

Acquisition and Operation of Durham Tees Valley Airport

Overview

This Report seeks approval for the Tees Valley Combined Authority (“the Combined Authority”) to acquire the 89% shareholding of Peel Holdings Limited (“Peel”) in Durham Tees Valley Airport Limited (“DTVVAL”), and separately, to enter into a joint venture arrangement with its preferred operator covering the ongoing ownership and operation of Durham Tees Valley Airport (“the Airport”) on the terms set out below.

Decision

1. Cabinet is recommended to mandate the Chief Executive, in consultation with the Mayor and Cabinet Member for Transport, to:-
 - (i) Conclude an agreement with Peel whereby the Combined Authority acquires the 89% shareholding held by Peel in DTVVAL (“the Peel Shareholding”) for a consideration of £40 million (“the Acquisition”);
 - (ii) Separately, and on the basis that the Combined Authority finalises legal arrangements with the preferred operator on the terms set out in this report, to conclude:-
 - a. a Joint Venture Agreement with the preferred operator pursuant to which the preferred operator would take a share of no more than 25% of the Combined Authority’s equity interest in the airport as an incentive mechanism to reduce ongoing losses. This would offer limited dividends to the preferred operator in the longer term to focus on the Combined Authority’s investment being recovered once the airport is in profit. This arrangement would be subject to the preferred operator funding its share of the losses in the interim; and
 - b. an Operating Contract pursuant to which the preferred operator will put in place arrangements for the supply of support services to DTVVAL, will provide strategic direction in accordance with an agreed 5 year business plan (to be reviewed annually) and oversight of the DTVVAL management team on the day to day operation of the airport; and
 - (iii) If the arrangements set out in paragraph (ii) above are not agreed, the Acquisition will proceed in any event and the Combined Authority will put into place arrangements to support the DTVVAL management team on the day to day operation of the airport required;
 - (iv) Complete all due diligence, sign all documents and complete all other actions required to give effect to this Report.

Recent History & Background Information

1. Durham Tees Valley Airport is within the Tees Valley conurbation and is situated on the border of the Darlington and Stockton-on-Tees local authority areas. Originally an RAF

airbase, the Airport has supported private and commercial air traffic since the mid-1960s, reaching peak passenger numbers of around 900,000 per annum in 2006.

2. On 1 April 2003 Peel acquired a 75% shareholding in the Airport with the Local Authorities (four Tees Valley Local Authorities and Durham County Council) retaining a 25% shareholding in aggregate. In 2004 Peel changed the name from Teesside International Airport to Durham Tees Valley Airport. The new owners committed to a minimum of £7.5 million of upfront investment. Passenger numbers grew significantly, to over 900,000 by 2007. This growth was supported by a mix of scheduled and charter services from KLM, BMI Baby and Ryanair, Thomson and First Choice holidays.
3. After 2007 however, passenger numbers declined quickly and significantly (to 190,000 per year in 2011, and 130,000 in 2017), due to a number of factors, including the global recession from 2007, structural changes in the aviation market and competition from other airports. The direct flight to Heathrow was lost in 2009 Investment plans predicated on continued growth in passenger numbers were cancelled. Over the period 2011-12 ownership changed, due to the purchase of a controlling stake in Peel Airports by Vancouver Airport Services, and the subsequent sale and re-purchase of the Airport by Peel under a new subsidiary. The Airport has since made significant cost reductions, including a move away from the chartered flight market, and aimed to consolidate around a smaller number of services and non-passenger related business. The only regular scheduled services are now to Amsterdam Schiphol by KLM and Aberdeen by Eastern.
4. The Airport has been loss making since 2003, with the current owners covering the losses. Consequently, the local authority shareholdings have been diluted from 25% to 11%, with Peel owning the majority (89%) stake. In the latest available accounts to March 2017, DTVAl declared a loss of £2.4m in 2017. This compared to £2.6m the previous year.
5. These shareholding arrangements included a commitment from Peel to keep the Airport open and functioning up to 2026. Additional steps were also taken by the local councils to reduce DTVAl's exposure to historical Local Government Pension Scheme liabilities. However Peel's "keep-open" commitment becomes conditional over the period 2021-2026, dependent on the achievement of financial benchmarks. On current performance, these are unlikely to be met and Peel would be entitled to close the Airport from 2021.
6. DTVAl published a Masterplan for the Airport in 2014, which established the principle of a business focused airport supported by commercial activity and nearby residential development. It proposed the development of the North and South Sides into an aviation themed business park. DTVAl also secured planning permission for a housing development of around 350 units on the Northside, which was highly contested but was supported by Darlington's planning committee in 2017 (this was recently brought forward for development but as it would have a potentially adverse effect on the future development of the Airport, it will not now go ahead if the Acquisition proceeds as set out in this Report).
7. The Airport now only offers scheduled flights to Aberdeen, Amsterdam Schiphol and Jersey (summer only) and hosts some other aviation-related activities including some general aviation services, the North-East Air Ambulance (who are in fact intending to relocate their operate offsite), firefighting training (run by Serco) and Cobham's air activity for the Ministry of Defence. Other activities include a hotel (now closed) and a TNT distribution depot in a former hangar. The total airport site extends to almost 819 acres (33 hectares/3.3million square metres) as shown in the map in Appendix 1 to this Report.

The Economic Role of the Airport in Tees Valley

8. Even at the current low level of activity, the Airport plays an important economic role within the Tees Valley. In 2012 consultants Regeneris produced an economic impact assessment for DTVL, which estimated the Airport's **direct** economic contribution to the Tees Valley then at £37 million a year. The reduced passenger numbers since 2012 will have reduced the impact of the Airport, so an estimate now would be around £23.8 million a year.
9. A number of more recent studies have highlighted the wider impact of international connectivity on regional economies. These include analysis by Oxford Economics for the Mayor of London in 2013 and Transport for the North's 2016 study of the international connectivity of the North of England. In an increasingly inter-connected global economy, air connectivity is becoming a more important driver of successful local development. Inward investors will often consider air routes to their key markets in deciding where to invest, and the Combined Authority routinely presents the benefits of connections through the Airport in presentations to potential inward investors. A number of existing local companies have also developed commercial relationships on the back of the connections made possible by the Airport. The Aberdeen route is regarded as valuable to the local offshore engineering industry. Circa 90,000 passengers a year use the flight to Amsterdam, including transfer to inter-continental connections which are of particular benefit to the many Tees Valley businesses with connections to the Middle East, Far Asia and America. The Airport also plays a role in enhancing the attractiveness of the South Tees Development Corporation site, the future success of which is highly dependent on securing mobile international investors who value easy connectivity to international markets and their HQs. The loss of the Airport would therefore significantly impact those businesses and have a significant (though unquantifiable) impact on their future investment decisions.
10. A return of the Airport to its pre-2006 peak of 900,000 passengers would raise its annual contribution to the Tees Valley to circa £210 million per year (including wider catalytic effect). This future potential for growth would be lost if the Airport is closed, or continues at its current level of operations.
11. There is also the consideration of regional pride and identity, which many residents of the Tees Valley associate with the Airport. The closure of the Airport could have a negative effect on reputation and image of the Tees Valley, beyond the immediately identifiable impact on GVA.

The Future of the Airport – Strategic Case for Intervention

12. The Combined Authority has now been informed by Peel that it intends to close the Airport as soon as it is able to under the terms of the existing Shareholders' Agreement, in 2021. As set out above, the Airport is economically important to the Tees Valley. It is therefore necessary to consider the commercial options for the Airport, including the "do nothing" option of allowing the Airport be closed by Peel with no intervention from the public sector.
13. The Strategic Case for public sector intervention is set out in the Business Case in Appendix 1 to this Report. In summary, the Strategic Case looks at a numbers of factors:-
 - UK, regional and local economic agenda, including Tees Valley's Strategic Economic Plan, the South Tees Development Corporation and both Stockton's and Darlington's Local Plans;

- UK, regional and local transport agendas;
- Assessment of Need including performance against key metrics: consumer choice, financial viability and wider economic impact; also case study evidence;
- Constraints, including timeframe, regulatory environment and property proposition; and
- Objectives and critical success factors, including:-
 - Greater consumer choice;
 - Financial viability;
 - Wider economic impact;
 - Timeliness of delivery; and
 - Regulatory compliance.

14. The Strategic Case conclusion is:-

- The Airport is currently operating at a loss, with substantially reduced passenger movements and negligible freight activity, at a time when neighbouring airports within the wider North of England are continuing to grow at or above national trend;
- There is a need for public intervention to avoid closure of a strategic asset and the consequent reduction in annual output of £32.6 million or 712 jobs (including 516 jobs and £23.8 of output directly related to the Airport) across the region;
- Devolved administrations such as Wales have recognised the strategic importance of airports and have brought back Cardiff Airport into public control on the principle of ensuring sustainable regional economic growth. Cardiff has significantly improved through a combination of public ownership and subsequent partnering with an experienced private sector airport management company; and
- Although the Airport will continue to require an ongoing direct financial subsidy it will have a sizeable positive economic impact on the region. Failure to support the Airport will deprive the region of a significant economic asset.

Options Appraisal

15. A formal options appraisal was then undertaken as set out in the Economic Case element of the Business Case in Appendix 1 to this Report. The appraisal looked at a range of 9 options in connection with the Airport, as set out in the table below:

Option 1: Status Quo Option: Peel continues to run the airport and it closes in 2021	This option makes the following assumptions: <ul style="list-style-type: none"> • Airport continues to make a loss; • The airport function closes; • Peel decides to develop the former airport site as residential property.
Option 2: Do something: Peel are supported to deliver a turnaround plan	This option identifies the ongoing financial problems faced by Peel and provides financial support to ensure the continued operation of the airport. The option assumes that Peel still have the inclination to operate the airport and that they have the discretion to use funds provided by the public sector.
Option 3: Do something: Peel are bought out by another commercial organisation	This option assumes a third party commercial organisation recognises the potential financial viability of the airport, purchases it for the market rate and subsequently operates it without public subsidy. It must be noted that the airport function is currently operating at a loss.
Option 4: Do something: Public sector becomes the majority shareholder of the airport, with Peel retaining a minority share	This option assumes that the public sector is free to purchase a controlling share of the airport from Peel,

	<p>who are also minded to have a minority shareholding and to continue managing the airport.</p> <p>This would mean Peel ceding overall control of the airport and continuing to have to fund (at a lower rate) ongoing losses.</p>
Option 5: Do something: The Combined Authority takes lease of airport and operates it	<p>This option assumes that Peel are minded to lease (for a defined period – circa 10 years) the airport to the Combined Authority who subsequently operate it.</p> <p>This option means that all risk is transferred to the Combined Authority without the benefit of having an asset for potential resale, if the airport can't be turned around.</p>
Option 6: Do something: The Combined Authority buys airport and operates it	<p>This option assumes that Peel are minded to sell the airport to the Combined Authority who subsequently operate it.</p> <p>All risk rests with the Combined Authority, however they do have an asset for potential resale.</p>
Option 7: Do something: The Combined Authority buys airport and sub-contracts out management to a third party	<p>This option assumes that Peel are minded to sell the airport to the Combined Authority and that the Combined Authority has a partner who are responsible for developing the airport proposition.</p> <p>The inclusion of a specialist partner mitigates a number of operational risks such as the ability to attract additional routes and ensuring regulatory compliance.</p>
Option 8: Do something: The Combined Authority buys airport with a third party under a joint venture who also act as an operating partner	<p>This option assumes that Peel are minded to sell the airport to the Combined Authority and a third party, who is also responsible for developing the airport proposition.</p> <p>The cost of purchasing and subsequently running the airport are shared between the Combined Authority and the third party and the inclusion of a specialist partner mitigates a number of operational risks such as the ability to attract additional routes and ensuring regulatory compliance.</p>
Option 9: Do something: Allow the airport to close and establish a new airport on another site	<p>This option assumes that Peel close the airport and that in order to ensure access to an aviation function within the region, a new airport is developed.</p> <p>Since there is no existing alternative within the region, this necessitates the purchase of a site, the provision of infrastructure, ensuring regularity compliance and subsequent promotion of a new brand and entity.</p> <p>It is anticipated that such a replacement airport would take between 10-15 years to be developed and could cost in excess of £1bn.</p>

16. Each of the identified options was assessed against SMART objectives and critical success factors (as set out in the Economic Case section of the Business Case). Four options were then shortlisted for further consideration:-

- Option 1: Status Quo Option: Peel continues to run the Airport and it closes in 2021;
- Option 2: Do something: Peel are supported to deliver a turnaround plan;
- Option 7: Do something: The Combined Authority buys the Airport and sub-contracts out management to a third party; and
- Option 8: Do something: The Combined Authority buys the Airport with a third party under a joint venture, who also act as an operating partner.

17. These four short-listed options were then assessed against the following scenarios (including costs and benefits):-

- Scenario 1: Organic: DTVA's market share remains constant relative to its North East peers and grows at the market rate. This scenario reflects no material change to how DTVA operates today, with growth coming from improvements to load factors on existing routes and marginal increases in capacity;
- Scenario 2: Seasonal/Regional: more active management allows DTVA to attract seasonal services, bringing its service levels to the standard seen at other UK airports; also that DTVA attracts a regional operator to better service the domestic and short haul market;
- Scenario 3: Low Cost Carrier (LCC): It is assumed that driven management is able to attract an established LCC from a regional competitor airport to DTVA.

For each shortlisted option, the associated cash flows were reviewed over a 35 year period. As per Green Book Guidance, the economic case considers all quantifiable costs, benefits and risks from the perspective of society as a whole – the public, private and third sectors.

Preferred Option

18. The following table sets out the assessment leading to the identification of the preferred option for each of the shortlisted “do something” options:

	Option 1	Option 2	Option 7	Option 8
Net present value	N/A (4 th)	£139m-£182m BCR: 1:5.1 – 1:6.16 (3 rd)	£875m - £7.15bn BCR 1:.34 – 1:5.2 (2 nd)	£876m - £7:182bn BCR: 1:4.6 - 1:16.2 (1 st)
Non-monetary benefits	0 (4 th)	400 (3 rd)	850 (2 nd)	1,000 (1 st)
Qualitative Risk Assessment	60 (4 th)	34 (=2 nd)	34 (=2 nd)	24 (1 st)
Overall ranking	4	3	2	1

Option 8 (“Do something: The Combined Authority buys airport with a third party under a joint venture who also act as an operating partner”) was identified as the preferred option. This option has the benefits of:-

- Maintaining public sector control of the Airport in the long term;
- Bringing in private sector expertise in airport turnaround and ongoing operations; and
- Sharing an element of risk and reward with another party.

19. The alternative option (Option 7) is for the Combined Authority to acquire the Airport and put in place any arrangements for strategic management and oversight of DTVAL's

management team and any support services required, while in the interim continuing with a transitional services arrangement with Peel. This represents a satisfactory solution but would take longer to put in place and does not achieve all the other benefits listed above.

Position of Peel Holdings

20. The current Shareholders' Agreement for DTVAl was finalised on 1 April 2003 and amended in 2017 includes a commitment by the company to retain airport operations until 2026, but after 2021 this commitment becomes conditional. In detail, the implication is that:-
 - If in any financial year after 2021 the Airport makes a loss of more than £1 million on operational activities, Peel Airports, as majority shareholder in the Airport Company, may downsize the Airport to general aviation; or
 - If such loss in any financial year post 2021 is more than £1.5 million on operational activities, then Peel may close the Airport.
21. The option of extending the keep-open commitment has been discussed with Peel previously. Peel's position has been that it is not willing to consider this as an option under its management.
22. In more recent discussions the Combined Authority has been informed by Peel that it has already taken the decision that the Airport will close in or shortly after 2021.
23. In late November 2018 the Combined Authority agreed a proposal with Peel for the Combined Authority to acquire Peel's 89% shareholding in DTVAl, on the basis that the proposal would be brought forward for discussion at Cabinet, as set out in this Report.

Joint Venture with the Preferred Operator

24. Since 2017, the Combined Authority has been exploring a specific opportunity for a partnership with an experienced airport operator (under Option 8). This arose as a consequence of a productive relationship already developed with TVCA and Stockton Borough Council in another area of the preferred operator's business.
25. The preferred operator has successfully grown another UK airport significantly in recent years. This experience in particular makes the preferred operator an attractive organisation to provide strategic direction and oversight to supplement with experience of the existing DTVAl management team (which is itself significant). The preferred operator's contacts with target airlines would also be helpful.
26. The preferred operator is keen to extend its role in regional aviation and sees this as a sector with a growth opportunity, particularly through the application of new forms of customer marketing and relationships with airlines. Discussions with the preferred operator have progressed well since initial meetings first took place in 2017 between the Mayor and Combined Authority officers, the Chief Executive of the preferred operator and other senior figures within their Group. From the start, the preferred operator has taken an optimistic and growth-orientated approach to the future of the Airport. These discussions have informed the scenarios for growth set out in the Business Case.

Legal Terms of Proposed Transactions

27. The proposed Sale and Purchase Agreement for the purchase of the Peel Shareholding has been negotiated on behalf of the Combined Authority by external lawyers highly

experienced in mergers and acquisitions including those in the aviation sector. Our advisers have ensured that the Combined Authority's liability in taking on the Peel Shareholding is limited as far as possible and that warranties and indemnities are in place where appropriate where such liability cannot be entirely removed. The due diligence process has identified the current DTVAl position which is set out in the disclosure letter prepared by Peel.

28. A Transitional Services Agreement is required to ensure that there is no gap in support operations which may put at risk the ability of DTVAl to continue to trade. This includes the provision of back office functions such as IT, payroll and HR. It should be noted, however, that DTVAl has all operational staff it requires to operate the airport itself in-house and does not require any external support to maintain airport operations.
29. Peel has agreed to continue to provide services under this Transitional Services Agreement to allow for a smooth handover to the preferred operator (or failing that, to other providers put in place through a procurement process). The price for these transitional services will reflect the cost of providing these services to DTVAl direct previously.
30. Assuming recommendation (ii) is taken forward, a Joint Venture Agreement shall be entered into which will govern the relationship between the Combined Authority and the preferred operator. This will detail how the shareholders shall appoint directors, sharing of voting rights, dividends, company losses etc, each of which shall be in proportion to the relative shareholdings of the parties, with the preferred operator having a maximum of a 25% of the Combined Authority's equity interest.
31. Also assuming recommendation (ii) is taken forward, the Combined Authority shall put an Operating Contract arrangement for the supply of support services to DTVAl, will provide strategic direction in accordance with an agreed 5 year business plan (to be reviewed annually) and oversight of the DTVAl management team on the day to day operation of the airport. Any deviation from the agreed business plan will need to be agreed by the Combined Authority. The operating fee shall be 10% of the agreed annual operating cost.
32. The Combined Authority will enter in to a Deed of Adherence to the existing Shareholders Agreement in place between the DTVAl shareholders. This is on the basis that the provisions in the Shareholders Agreement which are Peel specific and therefore no longer relevant are deleted going forward.

Legal Implications

33. The Combined Authority has powers pursuant to section 113A of the Local Democracy, Economic Development and Construction Act 2009 to do anything it considers appropriate for the purposes of carrying out its functions, anything incidental thereto and anything considered appropriate for purposes indirectly incidental (without regard to the degree of separation) thereto. For a commercial purpose, the Combined Authority may do anything under the same section above powers which it would otherwise do for a non-commercial purpose (section 113A (1)(e), 2009 Act). These powers enable the Combined Authority to carry out the recommendations set out in this report.
34. The award of the operating contract requires compliance with procurement legislation in this case the Utility Contract Regulations 2016. However, in this case, the Combined Authority is advised by a leading procurement QC that it can use the proposed joint venture structure to award an operating contract to the preferred operator pursuant to Regulation

29 of the Utility Contract Regulations 2016 without the need for a procurement exercise. This is on the basis that the contract is awarded to a wholly owned subsidiary of the company in which the Combined Authority and the preferred operator hold equity ('Subco') and that Subco is managed by the preferred operator and that Subco supported by services arrangements with the preferred operator. The Combined Authority is satisfied that this award of the operating contract would offer value for money.

35. If recommendation (ii) is not taken forward, the Combined Authority will procure the provision of any supplementary strategic and support services required through processes which comply with the Utility Contract Regulations 2016. In the interim, the Combined Authority will continue to rely on the provision of back-office support by Peel under the Transitional Services Agreement. As stated previously, DTVL has all operational staff it requires to operate the airport itself in-house and does not require any external support to maintain airport operations. As such, it is able to continue to operate the airport as it has done for many years during this interim period.
36. [The proposed transaction taken as a whole is required to demonstrate state aid compliance. An assessment that the proposed transaction has been carried out by the Combined Authority's external financial advisers to confirm that it complies with the market economy operator principle ('MEOP'). The Combined Authority's external legal advisers have confirmed that the proposed transaction is state aid compliant on the basis of the MEOP assessment.]

Financial Terms of Proposed Transactions

37. The acquisition price is £40m for an 89% majority shareholding in Durham Tees Valley Airport Limited. The acquisition of the shares will incur Stamp Duty at 0.5% which is £200k. Therefore the total acquisition cost is £40.2m. The Combined Authority will fund the share purchase and shall recover this investment over a [40] year period either by way of a loan or by way of a preferential dividend arrangement in the Joint Venture Agreement (depending on which approach is the most advantageous to the Combined Authority which will be established through the due diligence process being undertaken).
38. The airport is currently loss making and it is expected to continue to make losses until 2026. Financing will therefore be required in the short-term to enable the Business Plan to be delivered and achieve a financial turnaround. The Business Plan forecasts a requirement for additional financial support during the turnaround period of up to £19.4m to cover operating losses and up to £15m capital expenditure. The level of finance required will be reviewed on an annual basis by the Combined Authority. Any finance provided to meet these costs will be provided on a loan basis from the Combined Authority as required.
39. Under the proposed Joint Venture Agreement with the preferred operator, the operator shall receive limited dividends until the Combined Authority's investment is repaid and will have the option to either provide a cash injection to cover its share of losses / capex, thereby reducing the repayment requirements. Alternatively, the operator will be able to take an equivalent in share dilution. For the purposes of setting a prudent funding requirement it has been assumed that the operator will opt for the latter option and dilute their shareholdings.

Financial Implications

40. The Business Plan requires up to £74.6m to fund acquisition, operations and capex before the airport becomes profitable and begins to repay this investment. However, this level of investment will be under a level of confidence that delivery against the Business Plan growth targets are being achieved and the loans will be fully recovery. Based on Business Plan forecasts it is expected that recovery will take 40 years.
41. If the Business Plan growth targets were not being achieved then whilst the £40.2m for the acquisition would be recovered (see para.45) through residual land values there is a risk that further advances to fund revenue and capex to date would not be recovered. The extent of this will be dependent on how long the airport continues to be funded. For example, assuming the airport is fully funded for the first three years and growth targets are not achieved nor expected to be achieved then a decision to close would lead to a potential loss of £8.5m.
42. Arrangements will be in place to ensure that there is ongoing review of performance against an agreed Business Plan. Should at any time it become clear that the financial position is becoming much worse than expected then the Combined Authority, as majority shareholder, will be able to trigger airport closure and seek to recoup its investment through land values.
43. Any loans provided will be on a first charge basis and therefore the Combined Authority will be able to recover any value in the residual assets should a later decision to close the airport need to be made. With a total landholding of 820 acres there is potential for significant financial recovery. The most significant value in this circumstance would be through promoting the site for housing. Independent valuation has set the valuation on this basis at £41.8m (see Appendix 3).

Risk Assessment

44. The Risk Schedule associated with the Acquisition transaction is set out in the Management Case of the Business Case in Appendix 1, and the Risk Schedule in connection with the operation of the Airport post-acquisition is set out in the Commercial Case of the Business Case in Appendix 1. These schedules set out the risks and how it is proposed that they will be mitigated/managed. Arrangements for the governance of the Joint Venture Company and the management agreement with the preferred operator will be set out in the documentation covering those arrangements and will be managed, monitored and reported as set out in the Management Case.

Due Diligence and Assurance

45. Due diligence on the proposed arrangements has been carried out as follows:-
 - a. Legal – Pinsent Masons;
 - b. Financial – Ernst & Young LLP;
 - c. Property and valuation – Turner & Townsend;
 - d. Airport industry – ICF/ York Aviation; and
 - e. Insurance – JLT Specialty Limited.

Summary and Next Steps

46. In summary, this report sets out a credible proposition for the future development of the Airport under the majority ownership of the Combined Authority. It is clear that the

alternative is that the Airport will close and that this would impose wider economic costs and the loss of future economic benefits for the Tees Valley.

47. The Acquisition offers a pragmatic approach to the future ownership and operation of the Airport, and provides the Combined Authority with the opportunity to deliver a much stronger growth prospectus than is possible under the current ownership. The opportunity for a joint venture with the preferred operator brings in a credible private sector partner, with experience as an established airport operator and with growth ambitions and new opportunities for route development and revenue enhancement. The risks are significant, but the risk analysis identifies opportunities to mitigate the financial and operational risks involved.
48. Intervention would require a significant allocation of future Combined Authority funds, with the range of financial outcomes as set out in Business Plan in Appendix 2. Although this would secure important wider economic benefits of sufficient scale to justify this investment, the commitment of these funds has an opportunity cost in terms of alternative investments which could also secure other economic benefits. It is therefore important for Cabinet to consider the proposition in the round, and to make an assessment based on the importance of the Airport to the Tees Valley, the financial, legal and risk assessment, and the strength of the commercial arrangements proposed in this Report.
49. Following consideration of the proposals set out in this Report, it is recommended that Cabinet mandate the Chief Executive, in on-going consultation with the Mayor and Cabinet Member for Transport, to finalise the arrangements for the Acquisition from Peel, and for the Joint Venture with the preferred operator.

Consultation

50. Consultation has been undertaken with Tees Valley Management Group, Tees Valley Chief Executives, the LEP Board, Transport Committee, Informal Cabinet, Overview & Scrutiny Committee and Audit & Governance Committee.

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Appendices

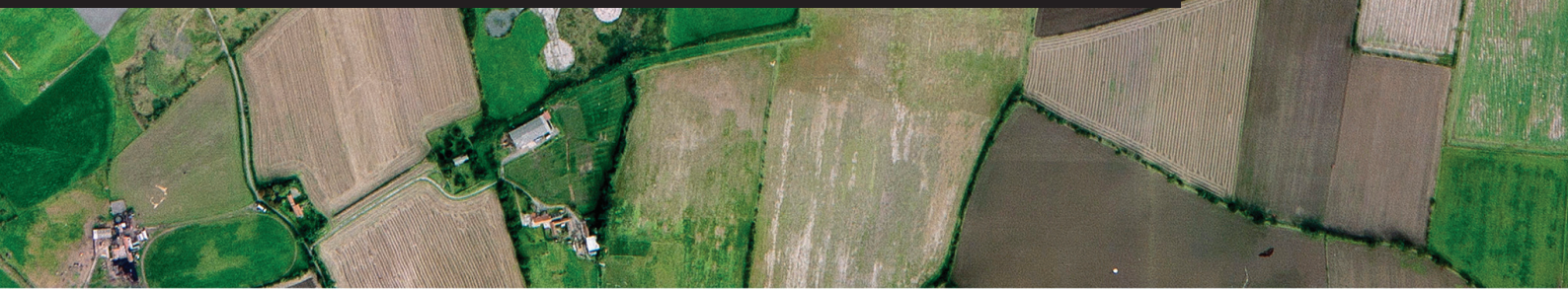
- 1 Full Business Case
- 2 ICF Business Plan (Please note that elements of the Business Plan have been redacted as they contain exempt information as defined by paragraph 3 of schedule 12A of the Local Government Act 1972).
- 3 Valuation Report



TEES VALLEY
COMBINED
AUTHORITY

TEES VALLEY MAYOR

FULL BUSINESS CASE: SECURING THE FUTURE OF OUR AIRPORT



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1. Introduction

Background, Description and Investment Proposition

ORGANISATIONAL CONTEXT

- 1.1 Tees Valley Combined Authority (the Combined Authority) was created in April 2016 with the aim of driving economic growth and increasing investment and job creation in the area. It is a partnership of five local authorities:¹ Darlington, Hartlepool, Redcar and Cleveland, Middlesbrough, and Stockton-on-Tees, working closely with the local business community and partners to make local decisions that support the growth of the economy.
- 1.2 Tees Valley is at the forefront of northern economic growth and a flagship for successful devolution. The Combined Authority has big ambitions for the region, and the Strategic Economic Plan (SEP) aims to create 25,000 new jobs and deliver an additional £2.8billion into the Tees Valley economy by 2026. The SEP sets out the main priorities of the Combined Authority and the Local Enterprise Partnership. They are working to improve: transport links, to better connect residents and businesses; housing, to ensure the provision of affordable, quality homes that meet the needs of a growing Tees Valley; skills and education, to make sure everyone has the same opportunities to access work; and tourism and culture, so that Tees Valley is an area residents feel proud of and that others want to visit or to make their home.
- 1.3 Tees Valley's Local Authorities and Local Enterprise Partnership agreed legislation with Government to enable devolution such that powers previously held by Whitehall, on matters of transport, planning, investment, skills, homes and communities and culture, were transferred to the area.
- 1.4 In his 2017 election manifesto, the elected Mayor pledged to take Durham Tees Valley Airport (DTVA or the airport) back under public control in order to address its visible decline.

VISION

- 1.5 The vision for the project is:

“To secure for Tees Valley an internationally connected airport and aviation orientated business park which will continue to support indigenous economic growth and act as a catalyst for enhanced inward investment and tourism activity.”

PURPOSE OF THIS BUSINESS CASE

- 1.6 This business case has been developed to assess the Combined Authority's future options with respect to the airport.
- 1.7 The business case will discuss options related to both the core functions of the airport – passenger numbers and logistical support – and wider co-locational activities, related to maximising the economic impact of the airport's associated property offering.

¹The region has a total population of 670,000 residents spread across the five Local Authorities.

BACKGROUND

1.8 The relative performance of the airport is a matter of public record, dropping from a peak of 900,000 passenger movements in 2006 to the present situation of 131,000 passengers in 2017. This is a decline of 769,000 (85%) passenger movements over a period when airports in neighbouring regions (Newcastle and Leeds Bradford) have experienced a rise of 1% and 6% respectively.

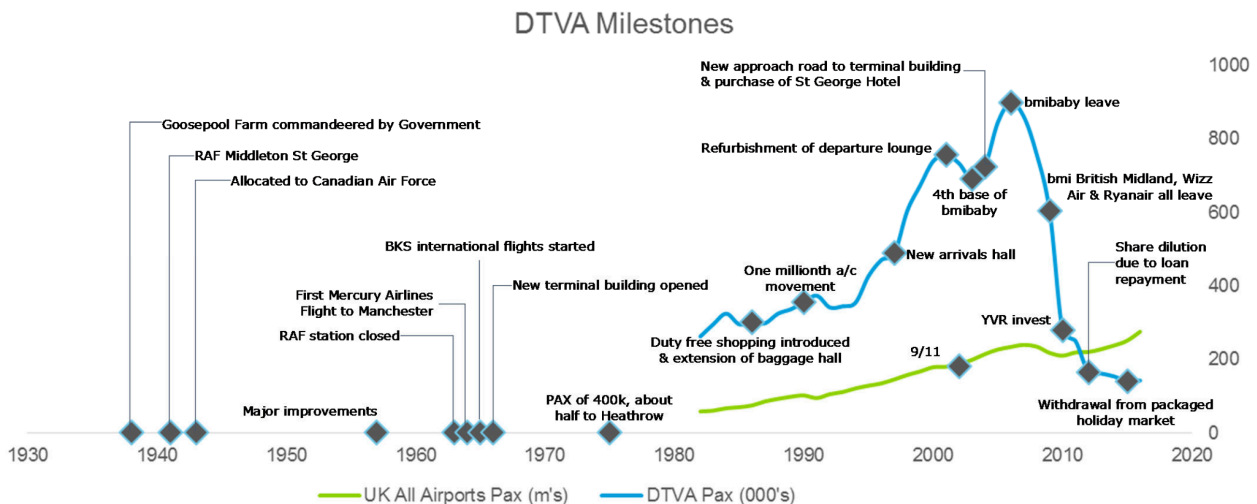
1.9 The rationale for the return to public control reflects the following imperatives:

- The airport will close in 2021 if not purchased leaving Tees Valley residents and businesses without a regional airport, the only major conurbation in the United Kingdom without such a provision. It would also see the loss of a significant employer (circa 400 direct employees).
- That a return to public ownership could bring with it three principal benefits:
 - **Consideration of wider economic impact:** The public sector can take into consideration the wider economic impact that an airport brings to a region, something commercial operators cannot do. The creation of a thriving regional airport is a vital strategic asset to realising the economic potential of Tees Valley and the wider Northern Powerhouse;
 - **Ensuring greater consumer choice:** The performance of DTVA has been weak compared with competitor airports across the UK and has consequently limited resident and business choice and their accessibility in to and out of the region; and
 - **Ensuring a return to financial viability:** Additional investment and a commitment to grow the airport could promote not only economic but financial viability and would ensure previous investment was not wasted.

