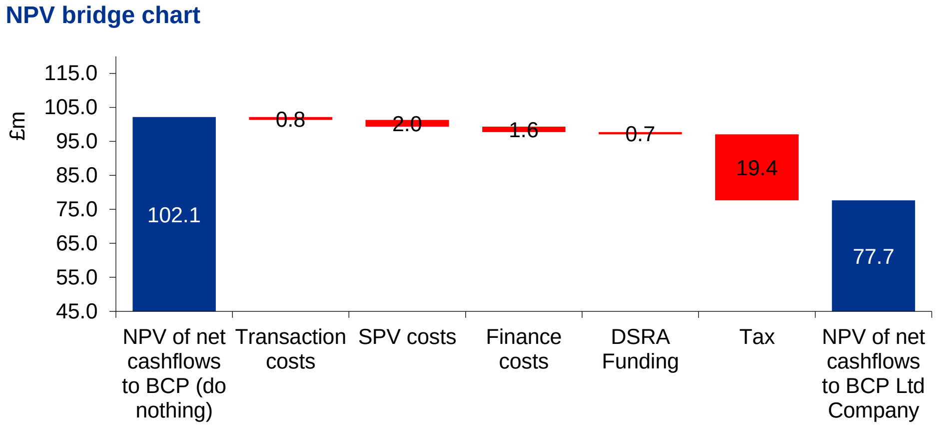
*Figure 4 - NPV of net cashflow to BCP*




*Source: KPMG analysis based on Council assumptions*

- In Figure 5, we present a bridge chart showing the NPV of the Do-nothing option to the NPV of the BCP guarantee.

*Figure 5 - NPV bridge chart for BCP guarantee (SPV - limited company)*




*Source: KPMG analysis based on Council assumptions*

## Alternative Beach Hut proposition structure

- While reviewing the Beach Hut proposition, we came to understand that there are important stakeholders and beneficiaries to the project some of which include BCP Futureplaces Ltd (Council owned), site owners such as the Meyrick Family and Cooper Dean and charities relevant to the foreshore.
- We note that there are additional structural options which could enable BCP incorporate the relevant stakeholders. This could involve the SPV's legal form being a Limited Liability Partnership ("LLP") or a structure including a charity vehicle.

### LLP structure

- The assets could be owned by an SPV whose legal form is an LLP. The LLP will consist of the Council and a third party or parties. Each party's holding could be determined by their equity or contribution of assets to the partnership e.g., 80% Council / 20% third party.
- This structure may enable BCP to spread the transaction risk and leverage the skills and expertise of its partners to commercialise the assets.

### Structural analysis assumption

- To inform BCP's decision on the structure, we extrapolated BCP's key assumptions for the Beach Huts with an LLP SPV. In this sub-section, we present the additional assumptions that we agreed with BCP for the LLP structure:
- LLP split: We have assumed an LLP structure of 80% Council / 20% Council owned entity which is a limited company. As such the distributions would remain within the Council group. Further analysis will be needed to consider the impact of bringing an external third partner into the LLP, including analysis of what assets they are willing to invest and the additional return generated from those assets.
- Tax: In addition to the corporate tax assumptions, we have included SDLT in the LLP option. A rate of 5% on the purchase of the assets is liable assuming a partner will have to pay this amount on their share

of the LLP. Further detailed work on the tax computation will be needed ahead of implementation and this is a high-level allowance only at this stage. Where the partner is a Council owned company it may be able to get group relief for the SDLT.

– Debt capacity: The SPV will have an increased debt capacity due to tax being paid by the partners rather than the SPV itself (and therefore excluded from debt coverage calculations). We have assumed a cap of senior debt to 85% of the asset value to retain a loan to value ratio below 1.

## Financial summary

– We provide the outcome from our initial high-level analysis. For comparative purposes, we have also included the results from the limited company guarantee option in the previous section.

– Table 4 shows the indicative pricing, upfront capital receipt to BCP and the maximum amount that the SPV can raise.

