

Agenda item	12
Report no	EDI 11/17

HIGHLAND COUNCIL

Committee: Environment, Development and Infrastructure Committee

Date: 8 November 2017

Report Title: Inverness Airport Business Park Ltd – Unsecured Loan Stock

Report By: Joint Report by Director of Corporate Resources and Director of Development and Infrastructure

1. Purpose/Executive Summary

- 1.1 This is a further report on the outstanding Loan Stock due to the Council from Inverness Airport Business Park Ltd. The report outlines the current position, the outcome of the review of the company's 2016/17 Annual Accounts, other developments that have occurred during 2016/17, the company's Repayment Intentions, the extended repayment timescale that is now proposed and the risks for the Council.

2. Recommendations

- 2.1 Members are asked to note the outcome of the assessment of IABP's 2016/17 Annual Accounts and the implications for repayment of the Council's Outstanding Loan Stock.

3. Background

- 3.1 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.
- 3.2 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.
- 3.3 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)
- 3.4 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.
- 3.5 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.
- 3.6 The new road was opened in 2006.
- 3.7 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.
- 3.8 To date, the Corporate 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.

3.9 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.

4. Current Position

4.1 The current position is that the full amount of Loan Stock £1.175m due to the Council remains outstanding. As per the terms of the Loan Stock Instrument the Company's Annual Accounts can be reviewed by an independent accountant to ascertain whether or not the company is in a position to make payment to the Council. As in previous financial years the Council's Corporate Finance Service has reviewed the company's Annual Accounts to ascertain if there would be any benefit from commissioning this independent review.

4.2 Outcome of the Council's Review of IABP 2016/17 Annual Accounts

4.2.1 The outcome of the Corporate Finance Service's assessment of the company's Accounts has highlighted a loss of £108,898 in 2016/17 compared with a loss of £143,907 in 2015/16. The assessment also highlighted that the company's Balance Sheet has weakened in 2016/17 compared to its 2015/16 position with Net Current Liabilities increasing to £1,139,173 in 2016/17 (from £818,214 in 2015/16) and the Net Worth of the company falling to £264,369 in 2016/17 (from £373,267 in 2015/16).

4.2.2 The increase in Net Current Liabilities has arisen from an increase in Creditors falling due within one year to £1,188,910 in 2016/17 (from £1,013,938 in 2015/16) and Current assets falling to £49,737 in 2016/17 (from £195,724 in 2015/16). From a liquidity point of view this means that the company's current liabilities (£1,188,910) exceed its total current assets (of £49,737). Normally total current assets should at least equal, and more likely exceed, total current liabilities.

4.2.3 Overall the company is in a weak financial position and does not have sufficient liquidity in their Accounts to make repayment to the Council. Consequently there would be no benefit from commissioning the independent assessment of IABP's financial ability to make repayment of the Loan Stock.

4.3 Other issues arising in 2016/17

4.3.1 In addition to their Annual Accounts, IABP has also provided the Council with details of a further £1.0m loan, to be taken from HIE, available from April 2018. The initial interest rate on this new loan is circa 9% although the company hopes this initial rate can be reduced to circa 6.5% by April 2018.

4.3.2 Repayment of this new loan from HIE will rank above repayment of the Council's outstanding loan stock. The implications for the Council's outstanding loan stock have been raised with IABP who have advised that to realise the value needed to repay the Council's loan stock they need to develop the site which requires facilitative infrastructure investment. The timing of repayment of the loan stock instrument continues to depend on the pace of sales. If this is higher than expected

then that increases the capacity to commence repayments to the Council.

4.4 Proposed Repayment Intentions

4.4.1 The current profile for repayment of the Council's Loan Stock remains largely as was reported to Planning, Development and Infrastructure Committee in August 2016. The following paragraphs reflect what was reported in 2016 updated to show the few changes that have occurred in 2016/17.

4.4.2 IABP provided the Council with an updated Loan Strategy paper in July 2016 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.

4.4.3 The Loan Strategy paper from IABP stressed 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 stated that 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 highlighted 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.

