

Gloucestershire Airport Runway Safety Project
Approved by Joint Airport Scrutiny Working Group (JASWG)

19 October 2009

1.0 RECOMMENDATIONS

1.1 Cabinets of Cheltenham Borough Council and Gloucester City Council are recommended to:

- (i) Approve the revised business case for Gloucestershire Airport Runway Safety Project
- (ii) Authorise the councils to enter into a 'Co-operation Agreement', delegating authority to the S151 Officers in consultation with the Heads of Legal Services, as to the terms of such agreement, and to consult with the relevant cabinet members
- (iii) Authorise the councils to enter into a 'Development and Funding Agreement' with Gloucestershire Airport Limited as set out in this report and delegate authority to the Heads of Property and S151 Officers, in consultation with the Heads of Legal Services as to finalising the terms of such agreement and to consult with the relevant cabinet members
- (iv) Authorise the councils to enter into the following land transactions, delegating authority to the Heads of Property in consultation with the Heads of Legal Services to negotiate the terms of the transactions:
 - Purchase of land at Blenheim House and sale to the owners of replacement land for the construction of a new house and kennels
 - Purchase of land for the construction of a new access road to the airport
- (v) Approve the revised dividend policy as detailed in paragraph 6.7 of the report as follows.

Dividend Policy: 'A dividend of 50% of the net profit after tax, to be shared equally between shareholders, payable annually. The shareholders may, by agreement, vary or forgo any dividend payment, in response to a formal request made to them by the airport board of directors'.

1.2 Gloucester City Council Cabinet is recommended to:

- (i) Approve, as owner, the lease arrangements for Parton Farm as detailed in paragraph 8.3 of this report.

1.3 Cabinets of Cheltenham Borough Council and Gloucester City Council recommend to both Councils that:

- (i) PWLB borrowing required for the project is jointly facilitated by both councils (£1.2m per authority) as detailed in paragraph 10.12 of the report.

2.0 SUMMARY

- 2.1 Gloucester City Council (GCC) and Cheltenham Borough Council (CBC) each own a 50% shareholding in Gloucestershire Airport Ltd (GAL). Gloucestershire Airport is operated by GAL.
- 2.2 GAL has for a number of years been progressing a Runway Safety Project (RSP) to enable it to comply with the requirements of the Civil Aviation Authority (CAA) so that it may improve airport safety and secure its status as a Code 2 airport. The works when completed will remove existing physical obstacles from the runway approach areas and as a consequence increase the usable length of the existing runways. Works are also proposed to introduce an Instrument Landing System (ILS) which has the potential to make the airport more accessible particularly to the commercial business flight market.
- 2.3 The project requires capital works to be performed and as a result the approval of both shareholders is being sought to progress the works. GAL is also requesting the shareholders jointly facilitate borrowing through the Public Works Loan Board (PWLB) to support a proportion of the RSP costs.
- 2.4 GAL issued an updated business plan for the RSP in April 2007 and both councils have been working together, to progress the plan within their respective authorities.
- 2.5 As joint and equal shareholders both GCC and CBC need to now consider whether all recommendations required by each party have been satisfactorily resolved so that both councils may indicate their support to GAL for the RSP. The consequence of this support will be to recommend to their respective Councils that borrowing from PWLB should be jointly and equally facilitated to progress the RSP and that this decision should be delegated to the S151 Officers from each council.

3.0 BACKGROUND

- 3.1 Gloucestershire Airport is located within the area of Tewkesbury Borough Council which determines any planning applications.
- 3.2 The airport operates under the licensing regime of the CAA and the safety restrictions are complex, but put simply, GAL cannot make use of the current runway length due to the physical obstructions at either end. The airport operates with a number of exemptions to the normal safety standards the CCA expects from this type of airport. If the CAA were to withdraw these exemptions it would further restrict the airport's activities.
- 3.3 In 2005 GAL issued a 5-year business plan, which included proposals for safety improvements. These were discussed by the Joint Airport Scrutiny Working Group (JASWG) comprising members from both councils and identical resolutions, generally supporting the proposals, were subsequently approved by the Cabinets of GCC and CBC, although there were a number of issues to be resolved before final approval to the RSP could be given.

3.4 Matters progressed slowly and in April 2007 GAL issued an updated business case for the RSP and CBC's Economy and Business Improvement (E&BI) Overview and Scrutiny Committee set up an airport working group of 3 members on the same terms as before to review the proposals. In May 2007 the Overview and Scrutiny Committee (O&S) Management Committee of GCC set up a scrutiny task and finish group of 3 members to review the RSP. The 2 sets of members came together again to form the JASWG.

4.0 BACKGROUND TO PREVIOUS DECISIONS

4.1 The revised business plan was considered by the JASWG and a joint report produced. The recommendations of the JASWG were that the business case for the RSP be approved by the Cabinets of both councils subject to:

- Agreement by both Cabinets to any arrangements required to replace Blenheim House;
- Agreement by both Cabinets to recommend to their respective Councils that Cheltenham Borough Council and Gloucester City Council jointly and equally facilitate the borrowing required from the PWLB for onward lending to GAL;
- A firm commitment from the airport board to prepare a "green policy" for all activities controlled by Gloucestershire Airport, which is approved by the cabinets of both councils in early 2008 and reviewed and approved by both councils on an annual basis.
- Agreements by both cabinets to the specified dividend policy subject to the outstanding issues in respect of inflation provisions.