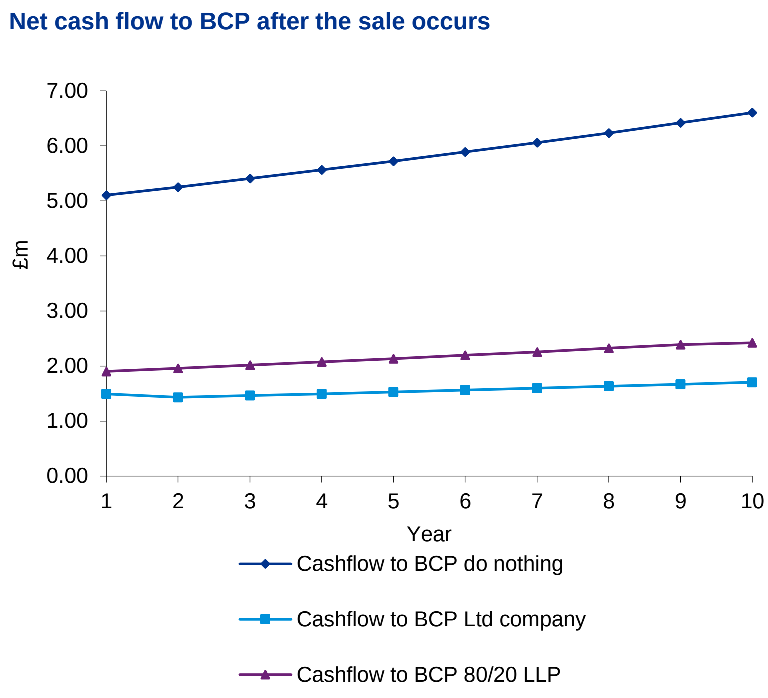
*Table 4 – LLP debt raise summary*

| | BCP guarantee (Ltd company) | BCP guarantee LLP structure (80% Council / 20% Council owned entity) |
|---|---|---|
| Pricing | Gilt + 1.25% | Gilt + 1.25% |
| DSRA prefund | £1.5m | £1.5m |
| Transaction cost | £0.8m | £0.8m |
| **Upfront capital receipt to BCP** | **£50.0m** | **£56.9m** |
| **Senior debt amount** | **£52.3m** | **£59.2m** |

*Source: KPMG analysis based on Council assumptions*

– In Figure 6, we present the net cash flow to BCP after the sale occurs. The do-nothing option of retaining the asset generates the most annual net cash flow for BCP. However, the LLP option generates more annual cash for BCP when compared to the Ltd company option. This is due to the other partner being a Council owned entity and the Council's tax exemption in the LLP structure.

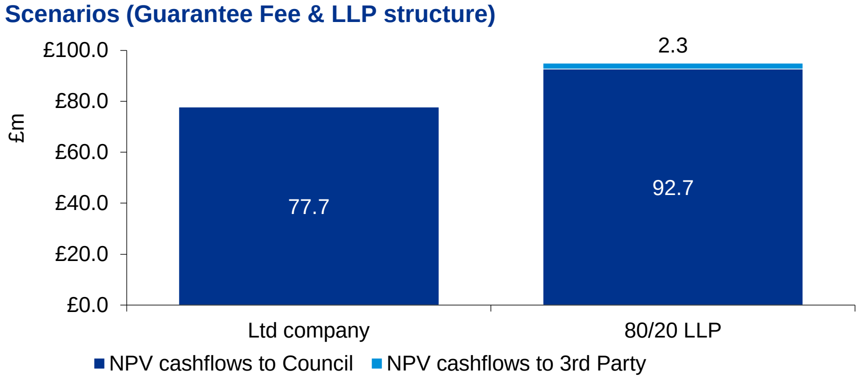
*Figure 6 - Net cashflows to BCP showing the LLP option*




*Source: KPMG analysis based on Council assumptions*

– Figure 7 shows the NPV of the net cash flow to BCP using a discount rate of 2.62% (PWLB 20-year annuity rate – 16/02/22). The LLP option will generate the most cashflow for BCP (£95.0m) due to the upfront receipt, the third party being a Council owned entity and the Council's tax exemption status.

