

The Highland Council
Planning, Development and Infrastructure Committee
17 August 2016

Agenda Item	21
Report No	PDI 55/16

Inverness Airport Business Park Ltd - Unsecured Loan Stock

Joint Report by Director of Finance and Director of Development and Infrastructure

Summary

This is a further report on the outstanding Loan Stock due to the Council from Inverness Airport Business Park Ltd outlining the outcome of the assessment of a revised Business Plan that was scheduled to be received by the Council. The report highlights the company's Repayment Intentions, the extended repayment timescale that is now proposed and the risks for the Council.

1. Background

- 1.1 As has been previously reported the Council entered into a Loan Stock Instrument for £1,175,000 Unsecured Loan Stock 2010/2015 with Inverness Airport Business Park Ltd ('IABP') on 16 May 2005. Under the Loan Stock Instrument IABP can exercise a right to defer the repayments due to be made to the Council in May 2010 and in May 2015. IABP have exercised this right on both repayment dates so that the full amount of Loan Stock due to the Council currently remains outstanding.
- 1.2 The Council originally intended to be a full shareholding party to the business park joint venture, and in so doing the intention at that time was to contribute a mix of land (in the form of the freehold assets of Dalcross Industrial Estate) and cash. However, whilst all other funding partners were able to agree the basis of valuation for their respective contributions to the joint venture, the Council could not reach agreement around the shareholding it should take in return for its land and cash contributions. The Council therefore withdrew from the joint venture structure.
- 1.3 The other partners continued to form the joint venture, and contributed the following:
 - Moray Estates and Lord Doune – 192 Ha of land [held under option]
 - Highlands and Islands Enterprise - £500k capital
 - Highlands and Islands Airports - £1.4M capital and 29 Ha of land [owned by IABP]
- 1.4 The parties were also able to successfully secure ERDF funding of around £1.5m, on the basis that this funding together with the initial capital contributions were used to fund the construction of the airport link road

running from the A96 at Mid Coul to the airport entrance. This had the dual effect of replacing an unsatisfactory road that ran adjacent to the end of the runway, delivering on the road listed in the Council's project plan (a road which the Council had examined as a necessary project prior to the IABP project and which they would have had to 100% fund), as well as opening up the development potential of the business park project.

- 1.5 The withdrawal of the Council from the proposed joint venture left a shortfall in the funding for the road, and so it was the Council that proposed to address this problem with the Loan Stock instrument. It should be noted that the Loan Stock was drafted specifically to provide flexibility to IABP and to ensure the company did not have a situation where it was forced into repayments that damaged the ability to make progress with the development project.
- 1.6 The new road was opened in 2006.
- 1.7 Under the Loan Stock Instrument, the Council as holders of the Loan Stock can require the financial ability of IABP to be independently assessed by a firm of Chartered Accountants in order to ascertain if IABP can make repayment without prejudicing the realisation of the Company's proposals for the Development.
- 1.8 To date the Finance Service has reviewed IABP's Annual Accounts to ascertain if there would be any likelihood of a successful outcome to the Council from commissioning this independent assessment. The outcome of these assessments has been that there would be no benefit to the Council from commissioning this independent assessment of IABP's financial ability to make repayment of the Loan Stock.
- 1.9 Under the terms of the Loan Stock Instrument, IABP shall not pay any dividends to its shareholders from the date on which written notice to defer the second repayment date is made until such time as the balance of the Stock has been redeemed; and sums which would otherwise have been paid to shareholders by way of dividend will be accumulated with a view to maximising the sums available to fund the redemption of the stock. This means that repayment of the outstanding amount owed to the Council ranks above IABP's obligations to repay capital and pay dividends to its shareholders. As a result the shareholders in the Company cannot withdraw monies from the company until after the Council's Loan stock has been fully repaid.