4.2 The recommendations were considered by Cheltenham's E&BI on 16 January 2008, and with slight amendments proposed by that committee, were recommended by Cabinet at its meeting on 12 February 2008 (Decision Notice 92/2007 refers).

4.3 Gloucester City's Management and Overview Scrutiny Committee considered the JASWG recommendations at its meeting on 21 January 2008. At that meeting, members were alerted to strategic land ownership issues for the GCC which would be impacted upon by the RSP. Members of that committee were also concerned regarding the reference to a ceiling on the number of flights which had been requested by Cheltenham's E&BI as part of the green policy. The committee resolved therefore to consult with GAL regarding the ceiling on the number of flights and await a further report to its O&S on 3 March 2008 regarding GCC's strategic land issues as they pertained to the RSP.

4.4 At its meeting on 8 December 2008 GCC's O&S Committee considered a further report, prepared by their officers at the request of their O&S committee, that included the recommendations of its task and finish group. It recommended to its Cabinet on 10 December 2008 the following:

- That Cabinet approve the Runway Safety Project as a shareholder;

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- That the airport's borrowing for the Runway Safety Project be supported subject to:
 - (i) Re-appraisal of the method of financing of the project, given current economic conditions;
 - (ii) There being no extension of Airport opening hours and this form part of the Airport's green policy;
 - (iii) That the Council's land should not be sold to achieve this, but that an alternative mechanism should be found to enable the project.

4.5 At its meeting on 15 January 2009 Gloucester City Council approved the recommendations of its Cabinet.

4.6 Thus the parameters for the next phase of the approval process for the RSP were established. The purpose of this report is therefore to outline the work carried out to provide the assurance necessary to both councils that their respective requirements have been met.

4.7 This report has been structured so as to respond to the matters raised in paras 4.1 and 4.4 and covers the following:

- **Green Policy (Section 5.0)**– explains how the Green Policy was approved by both shareholding councils
- **Dividend Policy (Section 6.0)** – outlines the background to the original proposal for a dividend policy and how this original proposal has now been revised and simplified
- **Planning Applications (Section 7.0)** – explains briefly the planning applications necessary to deliver the project together with the conditions attached
- **Land Matters (Section 8.0)** – explains the various land matters necessary for the project
- **Runway Safety Project – Implementation Plan Timescale (Section 9.0)** – brief explanation of the project timescale to deliver the RSP
- **Financial Analysis/Implications of the Business Case (Section 10.0)** – considers the revised business case and the financial assumptions underpinning the project
- **Section 151 Officer Opinion (Section 11.0)** – following on from the detailed financial analysis the opinion of the S151 Officers from Cheltenham Borough Council and Gloucester City Council on the RSP business case
- **Legal Matters – Legal Agreements (Section 12.0)**– explanation of the legal agreements which underpin the project and in particular two key legal agreements which need to be entered into by the parties, ie, the “Co-operation Agreement” and the “Development and Funding Agreement”
- **Other Legal Matters (Section 13.0)** – explanation of the other legal matters which members need to be aware of in relation to the recommendations proposed in this report

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- **Consultation (Section 14.0)** - explains the consultation process thus far in progressing the project within both shareholding councils.

4.8 This is clearly a complicated project which has been underway for some time and has now reached a critical stage where both shareholding councils are being requested not only to support the project but to borrow from PWLB on behalf of GAL. Therefore risk assessment and assurance has been a key aspect of the review and a high priority for both officers and members engaged in the review. Close working has happened between the project team and GAL to ensure that the risk assessments and assurances are comprehensive and aligned. The RSP Project Risk Matrix is attached at **Appendix 1**.

5.0 GREEN POLICY

5.1 Both councils endorsed the requirement for a green policy to cover all activities controlled by GAL.

5.2 The final version of the policy was issued by GAL on 13 March 2009 after review by the JASWG at its meeting on 25 February 2009. The JASWG recommended that the Green Policy be forwarded to the cabinets of both GCC and CBC and that the policy be approved as a means of minimising the environmental impact of Gloucestershire Airport's facilities and operations.

5.3 CBC's E&BI Committee considered the report of the JASWG at its meeting on 8 April 2009 and endorsed the recommendations of the working group. Cheltenham's Cabinet approved the recommendations of E&BI on 21 April 2009 (Decision Notice 19/2009 refers).

5.4 GCC's O&S Committee considered the report of the JASWG and recommendations of the JASWG at its meeting on 9 April 2009 and supported the report. The chair of the JASWG presented his working group's report to GCC's Cabinet on 15 April 2009 and they resolved to support the Green Policy.

5.5 Both the Green Policy and the Planning Consents from Tewkesbury Borough Council include detail on the maximum number of flight movements at the airport (see paragraph 7.3).

