Confidential

Epping Forest District Council

North Weald Airport Review

28th October 2011

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1. Executive summary

Background

North Weald Airport (the “airport”). is owned by Epping Forest District Council (“Council”) and is situated on greenbelt land. It is currently used for a range of activities including:

- ► Limited private aviation under long lease arrangements.
- ► Non-aviation activities including the Saturday Markets.
- ► A number of ad hoc leisure activities including car clubs and other activities.

Although the airport does return a profit, this is largely as a result of the Saturday markets. The aviation side of the business would be loss making as a stand alone business. As a result Council have sought over the last 10 years to look at ways in which the asset could be operated to deliver better value.

Ernst & Young have been appointed, as part of a wider study of the Council’s estates to review the work done to date on the airport and to outline the proposed way forward in meeting the Council’s goals for the airport.

This report outlines the findings from the high level review of the options for maximising the value from operations at the airport. The objective of this report is to independently assess the work done to date on the airport and to outline the work required to determine the optimal use of the site.

Limitations of the Halcrow Report

The following points outline the limitations of the Halcrow report in terms of the scope of the report:

- ► The report was limited to a technical assessment and did not consider what type of financial/commercial returns it will equate to, or what a private investor/operator would seek to gain from getting involved in the airport.
- ► The report considered only aviation revenues. A commercial operator would seek to generate various other revenue streams in addition this.
- ► The report only considers a period of 15 years. A private investor would typically take a long term view to any infrastructure investment (30+ years).
- ► There is no consideration of the potential for operating cost savings.
- ► The capital cost assumptions assume no financing costs so is understated.
- ► There does not appear to be any risk adjustments in the cash flow analysis.
- ► The financial analysis in the Halcrow report is based on a cumulative cash flow impact. This method of investment appraisal does not consider the time value of money and as such investors would assess investments based on net present value (“NPV”) and/or internal rate of return (“IRR”).
- ► The report does not include any market sounding, which would need to be considered before making any decision on the future use of the site.
- ► Non-aviation development has not been considered in the report. When considering options for the site the aviation options assessed should be assessed on an NPV basis and compared to non-aviation options to determine which option will return the best potential return.
- ► The commercial and legal structure of any operations at the site have not been considered in the report.

Further work required

The key areas of further work required to determine the ultimate potential for releasing value from the site are as follows:

- ► Development of a master plan of the construction work required to develop the airport and a detailed assessment of the capital costs required to develop the site for use as a business jet facility.
- ► An assessment of other potential revenue streams under an aviation intensification option including aviation “add on” services.
- ► A legal review of the proposed project development.
- ► A commercial and financial assessment of the potential development, including market sounding.

The ultimate deliverable from this further work should be a recommendation from the consultant as to the optimal option for developing and/or disposing of the site and a clear transaction strategy for delivering the option and realising the value.

2. Introduction

Background

North Weald Airport (the “airport”). is owned by Epping Forest District Council (“Council”) and is situated on greenbelt land. As a result of its greenbelt status, It is currently used for a range of activities including:

- ► Limited private aviation under long lease arrangements.
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Although the airport does return a profit, this is largely as a result of the Saturday markets. The aviation side of the business would be loss making as a stand alone business. As a result Council have sought over the last 10 years to look at ways in which the asset could be operated to deliver better value.

Ernst & Young have been appointed, as part of a wider study of the Council’s estates to review the work done to date on the airport and to outline the proposed way forward in meeting the Council’s goals for the airport.

Purpose of this Report

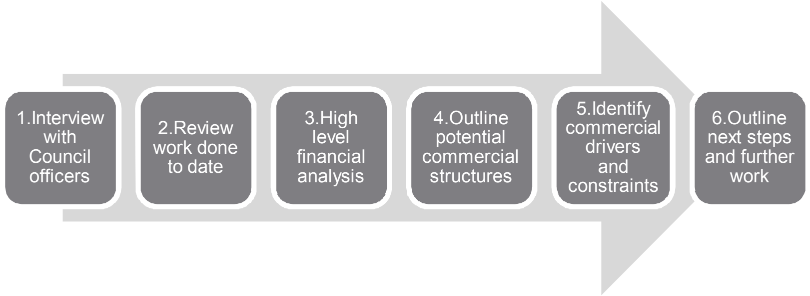
This report outlines the findings from the high level review of the options for maximising the value from operations at the airport. The objective of this report is to independently assess the work done to date on the airport and to outline the work required to determine the optimal use of the site.

The report outlines the following:

- ► An outline of the approach taken for the review of the airport.
- ► Initial view of the current airport operations
- ► A review of the Halcrow report and the potential financial impacts of the aviation options considered by Halcrow.
- ► An outline of the potential commercial structures to be considered for the airport.
- ► A summary of the likely constraints to the development of the site.
- ► An outline of the work proposed to be considered for the Council to take the opportunity forward.

Approach

The approach taken to this study is was follows:



Summary of base data used for the study

- ► Meetings were held with key Council officers to better understand the issues around the operations of the airport and constraints on future developments:
  - ► John Gilbert (Environment)
  - ► Chris Pasterfield (Estates)
  - ► John Preston (Planning).
- ► A site visit and tour of the airport provided by John Gilbert.
- ► Previous reports on the airport use prepared for the Council by Halcrow and Drivers Jonas.
- ► Copies of a sample of the lease agreements with leaseholders at the airport.

3. Initial view of the current airport operations

Overview

The following section outlines the key findings from the high level assessment of airport operations. Based on this initial review, it is apparent that the airport at present is not run on a "commercial" basis:

- The aviation operations appear to miss out on a number of potential revenue streams, covered below.
- The non-aviation operations do bring in more revenue but there is a heavy reliance on the Saturday markets. The marketing is undertaken in house and any long term strategy is constrained by the uncertainty over the future use of the site.