2. Current Position

- 2.1 As reported to PDI Committee in November 2015, IABP was to provide the Council with an updated Business Plan showing the updated arrangements for developing the Business Park and outlining when IABP is likely to be in a position to make repayment of the £1.175m Loan Stock due to the Council.

2.2 A Loan Stock Strategy Paper was received from IABP in January 2016 but this fell short in providing the level of detail that the Council officials had been anticipating. This led to a meeting between representatives of IABP and the Council's Director of Finance and Director of Development & Infrastructure on 19 April 2016. Following this meeting an updated Loan Strategy Paper was received from IABP on 20 April and further updated loan strategy Paper as received in July 2016. Section 3 of this report (below) outlines the Company's Repayment Intentions from the updated Loan Strategy Paper received in July 2016.

3. IABP'S Repayment Intentions

- 3.1 The Loan Strategy paper from IABP stresses that the dates set out in it represents IABP's best estimation as to when it should be possible to commence repayment of the Loan Stock to the Council. It also states that it is not in IABP's commercial interest to commence repayment sooner than is necessary or required under the terms of the Loan Stock Agreement. Equally the paper highlights that once the key test around financial liquidity, without prejudicing the development objectives of the business, is achieved, then it becomes important to ensure repayment to the Council commences otherwise the partners to the business will not be able to work towards repayment of their own loans and ultimately to the payment of dividends to shareholders.
- 3.2 IABP currently has no bank debt. It does have a short-term loan from HIE that facilitated road infrastructure works to the phase 1 site, which were completed in 2015.
- 3.3 IABP advise that repayment of the HIE Loan is the first priority, followed by the THC Loan Stock. The IABP Board (which includes THC representation) accepted the HIE loan on the basis that it would stimulate the level of enquiries and general interest in the IABP development opportunity, and IABP advise that this has certainly proved to be the case. Development is in turn required to generate funds to repay both the HIE debt and Loan Stock. The HIE Loan has contracted re-payment provisions and will be interest bearing from 2016 and so repayment of this loan has been prioritised over repayment of the Council's Loan Stock.
- 3.4 IABP's 5 year financial forecast assumes that land sales or similar development propositions will step up year on year to generate revenue of up to £200-300k per annum by the end of this period.
- 3.5 Based on this 5 year financial forecast, IABP are forecasting repayment of the HIE debt by 2020/21, and proposing commencement of repayment of the Council's Loan Stock from the following financial year. IABP's aspiration is that the same repayment profile of around £100k per annum from March 2022 onwards will be made, with these payments starting to re-pay the Loan Stock from this date onwards.

- 3.6 This sum is the best estimate that IABP can make at this point of what would be an acceptable maximum annual repayment that would not in turn undermine the ability of IABP to otherwise continue to invest in the economic success of the development project.
- 3.7 It is however important to add that should funding requirements come forward that are necessary for IABP to make to ensure the development objectives are continued to be met and the financial liquidity of the business achieved - and which require the repayment profile suggested above to be altered - then IABP will seek to make this change in consultation with THC.
- 3.8 IABP has advised that if the assumptions they are currently working to provide to be unduly pessimistic, in consultation with THC, IABP will then look to accelerate the repayment programme.
- 3.9 IABP Ltd remains very positive about the future prospects for the project and its importance over the long term for regional economic development. A comparison between the July 2016 and April 2016 Loan Stock Strategy papers indicates that IABP have undertaken development proposals since the April document has been received. These include the strategic foul water solution due for completion in mid-2017, focus on implementation of strategic infrastructure that will enable development to proceed across the entire site which will allow IABP to progress the release of serviced sites or turnkey packages with development partners and the appointment of a Business Development Manager in summer 2014 (originally on a 3 day per week basis but now extended by an additional day per week to market the airside site) on a fixed term contract until summer 2019. IABP has low levels of debt and has been supported by the shareholders and will continue to be. Those shareholders are unable to remove value from IABP until the Loan Stock instrument is repaid and IABP holds assets (in land and property) with a value vastly in excess of the Loan Stock sum.
- 3.10 IABP advise that the repayment of the Loan Stock is not in doubt. There is uncertainty over the timing of repayment based on market conditions and speed of development but IABP state that should be seen in the context of what the Loan Stock has already achieved and the future benefits for the Council.
- 3.11 IABP are of the view that the recessionary period is behind us and the prospects for development have improved significantly through 2014 and 2015. Key to this has been the following:
- sale of land to Bristow Helicopters Ltd (BHL) in 2014 to enable development of the relocation of the Maritime & Coastguard Agency Search and Rescue Facility;
 - loan funding of £423k secured from HIE in 2014 to build phase 1 inter-plot road infrastructure – this work is complete;
 - IABP are currently in discussions with 6 possible phase 1 occupiers – with building needs ranging from 5,000 to 15,000sqft. One specific enquiry is with a nationally significant logistics operation, and where