6.0 DIVIDEND POLICY

6.1 The desire for a dividend policy has been mooted by the councils in discussions with the company over a number of years. The existing dividend policy, in the shareholder's agreement is as follows:

6.2 *"If in respect of any accounting period the Company has profits available for distribution (within the meaning of Part VIII of the Companies Act 1985) the Company undertakes with the Shareholders to consult with them upon its proposals for the distribution of such profits prior to any formal decision thereon. In deciding whether in respect of any accounting period the Company has profits available for distribution the parties shall procure that the auditors of the Company from time to time shall certify*

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whether such profits are available or not and the amount thereof (if any) in giving such certificate the auditors shall act as experts and not arbitrators and their determination shall be binding on each of the parties hereto.”

- 6.3 The following proposed dividend policy was agreed by both Councils in 2008 and provided for the distribution of dividends both before and after investment in the airport as follows.

Dividend policy: *A dividend of 50% of the net profit after tax, to be shared equally between shareholders, payable annually. The sum payable to be subject to a minimum payment of £50,000 per annum (£25,000 per shareholder) inflated annually by the retail price index excluding mortgages (RPIX) as at September.*

Dividend policy following investment: *A dividend of 50% of the net profit after tax, to be shared equally between shareholders, payable annually, with effect from 5 years after the date of commencement of the project. The sum payable to be subject to a minimum payment of £80,000 per annum (£40,000 per shareholder) inflated thereafter annually by the retail price index excluding mortgages (RPIX) as at September.*

The shareholders may, by agreement, vary or forgo any dividend payment, in response to a formal request made to them by the airport board of directors. This policy included timings, which tie in with the budgeting cycles for both the airport and the respective councils and allows all parties more certainty for budgeting purposes.

- 6.4 The airport board, at a meeting on 4 January 2008, agreed in principle to the dividend policy, which is based upon dividing up the future profit of the airport equally between the shareholders and the airport company. However, the precise mechanism for the inflationary uplift in respect of minimum amounts payable remained under discussion.
- 6.5 In the course of reviewing the refreshed business plan and in discussion with the airport company it had become clear that the proposed policy was unnecessarily complex and not in the best long-term interests of either the shareholders or the company. The existence of a minimum level of dividend has the potential to jeopardise the longer-term stability of the company and would not necessarily be a sound approach if the company could not afford to make such a distribution.
- 6.6 The view of the airport board is that, for over 10 years, whilst mindful of the Shareholder's wish for high dividends has made it clear that sensible investment for the continued viability of the assets should be prioritised. Analysis by the Board has shown that aggregate payments over the last decade have been quite generous but, as this is a highly volatile industry, uncertainty rules and prudence must be exercised. The airport Board is of the view that the economic benefits derived from longer-term commercial growth outweigh those of immediate cash dividends.
- 6.7 The original business plan projections demonstrated that in fact the dividends due to the councils were likely to exceed the minimum dividend levels and they were not likely to be triggered, hence a complex

indexation process was being created which could be avoided. As such, an alternative simplified dividend policy, has now been proposed and supported by both S151 Officers as follows:

Dividend Policy: 'A dividend of 50% of the net profit after tax, to be shared equally between shareholders, payable annually. The shareholders may, by agreement, vary or forgo any dividend payment, in response to a formal request made to them by the airport board of directors'.

- 6.8 This has been incorporated into the shareholders agreement and the airport's Board of Directors approved the revised policy on 31st July 2009.

7.0 PLANNING APPLICATIONS

- 7.1 In December 2006, four planning applications were submitted to Tewkesbury Borough Council in connection with the Runway Safety Project. After considerable consultation, and independent review by their appointed aviation consultants, the applications were presented to Committee with Officer Recommendation in May 2009. All four applications were approved as shown below:

Blenheim House – 06/01671/FUL
Bank View Farm – 06/01670/FUL
RESA (Runway End Safety Area) - 06/01668/FUL
Entrance Road – 06/01669/FUL

- 7.2 A number of "Conditions" are attached to the planning permissions outlining various permissions for development. The conditions were finally issued by September 2009.
- 7.3 Amongst the conditions are a number which capture and reflect aspects of the airport's Green Policy. These conditions specifically relate to the airport operations and are set out below:
- (a) The number of air movements at the airport shall not exceed 95,000 a year (excluding police, emergency and military related flights)
 - (b) The airports main hours of operation shall be restricted to between the hours of 0830 – 1930 with no more than 1.5 % of movements per annum outside of these hours (excluding police, emergency and military related flights, and those arriving late for operational reasons)
 - (c) The number of movements between the hours of 23.00 and 06.00 shall be limited to 100 per calendar year (excluding police, emergency and military related flights).
- 7.4 The shareholding Council's planning consultants have reviewed the consents attached to each application and found them not to be restrictive and only to be expected.

8.0 LAND MATTERS

8.1 A number of land transactions are necessary to be completed to enable the RSP to happen. A diagram of the land interests is included as **Appendix 2**. The property implications of the Gloucester Airport Runway Safety Project are as follows:

- Addition to the western end of the runway by 30m. This can be achieved by constructing a culvert for the brook, removing Blenheim House and buildings and diversion of the present public footpath that follows the course of the brook.
- Access and safety improvements required at the eastern end of the runway. This requires demolition of Bank View Farm buildings and relocating the entrance road away from the runway and introducing traffic control on Bamfurlong Lane.

The various land transactions which are necessary to deliver the RSP are outlined in more detail below.

