Private and Confidential

Bay Venues Limited

Options Analysis
November 2020

pwc

DRAFT for discussion

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20 November 2020

Options Analysis for Bay Venues Limited

We refer to our engagement letter dated 28 September 2020 (the Engagement Letter), and provide our draft report to you.

We draw your attention to important comments regarding the scope and process of our work, set out in Appendix 1.

You may not make copies of this report available to other persons except as described in the Engagement Letter, and subject to the conditions described therein. We will not accept any duty of care (whether in contract, tort (including negligence) or otherwise) to any person other than you, except under the arrangements described in the Engagement Letter.

This report is draft and may not be relied upon until finalised.

If you have any questions, please do not hesitate to contact either of us.

We look forward to discussing this report with you.

Ngā mihi nui

Brett Johanson
Partner

Introduction

Introduction

- Bay Venues Limited (BVL) is a council-controlled organisation 100% owned by Tauranga City Council (TCC).
- BVL owns and/or operates a number of facilities and activities in Tauranga on behalf of TCC. These facilities and activities have differing degrees of commercial and community focus and are categorised as Funded and Non-funded.
- In this paper we refer to Funded and Community interchangeably and Non-funded and Commercial are also used interchangeably. This does not mean that Commercial activities do not provide community benefits. By their nature certain Non-funded activities provide community benefits (particularly in relation to diversity of activities) and some are operated out of Funded facilities.
- The delineation is complex and subjective. For the purpose of this report, we have used the classifications below to enable analysis to be undertaken in relation to the options we have been asked to consider.

Funded / Community	Non-funded / Commercial
• Community Aquatic Network • Community Centre Network • Community Hall Network • Community Indoor Sports Network	• Aquatic Network (Hotpools) • Programmes Network • Indoor Sports Network • Events Network

Background to this report

- TCC has recently commissioned a strategic review of BVL to determine options in relation to the future delivery of services that BVL provides (the Winder report). The Winder report identified three potential options:
  - **Enhanced Status Quo**: carry on as is with improved clarity on objectives, KPIs, funding and some changes to the BVL Board.
  - **Stronger Commercial Focus**: restructure of BVL to focus on Commercial activities with Community activities being transferred to TCC.
  - **In-house with Commercial Sales/Leases**: disestablishment of BVL with all activities initially brought in-house to TCC. Commercial activities will then be packaged up and sold or leased.
- The Winder report provided high level advantages and disadvantages of the options which are not repeated in this paper. The Winder report noted that in the opinion of the writer, that the third option would provide the optimal and preferred way forward.
- TCC has commissioned this report to provide a further level of detail to elected members on the options. This report provides commentary on:
  - a summary of the steps required to implement each option;
  - potential 'transaction costs' of implementing the options;
  - indicative change in cost (incl operating, management, governance and funding) following implementation, and the overall change in cost to the ratepayer; and
  - impact on community outcomes.
- This report does not provide a recommended course of action or preferred option as Elected Members will need to consider the financial and community impacts of the options and determine for themselves, on balance, a preferred course of action.
- Our scope of services are included in Appendix 1 and Appendix 9 provides a summary of next steps required to be able to validate the preferred option.

Our approach

Financial analysis

- Our analysis and commentary is based on information provided by BVL and TCC. We have assumed that this is complete and accurate and have not diligenced or made changes to financial information provided.
- Our analysis has focused on the 'cost to ratepayer' of delivering the Funding and Non-funded activities. Under the various options, elements of this cost will be met by BVL or TCC directly.
- COVID-19 disruption has impacted FY20 and FY21 numbers. As such, we have considered the average of FY18, FY19 and COVID-19 adjusted FY20 numbers as the baseline for comparison of the options.
- This provides a baseline to compare the relative impact of the three options. It does not provide a forecast of operating performance under each option.
- BVL's financial information is complex to understand. On pages 7-9 we provide an overview of recent performance to provide clarity on the baseline and explain the cost to the ratepayer.
- We briefly comment on BVL's forecast performance on page 10 including the actions BVL management are taking to improve profitability and reduce to the cost to ratepayers.

Introduction

- We have worked with BVL and TCC management in estimating the high level financial impact of the three options. The assumptions applied are relatively high level and detailed modelling of each option and forecast scenarios has not been undertaken and will differ under each of the options being considered. Detailed modelling may be required at a later date prior to confirming the eventual course of action.

C*ommunity outcomes*

- Our review of various documents including the Statement of Intent (SoI), Enduring Statement of Expectations (ESE) and annual accounts has shown a number of measures, KPIs, outputs and outcomes being sought from BVL. Based on this we have commented on community outcomes in relation to:
  - **Accessibility** *"maintaining and enhancing community access"*: Ensuring access and awareness of facilities / events and being responsive to changing community needs. This includes providing facilities, services and events that talk to the diverse population, encourages physical activity, fosters increased well-being and promotes cohesion. The SoI further notes outcomes around "a wide range of diverse activities, programmes, events and experiences" and "an appropriate fee structure that supports accessibility".
  - **Experience** *"maintaining levels of service"*: Ensuring consistent high levels of service as reflected in customer and community satisfaction. All facilities are to remain safe, welcoming and well looked after and that management is conducted in line with best practice. The SoI notes "a high level of customer focused service, communications and responsiveness" and "an effective asset management plan to ensure assets are managed and maintained to a high level".
- While these expectations appear to be prescribed to the Funded network, our analysis considers these outcomes from a community perspective, regardless of the classification of which part of the BVL or TCC provides the facilities or services.
- Our work has focused on how the community outcomes could be impacted by the three options being considered rather than whether BVL is currently meeting the outcomes or not (noting we understand that BVL has successfully met its objectives (excluding the impact of COVID-19) and has shown an upward and improving trend in this regard).

Summary findings

The table below provides a high-level summary of the findings in relation to the three options.

Under all options, Elected Members will need to consider and specify what outcomes they are seeking for the community, what level of commercial returns and risk they are willing to accept and consider this in light of the cost of delivering those outcomes. Preferences and requirements can be expressed and implemented through direct control of assets or facilities or via the governance mechanisms in place (BVL Board appointments and the ESE, SoI process).

	Option 1 **Enhanced Status Quo**	**Option 2** **Stronger Commercial Focus**	**Option 3** **In-house with commercial sales / leases**
Potential transaction cost (range) *One-off cost*	$20-120k	$70k-$300k	$100k-$390k+
		Given the tax losses currently in both BVL and TCC, the transactions may not actually give rise to tax payable. Specific tax advice will need to be sought to confirm this.	
Potential p.a. change of cost to ratepayer (range) *Net of additional cost and cost savings*	Nil / immaterial	Increase of $0.1m to $0.3m	Decrease of $0.3m to increase of $0.3m
		Detailed review of overhead requirements will be needed to determine likely change in ongoing cost base following agreement on which activities are to remain in TCC, BVL or exited. *Some of the relative cost increases above could fall away if BVL also adopts a Living Wage policy. As such cost increases vs the current cost to the ratepayer may be temporary in nature.*	
	Point in time analysis, not necessarily reflective of forecast position under each scenario		
Potential impact of community outcomes (summary)	• Unlikely to be a material change from the status quo	• Greater direct control by TCC over Community facilities. • Greater commercial flexibility by BVL could expand the range of services and commercial returns. • Potential increased financial and reputational risk associated with greater returns and outsourcing of management contracts.	• Greater direct control by TCC over Community facilities and alignment with other council activities. • Operational cost savings from reduction in governance and management costs • Loss of future revenue and profitability currently part-subsidising Funded activities. • Potential for a reduction in range of facilities, events and services available to the community (where TCC decides to cease the activity and it is not carried on by a third party).
Other considerations	• TCC retains control of the assets, albeit indirectly. The extent to which is choses to exercise this control (through Board mix and governance documentation, strategic direction and KPIs) will determine the final outcomes. • The current funding model will require adjustment to ensure it remains sustainable and fit-for-purpose in the long-term.	• Option is relatively complex to implement. • BVL may not be able to pay a dividend. Based on the current funding model, any dividend would reduce cash available for other purposes, which could result in an increased funding requirement from TCC. • There will need to be clarity around BVL's remit and any management contracts with BVL or third parties to ensure the community continues to benefit from a wide range of activities, services and events and has a high level of customer experience.	• Provides clarity to TCC of true cost of delivering the range of activities and events BVL currently provides to the community. • Potential for loss of revenue given lower level of commercial focus. • Some inefficiency in transferring everything prior to determining longer term strategy for the activities / facilities. • Gains on sale and immediate operating savings will need to be considered in light of lost operating contribution and reduced range of activities for the community.

Overview - Operating and funding structure (FY18-FY20)

BVL's financial performance, particularly the split between Funded and Non-funded operations, is relatively complicated to understand. This is due to different treatment of pre and post BVL-establishment depreciation (assets) and interest (debt), a range of different TCC grants and funding, and the difference between P&L grants and the true cost passed on to the ratepayer. The numbers below are an average of FY18-FY20 (covid-adjusted) performance.

The chart below and commentary following seek to explain this relationship and draw out that:

- BVL has made net losses year-on-year as the level of grant funding has been insufficient to fund operating losses. This is driven by Operating Grants not covering losses of the Funded business and to high depreciation costs; and
- The true 'cost to ratepayer' is not the same as the P&L loss or total grant funding. It includes various elements that TCC raises rates directly to fund.

Operating performance

BVL generated an average operating loss of $9.8m (prior to application of TCC grant funding). This represents the *underlying cost of running the BVL portfolio of activities*.The Non-funded business generated an average EBITDA of $600k which partially offset the Funded operating loss.

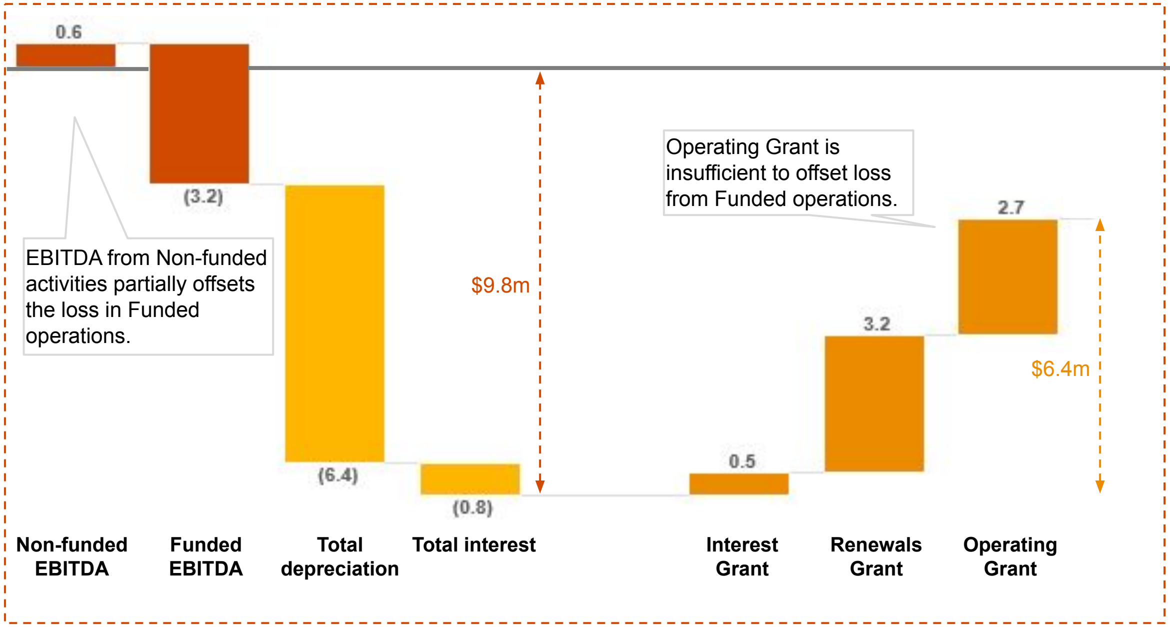
Total grant funding

TCC provided grant funding across three areas. This averaged $6.4m and has *been insufficient to offset the cost of operating the BVL network of activities and facilities*. As a result, BVL has made an average net loss* of $3-4m p.a.