DESCRIPTION

1.10 Durham Tees Valley Airport is within the Tees Valley conurbation and is situated on the border of the local authority areas of Darlington and Stockton-on-Tees. Originally an RAF airbase, the airport has supported private and commercial air traffic since the mid-1960s, reaching peak passenger numbers of circa 900,000 per annum in 2006. Since then, passenger numbers have declined significantly with a number of key airlines withdrawing from the airport.

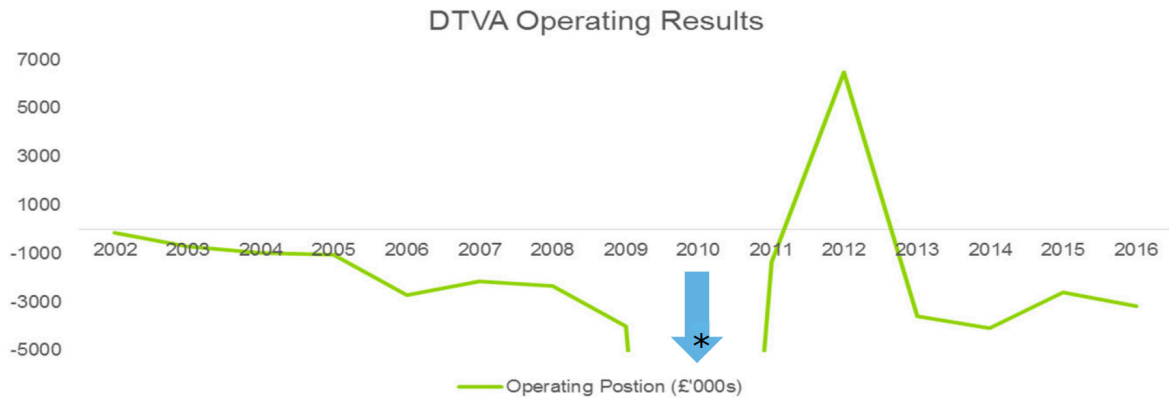
1.11 The following graphic shows selected key milestones in the history of the airport:



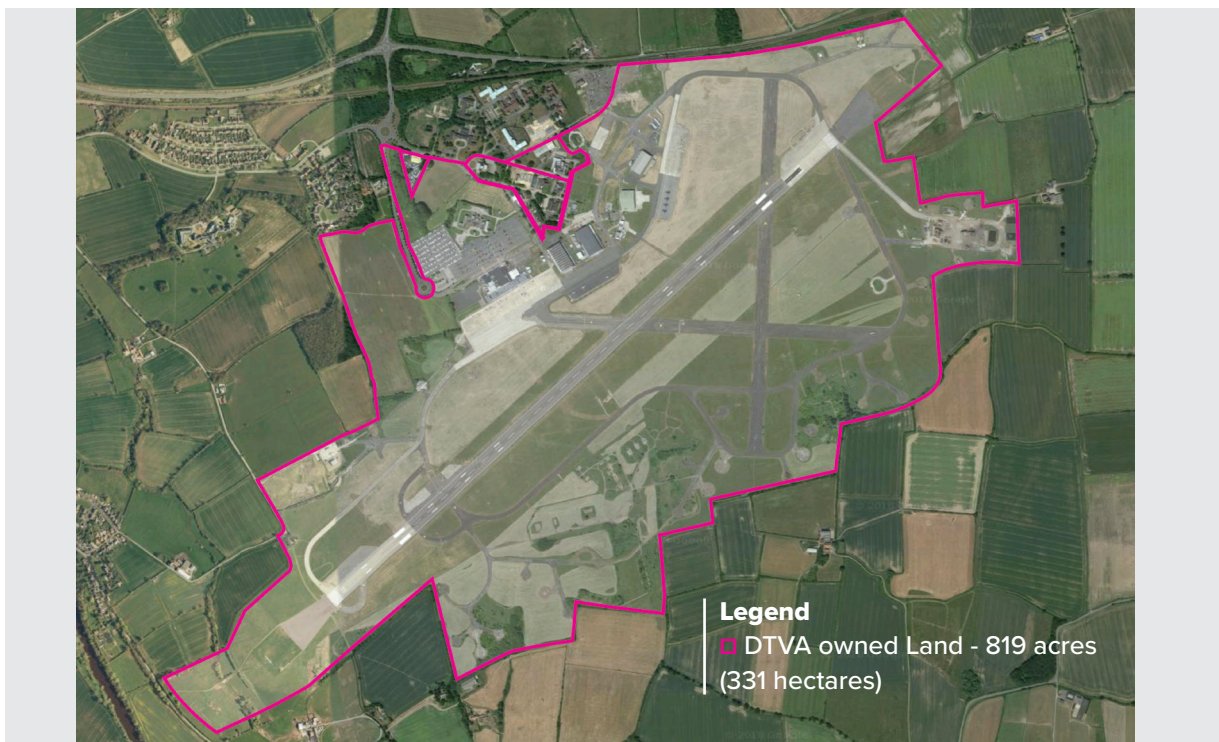
Source: Durham Tees Valley Airport Ltd, CAA, Department for Transport

1.12 On 1 April 2003 Peel Airports Ltd, part of Peel Group, acquired a 75% shareholding in the airport with the Local Authorities (five Tees Valley Local Authorities and Durham County Council) retaining a 25% shareholding in aggregate. The Combined Authority is not a shareholder in DTVA Ltd.

- 1.13 In 2003, passenger numbers had dipped as a result of the 11 September 2001 terrorist attacks in New York and operating costs were up, predominantly due to an increase in insurance costs as a result of that terrorist incident. This meant the airport remained in a loss making position, with losses after tax of £816k for the year ending 3 March 2003. Passenger numbers continued to grow until 2006.
- 1.14 Since then, passenger numbers and aircraft movements have reduced dramatically at the airport. This has also been reflected in the airport's financial position, as shown in the following chart of operating profits/losses (the 2012 profit arose from an exceptional £6.9million settlement payment by the airline bmi for breach of contract):



- 1.15 The largest drops in passenger numbers took place in 2009 and 2010 following the withdrawal of bmi (which had provided the service to Heathrow) and Ryanair.
- 1.16 At the time of writing, the airport only offers scheduled flights to Aberdeen, Amsterdam Schiphol and Jersey and hosts other aviation-related activities including general aviation services, the Great North Air Ambulance (although they currently intend to build new headquarters offsite), firefighting training (run by Serco), and Cobham's air activity for Ministry of Defence and aircraft decommissioning by Sycamore Aviation. Other activities include one hotel and a TNT distribution depot (in a former hangar).
- 1.17 The total airport site extends to 819 acres (331 hectares/3.3million square metres) and is shown below:



1.18 Of this site:

- The area relating solely to the operation of the airport is around 470 acres (190 hectares);
- The area described as the Northside has an overall area of around 90 acres (36 hectares); and
- The area described as the Southside has an overall area of around 260 acres (105 hectares).

1.19 The existing property provision at the airport includes:

- The Priory Hospital is classified under planning use 'C2' as they are part of a residential institution;
- The 'Fire Training Centre' and 'Technology House', operated by Serco Ltd fall under use class D1 which covers educational uses of buildings;
- The St George and Durham Tees Hotel buildings are classed under 'C1' which covers hotel uses;
- Motor Home Sales (classed as Sui Generis) is the use class of two buildings used by Cleveland Motor Homes;
- The Control Tower is also covered by Sui Generis use class; and
- All other buildings are either office uses (B1), general industrial (B2) (e.g. workshops), storage/distribution (B8) or a mixture of these three uses.

1.20 The table below summarises the scale and nature of employment assumed by previous economic studies of the airport, including Regeneris (2012) and York Aviation (2018).

ACTIVITY	NUMBER OF JOBS
Airport Company Employment	111
Employment associated with Terminal Operations, including:	183
• Airline/Handling Agents	50
• Concessions	36
• Security/Border Agency/Police	81
• Other Terminal Activity	16
Employment associated with third party operators at the Airport	306
Total Direct Employment linked to the Airport	600

| Source: Regeneris 2012 and York Aviation 2018

1.21 In preparing this business case, senior management at the airport was consulted regarding the numbers employed either directly by Durham Tees Valley Airport or in positions which were conditional on there being a continued aviation function at the site.

1.22 DTVA management was able to confirm (January 2019) that 111 staff were either directly employed or contracted to deliver certain functions, including security and airline handling. In addition, and adopting a conservative approach which we believe enhances the reliability of this report, around 290 were directly employed in third party operators at the Airport.²

ACTIVITY	NUMBER OF JOBS
Total Direct Employment linked to to the Airport	400

² It is assumed that the following companies are still operating at the airport, including but not limited too: Cobham, TNT, Serco, KLM, Flying Schools and emergency services. Notable closures include: Weston Aviation and Camair.

1.23 COST OF CLOSURE

COST OF CLOSURE

The immediate economic impact on the wider Tees Valley economy:

- Reduction in annual output of £32.6m; and
- The potential loss of 712 jobs direct and indirect jobs.

COST OF REPLACEMENT

1.24 At present DTVA is the only commercial airfield operating within the region. If closed, one option could be to identify a replacement site within the region. The size of site required (circa 500 acres) and aeronautical related regulatory issues significantly limit the number of possible location options, and because of lack of choice therefore potentially escalate both planning and cost risks. Useful benchmarks for new build airports in the UK are hard to find, as few have moved past initial planning over the last forty years (Cliffe, Thames Reach only reached preliminary planning stage). However a number of common factors have emerged: the extensive time between planning to development (circa 10-15 years minimum) and cost structure: (compensation for immediate land use/ wider flight path and subsequent site preparation and specialist construction costs). Preliminary benchmarking for the recently built St Helena Airport, identified a cost of circa £200-250million, however further analysis of plans developed by Oxera (2003) identified that more realistic costs for airport construction in the UK run in excess of one billion pounds, and in many locations significantly more than this.

A replacement airport is deemed not to be feasible due to the interruption of service and excessive costs.

INVESTMENT PROPOSITION

1.25 In response to the potential closure of the airport, the Combined Authority is considering the following actions:

- The purchase of the airport and ongoing management of the airport.
- Creation and delivery of an expansion plan for the airport, specifically aimed at increasing passenger movement and attracting additional routes;
- The on-going management of the existing portfolio of businesses currently operating at the airport; and
- The better utilisation of the wider property proposition on the airport site in line with key priority sectors (advanced manufacturing, materials and pharmaceuticals) within the SEP.

STRUCTURE AND CONTENT OF THE DOCUMENT

1.26 The remainder of the business case follows HM Treasury Green Book guidance and the five case business case model and is set out in the following structure:

- Section 2: Strategic Case;
- Section 3: Economic Case;
- Section 4: Commercial Case;
- Section 5: Financial Case; and
- Section 6: Management Case.

2. Strategic Case

Introduction

2.1 The strategic case seeks to consider the need for public sector intervention by assessing its ability to address relevant market failures. It will also confirm the subsequent scope and scale of support with recourse to identified critical success factors and associated constraints and project dependencies.

2.2 The strategic case has the following structure:

- Strategic Context;
- Assessment of Need;
- Constraints and Dependencies;
- SMART Objectives and Critical Success Factors; and
- Conclusion.

Strategic Context

2.3 The Strategic Context has been derived from a review of two principal policy areas potentially influenced by the acquisition of the airport:

- **Economic Growth:** The role of the airport as a strategic asset in support of wider economic development.
- **Transport Policy:** Focused on enhancing choice and convenience for passengers.

2.4 The review of the strategic context provides two critical outputs:

- Assessment of strategic fit as per policy areas; and
- Identification of key outputs and outcomes to influence development of logic model for assessment of need for the airport.

2.5 The table below provides a summary of the key documents per policy area:

Transport	Economic Development
<ul style="list-style-type: none">■ Airports National Policy Statement (2018); and■ Beyond the Horizon: The Future of UK aviation: Next steps towards an Aviation Strategy (2018).	<p>Impact of International/National Linkages</p> <ul style="list-style-type: none">■ UK Industrial Strategy;■ Northern Powerhouse Strategy;■ Refreshed Strategic Economic Plan; and■ South Tees Development Corporation. <p>Impact of Enhanced Property Provision</p> <ul style="list-style-type: none">■ Darlington Local Plan; and■ Stockton Local Plan.

Transport Agenda

2.6 The UK's Aviation Strategy aims to:

“Achieve a safe, secure and sustainable aviation sector that meets the needs of consumers and of a global, outward-looking Britain”

2.7 The strategy has the following six objectives:

- Help the aviation industry work for its customers;
- Ensure a safe and secure way to travel;
- Build a global and connected Britain;
- Encourage competitive markets;
- Support growth while tackling environmental impacts; and
- Develop innovation, technology and skills.

2.8 Of particular pertinence is:

- **Expanding our international connectivity:** The UK has 111 bilateral air service agreements (ASAs). These agreements provide access to overseas markets for UK carriers as well as access to UK airports for foreign carriers. The greater competition that liberalised access allows results in greater choice and connectivity for all consumers, at lower fares. The UK has opened up its markets to foreign carriers in return for access to their markets. The Government has also pursued greater access to airports outside of the South-East;
- **Facilitating the air freight market in the UK:** The industries which rely on aviation to deliver their products and services are often of high value to the economy. Aviation supports the more productive aspects of the UK economy and has directly and indirectly been a driver of innovation. The UK air freight sector is flourishing. In 2016, the volume of freight handled by UK airports grew by 5% to 2.4 million tonnes shipped. The Government recognises the crucial role this sector plays in the economy, especially high end manufacturing, engineering, pharmaceuticals, retailing and the automotive sectors. For time critical goods such as pharmaceuticals, air freight is the only method of shipping fast enough to deliver these items in the required timeframe. Although the volumes are comparatively small, the value of air freight per tonne is much greater than other modes of freight, due to the nature of the goods transported. In 2016, goods worth around £178billion were shipped by air between the UK and non-EU countries; this was over 45% of total non-European trade; and
- **Encouraging competitive markets:** While the total number of regional airports connected to Heathrow has remained stable over recent years, the total number of terminal passengers from UK regional airports handled by London Heathrow between 2000 and 2016 has fallen, mostly as a result of being driven out by more lucrative long haul flights. **The new aviation strategy calls for a review of the number of regions (such as Tees Valley) who do not have connectivity with London Heathrow, which they require to support economic growth for the regions they serve.**

Assessment of Strategic Fit

The securing of the airport is in line with the UK's Aviation Strategy and will:

- Ensure continued access to a vital regional airport, and retain the opportunity for a restored London flight as capacity is increased in the capital;
- Increase the propensity to travel by encouraging more choice and price competition;
- Deliver an opportunity to utilise air freight to enhance the productivity of locally based industries in priority industries such as advanced manufacturing, materials and pharmaceuticals; and
- Support economic growth including through inward investment.

Economic Development Agenda

UK INDUSTRIAL STRATEGY

2.9 The Industrial Strategy notes the following:

“The Industrial Strategy is designed to place us (the UK) at the forefront in finding solutions to both UK and global emerging trends and challenges. As set out in our paper Preparing for Our Future Trade Policy, we (the UK) will reach out to old friends and new allies in expanding access to markets, supporting our businesses to export, and welcoming investment and collaboration from emerging and established partners from across the globe.”

2.10 The Government has identified five foundations of productivity which are “the essential attributes of every successful economy.” These are:

- Ideas (R&D, innovation);
- People (skills and education);
- Infrastructure (broadband, energy, transport);
- Business environment (support for specific sectors and SMEs); and
- Places (tackling regional disparities).

2.11 Improving the Five Foundations will enable the UK to tackle a series of Grand Challenges that the Government has identified which will help the UK “take advantage of global changes, improve people’s lives and the country’s productivity.”

2.12 The Grand Challenges are:

- AI and the data revolution (how to embed and maximise the advantages of AI and data);
- Clean growth (low carbon technologies across the economy);
- Mobility (low carbon transport, automation, infrastructure); and
- Ageing society (healthcare and labour market challenges).

Assessment of Strategic Fit

The securing of the airport is in line with the Industrial Strategy and will:

- Enhance productivity by reducing the costs of doing business through the provision of infrastructure to nationally important sectors, such as clean growth (advanced manufacturing and process and chemicals); and
- Support economic growth including through inward investment.

Northern Powerhouse

2.13 The vision of the Northern Powerhouse includes:

- Boosting the local economy by investing in skills, innovation, transport and culture, as well as devolving significant powers and budgets to directly elected mayors to ensure decisions in the North are made by the North; and
- Backing business growth right across the North, and giving our great cities the power and resources they need to reach their huge untapped potential.

2.14 This is to be achieved by:

- **Connectivity:** to improve connections within and between the towns and city regions of the North;
- **Skills:** a highly skilled and educated workforce is critical to economic growth and productivity, the government is to work with Northern Powerhouse to improve educational standards and skill levels across the region;
- **Enterprise and innovation:** to ensure that the North continues to be an excellent location to complete ground breaking research, develop innovative ideas, and start and grow a business;
- **Trade and investment:** the North of England is now recognised across the world as a great place to do business, and is home to billions of pounds worth of exciting opportunities for international investors. A Northern Powerhouse Investment Taskforce will bring together the local authorities and businesses of the North to present a single internationally competitive offer to the world; and
- **Engagement:** the Government will engage with local authorities, local enterprise partnerships, businesses and others across the north to consider what more can be done to support the delivery of the Northern Powerhouse.

Assessment of Strategic Fit

The securing of the airport is in line with the Northern Powerhouse Strategy and will:

- Enhance productivity by reducing the costs of doing business through the provision of infrastructure to nationally important sectors, such as clean growth (advanced manufacturing and process and chemicals); and
- Support local economic growth including through international engagement and the facilitation of inward investment, from new and existing international investors.

Refreshed Strategic Economic Plan

2.15 The Tees Valley Strategic Economic Plan: Sector Action Plan Overview Document (2017) articulates the new economic geography of the Tees Valley:

“Tees Valley is no longer solely a component part of the North East, it now operates in new economic and political geographies: Part of the Northern Powerhouse, one of six Combined Authorities and according to the emerging Industrial Strategy, as an international cluster for sectors such as chemicals, advanced manufacturing and producer of intermediate goods for the automotive sector. Working across such geographies necessitates clearer messaging of strategic intent, alliance building and prioritisation of resources.”

2.16 Central to this revised economic geography is utilising national and international connectivity, by rail (Darlington and Middlesbrough Rail station upgrades), by sea (Investment at Teesport) and by air, releasing the economic potential of Durham Tees Valley Airport.

2.17 The overarching economic plan and Industrial Strategy for the Tees Valley, the refreshed SEP provides a framework for economic development to deliver six growth generating themes:

- **Business Growth:** Further increase jobs and business density through targeted support to create and attract new companies and to grow businesses and sectors with high growth potential;
- **Research, Development, Innovation & Energy:** Further enhance productivity in all core sectors through the commercialisation of knowledge;
- **Education, Employment & Skills:** Ensure a labour market which meets the needs of local business and supports the lifetime opportunities of all our residents;
- **Place:** Promote the Tees Valley as the preferred location in the UK for energy intensive indigenous firms and Foreign Direct Investment and create the conditions necessary to attract businesses and individuals with a focus on vibrant town centres;
- **Culture:** Change the external perceptions of Tees Valley through the arts, cultural and leisure offer, create places that attract and retain businesses and business leaders and make the area an attractive place to live, work and visit; and
- **Transport & Infrastructure:** Facilitate local, regional, national and international road, rail and broadband connectivity through collaborative investment in physical infrastructure.

2.18 To unlock potential growth and to create a Tees Valley where people want to live, work and visit, there is a need to improve:

- Road and rail connectivity for the region;
- A workforce that is fit for purpose; and
- A supportive business environment.

2.19 This will aim to further develop the Tees Valley growth narrative:

- By targeting support on Foreign Direct Investment and indigenous SMEs with high growth potential in internationally competitive key sectors such as chemicals, health innovation, energy and advanced manufacturing, whilst encouraging further diversification into new sectors and technologies (including logistics, digital & creative, culture & leisure and business & professional services); and
- By ensuring a fit for purpose labour force which also recognises the lifetime opportunities of all residents.

2.20 As the overarching economic plan and Industrial Strategy for the Tees Valley, the SEP provides a framework for economic development to deliver our six growth generating themes, one of which is 'Transport & Infrastructure' that will facilitate local, regional, national and international road, rail and broadband connectivity through collaborative investment in physical infrastructure.

South Tees Development Corporation

2.21 This 4,500-acre development area represents an international-scale opportunity to attract investors and improve the economy in what is the single biggest development opportunity in the UK. Chaired by the Tees Valley Mayor, a 25-year plan to create 20,000 good-quality jobs has been developed.

- STDC is the first Mayoral Development Corporation to be set up outside of Greater London;
- £137million has been secured from Government to prepare the site for private investment;
- STDC has a 25-year vision to bring 20,000 jobs and an additional £1billion a year for the local economy;
- More than 100 investor inquiries from global companies wanting to base themselves on site; and
- The project is a key part of the Government's Industrial Strategy.

Assessment of Strategic Fit

The securing of the airport is in line with the Tees Valley Strategic Economic Plan and the South Tees Development Corporation:

- Durham Tees Valley Airport has a long term role in contributing to the competitiveness and prosperity of the Tees Valley particularly through its regular services to the Amsterdam Schiphol hub and to Aberdeen, important routes for Tees Valley businesses, particularly in the oil and gas sectors; and
- The airport will also be key to ensuring accessibility to the region and will therefore be a key supporting structure in relation to the emerging place and culture proposition.

Darlington Local Plan

2.22 The current adopted Plan Core Strategy May 2011 is the subject of review with an emerging Local Plan, subject to public consultation in June 2018 and which includes:

- Policy E1: Safeguarding existing employment opportunities: confirming that the airport (Northside) has a total (DBC) gross area of around 150 acres (60 hectares) with a gross area of 16.6 acres (6.73 hectares) available for mixed use/B1 B2 airport and related uses; and
- Policy E2: Promotion of New Employment Opportunities: confirming that at the airport (Southside) a total gross area (DBC) of 97 acres (39.30 hectares) exists, with 67 acres (27.1 hectares) gross available for B2 airport uses.

Stockton-on-Tees Local Plan

2.23 The current adopted Local Plan recognises the economic benefits of the airport to the wider Tees Valley and promotes its growth and safeguards the continued operation of a regional airport:

- 124 acres (50 hectares) of land are allocated for airport related uses to the south of the runway. To support this expansion a further 50 acres (20 hectares) of general employment land is also allocated south of the runway;
- Transport improvements will be supported to enable future aviation and economic growth at the airport; and
- Public transport access to the airport and road access to the Southside employment site.

2.24 The Plan confirms that new development will only be permitted where it can be demonstrated that:

- The proposed development is necessary to enable long term sustainability and viability of the airport;
- The amount and type of development will not adversely impact on the Council's ability to deliver the locational strategy and key development sites of the Local Plan and its wider strategic objectives; and
- The use would not prejudice the operation of the airport and in circumstances where the proposal would result in the loss of employment land or specialist airport related land use.

OVERALL - Assessment of Strategic Fit

The securing of the airport is in line with key strategies at National, Northern Powerhouse and Tees Valley levels. The airport will ensure the following:

- **Outward Looking Region:** The Industrial Strategy, Northern Powerhouse Strategy and refreshed SEP have identified a number of priority sectors, which are viewed as being globally competitive. Within the Tees Valley, clean growth, including process, chemicals and energy, professional services (in particular high value servitisation functions) and advanced manufacturing are the most likely to benefit from enhanced connectivity associated with new route development and the restoration of some form of air cargo capability at DTVA. With a combined output of £4.2bn (one third of the regional total) and between them accounting for circa 60% of exports of goods and services, enhancing the number of air routes at DTVA will facilitate supply chain diversification and entry into new faster growing export markets;
- **Gateway point for the North:** Tees Valley receives a negligible number of international tourists to the region annually via Durham Tees Valley Airport. An enhanced number of air routes into the region would not only have a direct impact on Tees Valley tourism, but could potentially be a jumping off point for the wider region, including better known tourism destinations in both Durham and Yorkshire which are presently accessed via Manchester, Newcastle and London airports;
- **A more confident and visible region:** Enhanced perceptions and visibility in support of inward investment: Tees Valley has all the components of a successful international region, strong messages (through our international diaspora) and international connectivity. A recent Ernst and Young Report on foreign direct investment (inward investment) into Europe found that investors placed transport infrastructure as one of their top determinants of whether to invest in a place. Existing major users of the airport include the likes of multinationals such as Sabic, GlaxoSmithKline, Huntsman, AMEC and ABS with Tees Valley having close industry links across the globe: from France (EDF, Mersen), Netherlands (Heerema, Hertel) to Saudi Arabia (Sabic, Cleveland Bridge), the USA (Cummins, Darchem, Huntsman) and Japan and Singapore (Nifco, Fujifilm and Sembcorp). Such firms have collectively invested billions of pounds of capital expenditure in Tees Valley, and it is imperative that these investment channels are maintained in decades to come.

The region, through the South Tees Development Corporation, has the target of creating circa £1bn of additional output and around 20,000 jobs. These will not be sourced purely from the UK and so are to some degree dependent on inward investment. Success will be achieved through an easily accessible and increasingly visible region served by an international airport focused on strategically important routes; and

- **Ensuring the viability of a strategic asset and avoiding a significant closure:** Not only is the airport the strategic enabler for the delivery of the aforementioned themes, but with a direct workforce of circa 400, its loss would have a significant impact on local employment and output in its own right.

Assessment of Need

2.25 The assessment of need will be reviewed from the following perspectives:

- Performance against key metrics;
- Mitigation of identified market failures;
- Case study evidence; and
- SWOT/TOWS.

Performance against key metrics

2.26 The following table uses the key metrics identified in the strategic context section to develop robust baselines which can measure the comparative performance of the airport, including:

PERFORMING AIRPORT		
CONSUMER CHOICE	FINANCIAL VIABILITY	WIDER ECONOMIC IMPACT
PROPENSITY TO FLY	CURRENT PROVISION	PERCEPTIONS OF REGION
NUMBER OF ROUTES (DOM/ INTERNATIONAL)	OCCUPANCY RATES	SUPPLY CHAIN SUPPORT
NUMBER OF PASSENGER MOVEMENTS	INDUSTRIAL CLUSTERING	VISITOR IMPACTS
FREIGHT		

CONSUMER CHOICE

2.27 Central to securing the future of the airport is the impact it will have in terms of consumer choice, in particular increasing passenger and business use. This can be assessed through a review of the following key indicators:

- Propensity to fly;
- Access to airports/number of routes (domestic/international); and
- Freight.

2.28 The relative performance of the airport is on public record, dropping from a peak of 900,000 passenger movements in 2006 to the present situation of 131,000 passengers in 2017. This is a decline of 769,000 (85%) passenger movements at a time when neighbouring airports (Newcastle and Leeds Bradford) have experienced a rise of 1% and 6% respectively.

2.29 In quantifying passenger movements, emerging demand will be assessed through a review of population and its propensity to fly and emerging supply through a review of the operation of comparable airports across the potential catchment area (the wider North of England).

2.30 An analysis of population size and access to an airport was carried out and of the top 25 settlements **100% had access to an international airport.**

Position	Name of Region	Population	Presence of an airport (within 30 miles/45 minute)	Nearest airport
1	Greater London Built-up Area	9,787,426	Yes	Heathrow
2	Greater Manchester Built-up Area	2,553,379	Yes	Manchester
3	West Midlands Built-up Area	2,440,986	Yes	Birmingham
4	West Yorkshire Built-up Area	1,777,934	Yes	Leeds Bradford
5	Greater Glasgow Built-up Area	1,209,143	Yes	Glasgow
6	Liverpool Built-up Area	864,122	Yes	Liverpool
7	South Hampshire Built-up Area	855,569	Yes	Southampton
8	Tyneside Built-up Area	774,891	Yes	Newcastle
9	Nottingham Built-up Area	729,977	Yes	East Midlands
10	Sheffield Built-up Area	685,368	Yes	Doncaster Sheffield
11	Tees Valley	660,000	In question	DTVA
12	Bristol Built-up Area	617,280	Yes	Bristol
13	Belfast Urban Area	595,879	Yes	Belfast IA and City
14	Leicester Built-up area	508,916	Yes	East Midlands
15	Edinburgh	482,005	Yes	Edinburgh
16	Brighton and Hove Built-up area	474,485	Yes	Gatwick
17	Bournemouth/Poole Built-up area	466,266	Yes	Bournemouth
18	Cardiff Built-up area	447,287	Yes	Cardiff
19	Stoke-on-Trent Built-up Area	372,775	Yes	Manchester
20	Coventry Built-up area	359,262	Yes	Birmingham
21	Sunderland Built-up area	335,415	Yes	Newcastle
22	Birkenhead Built-up area	325,264	Yes	Liverpool
23	Reading Built-up area	318,014	Yes	Heathrow
24	Kingston upon Hull Built-up area	314,018	Yes	Humberside
25	Preston Built-up area	313,322	Yes	Manchester

| Source: ONS 2018

2.31 The closure of the airport would mean that Tees Valley would be the only significant urban area in the United Kingdom not to have access to an airport.

2.32 The table below provides an assessment of the region in terms of population and Gross Value Add per capita:

Area	GVA Per Capita	Population
County Durham	£15,475	520,000
Northumberland	£15,951	315,000
Newcastle Upon Tyne	£26,232	293,000
Sunderland	£20,728	277,000
North Tyneside	£20,026	202,000
Gateshead	£21,661	201,000
Stockton on Tees	£20,257	195,000
South Tyneside	£14,341	149,000
Middlesbrough	£18,540	140,000
Redcar and Cleveland	£15,188	135,000
Darlington	£24,585	105,000
Hartlepool	£15,777	92,000
Yorkshire and Humber	£20,351	5,391,000
Regional Total/Average	£20,176	8,016,000

| Source: Durham Tees Valley Airport: Business Case, ICF (August 2018)

2.33 DTVA is one of seven airports servicing the North of England (maximum 3 hour journey time), with a combined population of 15,190,000. The airports include:

Airport	Total Number of Passengers
Doncaster/Sheffield	1,290,000
Durham Tees Valley	130,000
Humberside	170,000
Leeds/Bradford	4,020,000
Liverpool	4,860,000
Manchester	27,720,000
Newcastle	5,290,000
Total	43,480,000

| Source: Durham Tees Valley Airport: Business Case, ICF (August 2018);

2.34 The table below compares the historical performance of the airports servicing the region (in terms of passenger numbers and percentage of share of catchment area market):

Airport	2005	2009	2017
DTVA	0.902 (11%)	0.288 (5%)	0.128 (2%)
Newcastle	5.187 (61%)	4,569 (68%)	5.298 (60%)
Leeds Bradford	2.609 (7%)	2.553 (8%)	4.075(13%)
Manchester	22.083 (14%)	18.630 (11%)	27.774 (16%)
Total Market NE and N. Yorkshire	7,493,000	5,900,000	7,537,000
Proportion of DTVA Passengers from outside of core catchment area	4%	5%	5%

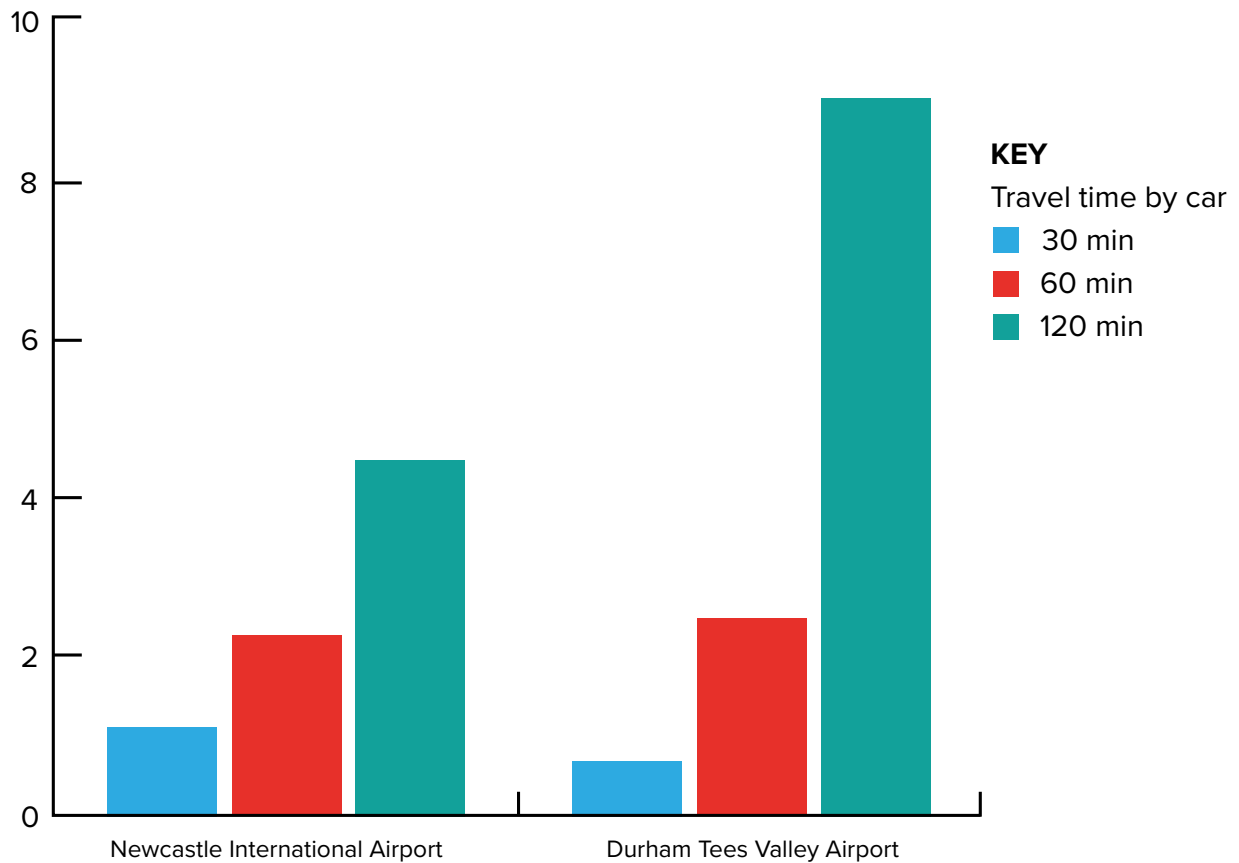
| Source: Future Scenarios for Durham Tees Valley Airport, York Aviation (June 2018).