IABP is likely to either agree or not to a transaction by the end of September 2016. The other enquiries are at different stages with two having development proposals prepared for the occupier to review;

- IABP is also marketing the opportunity for delivery of a 120-bed hotel adjacent to the airport entrance, and this process is moving forward positively; and
- the new railway station serving Inverness Airport and IABP should be operational in 2018.

4. Implications for the Council

4.1 Finance Risks

4.1.1 The main financial risk is that there remains a high degree of uncertainty on when the Loan Stock will be repaid to the Council. If everything should proceed as per IABP's forecast it will be March 2022 before the Council begins to receive any payment towards the outstanding loan stock and based on a repayment of £100k pa it will take 12 annual payments to recover the total amount due to the Council. This means it will be March 2033 before the full amount has been repaid to the Council which is obviously a much longer timescale than was originally envisaged. As no interest is payable on the outstanding Loan Stock the value of the outstanding amount is being eroded through inflation.

4.1.2 There are caveats around IABP's forecasts which could accelerate or further defer the repayment due to the Council. These caveats are subject to market conditions and are a risk that the Council will have to carry.

4.1.3 The Council's External Auditors, Audit Scotland, commented on this outstanding Loan Stock in the 2014/15 Accounts and have included this issue in their Annual Audit Plan 2015/16. As a result there is continuing external audit interest in this issue through the audit of the Council's 2015/16 Annual Accounts.

4.1.4 In accordance with accounting regulations, the loan stock is treated as a soft loan in the Highland Council Balance Sheet at 31 March 2016. It is recorded in the Balance Sheet at its fair value of £624k, being the present value of future cash receipts. Whilst the Council still expects IABP to repay the full amount of £1.175m the valuation in the Council's accounts reflects the accounting valuation of the loan which takes into account the length of time it is likely to take for the loan to be repaid. There is no impact on the General Fund from this adjustment.

4.2 Legal Risks

4.2.1 Based on IABP's updated Loan Strategy Paper, there may be a need to compile an amendment to the current legal agreement – the Loan Stock Instrument – between the Council and IABP. Any amendments to the current Loan Stock Instrument such as updated repayment dates agreed between the Council and IABP will need to be legally documented and this will require either an addendum to the current Loan Stock instrument or an entirely new Instrument if the agreed changes should be extensive and

significant. The current Loan Stock Instrument was compiled by an external Legal Adviser and if the new documentation was also to be compiled by an external legal firm there will be legal fees associated with this course of action.

4.3 Climate Change/Carbon Clever, Gaelic, Equality, and Rural
No implications to these risks are envisaged from this report.

4.4 Risk
The main risks are as outlined in the text of this report.

Recommendations

The Committee is asked to note:

- the proposed repayment terms proposed by IABP;
- the caveats around IABP's repayment profile;
- the ongoing External Audit interest in the issue; and
- the treatment of the outstanding Loan Stock as a soft loan in the Council's 2015/16 Annual Accounts.

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Background Papers:	Loan Stock Instrument and previous Committee Reports