8.2 Blenheim House

8.2.1 Terms have been agreed with the owners of Blenheim House, boarding kennels and cattery to dispose of their freehold interest subject to replacement of the same to an agreed specification to be sited on nearby land that forms part of the airport lease.

8.2.2 GAL will surrender their lease on the replacement site to enable the freehold transfer of the replacement premises upon practical completion. GCC/CBC will grant a lease to GAL in respect of the existing Blenheim House, boarding kennels and cattery site.

8.3 Parton Farm

8.3.1 The RESA will require part of Parton Farm which is owned by the Gloucester City Council and leased on an agricultural tenancy.

8.3.2 The tenants have agreed to surrender their lease on 4.446 acres, although only part of this is required for RESA purposes, the balance is to create a convenient site boundary.

8.3.3 GCC will grant a long lease on this land to GAL at an agricultural rent reviewable every five years. The lease will be for a minimum term of 20 years. In the event of planning permission being granted for comprehensive development on Parton Farm, Gloucester City Council may serve notice on GAL on a 5 yearly basis i.e. 20/25/30 years etc, triggering a payment of a premium on the RESA land subject to 2 years notice. In this event GAL may surrender their lease rather than pay a premium. The trigger event has been agreed as: *“Outline planning approval given for a comprehensive development of Parton Farm of at least 50% of the area, including the land adjacent to and contiguous with the RESA area.”*

In the event the airport ceases to operate on a permanent basis as a licensed airport then GCC may terminate the lease on 12 months' notice.

8.4 Bank View Farm

8.4.1 Terms have been agreed to re-site the farmhouse and buildings on the owner's land and to demolish the existing.

8.4.2 GAL will enter into a contract with the owners to build new premises to an agreed specification and demolish the existing on practical completion.

8.5 Access Road

8.5.1 Approximately 1 ha (2.47 acres) is required to accommodate a new access road. Terms have been agreed with the owners to purchase the land and their agent has served notice on the agricultural tenant so that vacant possession can be obtained from September 2010.

8.5.2 It is proposed that GCC/CBC will jointly acquire the land and lease to GAL on similar terms to the existing main airport lease.

9.0 RUNWAY SAFETY PROJECT – IMPLEMENTATION TIMESCALE

9.1 The headline project timescales which would be implemented if both councils approve the proposals are shown in **Appendix 3**. The appendix details the key actions that would be taken in each quarter over a three-year period. The timescale commences from the point of final approval of the business case by both shareholding Councils.

10.0 FINANCIAL ANALYSIS/IMPLICATIONS OF THE BUSINESS CASE

10.1 The initial business case was reviewed by each council's S151 Officer, supported by an external evaluation from Mott McDonald, who had significant expertise in the aviation field and were best placed to offer advice on whether the projected income streams were deliverable.

10.2 Given the length of time which has now elapsed since the approval of the business plan it is only appropriate, particularly given the economic downturn, to test whether the assumptions in respect of both costs and income levels are still reasonable in making a decision to facilitate borrowing. As such, the airport company have refreshed the business case projections with the support of their accountants, Harper Sheldon, and submitted revised figures to both councils. These have been reviewed by S151 Officers of both councils in consultation with the airport and their accountants. Given the lapse of time, some costs have increased and new costs identified but, as a result of the reduction in base rates, the cost of PWLB borrowing has reduced.

10.3 Validation of Project Costs / financial projections

10.3.1 The refreshed business plan, included in the background papers (available in the members room), includes the latest projections of the business plan. Previously, these projections were based on a period of 5

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years. However, in order to see the longer term impact on a decision to support the borrowing necessary to finance the work, the refreshed business plan now projects forward both the 'do nothing ' and 'investment' options over a period of 10 years **Appendix 4**. This will assist the shareholders in seeing the sustained impact on the bottom line i.e. the return to shareholders over the long term.

- 10.3.2 In the previous version of the business case (April 2007) project costs were estimated at £3.2m with a capital injection (borrowing requirement) of £1.9m, the balance of £1.3m being financed by the airport. The refreshed business plan includes revised project costs which have increased to £3.7m and the airport company now require a capital injection of £2.4m, the balance of £1.3m being financed by the airport company.
- 10.3.3 The revision to the business plan takes account of the latest land acquisition and construction costs. The revised capital costs have been built into the business plan projections. The primary drivers behind the overall increase in estimated cost since the initial business case was produced may be summarised as follows:
- Additional contingency, which has been increased from 5% to 10% after a recommendation from Mott Macdonald;
 - The weak pound against the Euro, which has affected the purchase price of the Instrument Landing System (ILS); and
 - The construction of the RESA, which has been recalculated using an up-to-date assessment of the costs by a specialist company currently building a RESA in the Isle of Man.
- 10.3.4 The component parts of the project are therefore:
- Legal and professional fees
 - Demolition of Blenheim house plus associated buildings and construction of replacement of house and outbuildings
 - Culverting of Norman's Brook, levelling of land, diverting of footpath, installation of security fencing, grading and enhance new RESA.
 - Demolition of Bank View farm and outbuildings and replacement within existing property boundary
 - Purchase of 4 acres of land behind the Airport Inn for the construction of a new entrance road.
 - Construction of a new Airport entrance road to a location to the South of Airport inn.
 - Remove or re-site poles, signs, etc.
 - Install traffic control on Bamfurlong Lane and access road to Bamfurlong hamlet
 - ILS installation (including AGL Works and Markings).
 - Runway Surface Repair

10.4 Capital / Infrastructure costs

10.4.1 A specialist Project Management team was contracted to review the capital infrastructure investment costs independently. A complete breakdown of the project was issued to a company called Burroughs, chosen owing to their work on the Isle of Man on a very similar project. The project infrastructure estimates were checked using up-to-date costs and assumptions. In addition, a specialist construction and engineering solicitor advised the business on designing appropriate legal contracts. By obtaining specialised construction and strategic procurement advice at this stage, the company can now rely on this advice in the event of a dispute which will ensure that the risk to the business is minimised.