2.35 Department for Transport statistics demonstrate the catchment population area for DTVA compares well to its closest competitor, Newcastle Airport. The table below notes the population living within specified travel times of the airport, calculated by driving time.

Airport Name	30 mins	60 mins	120 mins
Newcastle	1.1	2.3	4.5
Durham Tees Valley	0.7	2.5	9.0

| Source: DfT Transport Connectivity and Accessibility Statistics (updated June 2015).

Airport catchment / travel times



| Source: DfT Transport Connectivity and Accessibility Statistics (updated June 2015).

2.36 Benchmarking of the breakdown of business to leisure passengers using Newcastle, Bristol and Cardiff airports, assumed a ratio of 1:5 business to leisure breakdown. For DTVA this could equate to circa 24,000 business passenger movements annually. However given the routes presently on offer at DTVA it is probably closer to 75% business travel equating to 96,000 passenger movements annually.

PROPENSITY TO FLY

2.37 Based on the UK's ONS data for 2015, the North East has a propensity to fly (P2F) of between 1.9 and 2.1 trips per capita per annum. P2F is usually driven by a mix of factors such as:

- disposable income;
- pricing (which in turn is influenced by number of routes and choice of provider); and
- transport alternatives.

2.38 The Gross Value Add (GVA) per capita, a proxy for income levels, in the North East is 25% below the national average and as a result analysts would expect the region's P2F to reflect this income level and be **2.7 trips per capita**. The North East's P2F is actually 40% below the national average of 3.61 trips per capita, albeit that average is influenced by London's outlying P2F.

2.39 The following table identifies the reasons for selecting departure airport, which in turn impact on propensity to fly:

	Total (%)	Domestic Flights (%)	Short/mid haul (%)	Long haul (%)
Availability of flight route	56	79	72	60
Cost and convenience of getting to airport	55	48	52	53
Cheapest flights available	33	12	17	39
Airport facilities	8	36	39	8
Other	4	10	1	4

| Source: Passenger choice survey: Civil Aviation Authority Report (2011)

2.40 We have only assessed those issues most easily quantified and which have a material impact on choice of airport and propensity to fly:

- **Availability of flight route:** The following should be noted:
 - **DTVA:** Over the past decade, several airlines have exited the airport reducing its customer base to only a handful of carriers. Eastern is the airport’s second largest operator with 17% market share serving domestic routes such as Aberdeen and Jersey. The most significant in DTVA’s route map is summer seasonal destinations, along with other locations served from other NE airports. The summer seasonal market used to be served by charter operators and low cost companies such as Ryanair, Flybe, Easyjet but these routes have not been replaced following airline moves. DTVA also lacks domestic connectivity to London. While London can be reached within 2-3 hours by train, there is significant spill over to the capital and London hub airports which could be served by air rather than rail or road;
 - **Leeds/Bradford:** The airport’s route map is comparable to most UK regional airports with a strong focus on serving leisure destinations in Spain (Alicante, Malaga, Mallorca), domestically (London, Belfast, South/South West England) and European cities/hubs such as Dublin and Amsterdam; and
 - **Newcastle:** From a route perspective, Newcastle serves a wide range of domestic, short-haul and long-haul markets with the majority of frequencies bound for locations in Europe such as summer beach destinations in Spain, Greece and Portugal or capital cities/hubs such as Amsterdam, Paris and Dublin. Newcastle also has long haul services to Dubai, Orlando, Cancun and Barbados, reflecting its passenger and airline mix.
- **Cheapest flights available:** In a relatively static market the main beneficiary from the reduction in the number of passengers using DTVA between 2005 and 2017 is Leeds Bradford Airport, which has grown its market share substantially over that time. The key feature of competition with Leeds Bradford is the relative cost for airlines and passengers in terms of direct charges (i.e. excluding the costs of access and car parking). As noted above, these costs are a material factor in attracting airlines to use an airport as they ultimately impact on the air fare that can be charged and how many passengers can be attracted. The following table illustrates the relative costs per airport, using Leeds Bradford as a baseline (Source: Leigh Fisher):
 - **Doncaster Sheffield +1%;**
 - **Newcastle +2%;**
 - **Humberside +16%; and**
 - **Durham Tees Valley +20%**
- **Cost and convenience of getting to airport:** The immediate catchment population for DTVA (assuming a one hour travel distance) is 2.5 million, however in the interests of prudence and calculating the direct impact to the region, we have used a figure of 670,000 (the Tees Valley population) in this section.

- 2.41 In summary, the present lack of competition due to the low number of flights (compounded and caused by relatively high flight costs) is having a negative effect on both propensity to fly and overall volume **(considering that DTVA is potentially accounting for only 10% of Tees Valley flights³ even assuming the lower propensity to fly).**
- 2.42 A functioning airport would ensure greater choice through enhanced route availability. Assuming a propensity to fly figure of 2.7 (the national average) for the wider North East, this would increase the number of passenger movements to circa 8.6million per annum across the wider region. Assuming a 10% take up by DTVA this could equate to circa 860,000 passenger movements (comparable to 2005).
- 2.43 Increasing the propensity to fly to 25% below the national average would return Durham Tees Valley Airport back to its 2005 level, and illustrates extensive untapped demand. A more proactive route development strategy could further expand choice and in turn further stimulate demand, in particular the attraction of a low cost carrier.

Freight

- 2.44 The table below provides historical trend analysis for the amount of air freight (by tonne) from a selection of airports:

Airport	2007	2009	2017
DTVA	786	298	4
Newcastle	785	2,597	5,482
Leeds/Bradford	109	359	15
Manchester	165,366	102,543	120,181
Total UK airports	2,325,238	2,047,861	2,622,496

| Source: UK Airport Data - Freight: Civil Aviation Authority (2018)

- 2.45 The table clearly illustrates a slight increase in air freight over the period of 297,258 tonnes or 11% across the UK since 2007, compared to a decline in air freight of 41,364 tonnes or 25% across the North. Newcastle has significantly bucked the trend, but overall demand has declined. This is particularly the case for DTVA which has witnessed a reduction of 782 tonnes or 99.5% in air freight.
- 2.46 In summary, assuming air freight had continued to grow at the UK level of 11%, the output gap for DTVA would be 868 tonnes per annum, which assuming revenue per tonne of £1,000, is a direct loss of £868,000 per annum (notwithstanding wider catalytic effects).

Conclusion

- 2.47 It is our contention that a better functioning airport supported by a partner focused on economic development could realistically achieve circa 860,000 passenger movements per year and 868 tonnes of air freight per annum (extrapolated from ICF (2018) and CAA (2018) analysis).

³ Total population of catchment area 670,000 x 2 (propensity to fly for North East) = 1.34m flights

2.48 However independent analysis carried out by ICF has identified that driven management and the attraction of a low cost carrier has the potential to achieve even higher passenger numbers (1,579,000) and consequently a return to financial viability by year 8.

FINANCIAL VIABILITY OF THE PROPERTY PROPOSITION

2.49 Key to improving the financial viability of the airport is maximising its wider property assets and in particular developing a key cluster which maximises the co-locational benefits of close proximity to the airport. This can be assessed through the review of the following indicators:

- Occupancy Rates;
- Assessment of current provision; and
- Industrial Clustering:

2.50 The following reviews the current property proposition at the airport in terms of overall occupancy rate and its type of use:

- There is an occupancy rate of 92%, meaning that 8% of rentable space is currently vacant;
- Most vacant space is presently unlettable due to size, configuration or general quality; and
- Commercial take-up is mainly within the (comparatively lower value adding) logistics sector (circa 90%).

2.51 The following assessment of current provision was undertaken by Turner and Townsend and includes the views of existing tenants:

- The existing site is challenged in many ways but most notably from a lack of public transport connectivity and tired infrastructure;
- A visual inspection of the infrastructure shows the decline in the quality of the hard and soft landscaping areas and that good housekeeping is needed to maintain reasonable standards. This needs to be balanced between achieving a high standard of environment and the tenants' wish to pay service charges.
- There was unanimous complaint that the provision of broadband was lamentably poor at around 6MB. Investment is needed to provide 100Mb and continuous improvement to provide the highest capacity of broadband and to keep the provision up to date and investment continued to make it attractive to potential users and occupiers;
- Several of the occupiers had been in occupation for many years and were anxious that the declared planning position of allowing only 'airport use' to occupy the airport would result in their being prevented from investing further or having to vacate; and
- There was a general wish to remain at the airport and to support growth.

2.52 When taken in conjunction with the review of present occupancy and use, the aforementioned stakeholder feedback identifies many opportunities for increasing occupancy and a move to higher value-adding sectors (those sectors which would benefit from co-location on the airport) taking up airport premises.

2.53 The Peel Masterplan identified ambitious plans for developing the site, including:

- | | |
|---|--|
| <ul style="list-style-type: none">■ Northside development area:<ul style="list-style-type: none">• 9,600 sq m of office accommodation;• 1,900 sq m of workshops; and• 12,170 sq m of warehousing. | <ul style="list-style-type: none">■ Southside development area:<ul style="list-style-type: none">• 176,900 sq m of industrial space. |
|---|--|

2.54 The following table places these proposals in the context of the wider Tees Valley property proposition and notes the following:

	Offices (sqm)	Industrial (sqm)	Total (sqm)
Darlington	173,000	798,000	971,000
Hartlepool	71,000	550,000	62,000
Middlesbrough	212,000	568,000	780,000
Redcar & Cleveland	127,000	670,000	797,000
Stockton-on-Tees	330,000	1,215,000	1,545,000
Tees Valley	913,000	3,801,000z	4,714,000

| **Source: Stockton on Tees Employment and Land Review (2018)**

2.55 The overall vacancy rate in Tees Valley equates to around 9% of units and 6% of floorspace. In a healthy property market a vacancy rate of 5 to 10% allows market churn and facilitates the changing floorspace requirements of expanding businesses to be accommodated but avoids high volumes of floor space on the market for a prolonged period.

2.56 It is important to note that the build-out of the Southside (the more commercial of the two propositions) would equate to 5% of the total Tees Valley property proposition and would be at least 5 times the annual completion rate for the region.

2.57 It has been estimated that it would create circa 1,861 jobs (at full occupancy):

	Sum of floorspace (m²)	Gross Jobs	Net Jobs (including leakage)
Phase 1	7,920	133	81
Phase 2	24,367	455	277
Phase 3	57,914	1,170	713
Phase 4	86,502	1,297	790
Total	176,763	3,055	1,861

| **Source Regeneris Consultants**

2.58 However, the following should be noted:

- Leakage and displacement effects could be minimised through the careful phasing and marketing of the development as part of the wider Tees Valley property proposition; and
- Careful marketing in conjunction with additional powers (such as enterprise zone and/or Mayoral Development Corporation status) could bring with it a greater focus on higher value adding sectors, which may have a longer lead-in time, but would be of greater strategic importance to the region.

2.59 The assumed added value of (patient) public management of the airport property proposition could equate to 180 additional jobs and an increase of GVA per FTE of 50% per job leading to an additional £50million per annum solely for the Southside business park.

WIDER ECONOMIC IMPACT

2.60 The final core benefit of the airport is its impact on the wider economy, in particular ensuring connectivity, facilitating access to key supply chains and as a gateway for increasing visitor numbers. This can be assessed through the following variables:

- Perceptions of the region;
- Supply chain support; and
- Visitor income.

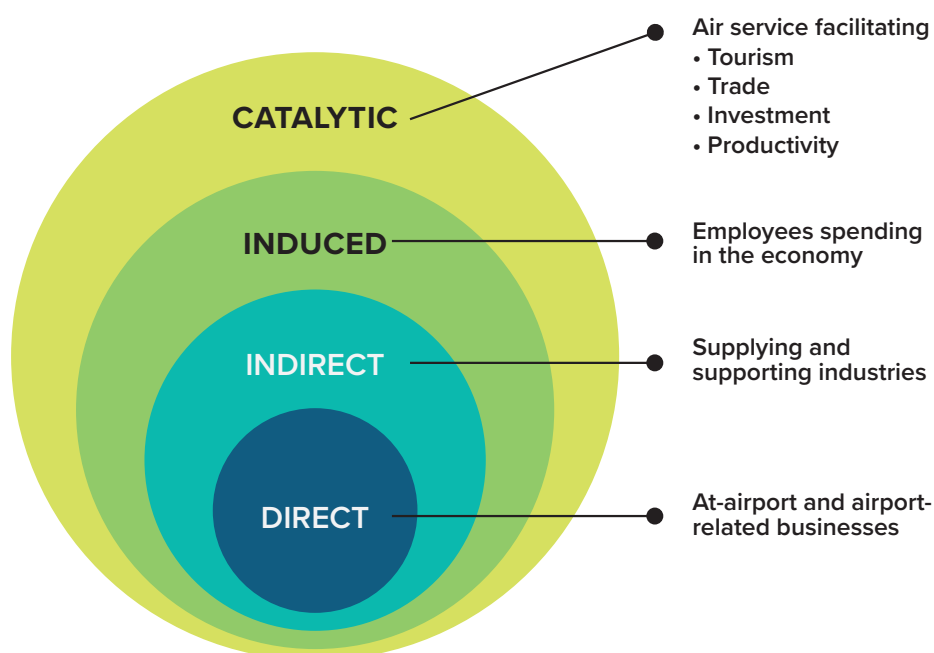
2.61 For regions like Tees Valley, the importance of the connectivity afforded by domestic and international air links, whether in addressing perceptions of peripherality, helping to facilitate trade, attract inward investment or stimulate inbound tourism is now well recognised in Government policy. If appropriate airport infrastructure is foregone locally, then the ability to capture the economic benefits associated with new air services will be lost altogether.

2.62 Reliance on air services from airports in neighbouring regions is rarely a satisfactory means of delivering strategically important connectivity. This is true, even when the immediate alternatives are only 60-90 minutes away and a global hub offering inter-continental services can be accessed within three hours, as is the case with DTVA for both Manchester and London airports.

CATALYTIC IMPACT

2.63 There are two kinds of economic effects related to airports. The first, the generation of employment, income and capital investment comes from the process of providing airport services. The second, the dynamic economic 'catalytic' or 'spin-off' benefits, include tourism, improved export levels and inward investment and are stimulated by the presence of an airport serving the wider sub-region.

2.64 These are summarised in the following chart:



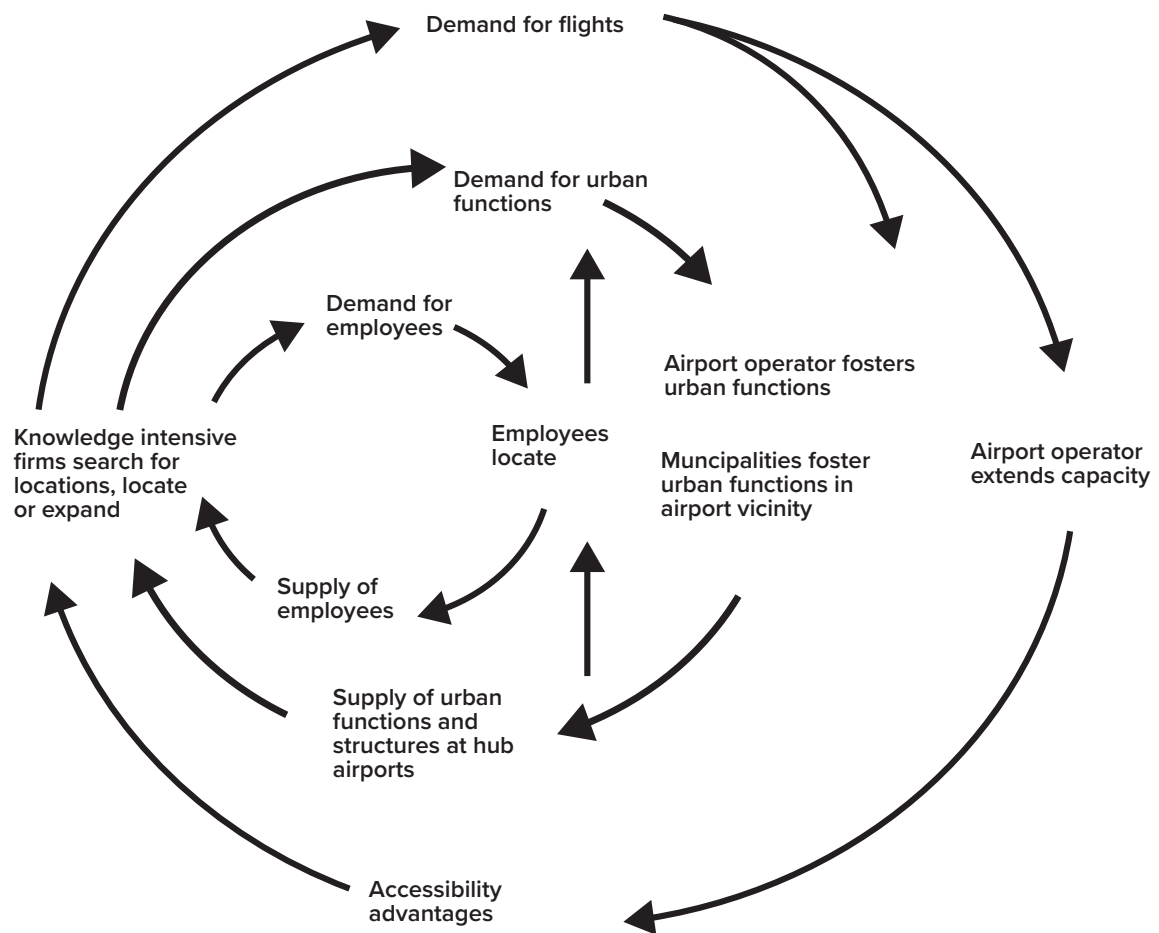
Source: Categories of Economic Impact Generated and Facilitated by European Airports: Economic Impact of European Airports, InterVISTAS 2015.

2.65 Recent economic impact assessments of DTVA have focused solely on the direct economic impacts of the airport, however as the earlier policy review has identified, the ‘substantive worth’ of the airport is as a key strategic asset and this analysis will seek to monetise the following benefits:

- Jobs/Gross Value Add (Output) (Direct, Indirect and Induced); and
- The Catalytic effect (Increased consumer choice and business activity related to tourism, inward investment and productivity).

2.66 As noted above, any airport has both direct and indirect (catalytic) effects. These catalytic effects may arise from enhanced air connectivity (e.g. trade, tourism, inward investment and productivity) and cluster effects (i.e. agglomeration economies and spill-over effects) associated with aviation related and non-aeronautical development in and outside the operational boundary of the airport.

2.67 The following chart provides a stylised model of the relationship between priority sectors, the region and air transport services:



Source: Thierstein et al (2011)

2.68 Thierstein’s conceptualisation defines the positive feedback loops between the sector concerned and aviation and identifies three main forms of benefit:

- By allowing better understanding of markets and competitors (especially internationally) so that resources may be redirected to the most productive uses and increase international trade in goods, services and tourism;
- By facilitating knowledge sharing and access to new markets and suppliers, more sophisticated technologies and new ways of working may be identified helping to improve cost efficiency and raise domestic productivity; and
- By enabling inward investment to be attracted, capital intensity can be increased, raising per capita output and the scale of trading activity.

2.69 Oxford Economic Forecasting (2006) demonstrated that a good air transport network positively affects economic growth by improving efficiency, boosting investments and encouraging innovation. It states:

“The improvement in productivity in firms outside the aviation sector comes through two main channels: through the effects on domestic firms of increased access to foreign markets and increased foreign competition in the home market, and through the freer movement of investment capital and workers between countries.”

2.70 The following table provides an assessment of the propensity to fly (both passenger and cargo) for the seven priority sectors in the region and also informs the wider catalytic effects:

Sector	Propensity to fly (Passengers)	Propensity to fly (Air Cargo)
Advanced Manufacturing	Yes	Yes
Chemicals and Energy	Yes	Yes
Life-sciences	Yes	Yes
Logistics	No	No
Digital	Yes	No
Culture, Creative and Leisure	Yes	No
Business & Professional Services	Yes	No

2.71 The table below provides a breakdown of the scale of each sector in terms of total jobs and output (GVA):

Sector	Jobs	GVA
Advanced Manufacturing	27,180	£1.8billion
Chemicals & Energy	7,600	£843 million
Life-sciences	1,000	£90 million
Logistics	16,500	£533 million
Digital	5,000	£285 million
Culture, Creative and Leisure	21,180	£332 million
Business & Professional Services	34,700	£1.65 billion
Total Business Base	318,900	£12.7 billion

| Source: SEP Sector Action Plans (2017)

2.72 As noted above the sectors which are likely to have a catalytic effect as a result of air connectivity are: Advanced Manufacturing, Chemicals & Energy, Life-sciences, Digital and Business & Professional services, which between them have a combined output of £4.6bn.

Measuring the catalytic effect

2.73 This is a two stage process:

- the first stage is to measure connectivity and develop a connectivity index⁴ for the airport; and
- The second stage is to apply the InterVistas calculation of economic impact⁵ as a result of an increase in connectivity (based on an increase in the connectivity index).

2.74 The following table utilises the growth scenarios developed by ICF and impact assumptions originally developed by Regeneris Consultants, and augmented by InterVistas analysis of Catalytic Impacts:

Scenarios		Jobs	GVA	Catalytic Impact	Total (Direct, Indirect, Induced and Catalytic Impacts)
ICF Organic Growth ^[1]	Direct	636	£33m	£14.6m & 324 jobs	£57.4m & 1,145 jobs
	Indirect/ Induced	185.5	£9.8m		
	Total	821.5	£42.8m		
ICF Seasonal Growth ^[2]	Direct	802	£49.8	£41m & 911 jobs	£105.6m & 1,947 jobs
	Indirect/ induced	234	£14.8m		
	Total	1,036	£64.6m		
Optimistic ^[3]	Direct	3,419	£211m	£147m & 3,266 jobs	£421m & 7,682 jobs
	Indirect/ induced	997	£63m		
	Total	4,416	£274m		

| Source: ICF and Tees Valley Combined Authority (2018)

⁴Connectivity index is calculated as (Number of destinations x weekly frequency x seats per flight/weighted by the size of the destination airport)

⁵A 10% increase in connectivity is associated with a 0.5% increase in GDP per capita. The assessment of economic impact using the catalytic approach has been endorsed through the following studies: European Airports Council (2004)- The Social and Economic Impact of Airports in Europe and CAPA (2015) 'Europe's Airports: Economic Impact – the theory and practice

^[1]Scenario 1: Organic: It is assumed that DTVA's market share remains constant relative to its North East peers and grows at the market rate. This scenario reflects no material change to how DTVA operates today with growth coming as a result of improvements to load factors on existing routes and marginal increases in capacity.

^[2]Scenario 2: Seasonal/Regional: It is assumed that more active management allows DTVA to attract seasonal services, bringing its service levels to the standard seen at other UK airports. It is also assumed that DTVA attracts a regional operator to better serve the domestic and short haul market. For this scenario, ICF have adopted a bottom up approach at the route level based on regional demand and benchmarking to other UK airports.

^[3]Scenario 3: Low Cost Carrier (LCC): It is assumed that driven management is able to attract an established LCC from a regional competitor airport to DTVA. It is assumed that the carrier moves all operations to DTVA over a two year period, with minor disruption to its market share. It is assumed that regional operations are established in addition to the LCC traffic, but at a lower throughput given the competition from the LCC operator. It is assumed that the LCC provides services to cater for the summer seasonal demand and that therefore only a limited charter operation remains at DTVA outside the LCC's network.

2.75 In summary, the airport has the potential to provide £363.6m of **additional** GVA through wider (catalytic) benefits.

Mitigation of identified market failures

2.76 At the time of writing, the airport is viewed by the market as not being commercially viable, however, as is demonstrated above the economic worth of this strategic asset far exceeds the short to medium term loss position.

2.77 However, in such a circumstance it is not feasible for a private concern to carry the financial cost of enabling a wider economic benefit. In this instance the airport may be considered that rare thing in economics a genuine public good in terms of its wider economic impact as it has the following characteristic:

- **Non rival/non-excludable:** Where one person's consumption of the wider economic impact does not prevent anyone else from benefiting from it.

2.78 The present financial position means that only the public sector and in particular a body charged with ensuring the wider economic development of the region would be in the position to fund/part fund a facility that indirectly supports the continuing wider economic benefits attributed to the airport.

2.79 The proposed purchase of the airport is also designed to address the following market failures associated with the provision of a public good, including:

- **Coordination Failure:** The ability and institutional patience to coordinate and fund the range of interventions essential to fully commercialise the operation of the airport and ensure the maximum economic benefit of the wider business park proposition; and
- **Funding Gap:** The public sector is the only body which has the risk appetite and willingness to wait on a financial return necessary to fund a medium term commitment of the scope and scale of the airport and the wider business park proposition.

2.80 Indicative activities related to developing the airport include:

- The acquisition of the airport and wider business park proposition;
- Establishment of a sector specific business growth hub and ensuring its complementarity with the wider business support structure across the region;
- Securing new routes, in particular access to main hubs such as Heathrow;
- Supporting inward investment to the sector specific business growth hub and ultimately secure enterprise zone status from central Government;
- Strategic investment in road and rail infrastructure; and
- Leading discussions with the Ministry of Defence to establish a potential joint military-civilian airport hub.

2.81 Individually these interventions will enhance the commercial viability of the airport, but their cumulative impact over the next 10 years will create the necessary step change to the region.

2.82 All of the aforementioned activities are judged to be beyond the ability of a private sector enterprise to deliver on its own, but can be delivered by a body such as the Combined Authority which has a strategic role in economic development and transport, and has direct access to central Government.

2.83 The table below reviews the ownership structure of other comparable regional airports and concludes that rather than being the exception, regaining control by the relevant municipality seems to be the guiding principle (accounting for 55% of airports) in ensuring sustainability in the regional airport sector:

Airport	Public Ownership
Aberdeen	No
Belfast International	No
Birmingham	Yes (49%)
Blackpool	Yes (5%)
Bournemouth	Yes (64%)
Bristol	No
Cardiff	Yes (100%)
Durham Tees Valley	Yes (25%)
East Midlands	Yes (64%)
Edinburgh	No
Exeter	No
George Best Belfast City	No
Glasgow	No
Glasgow Prestwick	Yes (100%)
Humberside	Yes (18%)
Inverness	Yes (100%)
Leeds Bradford	No
Liverpool John Lennon	No
Manchester	Yes (64%)
Newcastle	Yes (51%)
Norwich	Yes (19.9%)
Robin Hood Doncaster Sheffield	No

| Source: House of Commons Library - Assessment of Regional Airports (2016)

2.84 The move to enhanced public ownership/private sector operating partner⁶ is in line with the most recent Aviation Strategy (2018) which continues to encourage greater regional provision, and Transport for the North (TfN) strategy which also calls for more destinations to be serviced from Northern Airports (a target of 30 million passengers a year).

⁶ Such public sector provision of infrastructure is in accordance with economic theory: Baumol's Contestable markets theory. A contestable market is one with zero entry and exit costs. This means there are no barriers to entry and no barriers to exit.

Case study evidence

2.85 The following table demonstrates through the use of a case study how the public acquisition of an airport may mitigate the identified market failures of provision of a public good:

CARDIFF INTERNATIONAL AIRPORT

BACKGROUND

When the Welsh Government bought CIA for circa £52m in March 2013, the price paid was reported by industry commentators to be at a premium compared to that which a private sector investor would have paid. However, this ignored a series of factors that justify a valuation well above the kind of figure suggested by simplistic use of multipliers of EBITDA including:

- The apparent willingness of Abertis to continue to run down the condition of the asset and lose market share rather than make further investment (with the possible result that ultimately the airport would have closed or been moth-balled);
- The consequent need to accept an acquisition 'premium' in order to persuade a recalcitrant seller to agree to an early disposal when doing so would crystallise their losses. Abertis claimed the disposal price reflected the value of the asset in their accounts, but this public position almost certainly overlooked earlier write downs of the airport's book value as its profitability diminished between 2008-12; and
- The opportunity that the Airport represents to a new owner, wise enough to recognise its underlying commercial value, and with the resources and commitment to realise its long-term potential, if well run, to generate material investment returns is significant.

RATIONALE FOR INVESTMENT

Under Abertis's stewardship, CIA went into a period of significant decline (2,094m (2007) to 1.02m in 2014) and the Welsh Government faced a choice of acting to ensure Wales' capital city continued to have its own airport (as every other capital city in Europe does), or risking further deterioration, loss of accessibility and eventual closure. That it chose to take over the airport has been politically challenging and involves some financial risk, but it also gives Cardiff Capital region and South Wales more broadly, the opportunity to grasp the substantial economic opportunities that ownership of Cardiff and St Athan airports bestows. These include:

- The creation of a thriving regional airport with prospectively significant future realisable asset value;
- Retention of a symbolically important gateway to Wales and one that is important in realising some of the broader ambitions of the Capital Region board to attract major events and investment in new venues;
- Securing enhanced domestic and international route connectivity that will support many of the priority sectors identified in the Welsh Government's economic strategy; and
- Underpinning and expansion of a key economic cluster that is vital to the wider economy of South Wales;

EMERGING INTERVENTIONS AT CARDIFF:

- The acquisition of the airport and wider business park proposition;
- Establishment of a sector specific business growth hub and ensuring its complementarity with the wider business support structure across the region;
- Securing new routes, in particular access to main hubs such as Heathrow;
- Strategic investment in road and rail infrastructure; and

Since the Welsh Government acquired the business from Spanish conglomerate Abertis in 2013, passenger numbers have grown by 50%.

2.86 The following table summarises the assessment of need into a SWOT analysis:

Strengths	Weaknesses
<ul style="list-style-type: none"> ■ The airport has a catchment population of circa 670,000 residents within the Tees Valley and circa 2.5m in wider 1 hour drive time; ■ The airport is currently operational and with a highly recognised brand; ■ The airport has a runway of sufficient scale to be able to cope with intercontinental flights; ■ The airport is close to major road and rail infrastructure and could be a main logistics hub; 	<ul style="list-style-type: none"> ■ There are currently too few scheduled routes; ■ Freight carriage through the airport is at an all-time low; ■ The airport is viewed as having a high cost per passenger, exacerbated by high fixed costs and low passenger numbers;
Opportunity	Threat
<ul style="list-style-type: none"> ■ The airport is being sold with an experienced management team in place; ■ The attraction of one low cost carrier to the airport would be sufficient to return the airport back to profitability; ■ The propensity to fly in the North East is lower than national averages, meaning that there is significant untapped demand; ■ Terms of trade moving towards diversification out side of Europe, need for more transatlantic flights; ■ The airport is a key strategic asset in the attraction and retention of inward investment, particularly in relation to the following air freight intensive sectors: <ul style="list-style-type: none"> • Advanced manufacturing; • Biologics/Pharmaceuticals; • Logistics. ■ Sizeable inward investment opportunities across the region, which should increase the demand for international connectivity, beyond the existing Schiphol route; ■ The airport has significant land which could be utilised for wider economic development purposes 	<ul style="list-style-type: none"> ■ The airport is currently operating at a loss and is under risk of closure; ■ The current airport management have pledged to develop housing options on the site, which increase any future purchase price at the same time as diminishing the commercial viability of the site for aviation and wider economic development purposes; ■ There has been under-investment in the physical infrastructure of the airport; ■ There is increasing price sensitivity in the airline industry and its selection of airports; ■ The closure of the airport would exacerbate negative perceptions of the Tees Valley amongst potential inward investors

2.87 The following table addresses the opportunities and threats in the SWOT to create a TOWS summary which was used to develop the proposal:

<p>Internal Strengths and External Opportunities (S-O) – how can they use the strengths to benefit from existing external opportunities?</p>	<p>Internal Strengths and External Threats (S-T) how can they benefit from their strengths to avoid or lessen (potential) external threats?</p>
<ul style="list-style-type: none"> ■ Ensure the airport is controlled by an organisation which recognises its key strategic role within the region; ■ Secure the operational functions of the airport, by attracting more and varied (Business focused) routes and specifically the attraction of a low cost carrier. 	<ul style="list-style-type: none"> ■ Need to reduce the high cost per passenger, by increasing passenger numbers at same time as reducing overhead costs;
<p>Internal Weaknesses and External Opportunities (W-O) – how can they use opportunities to overcome the organisation’s internal weaknesses?</p>	<p>Internal Weaknesses and External Threats (W-T) – how can they minimise weaknesses and thus avoid potential threats</p>
<ul style="list-style-type: none"> ■ Maximise the freight and co-locational benefits of sympathetic (priority sectors) inward investment on to the airport site; 	<ul style="list-style-type: none"> ■ Purchase the airport before Peel has an opportunity to invest in a large scale housing development;

Constraints

2.88 The proposed airport acquisition has been developed to address the following constraints:

- **Timeframe:** There is a need to purchase the airport prior to contracts being finalised to build houses on a key part of the site. This would significantly increase the potential purchase price of the airport and consequently reduce the likelihood of sale by Peel and the continuing use of the site as a functional airport and would prejudice wider commercial development of the site;
- **Regulatory environment:** The purchase price of the airport reflects the opportunity cost in ensuring compliance with the complex regulatory environment faced by airports;
- **Property proposition:** The sale includes not just the airport but also the wider property proposition within the airport environs;
- **Management structure:** The existing operational team will be included in the transfer of responsibilities; and
- **Choice of operator:** Given the tight regulatory environment, there is a significant constraint as to the selection of operator partners.