Landing charges

- Although leaseholders do pay an annual lease, this is for the rights to use the land rather than the airfield. No fees are levied for the use of the airfield.
- This would appear to be a lost revenue stream for the Council and one which could be quite easily levied and monitored. Based on the Halcrow Report (Fig 2.3, page 8), the airport handled c. 20,000 movements in 2009/10. Even with a modest landing fee of £10-15 this would provide an additional income of £200-300k per annum.
- It is recommended that further work is undertaken to understand what infrastructure would be required to begin levying charges. Also some benchmarking should be undertaken to determine a suitable charging structure to reflect the level of service provided for users.
- Additional fees could be sought from other aviation sources such as airport parking, hangar rental, etc. Again this should be considered.

Monitoring of lease arrangements

- There are a number of leases to private parties covering various rights to land on the site and in some cases, the use of the airfield.
- Although the use of the airfield is limited under the terms of the lease in the case of the Squadron and Weald Aviation, there are no additional charges levied for use of the airport over and above the usage allowed in the lease.
- There is a clear opportunity to increase revenue by using this situation to create a mechanism whereby additional fees are levied where usage exceeds the agreed levels. It is our understanding that the Council does monitor the use of the airfield so the data to support this move is available but is not used at present.

Potential for aviation support service expansion

- There is likely to be potential for expanding the use of the site for aviation support services. It is unclear what the marketing strategy is for seeking additional tenants for private hangars or additional aviation related business, but a more commercial and strategic approach to this could lead to additional tenants and users of the airfield. Further work to establish what appetite there may be for this use should be considered further through some sort of market engagement.

Lease arrangements

- The lease arrangements in place appear to vary across the various lease holders both in terms of tenor and general conditions. It is recommended that a process of reviewing and rationalising the leases is undertaken so that common terms can be applied. This would provide greater clarity for the Council going forward as to its contractual obligations to leaseholders and the constraints on development of the site.

Non-aviation revenues

- The heavy reliance on the Saturday market revenues is very risky given the current economic conditions. If the market were to cease the airport would be loss making.
- It is unclear as to the strategy for marketing the site for non-aviation use is but potentially bringing in a private party to look at what the options may be at a strategic level would lead to potentially more revenue opportunities and a more balanced revenues stream.

4. Assessment of Halcrow report

Overview

The following section outlines the key findings from the high level assessment of the reports prepared on behalf of the Council from Halcrow. On the basis that the Drivers Jonas report was prepared more than 10 years ago, the focus of the review was on the Halcrow report.

Review of the Halcrow report

The report prepared in March 2011 by Halcrow on behalf of the Council, entitled; *North Weald Airfield Intensification Study,* was reviewed as part of this study. The review did not consider the content of the Halcrow report as this was purely a technical study of the potential cost and demand impacts of a range of aviation options.

The following points outline the limitations of the Halcrow report in terms of the scope of the report:

- ► The report considers the cost and revenue impacts of a range of aviation options, mainly around the business jet market. What is does not do is consider what type of financial or commercial returns it will equate to, or what a private investor or operator would seek to gain from getting involved in the airport.
- ► Typically an airport operator would seek a commercial return of anywhere between 8% and 15% depending on the level of risk involved, and this needs to be considered in determining whether or not these aviation intensification options are feasible and worth pursuing. In addition, they would typically take a long term view to any infrastructure investment, potentially 30 years or more. The Halcrow report only considers a period of 15 years including the investment period.
- ► The Halcrow report considers only pure aviation revenue. A commercial airport operator would seek to expand his revenue stream to include more revenue including; aircraft parking, servicing, security. maintenance, training, logistics and other commercial enterprises. Consideration of these other revenues could have improved the financial performance of the potential options and would have presented a more realistic picture of what a commercial operator might seek to generate from the site.
- ► The focus of the report is very much on the revenue side, there is no consideration of the potential for operating cost savings. An operational review of the airport could identify savings in the operating costs.
- ► The capital cost assumptions assume no financing costs. Typically the cost of borrowing would be included in the analysis, either by the inclusion of interest costs and arrangement fees in the cash flows or through an adjustment to the discount rate to reflect the cost of borrowing.
- ► There does not appear to be any risk adjustments in the cash flow analysis. Although there is a discussion around some of the risks involved in the development of the options, typically a corresponding adjustment would be made to the cash flows to reflect the risks associated. This may also include an adjustment to the discount rate to reflect the impact of demand risk on revenues.
- ► The financial analysis in the Halcrow report is based on a cumulative cash flow impact, which effectively demonstrates that the investment in the infrastructure of £5.6m is repaid by the resulting aviation revenues by 2024 and by 2026 return a positive cumulative cash flow of c.0.5m. This method of investment appraisal does not consider the time value of money and hence generally investors would use alternative ways to assess the potential returns from an investment which do take this into account, including net present value (“NPV”) and internal rate of return (“IRR”).
- ► The report does not include any market sounding. This was not included in the scope of the initial report, however, this is a vital step in understanding the viability of a project, as if there are no willing buyers or investors for the airport then the project cannot succeed. Equally market sounding can identify a number of key issues, risks, opportunities or other considerations for the project which need to be considered in developing the project business case.
- ► Non-aviation development has not been considered in the report. When considering options for the site the aviation options assessed should be assessed on an NPV basis and compared to non-aviation options to determine which option will return the best potential return. Clearly non-aviation options would need to be risk adjusted to reflect the risks associated with them, for example planning,