10.4.2 The revised business plan submitted in 2007 included a contingency sum of 5% but Mott McDonald recommended that this should be increased to 10%. The latest refreshed business plan uses project cost projections, supported by Burroughs, which include a contingency sum for each segment of the project with an additional sum on top of £130,000 which overall amounts to a total contingency of 10% in line with Mott McDonald's recommendations. The costs are based on a recent similar project on the Isle of Man and therefore should give Members and Officers better assurance that the provisional sums are likely to be a more reasonable assessment of the actual cost than the original estimates made in earlier submissions of the airport business plan.

10.4.3 GAL has funded £124k of the legal and professional fees associated with the project from annual operating profits over a number of years. The refreshed business plan projections assume a further budget for legal and professional fees to complete the project of c£72k.

10.5 Staff Costs

10.5.1 The refreshed business plan includes increased staff costs which result from the business positioning itself in advance of the project being completed in order to satisfy safety requirements. This ensures the business is ready to provide the level of service needed to support the anticipated levels of traffic safely and securely.

Whilst the majority of staff can be brought in from a variety of industries, specialist trades need to be developed. For example, Air Traffic Controllers need to be nationally and locally trained. The national training is mandatory and ensures they are licensed to operate equipment types, giving them specific type ratings. Locally, they are required to undergo familiarisation training on the local environment and equipment specific to Gloucestershire Airport. Once they have undergone this requirement and satisfied the Senior Air Traffic Controller, they are put forward for validation from the CAA. This process can take up to 9 months and is a tremendous drain on resources since they have been absorbed by the business over the last two years in anticipation of securing support for the RSP. In essence, the business has been staffed, by necessity, at a level higher than it currently operates and no further increases in costs are required.

10.6 Project financing costs

10.6.1 The financial projections assume borrowing costs of the Public Works Loans Board (PWLB), which have been factored into the revised financial projections at a rate of 5.35% over 15 years. Currently rates are c4.35% so this allows for rates to move up and appears to be a prudent assumption to make at this stage.

10.7 Income Projections

10.7.1 The income projections were revisited to ensure accuracy and deliverability particularly given the current economic climate. The figures are deemed to be an accurate assessment of anticipated levels of traffic and have been based upon empirical data through an in-depth knowledge of the industry and supporting evidence provided by Operators (provided as an appendix in the Business Case).

10.8 Home-based and visiting training

10.8.1 Three home-based instrument training operators have provided estimates of their requirements to use the ILS on the basis of discussions with the airport company. These operators currently go elsewhere for this training. The approval of the planning applications has helped the airport company to test the potential for future income streams relating to the use of the ILS. The revised projections indicate additional income of circa £155,000 per annum for additional home based and visiting training, a modest increase of c£32,000 per annum over the April 2007 projections.

10.9 Home-based and visiting corporate

10.9.1 With the RESA and ILS work completed, the airport would be available to more corporate aircraft some of which would find it beneficial to be based at Gloucestershire. A modest assumption would be for one additional aircraft in Year 4 and two in Year 5. It is possible that home-based corporate aircraft would also generate hangerage income although this is not assumed for the purpose of this analysis. As well as home-based corporate aircraft, the Airport would attract more visiting corporate aircraft from Year 4. One additional landing per day is a modest assumption for Year 4, two landings per day for Year 5. The refreshed business case assumes an additional £493,000 by year 5, a modest increase of c£8,400 over the April 2007 projections.

10.9.2 Given the interest in the airport following the planning approvals, the income projections appear to be a conservative and an achievable level of additional projected income based upon sound assumptions.

10.10 Impact of Parton Farm on the Business Case

10.10.1 Part of the RESA requires the use of airspace and land within Parton Farm which is outside the boundary of the land currently jointly owned and leased to the airport company and solely in the ownership of Gloucester city council.

10.10.2 A condition of Gloucester City Council's support of the project was that its land should not be sold to achieve the project (para 4.4 (iii)) but that an alternative mechanism should be found to enable the project. To identify these alternative arrangements property advisers for both councils and the airport company have worked together to advise on an appropriate solution. This work has considered a number of different options ranging from land swaps to different types of lease arrangements. The agreed lease arrangements are detailed in paragraph 8.3

10.10.3 The lease for the area of Parton Farm land will be on an agricultural tenancy basis and has not been built into the business plan projections. However, it is not considered to have a significant impact on the projections. However, longer term, the option may result in GAL having to acquire approximately 2 acres of land at Parton farm at residential development value from Gloucester City Council. There are many uncertainties around this and it is very difficult to determine a potential value at this stage and therefore no provision has been made for this scenario in the financial projections. GAL will need to consider a forward mechanism to potentially make provision for this land and both councils need to be aware that a funding mechanism may have to be considered at the time.