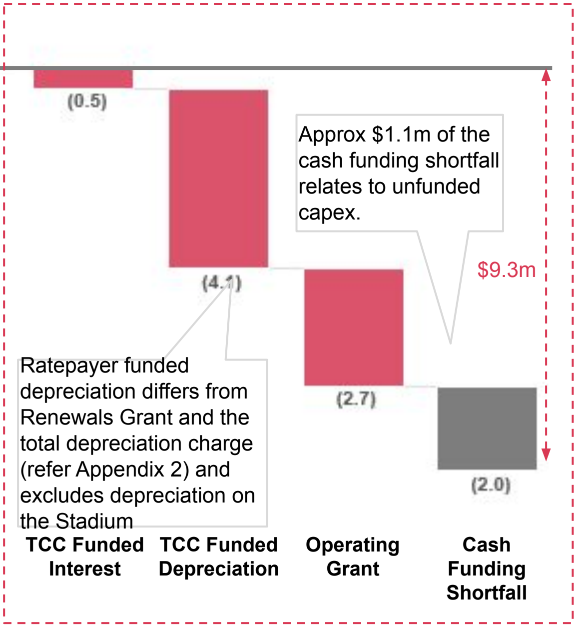
Cost to ratepayer

The cost to the ratepayer consists of all BVL costs that TCC rates fund. This includes an agreed level of operating, interest and depreciation funding. The 'Cash Funding Shortfall' reflects cash costs (opex and capex) not met from BVL operating cash flows and TCC grant funding. This is currently funded via a loan from TCC to BVL.

Operating loss of $9.8m not fully funded through grant funding of $6.4m



Total cost to ratepayer of $9.3m p.a.**

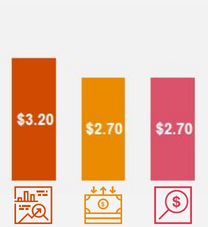
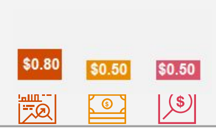


*Net loss before tax

**In addition to these costs of operating the BVL business, ratepayers also fund interest on a loan taken out by TCC to fund BVL on establishment (c.$4m p.a.) This debt would remain in TCC under all scenarios.

Source: BVL and TCC information and PwC analysis

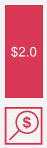
Overview - Operating and funding structure (FY18-FY20)

Cost area	Operating Performance	TCC Grant Funding	Cost to Ratepayer
Operating cost  *Loss of Funded operations only included above*	Non-funded operations: BVL's Non-funded operations generated an average positive EBITDA of $0.6m which partially offsets the loss from Funded operations and, therefore, the overall funding requirement from TCC (and ratepayers). Funded operations: BVL's Funded business returned an average EBITDA loss of $3.2m.	Operating Grant: The TCC Operating Grant was put in place at the formation of BVL. It increases annually by CPI, rather than directly reflecting the cost of delivering the Funded operations or on a per user basis. The Operating Grant has averaged $2.7m over the three years and is insufficient to cover the Funded network's EBITDA losses.	Operating Grant: **The amount of grant funding is fully funded by the ratepayer.** **If activities transfer to TCC, this cost will become a direct cost of operating the network and will still be ratepayer funded.**
Depreciation *Refer Appendix 2 for further detail on depreciation*  **Interest** 	Depreciation and interest charges reflects the total P&L charge for these items whether funded by BVL or TCC. BVL funded depreciation and interest: BVL directly funds depreciation and interest on assets acquired, and debt incurred, since its establishment whether this relates to Funded or Non-funded activities. This has averaged $0.8m over the three year period. Other depreciation and interest: Depreciation and interest attributable to assets that were in place at the date of BVL's establishment. This covers both Funded and Non-funded activities and includes depreciation on the stadium. This has averaged $6.4m over the three year period.	Renewals Grant: Is provided to BVL each year to meet renewals on assets transferred to BVL on establishment. It is lumpy in nature and can be higher or lower than the actual depreciation charge and TCC funded depreciation (which is charged to ratepayers as noted in the right hand column). Over the three year period this has averaged $3.2m compared to $4.1m average rated by TCC with the balance retained in a depreciation reserve in TCC. We note that TCC is introducing a 'Debt Retirement Grant' of $0.75m from FY20 to reflect loan repayments funded out of the reserve at a TCC level, which would reduce this variance. Interest Grant: The Interest Grant was sized to match the debt servicing costs on the initial debt transferred to BVL at establishment.	TCC Funded Depreciation: TCC rates the ratepayer for the depreciation cost on assets transferred on BVL establishment other than the stadium. Any amount not transferred via the Renewal Grant is retained in TCC in a depreciation reserve account. **The cost to the ratepayer is the full amount rated rather than the Renewal Grant transfer to BVL.** **This depreciation cost will remain while assets are retained by TCC or BVL.** TCC Funded Interest: **TCC rates the ratepayer for the full interest cost** on debt transferred on BVL establishment. Over the period this has broadly mirrored the amount transferred.

Overview - Operating and funding structure (FY18-FY20)

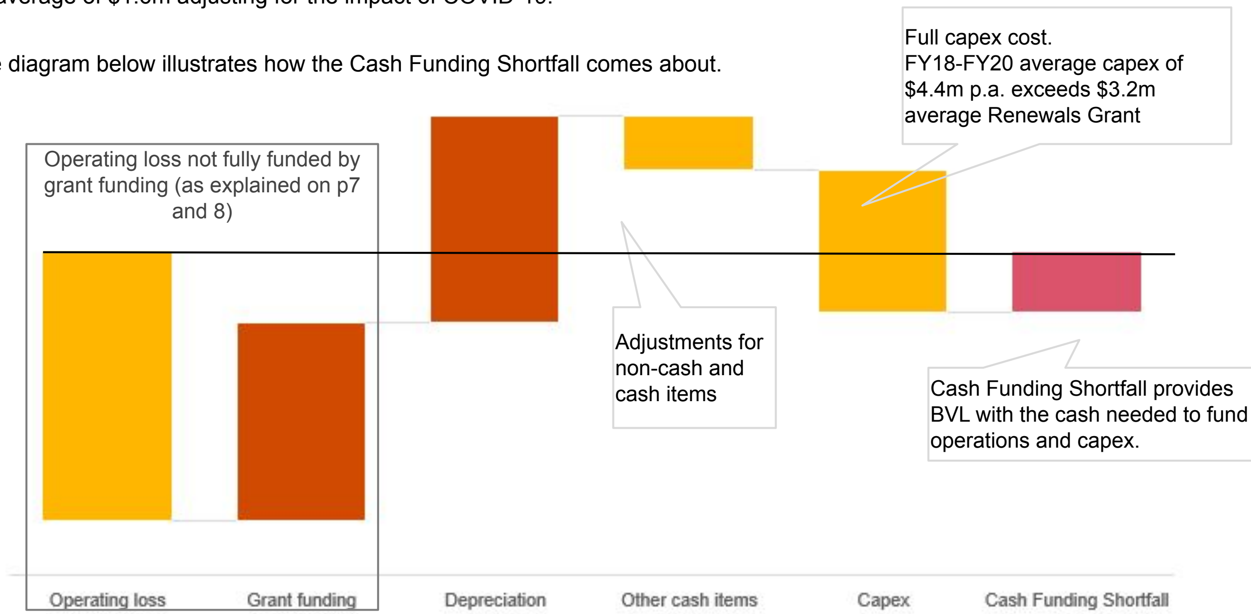
Cost area	Operating Performance	TCC Grant Funding	Cost to Ratepayer

Cash Funding Shortfall



Cash Funding Shortfall: TCC has provided loan funding to BVL to cover operating cash flows and capex that have not been met out of BVL cash generation or TCC grant funding (Operating, Interest and Renewals Grants). The **loan movement is a cost to the ratepayer** as we understand that TCC is raising debt to fund this shortfall in BVL. This has averaged c.$2.0m p.a. over the three years, reducing to an average of $1.6m adjusting for the impact of COVID-19.

The diagram below illustrates how the Cash Funding Shortfall comes about.



We have not performed detailed analysis on the capex and opex portions of the Cash Funding Shortfall. High level analysis suggests that in the FY18-FY20 period, $1.1m (57%) of the cash funding shortfall relates to capex costs over and above the level of funding provided by the Renewals Grant. Capex on the Stadium is neither rate funded or funded via the Renewals Grant and is therefore directly funded by BVL. We also note that capex includes investment in assets that generate future revenues for BVL.

When considering the three options, any change in profitability of running the operations (whether in BVL or TCC) is assumed to impact the requirement for this additional Cash Shortfall Funding through the TCC Loan. For example, where efficiencies in overheads are achieved, it is assumed that the Cash Funding Shortfall requirement would decrease compared to the baseline numbers presented on page 7, either through a reduction in the loan to BVL or through lower operating costs in TCC. Either way, the requirement for ratepayers to fund this shortfall declines.

Forecast operating and funding structure (FY22)

BVL has provided forecasts for the FY20 to FY22 period. Through the forecast period BVL is seeking to improve financial performance through new Commercial activities including the Free and Healthy School Lunches programme (generating c.$0.9m in FY22 and increasing to $1.2m by FY23) and user growth of 5%. It has also disposed of / closed loss making OSCAR and BayKids operations. Based on these assumptions and a continuation of BayDreams, BVL is forecasting to increase EBITDA for Non-funded operations by around $0.8m to $1.4m in FY22. If achieved, this could help reduce the 'Cash Funding Shortfall' and continued loan funding increases.

We have not reviewed the achievability of these forecasts. The forecast below is based on BVL in its current form, forecasts will need to be reviewed in light of which option is pursued and reviewed accordingly.

Operating performance

Non-funded EBITDA is forecast to increase from $0.6m (average of last 3 years) to $1.4m by FY22, largely reflecting the impact of the Free and Healthy School Lunches programme.
The increased overall loss reflects higher depreciation costs due to BVLs renewals capital programme.

