
Premises Management Trust (Te Whaea) Loan guarantee or letter of comfort request

The Proposal

The NZ Schools of Dance and Drama Premises Management Trust (PMT trading as Te Whaea Services) hold the lease for the Showground Buildings site. The tenants for this site include; NZ School of Dance, NZ School of Drama, Wellington Basketball Association (WBA), Wellington Indoor Sports and Capital Gymnastics.

The School of Drama (the School) is seeking a loan from the Bank of New Zealand for \$400,000 repayable over 10 years. They have stated that the purpose of the loan is to further develop the fit out of the School of Drama located at 11 Hutchison Road, Newtown (the Showgrounds Building).

Due to their position as head lessee the borrower is named as PMT with security over the assets of both PMT and the School of Drama (which total approx. \$3m net). For the loan to be approved the BNZ have indicated that it also requires a guarantee or letter of comfort from the Council. A guarantee allows BNZ to call directly on the Council for immediate repayment of the outstanding balance owing should the School default on repayment of its loan. A letter of comfort while less binding can effectively result in a similar obligation if it contains a common clause that requires the Council to ensure the borrower is able to meet its obligations to the bank.

Proposal Costs

Should the Council guarantee the loan the potential costs associated with the proposal are directly related to the assessed level of risk of default on loan payments by the School and/or PMT. While this risk is assessed as low, the potential Council exposure is up to the \$400,000 value of the loan requested.

Discussion

The School of Drama has already committed to the expenditure by entering into contract for the building work. The Chair of PMT has confirmed that the combined reserves of the NZ School of Drama and PMT are sufficient to fund the capital works, without a bank loan. This is validated by officers' review of the financial statements and the forecasts of both entities.

The Chair of PMT has further indicated that the preference of the School and PMT is to retain their reserves to provide operating support for the School should this be required in future, hence the decision to seek loan funding.

Under the terms of the Memorandum of Lease, Council approval is required before any capital works on the premises can be carried out. In accordance with Council delegated authority, a loan guarantee also requires approval by the Council.

From our discussions with the Chair of PMT and our review of the financial statements of the two entities concerned, we understand that the loan (and the associated Council guarantee) is not required to complete the capital works desired. By requesting a Council guarantee for a loan the School is effectively asking the Council to provide a \$400,000 guarantee over the operational sustainability of the School and PMT.

The financial forecasts provided by the School and PMT indicate that if a bank loan was provided there is a relatively low risk of a guarantee being called upon. However given the positive working capital

positions (cash reserves) of both entities, with the exception of potentially providing PMT with a lower cost of funds, there is little to substantiate the need for the Council to provide such a guarantee.

The financial projections provided by the School indicate that the capital expenditure proposed could be funded out of the reserves of the School and PMT. This assumes PMT continues to receive favourable lease terms from the Council through until 2012, as this reduces PMT's rental income requirements from its sub-leasees including the School of Drama.

Should the School and PMT wish to safe-guard their short to medium term cash position by borrowing to fund capital improvements rather than using reserves, there is no reason for the Council to prevent this, as long as PMT and its sub-lessees can meet their financial obligations including property maintenance and other contract obligations under its agreements with the Council.

As the Council has no direct influence over the governance or operational management of PMT or the School of Drama, the provision of a letter of comfort which incorporates a clause requiring the Council to ensure the borrower is able to meet its obligations to the bank, is akin to the provision of a loan guarantee and is therefore not recommended.

The proposed alternative is to provide a letter of comfort to PMT's lender, outlining the lease conditions and tenure of both PMT and School, but without the inclusion of the aforementioned clause, therefore enabling PMT and the School to obtain a loan should their business case meet bank risk criteria requirements.

Officer recommendation

Providing a guarantee would impose monitoring obligations on the Council through the life of the loan. While the risk of the guarantee being called in has been assessed as reasonably low, officers consider that the PMT should be able to finance the redevelopment from its reserves. If the Trust or the drama school find that its reserves are coming under undue pressure for operational reasons, it could approach the Council for assistance at that time. This approach provides both lower risk and fewer monitoring obligations for the Council.

It is recommended however that the Council provide the Premises Management Trust (trading as Te Whaea) and the School of Drama and/or their lender, with a *letter of comfort* in regard to lease arrangements and tenure of these entities. It is further recommended that this *letter of comfort* does not include a clause that requires the Council to ensure the borrower is able to meet its obligations to the bank.

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