4.4.4 The IABP paper in 2016 stated it had no bank debt but in 2016/17 IABP has a bank loan/overdraft of £13,623. In addition the company's paper in 2016 highlighted that it has a short-term loan from HIE that facilitated road infrastructure works to the phase 1 site, which were completed in 2015. This loan is now supplemented by the new £1.0m loan mentioned in para 2.2 of this report.

4.4.5 In 2016 IABP advised that repayment of the original HIE Loan was the first priority, followed by the Council's Loan Stock. Clearly the new loan from HIE will now rank above the Council's Loan Stock so that repayment of both HIE loans ranks above repayment of the Council's outstanding 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 advises 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 Loans have contracted re-payment provisions and will be interest bearing and so repayment of this loan has been prioritised over repayment of the Council's Loan Stock.

4.4.6 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.

4.4.7 Based on this 5 year financial forecast, IABP are forecasting repayment of the original HIE debt by 2020/21, and proposing commencement of Loan Stock repayment from the following financial year. IABP's aspiration is that the same repayment profile of around £100k per annum from March 2022 onwards, but with these payments starting to re-pay the Loan Stock from this date onwards.

4.4.8 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.

- 4.4.9 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 the Council.
- 4.4.10 IABP has advised that if the assumptions they are currently working to, prove to be unduly pessimistic, in consultation with the Council, IABP will then look to accelerate the repayment programme.
- 4.4.11 IABP recently announced its first occupier at Phase 1 with the Co-op's new 12,000sqft distribution centre due to open at Plot 2/1 (2.5-acres) in Q4 2018. The strategic foul water solution will be completed in the coming weeks and the same civils contractor is soon to carry out an extension of the existing water main network. The delivery of the strategic infrastructure at Phase 1 is underway and by the end of Q1 2018 there will be 7 fully serviced sites (approx.11-acres of land) immediately available for development. IABP has received a number of enquiries to sell serviced sites (on a long leasehold) to occupiers and developers while the company is also engaged with local development partners to deliver bespoke design & build facilities for 2 new-build projects – a 10,000sqft industrial unit at Plot 2/2 (1.4-acres) and a 14,000sqft distribution facility at Plot 3/11 (2.3-acres). The company's Business Development Manager remains in post and is working alongside local property agents actively pursuing suitable tenants for the remaining sites in Phase 1. IABP has secured funding to finance the infrastructure costs on the 7 sites and for the foreseeable future and will continue to be supported by the shareholders, if required. It is important to note that shareholders are unable to remove value from IABP until the Loan Stock instrument is repaid.
- 4.4.12 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 states that should be seen in the context of what the Loan Stock has already achieved and the future benefits for the Council.

5. Implications

5.1 Finance Risks

- 5.1.2 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 from 2016 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.
- 5.1.3 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.
- 5.1.4 IABP's ability to repay the outstanding Loan Stock to the Council is totally

dependent on the development of the site taking place as envisaged. Should this site development not occur as expected, there is a growing risk that the Council may not be able to recover the outstanding Loan Stock amount.

- 5.1.5 In accordance with accounting regulations, the Loan Stock is treated as a soft loan in the Highland Council Balance Sheet at 31 March 2017. It is recorded in the Balance Sheet at its fair value of £677k, 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.
- 5.1.6 The outstanding Loan Stock has been subject to previous External Audit review and there will be continuing external audit interest in this issue through the auditing of the Council's Annual Accounts.
- 5.2 **Legal Risks**
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.
- 5.3 **Climate Change/Carbon Clever, Gaelic, Equality, and Rural**
No implications to these risks are envisaged from this report.
- 5.4 **Risk**
The main risks are as outlined in the text of this report.

Designation: Director of Development and Infrastructure
Director of Corporate Resources

Authors: Stuart Black Director of Development and Infrastructure;
Michael W Fraser, Finance Manager Partnerships & JV

Date: 23 October 2017

Background Papers: Loan Stock Instrument and previous Committee Reports