4. Assessment of Halcrow report (continued)

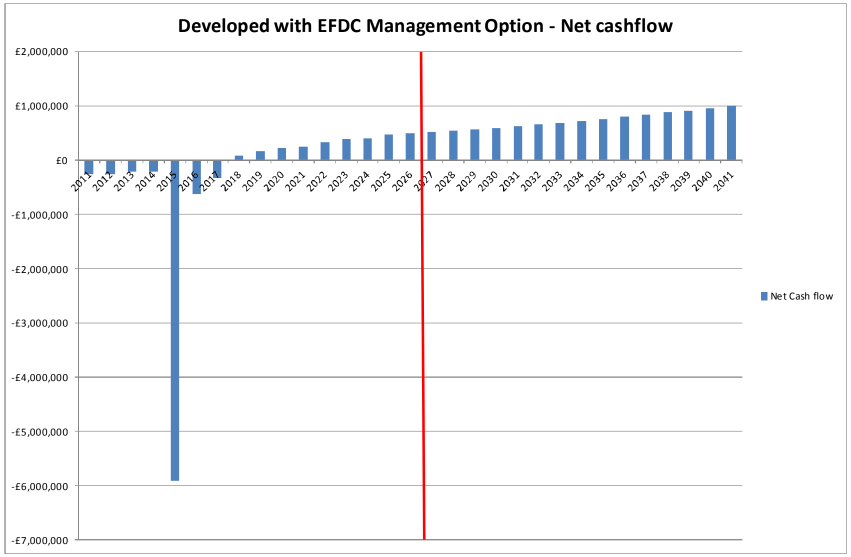
- The commercial and legal structure of any operations at the site have not been considered in the report. The ultimate arrangements would be based on the market's views as to the optimal structure and would considerably impact the structure and timing of payments from any transaction and the role of the Council in the ongoing management of the site.

High level financial analysis

We have undertaken some high level analysis on the cash flows detailed in the Halcrow report to provide a preliminary assessment of the level of return achievable.

- The numbers for the highest level of intensification, the option entitled "Developed with EFDC Management" do not return a commercial return on an IRR (Internal Rate of Return) basis. They return a negative NPV of c.£4.381m, assuming a discount rate of 8%. This suggests that the investment in the new infrastructure does not return a commercial return within the period of analysis (2011-2026)
- In order to assess whether or not this position altered if a longer term view was taken, we pushed out the analysis period a further 15 years to 30 years. The assumed a 5% year on year increase in net cash flows from year 2026 – 2041, based on the increase from 2025-2026. This resulted in the following results:
    - IRR of 3%
    - NPV of (£2.7m)
- Therefore although this result has improved over a longer period, it still does not provide a return on investment, as demonstrated by the negative NPV. On this basis a commercial investor would not invest in this project as it does not make a commercial return.

- The diagram below shows the cash flows as outlined in the Halcrow report (up to the red line). These have been expanded out a further 15 years for the purposes of our analysis.



4. Assessment of Halcrow report (continued)

Further work required

Based on the high level review of the Halcrow report, the key areas of further work required to determine the ultimate potential for releasing value from the site are as follows:

- **Development of a master plan of the construction work required to develop the airport and a detailed assessment of the capital costs required to develop the site for use as a business jet facility.**
  - The assumption in the Halcrow report of £5.6 million appears conservative when compared to the benchmark development costs at other business jet airports e.g. £45m at Farnborough and £27m at Frankfurt-Egelsbach as outlined at Appendix A.
  - The development costs should include all works required at the site and external to the site required to make the proposed business work. This would include any amendments required to surrounding road network and additional land purchases required.
  - This work could be carried out by a technical or engineering consultancy firm such as Halcrow or Mott MacDonald.
- **An assessment of other potential revenue streams under an aviation intensification option.**
  - An overview of the types of revenues which are generated at similar facilities in the South East is included at Appendix B. An assessment of the level of revenues which could be generated from these types of businesses is the next step required.
  - This work could be carried out by a technical/engineering consultancy firm such as Halcrow or Mott MacDonald or a specialist aviation advisor such as York Aviation.
- **A legal review of the proposed project development.** This would include:
  - A review of the planning consents required and process and consultations required to achieve the consents required.
  - A review of the commercial structures proposed to be used.
  - A review of the leases currently in place and implications for the development, for example termination costs.
  - This work could be undertaken by a legal advisor.
- **A commercial and financial assessment of the potential development** which assesses the following:
  - The likely commercial structure of the deal. This would include an assessment of the potential delivery models (as outlined in Appendix C) and an assessment of the likely sources and costs of financing under each model, i.e. the level of debt or equity, the cost of debt, the cost of equity and overall weighted average cost of capital.
  - On the basis of the commercial structures assessed above, a financial assessment of the potential range of value which could be achieved under the different delivery options.
  - An assessment of the potential buyers for the airport based on the buyers of similar assets.
  - Undertake a market sounding process to test the marketability of the project and the proposed structures to assist with deal structuring.
  - This work could be undertaken by a financial advisory firm such as Ernst & Young.

These work streams could be undertaken under one mandate with a lead contractor, such as Ernst & Young who manages each of the work streams through sub-contractor arrangements with a suite of advisors.

5. Review of potential aviation “add-on” services

Overview

This section outlines the potential alternative “mixed use” options which could be developed to manage the site going forward either instead of or alongside the aviation intensification option presented in the Halcrow Report. In order to demonstrate the sort of add-on services that can be offered at an airport such as North Weald a review of the add-on services available at four similar sized airports in proximity to London and Frankfurt was performed. The airports reviewed operate a range of related services both in house and from companies based at the airports. These services include the likes of maintenance, flight planning, handling and flight training.

Airport	Add-on Services offered
Biggin Hill, South London, UK	► Flight Training - five flights schools offer flight training at the airport. ► Aircraft Services including cleaning, respraying and catering. ► Aircraft and Helicopter Chartering - six aircraft chartering companies are based at the airport. ► Aircraft Basing and Hangarage - facilities and companies available to base an aircraft at the airport including on site hanger operators or the option to build your own hanger. ► Aircraft Maintenance - six aircraft maintenance companies onsite. ► Flight Planning - flight operations personnel provide crews with weather reports, airport briefing packs and other flight planning services. ► Freight Services - facilities for low-volume high value freight deliveries. ► Skypets - specialist pet handling and immigration centre.
Oxford Airport, Oxford, UK	► Flight Training - four flight training schools are based at the airport including one of Europe's largest ‘Oxford Aviation Academy’. ► Aviation Medicals - onsite medical centre offering medical assessment for aviation clearance. ► Business jet services including valet, cleaning , de-icing and crew rest facilities. ► Aircraft maintenance - repairs and maintenance facilities including respraying. ► Helicopter maintenance - Eurocopter UK maintenance, conversion and retrofit services. ► Medical Air Services: Air Med operate a fleet of jets dedicated to medical repatriation.