10.11 **Shareholder returns - impact of support for the airport investment**

10.11.1 Previously, a number of indicators had been used to measure the impact of the investment in the airport. Previous analyses of the business case have considered the impact on the value of GAL as a result of the RESA project investment. This has been expressed as two options - The "investment" option or the "do nothing" option. These have been re-considered below.

Dividend/Property Rent

10.11.2 The April 2007 version of the business plan projected the profit and loss account over a period of 5 years from 2006/07 (year1) to 2010/11 (year 5). Over this period, the net profit increased gradually, compared to the 'do nothing' option to c£125k by year 5 beyond which it was likely to be sustained. As a result, the returns to each shareholder, compared to the 'do nothing' option and based upon the proposed divided policy at the time, were projected to increase a net c£18k per shareholder per annum by year 5. No projections beyond year 5 were made at the time.

10.11.3 The refreshed business plan now includes a much longer-term projection over a 10 year period 2009/10 to 2018/19. A comparison of the net projected profit for the investment options and the returns to each council over this 10-year period, in accordance with the revised dividend policy, is contained in Appendix 1.

10.11.4 The projections indicate that that the net company profits, compared to the 'do nothing' option increase by £39,000 to £493,000 by year 10. The returns to shareholders increase by £9,800 to £123,400 per annum by year 10. As such the refreshed business plan projections for both net

company profit and returns to shareholder exceed previous business plan projections.

Internal Rate of Return

- 10.11.5 The independent advisors, Mott MacDonald, used a number of accounting ratios to evaluate the project, including the Internal Rate of Return (IRR) which they assessed would result in a turnaround in business measured of some 13%. This work has not been repeated given its limited value.

Enterprise Value

- 10.11.6 Mott McDonald have previously provided a view of the impact of investment in the RESA and ILS on the company by calculating an 'enterprise value' Enterprise Value, which indicated that the business could potentially double in value following investment.

Company Value

- 10.11.7 Given that the methods above are effectively indicative accounting ratios, rather than specific values, property advisers have been asked to derive an 'existing use' valuation of the business given the 'do nothing' and investment' options to provide a more informed view of their impact. The evaluation matrix /executive summary is attached at **Appendix 5. (Exempt Appendix)**
- 10.11.8 The table shows that the value of GAL with no RSP investment is estimated to be £1.180m. Given the anticipated decline in profitability under this option, the value of those parts of the business which are dependent on direct aviation operations will also decline.
- 10.11.9 It is clear from the analysis and valuation work undertaken that the value of the airport is enhanced by the completion of the RSP.
- 10.11.10 The "stabilised valuation" following capital investment shown in the Appendix clearly demonstrates that the implementation of the RSP increases the value of the business on all options. The analysis also shows that the estimated value of GAL is only marginally affected by the GCC's desire for 20-year break period/premium payment in the lease.
- 10.11.11 During the valuation process, the property advisers indicated that it would be normal practice when carrying out such a valuation, to separately value core activities and other operations of the business. The value of the airport is supported by the income generated from the business park operations. This is clearly demonstrated by the value of Meteor Business Park (MBP), the value of which on a standalone basis is shown in the third page of DTZ's executive summary. This compares with the valuation of GAL, including the business park, at a lower level.
- 10.11.12 The inclusion of the business parks as part of the GAL's operations has financially sustained the business to date. The business case demonstrates that the RSP implementation will increase shareholder

returns in future and reduce reliance on the business park operations, however members should note that although GAL pays a 5% of the business park rent rolls to the shareholders, under the current arrangements, the councils forego a significant proportion of direct revenues from this income stream whilst it forms part of GAL's business.

10.11.13 Property advisers concluded that there would be a strong argument to separately value MBP from the remainder of the site, and in the event that a sale was considered, the sale of separate parts of the business would maximise proceeds for the two councils.

10.12 Public Works Loan Board (PWLB) borrowing

10.12.1 One of the conditions of GCC's agreement to support the airport's borrowing was to carry out a re-appraisal of the method and financing of the project, given current economic conditions.

10.12.2 GAL had previously considered external financing to part fund the borrowing requirements for the airport runway safety project. Some time ago, the Joint Airport Scrutiny Working Group considered the merits of this approach. Given that potential external funding bodies would want security against any loan, likely to be in the form of airport assets, it was concluded that was an unacceptable risk

10.12.3 As such, the S151 Officers of the respective councils investigated the potential for the councils to jointly act as facilitators in obtaining funding from the Public Works Loan Board for onward lending to the airport to fund the project. The PWLB are comfortable with the proposed approach and have agreed to the principle.

10.12.4 The benefit of this approach is that the interest rates are cheaper than prevailing bank rates and method of financing will ensure that the assets remain firmly in the control of the airport company and ultimately the shareholders. As such, the Chief Finance/S151 Officers of both councils consider that PWLB borrowing remains the most appropriate vehicle for financing the external borrowing requirements.