Objectives and Critical Success Factors

2.89 The critical success factors (CSFs) are the attributes essential to the successful delivery of the airport acquisition and subsequent operation. The CSFs will be used to assess the long list of options prior to the economic appraisal being undertaken. CSFs should encompass:

- **Greater consumer choice:** This relates to the increased number of routes and the frequency of flights resulting in increased passenger numbers;
- **Financial viability:** This relates to the airport (both aviation and property related activities) returning to surplus;
- **Wider economic impact:** This relates to enhanced supply chain activity, a rough proxy of which is enhanced freight activity at the airport (particularly in higher value adding sectors such as pharmaceuticals and advanced engineering);
- **Timeliness of delivery:** This relates to ensuring no break in service; and
- **Regulatory compliance:** This relates to ensuring that the airport continues to operate in line with regulatory requirements.

2.90 The SMART objectives for the acquisition and subsequent operation of the airport include:

- Purchase of the airport by end March 2019;
- The attraction of 10 additional routes by 2022; of which:
 - **50% are chartered; and**
 - **50% are scheduled.**
- The attraction of a low cost carrier by 2022;
- The increase in freight tonnage to 500 tonnes per annum by 2023;
- The tenfold increase in passenger numbers by 2023, of which:
 - **25% are business passengers;**
 - **75% are recreational passengers**
- Increase the propensity of Tees Valley residents to fly to the national average of 3.41 flights per annum;

Conclusion

2.91 The airport is currently operating at a loss, with declining passenger movements and negligible freight activity, at a time when neighbouring airports within the wider North of England are continuing to grow at or above national trend.

2.92 There is a need for public intervention to avoid closure of a strategic asset and the consequent reduction in annual output of £57.4 million or 1,145 jobs (including 634 jobs and £33m of output directly related to the airport) across the region.

2.93 Devolved administrations like the Welsh and Scottish Governments have recognised the strategic importance of airports. The Welsh Government has brought back into public control Cardiff on the principal of ensuring sustainable regional economic growth. Cardiff has significantly improved through a combination of public ownership and subsequent partnering with an experienced (private sector) airport management company.

2.94 Although it is possible the airport may continue to require an ongoing direct financial subsidy it will have a sizeable positive economic impact on the region. Failure to support the airport will deprive the region of a significant economic asset.

3. Economic Case

Introduction

3.1 This section sets out the proposed options related to the provision of an airport within the Tees Valley.

3.2 The section is structured as follows:

- Options Development;
- Long-list of Options;
- Short- Listing of Options;
- Economic Appraisal:
 - **Costs;**
 - **Benefits;**
 - **Non-Monetary Assessment; and**
 - **Risk Assessment**
- Preferred Option.

Options Development

3.3 When drafting the long list of options consideration was given to two principal factors: ownership structure/control and the expertise of possible delivery partners. Consequently, the following long list of options has been developed:

Options	Description
Option 1: Status Quo Option: Peel continues to run the airport and it closes in 2021	This option makes the following assumptions: <ul style="list-style-type: none"> • Airport continues to make a loss; • The airport function closes; • Peel decides to develop the former airport site for residential purposes.
Option 2: Do something: Peel are supported to deliver a turnaround plan	This option identifies the ongoing financial problems faced by Peel and provides financial support to ensure the continued operation of the airport. The option assumes that Peel still have the inclination to operate the airport and that they have the discretion to use funds provided by the public sector.
Option 3: Do something: Peel are bought out by another commercial organisation	This option assumes a third party commercial organisation recognises the potential financial viability of the airport, purchases it for the market rate and subsequently operates it without public subsidy. It must be noted that the airport function is currently operating at a loss.

<p>Option 4: Do something: Public sector becomes the majority shareholder of the airport, with Peel retaining a minority share</p>	<p>This option assumes that the public sector is free to purchase a controlling share of the airport from Peel, who are also minded to have a minority shareholding and to continue managing the airport.</p> <p>This would mean Peel ceding overall control of the airport and continuing to have to fund (at a lower rate) ongoing losses.</p>
<p>Option 5: Do something: The Combined Authority takes lease of airport and operates it</p>	<p>This option assumes that Peel are minded to lease (for a defined period – circa 10 years) the airport to the Combined Authority who subsequently operate it.</p> <p>This option means that all risk is transferred to the Combined Authority without the benefit of having an asset for potential resale, if the airport cannot be turned around.</p>
<p>Option 6: Do something: The Combined Authority buys airport and operates it</p>	<p>This option assumes that Peel are minded to sell the airport to the Combined Authority who subsequently operate it.</p> <p>Responsibility rests with the Combined Authority, however they do have an asset for potential resale.</p>
<p>Option 7: Do something: The Combined Authority buys airport and sub-contracts out management to a third party;</p>	<p>This option assumes that Peel are minded to sell the airport to the Combined Authority and that the Combined Authority has a partner jointly responsible for developing the airport proposition.</p> <p>Although the Combined Authority will still incur risk, the inclusion of a specialist partner mitigates a number of operational issues such as the ability to attract additional routes and ensuring regulatory compliance.</p>
<p>Option 8: Do something: The Combined Authority buys airport with a third party investor under a joint venture who also act as an operating partner</p>	<p>This option assumes that Peel are minded to sell the airport to the Combined Authority and a third party investor, who is also responsible for developing the airport proposition.</p> <p>The cost of purchasing and subsequently running the airport are shared between the Combined Authority and the third party investor and the inclusion of a specialist partner mitigates a number of operational risks such as the ability to attract additional routes and ensuring regulatory compliance.</p>
<p>Option 9: Do something: Allow the airport to close and establish a new airport on another site</p>	<p>This option assumes that Peel close the airport and that in order to ensure access to an aviation function within the region, a new airport is developed.</p> <p>Since there is no existing alternative within the region, this necessitates the purchase of a site, the provision of infrastructure, ensuring regulatory compliance and subsequent promotion of a new brand and entity.</p> <p>It is anticipated that such a replacement airport would take between 10-15 years to be developed and could cost in the region of £200-250 million⁷. UK airport construction is likely to cost considerably more than this.</p>

⁷Based on Department for International Development estimates for the construction of a new airport (2018).

Short Listing of Options

3.4 The table below shows the identified options assessed against the SMART Objectives and Critical success factors outlined in the strategic case section. Any option which does not score yes against each criteria has not been shortlisted:

	Option 1	Option 2	Option 3	Option 4	Option 5	Option 6	Option 7	Option 8	Option 9
Critical Success factors									
Greater consumer choice:	No	Yes	Yes	Yes	No	No	Yes	Yes	No
Financial viability:	No	Yes	No	No	No	No	Yes	Yes	No
Ensure wider economic impact: can be delivered	No	Partial	No	Yes	Yes	Yes	Yes	Yes	No
Timeliness of delivery:	No	Yes	Yes	Yes	No	No	Yes	Yes	No
Regulatory compliance:	No	Yes	Yes	Yes	No	No	Yes	Yes	No
SMART Objectives									
Purchase of the airport by March 2019;	No	No	No	No	No	No	Yes	Yes	No
The attraction of a low cost carrier by 2022;	No	Yes	No	No	No	No	Yes	Yes	No
The tenfold increase in passenger numbers by 2023	No	Yes	No	No	No	No	Yes	Yes	No
The increase in freight tonnage up to 500 tonnes per annum by 2023;	No	Yes	No	No	No	No	Yes	Yes	No

SHORTLISTED:

Option 1: Status Quo Option: Peel continues to run the airport and it closes in 2021;

Option 2: Do something: Peel are supported to deliver a turnaround plan;

Option 7: Do something: The Combined Authority buys airport and sub-contracts out management to a third party; and

Option 8: Do something: The Combined Authority buys airport with a third party under a joint venture - this company also acts as an operating partner.

NOT SHORTLISTED

■ **Option 3:** Do something: Peel are bought out by another commercial organisation:

Rationale: Given the current financial position it is highly unlikely that another commercial organisation would choose to invest in the airport without public subsidy.

■ **Option 4:** Do something: Public sector becomes the majority shareholder of the airport with Peel retaining a minority shareholding;

Rationale: This option is highly unlikely as there is little appetite by Peel to become a junior partner and at the same time continue to share the ongoing costs and risks of operating an airport they wish to close.

■ **Option 5:** Do something: The Combined Authority takes lease of the airport and operates it;

Rationale: This is not considered further due to concerns regarding deliverability and the fact that the Combined Authority only gains risk but does not get a tangible asset.

■ **Option 6:** Do something: The Combined Authority buys airport and operates it itself;

Rationale: This has been rejected due to concerns regarding deliverability i.e. Combined Authority does not have the capacity or capability to run an airport.

■ **Option 9:** Do something: Allow the airport to close and establish a new airport on another site.

Rationale: This has been rejected due to concerns regarding deliverability i.e. the capital costs are entirely prohibitive, build out would take at least ten years, and it would require the availability of a suitable site for development - this is unlikely to be available.

Economic Appraisal

SENSITIVITY ANALYSIS

3.5 Where deemed relevant, short-listed options will be assessed against the following scenarios developed by ICF (which include costs and benefits):

- **Scenario 1: Organic:** It is assumed that DTVA's market share remains constant relative to its North East peers and grows at the market rate. This scenario reflects no material change to how DTVA operates today with growth coming as a result of improvements to load factors on existing routes and marginal increases in capacity;
- **Scenario 2: Seasonal/Regional:** It is assumed that more active management allows DTVA to attract seasonal services, bringing its service levels to the standard seen at other UK airports. It is also assumed that DTVA attracts a regional operator to better service the domestic and short haul market. For this scenario, ICF have adopted a bottom up approach at the route level based on regional demand and benchmarking to other UK airports;
- **Scenario 3: Low Cost Carrier (LCC):** It is assumed that driven management is able to attract an established LCC from a regional competitor airport to DTVA. It is assumed that the carrier moves all operations to DTVA over a two year period, with minor disruption to its market share. It is assumed that regional operations are established in addition to the LCC traffic, but at a lower throughput given the competition from the LCC operator. It is assumed that the LCC provides services to cater for the summer seasonal demand and that therefore only a limited charter operation remains at DTVA outside the LCC's network.

COSTS

3.6 For each shortlisted option, the associated cash flows have been reviewed over a thirty five year appraisal period.

3.7 As per Green Book Guidance, the economic case considers all quantifiable costs, benefits and risks from the perspective of society as a whole – the public, private and third sectors. Outlined below are the estimated high-level capital and revenue costs and the benefits associated with each of the short-listed options.

■ **Option 1: Status Quo Option: Peel continues to run the airport and it closes in 2021**

3.8 There is no direct cost to the public purse, however Peel would still incur losses up until 2021.

■ **Option 2: Do something: Peel are supported to deliver a turnaround plan**

3.9 This option is based on a submission made by the Combined Authority to DTVA in 2017: 'Creating a sustainable flourishing airport: A development programme for growth at Durham Tees Valley Airport.' It involved funding for the following actions:

- Establishing a growth trajectory for Durham Tees Valley Airport and ensuring long term financial sustainability by 2021;
- Retaining existing flights, establishing new routes and paving the way for the re-establishment of flights to an expanded Heathrow;
- Establishing Durham Tees Valley as a business growth hub, opening up new sites for business to locate near a successful international gateway;

- Developing a successful new community around the Airport, with excellent transport connections and community facilities; and
- Strengthening the partnership between the Airport, Peel Group, the Combined Authority and the Councils and the wider community.

3.10 The capital and operating costs of Option 2 over a thirty five year appraisal period are summarised in the table below. Note: these figures are presented in nominal terms:

Area of investment	Nominal Cost
Route development fund (£0.5m per annum for four years)	£2m
Total	£2m

Option 7: Do something: The Combined Authority buys airport and sub-contracts out management to a third party

3.11 The capital and operating costs of Option 7 over a thirty five year appraisal period are summarised in the table below. Note: these figures are presented in nominal terms for each of the three scenarios identified by ICF (the difference between Option 7 and Option 8 is the inclusion of payment for third party delivery partner).

Scenario 1 Area of Investment	Nominal Cost (£000's)
Aeronautical Revenue	116,795
Non Aeronautical Revenue	87,229
Total Revenue	204,023
Staff Costs	116,433
Non staff costs	145,951
Support Initiative	0
Payment for Third party (based on 10% staff costs)	26,238
Total Costs	288,622
Airport Capex	15,000
Purchase Cost	40,000
Overall Total	547,645

Source: ICF – see appendix 1

Scenario 2 Area of Investment	Nominal Cost (£000's)
Aeronautical Revenue	129,181
Non Aeronautical Revenue	116,845
Total Revenue	246,026
Staff Costs	116,433
Non staff costs	159,010
Support Initiative	3,123
Payment for Third party (based on 10% staff costs)	27,856
Total Costs	306,422
Airport Capex	15,000
Purchase Cost	40,000
Overall Total	607,448

Scenario 3 Area of Investment	Nominal Cost (£000's)
Aeronautical Revenue	330,276
Non Aeronautical Revenue	278,826
Total Revenue	609,103
Staff Costs	286,027
Non staff costs	228,276
Support Initiative	21,417
Payment for Third party (based on 10% staff costs)	53,572
Total Costs	589,292
Airport Capex	25,000
Purchase Cost	40,000
Overall Total	1,263,395

Source: ICF – see appendix 1

Option 8: Do something: The Combined Authority buys airport with a third party investor under a joint venture who also act as an operating partner

3.12 The capital and operating costs of Option 8 over a thirty five year appraisal period are summarised in the table below. Note these figures are presented in nominal terms for each of the three scenarios identified by ICF:

Scenario 1 Area of Investment	Nominal Cost (£000's)
Aeronautical Revenue	116,795
Non Aeronautical Revenue	87,229
Total Revenue	204,023
Staff Costs	116,433
Non staff costs	145,951
Support Initiative	0
Total Costs	262,384
Airport Capex	15,000
Purchase Cost	40,000
Overall Total	521,407

Source: ICF Assumptions – see appendix 1

Scenario 2 Area of Investment	Nominal Cost (£000's)
Aeronautical Revenue	129,181
Non Aeronautical Revenue	116,845
Total Revenue	246,026
Staff Costs	116,433
Non staff costs	159,010
Support Initiative	3,123
Total Costs	278,566
Airport Capex	15,000
Purchase Cost	40,000
Overall Total	579,592

Source: ICF Assumptions – see appendix 1

Scenario 3 Area of Investment	Nominal Cost (£000's)
Aeronautical Revenue	330,276
Non Aeronautical Revenue	278,826
Total Revenue	609,103
Staff Costs	286,027
Non staff costs	228,276
Support Initiative	21,417
Total Costs	535,720
Airport Capex	25,000
Purchase Cost	40,000
Overall Total	1,209,823

Source: ICF Assumptions – see appendix 1

Benefits

3.13 This section outlines the quantifiable benefits of each of the proposed options in relation to:

- Gross Value Added (GVA); and
- Employment.

3.14 For each of the 'do something options' the benefits are initially analysed separately for the airport.

3.15 We have also made the following assumptions in terms of additionality in line with earlier reports produced by Regeneris, York Aviation and ICF Consultants:

- Aviation Activities:
 - Displacement: Minimal; and
 - Leakage: 25% based on a 2004 survey of employees and their residence, referenced in Regeneris 2012.

■ Option 1: Status Quo Option: Peel continues to run the airport and it closes in 2021

3.16 It is assumed that there will be no benefits attributable, as the airport will close.

■ Option 2: Do something: Peel are supported to deliver a turnaround plan

3.17 It is assumed that benefits will only be attributable for the period up until 2021, however the impacts of all 3 scenarios will be assessed.

Option 7: Do something: The Combined Authority buys airport and sub-contracts out management to a third party

Option 8: Do something: The Combined Authority buys airport with a third party investor under a joint venture who also act as an operating partner

3.18 It is assumed that the same benefits profile will be experienced by both Options 7 and 8 as contracting out should bring with it the same benefits of having a specialist operating partner (but at a potentially higher cost and with different means of control).

NET PRESENT VALUE AND ASSESSMENT OF BCR

3.19 This section outlines the net present value and BCR for each of the do something options under each of the three listed scenarios:

Option	Scenario 1	Scenario 2	Scenario 3	Explanation
Status Quo: Peel continues to run the airport and it closes in 2021	N/A	N/A	N/A	An NPV and BCR were not considered due to the imminent closure of the airport
Option 2: Do something: Peel are supported to deliver a turnaround plan	£131m BCR 1:5.29	£146m BCR 1:5.70	£106m BCR 1:2.9	NPV and BCR were calculated for the first four years, however costs (even including the subsidy) were above revenues
Option 7: Do something: The Combined Authority buys airport and sub-contracts management to a third party	£870m BCR 1:5.07	£1,617m BCR 1:8.22	£6,033m BCR 1:16.6	35 year period, with direct and indirect benefits included
Option 8: Do something: The Combined Authority buys airport with a third party investor under a joint venture who also act as an operating partner	£876m BCR 1:5.21	£1,633m BCR 1:8.84	£6,064m BCR 1:18	35 year period, with direct and indirect benefits included

NON-MONETARY ANALYSIS

3.20 Benefits which can be quantified financially have been included in the economic appraisal and subject to cost benefit analysis (using NPV and BCR) for each option. However there are a number of benefits of the proposed acquisition which are not amenable to monetisation.

For these we have used weighting and scoring. This involves assigning weights to the criteria (from 10% to 100%) and then scoring options (from 0 to 10-0 being non-compliant and 10 indicating strong compliance) against those weighted criteria. The weighted scores are then added together and resulting totals used to rank the options. The scoring must be completed in an objective manner and the rationale behind the scores should be evidenced.

NON-MONETARY CRITERIA

Criteria	Explanation	Weighting
Pride in the region and its institutions	Demonstrates the validity of devolution	25%
Innovation	Provides opportunities to test new technologies in a regulated environment	25%
Creating a positive investment climate	Highlights a region open to trade and investing in key infrastructure	25%
Environment and sustainability	Provides more sustainable travel solutions, as Tees Valley residents will not need to travel to out of region airports	25%

3.21 The criteria have been assessed and a score applied to better understand the relative non-monetary value of each of the options.

NON-MONETARY ASSESSMENT

Criteria	Max Score	Score/Weighted score			
		Option 1	Option 2	Option 7	Option 8
Pride in the region and its institutions	250	0	100	250	250
Innovation	250	0	100	200	250
Creating a positive investment climate	250	0	100	200	250
Environment	250	0	100	200	250
Total	1,000	0	400	850	1,000
Ranking		4th	3rd	2nd	1st

PRIDE IN THE REGION AND ITS INSTITUTIONS

3.22 Option 8 scored highest for this aspect as it demonstrated a region which was able to develop robust institutional solutions which were partnered and therefore validated by active engagement with the private sector (and preferably a national level partner). Option 7 scored second highest as it proved the benefits of devolution in being able to provide innovative solutions to emerging constraints, but lacked the direct private sector buy-in.

3.23 Option 2 scored third highest, as the airport was still in place, but there was not the same ability to control policy direction and delivery at the airport. Finally Option 1 did not score as the closure of the airport would have significant impacts on regional pride in place and the ability of institutions to develop innovative solutions.

INNOVATION

3.24 Option 8 scored highest as it married maximum policy control on the part of the Combined Authority with the innovative actions of a motivated partner. Option 7 scored second highest, as although the Combined Authority can set the policy agenda the sub-contracting to a third party limits the degree of innovation from two perspectives: it depends on the Combined Authority setting the innovation agenda for subsequent delivery and secondly the flexibility of the contract and how willing a delivery partner is to be innovative. There were concerns that this option may not provide significant opportunities to motivate the delivery partner.

3.25 Option 2 scored third highest, as Peel would be in control and although the Combined Authority could influence through directed spending, ultimately Peel has the final discretion as to what would be delivered. Finally Option 1 did not score as the closure of the airport would deliver no innovation.

CREATING A POSITIVE INVESTMENT CLIMATE

- 3.26 Option 8 scored highest for this aspect as it demonstrated a region which had a positive investment climate validated by active investment in the airport by a third party. Option 7 scored second highest as it still provided a functioning airport, but was actively directed at supporting inward investment activities.
- 3.27 Option 2 scored third highest, as the airport was still in place, but there was not the same ability to control policy direction and delivery at the airport. Finally Option 1 did not score as the closure of the airport would have significant impact on accessibility to the region.

ENVIRONMENT

- 3.28 Option 8 scored highest as it married maximum policy control on the part of the Combined Authority with the innovative actions of a motivated partner, which in this case would be directed at supporting the environment. Option 7 scored second highest, although the Combined Authority can set the policy agenda the sub-contracting to a third party limits the degree of environmental control from two perspectives: it depends on the Combined Authority setting an informed environmental agenda for subsequent delivery and secondly the flexibility of the contract and how willing a delivery partner is to be environmentally sustainable. There were concerns that this option may not provide significant opportunities to motivate the delivery partner.
- 3.29 Option 2 scored third highest, as Peel would be in control and although the Combined Authority could influence through directed spending, ultimately Peel has discretion over what would be delivered. Finally Option 1 did not score as the closure of the airport would cause significant displacement of activity (and hence a wider negative environmental impact).

RISK ASSESSMENT

- 3.30 There are a number of risks that could impact on the delivery of the project. This assessment considered the risk and uncertainties in relation to the short listed options. The shortlisted options have been assessed against the following risks:
- Timeliness of delivery;
 - Compliance with regulatory environment;
 - Ability to gain Cabinet/Local Authority buy-in;
 - Ability to attract a Low cost carrier and so reach passenger targets;
 - Ability to develop the commercial property proposition; and
 - Ability to develop a sustainable long term partnership.
- 3.31 The tables below outline the assessment of options scored against the risk criteria in terms of likelihood and impact. A RAG rating system has been used with scores allocated to allow quantification of assessment.

Red= 5 High Risk

Amber= 3 Moderate Risk

Green = 1 Low Risk

Timeliness of delivery;

Option	Description	Probability	Impact	Score
Option 1	This option will result in the closure of the airport	H	H	10
Option 2	This option can be delivered within a reasonable timeframe, but it does not guarantee the continued presence of the airport	H	H	10
Option 7	There may be a delay in delivery due to the need to procure a delivery partner	M	H	8
Option 8	There may be a delay in delivery due to to need to identify a partner	H	M	8

Compliance with regulatory environment;

Option	Description	Probability	Impact	Score
Option 1	This option will result in the closure of the airport	H	H	10
Option 2	An experienced body runs the airport, who are cognisant of the regulatory environment.	L	M	4
Option 7	An experienced body runs the airport, who are cognisant of the regulatory environment.	L	M	4
Option 8	An experienced body runs the airport, who are cognisant of the regulatory environment.	L	M	4

Ability to gain Cabinet/Local Authority buy-in;

Option	Description	Probability	Impact	Score
Option 1	This option will result in the closure of the airport and would not be favourable to the cabinet	H	H	10
Option 2	This has been to date the preferred option of the Cabinet	L	L	2
Option 7	This may increase the concern of the Cabinet as there is less sharing of risk.	H	H	10
Option 8	This option may mitigate some of the concern of the Cabinet in particular the need to robustly commercialise the airport	M	M	6

Ability to attract a Low cost carrier and so reach passenger targets;

Option	Description	Probability	Impact	Score
Option 1	This option will result in the closure of the airport and so will not meet the core objective.	H	H	10
Option 2	The continuing involvement of a less motivated partner limits the ability to meet this target.	M	M	6
Option 7	Although the procurement of a specialist partner would assist delivery, their impact may be partially impaired due to contractual terms of reference and their degree of buy in to the process, which may involve medium term commitment.	L	M	4
Option 8	This would include the active engagement of an informed delivery partner who has shared interest in success.	L	L	2

Ability to develop the commercial property proposition

Option	Description	Probability	Impact	Score
Option 1	This option will result in the closure of the airport and so will not meet the core objective.	H	H	10
Option 2	The continuing involvement of a less motivated partner limits the ability to meet this target.	M	M	6
Option 7	Although the procurement of a specialist partner would assist delivery, their impact may be partially impaired due to contractual terms and their degree of buy-in to the process, which may involve a longer term commitment.	L	M	4
Option 8	This would include the active engagement of an informed delivery partner who has shared interest in success.	L	L	2

Ability to develop a sustainable long term partnership				
Option	Description	Probability	Impact	Score
Option 1	This option will result in the closure of the airport and so will not meet the core objective.	H	H	10
Option 2	The continuing involvement of a less motivated partner limits the ability to meet this target.	M	M	6
Option 7	Although the procurement of a specialist partner would assist delivery, their impact may be partially impaired due to either terms of reference and their degree of buy in to the process.	L	M	4
Option 8	This would include the active engagement of an informed delivery partner who has shared interest in success.	L	L	2

3.32 The table below provides a summary of the scoring of each option against each risk as identified above:

Risk	Score			
	Option 1	Option 2	Option 7	Option 8
Timeliness of delivery;	10	10	8	8
Compliance with regulatory environment.	10	4	4	4
Ability to gain Cabinet/ Local Authority buy-in.	10	2	10	6
Ability to attract a Low cost carrier and so reach passenger targets;	10	6	4	2
Ability to develop the commercial property proposition.	10	6	4	2
Ability to develop a sustainable long term partnership.	10	6	4	2
Total	60	34	34	24
Position	4th	=2nd	=2nd	1st

Preferred Option

3.33 The following table provides an assessment leading to the identification of the preferred option for each of the shortlisted do something options:

	Option 1	Option 2	Option 7	Option 8
Net present value	N/A (4 th)	£106-£146m BCR: 1:2.9 – 1:5.70	£870M- £6BN BCR: 1:5.07 – 1:16	£876M -£6BN BCR: 1:5.21 – 1:18
Non-monetary benefits	0 (4 th)	400 (3 rd)	850 (2 nd)	1,000 (1 st)
Qualitative Risk Assessment	60 (4 th)	34 (=2 nd)	34 (=2 nd)	24 (1 st)
Overall ranking	4	3	2	1

3.34 Option 8 is the preferred option and has the key characteristics:

- Recruitment for a commercial partner by March 2019;
- Purchase of the airport by March 2019;
- The attraction of 10 additional routes by 2022; of which:
 - **50% are chartered; and**
 - **50% are scheduled.**
- The attraction of a low cost carrier by 2022;
- The increase in freight tonnage up to 500 tonnes per annum by 2023;
- The tenfold increase in passenger numbers by 2023, of which:
 - **25% are business passengers**
 - **75% are recreational passengers**
- Increase the propensity of Tees Valley residents to fly to the national average of 3.41 flights per annum;

4. Commercial Case

Introduction

- 4.1 This section of the business case examines the commercial implications, actions and responsibilities associated with the purchase of the airport.
- 4.2 The Commercial Case sets out the main commercial activity that is required and assumes that final arrangements are concluded with the preferred operator. If this is not the case, the Commercial Case will need to be revised accordingly.

Commercial Strategy

- 4.3 This section of the Business Case sets out the negotiated arrangements which can be summarised as follows:

JOINT VENTURE STRUCTURE

- 4.4 The Combined Authority will acquire the 89% shareholding in Durham Tees Valley Airport Limited (“DTVAL”) from Peel Investments (DTVA) Limited (“Peel”).
- 4.5 Ideally at the same as the acquisition above takes place, or shortly thereafter, the Combined Authority and its preferred operator (‘the Parties’) will enter into a Shareholders’ Agreement (“SHA”) and the Combined Authority will:-
- transfer a maximum of 25% of its equity interest in DTVAL to the preferred operator; and
 - establish a new company, which is a wholly owned subsidiary of the company in which the Combined Authority and the preferred operator hold shares (‘Opco’).
- 4.6 The preferred operator will have oversight of Opco activities on a fully transparent basis.

JOINT VENTURE FUNDING

- 4.7 The Combined Authority will fund the purchase the shareholding in DTVAL on a fully recoverable basis either through a loan or through a preferential dividend arrangement.
- 4.8 Working capital to fund DTVAL’s operational requirements will be provided on a loan basis from the Combined Authority, and will be capitalised on a rolling 3 year basis with the preferred operator meeting its share of those losses at each 3 year point, in accordance with the provisions set out below.

AIRPORT OPERATIONS

- 4.9 The Parties will negotiate a transitional support agreement with Peel to ensure a smooth transition from the outgoing operator (Peel) to the preferred operator. Core operational requirements can continue to be met by DTVAL management team during this interim period with additional support from Peel under the transitional support agreement.

- 4.10 Opco will be granted a contract to manage the Airport (DTVAL) on its behalf. This contract will be for a ten year period initially, renewable with consent from both parties.
- 4.11 The fee to the preferred operator for those management services will be a fixed fee set at 10% of the year 1 base costs, which will be agreed through due diligence.
- 4.12 The parties will agree the following:-
- a Site Development Plan; and
 - a 5 Year Business Plan reviewable annually.
- 4.13 To incentivise the preferred operator to manage the Airport efficiently and on the basis of reduced losses/increased profit it is envisaged that:-
- reductions achieved from the base costs at year 1 will be shared equally between the parties; and
 - there will be a rolling 3 year review of losses – i.e. at the end of the 3 year period, the Preferred Operator will have the option to meet its share of any losses, or have its equity share at that time reduced by an equivalent percentage.

REQUIRED OUTCOMES

- 4.14 The key contractual outcomes required from this Project are the completion of:
- a Joint Venture Agreement;
 - Loan Agreements to fund the operating costs and capex requirements for a ten year period (and to fund the purchase of Peel's shares where a preferential dividend approach is not taken);
 - a Transitional Services Agreement, pursuant to which Peel agree to continue to provide certain support services until the preferred operator can put the necessary arrangements in place to take over service provision; and
 - an Operating Contract pursuant to which the preferred operator agrees to operate the Airport on behalf of Holdco in accordance with an agreed 5 Year Business Plan.

AGREED RISK TRANSFER

- 4.15 The general principle is that risk is passed to 'the party best able to manage it', subject to value for money.

4.16 We intend to apportion risks under the contract as follows:

Risk Category	Comments	Potential allocation		
		Public	Private	Shared
1. Transition and implementation risk	<ul style="list-style-type: none"> • Peel to provide transitional services • Preferred operator (via Opco) to manage implementation as operator • Preferred operator experienced in handover from previous operator 		✓	
2. Performance risk	<ul style="list-style-type: none"> • Preferred operator responsible for day to day operation and performance in accordance with business plan • Combined Authority and Preferred operator share responsibility for setting long term strategic business plan • Ultimately both JV partners share losses 			✓
3. Operating risk	<ul style="list-style-type: none"> • Preferred operator responsible for day to day operation and performance • Operating losses are shared 			✓
4. Variability of revenue risks	<ul style="list-style-type: none"> • Preferred operator receive the same operation fee regardless of level of revenue • Operating losses are shared 			✓
5. Termination risks	<ul style="list-style-type: none"> • If Preferred operator were to terminate the operating agreement, the Combined Authority continued operations at the airport 		✓	
6. Technology and obsolescence risks	<ul style="list-style-type: none"> • Preferred operator are responsible for operating the airport in accordance with the business plan for the agreed fee • Operating losses are shared 			✓
7. Residual value risks	<ul style="list-style-type: none"> • The residual value of the land for mixed use exceeds the value of the land as an airport • Parties will share the losses under the joint venture arrangement 			✓
8. Financing risks	<ul style="list-style-type: none"> • Combined Authority to fund operation through loans 	✓		
9. Legislative risks	<ul style="list-style-type: none"> • Stobart are responsible for operating the airport in accordance with the business plan for the agreed fee • Operating losses are shared 			✓

4.17 Project risks are set out in the risk register included in the Management Case.

AGREED PAYMENT MECHANISM FOR SERVICE PROVISION

4.18 The payment mechanism agreed with the Operator under the Operating Concession Contract is a [monthly] payment of [£xxxx] which represents 10% of the agreed base annual operating cost of the Airport.