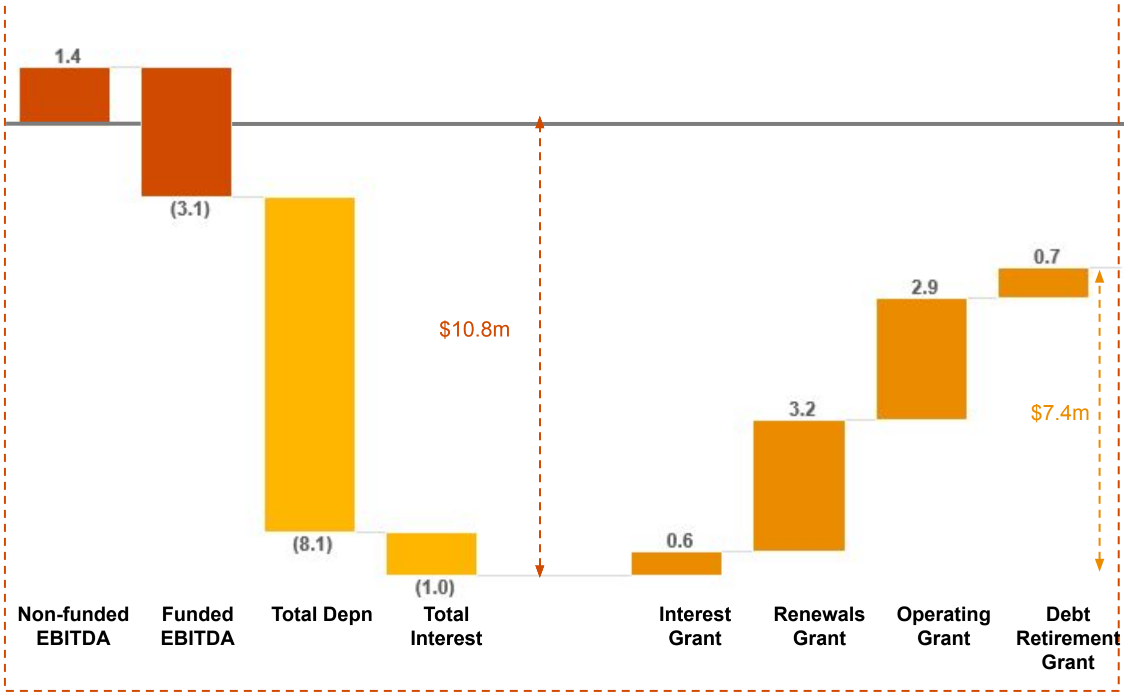
Total grant funding

A new Debt Retirement Grant is introduced ($0.75m p.a.) to reflect loan repayments funded from the TCC depreciation reserve at a TCC level (essentially bridging some of the gap between TCC Funded Depreciation and the Renewals Grant). Other grant funding is largely unchanged.

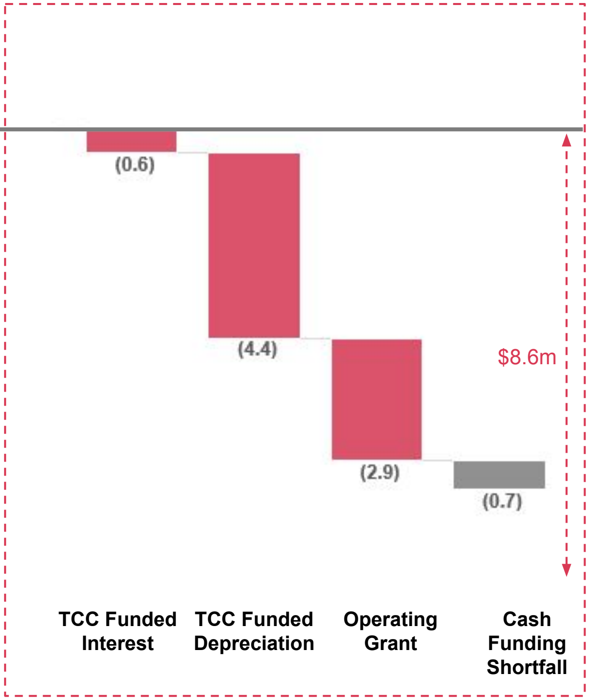
Cost to ratepayer

BVLs forecasted increase in Non-funded EBITDA, if achieved, would reduce the Cash Funding Shortfall required in FY22. Other ratepayer funded items remain relatively unchanged. **The forecasted increase in profitability reduces the overall cost to the ratepayer.**

BVL is forecasting continued losses as grant funding of $7.4m is insufficient to fund the operating loss of $10.8m



Total cost to ratepayer of $8.6m p.a.



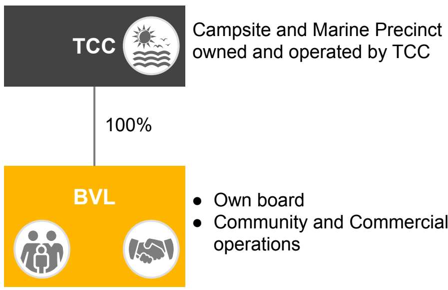
Option 1 - Enhanced Status Quo (1 of 3)

Overview of the proposed option

- Continuation of current operational and governance arrangements, strengthened by:
  - A review of Board skills matrix to ensure it reflects the range of activities and expectations placed on BVL and its Board.
  - A review and update to KPIs and expectations of BVL to ensure alignment on objectives for BVL.
  - A review of the current funding model for community activities and the viability of the commercial network to determine whether the current model is financially sustainable and, if not, what changes may be required to enable it to be so. This may result in the need for a recapitalisation or change to the funding model.
- No material change or process required.

Steps to implement

Pre-transaction



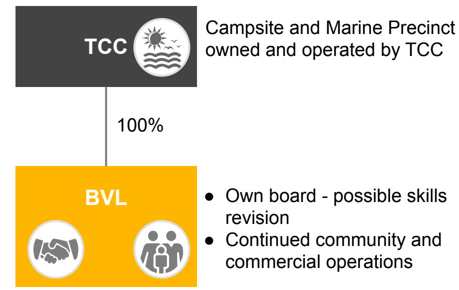
- Commission reviews either in-house or by consultants to cover:
  - Governance skills assessment.
  - Strategic prioritisation and development of new KPI framework to reflect Council's desired strategic objectives and community outcomes to be delivered by BVL. This can be achieved through the ESE, SoI framework with clear requirements around desired usage and revenue mix.
  - Funding assessment in relation to Operating Grant and Funded activities, and Commercial activity viability analysis. This will require consideration of financial and tax aspects.
  - The work is likely to involve a series of workshops between key BVL and TCC representatives.
- The above reviews can be undertaken in a relatively short timeframe with limited impact on BVL or TCC during the review process.

Transaction

No material change

- Based on the outcomes of the reviews there may be the need for:
  - Changes to the Board
  - Changes to ESE or other documents
  - Changes to funding model. As a minimum it would appear to make sense for the Operating Grant to cover at least the EBITDA loss of the Funded network.
- Should a recapitalisation be required, the impact of this will need to be considered and appropriate steps taken to implement it.

Post-transaction



- Implement new strategic / KPI framework.
- Embed any new strategic direction and induct new Board members.
- Undertake recapitalisation if required.

Option 1 - Enhanced Status Quo (2 of 3)

Indicative financial costs and benefits

Transaction

- No material cost of transaction given the limited change proposed.
- There may be advisory costs in relation to strategic advice around strategy and KPIs, governance and funding reviews. The extent of these will depend on whether third parties are commissioned and the scope of the work. Indicative cost of $20k to $120k across all areas.
- BVL's current debt to equity ratio is 17:83. Based on BVL forecasts this is expected to increase to around 19% by FY23. This is in line with your preference to retain a 20:80 ratio suggesting no immediate need for a recapitalisation.
- There are no tax implications of this option. Should an equity injection or debt write-off / right size be required, tax advice should be sought.

Potential transaction cost:

$20-120k

Ongoing

- **Governance**:The impact of implementing changes reflected in the governance review may include increased community representation or a reduction in the number of Board members. This may result in a reduction in governance cost, albeit is unlikely to be material.
- **Operational**: No change to operating costs assumed as a part of the analysis.
- **Funding / financing**: the current funding model is unsustainable and does not reflect the true cost of running BVL's varied activities. As a minimum it would appear to make sense to ensure the Operating Grant better reflects the EBITDA losses of the Funded operations. Any change to this model would essentially increase the Operating Grant and reduce the Cash Funding Shortfall by an equal and opposite amount - the net impact would be nil.

Operating Grant unchanged.

No change to TCC Funded Depreciation or Interest.

Cash Funding Shortfall unchanged.
Noting BVL forecasts suggest that this could be reduced through improved operating performance including the Healthy School Lunches programme.

Cost to ratepayer - $9.3m

Operating Grant
$2.7m

Depreciation
$4.1m

Interest
$0.5m

Cash Funding Shortfall
$2.0m

Potential change to cost to ratepayer:

nil / immaterial

Option 1 - Enhanced Status Quo (3 of 3)

Indicative impact on community outcomes

The impact on community outcomes will ultimately depend on the strategic direction chosen following the strategic prioritisation and KPI review. Given the concerns raised in the Winder report, w**e understand that this option may result in increased representation from Board members experienced in ‘delivering community outcomes’ or with a higher degree of Tauranga community connection with a reduced focus on commercial outcomes and returns**. We have also assumed that there is greater clarity on strategic direction and TCC requirements regarding community outcomes. The commentary below has been drafted on that basis.

Outcome	Comment
Accessibility	~ Unlikely to be a material change from the status quo. ✓ Potential for greater alignment with TCC strategy which could improve the focus on well-being. X Potential for strategic direction to limit innovation, flexibility and ability to adapt the range of activities available to the community. Noting that the Board and TCC will need to determine the level of commercial return it is seeking from BVL and the risk it is willing to accept to achieve this. X If expected returns from BVL’s Commercial activities are reduced, the cost to ratepayers to fund Community activies will need to increase (either through rates or user fees) to maintain the range of services and level of customer experience.
Experience	~ Unlikely to be a material change from the status quo. We understand that BVL currently achieves high levels of customer satisfaction. ✓ Creation of more specific KPIs would drive greater alignment of expectations with TCC. X Constrained flexibility and financial contribution may negatively impact the ability to maintain facilities and invest to make facilities attractive to the community.

Other key considerations

- The current funding model is likely to require adjustment to ensure it remains sustainable in the long-term. Simplification of the funding model would allow better clarity on the real funding needs of the Funded part of the business. A process would need to be developed to provide TCC with the ability to forecast this over a period of time to manage rates and uses of rates accordingly.

Summary

- This option is unlikely to materially impact ratepayers either through changes to funding or change to outcomes.
- The greater strategic alignment and governance balance resulting from this option would likely reduce uncertainty between TCC and BVL through greater clarity on objectives and flexibility to achieve these.
- Ultimately, TCC retains control of the assets, albeit indirectly. The extent to which it chooses to exercise this control (through Board mix and governance documentation, strategic direction and KPIs) will determine the final outcome.