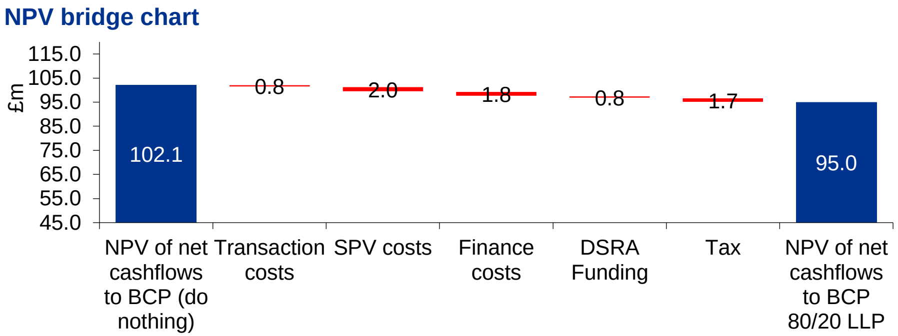
*Figure 7 - NPV of net cashflow to BCP including the LLP option*




*Source: KPMG analysis based on Council assumptions*

– Lastly, in figure 8, we present a bridge chart showing the NPV of the Do-nothing option to the NPV of the BCP guarantee LLP option.

*Figure 8 - NPV bridge chart for BCP guarantee LLP structure*




*Source: KPMG analysis based on Council assumptions*

## Sensitivities:

– Interest rate and inflation sensitivity outputs for both SPV options can be found in Appendix 3.

## Conclusion

– As a result of the above, we consider that the use of an SPV structure could enable the commercialisation of assets which may ultimately provide various benefits to BCP including a capital receipt. Further analysis of the potential for additional revenue or operating cost efficiency from commercialisation is needed to determine whether this offsets the increased cost driven by the structure, most notably tax and transaction cost.

– This is subject to BCP being able to provide evidence to it's auditors that the chances of a guarantee being called (which relies on income being less than 67% of forecast) is remote. The case for this required detailed development at the next stage.

– The net impact on BCP revenue surpluses of the limited company option is £3.6m rising to £6.5m in the 20-year period. This is driven by the interest on debt, transaction costs and tax of the SPV.

– In NPV terms (using the PWLB rate as a discount rate) for the limited company option, there is a net cost to the Council over 20 years of £24.4m. The largest part of this is due to corporation tax payable by the SPV. However, other commercial structures such as the LLP reduce this amount materially and allows the other stakeholders to be involved in the transaction. Detailed tax advice is required if the Project is progressed.

– The analysis in this report also assumes that total income from the Beach Huts is unchanged under the SPV structure. The Council may wish to further explore opportunities to enhance the income generated from the assets, through strategies such as increasing deployment or changing pricing strategy. It is possible this may mitigate or exceed the transaction costs and corporate tax leakage and this will be important to be able to reach a conclusion on the value for money of the proposals.

- Under an 80/20 LLP structure the capital receipt will increase to £56.9m. We note that BCP will require detailed tax advice for the use of an LLP structure and there may be some tax risk associated with the structure.
- The initial funding analysis demonstrates that there is potential for the SPV to raise debt from a senior lender. However, there are a few broader considerations for the transaction. Below we list some of them:
  - Tenor: the initial analysis is based on a 20-year tenor. We note that PP funders can provide debt for up to around 45 years if there is a guarantee in place. The longer tenor will enable the debt repayment to be spread over an extended period, increasing the annual amount of cash to BCP after senior debt repayments. However, a longer guarantee may weaken the argument that it is unlikely to ever be called as cashflows become less certain the longer into the future they are predicted.
  - Fixed rate vs inflation-linked: the analysis assumes fixed rate debt. However, since the rental profile is expected to rise in line with inflation, there could be merit in exploring index-linked debt. The main advantage of index-linked debt is that it can help to hedge against inflation risk. However, a disadvantage is that funders sometimes charge a premium in the margin for the inflation hedge.
  - Funding placement: The analysis is based on a private placement funding from the capital markets. However, we note that a private placement and other forms of debt will have punitive breakage costs for early repayment if ever needed. There are other funding mechanisms that are available such as banks and debt funds that may have lower break costs and more flexibility to repay early, however, may charge a higher initial rate.
- Additional considerations for BCP regarding the SPV include:
  - Staffing: The SPV will require staff for various purposes. This could include BCP transferring or seconding a few staff to the SPV. The SPV could also purchase support from the Council via a service-level agreement.
  - Governance: effective governance measures will have to be implemented for the SPV i.e. board composition, constitution, reporting requirements.