10.12.5 The councils have power under section 25 of the Airports Act 1986 to make loans to the airport as an associated company for the provision of working capital or improvement of assets for the airports business.

10.12.6 The latest revision to the business case indicates that there will be a borrowing requirement to be facilitated jointly by the councils of £2.4m. It has been agreed that the councils will jointly share the facilitation of the PWLB borrowing hence each council will drawdown £1.2m. Discussions with the PWLB have indicated that as the borrowing is being carried out in accordance with CIPFA's *Prudential Code on Capital Finance For Local Authorities*, each council is able to determine the most appropriate time to draw down this financing, either in tranches during the course of the project or in a single sum, passing on the allocation to the Airport in accordance with the projects cash flow requirements. The detail of the borrowing arrangements is delegated to the S151 Officers to organise between them.

10.12.7 Borrowing from PWLB will result in a revision to the prudential indicators for each council. These will be incorporated in the treasury management strategies and prudential indicators prepared for the budget setting process for 2010/11 to be approved by the respective councils in February 2010.

11.0 S151 OFFICER OPINION

11.1 Overall, the review by both S151 Officers of the refreshed business plan would indicate that, whilst the project costs have risen, the resulting net improvement in profitability is still in line with previous projections with greater returns identified for years 5-10. Indeed, given informal discussion with operators, the assumptions about future increased use of the airport following the installation of the ILS coupled with the longer usable runway, the improvement in income streams projected appear modest. The various measures of the impact on the business including increased dividends, enterprise value and increased company value would indicate that supporting the investment is a justifiable decision financially – a conclusion consistent with the previous reports to members.

12.0 LEGAL MATTERS – LEGAL AGREEMENTS

12.1 Development and Funding Agreement and Cooperation Agreement

12.1 There are a number of legal agreements which are necessary to underpin the RSP and these are outlined in **Appendix 6**. Broadly they fall into two categories. Firstly legal agreements relating to land and property matters necessary to deliver the project itself, eg, construction of a replacement for Blenheim House, transfers of various land interests etc.

12.2 Secondly, there need to be agreements involving the parties to the RSP from a shareholder and airport company perspective, this will be achieved through the following legal agreements:

- Co-operation Agreement;
- Development and Funding Agreement

12.3 Solicitors will be jointly appointed by Gloucester City Council and Cheltenham Borough Council to act for them on the drafting of the Co-operation Agreement and the Development and Funding Agreement referred to above. In the case of the Co-operation Agreement, internal solicitors at each council will check the agreements to ensure each council has independent advice.

Co-operation Agreement

12.4 The relationship between Gloucester City Council and Cheltenham Borough Council needs to be formally set down to ensure clarity between the parties. This is particularly important because each shareholding Council is being asked to jointly facilitate PWLB borrowing. This document is to be known as a 'Co-operation Agreement' which will set down the details of the loan, how it will be drawn down and paid on to the

Company, cost overruns, long stop dates, indemnities and the like. This agreement will be drafted by solicitors with suitable experience in drafting such legal agreements.

Development and Funding Agreement

- 12.4 The Development and Funding Agreement is an essential document which sets down the rights, duties and liabilities of GAL, Gloucester City Council and Cheltenham Borough Council in carrying out this project. The document will be drafted by Solicitors instructed jointly by the Councils and considered by GAL Solicitors.
- 12.5 The document will deal with the mechanics of the development, how much money is required from the Councils, when it will be paid, how it will be spent, the quality of the work, how it is organised and carried out, repayment mechanisms, as well as mechanisms to deal with risk and disputes, long stop dates, claw-back etc.
- 12.6 The detailed terms of the Agreement will be agreed by Gloucester City Council's Head of Legal Services and Cheltenham Borough Council's Head of Legal or another internal solicitor acting on his behalf.

13.0 OTHER LEGAL MATTERS

- 13.1 The decision whether or not to support the business case rests with the Cabinet of each Council.
- 13.2 The final decision whether or not to facilitate the proposed borrowing by onward lending a loan obtained from PWLB rests with full Council. This is because it will involve changes to the approved prudential indicators approved as part of each council's Treasury Management Strategy. Therefore the recommendations of the JASWG are split into those for cabinet and those for Council.
- 13.3 The decision on the acquisition and disposal of land is a Cabinet function at Cheltenham Borough Council, which may be exercised by the Cabinet Member for Built Environment if the value of the land is under £250,000. In Gloucester City Council the delegated power is given to the Strategic Property, Estates and Valuation Services Manager in consultation with the Corporate Director of Resources and Leader of the Council. For completeness sake it has been considered best for recommendations pertaining to land in relation to the RSP to be exercised in any event by cabinet irrespective of value in order to provide a comprehensive picture for members.
- 13.4 The Head of Property and Asset Management at Cheltenham Borough Council has the delegated authority to lease and accepted surrenders of the lease of land save where such disposal is at less than best consideration when it has to be a Cabinet decision. At Gloucester City Council this power is given to Strategic Property, Estates and Valuation Services Manager.