5. Review of potential aviation “add-on” services (continued)

Airport	Add-on Services offered
Farnborough, Hampshire, UK	► Aircraft Charter Services - TAG Aviation offer a fleet of aircraft to charter a the airport. ► Aircraft Management Services - Business jet offering using TAG’s fleet of aircraft. ► Aircraft Maintenance - Maintenance facilities run by TAG. ► FBO Handling - handling services including an exclusive terminal facility for fixed base operators (FBOs). ► Cabin crew training - TAG Global Training School offering qualified training for cabin crew personnel. See Appendix B for further detail.
Frankfurt-Egelsbach, Frankfurt, Germany	► Police Helicopter base - local police force helicopter facility based at the airport. ► MRO - Multiple Maintenance, Repair and Operations (MRO) companies are present at the airport. ► Flight training - Aircraft and Helicopter Training schools are present at the airport. ► Plane and Helicopter chartering - multiple companies offering charters of business jets and helicopters. ► Aircraft Handling services - offering Aircraft storage and operations services. ► Aircraft catering services – offering catering for business jets based at and operating from the airport.

Summary

As outlined by he business jet airports considered above, there are a vast range of alternative revenue services provided in addition to the pure aviation revenue sources provided. The studies to be commissioned to develop the options for delivering value form the airfield should look at the types of revenues which could be generated from these types of activities in order to get a true value that a commercial operator might be willing to pay for the airfield.

6. Outline of potential commercial structures

Overview

This section outlines the potential commercial structures for the airport and considers the impact of these structures on the potential timing and structure of cash receipts which could be driven form the airport. A more detailed assessment of these structures is presented in Appendix C.

Commercial structures

The types of structures which are typically applied to assets such as the airport include:

- **A joint venture** arrangement between Council and a private investor/operator. This could involve a minor receipt being received upfront with a share of profits going forward or some sort of success fee payable following successful commencement of commercial operations. This would likely increase the overall receipt but the payments would be spread over a longer period (determined by the timeframe to achieving commercial operations).
- **A tenant arrangement or short term concession**, whereby Council receives an annual fee for the use of the site as an airfield. Again this could include some sort of profit sharing where receipts are significantly higher than anticipated. This would likely increase the overall receipt but the payments would be spread over a much longer period.
- **A long term concession agreement**, whereby Council achieves all of the approvals and licenses to use the site as an airfield and receives an upfront payment from the concessionaire for the right to do so. The concession payment would not be receivable until all approvals are in place and the potential for securing any receipts other than the existing operating cash flows are likely to be limited given the uncertainty over the timing of the planning process.
- **A full sale**, whereby the Council sells the site completely to a third party.

It is recommended that these options are considered in more detail going forward and assessed against the Council's commercial objectives for the site.

Timing and structure of potential cash receipt

There is an inherent value in the airfield as is stands currently, but this would need to include non-aviation activities. This could be enhanced by the levying of additional landing charges to existing lease holders. On the basis that these cash flows are achievable without the need for additional planning and regulatory approvals, it is likely that a structure could be developed to realise some receipts early in the process. This could involve the following:

- A payment is secured from a private party upfront representative of the current value.
- A further (more significant) payment is paid by the private party following the completion of the planning and regulatory approvals and works required to commence commercial operations. This would effectively reflect the balance of the NPV of option the full aviation option.
- The upfront payment is likely to be reduced to reflect the additional expenditure which will be incurred by the private party to operate and manage the airfield.
- The timing of any payments received by Council upon the sale of the airport will be dependent on the tactics adopted in that sale, e.g. the degree to which planning approvals are granted at the time of the sale.

7. Likely constraints to development

Overview

Outlined below are some of the constraints which will be faced in developing the airport to maximise the value form the site

Constraints to aviation development

- Planning – greenbelt restrictions are likely to restrict any future developments. Specifically residential development would not be acceptable due to the greenbelt status of the site.
- Regulatory approval – attaining the airport licence will require additional initial capital investment and additional ongoing maintenance costs.
- Transport links – the configuration of the surrounding road network will need to be considered should an aviation option be considered and sound transport links are vital to a successful airport.
- Pricing achievable – given the depressed market at present, what level of discounting would be applied by any incoming investor/operator/developer?
- Deal structure given market conditions – investors may take a less aggressive view on the project in light of the current market conditions which may impact on the type of commercial structure developed.
- Investment requirements – the level of investment required to make the airport fit for purpose to deliver the intensification options is likely to be conservative. The Halcrow report suggest £5.6m in capital costs but this is noted to be conservative and does not consider the impact of funding costs.
- Current lease arrangements – in order to develop the site to meet the aviation needs there may need to be an amendment to the conditions of the lease agreements. These could be costly and time consuming to negotiate and legal advice will be required to understand what can be done and the likely impacts.

Planning issues

Any development at North Weald will require planning consents which would be done through submission of detailed planning submission to the local planning authority and would need to include a full Environmental Impact Assessment (EIA). The following areas have been identified as requiring consultations and permissions, if North Weald were to be used as a civilian airfield:

- Provision of additional facilities to handle passengers will require appropriate aircraft, passenger and baggage handling facilities and open public access to the aerodrome. Such facilities would generally be new and those that are relevant to licensing would be built accordingly. These facilities would require planning permission which can be sought using a conventional application to the Local Planning Authority.
- In response to an application for a Licence for North Weald, CAA would likely consider this as being an existing operating aerodrome and to review all aspects and identify any areas that do not comply with its requirements. The CAA would then request that the operator bring those facilities into compliance with the provisions of CAP168, or to demonstrate a safety case for retaining the existing situation, or some modification thereof.
- In order to convert the airport into a civilian airfield with increased capacity new aprons, taxiways, lighting systems and road connections will be required. Accompanying an application to the Local Planning Authority the following documents will also be required: an Application Form, Plans, Consultation Statement, Design and Access Statement, Planning, Environmental Statement (including noise assessment), Surface Access Strategy and Sustainability Strategy.
- It is recommended that a formal legal opinion is obtained in relation to planning requirements of the preferred option.