## Implementation

- In the paragraphs below we set out the key steps to implementing the transaction.
- Step 1, detailed design: The following areas need further exploration as part of the detailed design of the transaction:
  - Governance arrangements of the SPV
  - Resourcing of the SPV, i.e. whether the SPV functions through a management agreement with BCP, BCP seconds staff into the SPV or it independently employs staff an management
  - Formal valuation of the assets
  - Consideration of the optimal method of getting cash surpluses generated by the assets after third party debt service back to BCP, i.e. whether through guarantee fee, subordinated loan interest and principle repayment or dividend
  - Further analysis of the tax implications, including corporation tax, VAT and SDLT
  - Analysis of the optimal term length for the third-party debt
  - Consideration of the optimal debt structure, such as whether index linked or not, repayment profile and tenor.

- Further consideration of optimal debt placement strategy and structure.
- Detailed accounting treatment and tax advice based on final deal design.

– Step 2, preparation for transaction:
  - Market sounding of potential investors to confirm investor appetite.
  - Detailed credit analysis on the Project and BCP (as guarantor) to inform future funder engagement
  - Development of funding heads of terms.
  - Additional tax and accounting advice (if required).

– Step 3, transact:
  - Setting up of the SPV and bank accounts.
  - Preparation of an information memorandum for funders.
  - Funding competition.
  - Detailed legal documentation.
  - Funds flow.

Indicatively we would expect Step 1 to be 2-3 months (including allowing for Easter); Step 2 to take 6 weeks to 2 months; Step 3 to take 2 months. This suggests end to end the transaction is likely to take around 6 months to execute.

# Appendix 1- Cashflows BCP Ltd company (guarantee gilt + 1.25%)

## SPV cash flow – nominal £m

| | Total | Year | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 15 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cashflow statement** | | | | | | | | | | | | | | | |
| Revenue | **155.0** | | - | 5.8 | 6.0 | 6.2 | 6.3 | 6.5 | 6.7 | 6.9 | 7.1 | 7.3 | 7.5 | 8.7 | 10.0 |
| Operating Costs & Maintenance Costs | **(19.2)** | | - | (0.7) | (0.7) | (0.8) | (0.8) | (0.8) | (0.8) | (0.9) | (0.9) | (0.9) | (0.9) | (1.1) | (1.2) |
| SPV costs | **(2.7)** | | - | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.2) |
| Tax | **(26.4)** | | - | (0.6) | (0.8) | (0.8) | (0.9) | (0.9) | (1.0) | (1.0) | (1.1) | (1.2) | (1.2) | (1.6) | (2.1) |
| Cashflows from operations | **106.7** | | - | 4.4 | 4.4 | 4.5 | 4.6 | 4.7 | 4.8 | 4.9 | 5.0 | 5.1 | 5.2 | 5.8 | 6.5 |
| **CFADS** | **106.7** | | - | 4.4 | 4.4 | 4.5 | 4.6 | 4.7 | 4.8 | 4.9 | 5.0 | 5.1 | 5.2 | 5.8 | 6.5 |
| **Debt service reserve cash flow** | - | | 1.5 | (0.0) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | (2.2) |
| **Senior Debt service** | | | | | | | | | | | | | | | |
| Opening balance | **647.9** | | - | 52.3 | 50.9 | 49.4 | 47.9 | 46.2 | 44.4 | 42.5 | 40.5 | 38.3 | 36.0 | 22.3 | 4.2 |
| Drawdown | **52.3** | | 52.3 | - | - | - | - | - | - | - | - | - | - | - | - |
| Repayment | **52.3** | | - | 1.4 | 1.4 | 1.6 | 1.7 | 1.8 | 1.9 | 2.0 | 2.2 | 2.3 | 2.4 | 3.2 | 4.2 |
| Interest | **18.9** | | - | 1.5 | 1.5 | 1.4 | 1.4 | 1.3 | 1.3 | 1.2 | 1.2 | 1.1 | 1.0 | 0.6 | 0.1 |
| Closing balance | **647.9** | | 52.3 | 50.9 | 49.4 | 47.9 | 46.2 | 44.4 | 42.5 | 40.5 | 38.3 | 36.0 | 33.6 | 19.0 | - |
| | **-** | | | | | | | | | | | | | | |
| Cashflows after Senior Debt service | **79.8** | | 50.8 | 0.8 | 0.8 | 0.8 | 0.9 | 1.0 | 1.0 | 1.1 | 1.1 | 1.2 | 1.3 | 1.6 | 4.3 |
| Guarantee Fee | **(8.1)** | | - | (0.7) | (0.6) | (0.6) | (0.6) | (0.6) | (0.6) | (0.5) | (0.5) | (0.5) | (0.5) | (0.3) | (0.1) |
| **Subordinated Debt service** | | | | | | | | | | | | | | | |
| Opening balance | **339.4** | | - | 17.0 | 17.2 | 17.5 | 17.7 | 17.9 | 18.1 | 18.2 | 18.2 | 18.2 | 18.2 | 16.8 | 12.8 |
| Drawdown/ (Repayment) | **9.5** | | 17.0 | 0.2 | 0.3 | 0.2 | 0.2 | 0.2 | 0.1 | 0.1 | 0.0 | (0.1) | (0.1) | (0.6) | (3.3) |
| Closing balance | **348.9** | | 17.0 | 17.2 | 17.5 | 17.7 | 17.9 | 18.1 | 18.2 | 18.2 | 18.2 | 18.2 | 18.1 | 16.3 | 9.5 |
| Cashflows after Subordinated Debt service | **69.2** | | 67.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 |
| Dividend | **1.4** | | - | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 |