4.19 The Operator will operate the Airport in accordance with an agreed 5 Year Business Plan.

4.20 Working capital to fund the joint venture's operational costs will be provided by loans from the Combined Authority. To incentivise the Operator to operate the Airport efficiently and on the basis of reduced losses/increased profit:

- reductions achieved from the base costs at year 1 will be shared equally between the parties; and
- there will be a rolling 3 year review of losses – i.e. at the end of the 3 year period, Preferred operator will have the option to meet its share of any losses, or have its equity share at that time reduced by an equivalent percentage.

4.21 In this way if Preferred operator fail to operate the Airport in a way which achieves the agreed annual income target over the course of the ten year operating concession contract their shareholding in the joint venture company shall be adjusted so as to make good the loss.

AGREED CONTRACT LENGTH

4.22 The agreed length of the operating concession contract is 10 years. This is considered to be the optimal contract length as it gives sufficient time for the Airport to start to turnaround its prospects and does not require the parties to be tied in for the medium to long term if the arrangement does not operate as successfully as anticipated by the agreed Business Plan.

KEY CONTRACTUAL CLAUSES

4.23 The key contractual clauses in each key contract are as follows:

SALE AND PURCHASE AGREEMENT

- 89% of issued share capital in DTVAL to be purchased by Holdco;
- Assumed all property assets within redline owned by DTVAL in 2003 continue to be owned by DTVAL including the residential development site;
- Appropriate warranties to provide to enable Holdco to understand the extent of its potential liability under the purchase;
- Sale on a no debt/ no cash basis with [x] operational income to be left in business accounts; and
- Completion on completion of due diligence and subject to no significant alterations to the known position.

LOAN AGREEMENT

- Loan to be made by the Combined Authority to Holdco to fund purchase of shares (£40m).
- Loan to be made on state aid compliant terms; and
- Loan repayable through Holdco profits and to be paid out ahead of equity in any distribution on winding-up.

JOINT VENTURE AGREEMENT

- Powers to appoint directors and voting rights to reflect relative levels of shareholding (75%:25%); and
- Parties to share profits and losses pro rata to shareholding (3 year reconciliation).

TRANSITIONAL SERVICES AGREEMENT

- To deliver agreed Specification of Services;
- Payment terms to be agreed; and
- Key performance indicators to be agreed.

OPERATING CONCESSION CONTRACT

- This contract will be awarded as part of the acquisition process on the basis that Preferred operator will be a shareholder in Holdco;
- Operation strictly in accordance with the agreed Business Plan;
- Deviations from plan to be agreed by Holdco;
- All operative services to be provided;
- Payment terms - 10% of agreed operating cost – after benchmarking process of Peel’s current cost; and
- Key performance indicators to be agreed to include appropriate maintenance growth in passenger numbers and other targets set out in the Business Plan.

PERSONNEL IMPLICATIONS (INCLUDING TUPE)

- 4.24 It is not currently envisaged that TUPE – the Transfer of Undertakings (Protection of Employment) Regulations 1981 – will apply to this project as this is a share sale. Members of staff at the Airport before the share sale will continue to be employed by the Airport once it is completed.
- 4.25 There are however, a number of areas in which Peel companies provided support services to the Airport and these arrangements will come to an end at the end of the Transitional Services Agreement when the Operating Concession Contract comes into force in full. There is a potential that a small number of Peel members of staff could in theory transfer to The Operator when this transfer of support services to the Airport takes place but this is currently considered unlikely/minimal.
- 4.26 The current pension scheme for DTVA employees is a Peel scheme and arrangements need to be put in place to establish a new scheme for the benefit of these employees.

IMPLEMENTATION TIMESCALES

4.27 The implementation milestones agreed for the scheme are as follows:-

Milestone	Date
Enter Conditional Sale and Purchase Agreement with Peel	31st January 2019
Complete Sale and Purchase Agreement	As soon as possible after 31st January 2019 and no later than end March 2019
Interim Services Agreement with Peel comes to an end and full operation passes to The Operator	To be confirmed

FRS 5 ACCOUNTANCY TREATMENT

4.28 The assets underpinning delivery of service will be on the balance sheet of the Combined Authority.

5. Financial Case

Introduction

FINANCIAL CASE

- 5.1 The purpose of the financial case is to ascertain the funding requirement and affordability of the proposal.

FUNDING REQUIREMENT

- 5.2 In establishing the funding requirement consideration must be given to both known costs and estimated costs. The known costs largely relate to the acquisition costs with a number of scenarios and assumptions providing the basis for the expected post-acquisition implementation costs.
- 5.3 In presenting the financial case the objective is to present a prudent assessment of the funding requirement, noting where appropriate the scope for a more optimistic outcome.
- 5.4 In setting out the funding requirement there are three specific areas to consider:
- Funding the acquisition;
 - Funding aeronautical operations; and
 - Funding land and property investment.

FUNDING THE ACQUISITION

- 5.5 The agreed acquisition price is £40m for an 89% shareholding in Durham Tees Valley Airport Limited.
- 5.6 As set out in the commercial case, the Combined Authority will provide a £40m loan to HoldCo. HoldCo is a joint venture company in which the Combined Authority will hold a 75% majority shareholding and Preferred operator a 25% shareholding.
- 5.7 HoldCo will then acquire an 89% majority shareholding in Durham Tees Valley Airport Limited from Peel Investments (DTVA) Limited.
- 5.8 To ensure state aid compliance an appropriate interest rate will be applied to the loan agreement. This will also ensure that the Combined Authority recovers any financing costs.
- 5.9 HoldCo will be responsible for loan repayment. Repayment terms will be agreed as part of the loan agreement and will include a repayment trigger mechanism linked to financial performance. Based on the Business Plan forecast it is expected that HoldCo will begin its loan repayments in 2026.

FUNDING AERONAUTICAL OPERATIONS

- 5.10 Based on detailed analysis, key assumptions, forecasts and scenario modelling the aviation business plan identifies a need for operational funding. The funding requirements are for both revenue operations and capital expenditure.

REVENUE OPERATIONS

5.11 The aviation Business Plan financial forecast over the 10 year period 2019 to 2028 is as follows:

	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Revenue	5.76	5.82	10.76	16.69	17.00	17.05	17.28	17.38	17.57	17.84	143.15
Costs	(8.44)	(8.45)	(15.33)	(20.02)	(20.36)	(19.19)	(18.06)	(16.71)	(15.35)	(15.3)	(157.21)
Surplus/(Deficit)	(2.68)	(2.63)	(4.57)	(3.33)	(3.36)	(2.14)	(0.78)	0.67	2.22	2.54	(14.06)

5.12 The Business Plan financial forecast as set out above is based on Scenario 3 of the ICF report. Key assumptions within this plan are that passenger numbers will grow to 1.61m by 2028 on the basis that the airport will secure a low cost carrier and there will be an increase in seasonal and regional operator flights.

5.13 The Business Plan forecast is that losses will continue to 2025 at a total cost of £19.4m. After this point the airport will be in annual financial surplus, which will steadily increase from £0.65m in 2026 to £4.32m in 2037. In the total plan period to 2037 the outturn forecast is £17.8m surplus.

5.14 In assessing the financial risks should passenger growth not be achieved as forecast two further financial scenarios were considered. Firstly, that a low cost carrier not secured and secondly, that there is neither growth in seasonal / regional activity nor is a low cost carrier secured. The detail of both these scenarios have been set out as Scenario 1 and 2 in the ICF report.

5.15 If a low cost carrier is not secured but growth in seasonal and regional activity is achieved as planned then passenger numbers will increase to 379k by 2028 (as set out the Scenario 2 in the ICF report). Under this scenario losses will continue throughout the first 10 years, with a total loss of £16m. The level of losses will however decline on an annual basis from £2.7m in 2019 to £0.9m by 2028. By 2037 losses are forecast at £0.4m per annum.

5.16 In the worst case scenario with neither growth in seasonal / regional activity nor a low cost carrier secured then passenger numbers will only grow organically to 167k by 2028. The financial impact of this would be a £20.6m loss over the first 10 years. The level of losses will however decline on an annual basis from £2.7m in 2019 to £1.7m by 2028. By 2037 losses are forecast at £1.4m per annum.

5.17 Based on the Business Plan and potential risks (i.e. growth scenarios 1 and 2) it is proposed that the Combined Authority set aside a contingent funding requirement to support aviation operations of up to £20.6m. The funding requirement will be determined at the end of each financial year and be limited to actual revenue shortfall. The funding will be provided as a loan from the Combined Authority to HoldCo.

5.18 The terms of lending to HoldCo will be on the same basis as the acquisition loan.

AERONAUTICAL CAPITAL EXPENDITURE FUNDING REQUIREMENTS (CAPEX)

- 5.19 Additional capex requirements for the airport in the next 10 years are identified in the ICF report as between £5m and £15m dependent on the level of growth. If a low cost carrier is secured estimated capex requirements are identified as between £6m and £10m in the first 10 years. If a low cost carrier is not secured then estimated capex requirements are £5m each 15 years for the periodic maintenance of the runway.
- 5.20 It is important to note that these capex requirements are additional to ongoing repairs and maintenance costs that are already included in the revenue costs and equate to £6.8m to 2028. ICF note that this cost is higher than their expectation and likely includes elements of capex.
- 5.21 Based on the Business Plan and potential risks (i.e. growth scenarios 1 and 2) it is proposed that the Combined Authority set aside a contingent funding requirement to support capex of up to £15m in the first 10 years.
- 5.22 The terms of lending to HoldCo will be on the same basis as the acquisition loan.

POTENTIAL INVESTMENT RETURNS FROM PROPERTY AND LAND

- 5.23 The acquisition also provides significant opportunities for property investment returns. In addition to 470 acres of land for aviation operations, DTVA Ltd also owns a further 350 acres of developable land (known as Northside and Southside).
- 5.24 This land has been the subject of previous masterplans which have indicated significant economic and financial opportunities, with the potential for developing over 4 million square feet of employment space over a 20 year period and generating a rental income in excess of £30m per annum.
- 5.25 As with all such development it is expected that the financing will be private sector led. However, as the landholder this presents significant opportunity for financial return. Based on a market valuation of £34k per acre the Northside and Southside land is currently worth £11.6m for commercial development. Taking a developer, investor and/or landlord role in the build out may provide opportunities for further financial returns.

TOTAL FUNDING REQUIREMENT

- 5.26 The total funding requirement for the Combined Authority comprises a combination of fixed costs and budget provision for contingencies. It is proposed to set aside sufficient funding to meet potential contingency costs for the first 10 years. This period also aligns with the appointment of the airport operator.
- 5.27 Under the proposed commercial agreement as 25% shareholder the operator will have the option to either provide a cash injection to cover its share of losses / capex. Alternatively, the operator will be able to take an equivalent in share dilution. For the purposes of setting a prudent funding requirement it has been assumed that the operator will opt for the latter option and dilute their shareholdings.

5.28 Total funding requirements are summarised as:

	Business Plan	Risk: No LCC (scenario 2)	Risk: No LCC or seasonal growth (scenario 1)
Acquisition	£40.2m	£40.2m	£40.2m
Contingency for aviation operations	Up to £19.4m	Up to £16.0m	Up to £20.6m
Capex	Up to £15.0m	Up to £5.0m	Up to £5.0m
Total funding	Up to £74.6m	Up to £61.2m	Up to £65.8m

5.29 The total funding requirement is therefore in the range of £61.2m to £74.6m.

MANAGING THE FINANCIAL RISK

5.30 The loans provided to HoldCo will be on a first charge basis and therefore the Combined Authority will be able to recover any value in the residual assets. With a total landholding of 820 acres there is potential for significant financial recovery. The most significant value in this circumstance would be through promoting the site for housing. Independent valuation has set the valuation on this basis at £41.8m.

5.31 The Business Plan requires up to £74.6m in loans to fund acquisition, operations and capex before the airport becomes profitable and begins to repay the loans. However, this level of investment will be under the assurance that delivery against the business plan growth targets are being achieved and the loans will be fully repaid.

5.32 If the Business Plan growth targets are not being achieved then whilst the £40.2m loan for the acquisition will be recovered through residual land values, there is a risk that loans to fund revenue and capex will not be recovered. The extent of this will be dependent on how long the airport continues to be funded. For example, assuming the airport is fully funded for the first three years and growth targets are not achieved nor expected to be achieved, then a decision to close would lead to a potential loss of £8.5m.

5.33 Arrangements will be in place to ensure that there is ongoing review of performance against an agreed Business Plan. Should at any time it become clear that the financial position is becoming much worse than expected then the Combined Authority, as majority shareholder, will be able to trigger airport closure and seek to recoup loans through land values.

AFFORDABILITY

5.34 To achieve the Business Plan aim of securing a low cost carrier and growth on seasonal and regional flights the Combined Authority will need to provide loans of up to £74.6m. According to the Business Plan forecast, this lending will be provided across seven years from 2019 to 2025.

5.35 The revised Combined Authority Investment Plan sets out priorities for investment in the next 10 years. Within this plan £74.6m has been set aside for the airport. Overall, the Investment Plan sets out total spending to 2029 of £1.415bn, which is funded through a combination of known income streams and prudential borrowing (See Appendix 2 – Investment Plan cashflow).

5.36 It is therefore concluded that the proposals as set out in this Business Case are affordable.

6. Management Case

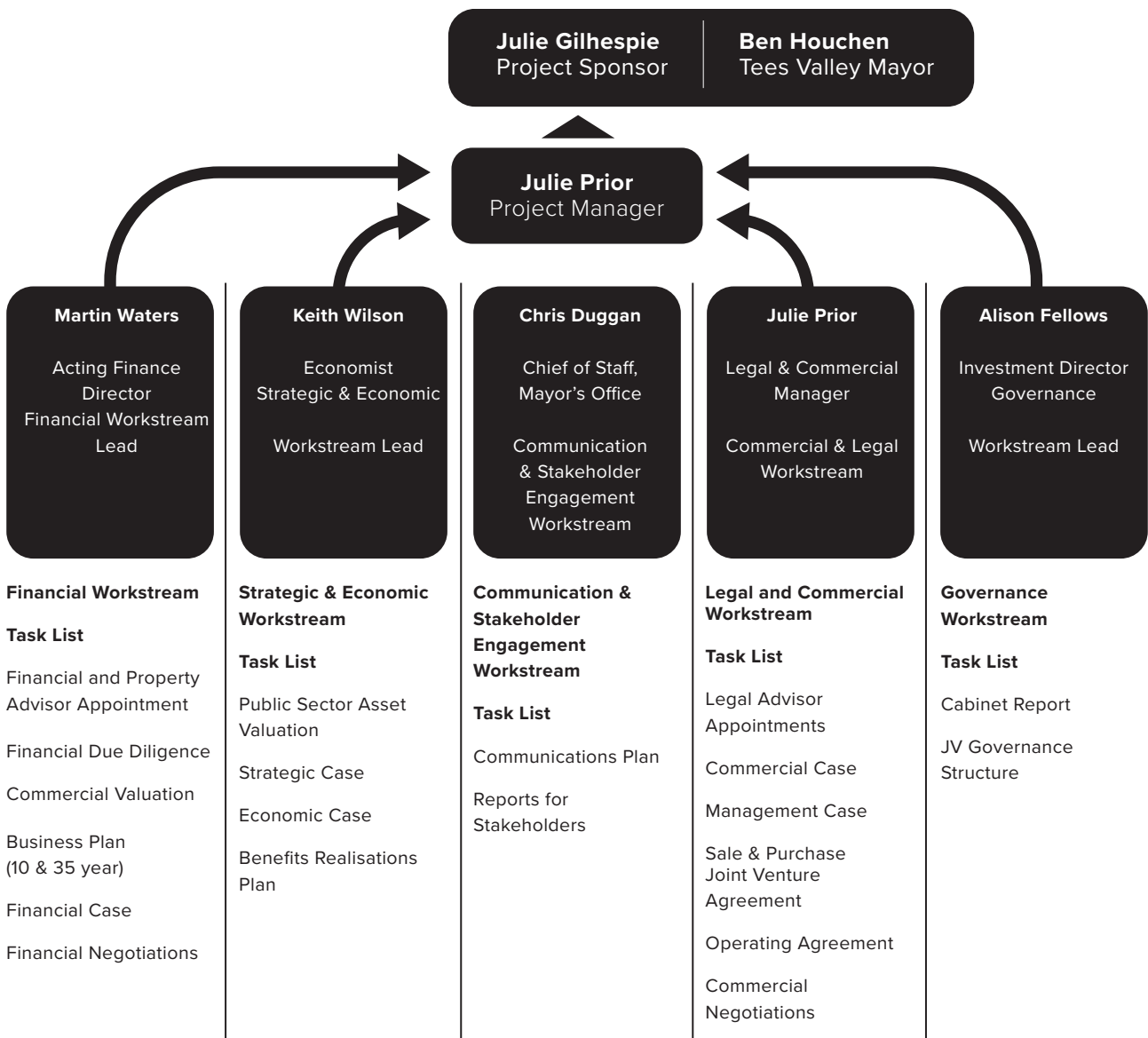
Introduction

6.1 This section of the Business Case addresses how the scheme will be delivered successfully. Part A covers the Airport Acquisition Project and Part B covers the ongoing operation of the Airport following that acquisition.

PART A: AIRPORT ACQUISITION

PROJECT REPORTING STRUCTURE

6.2 The diagram below sets out the formal arrangements for managing this element of the overall Project:



AIRPORT ACQUISITION PROJECT - ROLES AND RESPONSIBILITIES

Role	Name	Job Title	Key Responsibilities
Project Sponsor	Julie Gilhespie	Chief Executive	<p>Overall project delivery</p> <p>Sign off of all Project Documentation including key commercial decisions</p> <p>Any amendment to the scope of the Project as set out in the Project Initiation Document</p> <p>Officer lead on relationships with Peel and Preferred operator</p>
Project Manager and Legal & Commercial Workstream Lead	Julie Prior	Legal and Commercial Manager	<p>Day to day progress of the project in accordance with the Project Initiation Document</p> <p>Appointment and management of external legal advisers</p> <p>Preparation of Commercial Case</p> <p>Commercial Negotiations</p>
Financial Workstream Lead	Martin Waters	Interim Finance Director	<p>Preparation of Financial Case</p> <p>Appointment and management of external financial and property advisers</p> <p>Ensuring all supporting financial reports and other information are obtained</p> <p>Financial lead</p> <p>Preparation of Business Plans</p>
Strategic & Economic Workstream Lead	Keith Wilson	Economist	<p>Preparation of the Strategic and Economic Cases</p> <p>Oversight of the complete Business Case</p>
Communication & Stakeholder Engagement Lead	Chris Duggan	Executive Officer to the Mayor	<p>Ensuring project development is in line with political mandate</p> <p>Lead on communications plan</p> <p>Briefing stakeholders including local authority shareholders</p>
Governance Workstream Lead	Alison Fellows	Investment Director	<p>Preparation of Management Case</p> <p>Risk Register</p> <p>Cabinet Report</p>

AIRPORT ACQUISITION PROJECT – PROJECT MANAGEMENT APPROACH

- 6.3 Comprehensive and transparent project management arrangements have been put in place as set out in the diagram above. The project will be managed in accordance with the Combined Authority's adopted project management methodology which is based on PRINCE 2 principles. The Project Manager is Julie Prior who is the Authority's Legal & Commercial Manager. The Project Team (which combines to report to the Mayor as the Project Board) meets frequently and the Project Manager maintains the Project Plan and action and issues logs, while the Governance & Workstream Lead (Investment Director) maintains the Project risk register - all these documents are reviewed at Project Team meetings. The Project Board maintains oversight of the Project, takes key decisions and resolves issues that cannot be resolved at Project Team level.

AIRPORT ACQUISITION PROJECT – PROJECT PLAN

- 6.4 A full project plan has been prepared for this element of the project up to Contract Close on the Sale and Purchase of the Airport. This key milestones to be achieved are as set out in the following table.

Milestone Activity	Target Date
Completion of Business Case	11th January 2019
Obtain Cabinet Approval for Business Case to Purchase Airport and to Appoint Airport Operator	24th January 2019
Enter Conditional Sale and Purchase Agreement with Peel	31st January 2019
Complete Sale and Purchase Agreement	1st March 2019
Interim Services Agreement with Peel comes to an end and operation passes to Preferred operator	1st September 2019

USE OF ADVISERS

- 6.5 Expert advisers have been appointed to support the Acquisition phase of the Project as follows.

Specialist Area	Adviser
Financial	Ernst & Young
Procurement and legal	Pinsent Masons
Property	Turner & Townsend (including work from JK Property Consultants and Lichfields)

RISK MANAGEMENT

- 6.6 A copy of the Acquisition Project risk register is attached at Appendix 3, and has been prepared in accordance with the Authority's Risk Management Strategy.

- 6.7 This lists key risks and sets out who is responsible for managing them, along with specified mitigations. The Investment Director leads on the management of the Acquisition risk register and risks are discussed at Project Team and Project Board meetings.

Benefits Realisation Plan

STAKEHOLDER MANAGEMENT

- 6.8 The Mayor gave a very visible manifesto pledge to take control of the Airport and it has remained a very high profile aim in the media. As well as consulting directly with the local authorities and the LEP Board, this coverage has generated a great deal of communication and discussion with many organisations, groups and individuals, including the following:

- Local MPs;
- Government (including Aviation Ministers and Secretary of State for Transport);
- Homes England;
- TfN, Network Rail, Northern Rail, TPE;
- Current Airport tenants;
- Landowners adjacent to Airport;
- Major businesses;
- SME Advisory Group;
- Tees Valley Business Club;
- CBI, NECC, Entrepreneurs Forum;
- North Yorkshire County Council;
- Teesside University;
- Tees & Hartlepool Port Users Association;
- Strategic Harbour Authority;
- M8 Metro Mayors;
- Other Airports; and
- Media.

- 6.9 A large volume of feedback has been generated by media coverage – via conventional communications and via social media.

- 6.10 Post-acquisition, airport stakeholder negotiations will be overseen by the Airport Board.

NON-ACQUISITION

- 6.11 In the event that the Airport Acquisition Project does not proceed for any reason, the Airport will continue to be operated by Peel under its existing governance and management arrangements.

PART B -AIRPORT MANAGEMENT POST ACQUISITION

AIRPORT MANAGEMENT ARRANGEMENTS

- 6.12 The parties will negotiate a transitional support agreement with Peel for a period of [x] months from the date of the DTVA Limited acquisition.

- 6.13 DTVA Limited will award Preferred operator a contract to manage the Airport on its behalf. This contract will be for a ten year period initially, renewable with consent from both parties.
- 6.14 An agreed fee will be paid to Preferred operator for those management services (see Financial Case for details).
- 6.15 The parties will in due course agree the following:
- an Airport Masterplan;
 - a Turnaround Plan (which will include change management arrangements for the Airport's operation); and
 - an annual operational Business Plan on a rolling basis.

AIRPORT GOVERNANCE ARRANGEMENTS

- 6.16 The Shareholders' Agreement to be entered into between DTVA and Preferred operator will be detailed and will include the usual provisions on shareholders' and directors' meetings including for managing any conflicts of interest, decision making and also dispute resolution. The Board of Directors will meet bi-monthly and will consist of [3] directors from the Combined Authority and [1] from Preferred operator, with the Board chair being one of the Combined Authority directors. The Board of Directors will have oversight of all matters relating to the operation of the Airport and the Company through normal management reporting, including (but not limited to):-
- Airport performance;
 - Regulatory management;
 - Business management including assets, contracts, marketing and other key business issues;
 - Financial management;
 - Risk management;
 - HR management;
 - Health & safety management;
 - Property development matters; and
 - Wider stakeholder engagement.

■ Combined Authority (as Shareholder) Governance Arrangements

- 6.17 The Senior Officers of the Combined Authority will be responsible for reporting on Airport management and activity in accordance with the Combined Authority's normal governance arrangements (as required in accordance with specific matters in each case), as follows:
- Transport Advisory Group;
 - Tees Valley Management Group;
 - Tees Valley Chief Executives' Group;
 - Tees Valley Informal Cabinet;
 - Tees Valley LEP Board; and
 - Tees Valley Cabinet.

ARRANGEMENTS FOR BENEFITS REALISATION

6.18 The following table provides a mechanism for capturing the anticipated benefits for the programme:

Benefit owner	Benefit description	Baseline	Target	How will it be measured	Dates/ Timing
Julie Gilhespie	Recruitment of a commercial partner	Output	March 2019	Signed contract	March 2019
Julie Gilhespie	Purchase of the airport	Output	March 2019	Signed contract	March 2019
Airport operator	Attraction of 10 additional routes by 2022, of which 50% are chartered; and 50% are scheduled.	2 existing scheduled routes	10 additional routes	Signed contracts	Dec 2022
Airport operator	Attraction of a low cost carrier by 2022	Output	Low cost carrier	Signed contracts	Dec 2023
Airport operator	Increase in freight tonnage up to 500 tonnes	1 tonne	500	Civil Aviation Authority records	Dec 2023
Airport operator	Tenfold increase in passenger numbers of which 25% are business passengers; and 75% are recreational passengers of whom 20% (15% of total incoming passengers do not originate from the Tees Valley)	130,000	1.3m	Civil Aviation Authority records	Dec 2022
Airport operator	Increase the propensity to fly of Tees Valley residents up to national average of 3.41 flights	1.9	3.41	Civil Aviation Authority records	Dec 2028

ARRANGEMENTS FOR ACQUISITION PROJECT REVIEW

- 6.19 This review will appraise how well the acquisition project itself was managed and whether or not it delivered to expectations, and any lessons learned for future projects. It is timed to take place within 3 months of completion of the share acquisition.

AIRPORT OPERATION REVIEW

- 6.20 The Airport will be managed in accordance with the agreed Business Plan. The overall Airport Project will be evaluated after acquisition, once the agreed Business Plan has been agreed and implemented and has been running for a period of [1 year]. This evaluation will link back to the deliverables and outputs set out in this Business Case, and ascertain whether the anticipated benefits have been achieved by that point, and that arrangements are in place to make sure that longer term benefits are on track to be achieved.

Project:	Acquisition of Durham Tees Valley Airport		Priority:
Updated:	January 2019		Red = high
To identify matters that HAVE happened or COULD happen and which may materially impact upon the success of the project.			Amber = medium
			Green = low

	Risk Description	Risk Effects	Impact	Likelihood
1	Combined Authority is unable to reach commercially acceptable terms with Peel on sale terms	<ul style="list-style-type: none"> • Damage to reputation • Risk of airport closure remains 	4	2
2	Delay - deal cannot be achieved by date Peel require	<ul style="list-style-type: none"> • Acquisition at risk • Reputational damage 	3	2
3	Combined Authority strategy for managing negotiations isn't agreed or clearly understood	<ul style="list-style-type: none"> • Negotiations sub-optimal • Delays to agreement • Price goes up or other terms less attractive 	3	2
4	Combined Authority is unable to obtain Cabinet approval to a commercially acceptable deal to which delivers the Project:- <ul style="list-style-type: none"> • In the time required • At all 	<ul style="list-style-type: none"> • Delay to acquisition • Acquisition not possible • Damage to Combined Authority reputation • Risk of airport closure remains • Abortive time and costs 	4	2
5	Leak of commercial / negotiating strategy	<ul style="list-style-type: none"> • Negotiations sub-optimal • Delays to agreement • Price goes up or other terms less attractive 	4	2
6	Communications not well managed	<ul style="list-style-type: none"> • Public buy-in more difficult • LA support more difficult • Reputational damage to Combined Authority 	3	2
7	LA Shareholders do not waive pre-emption rights	<ul style="list-style-type: none"> • Delay to getting agreement to acquisition 	3	2
8	Transaction cost overrun	<ul style="list-style-type: none"> • Increased costs – further approval required 	3	2
9	Inadequate due diligence in advance of acquisition – eg level of losses, land values, turnaround plan deliverability	<ul style="list-style-type: none"> • Price paid turns out to have been unjustifiable • Combined Authority acquires specific risks that were unknown • Turnaround plan cannot be delivered without increased financial input • Reputational risk 	3	2
10	State aid – risk of challenge	<ul style="list-style-type: none"> • Risk of challenge • Delays to project roll out • EU intervention • Airport operations affected • Reputational risk 	4	2

IMPACT	Critical	4				
	Significant	3				
	Moderate	2				
	Minor	1				
Risk Rating Matrix			1	2	3	4
(RAG status)			Unlikely	Possible	Likely	Almost certain
LIKELIHOOD						

Priority Rating	Mitigating Actions	Owner	Current RAG Status	Status (Closed)
8	<ul style="list-style-type: none"> Appointing legal and financial advisers Obtaining updated valuation Aviation advisers already secured 	JG	Red	Open
6	<ul style="list-style-type: none"> Appointing legal and financial advisers Obtaining updated valuation Aviation advisers already secured 	AF	Red	Open
6	<ul style="list-style-type: none"> Restrict involvement in project Internal team arrangements clear Regular team meetings Manage communications 	AF	Amber	Open
8	<ul style="list-style-type: none"> Ongoing briefings and discussions with all key stakeholders Regular briefing of LEP Board 	JG	Red	Open
8	<ul style="list-style-type: none"> Restrict involvement in project Manage communications 	AF	Amber	Open
6	<ul style="list-style-type: none"> Agree & implement comms strategy Monitor comms closely 	NS	Amber	Open
6	<ul style="list-style-type: none"> Obtain advice from Legal Manager, Monitoring Officer and from external advisers Seek to agree terms for ongoing participation in DTVL 	JP	Amber	Open
6	<ul style="list-style-type: none"> Project plan in preparation, including project budget Monitor estimates and spend closely 	MW	Amber	Open
6	<ul style="list-style-type: none"> Due diligence arrangements in train – advisers selected and appointed 	MW	Amber	Open
8	<ul style="list-style-type: none"> Take legal advice on purchase and JV/operational arrangements Ensure structure is state aid compliant 	JP	Amber	Open



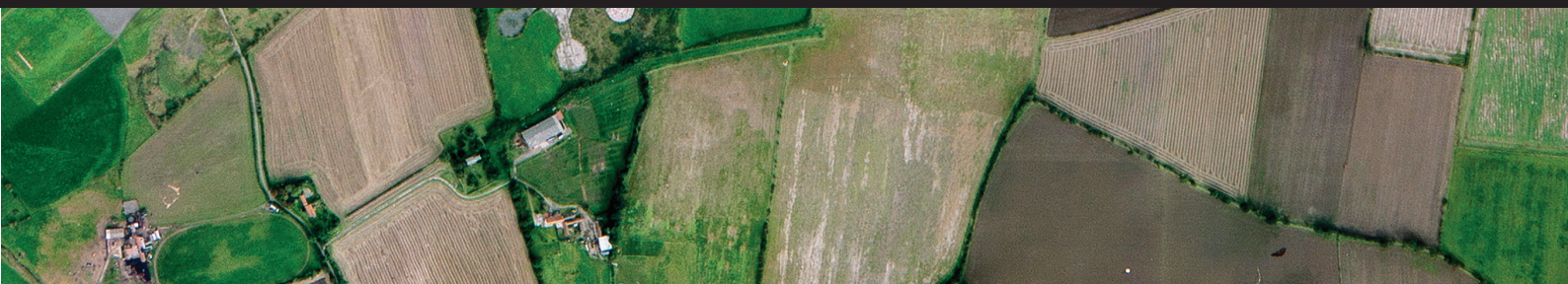
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Durham Tees Valley Airport

Business Plan

REDACTED

11 January,
2019

Prepared for:



SCOPE OF WORK

- ICF have been engaged by Tees Valley Combined Authority (TVCA, “the Combined Authority”) to provide an independent forecast for Durham Tees Valley Airport (DTVA). TVCA is considering the potential for greater involvement in the future management and/or ownership of DTVA.
- In conducting our analysis we have made use of the following:
 - Information provided by TVCA
 - UK Civil Aviation Authority (CAA) data
 - Public information
 - Industry publications and databases including OAG
 - Our own extensive experience within the sector

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Non-Aeronautical Revenue	47
Operating Costs	57
Forecast	70
Capital Expenditure	86



Opportunities

Issue	Comment	Mitigation/Next Steps
Service summer seasonal holiday market	<ul style="list-style-type: none"> Aside from a new entrant this summer, solely serving Bulgaria, Durham does not serve the summer holiday market, unlike its regional competitors where the summer forms a significant proportion of annual traffic at both Newcastle and Leeds Bradford. 	<ul style="list-style-type: none"> Start discussions with charter and LCCs to serve a summer holiday market
Higher commercial revenue	<ul style="list-style-type: none"> Terminal concession revenue is currently low with potential in growth scenarios to approach an industry benchmark level of performance 	<ul style="list-style-type: none"> Introduce a specialist concession operator to optimise performance
Higher hotel revenue	<ul style="list-style-type: none"> The hotel currently operates at a loss in most years. Moving to a third-party operated, concession fee earning model would improve performance. 	<ul style="list-style-type: none"> Introduce a specialist operator to optimise performance