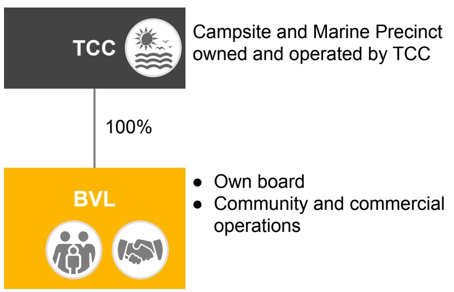
Option 2 - Stronger Commercial Focus (1 of 3)

Overview of the proposed option

- Restructure of BVL to focus on Commercial activities across the Council group. This involves:
  - Transferring the Campground and Marine Precinct from TCC into BVL management; and
  - Transferring Funded assets back into TCC direct management (Community Aquatic, Halls, Centres and Indoor Sports networks)*.
- The facilities transferred to TCC could be managed via external management contracts or through agreements with BVL.
- Agreement would need to be reached regarding terms for BVL's continued usage of facilities to deliver Commercial services (e.g. BaySwim and cafes).
- BVL would be expected to generate a profit and return a dividend to TCC (reasonable return on equity).
- The ESE would need to be updated to provide for the change in operations, expectations and dividend requirement.
- The Board skill mix and KPIs would need to be reviewed and amended, as needed, for the new operations.

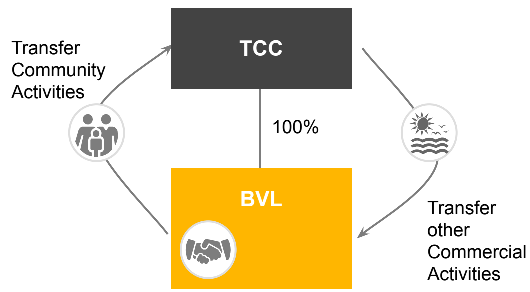
Steps to implement

Pre-transaction



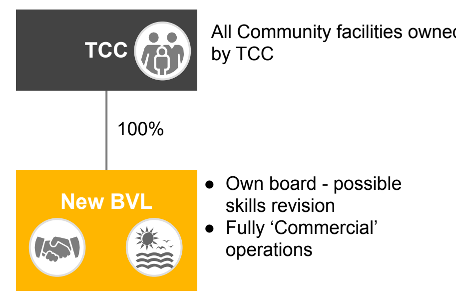
- Identification of all assets, liabilities, people, revenues and operating costs relating to Community activities in BVL.
- Review of contracts for each Community activity and whether these need to be renegotiated / novated (including employment contracts) if operations and asset ownership change entity.
- Review operational model for each Community activity to determine whether BVL or third party management is preferable.
- Review operating arrangements and overlap between Funded and Non-funded activities (incl BaySwim, Arena programmes and leagues).
- Same analysis required relating to Campground and Marine Precinct assets, operations and contracts.
- Identify new mix of corporate overhead and functions required for 'New BVL' and appropriate level at a TCC level to cover new operations.

Transaction



- Undertake valuations as needed.
- Commence discussions and negotiations with counterparties.
- Negotiate terms with BVL and / or third party management providers, to include management fees and rental of space in Community facilities.
- Draft and execute contractual changes including employment contracts.
- Draft amendments to governance documentation.
- Modelling to determine:
  - New BVL forecast performance to identify potential dividend model; and
  - Recapitalisation or debt forgiveness that may be required to ensure New BVL is sustainable and debt to equity is in line with Elected Member preferences.

Post-transaction



- Undertake Board skills assessment review and make changes to the Board as needed.
- Determine strategy of New BVL and draft appropriate KPIs.
- Undertake changes to shared services and corporate overhead. This may include redundancies.
- Update accounting systems to reflect operations in TCC and New BVL.

*Our analysis assumes all Funded activities are transferred to TCC. The Winder report assumed some would transfer and some would be retained by BVL.

Option 2 - Stronger Commercial Focus (2 of 3)

Indicative financial costs and benefits

Transaction related

- Significant amount of legal work required to understand, negotiate and update the legal position with suppliers and other counterparties. This could be in the range of $50k-$150k depending on complexity and amount managed in-house.
- Internal resource or additional advisory work required to understand staffing requirements, commercial rental and management fee arrangements. Potential costs of $20k-$100k depending on scope and amount managed in-house. There may also be further costs to arrange management contracts with BVL or third parties (possibly c.$50k).
- Transfer of the assets between the entities is complex and will have tax implications (see Appendix 3). Given the tax losses currently in both BVL and TCC, the transactions may not actually give rise to tax payable. Specific tax advice would need to be undertaken to confirm if tax would be payable and to consider the most efficient option for transfer.
- We have not been able to obtain a detailed breakdown of assets and liabilities for the Marine Precinct and Campsite to consider a revised balance sheet and debt to equity ratio of New BVL. When this is understood, Elected Members will need to consider whether the resulting ratio is appropriate given the change in commercial focus of the entity.

Potential transaction cost:

$70k-$300k
Legal $50k-$150k
Other adviser costs $20k-$150k

Ongoing

- **Governance**: Unlikely to require any material change to governance. The cost of the BVL Board is likely to be retained despite the smaller size of the New BVL. Consideration will need to be given to expertise to govern over new operations (Marine Precinct and Campsite).
- **Operational**: There are a number of changes to operating costs including:
  - Staff transferred to TCC paid in line with TCC Living Wage policy $130k-$350k (BVL management estimate): range reflects cost of applying the policy to minimum wage earners only and the potential knock on impact on other pay bands.
  - For the purpose of our analysis, we have assumed that both TCC and BVL could absorb a large degree of the overheads and the impact of the 'swap' in operations would offset against each other.
  - There are likely to be stranded costs in both BVL and TCC when the assets are transferred. This could include systems, IT, headcount in other support functions (e.g. HR, payroll). Detailed understanding of existing and forecast structures would be required to estimate this.
  - Further analysis in relation to the impact of overheads would need to be undertaken at the next stage if this option is progressed.
- **Funding / financing**: The Operating Grant would no longer be required with TCC funding losses from the Funded business directly. Assuming TCC continues to fund depreciation and interest on pre-BVL establishment assets and debt, the total depreciation and interest cost to TCC will remain unchanged, and split between direct funding and grants to BVL.
- The Winder report refers to an annual dividend payment from BVL to TCC. Despite forecasting improved profitability and the addition of the Campsite, New BVL will likely continue to make a loss at a net profit level and may not be able to pay a dividend.
- Any dividend paid would reduce cash available for other purposes (including capex), which could result in an increase in Cash Funding Shortfall requirement with a net nil impact from a ratepayer perspective.
- The Campsite has historically allocated $280k p.a. to TCC towards rent on the Mauao. Management's forecast suggest this amount will continue to be able to be paid.

Cost to ratepayer - $9.4m-$9.6m

Operating Grant	nil
Depreciation	$4.1m
Interest	$0.5m
Cash Funding Shortfall	$4.8-$5.0m*

Potential change to cost to ratepayer:

Increase of $130k-$350k *

Operating Grant falls to nil as Funded operations are directly funded by TCC. Losses transfer to 'Cash Funding Shortfall' category.

Depreciation and interest costs remain the same whether in BVL or TCC.

Increase in Cash Funding Shortfall reflects transfer from Operating Grant $2.7m and increased Living Wage related salary costs for staff transferring to TCC (range).

*BVL does not currently have a Living Wage policy. Should this be implemented, the increase in cost noted above would need to be reflected in the baseline numbers also. As such, the cost differential between the current cost to the ratepayer and Option 2 may only be temporary in nature.

Option 2 - Stronger Commercial Focus (3 of 3)

Indicative impact on community outcomes

In the commentary below we have assumed that New BVL, as a commercial entity, would be given a greater degree of commercial flexibility.

Outcome	Comment
Accessibility	✓ TCC retains full direct control of community facilities to amend and adjust its strategy as needed to meet community needs. This can be tied readily to other TCC strategies around events and wellbeing. ✓ With a broader commercial mandate, New BVL may be able to expand the range of services, facilities and events it is able to provide the community. For example BVL has done some work around the potential to add a cafe between the Campsite and Hot Pools which management believe could generate approx $150k p.a. net profit before tax on a relatively small investment of c.$200k. X Through controlling the full set of facilities and services, we understand that BVL is able to raise awareness of the suite of options available to the customer. Where these are split between TCC and BVL, there is a risk that this becomes confused and benefits are diluted. The two will need to work together to continue to provide a unified platform and ensure the community is aware and able to access the range of facilities and services.Arrangements will need to be made to ensure the work done by BVL in relation to customer data collection and the customer journey is understood and leveraged. X There is risk (financial and reputational) associated with some commercial activities and the generation of commercial returns (as evidenced recently with BayDreams). The current business case process, clear KPIs and appropriate capability, processes and communication at a management and Board level would help manage any associated risk. X A requirement for BVL to generate a return / dividend to TCC may require it to increase user charges reducing affordability and accessibility to the community.
Experience	✓ Greater direct control of customer service in Community activities for TCC. X Should TCC choose to outsource the management of Community facilities to a third party, control becomes more removed. ~ Appropriate expertise in the management of pools, community centres and halls will need to be retained in TCC or ensured through a robust management agreement (with clear KPIs and incentives) to ensure there is no negative impact on the level of customer service could decline.

Other key considerations

- Clarity and certainty around BVL's ability to deliver some of its operations within Funded facilities is needed to so that BVL can plan and arrange its business accordingly.
- TCC will need to determine whether dividends and financial returns are required from BVL and set appropriate parameters to enable it to achieve this, without creating undue risk.
- Current discussions around BVL's ability to 'compete with the private sector' would also need to be resolved to ensure New BVL has clarity on its remit including requirements to generate positive returns and risk it is able to take in doing so.
- The payment of dividends may not provide a net benefit to ratepayers as any cash distribution from BVL to TCC may increase the requirement for the Cash Funding Shortfall and an increase in the intercompany loan.

Summary

- This option is complex to implement and will involve time commitment from TCC and BVL teams. Tax implications of the transaction may be able to be managed through existing tax losses. This option is likely to result in a net increase in cost to the ratepayer, the extent of this will only be understood with a detailed review of overheads and requirements following the transfer of businesses between TCC and BVL.
- For this option to be successful, there will need to be clarity around New BVL's remit, a focus on customer outcomes in Community facilities, and rigour around continued arrangements between TCC and New BVL to ensure the community continues to benefit from a wide range of activities, services and events and has a high level of customer experience.

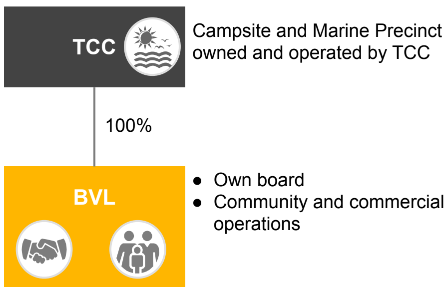
Option 3 - In-house with commercial sales/leases (1 of 4)

Overview of the proposed option

- All BVL assets and operations transfer to TCC.
- A TCC-wide events strategy is developed and a review of 'business units' (e.g. Catering, Clubfit, Bay Swim, Audio Visual and Holiday Park) is undertaken to consider whether they should remain as they are, sold or leased.
- Following the review, sale processes undertaken as required.