*Source: KPMG analysis based on Council assumptions*

# Appendix 1- Cashflows BCP Ltd company (guarantee gilt + 1.25%)

## Council cash flow – nominal £m

| | Total | Year | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 15 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Council cashflows** | | | | | | | | | | | | | | | |
| Purchase price | **67.1** | | 67.1 | - | - | - | - | - | - | - | - | - | - | - | - |
| Guarantee Fee | **8.1** | | - | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.5 | 0.5 | 0.5 | 0.5 | 0.3 | 0.1 |
| Subordinated debt drawdown | **(17.0)** | | (17.0) | - | - | - | - | - | - | - | - | - | - | - | - |
| Subordinated debt interest | **20.1** | | - | 1.0 | 1.0 | 1.0 | 1.0 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 1.1 | 1.0 | 0.8 |
| Subordinated repayment | **7.5** | | - | (0.2) | (0.3) | (0.2) | (0.2) | (0.2) | (0.1) | (0.1) | (0.0) | 0.1 | 0.1 | 0.6 | 3.3 |
| Equity contribution | **(0.0)** | | (0.0) | - | - | - | - | - | - | - | - | - | - | - | - |
| Dividends | **1.4** | | - | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.2 |
| Total net cashflows to the Council | **87.1** | | 50.0 | 1.5 | 1.4 | 1.5 | 1.5 | 1.5 | 1.6 | 1.6 | 1.6 | 1.7 | 1.7 | 1.9 | 4.3 |