Risks

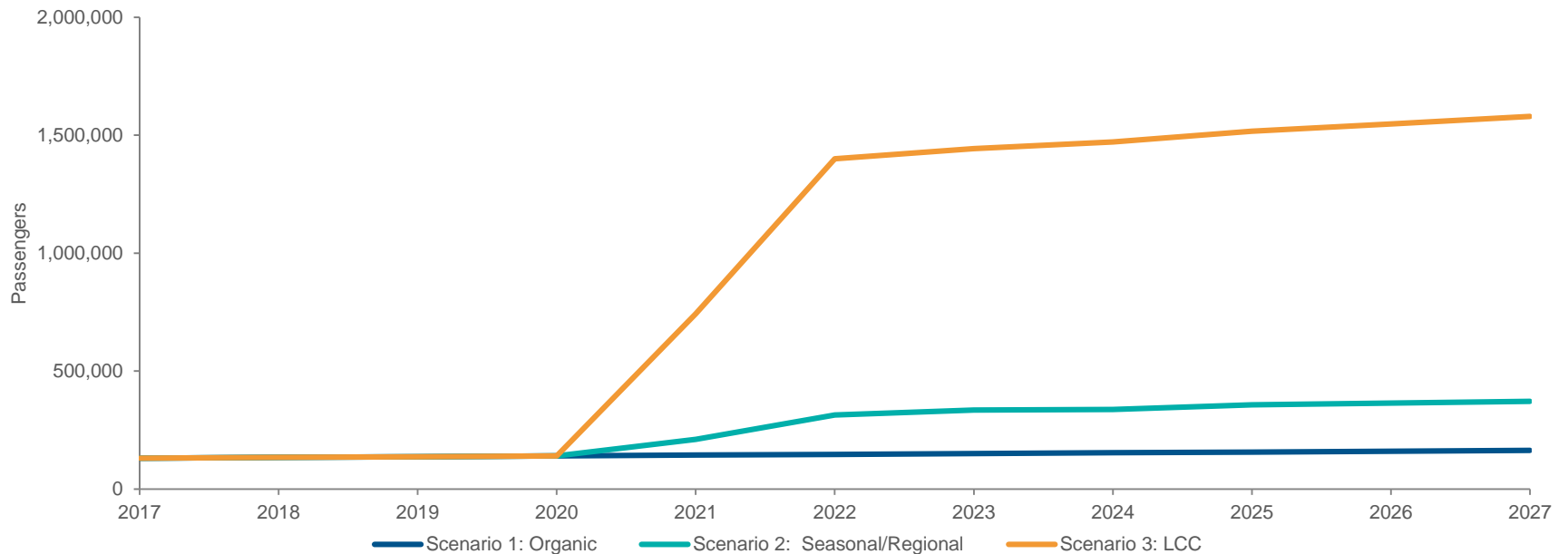
Issue	Comment	Mitigation/Next Steps
Significance of car parking revenue	<ul style="list-style-type: none"> Car parking currently represents 10% of non-aeronautical income, forecast to increase to 30-50% depending on scenario (given the assumption that certain other revenue streams are held constant). Revenue would therefore be sensitive to off site competition or shift in modal share away from private car. 	<ul style="list-style-type: none"> Ensure the on-site parking product is attractive, efficient and an attractive option Encourage planning policy to presume against off-site car parking developments
Reliance on land lease and tenant recharges revenue	<ul style="list-style-type: none"> Property related revenues currently account for 50% of revenue. An increase has not been forecast as we understand the Combined Authority is consider property opportunities separately, but DTVA's over all profitability is sensitive to its property performance. 	<ul style="list-style-type: none"> Protect and develop property revenues
Reliance on fuel margin and therefore on Cobham	<ul style="list-style-type: none"> Similarly, the fuel operation achieves a substantial margin, but is, we understand, reliant on a single principal operation. 	<ul style="list-style-type: none"> Diversify fuel clients
Reliance on Cobham	<ul style="list-style-type: none"> Through its dominance of fuel revenue, plus its property revenues, Cobham contributes significantly to DTVA's profitability. 	<ul style="list-style-type: none"> Protect Cobham's operation
FTEs, albeit with changed functions, can handled 500,000 passengers per year	<ul style="list-style-type: none"> We assume a reduction in head count immediately the airport is taken-over by the Combined Authority, and that the resulting FTEs can handle c 500,000 passenger per year. This assumes some redeployment of staff within the over all head count, but failure to achieve this would increase staff costs. 	<ul style="list-style-type: none"> Establish effective staff relations Provide necessary training

ICF Forecast Summary

SUMMARY

(Financial year ending March)

Total Passengers (000s)	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	CAGR 17-27
Scenario 1: Organic	131	135	138	141	144	147	151	154	157	161	164	2%
Scenario 2: Seasonal/Regional	131	135	138	141	211	314	335	337	357	365	372	11%
Scenario 3: LCC	131	135	138	141	743	1,400	1,443	1,472	1,516	1,548	1,579	28%



Source: ICF analysis

ICF proprietary and confidential. Do not copy, distribute, or disclose.

Forecast Summary: Scenario 1 – Organic Growth

NOMINAL



Source: ICF analysis

ICF proprietary and confidential. Do not copy, distribute, or disclose.

Forecast Summary: Scenario 2 – Seasonal/Regional

NOMINAL



Source: ICF analysis

ICF proprietary and confidential. Do not copy, distribute, or disclose.

Forecast Summary: Scenario 3 – LCC

NOMINAL



Source: ICF analysis

ICF proprietary and confidential. Do not copy, distribute, or disclose.



Traffic



Regional Overview

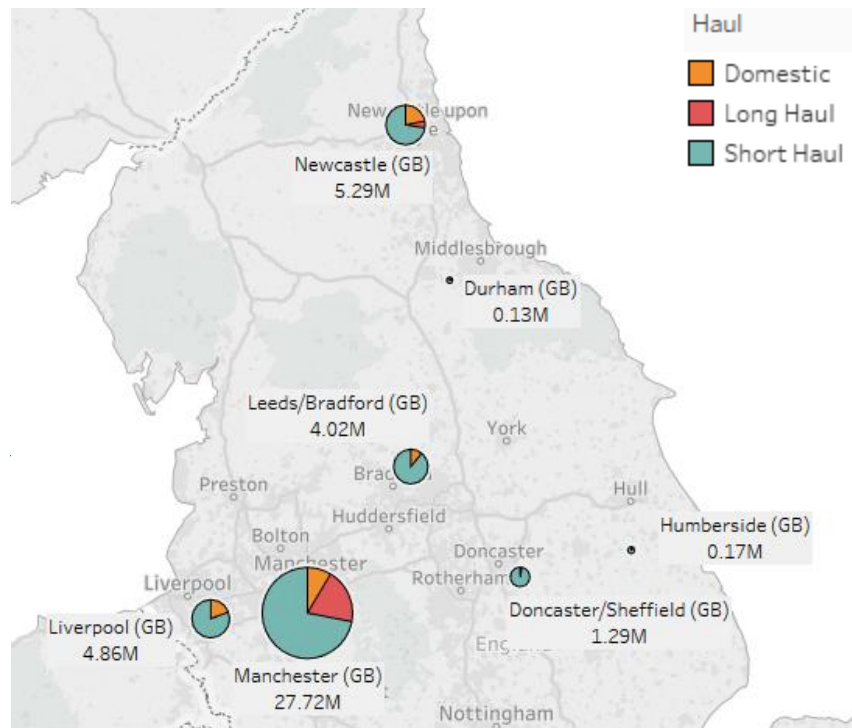


Northern England provides seven airports handling circa 44m passengers, DTVA being the smallest

REGIONAL OVERVIEW

- The north of England delivers approximately 44 million annual passengers, served by seven airports ranging from Manchester with almost 30m passengers and long-haul services to the Middle East and U.S. to Durham Tees Valley and Humberside, with limited short-haul services.
- The primary airport within the region is Newcastle (NCL) which has a route network covering most European cities and summer destinations, domestic connectivity and increasing long-haul services. While Durham serves limited markets due to its lack of airline mix.
- The CAA's 2017 Survey Data show that 450,000 passengers travelled from the North East (NE) to Manchester and 165,000 flew from Leeds Bradford, while a further 290,000 fly from London airports. i.e. Almost 1m passengers are spilled from the NE to other airports across the UK. Spilled demand is usually led by a mix of supply side factors such as pricing, route mix and service frequency.
- Newcastle's passenger base is largely defined by the NE (93% of total passengers) while over 240k passengers travel from Scotland and almost 400k passengers come from the North West and the Yorkshire and Humber region.
- Durham is more conveniently located to serve the catchments south of Newcastle such as Middlesbrough, Darlington and Stockton, and could also attract passengers from north Yorkshire.

Northern England Airports, 2017

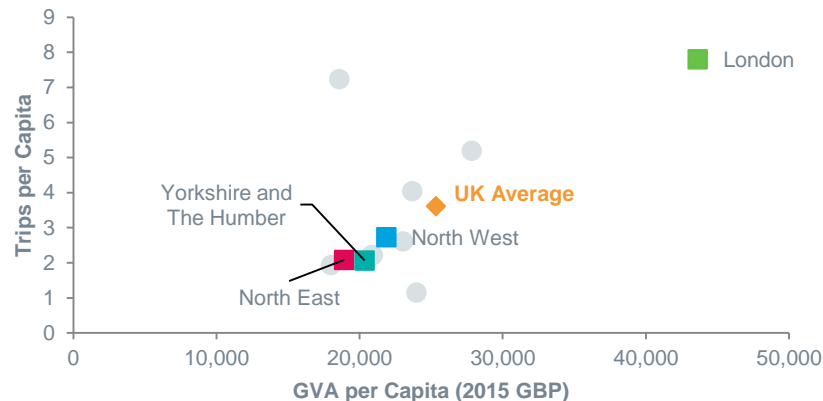


The North East of England's propensity to fly is amongst the lowest in the UK

REGIONAL OVERVIEW

- Between 2016 and 2017, the CAA and Department for Transport (DfT) estimate between 4.8 to 5.5m passengers originated their journey from the NE.
- Based on the UK's ONS data for 2015, the North East's population of 2.6m has a propensity to fly (P2F) of between 1.9 and 2.1 trips per capita.
- P2F is usually driven by a mix of factors such as disposable income, pricing and transport alternatives.
- The Gross Value Added (GVA) per capita, a proxy for income levels, in the North East is 25% below the national average and as a result we would expect the region's P2F to be proportionately lower. The North East's P2F is 40% below the national average of 3.61 trips per capita, albeit that average is influenced by London's somewhat outlying P2F.

UK Regional Propensity to Fly



Regional GVA per Capita & Population

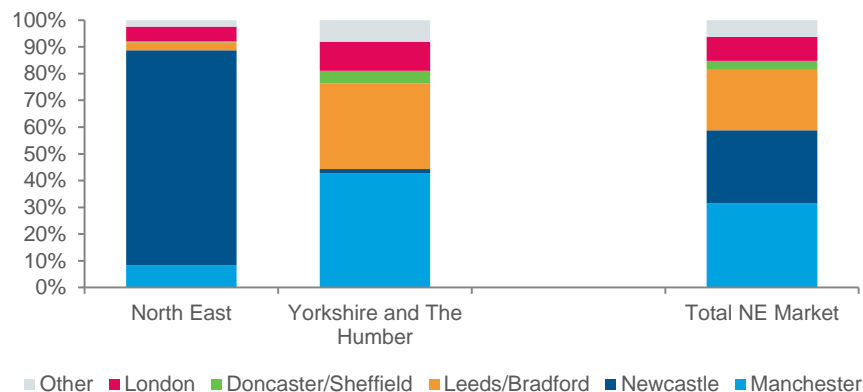
	GVA Per Capita	Population
North East	£18,927	2,625,000
County Durham	£15,475	520,000
Northumberland	£15,951	315,000
Newcastle upon Tyne	£26,232	293,000
Sunderland	£20,728	277,000
North Tyneside	£20,026	202,000
Gateshead	£21,661	201,000
Stockton-on-Tees	£20,257	195,000
South Tyneside	£14,341	149,000
Middlesbrough	£18,540	140,000
Redcar and Cleveland	£15,188	135,000
Darlington	£24,585	105,000
Hartlepool	£15,777	92,000
Yorkshire & The Humber	£20,351	5,391,000
North West	£21,867	7,174,000
UK Average	£25,351	65,110,000

Durham has an addressable market size of over 11m passengers which are heavily competed for

REGIONAL OVERVIEW

- In addition to the 5.5m passengers which originate from the North East, a further 11.3m originate from the Yorkshire and The Humber region. Removing passengers from South Yorkshire, which are unlikely to fly from Durham or Newcastle, creates a potentially addressable market of just over 11m passengers for Durham.
- Of this 11m, Newcastle captures circa 40%, Leeds Bradford 34% and Doncaster Sheffield 5%, leaving 21% which is mostly captured by other airports across the UK.
- The remaining demand, approx. 2m passengers, is largely captured by London (1.5m passengers), leaving circa 0.5m passengers to be shared between Durham, Humberside and other UK airports, highlighting the competitiveness in the region.
- In theory at least, the 1.5m passengers travelling to London could be captured by the NE, if adequate services could be provided. However, practically, this is unlikely in the near-term due to airlines' commitments to their London bases, London's far greater route network, and the evident willingness of passengers to travel to London. A regional service from Durham however could feed into the London system. For this to succeed, Durham would require a slot at Heathrow, or Gatwick, which is unlikely, given current capacity constraints at both airports.
- Therefore, growth at Durham is likely to be driven by capturing market share from passengers within the region at the expense of its competing regional airports.

Passengers by Originating Region and Airport Used, 2017



Distribution of NE Passengers by region & airport, 2017

Originating Passengers by Region		Terminating NE Passengers* by Airport Used	
North East	5.5m	Newcastle	4.6m
Yorkshire/Humber	11.3m	Leeds Bradford	3.8m
Total Market	16.8m	Doncaster Sheffield	0.6m
Minus Yorkshire and Humber at EMA	-654k	Major Airports	8.9m
Minus Yorkshire and Humber at MAN	-4.8m	London	1.5m
Total Capturable Market	11.3m	Other UK	0.8m
		Sub-Total	2.4m
		Total	11.3m



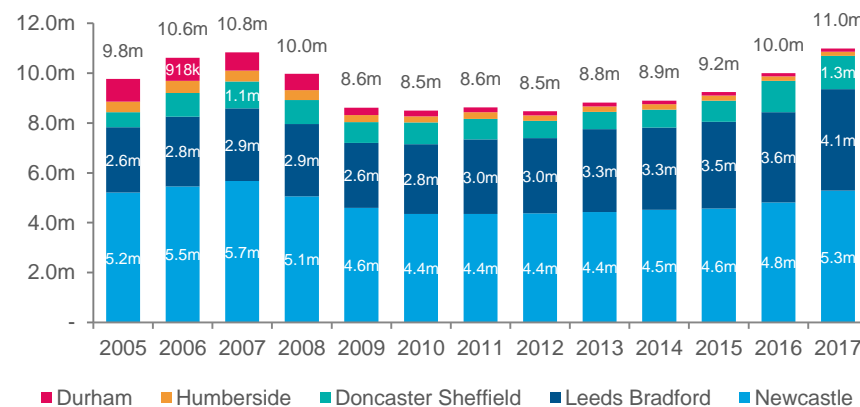
*excludes transfers
 Source: CAA Passenger Data, CAA Survey Data 2009, 2015 and 2017
 ICF proprietary and confidential. Do not copy, distribute, or disclose.

The NE region has seen traffic volumes remain flat over the past ten years with a changing airport mix

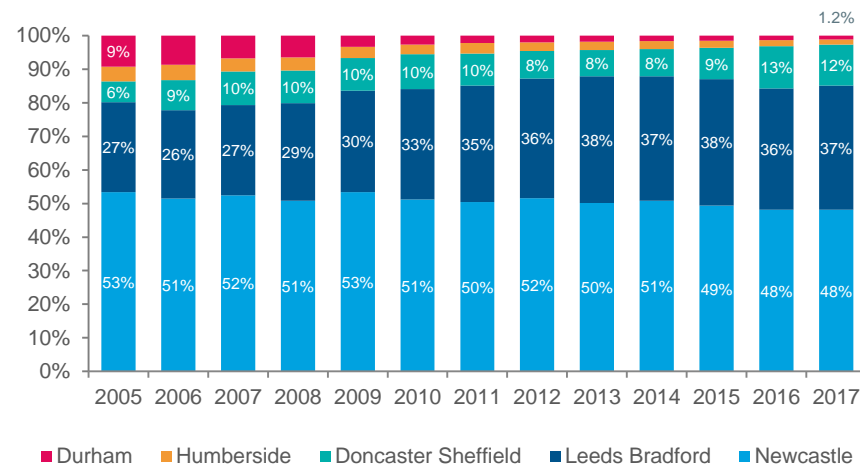
REGIONAL OVERVIEW

- For the purposes of understanding the local market, ICF has grouped Newcastle, Leeds Bradford, Doncaster Sheffield, Humberside and Durham into a collective 'North Eastern' region.
- The region's traffic peaked in 2007 at 10.8m passengers, however in the aftermath of the Global Financial Crisis ('GFC') the market suffered as airlines restructured and economies fell into recession.
- The market has seen growth each year since 2013, with growth of 10% in 2017 reaching 11m, slightly above the 2007 peak.
- Newcastle is the largest airport in the region, accounting for 48% of North Eastern traffic with 5.3m passengers in 2017. Leeds Bradford is the second largest airport in the region with 4.1m passengers or 37% market share.
- Of the three main airports, NCL has seen its market share erode while LBA has seen strong growth over the last decade with its market share rising from 27% to 37%. Doncaster saw strong growth in 2006/2007 but has seen its market share remain stable at circa 10% thereafter.
- Durham and Humberside, the two smallest airports in the region, have seen passenger volumes fall over the past decade following the failure of BMI and several charter operators who exited the market.

North-Eastern Airports Volumes, mppa



North-Eastern Airports Market Mix



Source: CAA Passenger Data

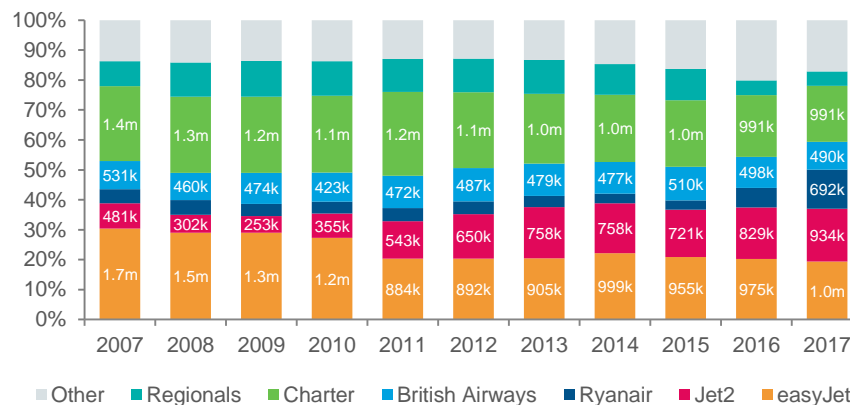
ICF proprietary and confidential. Do not copy, distribute, or disclose.

Ryanair has aggressively gained market share at NCL from regionals and charters in the past two years

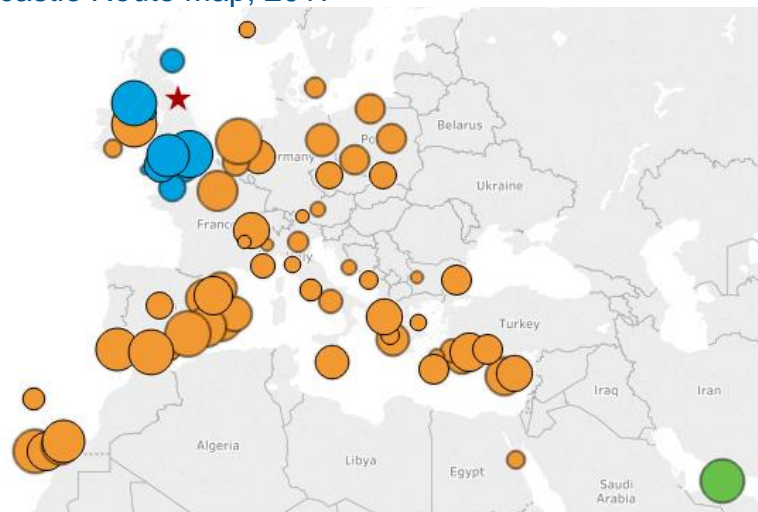
NEWCASTLE OVERVIEW

- While NCL's traffic has remained largely flat over the past decade, the airport has seen some significant change in market mix.
- Historically, NCL has been a major stronghold for easyJet, who held 30% of the traffic until 2010. In 2011, Jet2 started to increase its network in the NE and began to compete with easyJet.
- More recently, Ryanair has identified NCL as a key growth market. Growing from 140,000 passengers in 2015 to almost 700,000 in 2017, gaining market share from other LCCs and charter operators.
- Regional airlines such as flybe and Eastern Airways have also come under pressure in recent years with passenger volumes halving in the space of 2 years.
- From a route perspective, Newcastle serves a wide range of domestic, short-haul and long-haul markets with the majority of frequencies bound for locations in Europe such as summer beach destinations in Spain, Greece and Portugal or capital cities/hubs such as Amsterdam, Paris and Dublin.
- Newcastle also has long-haul services to Dubai, Orlando, Cancun, New York and Barbados, reflecting its passenger and airline mix.

Newcastle Airline Mix



Newcastle Route Map, 2017¹

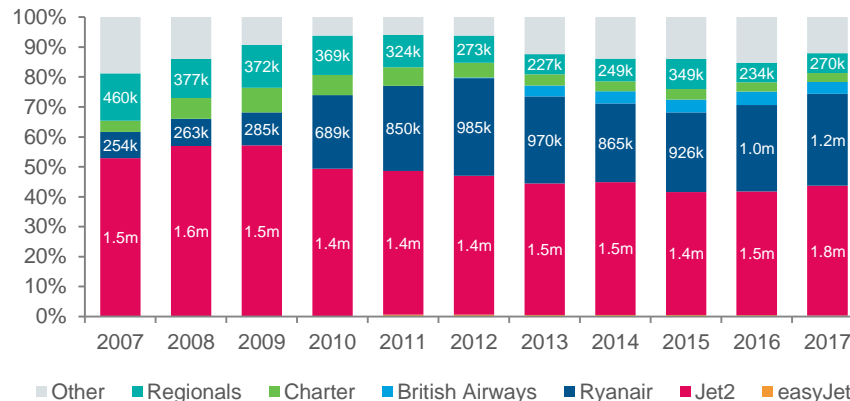


Ryanair has put pressure on Jet2 at LBA and has gained market share

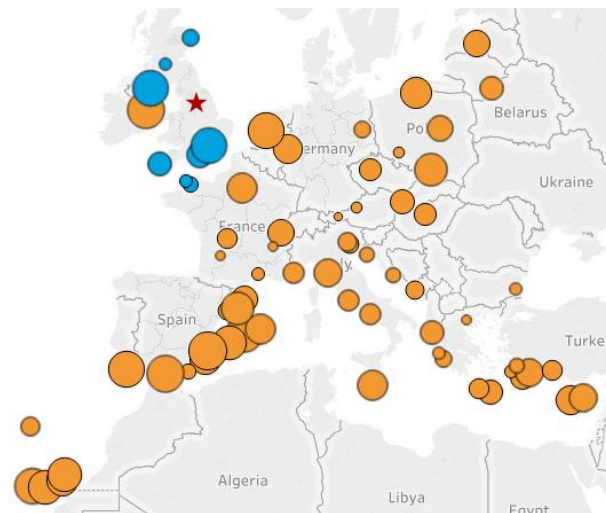
LEEDS BRADFORD OVERVIEW

- Jet2, which is based at Leeds Bradford, is the largest carrier at the airport, accounting for over 40% of the traffic. Ryanair began aggressively growing its presence at Leeds Bradford in 2010, growing from 11% to 25% market share in one year.
- Ryanair has continued its strong growth in recent years and now accounts for 31% of traffic, which has largely come at the cost of Jet2, charter and regional carriers.
- A notable exception from Leeds Bradford is any material presence of easyJet, which has a limited Geneva service in the winter. Regional services have lost market share as a result of BMI regional moving from to NCL and the collapse of Air Southwest.
- LBA's route map is comparable to most UK regional airports, with a strong focus on serving leisure destinations in Spain (Alicante, Malaga, Mallorca, etc), domestically (London, Belfast, South/South West England) and European cities/hubs such as Dublin and Amsterdam.

Leeds Bradford Airline Mix



Leeds Bradford Route Map, 2017

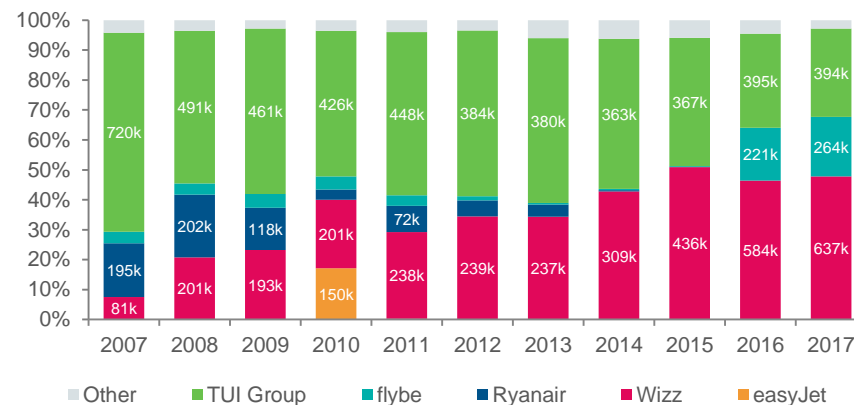


Wizz has established a strong presence at DSA serving Eastern Europe

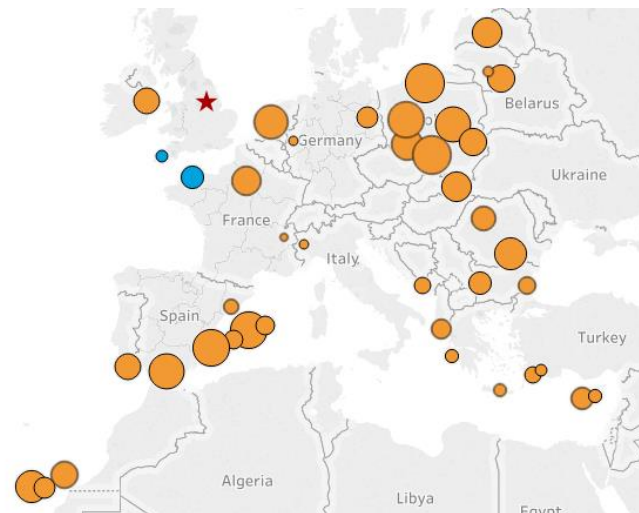
DONCASTER SHEFFIELD OVERVIEW

- Doncaster Sheffield's airline mix is less diverse than either of Leeds Bradford or Newcastle's, with three carriers accounting for 96% of the market.
- The largest carrier is Wizz, which serves the Eastern and Central European markets, serving city-breaks and the "visiting friends and relatives" (VFR) markets.
- easyJet served the airport briefly in 2010 but failed to maintain a presence, while Ryanair exited the airport in 2014. The rest of today's demand is served by flybe, which serves markets such as Amsterdam, Jersey, Paris and Dublin. While TUI group is the largest charter operator accounting for 30% of traffic, a significant step down from the 66% held in 2007.
- Unlike LBA or NCL, Doncaster Sheffield's routes have a much larger Eastern European component with significant services to countries such as Poland, Romania and Lithuania. Wizz, a Hungarian based carrier, is the primary driver of this, serving the region's VFR and leisure markets.
- Behind Poland, Spain is the second largest market reflecting the large demand for outbound leisure destinations, particularly in the summer holiday months.

Doncaster Sheffield Airline Mix



Doncaster Sheffield Route Map, 2017

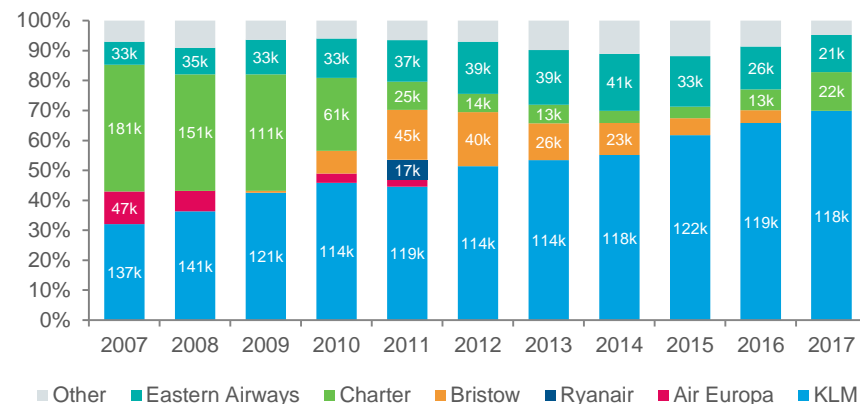


KLM's service to AMS makes up most of HUY's traffic, while summer services exist to Spain and Bulgaria

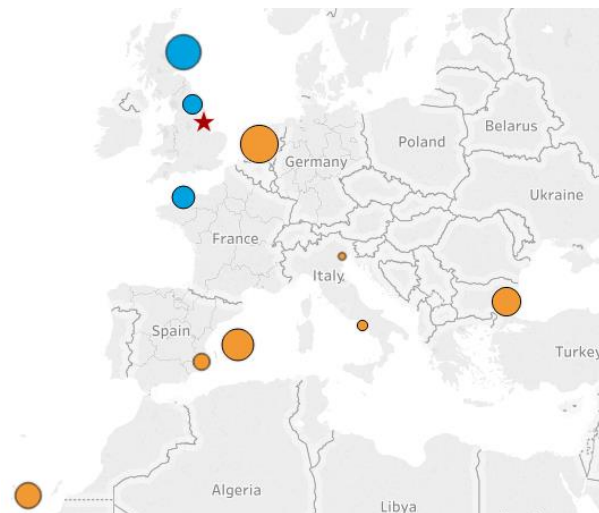
HUMBERSIDE OVERVIEW

- Humberside is the second smallest of the NE region's airports, with a comparable passenger base to Durham. The majority of traffic is handled by KLM's feeder service into Amsterdam (a trait shared with Durham). The rest of the traffic is handled by charters in the summer and regional operator Eastern Airways.
- Charter operations started to decline significantly from 2009 to 2015. There has been a recent uptick in 2016 and 2017 which have seen volumes grow from a low of 8,000 to 22,000 passengers.
- Most passengers using Humberside airport are bound for Amsterdam, reflecting the limited selection of year round routes. KLM's Amsterdam service accounts for 70% of passengers, while the remaining traffic is largely bound for Aberdeen (oil industry) or outbound leisure destinations in Spain or Bulgaria.

Humberside Airline Mix



Humberside Route Map, 2017

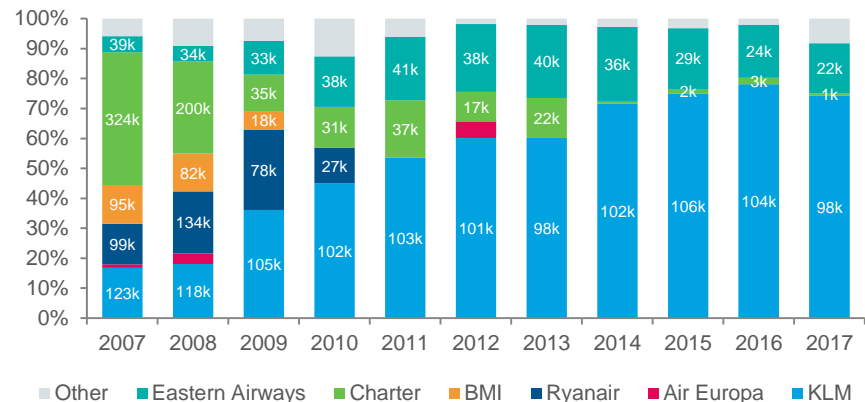


Unlike its peers, Durham lacks services to summer seasonal destinations such as Spain

DURHAM OVERVIEW

- Durham is the smallest airport in the NE region, with 130,000 passengers handled in 2016 and 2017. The airport primarily serves as a feeder route into Amsterdam by KLM which accounts for 74% of traffic. Of that traffic, 40% of passengers are destined for Amsterdam, with 60% transferring worldwide through KLM's global route network.
- Over the past decade, several airlines have exited the airport reducing its customer base to only a handful of carriers. Eastern is the airport's second largest operator with 17% market share serving domestic routes such as Aberdeen and Jersey. In late 2017, Eastern and flybe entered into a five year franchise agreement, whereby Eastern will operate under the flybe banner. This agreement replaced the previous one held with Loganair.
- The most significant gap in Durham's route map is summer seasonal destinations, along with many other locations served from other NE airports. The summer seasonal market used to be served by charter operators and LCCs such as Ryanair but these routes have not been replaced following airline moves. Durham has a secured charter services to Bulgaria for Summer 2018, but continues to not serve the Spanish summer destinations.
- Durham also lacks domestic connectivity to London. While London can be reached within 2 to 3 hours by train, there is significant spill to the capital which could be served by air rather than rail or road if the right network and pricing were in place.