7. Likely constraints to development (continued)

Non- aviation option constraints

- Many of the constraints outlined above for the aviation options will apply to the non-aviation options, particularly around the planning. The greenbelt restrictions at the site would need to be overcome for a development to be successful and further work on the ability for any development to be acceptable to planners would need to be carried out.
- The current economic conditions are likely to have a significant impact on potential value achievable and the market appetite for a non-aviation development option. The pricing achievable, optimal deal structure and potential identity of interested development partners/investors will need to be considered more in light of current conditions before a preferred options is selected. A market sounding process would be an important part of this work going forward to inform any decision on future developments.
- The leasing arrangements in place would need to be considered if a non aviation option for the site was to be pursued as most of the leases in place include the use of the airfield and the cost implications of breaking these leases would need to be considered.
- Council objectives and political will to change the land use will need to be considered in light of the local community views on the land use.

8. Proposed next steps

It is likely that the Council will need consultancy support to deliver the changes required to secure the future of the site and maximise the value for the Council of the development. The diagram below outlines the key tasks required to deliver this as well as an outline of the scope of work which would be required of any incoming consultant. The diagram also indicates the likely packages of work which could be tendered. The tasks below are varied and hence it is likely that a group of consultants would be required to deliver the scope, to include financial/commercial experts, engineering experts and real estate/property/planning experts. Timeframes do not consider time for Council approval processes.

Estimated Delivery Timeframe – 2-3 months

Work Package 1

1.Detailed Commercial assessment of aviation options

- Identify additional aviation related revenue streams to support aviation options
- Develop more detailed cost and pricing assumptions
- Soft market testing to assess market appetite of options
- Assess planning constraints and cost implications of remedial works
- Assess commercial feasibility of aviation options based on likely commercial returns

2.Development of non-aviation and mixed use options

- Identify non-aviation related development options, e.g. Real estate development
- Develop detailed cost and pricing assumptions to support the options
- Soft market testing to assess market appetite
- Assess planning constraints and cost implications of remedial works
- Assess commercial feasibility of aviation options based on likely commercial returns
- Consider potential aviation add on service revenues

3.Assessment of all options against the Council's commercial objectives

- Agree Council's commercial objectives
- Assess options against commercial objectives and identify preferred options(s)
- Undertake formal market sounding of preferred options(s) to assess deliverability
- Develop commercial structures for delivery of preferred option
- Assess funding options for preferred option(s) including forms of local government support (for example, business rate reforms)

Estimated Delivery Timeframe – 12 months

Work Package 2

4.Prepare implementation strategy of preferred option and take to market

- Prepare implementation strategy for preferred option
- Identify and lead engagement with potential partners
- Prepare procurement documentation
- Market project to potential interested parties

5.Support the Council through the procurement process

- Lead negotiations with potential investors and/or development partners
- Evaluate proposals from developers
- Manage engagement with stakeholders through the process
- Manage process through to completion
- Assist Council in raising/arranging any funding as required

8. Proposed next steps (continued)

Work Package 1

Evaluation Methodology

As discussed with Council members, specific issues which need to be established in framing work package 1 is the evaluation methodology for the assessment of options. In our view the process for this should include the following:

- Define the commercial objectives of the Council.
- Define potential options for managing the site.
- Assess these options Council's against commercial objectives on a qualitative basis.
- Establish a shortlist of options based on the qualitative assessment.
- Undertake a more detailed quantitative assessment of the shortlisted options to assess which options provides best value for the Council.

Development of mixed use and non-aviation options

One of the key aspects of work package 1 is the second of the three work streams, which is to establish the range of mixed use and non aviation options. The council should leave this open for the consultants to propose what non-aviation they believe can offer the best value. As outlined in Section 5 of this report there is likely to be a range of options available in relation to aviation add on services. However what is not considered as part of the aviation study to date is the potential for mixed use or non-aviation development to take place. This could include commercial real estate, science parks, logistics hub or similar developments. It is recommended that these options are left open for the consultants to explore.

Work Package 2

Following completion of Work Package 1, there is likely to be a period of approvals within Council to progress to the procurement phase (Work Package 2). As such, the timeframe for this is unclear and will be dependent on the ability to get unilateral support for the preferred option.

Contracting arrangements

The services outlined in work package 1 and 2 would be most efficiently delivered under one contract for each work package with one party taking contractual responsibility for delivering the work with potentially a number of other parties sub-contracting to them for discrete parts of the study, e.g. design, costing, etc. This is common in these types of mandates and makes it easier for Council to manage the interfaces with one key point of contact.

Appendix A – Benchmarking of similar airport developments and transaction values

In order to validate the business jet airport development outlined in the Halcrow report, precedent transactions and investments in airports of this nature were sought. The three transactions identified are for airports in proximity to the financial centres of London and Frankfurt and are therefore comparable to both current and potential future business jet operations at North Weald. The three transactions are detailed opposite.

The key conclusion is that the level of investment at these airports is significantly more capital investment than that envisaged at North Weald in the Halcrow Report.