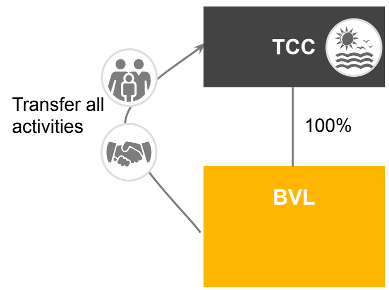
Steps to implement

Pre-transaction



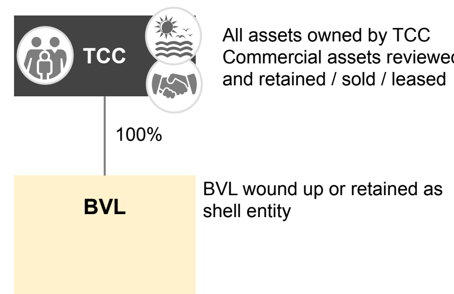
- Identification of all assets, liabilities, people, revenues and operating costs relating to all activities in BVL.
- Review of contracts to determine whether these need to be renegotiated / novated (including employment contracts) if operations and asset ownership change entity.
- Review of combined overhead requirement.
- Develop TCC wide events strategy.
- Commence strategic review of commercial activities.

Transaction



- Undertake valuations as needed.
- Commence discussions and negotiations with counterparties.
- Draft and execute contractual changes including employment contracts.
- Detailed analysis phase regarding strategic options for commercial businesses.
- Transfer assets via distribution in specie.
- Implement changes to team and overhead structure where duplication is identified.

Post-transaction



- Determine preferred outcome for each of the Commercial activities / assets and commence appropriate actions, which may include:
  - Engaging a business broker
  - Seeking management contracts
  - Ceasing trading
  - Further overhead and corporate simplification
- Process to wind up BVL if required (refer tax considerations in Appendix 3).

Option 3 - In-house with commercial sales/leases (2 of 4)

Indicative financial costs and benefits

Transaction

- As with Option 2, there will be a significant amount of legal work required to understand and negotiate legal positions and update contracts ($50kk-$150k). This work will need to be carried out across all BVL activities, whether they are likely to be continued from within TCC or not.
- Internal resource or additional advisory work required to undertake strategic review of activities (refer following page) ($50k-$100k) and later to understand staffing requirements, commercial rental and management fee arrangements. Potential costs of $20k-$100k depending on scope and amount managed in-house.
- The transfer of assets from BVL to TCC will have tax implications (refer Appendix 3). However, given existing tax losses, the transaction may not actually give risk to tax payable. Specific tax advice would need to be undertaken to confirm this and consider the most efficient option for transfer.
- Following transfer, TCC may choose to wind BVL up (TCC may wish to preserve tax losses and retain BVL - refer Appendix 3). The winding-up of BVL would likely occur via a solvent liquidation following a distribution in specie of the assets. The cost of this process will depend on the work done prior to the actual liquidation (i.e. simple winding up following a distribution or assisting with the distribution) and could be in the region of $10-40k. Any valuations required as part of the process would be additional.
- Where staff are no longer required in TCC following the transfer of operations, holiday pay and redundancy may become payable. This cost would need to be estimated based on anticipated changes. Employees required to operate the day-to-day activities in the facilities are unlikely to be impacted.

Potential transaction cost:

$100k-$390k+
Legal $20k-$150k
Other adviser costs $70k-$200k
Solvent liquidation $10k-$40k
Potential redundancy costs

Ongoing

- **Governance**: The BVL Board will no longer be required following transfer of all operations into TCC (current cost of approx $255k p.a.).
- **Operational**: There are a number of changes to operating costs including:
  - Reduction in senior management overhead cost net saving of c.$400k: removal of existing BVL executive team ($655k), partially offset by the requirement for senior management ($260k). This change may not be immediate to allow a transition period.
  - Staff transferred to TCC paid in line with TCC Living Wage policy $350k-$950k (BVL management estimate): range reflects cost of applying to minimum wage earners only and potential knock on impact on other pay bands.
  - There may be further efficiency savings at an administrative and centralised services level (such as HR, finance, digital) which would require detailed review. There will also likely be efficiencies in relation to financial and IT systems and platforms used by both entities.
- Overall savings in governance and senior management ($650k) would be (partially) offset by the increase in Living Wage costs.
- **Funding / financing**: TCC will directly fund the operations that are retained, including losses and depreciation.

Cost to ratepayer - $8.9m-$9.6m

Operating Grant nil	Operating Grant falls to nil as all operations are directly funded by TCC. Losses transfer to Cash Funding Shortfall.
Depreciation $4.1m	Depreciation and interest costs remain the same whether for assets that are retained by TCC.
Interest $0.5m	
Cash Funding Shortfall $4.3-4.9m*	Increase in Cash Funding Shortfall reflects transfer from Operating Grant $2.7m and net saving in operating costs (governance, management and Living Wage impacts).

Potential change to cost to ratepayer:

Decrease of $0.3m to an increase of $0.3m*

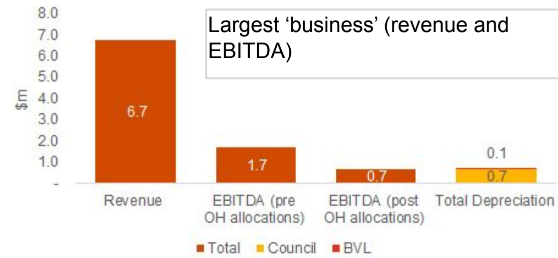
*BVL does not currently have a Living Wage policy. Should this be implemented, the increase in cost noted above would need to be reflected in the baseline numbers also. As such, the cost differential between the the current cost to the ratepayer and Option 3 may only be temporary in nature.

Option 3 - In-house with commercial sales/leases (3 of 4)

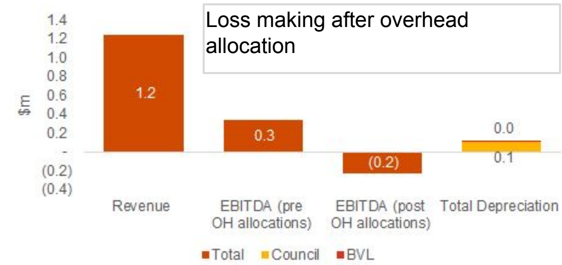
Strategic review of commercial activities

- In considering the longer term alternatives for the Commercial activities, TCC will need to consider, amongst other things:
  - Community need / benefit to community of the activity / service
  - Interrelationship with other Community activities / services
  - Financial performance of the activity / service including long-term contribution and subsidisation of Funded activities
  - Alternative models of delivery and cost benefit of those vs retaining in house
  - Likely realisable value.
- The charts opposite provide an overview of forecast financial performance (average of FY22 and FY23) for a selection of Commercial activities currently undertaken by BVL, and the Holiday Park. These were activities identified in the Winder Report as potentially being leased / sold.The Hot Pools has also been presented opposite. Childcare and Bay Kids have been disposed of since the Winder report was drafted and therefore not included opposite.
- Key financial considerations in determining a strategy:
  - Disposals of activities would generate one-off income, however, TCC would forfeit future revenue and profitability of these activities over time;
  - The realisable value for each activity will be subject to valuations and may all have different desirability. Packaging of activities will need to consider the individual and sum of the parts;
  - Profitability of activities may change following overhead efficiencies generated through implementation of Option 3;
  - Depreciation of assets retained by TCC will need to continue to be funded. Without BVL funded depreciation, the full cost would fall to TCC and ratepayers.

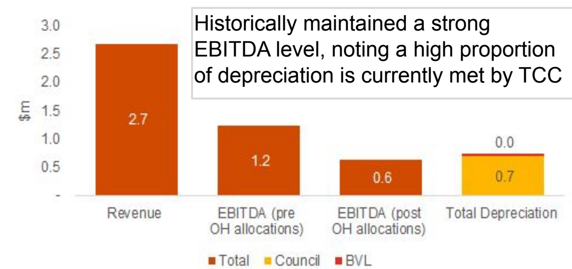
Catering



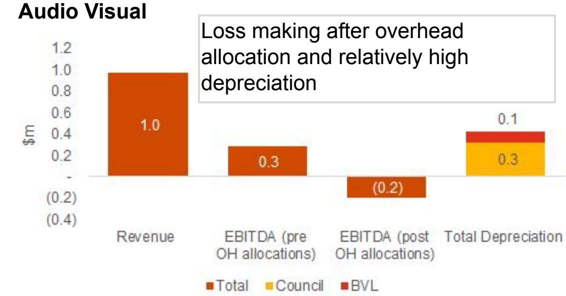
Bay Swim



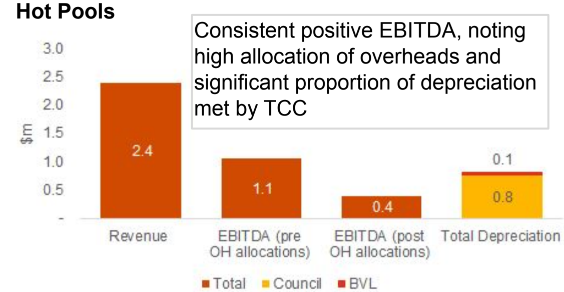
Clubfit



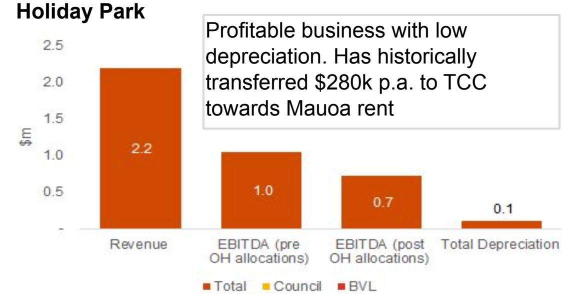
Audio Visual



Hot Pools



Holiday Park



Option 3 - In-house with commercial sales/leases (4 of 4)

Indicative impact on community outcomes

The impact on community outcomes will depend on the strategy adopted and the activities / assets retained, disposed of or leased. The comments below are based on the assumption that TCC would look to dispose of or lease certain activities.