Durham Airline Mix



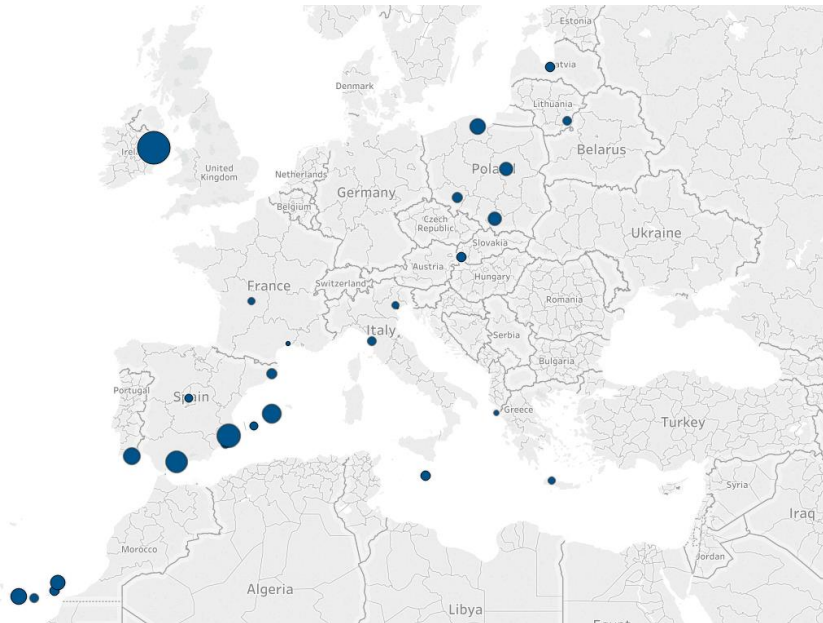
Durham Route Map



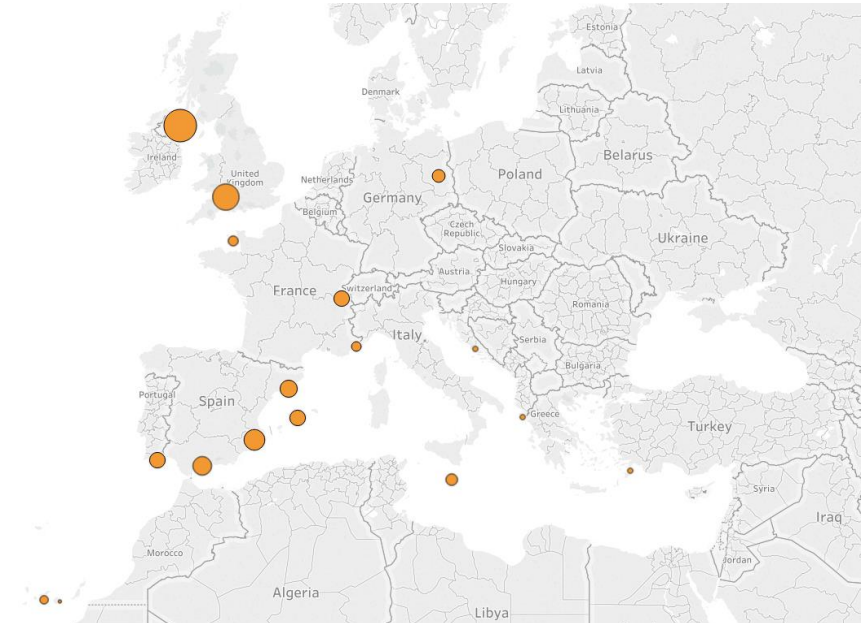
Ryanair's network spans across Europe, easyJet's is more focused on serving Western Europe and the UK

CARRIER ROUTE MAPS FROM THE NE, 2017

Ryanair Route Map from NCL and LBA



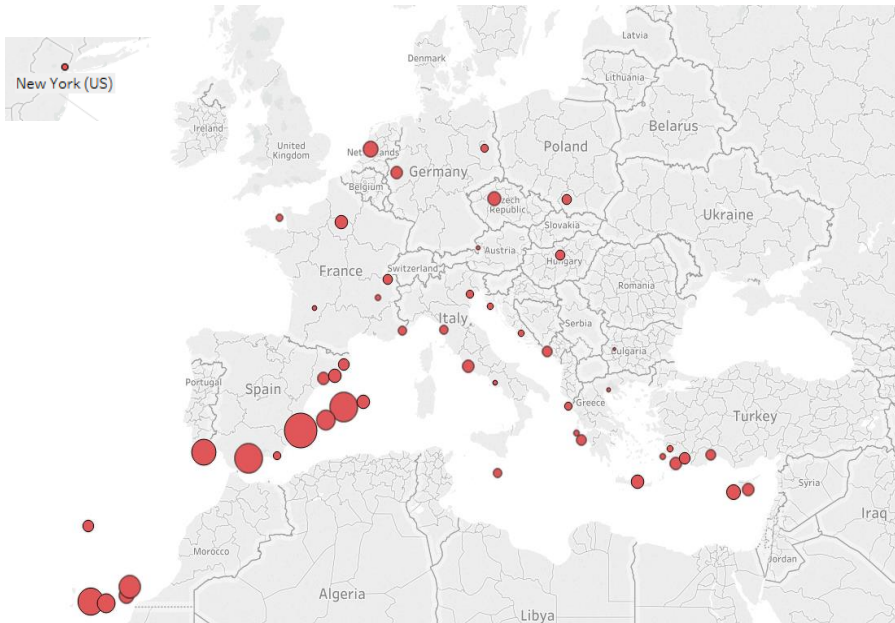
easyJet Route Map from NCL and LBA



Jet2 has a broad network across Western and Southern Europe, Wizz's network is exclusively Eastern Europe

CARRIER ROUTE MAPS FROM THE NE, 2017

Jet2 Route Map from the NCL and LBA



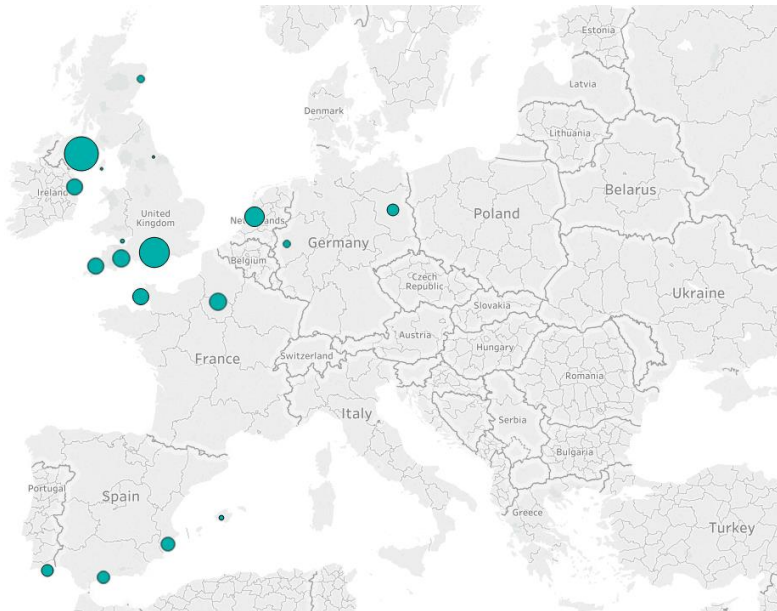
Wizz Route Map from the DSA



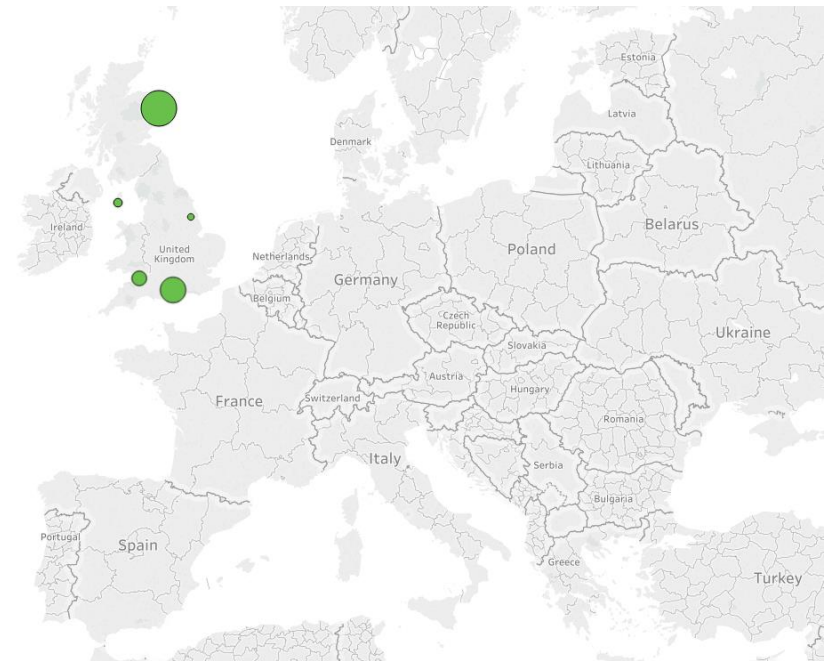
flybe's network covers a range of domestic and international routes, Eastern exclusively serves the UK

CARRIER ROUTE MAPS FROM THE NE, 2017

flybe Route Map from the NE



Eastern Route Map from the NE

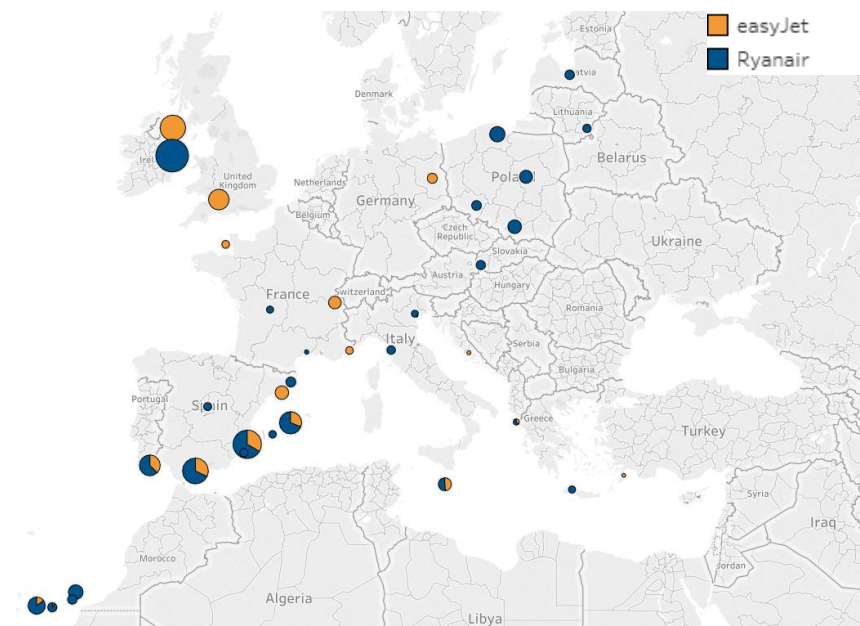


easyJet's route network is highly competed for, with Ryanair gaining market share from easyJet

RYANAIR AND EASYJET COMPETITION

- Ryanair's route network from the North East covers 27 destinations to Ireland, Spain, Poland and several other countries scattered across Europe.
- easyJet's network is smaller with 17 services in total to Spain, the UK and some minor services across Western Europe.
- The two carriers serve different markets for the most part, but are increasingly competing for the same passengers and now compete on nine city pairs.
- In eight out of the nine cities Ryanair is the dominant carrier. The one market where easyJet has a larger market share is Barcelona, which Ryanair serve from the secondary airport, Girona, which is over 100km from Barcelona.
- Ryanair's ability to enter Newcastle and Leeds Bradford and gain market share from the established LCC highlights the pressure felt by incumbents such as easyJet and Jet2.
- easyJet is likely to see more pressure on yields and load factors as Ryanair continues to gain market share. It is also a possibility that Ryanair enters more easyJet destinations, putting further pressure on easyJet.

easyJet and Ryanair Route Map



Durham Tees Valley Airport Overview

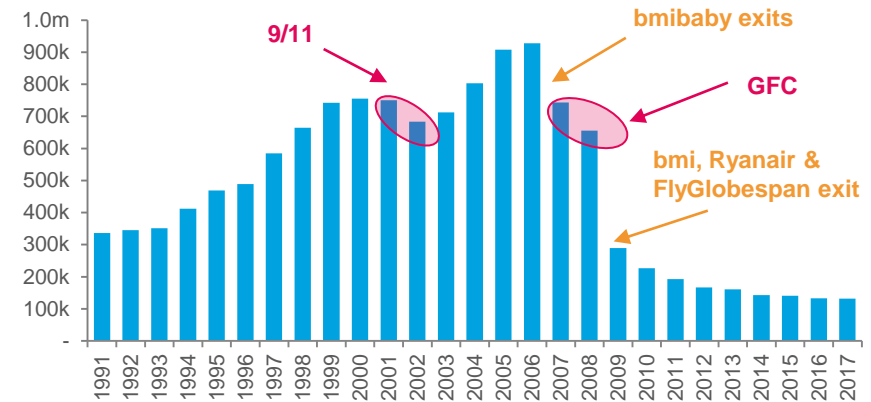


Durham's traffic has fallen from over 900,000 to 130,000 since 2006 as a result of airline consolidation

DTVA OVERVIEW

- In 2017, DTVA handled 131,000 passengers, a 0.6% decrease on the previous year. Passenger traffic at DTVA grew rapidly during the 1990s, growing from 300,000 to over 700,000 in 1999/2000.
- Following 9/11 in 2001, the aviation industry suffered a global decline in demand, with DTVA suffering a 10% fall in passengers, comparable to many UK airports. Traffic recovered shortly after, with traffic peaking in 2006 at 930,000 passengers.
- In 2007, traffic fell by 20% following the GFC, proving the start of 11 years of consecutive traffic decline as airlines such as bmi, Thomas Cook and Ryanair exited the market.
- Since the exit of most carriers, the airport has only managed to maintain KLM's triple daily service to Amsterdam and some regional flying. Load factors on the KLM route are below industry standards at 66%, while the airport's Aberdeen service achieves load factors in the low 40% suggesting a lack of demand for both services.
- Routes to summer destinations such as Spain, Bulgaria, Turkey and Malta however all achieved high load factors when previously operated, suggesting demand exists for seasonal services.

Historical Passenger Growth – DTVA

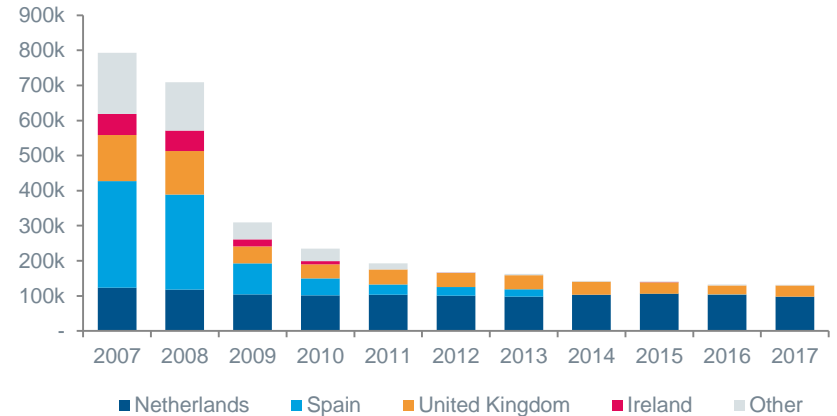


Passenger choice at Durham is limited to a small selection of routes and airlines

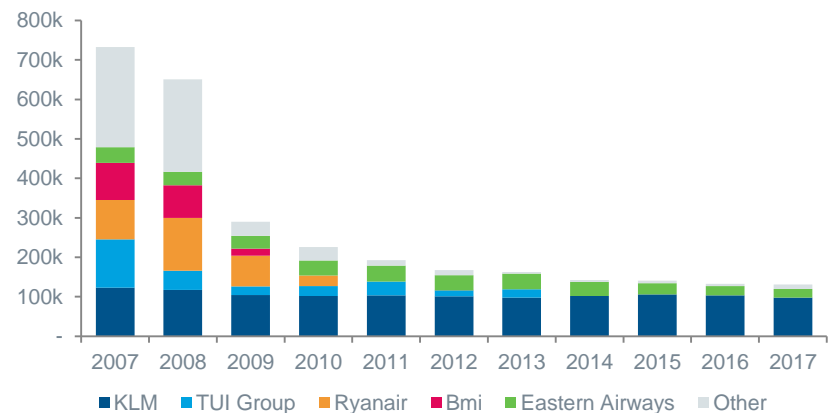
DTVA OVERVIEW

- Durham’s passenger traffic is largely bound for Amsterdam or Aberdeen. Spain was once the largest market, achieving strong load factors and was served by several operators including TUI, Ryanair, BMI, Air Europa and other charter operators.
- Connectivity to other parts of the UK, and Ireland, have also largely been abandoned as Durham’s airline mix fell. London once accounted for over 80,000 passengers while Newquay and Jersey accounted for almost 50,000 passengers collectively. Dublin has also not been served for a number of years despite almost 60,000 passengers in 2007 and 2008.
- The small selection of routes is driven by the lack of airlines serving Durham. KLM’s model is to feed traffic through to its Amsterdam hub, while Eastern lacks the scale to develop a significant network without consolidating operations at other airports.
- The combination of few destinations and monopoly routes means that for many passengers Durham is not a viable airport to travel from. As such, passengers are travelling beyond Durham to Newcastle, Leeds Bradford, Doncaster Sheffield and further afield.

Passengers by Destination Country



Passengers by Airline

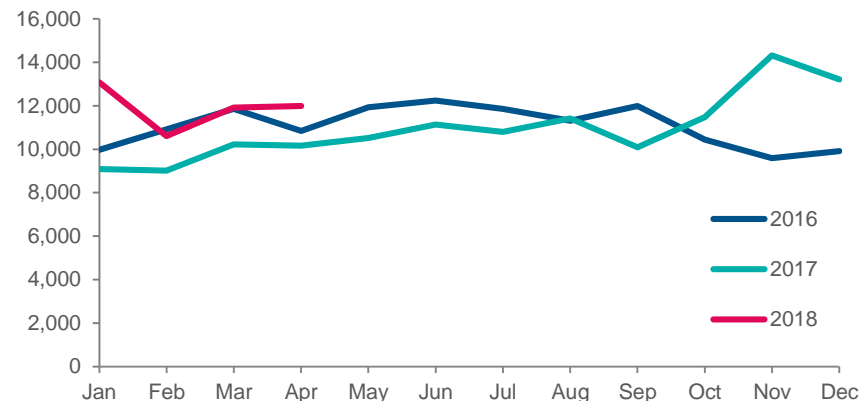


Unlike other NE airports, DTVA has no summer seasonal service

SEASONALITY

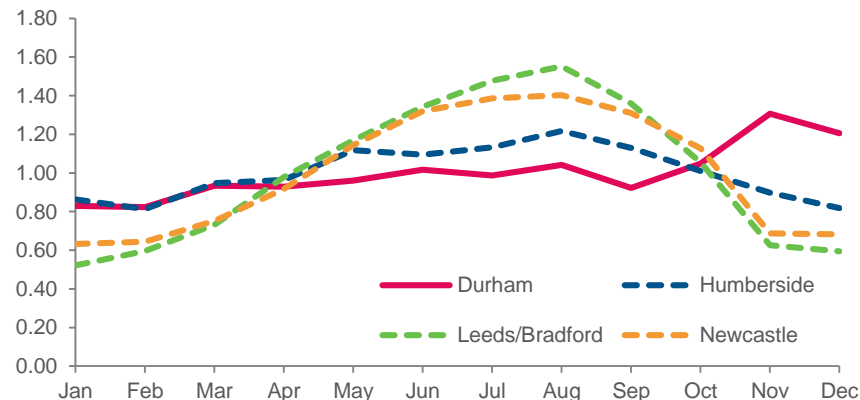
- Annual demand at DTVA has remained fairly flat since 2016, with no noticeable peak in traffic. This is a reflection of the airport's operations which lack meaningful seasonal services and mostly consists of KLM's year round service to Amsterdam.
- Other airports in the region have a much busier summer peak (April to October) than DTVA. The summer peak season accounts for over 70% of annual passenger throughput at Leeds Bradford and Newcastle.
- In late 2017, the Aberdeen route became competed by Loganair and flybe (previously operated under Eastern), which demonstrated that increased competition can have a significant impact on travel demand.

DTVA Monthly Passengers



Seasonality of Select Airports

(Monthly Passengers relative to annual average, 2017)



Traffic Forecast Methodology



ICF have forecast three scenarios for DTVA's future traffic flows

FORECAST METHODOLOGY

- ICF have analysed three scenarios for DTVA's future traffic.
- We have prepared analysis on each airline type and summarised their likeliness to move to DTVA.
- **Scenario 1: Organic:** We assume that DTVA's market share remains constant relative to its NE peers, and grows at the market rate. This scenario reflects no material change to how DTVA operates today with growth coming as a result of improvements to load factors on existing routes and marginal increases in capacity.
- **Scenario 2: Seasonal/Regional:** We assume that more active management allows DTVA to attract seasonal services, bringing its service levels to the standard seen at other UK regional airports. We also assume that DTVA attracts a regional operator to better serve the domestic and short-haul market. For this scenario, ICF have adopted a bottom-up approach at the route level based on regional demand and benchmarking to other UK airports.
- **Scenario 3: LCC:** We assume that driven management is able to attract an established LCC from a regional competitor airport to DTVA. We assume the carrier moves all operations to DTVA over a two year period, with minor disruption to its market share. We assume regional operations are established in addition to the LCC traffic, but at a lower throughput given the competition from the LCC operator. We assume that the LCC provides services to cater for the summer seasonal demand and that therefore only very a limited charter operation remains at Durham in this scenario serving remote destinations outside the LCC's network.

In addition to summer services, regional operators could provide greater year-round connectivity

POTENTIAL AIRLINES: REGIONAL CARRIERS

- Regional carriers have been most adversely affected by LCC competition in the past few years. Carriers such as flybe and Eastern have suffered but continue to operate across a range of UK regional airports with similar characteristics to Durham.
- Due to the business model of regional carriers, they do not require as much demand as an LCC to start flying inbound from one of their existing bases, and as such we believe that they could be attracted to Durham.
- The London market has seen capacity decline from the regions, but as indicated by the CAA surveys, a significant portion of NE passengers still travel from London, highlighting the potential for an operator to enter the market and recapture spilled demand.
- In addition to London, regional operators could also serve markets in the South and South West of the UK, where ground travel times can be long and unpredictable.
- Regional operators have also previously served international locations such as Paris, Brussels and Dublin and could potentially relaunch these markets if scheduled and priced to market.

Airline	NCL Pax Change (2014 - 2017)	LBA Pax Change (2014 - 2017)	Comments
Brit Air / Hop	150,000↓	-	Air France's HOP! connecting Paris and Lyon to Europe
Eastern	33,000↓	9,600↑	Cut service at NCL and grew SOU service at LBA
TUI Group	34,000↓	2,000↑	Reduced service to Turkey, Egypt, Portugal but has grown Spain and long-haul routes
Onur Air	18,000↓	-	Exited UK in 2014
Monarch	-	17,000↓	Ceased in 2017
Wideroe	16,000↓	-	Exited UK in 2016
Thomas Cook	11,000↓	-	Reduced capacity to Spain and Turkey and ceased Tunisia

Charters serving the summer market are a further option for DTVA's growth plans

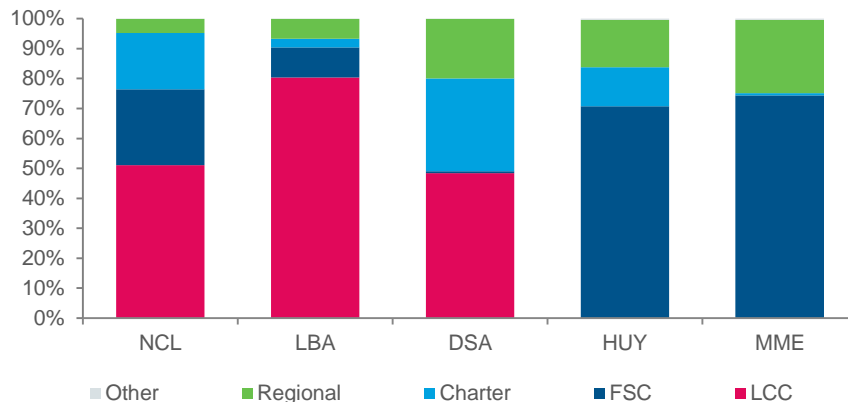
POTENTIAL AIRLINE TARGET LIST: CHARTERS AND FSC

- Full service carriers (FSC), such as British Airways could be a target for Durham. However, FSCs typically focus on serving their hubs and are unlikely to serve destinations beyond that. KLM for instance, will likely only ever serve its hub in Amsterdam and BA will likely only serve Heathrow or Gatwick.
- Additionally, FSCs have largely been squeezed out of the regional market by LCCs and have not grown their services to the NE in the past decade.
- As such, we consider the opportunity to attract a FSC to be limited.
- Since the rise of LCCs, charter operations have declined into a small but profitable market. LCCs have largely substituted charters, particularly on short-haul routes, and this can be seen in the NE with TUI and Thomas Cook both suffering.
- However, Durham offers charters an opportunity to operate without the direct competition of an LCC, which could attract summer seasonal services to the Mediterranean.
- In addition to home-based carriers such as TUI and Thomas Cook, Durham could also attract foreign carriers in Turkey, Greece and Bulgaria.
- The lack of any summer service at Durham suggests that there is potential to attract a charter to fill this gap in the market. Humberside and other small regional airports have summer services, despite nearby competition, and we believe that Durham should be able to compete in this space based on its local catchment.

POTENTIAL AIRLINES: LOW COST CARRIERS

- If DTVA were able to attract an LCC, this would signify a significant step-change in the airport's operations.
- However, carriers face the risk of cannibalising their existing market share were they to establish an additional operation at DTVA, or, alternatively, allow an incumbent competitor to back-fill their share should they exit a regional peer to operate from DTVA. However, relocating services to DTVA, would allow a carrier to dominate DTVA's local demand which currently spills to other local airports.
- Although Jet2 has lost market share to Ryanair, LBA is it's base, and it is unlikely to abandon its relatively strong market position.
- Wizz's business model is to serve the Eastern and Central European markets with a focus on VFR. This works for DSA where there is a material expat community. While Wizz does not have a presence at LBA or NCL, limiting the risk of cannibalising existing traffic, the Eastern European community in the North East is less sizable, meaning the airline would have to compete directly with Ryanair, Jet2 and easyJet for passengers.
- Ryanair has previously served DTVA while also serving NCL and LBA, so is not against serving all three markets. The carrier however, has rapidly grown its presence and market share at both airports, and as such is unlikely to reallocate to an airport between two key markets where it is succeeding.

Airline Mix, 2017



Traffic Forecast

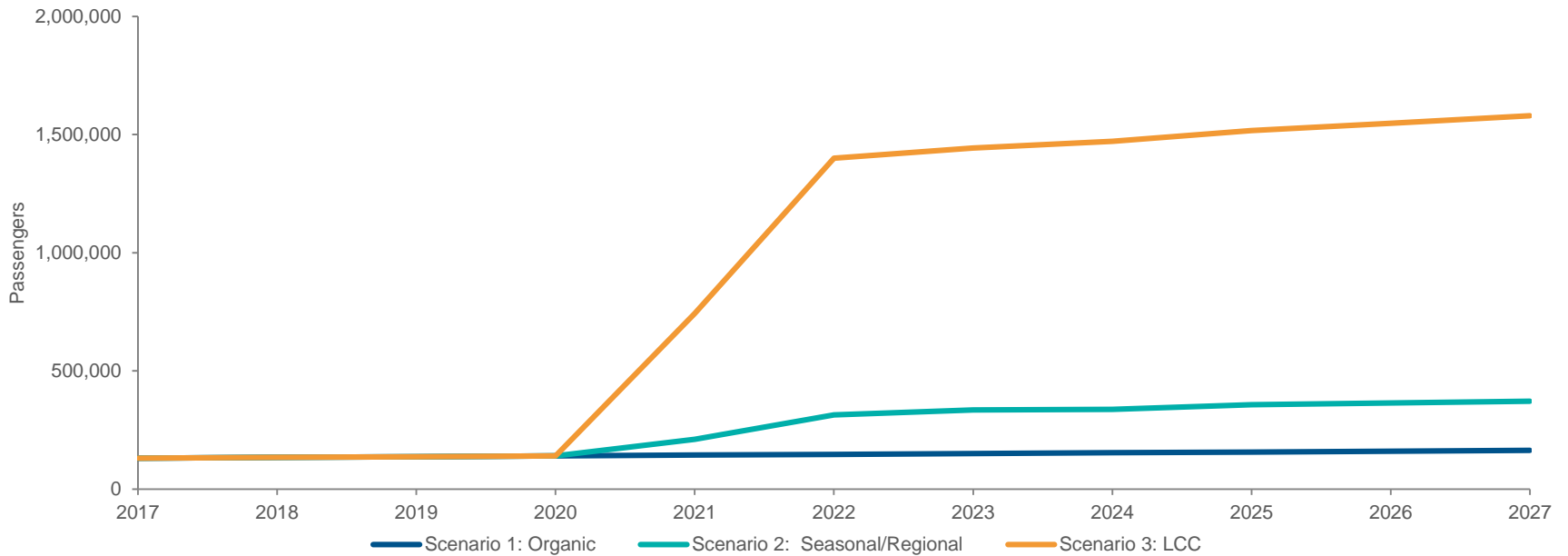


ICF Forecast Summary

SUMMARY

(Financial year ending March)

Total Passengers (000s)	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	CAGR 17-27
Scenario 1: Organic	131	135	138	141	144	147	151	154	157	161	164	2%
Scenario 2: Seasonal/Regional	131	135	138	141	211	314	335	337	357	365	372	11%
Scenario 3: LCC	131	135	138	141	743	1,400	1,443	1,472	1,516	1,548	1,579	28%



Source: ICF analysis

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Business Plan



Aeronautical Revenue



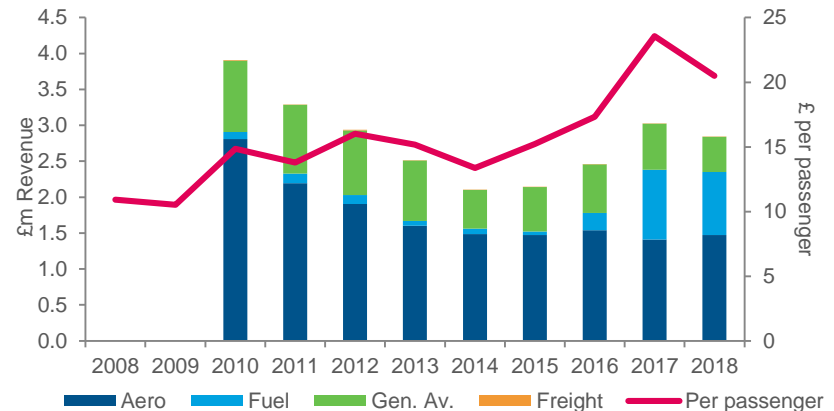
DTVA's aeronautical revenues have fallen as a result of declining passenger volumes

HISTORICAL PERFORMANCE

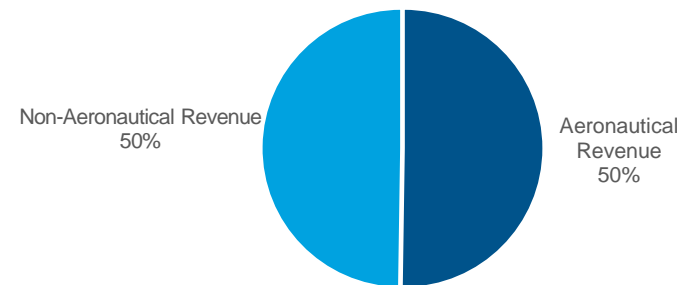
- 50% of DTVA's revenue in FY18 was derived from aeronautical activities. These include:
 - Landing/Parking and Passenger charges;
 - Other ancillary charges
 - General Aviation and Freight handling charges
 - Fuel revenue
- In FY18, DTVA generated £2.84m of Aeronautical Revenue, or £20.50 per passenger.
- Over the period FY10 to FY18, real aeronautical revenue decreased from £3.9m by a CAGR of -3.9% per annum, driven by the drop in passenger volumes at the airport.
- Revenues experienced strong uplift in 2016 and 2017 as a result of DTVA bringing fuel farm activities in house, increasing revenues by over £800,000.
- Revenue generate from commercial flights (aero charges) have remained largely flat in real terms since 2014 and account for just over half of the airport's total aeronautical revenue
- Regional airports in the UK are free to set airport tariffs as they desire. In practice, these are determined by market conditions such as airlines' appetite to serve the market.
- Note that DTVA includes the Passenger Facility Fee as non-aeronautical, and the above analysis has been undertaken on that categorisation, however, we would ordinarily consider it to be aeronautical revenue.