Airport	Transaction/development value	Other airport information
Farnborough - 2002 **(UK)**	► £2m for a 25 year lease, £1m for acquiring the airport freehold and £45m of investment ► Purchased by business jet operator TAG Aviation	► Subject to an Air Traffic Movement cap of 28,000 per year at the time of transaction (In 2011 a phased increase to 50,00 by 2019 was granted) ► CAA ordinary license holder with 2,400m asphalt runway ► Location of Air Traffic Investigation Branch and BAE Systems Farnborough ► Biannually hosts the international aviation trade fair the 'Farnborough Air Show' ► See Appendix C for further detail.
Oxford Airport - 2007 **(UK)**	► Sold for £40 million in 2007, purchased by property investors (Reuben Brothers) ► Significant investment since 2007, including a new 21,000 sq/ft hangar in 2009, runway extension in 2008, to allow Code 3C status and investment of £4.5 m in 2011 in a new radar system.	► 36,316 Air Traffic Movements in 2009 ► CAA ordinary license holder with 1,592m and 760m asphalt runways ► Location of Oxford Aviation Academy
Frankfurt-Egelsbach – 2009 **(Germany)**	► £30.5 million (including a £3.5m payment and £27m of investment) ► Purchased by business jet operator Netjets	► Air Traffic Movements approximately 70,000 per year ► 1,400m asphalt and 670m grass runways ► Planned 270m runway extension

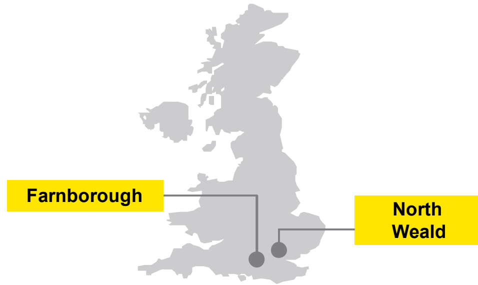
Appendix B – Case Study – Farnborough Airport

Background

Farnborough Airport is an ex Ministry of Defence (MOD) airport with a 2,400m ILS (Instrument Landing System) equipped runway situated 35 miles south west of London. The airport is globally renown for the biennial Farnborough Airshow, which attracts over 250,000 visitors every other year. Following a commercialisation process in the 1990s the airport was developed by Techniques d'Avant Garde (TAG) Aviation for business aviation.

Timeline of commercialisation of Farnborough Airport

- 1991: MoD declare Farnborough site surplus to requirements, Government states desire for operational areas of the airfield to remain in aviation use having previously identified a lack of capacity for business aviation in South East England.
- 1996: Publication of Draft Local Plan Review incorporating policies for the future use of the aerodrome produced by Rushmoor Borough Council.
- 1998: TAG confirmed as the future operator of the site.
- 2000: TAG granted planning permission to develop the site for business aviation to Civil Aviation Authority (CAA) standards.
- 2003: Acquires 25 year lease for £3m from MoD, completion of new control tower, hangers and terminal.
- 2007: TAG become freeholder of airport for £1m.
- 2008: Following an appeal, TAG is granted permission to operate 5,000 flights (previously 2,500) per annum during weekends and bank holidays.
- 2011: Airport granted permission following intervention by Transport Minister Phillip Hammond to operate 50,000 flights per annum including up to 8,900 during weekends and bank holidays by 2019.



Development

TAG is in the final stages of completing a £96m ten year programme of investment at Farnborough Airport. Facilities developed so far include:

- A 35 metre high ATC tower costing £5m and operated by NATS provides ATC to local airports and low level support for London terminal manoeuvring area (completed 2002).
- 5,000m² executive terminal costing £10.2m (completed 2006).
- 15,600m² hangar (completed 2003) and a further three hangars costing £30m (completed 2011).

"Add-on" services

TAG operate ground handling, Hangarage and passenger reception at the airport, however other services are also offered on site include:

- 100,000m² site let to Farnborough International who run the Farnborough Airshow and 3,000m² permanent events venue 'FIVE'.
- Flight training company Flight Safety International European headquarters and flight simulators.
- The TAG operated boutique 'Aviator' Hotel .
- QinetiQ and BAE Systems sites and 'IQ' Farnborough Business Park development next to the airport.

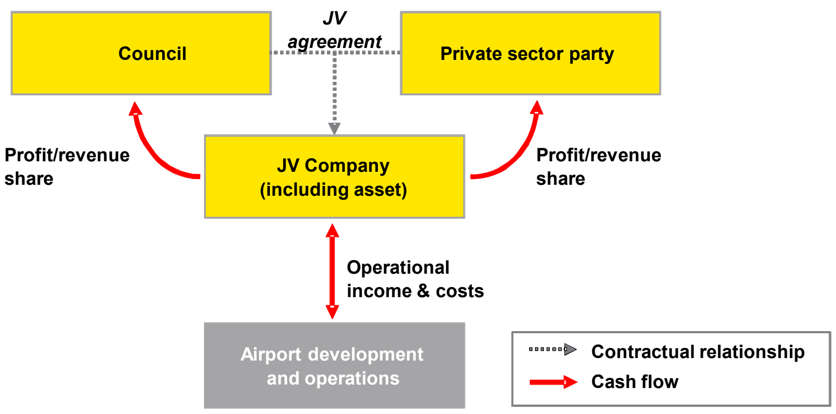
Appendix C – Review of commercial structures

Below we outline the features of the possible commercial structures, the pros and cons of each and some examples of where they have been used.

1. Joint venture

A joint venture (JV) arrangement is where the Council would retain ownership of the site and enter commercial arrangements with a private sector party to operate civilian aircraft under joint control. The JV would likely seek to transfer responsibility of civilian operations to the private sector party whilst agreeing some sort of profit/revenue share mechanism whereby Council take a proportion of the profit/revenue of the operations above an agreed level of return. The following diagram shows the likely contractual relationships and money flow.

Joint venture illustration



The key features of a JV arrangement are shown below:

- A small upfront receipt for Council could be received based on the equity investment by both parties.
- The ongoing payment to Council would likely take the form of share of profit or revenue, or dividend payments. The quantum of dividend or profit/revenue share that the Council would take would depend on their percentage share in the JV; for example should Council invest (by way of land, upfront cost or development cost) 50% of the total value of the JV then Council would receive 50% of the dividends or profit/revenue share.
- Development capex, risk and benefits would be shared between the Council and the private sector. In practise, this is likely to be challenging in the case of the civilian operations as both parties will need to have a mutually agreed development plan with set annual investments.
- An ongoing profit/revenue share would allow Council to retain an income stream and hence increased value in the long term, however if there is a low level of capex investment then the long term upside may be limited.
- There is an element of flexibility in a JV so that the Council and the private sector party could agree changes to the agreement where mutually beneficial/acceptable.