Outcome	Comment
Accessibility	✔ Having all activities in-house will drive clear alignment with wider TCC activities, policies and strategies. The creation of a TCC wide events strategy will help tie this together. **Noting that an events strategy could be developed under the other options also and key aspects included in governance documents and KPIs.** ✔ TCC will retain direct control of the assets and operations to amend and adapt them over time while these are managed and operated internally. We understand that under current governance arrangements, TCC approves capex of over $200k. ✔ TCC would retain full control of fee structure controlling the cost to the community of accessing the facilities, events and activities (noting a reduction in user fees will likely require greater rate funding). X Disposal or winding up of commercial operations could result in a reduction in the range of facilities, events and services available to the community. X Leases or outsourcing of certain activities to third party management providers would result in a potential loss of control for TCC and increased difficulty in managing outcomes from these.
Experience	✔ Direct control of facilities will provide TCC with first hand ability to drive desired customer experience outcomes. X Risk that the current level of expertise would be lost to ensure this is done the the desired level. ✔ Immediate operational cost savings generated (where not offset by living wage salary increases) could help reduce the total cost to TCC and provide it with additional funds to invest in facilities if required. X If assets / operations are disposed of, TCC would no longer benefit from the profitability of these activities to offset operating losses elsewhere in the network and any future investment and depreciation would need to be fully funded by TCC.

Other key considerations

- Legal and transfer work will need will need to be carried out regardless of whether operations are anticipated to continue in TCC longer term. There may need to be a further round of negotiations and contract updates once decisions are made regarding the future of the activities which would result in a possible double up in legal costs and administration. Refer Appendix 4 for further detail of legal considerations.
- We understand that the Healthy School Lunches contract was awarded to BVL given the profit and proceeds would be reinvested in the community. There is no guarantee that the contract could be transferred, and therefore monetised, if the catering business was sold to a third party.
- There is a risk that revenue will decline when activities are brought in house to TCC given it may have a lower level of commercial focus. This may be further compounded by an increased focus on community benefit which could result in an overall increase in cost over time.
- An experienced general manager would need to be hired or retained to cover existing BVL leadership to ensure there is dedicated focus on the activities. Consideration should be given to whether a specialist advisory committee might also be required to cover these activities (particularly if Commercial activities are retained), to provide Elected Members and TCC Officials with a level of risk management and mitigation. Any such committee could be made up of internal or external people with the relevant expertise and may result in additional cost.

Summary

- Bringing all activities in-house provides clarity to TCC and Elected Members on the true cost of delivering the range of activities and events BVL currently provides to the community and whether the activities align to TCC's strategy.
- Any gains on sale will need to be considered in light of lost operating contribution from the business and the loss of control (direct or indirect) over the provision of the activities, services and events to the community. Further operating efficiencies are possible and should be investigated.

Appendices

Appendix 1: PwC Scope of work (1 of 2)

Scope	Process
Scope of our work	This report has been prepared for the Tauranga City Council. We specifically disclaim any responsibility to any party seeking to rely on this Report.
Exclusions from scope	This report covers the ‘Options Evaluation’ phase of work as detailed on the following page. Detailed modelling of specific scenarios and further detailed tax analysis may be required before validating an option. We have not reviewed BVL’s forecast performance not the financial performance of the individual activities / businesses within it. Information provided in relation to the Campground and Marine Precinct has been prepared by TCC and included in our analysis, we have not assessed or reviewed the information provided. No detailed balance sheet has been available and therefore we have not been able to assess the value of net assets to be transferred and the resulting impact on the debt to equity position of New BVL.
Review process	We had access to Justine Brennan (BVL Acting CEO), Adam Ellmers (BVL CFO), Anne Blakeway (Manager CCO Relationships & Governance), Gareth Wallis (GM Community Services), Frazer Smith (Manager Strategic Financing & Growth) and Sherry Tecofsky (Manager, Management Accounting and Business Advice). We have been based in our offices in preparing this report.
Access to information	Our work has comprised a review and analysis of the financial and other information provided to us by BVL and TCC and discussions with BVL and TCC management as detailed above. We have assumed that this information and management’s explanations and representations are complete, accurate and reliable. We have utilised the completed Winder report as a basis for the options assessed and we make no assessments or recommendations on the selection of these options. The statements and opinions expressed in this report are based on information available as at the date of this report. We reserve the right, but will be under no obligation, to review or amend our report, if any additional information in existence at the date of this report, but not brought to our attention, subsequently comes to light.
Basis of our work	We have not carried out anything in the nature of an audit nor, except where otherwise stated, have we subjected the financial or other information contained in this report to checking or verification procedures. Accordingly, we assume no responsibility and make no representations with respect to the accuracy or completeness of the information in this report, except where otherwise stated.
Clarity of information	BVL accounting is relatively complex to understand. We have worked with BVL and TCC management to clarify aspects of this. Balance sheet information relating to the Marine Precinct and Campsite is not readily available given these assets are operated within TCC. Our analysis is based on BVL management accounts which may differ slightly from statutory accounts.
Management representations	We have discussed previous drafts of this report with both TCC and BVL management. To the extent we consider appropriate, we have incorporated their comments regarding factual accuracy in this report.
Other	Certain numbers in tables throughout this report have been rounded and therefore may not add up exactly. Unless where otherwise stated all amounts are in New Zealand dollars.

Appendix 1: PwC Scope of work (2 of 2)

Scope of Services and Approach

1) Progressing any of the options noted in the Winder report will require resource to assess, validate and implement. Having completed initial options identification through the strategic review, a staged approach to continued assessment is beneficial. This will ensure the process is efficient, through option refinement and selection prior to additional review and diligence of the preferred option.

2) In order to support you through the Options Evaluation stage, we propose providing the following Services:

   a) For each of the three options identified as part of the strategic review, we will provide an indication of:

      i) the cost of the transaction including, but not limited to, processes needing to be undertaken and associated accounting and tax implications;

      ii) the change in operating, management and governance costs and funding mechanisms. This will also include consideration of legal and property related issues that will need be addressed, along with the separability of the businesses within the portfolio (at a high level); and

      iii) the impact on the ability to deliver on the community outcomes detailed in the Enduring Statement of Expectations.

   b) For each option, we will also summarise:

      i) next steps required to validate the option; and

      ii) other issues or benefits identified and relevant to your decision making.

   c) A short-form bullet point style paper will be provided with key points identified above in a table format.

   d) Once a preferred option is selected, the scope of work relating to Preferred Option Validation can be determined as this will vary for the chosen option. It is likely to include:

      i) detailed financial modelling including quantification of financial benefits;

      ii) review of contracts;

      iii) estimates of any funding, accounting and tax implications;

      iv) assessment of each of the activities currently performed by BVL to determine TCC's strategy in relation to this; and

      v) identification of an appropriate go to market strategy (where applicable).

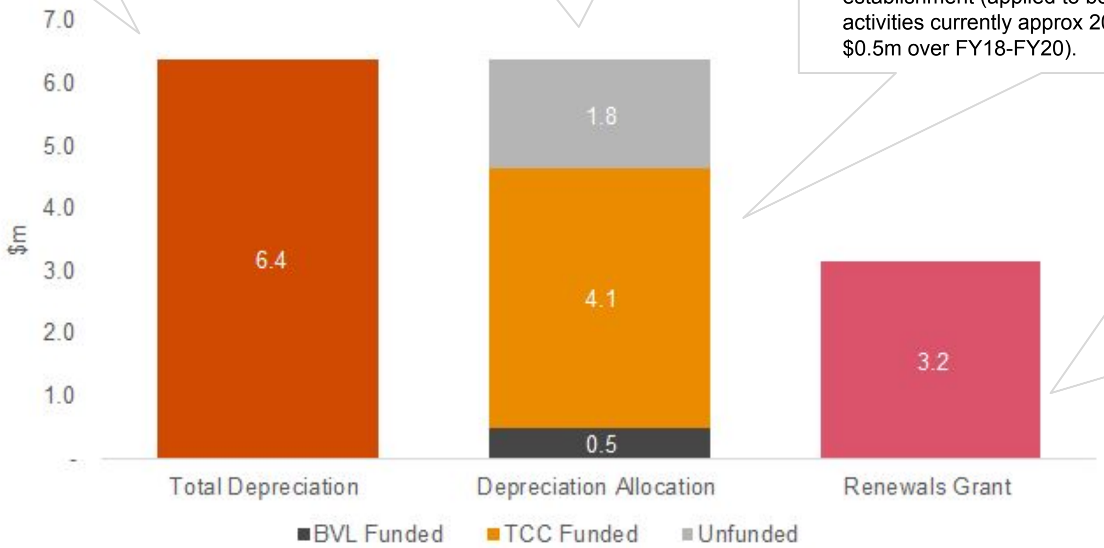
Appendix 2: Depreciation explained

Total depreciation charge to BVL across all assets required to operate the network

Approx $1.8m of depreciation is unfunded. This relates to the stadium. We understand a decision was made to not fund this as the stadium would only be replaced if funded by a third party.

The balance of depreciation is funded by:

- **TCC** where it relates to assets transferred to BVL on establishment (used for both Funded and Non-funded activities currently approx 60:40 split). *This depreciation charge is rated for by TCC and is a cost to the ratepayer.* (Average of $4.1m over FY18-FY20).
- **BVL** where it relates to assets acquired since its establishment (applied to both Funded and Non-funded activities currently approx 20:80 split). (Average of $0.5m over FY18-FY20).



Every year, TCC provides BVL with a Renewals Grant to cover renewal costs in that year relating to assets that were transferred to BVL at the date of establishment.
This amount varies year on year depending on investment needs.
The difference between the amount TCC rates for and the Renewals Grant is retained in TCC reserve account.

Source: based on BVL information average of the past three years FY18-FY20 (Covid adjusted), PwC analysis

Appendix 3: Overview of tax and accounting considerations

Tax considerations

Transfer of assets from BVL to TCC

- Transfer of assets will need to be at market value and agreed to by both parties. The transfer of assets from BVL to TCC can be achieved through:
  - Sale of assets; or
  - Distribution in specie.
- These options may trigger tax events, such as depreciation recovered or loss on sale of the assets or a taxable dividend for an in-specie distribution.
- Given the level of tax losses as at 30 June 2020 in BVL ($35m) and TCC ($18m), there may not be actual tax payable under either option.

Transfer of assets from TCC to BVL

- Transfer of assets will need to be at market value and agreed by both parties.
- The transfer of the Marine Precinct and Campground from TCC to BVL would have income tax implications (but sheltered by tax losses) and would be taxable supplies for GST purposes. However, as both entities are GST registered, the overall GST position would be neutral.
- As a Port-Related Commercial Undertaking, the commercial activities of the Marine Precinct are already taxable in by TCC. On transfer to BVL, the recreational part of the Marine Precinct business would also become subject to income tax (depreciation recovery). Given the current loss status of BVL, we do not consider that this will result in additional cost to BVL, albeit this will need to be considered in more detail once the transaction and new entity funding models are agreed.

Tax depreciation recovery

- To the extent that assets that are depreciable for tax purposes are sold for greater than their tax written down value, depreciation recovery income will arise on the difference up to the original cost of the asset.
- In view of the tax losses in each entity this may not result in any tax being payable.
- While depreciation recovery income may arise as described above, restrictions apply to the cost base for future tax depreciation claims where assets are bought and sold between associated persons. In this instance, because TCC and BVL are associated persons for tax purposes, the purchaser is restricted to claiming tax depreciation in future on the tax written down value of the assets according to the fixed asset register of the vendor at the time of sale.