*Source: KPMG analysis based on Council assumptions*

# Appendix 2- Cashflows BCP 80/20 LLP (guarantee gilt + 1.25%)

## SPV cash flow – nominal £m

| Year | Total | Year | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Cashflow statement** | | | | | | | | | | | | | | | | | | | |
| Revenue | **155.0** | | - | 5.8 | 6.0 | 6.2 | 6.3 | 6.5 | 6.7 | 6.9 | 7.1 | 7.3 | 7.5 | 7.8 | 8.0 | 8.2 | 8.4 | 8.7 | 10.0 |
| Operating Costs & Maintenance Costs | **(19.2)** | | - | (0.7) | (0.7) | (0.8) | (0.8) | (0.8) | (0.8) | (0.9) | (0.9) | (0.9) | (0.9) | (1.0) | (1.0) | (1.0) | (1.0) | (1.1) | (1.2) |
| SPV costs | **(2.7)** | | - | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.2) |
| Tax | **-** | | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Cashflows from operations | **133.1** | | - | 5.0 | 5.2 | 5.3 | 5.5 | 5.6 | 5.8 | 5.9 | 6.1 | 6.3 | 6.5 | 6.7 | 6.9 | 7.1 | 7.3 | 7.5 | 8.6 |
| | | | | | | | | | | | | | | | | | | | |
| **CFADS** | **133.1** | | - | 5.0 | 5.2 | 5.3 | 5.5 | 5.6 | 5.8 | 5.9 | 6.1 | 6.3 | 6.5 | 6.7 | 6.9 | 7.1 | 7.3 | 7.5 | 8.6 |
| **Debt service reserve cash flow** | **-** | | 1.5 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | (2.6) |
| **Senior Debt service** | | | | | | | | | | | | | | | | | | | |
| Opening balance | **754.1** | | - | 59.3 | 58.0 | 56.5 | 54.9 | 53.2 | 51.3 | 49.3 | 47.1 | 44.8 | 42.2 | 39.5 | 36.6 | 33.5 | 30.1 | 26.6 | 5.1 |
| Drawdown | **59.3** | | 59.3 | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Repayment | **59.3** | | - | 1.3 | 1.5 | 1.6 | 1.7 | 1.9 | 2.0 | 2.2 | 2.4 | 2.5 | 2.7 | 2.9 | 3.1 | 3.3 | 3.6 | 3.8 | 5.1 |
| Interest | **22.0** | | - | 1.7 | 1.7 | 1.6 | 1.6 | 1.6 | 1.5 | 1.4 | 1.4 | 1.3 | 1.2 | 1.2 | 1.1 | 1.0 | 0.9 | 0.8 | 0.1 |
| Closing balance | **754.1** | | 59.3 | 58.0 | 56.5 | 54.9 | 53.2 | 51.3 | 49.3 | 47.1 | 44.8 | 42.2 | 39.5 | 36.6 | 33.5 | 30.1 | 26.6 | 22.8 | 0.0 |
| Cashflows after Senior Debt service | **101.8** | | 57.8 | 1.2 | 1.2 | 1.3 | 1.4 | 1.5 | 1.6 | 1.6 | 1.7 | 1.8 | 1.9 | 2.0 | 2.2 | 2.3 | 2.4 | 2.5 | 5.9 |
| Guarantee Fee | **(9.4)** | | - | (0.7) | (0.7) | (0.7) | (0.7) | (0.7) | (0.6) | (0.6) | (0.6) | (0.6) | (0.5) | (0.5) | (0.5) | (0.4) | (0.4) | (0.3) | (0.1) |
| **Subordinated Debt service** | | | | | | | | | | | | | | | | | | | |
| Opening balance | **63.4** | | - | 10.0 | 9.5 | 8.9 | 8.2 | 7.4 | 6.4 | 5.3 | 4.0 | 2.6 | 1.0 | - | - | - | - | - | - |
| Drawdown/ (Repayment) | **-** | | 10.0 | (0.5) | (0.6) | (0.7) | (0.8) | (1.0) | (1.1) | (1.3) | (1.4) | (1.6) | (1.0) | - | - | - | - | - | - |
| Closing balance | **63.4** | | 10.0 | 9.5 | 8.9 | 8.2 | 7.4 | 6.4 | 5.3 | 4.0 | 2.6 | 1.0 | - | - | - | - | - | - | - |
| Cashflows after Subordinated Debt service | **98.0** | | 67.8 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.8 | 2.0 | 2.2 | 2.3 | 2.4 | 2.5 | 5.9 |
| | | | | | | | | | | | | | | | | | | | |
| Dividend | **30.2** | | - | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.8 | 2.0 | 2.2 | 2.3 | 2.4 | 2.5 | 5.9 |