The pros and cons of the JV structure are:

Pros	Cons
Payments could be structured to meet Council's requirements	Hard to justify Council injecting capital for commercial operations & benefit.
Joint responsibility for development	Joint responsibility for development – politically challenging in light of likely strong opposition from local residents
Flexible model to agree changes where mutually beneficial/acceptable	Need close alignment of objectives and direction for JV to be successful – this would be difficult to match objectives of public and private sector
Council retains joint control over the asset to allow it to change its mind as/if required with different parliament	Council shares development risk with the private sector

Appendix C – Review of commercial structures (continued)

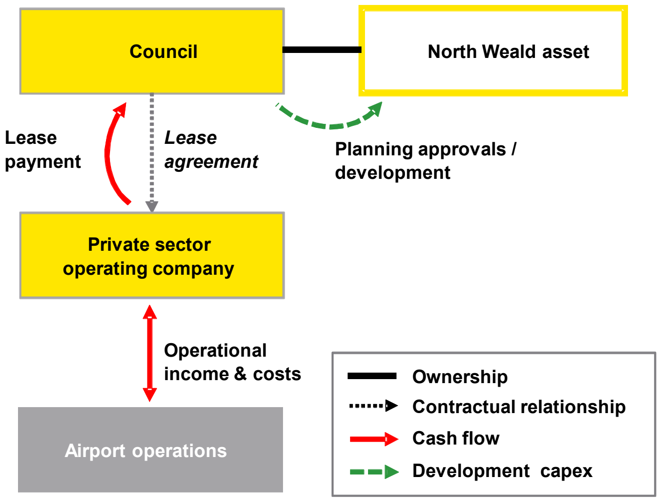
Joint Venture: Examples

One example of where the public and private sector have joint ownership of an airport is Newcastle Airport where 7 local authorities and Copenhagen Airport (Macquarie) have joint ownership of the airport with the private sector holding the Technical Services Agreement (TSA) for airport operations. The joint venture partnership has worked well but recently has faced challenges when trying to agree refinancing and recapitalisation, illustrating the difficulty of matching both private and sector party needs.

2. Short-term lease

A tenant arrangement or lease is where the Council would retain ownership of the site and lease the use to a private sector party who would operate under a short-term lease agreement The following diagram shows the likely contractual relationships and money flow.

Short-term lease illustration



The key features of a short-term lease arrangement are as follows:

- As for JV, an upfront receipt could be possible based on the existing value of the site but this would diminish any ongoing payment.
- Responsibility for development capital expenditure would sit with the lessor i.e. Council as tenant arrangements are typically relatively short e.g. 2-10 years and hence would not allow the private sector sufficient time to invest significantly in the site and make a reasonable return. Should the Council desire the private sector to fund development, a long term lease or concession structure may be more appropriate, however, as discussed in the following section there are specific limitations and concerns relating to this approach.
- Council would receive an annual fee for use of the site. Again, this could include some sort of revenue/profit share but if Council is unable to invest in site development, the long term upside would be limited due to the restricted increase of movements.
- A lease structure would typically be relatively short term thereby allowing flexibility for the Council to change the terms at the end of each lease term should it desire.
- The agreement could be drafted such to allow Council use of the site at its convenience.

The pros and cons of the short-term lease structure are:

Pros	Cons
A short-term lease could generate a small upfront receipt based on existing operations	Requires time and resource to deliver increased value through planning approvals
If a short-term lease were used as the first part of a longer development plan with a follow on transaction after obtaining planning permissions for development then high value could be realised from the whole development plan	High level of costs associated planning approvals and retender
Allows Council to design development of the site to its own specification	Low initial upfront/ongoing value
Allows flexibility for change after the end of the short-term lease.	Short term solution

Appendix C – Review of commercial structures (continued)

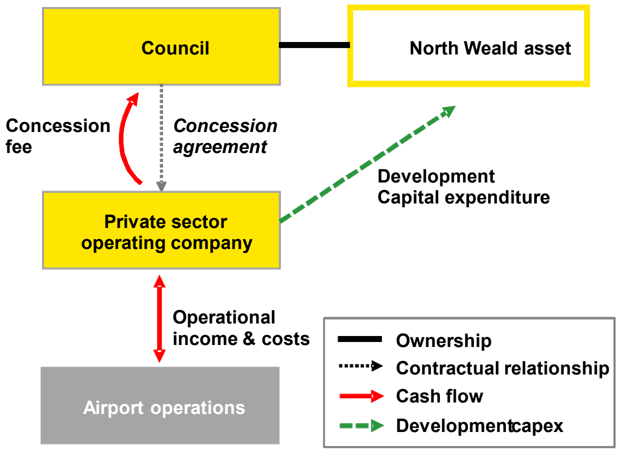
Short-term lease: Examples

Short-term leases are not common-place in airports due to the capital intensive nature of airports and the short time to make a suitable return.

3. Long-term lease or Concession

A long-term lease or concession share largely common characteristics, so for the purposes of this analysis we refer to a concession. The Council would retain ownership of the site but contracts with a third party (concessionaire) to undertake the operation, maintenance and development of the airport for an agreed period of time. Often the contract may include large capital requirements. In order to incentivise long term development and capital expenditure, the term is typically set to provide a reasonable payback period to realise a bankable level of return. The following diagram shows the likely contractual relationships and money flow.

Concession illustration



The key features of a concession arrangement are as follows:

- The Council would receive a concession fee from the concessionaire that may be in the form of an upfront payment, an indexed annual fee, a share of airport revenues or some combination thereof. Current market trend is for the concession fee to be a percentage of airport revenues (with a minimum payment in place). Therefore, we anticipate that Council could receive an upfront payment as well as an ongoing annual concession fee, likely linked to airport revenues.
- Operational, maintenance and capital expenditures generally remain the responsibility of the concessionaire, with the agreement commonly containing provisions for the capital status of the airport upon hand back.
- Commercial revenues are also typically transferred to the concessionaire and these cash flows are used to service its debt and generate investment returns.
- Operational and management control is transferred to the private sector by way of a “right to use” of land and assets for a pre-defined period, after which they revert back to Council.
- Concessions however are longer term (above 20 years) so reduce the flexibility available for the Council – after entering the concession any change would likely trigger penalties.
- Depending on the specific aspects of a transaction, a long term concession can be structured to share many of the attributes of an outright sale, without transferring the long term ownership of the asset.