Winding up of BVL under option 3

- BVL currently has $35m of tax losses. If the company is wound up, these losses would no longer be accessible by TCC however if BVL was retained as a dormant company, the losses would continue to be available.

Debt forgiveness

- Following the transfer of assets and associated share buy-backs / distributions, BVL's debt to equity position will be altered.
- To rectify this, and ensure BVL is on a more financially robust footing. There may be a requirement to reduce the level of inter-company debt.
- Debt forgiveness is not allowed under the Local Government Act and instead the debt could be restructured through a recapitalisation of BVL, ie. equity injection by TCC to enable BVL to pay down its debt.
- A reduction in debt will also reduce the level of tax deductible interest paid by BVL.

Dividend

- Where BVL pays a dividend to TCC, this will be taxable income to TCC.

Accounting considerations

- There is no impact from an accounting perspective if option 1 is selected.
- The accounting treatment will follow the economic substance of the transaction. For example, if a transfer of assets/operations from an entity to its owner is in substance a non-cash distribution or capital return, it will be accounted for as such even if it is not executed through a legal dividend or return of shares.
- If the assets and liabilities /operations transferred remain under the ultimate control of TCC following the transaction, there will be no impact on the consolidated financial statements of TCC.
- The accounting treatment in the separate parent financial statements of TCC and in the financial statements of BVL would have to be worked through depending on the option selected. If the transaction involves the transfer of assets and liabilities /operations between the group entities such that those assets and liabilities remain under the ultimate control of TCC before and after the transaction, the transaction would be considered a common control transaction. There is no specific guidance in the accounting standards in this area so the entities may have a choice to measure the transaction at the transaction price, fair value or predecessor value. Predecessor carrying values are the carrying amounts of assets and liabilities of the acquired entity from the consolidated financial statements of the highest entity that has common control for which consolidated financial statements are prepared.
- Accounting advice should be sought once a strategy is determined to understand how this should be treated in TCC and BVL's accounts.

Appendix 4: Overview of Legal and Property considerations

Legal considerations

- The transfer of operations from BVL to TCC (and vice-versa), will require work to be undertaken to understand the contracts in place, counter-parties and contractual terms. Key considerations include:
  - Some contracts may be able to be transferred by providing a letter to counterparties to state the contract has transferred to TCC and that all terms remain the same. This might be possible for some commercial contracts, however there may be transferability restrictions in the contracts and there is a risk that counterparties take the opportunity to renegotiate terms or exit contracts.
  - Given the transfer is within the same Council group (and in many cases transfer to the parent entity) this may prove to be less of an issue than if it was moving to another corporate structure.
  - Employee contracts will not automatically roll over to the new parent, employees will need to agree to the transfer (the mechanics of which may be prescribed under contract). To the extent there are any 'vulnerable workers' (as employees of either BVL or any contractor of BVL), the specific 'right to elect to transfer' provisions under the Employment Relations Act 2000 will apply, and will need to also be considered. In each event, a form of consultation process would be necessary.
  - Some asset transfers may have a regulatory or a consenting overlay that does not transfer with the land, but rather the land holder. This should be considered to reduce lack of continuity of service risk.
- Under Option 2, consideration will need to be given to contracts that currently span across Funded and Non-funded operations and how best to structure this going forward.
- Under Option 3 where some operations / assets may be disposed of, TCC may wish to do more work to ensure contracts are all in place to satisfy the new transaction.
- Option 3 may result in inefficiency with certain contracts being amended / novated to TCC and then shortly thereafter as part of a disposal / lease.
- There may be legal costs in relation to the transfer of assets. Given it is remaining within the same group, this may be relatively simple to implement via a Deed of Assignment.
- The legal costs involved in Option 2 and Option 3 could range from $20k-$150k based on:
  - Capacity and capability of TCC / BVL to manage the asset/people transfers in-house
  - Approach to transfers (i.e. letters or more formal discussions and negotiations)
  - Complexity of contractual arrangements
  - Number of contracts and assets to address.

Property considerations

- We understand that BVL currently owns all properties it uses and that the land the properties is on is owned by TCC.
- Under all options, once a strategy is determined for BVL, the property portfolio currently used to deliver the range of activities will need to be considered to ensure it is being optimised and efficient.
- This may result in:
  - Changes made to properties to:
    - optimise delivery of BVL/TCC activities, or
    - unlock value through sale and / or alternative use.
  - Potential disposals of properties that may no longer be needed or where alternative cheaper ways of delivering the activity are possible
- Option 2 will also need to consider appropriate rental arrangements between TCC and BVL where BVL continues to operate activities within a TCC owned facility.

Appendix 5: Historical performance P&L (FY18-FY20)

Profit and Loss

$m 3 Year Historical Average	Funded Operations	Non-Funded Operations	Total BVL
Revenue	2.6	15.2	**17.8**
Expenses	(3.4)	(10.4)	**(13.8)**
Overhead allocation	(2.4)	(4.2)	**(6.6)**
EBITDA (pre operating grant)	**(3.2)**	**0.6**	**(2.7)**
BVL funded interest expense	(0.0)	(0.3)	**(0.3)**
BVL funded depreciation	(0.1)	(0.4)	**(0.5)**
Other	(0.0)	0.0	**(0.0)**
BVL Operating surplus / (loss)	**(3.4)**	**(0.1)**	**(3.4)**
TCC funded interest expense	(0.3)	(0.2)	**(0.5)**
Other depreciation	(3.5)	(2.4)	**(5.9)**
Operating surplus / (loss)	**(7.1)**	**(2.7)**	**(9.8)**
Operating Grant	2.7	-	**2.7**
Renewals Grant	1.8	1.3	**3.2**
Interest Grant	0.3	0.2	**0.5**
Debt Retirement Grant			
Total surplus / (loss)	**(2.3)**	**(1.1)**	**(3.4)**
Cost to Ratepayer			
TCC funded interest	0.3	0.2	**0.5**
TCC funded depreciation	2.4	1.7	**4.1**
Operating Grant	2.7	-	**2.7**
Fundng shortfall			**2.0**
Total cost to the ratepayer			**9.3**

EBITDA from Non-funded operations has partially offset the losses of the Funded network.

Assumption: TCC funded interest and shared services depreciation is split between Funded / Non-funded on basis of FY2020 (actual) split of combined depreciation and interest between Funded / Non-funded.

Total cost of operating the BVL business.

Assumption: Renewals Grant and Interest Grant allocated to Funded / Non-funded on basis of fixed asset allocation between Funded / Non-funded in FY20 (actual).

The Cash Funding Shortfall reflects the increase in the loan from TCC to BVL.

The total cost to the ratepayer.

Source: BVL 'Financial Story' information. PwC analysis.
Average figures for FY18, FY19 and FY20 (adjusted for COVID-19)

Appendix 6: BVL forecast FY21 to FY23

Profit and Loss

FY21 impacted by Covid and August 2020 lockdown

$m	Funded Operations FY21	Non-Funded FY21	Total BVL FY21	Funded Operations FY22	Non-Funded FY22	Total BVL FY22	Funded Operations FY23	Non-Funded FY23	Total BVL FY23
Revenue	2.9	14.7	**17.6**	3.9	18.0	**22.0**	4.2	18.9	**23.0**
Expenses	(3.7)	(9.8)	**(13.5)**	(4.1)	(11.5)	**(15.6)**	(4.3)	(11.8)	**(16.1)**
Overhead allocation	(2.7)	(4.7)	**(7.4)**	(2.9)	(5.2)	**(8.1)**	(3.1)	(5.4)	**(8.5)**
EBITDA (pre operating grant)	**(3.5)**	**0.2**	**(3.3)**	**(3.1)**	**1.4**	**(1.7)**	**(3.2)**	**1.7**	**(1.5)**
BVL funded interest expense	(0.1)	(0.3)	**(0.4)**	(0.1)	(0.4)	**(0.5)**	(0.1)	(0.5)	**(0.7)**
BVL funded depreciation	(0.1)	(0.5)	**(0.6)**	(0.1)	(0.6)	**(0.7)**	(0.1)	(0.6)	**(0.8)**
Other	-	-	-	-	-	-	-	-	-
BVL Operating surplus / (loss)	**(3.7)**	**(0.6)**	**(4.3)**	**(3.4)**	**0.4**	**(2.9)**	**(3.5)**	**0.6**	**(2.9)**
TCC funded interest expense	(0.4)	(0.2)	(0.6)	(0.3)	(0.2)	(0.6)	(0.3)		(0.3)
Other depreciation	(3.1)	(2.9)	**(6.0)**	(3.8)	(3.6)	**(7.3)**	(3.8)	(4.0)	**(7.7)**
Operating surplus / (loss)	**(7.1)**	**(3.7)**	**(10.9)**	**(7.4)**	**(3.4)**	**(10.8)**	**(7.5)**	**(3.4)**	**(10.9)**
Operating Grant	2.9	-	**2.9**	2.9	-	**2.9**	3.0	-	**3.0**
Renewals Grant	3.2	2.6	**5.8**	1.8	1.4	**3.2**	1.3	1.1	**2.4**
Interest Grant	0.3	0.2	**0.5**	0.3	0.2	**0.6**	0.3	0.2	**0.6**
Debt Retirement Grant	0.4	0.3	**0.7**	0.4	0.3	**0.7**	0.4	0.3	**0.7**
Total surplus / (loss)	**(0.3)**	**(0.6)**	**(0.9)**	**(2.0)**	**(1.4)**	**(3.4)**	**(2.5)**	**(1.7)**	**(4.3)**
Cost to Ratepayer									
TCC funded interest	0.4	0.2	**0.6**	0.3	0.2	**0.6**	0.3	-	**0.3**
TCC funded depreciation	2.6	1.8	**4.4**	2.6	1.8	**4.4**	2.6	1.8	**4.4**
Operating Grant	2.9	-	**2.9**	2.9	-	**2.9**	3.0	-	**3.0**
Fundng shortfall			**(0.4)**			**0.7**			**1.5**
Total cost to the ratepayer			**7.5**			**8.6**			**9.2**

Non-funded operations forecast improving EBITDA due to healthy school lunches contracts and user growth

The Operating Grant increases by 1% annually.

Assumption: Renewals Grant, Interest Grant and Debt Retirement Grant allocated between Non-funded and Funded operations based on value of assets for each in FY20.