*Source: KPMG analysis based on Council assumptions*

# Appendix 2- Cashflows BCP 80/20 LLP (guarantee gilt + 1.25%)

## Council cash flow (BCP and Council owned company) – nominal £m

| Year | Total | Year | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 20 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Total cashflows** | | | | | | | | | | | | | | | | | | | |
| Purchase price | **67.1** | | 67.1 | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Guarantee Fee | **9.4** | | - | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.5 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 | 0.1 |
| Subordinated debt drawdown | **(10.0)** | | (10.0) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Subordinated debt interest | **3.8** | | - | 0.6 | 0.6 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 | 0.2 | 0.2 | 0.1 | - | - | - | - | - | - |
| Subordinated repayment | **10.0** | | - | 0.5 | 0.6 | 0.7 | 0.8 | 1.0 | 1.1 | 1.3 | 1.4 | 1.6 | 1.0 | - | - | - | - | - | - |
| Equity contribution | **(0.0)** | | (0.0) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Dividends | **30.2** | | - | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.8 | 2.0 | 2.2 | 2.3 | 2.4 | 2.5 | 5.9 |
| **Net total cashflows** | **110.4** | | 57.0 | 1.9 | 2.0 | 2.0 | 2.1 | 2.1 | 2.2 | 2.3 | 2.3 | 2.4 | 2.5 | 2.5 | 2.6 | 2.7 | 2.8 | 2.8 | 6.0 |
| | | | | | | | | | | | | | | | | | | | |
| **Total cashflows pre-tax to Council Group Companies** | **110.4** | | 57.0 | 1.9 | 2.0 | 2.0 | 2.1 | 2.1 | 2.2 | 2.3 | 2.3 | 2.4 | 2.5 | 2.5 | 2.6 | 2.7 | 2.8 | 2.8 | 6.0 |
| **Council cashflows** | | | | | | | | | | | | | | | | | | | |
| Purchase price | **67.1** | | 67.1 | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Guarantee Fee | **9.4** | | - | 0.7 | 0.7 | 0.7 | 0.7 | 0.7 | 0.6 | 0.6 | 0.6 | 0.6 | 0.5 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 | 0.1 |
| Subordinated debt drawdown | **(10.0)** | | (10.0) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Subordinated debt interest | **3.8** | | - | 0.6 | 0.6 | 0.5 | 0.5 | 0.4 | 0.4 | 0.3 | 0.2 | 0.2 | 0.1 | - | - | - | - | - | - |
| Subordinated repayment | **10.0** | | - | 0.5 | 0.6 | 0.7 | 0.8 | 1.0 | 1.1 | 1.3 | 1.4 | 1.6 | 1.0 | - | - | - | - | - | - |
| Equity contribution | **(0.0)** | | (0.0) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Dividends | **24.1** | | - | 0.0 | 0.0 | 0.0 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 | 0.7 | 1.6 | 1.7 | 1.8 | 1.9 | 2.0 | 4.7 |
| **Pre-tax cashflows** | **104.3** | | 57.0 | 1.9 | 1.9 | 2.0 | 2.1 | 2.1 | 2.2 | 2.2 | 2.3 | 2.4 | 2.3 | 2.1 | 2.2 | 2.2 | 2.3 | 2.3 | 4.8 |
| Tax Payable | **-** | | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| **Post-tax cashflows to the Council** | **104.3** | | 57.0 | 1.9 | 1.9 | 2.0 | 2.1 | 2.1 | 2.2 | 2.2 | 2.3 | 2.4 | 2.3 | 2.1 | 2.2 | 2.2 | 2.3 | 2.3 | 4.8 |
| **Limited company cashflows** | | | | | | | | | | | | | | | | | | | |
| Purchase price | **-** | | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Guarantee Fee | **-** | | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Subordinated debt drawdown | **-** | | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Subordinated debt interest | **-** | | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Subordinated repayment | **-** | | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Equity contribution | **(0.0)** | | (0.0) | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - | - |
| Dividends | **6.0** | | - | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 1.2 |
| **Pre-tax cashflows** | **6.0** | | (0.0) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.2 | 0.4 | 0.4 | 0.5 | 0.5 | 0.5 | 1.2 |
| Tax Payable | **(2.2)** | | (0.7) | (0.0) | (0.0) | (0.0) | (0.0) | (0.0) | (0.0) | (0.0) | (0.0) | (0.0) | (0.0) | (0.1) | (0.1) | (0.1) | (0.1) | (0.1) | (0.3) |
| **Post-tax cashflows to the Limited Company** | **3.9** | | (0.7) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.1 | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 | 0.9 |
| | | | | | | | | | | | | | | | | | | | |
| **Total cashflows post-tax to Council Group Companies** | **108.2** | | 56.3 | 1.9 | 2.0 | 2.0 | 2.1 | 2.1 | 2.2 | 2.3 | 2.3 | 2.4 | 2.4 | 2.4 | 2.5 | 2.6 | 2.6 | 2.7 | 5.7 |

*Source: KPMG analysis based on Council assumptions*

# Appendix 3 - Sensitivity analysis

The tables in this section display the outcome of interest rate and inflation sensitivity analysis:

**Interest rate sensitivity**

The interest rate sensitivity below, assumes movements of +25bps, +50bps and +75bps in the gilt rates before financial close. As displayed in the table, as interest rates increase before financial close, the borrowing capacity decreases and the upfront capital receipt.