Appendix C – Review of commercial structures (continued)

Concession (continued)

The pros and cons of the long-term concession structure are:

Pros	Cons
Council has no responsibility for operation or development of the asset – long term concession is similar to share sale with asset reverting to public sector at end of concession	Longer term (above 20 years) reduce flexibility for Council – after entering the concession any change would likely trigger penalties
The concessionaire to invest in development of the site with no investment required from Council	Hard to structure a long term concession effectively if step-change capacity/throughput – hard to set appropriate benchmarks and triggers at outset
Would give Council assurance of long term income from asset	Towards the end of the concession, the operator could stop investing in the asset (to maximise return), negatively impacting on asset value at handback

Concession: Examples

There are many examples of airports operating successfully under a long-term lease or concession structure. A sample of worldwide examples are detailed below:

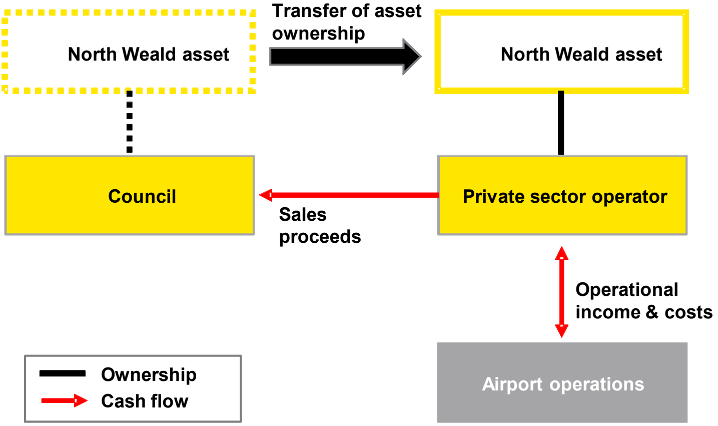
- Farnborough airport - Leased by the MOD to TAG Aviation for 25 years from January 2003 with the freehold being sold in 2007. The terms of the lease require TAG to use the airport solely for business aviation and commit to holding the Farnborough Air Show every two years. The lease structure incentivised TAG to fund a c.£45m redevelopment which included the construction of a new terminal, air traffic control tower and hangars; this increased the capacity from c. 17,000 movements in 2001 to c.50,000 in 2011. The terms of the sale were not disclosed, however it is believed that there are claw-back arrangements which would require TAG to pay the MOD in the event that any part of the site is sold off for non airfield use.
- Luton airport – 30 year concession granted to Abertis by public sector owner, Luton Borough Council. The concession successfully increased the Airport’s capacity from c. 3 mppa in 1997 to 11.5 mppa in 2011. However, there is currently an opportunity to expand the airport further, to a capacity of c. 18 mppa, but the concessionaire is not incentivised to fund the development due to the relatively short payback period (remaining contract term). In addition, there are no provisions in the contract that require the Concessionaire to commit to development when certain milestones are met, as is the case with other concessions such as Queen Alia airport, shown below.
- Queen Alia International Airport – 25 year concession granted to AIG by the Jordanian Government. The concessionaire committed to a two phase development plan, the first phase requires the expansion from a capacity of c. 5 mppa to 9 mppa. The second phase will increase the capacity to 12 mppa and is triggered in advance of the expected achievement of passenger threshold. This structure is attractive to both parties as it provides the flexibility of developing the airport in line with the growth in passenger demand.

Appendix C – Review of commercial structures (continued)

4. Share sale

Under the structure of an outright (or majority) share sale, a third party would acquire all (or majority) of the shares of the airport and would take over responsibility for operations of the airport. Alternatively, under a minority sale option, the Council may maintain certain controls in the asset. As the future of the North Weald site is uncertain, a minority share sale would have very limited, if any, interest – we do not believe that a minority share sale would represent a value for money outcome for the Council, so for the purposes of this analysis has been discounted. The following diagram shows the likely contractual relationships and money flow of an outright sale.

Share sale illustration



Key points of the sale option are as follows:

- The Council would receive a lump-sum amount at sale of the asset. The purchase price would be determined based on the net present value of future cash flows based on a development plan determined by the bidders.
- Successful airport sale transactions typically involve little or no commitment from the acquirer to a particular capital investment programme but development of the site is left up to the private sector.
- There is a significant risk associated with obtaining successful planning permissions in the development of any airport. The private sector would therefore form a view of the development potential of the site prior to acquisition and the price paid for the asset would reflect their view of the future potential of the site, adjusted for planning risk. Bidders may assume the planning risk to be so large that they pay nothing for the possibility of future development.
- Obtaining an uplift in value should the new private sector owner achieves a significant development of the site is harder to manage under a sale.

Appendix C – Review of commercial structures (continued)

Share sale (continued)

The pros and cons of the sale option are:

Pros	Cons
Outright sale would generate significant upfront cash receipt to Council.	Harder to release value to Council from future increase of activity
No responsibility or cost to Council to develop the asset	Harder to ensure Council's continued use of the site
No time or cost associated with monitoring concession agreements, developing planning applications, etc	If full planning risk remained during the sale process, value will be capped by the risk premium bidders would apply to future development of the asset
Politically acceptable – helps to address the market capacity shortage by allowing the private sector to develop new capacity in the South East/London area	No ongoing income from investment, one single opportunity to realise value

Share sale: Examples

There are many examples of the sale of airports in the UK and globally. Recent significant airport sales are:

- Gatwick airport – BAA sold LGW in 2009 to GIP
- Belfast City airport - Ferrovial sold BHD in 2008 to ABN Amro Infra Fund

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