Balance Sheet

$m	FY21	FY22	FY23
Current assets	1.6	1.6	1.6
Fixed assets	114.1	115.5	115.0
Other	1.9	2.1	2.1
Total assets	117.6	119.2	118.7
Current liabilities	4.8	4.8	4.8
TCC Loan	16.7	17.4	18.9
Other	10.6	13.1	12.9
Total liabilities	32.1	35.3	36.6
Total Equity	85.5	83.9	82.1
Debt / (Debt + Equity)	16%	17%	19%

Debt / (Debt + Equity) forecast to remain below 20% threshold

Source: BVL 'Financial Story' information. PwC analysis.
Average figures for FY18, FY19 and FY20 (adjusted for COVID-19)

Appendix 7: Option 2

Impact on BVL

$m 3 Year Historical Average	Total BVL (currently)	Add TCC Activities	Less Funded Operations	Adjustments	Total BVL
Revenue	17.8	3.1	2.6		**18.3**
Expenses	(13.8)	(2.5)	(3.4)		**(12.9)**
Overhead allocation	(6.6)	(0.4)	(2.4)	-	**(4.6)**
EBITDA (pre operating grant)	**(2.7)**	**0.2**	**(3.2)**	**-**	**0.8**
BVL funded interest expense	(0.3)	(0.2)	(0.0)		**(0.4)**
BVL funded depreciation	(0.5)	(0.5)	(0.1)		**(0.9)**
Other	(0.0)	-	(0.0)		**0.0**
BVL Operating surplus / (loss)	**(3.4)**	**(0.5)**	**(3.4)**	**-**	**(0.5)**
TCC funded interest expense	(0.5)	-	(0.3)		**(0.2)**
Other depreciation	(5.9)	-	(3.5)		**(2.4)**
Operating surplus / (loss)	**(9.8)**	**(0.5)**	**(7.1)**	**-**	**(3.2)**
Operating Grant	2.7	-	2.7		**-**
Renewals Grant	3.2	-	1.8		**1.3**
Interest Grant	0.5	-	0.3		**0.2**
Debt Retirement Grant	-	-	-		**-**
Total surplus / (loss)	**(3.4)**	**(0.5)**	**(2.3)**	**-**	**(1.6)**
Cost to Ratepayer					
TCC funded interest	0.5	-	0.3	-	**0.2**
TCC funded depreciation	4.1		2.4		**1.7**
Operating Grant	2.7	-	2.7	-	**-**
Fundng shortfall	2.0	0.5	1.7	-	**0.7**
Total cost to the ratepayer	**9.2**	**0.5**	**7.1**	**-**	**2.6**

Total cost to ratepayer of $9.4m is the sum of the cost in BVL ($2.6m) and TCC ($6.8m).

Transfer of the Campground and Marine Precinct activities from TCC into BVL management and transfer of the Funded assets back into TCC direct management.
We note BVL management have a preference for an option 1.5 which adds the Marine Precinct and Campground to all current activities, without the transfer out of Community activities back into TCC. It has not been in our scope of work to comment on this option.

Operating Grant funding is no longer provided to BVL given all Funded operations are in-house for TCC.

Impact on TCC

$m 3 Year Historical Average	BVL Funded	Adjustments	Less TCC activities	Adjustments	Total TCC
Revenue	2.6		3.1		**(0.5)**
Expenses	(3.4)		(2.5)	(0.1)	**(1.1)**
Overhead allocation	(2.4)	-	(0.4)		**(2.0)**
EBITDA (pre operating grant)	**(3.2)**	**-**	**0.2**	**(0.1)**	**(3.6)**
BVL funded interest expense	(0.0)		(0.2)		**0.1**
BVL funded depreciation	(0.1)		(0.5)		**0.5**
Other	(0.0)		-		**(0.0)**
BVL Operating surplus / (loss)	**(3.4)**	**-**	**(0.5)**	**(0.1)**	**(3.0)**
TCC funded interest expense	(0.3)		-		**(0.3)**
Other depreciation	(3.5)		-		**(3.5)**
Operating surplus / (loss)	**(7.1)**	**-**	**(0.5)**	**(0.1)**	**(6.8)**
Operating Grant	2.7	(2.7)	-		**-**
Renew als Grant	1.8	(1.8)	-		**-**
Interest Grant	0.3	(0.3)	-		**-**
Debt Retirement Grant	-		-		**-**
Total surplus / (loss)	**(2.3)**	**(4.8)**	**(0.5)**	**(0.1)**	**(6.8)**
-	-				
Cost to Ratepayer					
TCC funded interest	0.3	-	-	-	**0.3**
TCC funded depreciation	2.4				**2.4**
Operating Grant	2.7	(2.7)	-	-	**-**
Fundng shortfall	1.7	2.7	0.5	0.1	**4.1**
Total cost to the ratepayer	**7.1**	**-**	**0.5**	**0.1**	**6.8**

Adjustment of $130k to reflect the minimum estimate cost of bringing BVL employees transferred with Funded operations up to Living Wage (based on TCC living wage policy) This includes the cost of bringing employees currently below this threshold up to the minimum level. Application to other impacted salary bands could potentially increase this expense $350k).

TCC interest and depreciation allocated to BVL's Funded business becomes a direct cost to TCC.
Operating Grant funding is no longer provided to BVL and instead becomes a direct expense to TCC and falls to the 'Cash Funding Shortfall' category.

Source: BVL 'Financial Story' information. PwC analysis.
Average figures for FY18, FY19 and FY20 (adjusted for COVID-19)

Appendix 8: Option 3

Profit and Loss

$m 3 Year Historical Average	Total BVL	Adjustments	Total TCC
Revenue	17.8		**17.8**
Expenses	(13.8)	(0.4)	**(14.2)**
Overhead allocation	(6.6)	0.7	**(6.0)**
EBITDA (pre operating grant)	**(2.7)**	**0.3**	**(2.4)**
BVL funded interest expense	(0.3)		**(0.3)**
BVL funded depreciation	(0.5)		**(0.5)**
Other	(0.0)		**(0.0)**
BVL Operating surplus / (loss)	**(3.4)**	**0.3**	**(3.1)**
TCC funded interest expense	(0.5)		**(0.5)**
Other depreciation	(5.9)		**(5.9)**
Operating surplus / (loss)	**(9.8)**	**0.3**	**(9.5)**
Operating Grant	2.7	(2.7)	**-**
Renewals Grant	3.2	(3.2)	**-**
Interest Grant	0.5	(0.5)	**-**
Debt Retirement Grant	-		**-**
Total surplus / (loss)	**(3.4)**	**(6.1)**	**(9.5)**

Cost to Ratepayer			
TCC funded interest	0.5	-	**0.5**
TCC funded depreciation	4.1		**4.1**
Operating Grant	2.7	(2.7)	**-**
Fundng shortfall	2.0	2.4	**4.3**
Total cost to the ratepayer	**9.2**	**(0.3)**	**8.9**

Adjustment of $350k to reflect the minimum estimate cost of bringing BVL employees transferred with Funded operations up to Living Wage (based on TCC living wage policy) This includes the cost of bringing employees currently below this threshold up to the minimum level. Application to other impacted salary bands could potentially increase this expense $950k)

Net reduction in governance overhead. Removal of BVL Board ($255k) and Senior management cost ($655k) partially offset by additional management resource at TCC ($260k).

Grant funding is no longer provided to BVL given all operations are in-house for TCC.

Funded activity loss previously funded through Operating Grant now becomes a direct Cash Funding Shortfall to TCC.

Source: BVL ‘Financial Story’ information. PwC analysis.
Average figures for FY18, FY19 and FY20 (adjusted for COVID-19)

Appendix 9: Steps required to validate options

Option 1
Enhanced Status Quo

- Elected Members to agree on strategy for BVL to provide greater clarity on operational priorities and targets.
- Based on this strategy, work with BVL management to prepare forecast financial information to better understand the financial impact of any proposed changes (possibly up to 10 years to ensure a mid to long-term view is taken).
- Review of forecast financial information to determine whether a change in funding model is required and whether TCC wishes to recapitalise BVL to support ongoing operations.
- Assess the impact of the above on the overall cost to ratepayers and the likely impact on community outcomes.

Option 2
Stronger Commercial Focus

- Detailed analysis and modelling required including:
  - Confirmation of which activities and assets to transfer
  - Proposed operating model for Community activities transferred to TCC (TCC and BVL charges and fees or 3rd party provider)
  - Confirm likely Living Wage cost impact
  - Estimate Marine Precinct and Campground assets and liabilities to transfer
  - Forecast financial information of the new entity (possibly up to 10 years to ensure a mid to long-term view is taken)
  - Ability for BVL to pay a dividend and the net impact of this on the cost to the ratepayer
  - Forecast balance sheet of New BVL to determine debt to equity ratio.
- Based on the above, review the forecast profitability and balance sheet of New BVL and alter funding and / or capitalisation as required.
- Determine number of contracts to be impacted and review relevant clauses to determine complexity and work required.
- Obtain tax advice in relation:
  - to potential transfer implications
  - Marine Precinct recreational activity becoming taxable
  - any dividends forecast to be paid.
- Asset valuations may be required to support the analysis above.
- Assess the impact of the above on the overall cost to ratepayers and the likely impact on community outcomes.

Option 3
In-house with commercial sales / leases

- Review of each BVL business to determine strategy (retain, lease, sale or stop trading) taking into account the areas noted on p19.
- Based on this, determine optimal property strategy.
- Consider obtaining valuations or undertaking market comparator analysis to understand potential value achievable.
- Determine number of contracts to be impacted and review relevant clauses to determine complexity and work required.
- Detailed analysis and modelling required once strategy determined for the assets / activities, including:
  - Assessment of required management resource to operate BVL activities once incorporated into TCC
  - Estimate of overhead requirements needed in New BVL and TCC to deliver the changed mix of activities
  - Confirm likely Living Wage cost impact
- Obtain tax advice in relation to the implication of transfer of assets and operations to TCC.
- Assess the impact of the above on the overall cost to ratepayers and the likely impact on community outcomes.

Appendix 10: Key assumptions in changes to cost to ratepayer

Assumption	Comment	Confidence in impact	Confidence in quantum
Option 2			
Living Wage cost: Cost increase of $150k to $350k Employees transferred to TCC would have pay increased to Living Wage. The bottom end of the range is the minimum amount. The top end of the range assumes a knock on impact on other employee salary increases.	• Transfer of staff would result in increased cost while TCC has the policy and BVL does not • Estimated by BVL management. Not reviewed in detail or cross-checked with TCC management.	High	Medium
Other costs and efficiencies: $nil included There may be stranded costs (people and systems) due to split of operations from current 'home'	• To be estimated when the details of businesses, assets and liabilities to be transferred are confirmed and estimated.	Medium	Low
Option 3			
Living Wage cost: Cost increase of $350k to $950k As above	As above	High	Medium
Management cost savings: Net saving of c.$400k Current management cost of $450k less requirement for some senior management $260k.	• Degree of management cost will be required. Further work required to validate.	High	Medium
Governance cost savings: Saving of c.$250k Board of BVL no longer required where all operations and assets brought into TCC.	• Based on cost in annual accounts	High	High
Other costs and efficiencies: $nil included Further efficiencies generated as a result of combining the Funded and Non-funded operations.	To be estimated when the details of businesses, assets and liabilities to be transferred are confirmed and estimated.	High	Low
General			
Advisory costs - various as detailed in Option 2 and 3.	Ranges reflect a potential spectrum of cost based on how much can be done in house and how much commissioned externally. The amount would depend on the scope of work agreed.	High	Medium
Tax impact - Assumed no impact of asset transfers under Options 2 and 3 given existing tax losses in TCC ($18m) and BVL ($35m).	This would need detailed tax advice when details of the transaction (quantum, form of transfer, consideration etc) are clearer.	Medium	Medium

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