- 13.5 The decisions will be those identified in the Leaders Forward Plan of both Councils' as the transactions will be a Key Decision.
- 13.6 The Councils have power under Section 25 Airports Act 1986 to make loans to the Airport as an associated company for the provision of working capital or in connection with the provision of working capital or in connection with the provision or improvement of assets in connection with the Airport Business. Any such loan must be made on terms, both as to rates of interest and otherwise, no more favourable than the terms on which the council making the loan would themselves be able to borrow at the time when the loan was made.
- 13.7 **Land Transactions/Contractual Matters**
- 13.7.1 The Councils are proposing to purchase, sell and lease land. They have powers to do so under Sections 120 and 123 of the Local Government Act 1972. There is the duty under S123 to obtain the best consideration reasonably obtainable when disposing of land unless there is an applicable general or specific consent issued by the Secretary of State. The land and buildings transactions that the councils are entering into will be fully funded by the RSP project and the councils advisers have confirmed that the transactions represent best consideration for the councils. The councils will be party to GAL's contracts in order to have step-in rights. In relation to the terms agreed for the land/building transactions the property advisers for the Councils have confirmed that best consideration has been achieved.
- 13.8 **Legal Documentation**
- 13.8.1 The transactions mentioned above will be formalised by the Legal Teams of the Councils and GAL, and the relationship between the Councils and the Councils and GAL will be clearly documented setting down how the transactions will work. The land transactions will be documented in the normal way and Heads of Terms have been agreed in most cases subject to approval being given.
- 13.8.2 The work will be carried out under formal contracts and tendered in the normal way. The EU procurement rules are not applicable in this case but the principles of openness, equality and transparency will be complied with. Both councils will be party to the governance arrangements for assurance purposes.
- 13.8.3 The Shareholders Agreement and Memorandum and Articles of Association are also being updated to take into account changes in the financing regime
- 13.9 **State Aid**
- 13.9.1 The Councils need to be mindful of the 'state aid' principles contained in the EC Treaty (Article 87(1)). State aid broadly means financial aid from a public body which favours selected businesses and has the potential to distort competition or give an unfair advantage and affect trade in the European Union. Provision of a loan at less than market rate will, in effect,

be a subsidy and may constitute state aid. The European Commission prohibits state aid, subject to certain exceptions or where specific approval is obtained.

- 13.9.2 The Council has sought advice from specialist solicitors on this point and state aid should not be an issue in this case for 2 standalone reasons. Firstly a regional airport the size of Gloucestershire Airport is considered too small to have any effect on trade by reference to the Communication on Financing Airports (2005/C 312/01). Secondly, the market investor principle permits the council to facilitate a loan in order to protect its interests/investments in the Airport.

14.0 CONSULTATION

- 14.1 The JASWG was established back in 2002 and is the main consultative group used by the shareholders. The Terms of Reference for the group outline its objectives as *“to make recommendations on the business development opportunities for Gloucestershire Airport”*.
- 14.2 The sustainability officers of both councils were fully engaged with the process for reviewing the development of GAL’s Green Policy and their input was greatly appreciated by members of the JASWG and the Airport Board. During the development of the Green Policy a number of public questions were received by scrutiny committees of Cheltenham and these were held pending the review of the Green Policy and full answers provided to questioners as part of the report back to E&BI.
- 14.3 Both Environment O&S and E&BI O&S committees have been involved in the development of the Green Policy and RSP Business Case. Environment O&S considered the recommendations of JASWG relating to the Green Policy adoption, whilst E&BI will monitor and review its implementation. JASWG is a working group of E&BI and has played an important role over the years in reporting at various stages on GAL’s activities and in more recent years the review of the Business Case.
- 14.4 Gloucester City’s Overview and Management Committee has played a similar role to E&BI at Cheltenham in providing scrutiny role for GAL and the various reports relating to the development of the Business Case.
- 14.5 Both Councils have made concerted efforts to consider reports relating to the airport in the public domain. This has been important to keep members of the public apprised of the development of the Business Case and the consideration by both shareholding councils. Public meetings have provided opportunities for public questions to be asked and for member debate to be viewed and heard.
- 14.6 In relation to planning matters the airport falls within the borough of Tewkesbury and therefore planning applications relevant to the Business Case have been considered by that Council.

Appendix A
Gloucestershire Airport Runway Safety Project
JASWG Report 19 October 2009

Appendices

- Appendix 1 – RSP Project Risk Matrix
- Appendix 2 – Diagram of Land Matters Pertaining to the RSP
- Appendix 3 – Runway Safety Project – Implementation Timescale
- Appendix 4 – 10 Year Projected Profit Returns
- Appendix 5 – Gloucestershire Airport Limited – Company Value (Exempt Appendix)
- Appendix 6 – Runway Safety Project – Legal Agreement Matrix

Background Papers :

1. Runway Safety Project Business Case Update
(Redacted version only available for public inspection)
2. Gloucestershire Airport Green Policy – 13 March 2009
3. Articles of Association – Approved by GAL Board and JASWG 19.10.09
4. Shareholders Agreement – Approved by GAL Board
5. Cheltenham Cabinet Decision 92/2007 – RSP Recommendations (at Cabinet on 12 Feb 2008)
6. Cheltenham Cabinet Decision 19/2009 – Green Policy Recommendations
7. Gloucester City Council Overview and Scrutiny Recommendations and Cabinet Decisions

The above background papers are available on request for inspection. Please contact the Democratic Services Unit – see agenda for contact details.