In the LLP option, the SPV's debt capacity will increase due to tax being paid by the partners rather than the SPV itself (and therefore excluded from debt coverage calculations). For the sensitivities, similar to the base case, we have assumed a cap of senior debt to 85% of the asset value to retain a loan to value ratio below 1. In addition, the DSCR ratio has been adjusted (1.64x) to ensure the debt is repaid in full over 20 years.

| | Interest rate sensitivity | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | BCP guarantee | | | | | BCP guarantee LLP structure (80% Council / 20% Council owned entity) | | | |
| Interest rate | Gilt + 1.25% | Gilt +125 bps | Gilt +125 bps | Gilt +125 bps | | Gilt + 1.25% | Gilt +125 bps | Gilt +125 bps | Gilt +125 bps |
| Movement in gilt | | +25bps | +50bps | +75bps | | | +25bps | +50bps | +75bps |
| DSRA prefund | £1.5m | £1.5m | £1.5m | £1.5m | | £1.5m | £1.5m | £1.5m | £1.5m |
| Transaction cost | £0.8m | £0.8m | £0.8m | £0.8m | | £0.8m | £0.8m | £0.8m | £0.8m |
| **Upfront capital receipt to BCP** | **£50.0m** | **£48.9m** | **£47.8m** | **£46.7m** | | **£56.6m** | **£55.1m** | **£53.7m** | **£52.3m** |
| **Senior debt amount** | **£52.3m** | **£51.2m** | **£50.1m** | **£49.0m** | | **£58.9m** | **£57.4m** | **£56.0m** | **£54.6m** |
| **NPV of payment to BCP** | **£77.1m** | **£76.7m** | **£75.6m** | **£74.7m** | | **£95.1m** | **£93.7m** | **£92.4m** | **£91.1m** |

*Source: KPMG analysis based on Council assumptions*

**Inflation rates**

The inflation sensitivity table assumes movements in inflation after financial close. The inflation rates used include 0.90%, 1.90%, 3.90%, 4.90%, 3.90% with a decrease to 2.90% from year 6 and 4.90% with a decrease to 2.90% from year 6.

In line with the base case, the revenues, operating cost and maintenance cost increase by inflation. As such, in a high inflation environment, the SPV will meet its senior debt obligations with greater headroom than a low inflation environment. Based on BCP's assumptions, for the Ltd company option, in a low inflation environment of 0.90%, the minimum DSCR is 1.04x over 20 years; however, the minimum debt cover is 1.50x in 20 years in a high inflation environment (4.90%). For the LLP option, in a low inflation environment of 0.90%, the minimum DSCR is 1.13x over 20 years; however, the minimum debt cover is 1.64x in 20 years in a high inflation environment (4.90%).

If the Beach Huts rent were linked to inflation, the Council should consider inflation-linked debt to hedge against inflation and ensure the rental income stream matches the debt repayment. These are among the considerations that will be discussed in the next step.

| **Inflation sensitivity**<br>BCP guarantee Ltd Company | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Inflation | 2.90% | | 0.90% | | 1.90% | | 3.90% | | 4.90% | | 3.90% for 5 years then reduction by 1% | | 4.90% for 5 years then reduction by 2% | |
| | Maximum | Mininum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum |
| Senior Debt Service Cover | 1.50x | 1.50x | 1.50x | 1.04x | 1.50x | 1.25x | 1.80x | 1.50x | 2.16x | 1.50x | 1.56x | 1.50x | 1.62x | 1.50x |
| NPV of payment to BCP | £77.7m | | £65.3m | | £71.2m | | £85.1m | | £93.4m | | £80.3m | | £82.9m | |

| **Inflation sensitivity**<br>BCP guarantee LLP structure<br>(80% Council / 20% Council owned entity) | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Inflation | 2.90% | | 0.90% | | 1.90% | | 3.90% | | 4.90% | | 3.90% for 5 years then reduction by 1% | | 4.90% for 5 years then reduction by 2% | |
| | Maximum | Mininum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum | Maximum | Minimum |
| Senior Debt Service Cover | 1.64x | 1.64x | 1.64x | 1.13x | 1.64x | 1.36x | 1.97x | 1.64x | 2.36x | 1.64x | 1.70x | 1.64x | 1.80x | 1.64x |
| NPV of payment to BCP | £95.0m | | £80.2m | | £88.0m | | £106.5m | | £117.6m | | £100.2m | | £103.2m | |

| **Inflation sensitivity**<br>(Do nothing) | | | | | | | |
|---|---|---|---|---|---|---|---|
| Inflation | 2.90% | 0.90% | 1.90% | 3.90% | 4.90% | 3.90% for 5 years then reduction by 1% | 4.90% for 5 years then reduction by 2% |
| NPV of payment to BCP | £102.1m | £85.1m | £93.1m | £112.2m | £123.6m | £105.7m | £109.3m |

*Source: KPMG analysis based on Council assumptions*