Historical Aeronautical Revenue

(Year ending March, £m, Real 17/18)



Split of Aeronautical & Non-Aeronautical Revenue, FY18

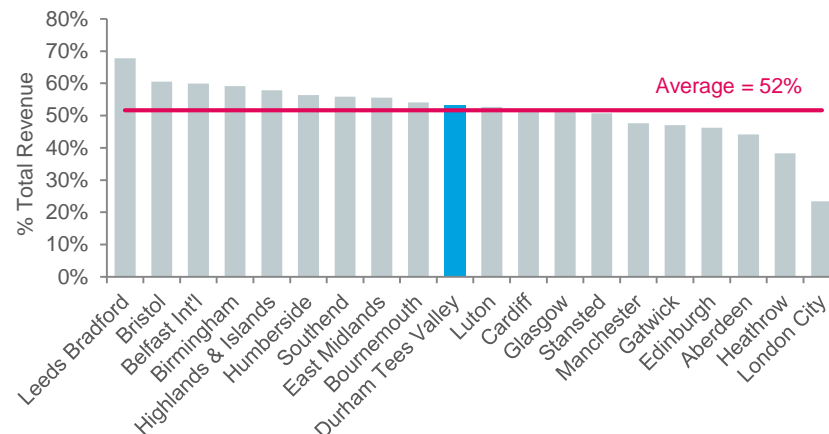


Although difficult to benchmark DTVA's aeronautical revenue its yield is high by UK comparison

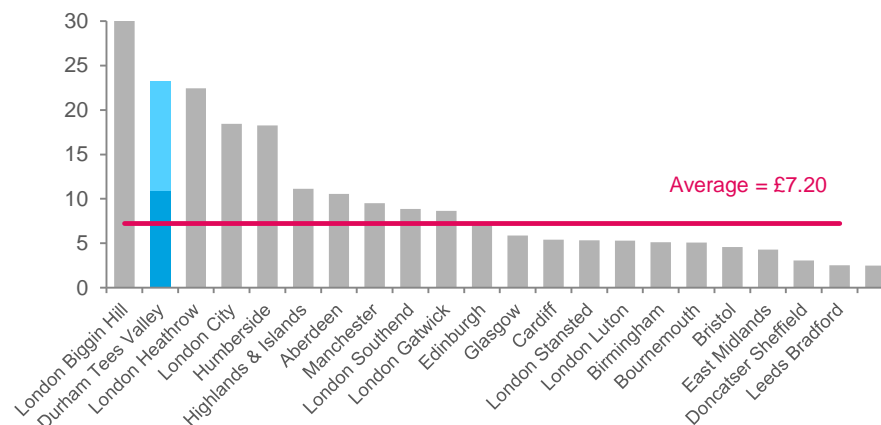
HISTORICAL PERFORMANCE

- Given the relatively low passenger throughput at DTVA, it is difficult to benchmark its aeronautical yield with accuracy. However the two charts opposite (taken from LeighFisher's 2018 publication relating to financial year ending March 2017 and calendar year 2016), indicate that:
 - DTVA's share of aeronautical revenue is in line with UK norms
 - Its per passenger yield is high
- Excluding the outlier of London Biggin Hill, and Heathrow, which serves a distinct market from the other airports, the remaining airports in LeighFisher's sample average around £7 per passenger weighted by passengers, but with a significant number of airports earning less than that rate.
- Excluding DTVA's freight, fuel and general aviation revenue, the underlying aeronautical charges yield averages around £11 per passenger (shown in total and excluding other aeronautical revenues in the shades the chart opposite).
- In a significant growth scenarios, therefore, it is unlikely that the airport will be able to sustain its current level of charges.

Aeronautical Revenue Share of Total Revenue (%)



Benchmarking of Aeronautical Yields



ICF forecasts aero charges to reduce in real terms along with short-term incentives to attract airlines

ICF AERONAUTICAL FORECAST

- We forecast aero yield differently by scenario to reflect the competitive dynamics of each and to include the incentive that DTVA would have to offer to attract airlines in our different scenarios.
- In all scenarios we maintain fuel and general aviation revenues constant in real terms. We also remove the Passenger Facility charge in the first full year of operation by the Combined Authority (FY ending March 2021).
- For Scenario 1, we maintain aeronautical charges at the current rate per passenger (£10.9), on the assumption that KLM is willing to pay the current charge and that, absent growth, there is no need for the airport to lower charges, nor does the airport have the ability to raise charges.
- Scenarios 2 and 3 are summarised in the table opposite.

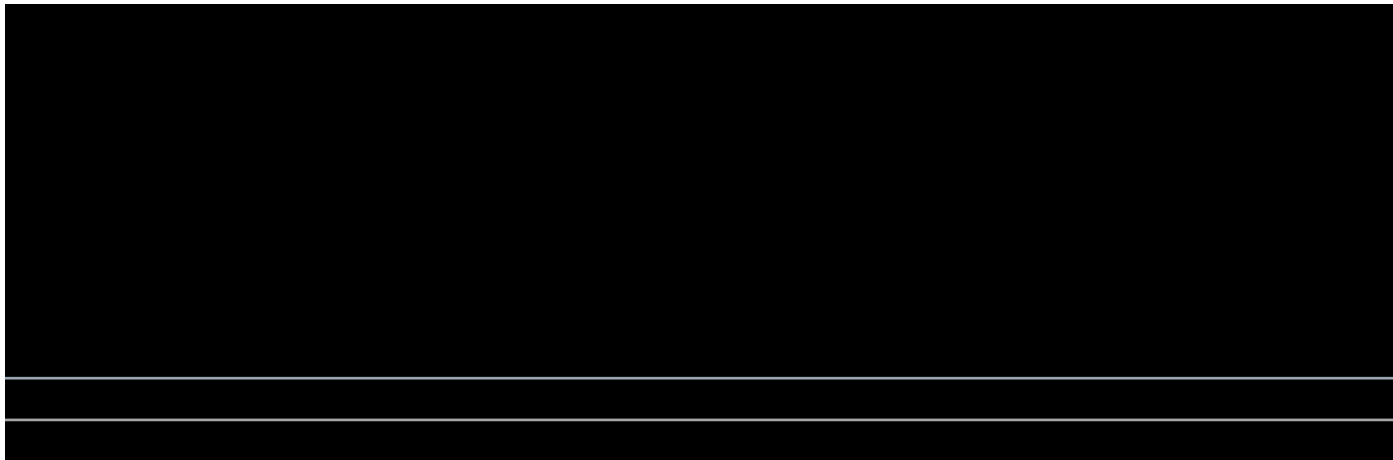
Aero Charge Yields Forecast Assumptions – Scenario 2

Aero Charge Yields Forecast Assumptions – Scenario 3



ICF Forecast: Scenario 1

AERONAUTICAL REVENUE FORECAST



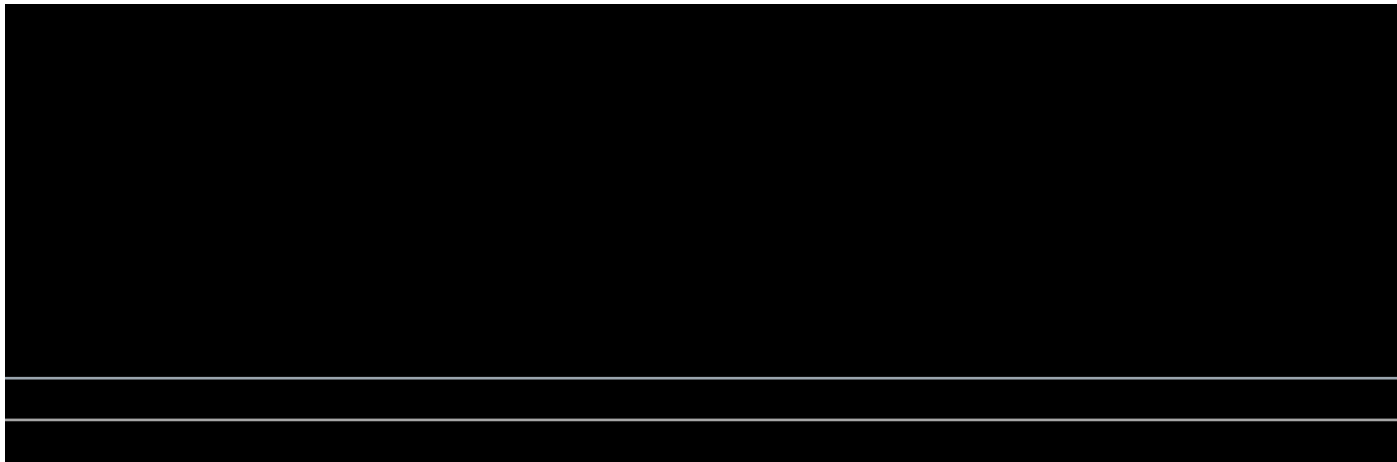
ICF Forecast: Scenario 1

SUPPORT INITIATIVE FORECAST



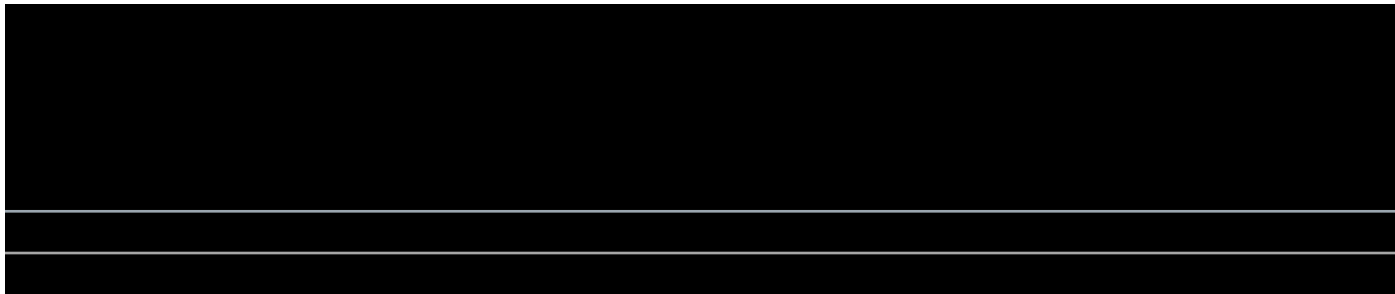
ICF Forecast: Scenario 2

AERONAUTICAL REVENUE FORECAST



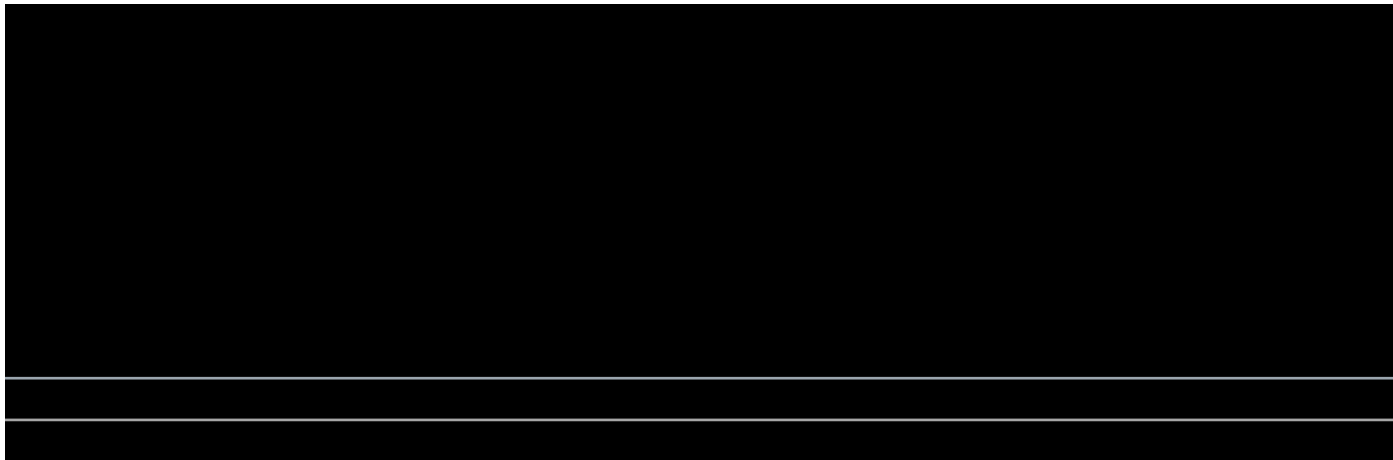
ICF Forecast: Scenario 2

SUPPORT INITIATIVE FORECAST



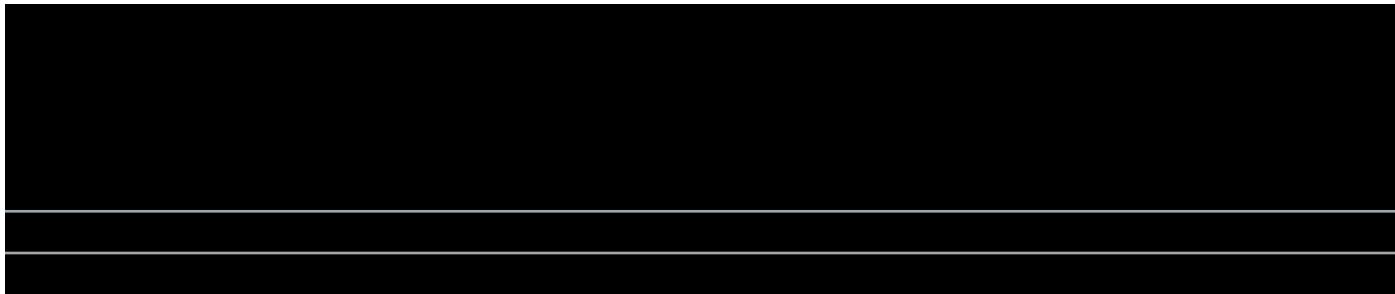
ICF Forecast: Scenario 3

AERONAUTICAL REVENUE FORECAST



ICF Forecast: Scenario 3

SUPPORT INITIATIVE FORECAST



Non-Aeronautical Revenue

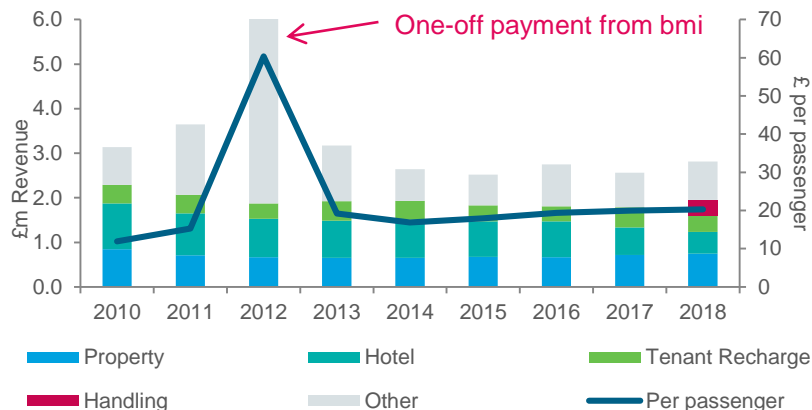


DTVA's non-aeronautical revenues have fallen as a result of declining passenger volumes

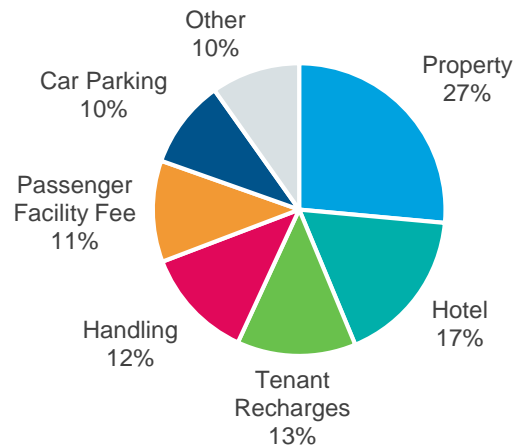
HISTORICAL PERFORMANCE

- In FY18, DTVA generated £2.82m in non-aeronautical revenue or 50% of total revenue, equating to £20.3 per passenger.
- Between 2010 and 2018 non-aeronautical revenues decreased from £3.1m to £2.8m, an average annual decrease of -1.3%. Revenue passenger increased from £11.9 to £20.3, a CAGR of 6.9%, as a result of the large non-passenger related share of non-aeronautical revenue which fell less severely than passenger volumes.
- The chart to the right shows the split of non-aeronautical revenue between the key activities. This shows that:
 - The airport has a diversified portfolio of income streams with a mix of passenger driven elements such as car parking and passenger fees, and other property related revenue.
 - The single largest commercial activity undertaken at the airport is property, generating £745,000 in 2018 or 27% of total non-aeronautical revenues.
 - The second largest source is the airport's on-site hotel, accounting for 17% of total non-aeronautical revenues, although this activity appears to generate an annual loss as the revenue has not covered the itemised cost in most years.
 - The in-sourcing of handling in FY2018 has added significantly to revenue, though it is not clear how the operational costs have fully reflected the additional revenue.
 - Excluding the passenger facility fee, which we treat at aeronautical revenue, car parking accounts of the largest passenger related non-aeronautical revenue at a revenue of consistently around £2 per passenger.

Historical Non-Aeronautical Revenue¹
(Year ending March, £m, Real 17/18)



Commercial Revenues Category Split, FY18



Source: DTVA

Note: 1. Includes the passenger facility fee.

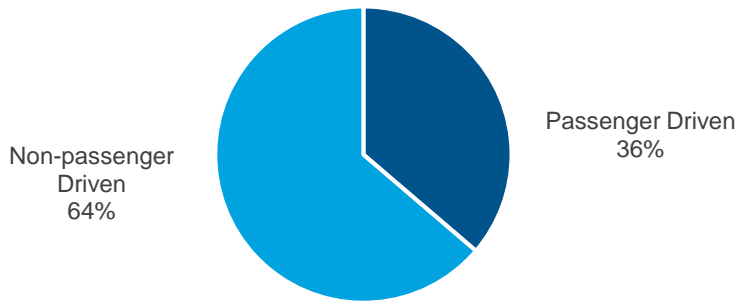
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Approximately 36% of DTVA's Non-Aeronautical Revenue comes from passenger driven services

OVERVIEW: KEY DRIVERS

- Airports generate non-aeronautical revenues from two key sources:
 - services provided to passengers
 - services provided to airlines and other business customers
- The key activities of each of these sources at the airport is shown to the right
- Overall, 36% of non-aeronautical revenues at DTVA are derived from passenger driven activities. This reflects the airport's low passenger volumes and reliance on non-passenger related revenue streams such as property and recharges to its tenants.

Split of Passenger & Non-Passenger Driven Revenue, FY18



Commercial Activities Drivers

Activity	Description
Passenger Driven	
Car parking	Revenue generated from ticket sales to customers parking in the airport's car parks
Passenger Facility Fee	Fees charged to the airline for each passenger's use of the airport's facilities
Other Concessions	Concession fees paid to the airport by retail, car rental, and other service operators
Non Passenger Driven	
Property	Rent and royalties earned from offices, check-in desks and other rentals
Hotel	Revenue from the airport owned on-site hotel
Tenant Recharges	Recharge of utility and service costs from airport tenants
Other	Advertising, Telecoms, and other miscellaneous revenue streams

ICF forecasts increasing revenue from car parking and terminal concessions

ICF NON-AERONAUTICAL FORECAST

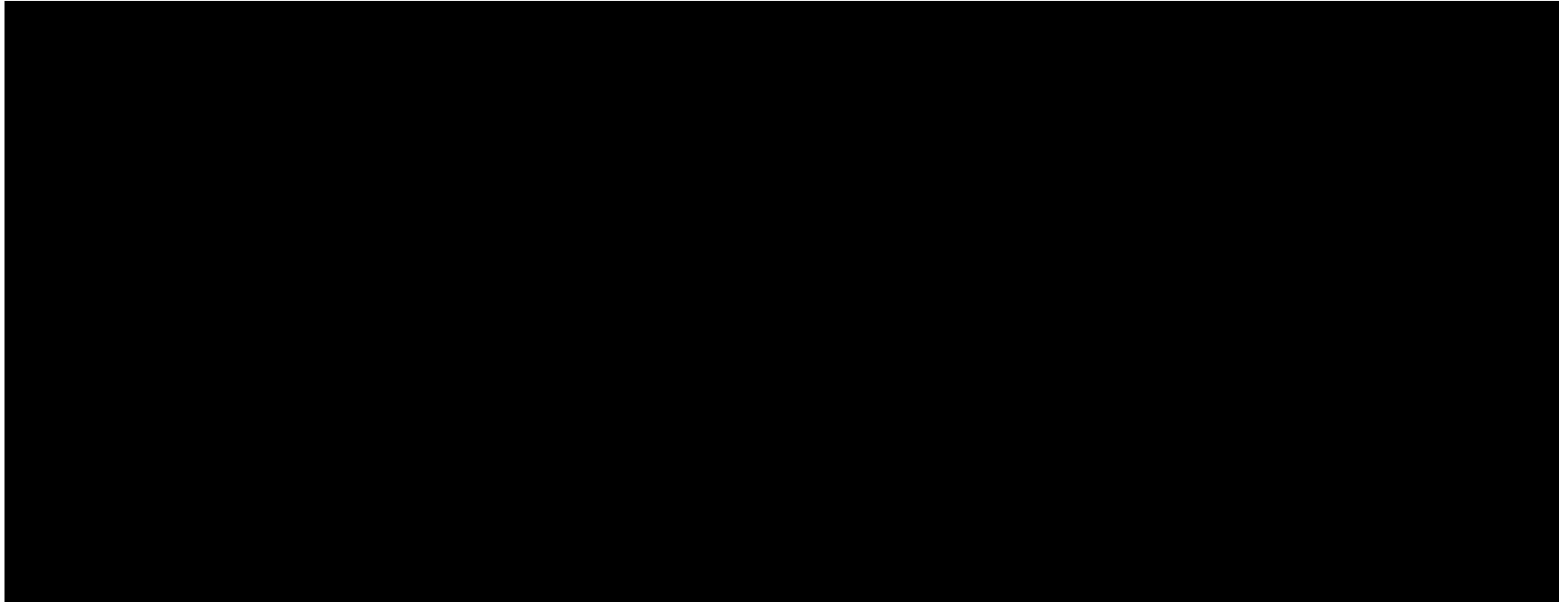
- We forecast non-aeronautical revenue generally on a revenue per passenger basis, with a number of categories held constant in real terms as summarised in the table opposite.
- The airport generates a significant proportion of income from its property portfolio and consequential recharges. We hold these revenues constant in real terms as we understand that the Combined Authority is separately investigating the potential for property revenues associated with the airport.
- Our notable assumptions therefore relate to car parking, terminal concessions and the hotel.
- DTVA already earns around £2 per passenger from its car parking, which is a reasonably good performance and is unlikely to be significantly exceeded.
- Terminal concessions under-perform and we assume a period of increase over the first three years of new ownership resulting from negotiation of new F&B and retail concessions.
- We assume that the airport ends its loss-making hotel operation under new ownership, and replace the revenue with a concession fee from a third-party operator of the hotel.

Non-Aero Revenue Forecast Assumptions

	Assumptions
Executive lounge	50% elasticity to organic growth passengers only
In-house handling	50% elasticity to growth in passengers
Concessions	10% increases to revenue per passenger in financial years 2021, 2022 and 2023
Ancillary	Constant in real terms
Land leases and tenant recharges	Constant in real terms
Hotel	Hotel out-sourced from FY21; concession fee revenue thereafter.
IT and telecoms	Constant in real terms
Advertising	Constant in real terms
Miscellaneous	Constant in real terms

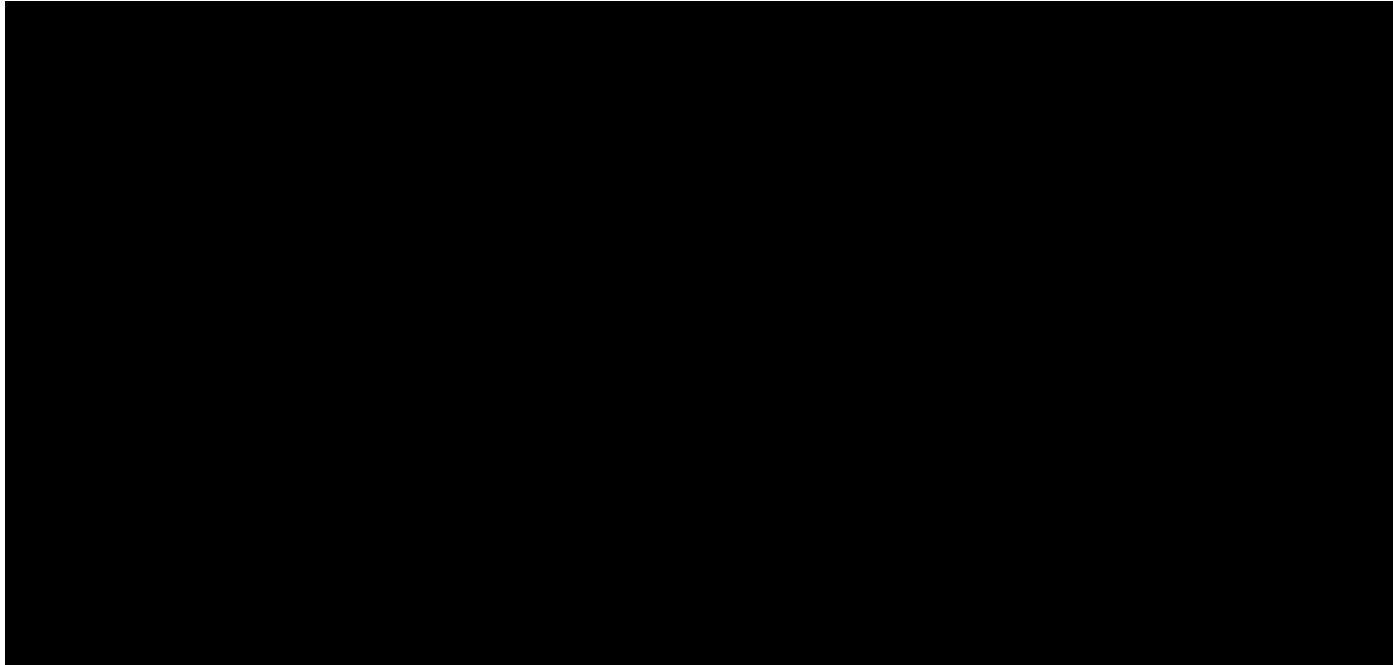
ICF Forecast: Scenario 1

NOMINAL (1/2)



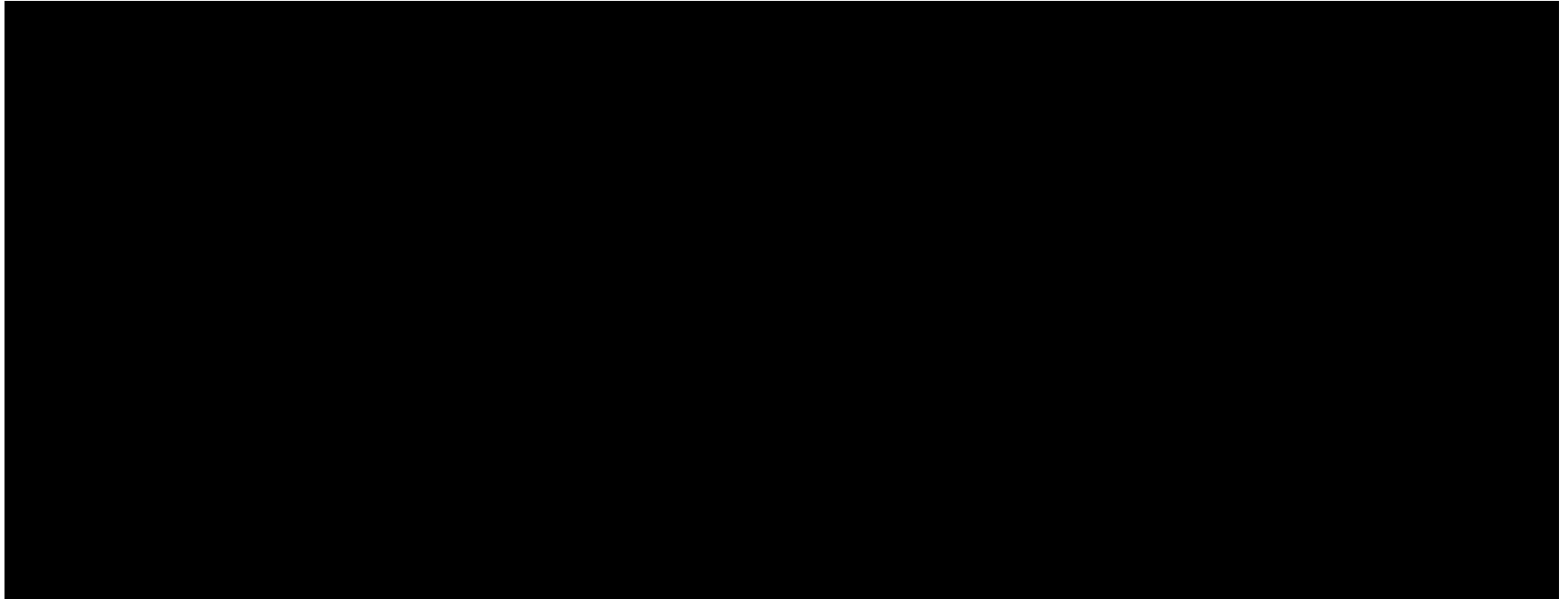
ICF Forecast: Scenario 1

NOMINAL (2/2)



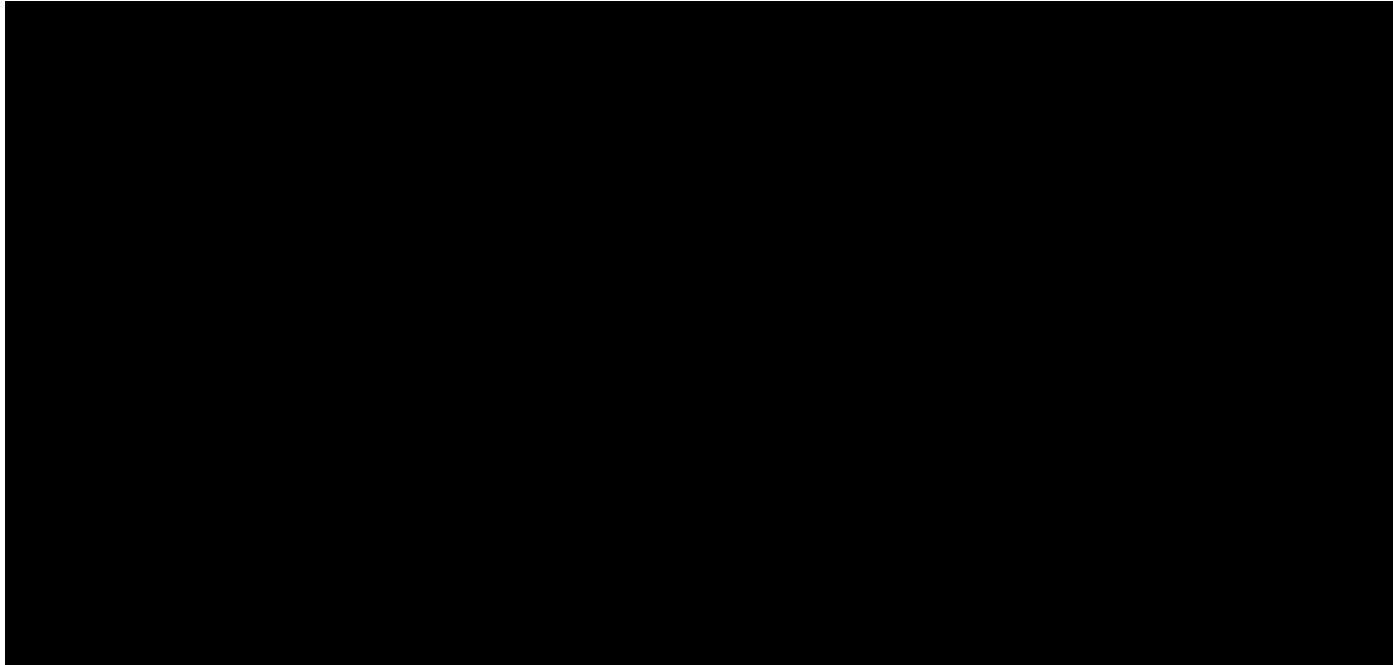
ICF Forecast: Scenario 2

NOMINAL (1/2)



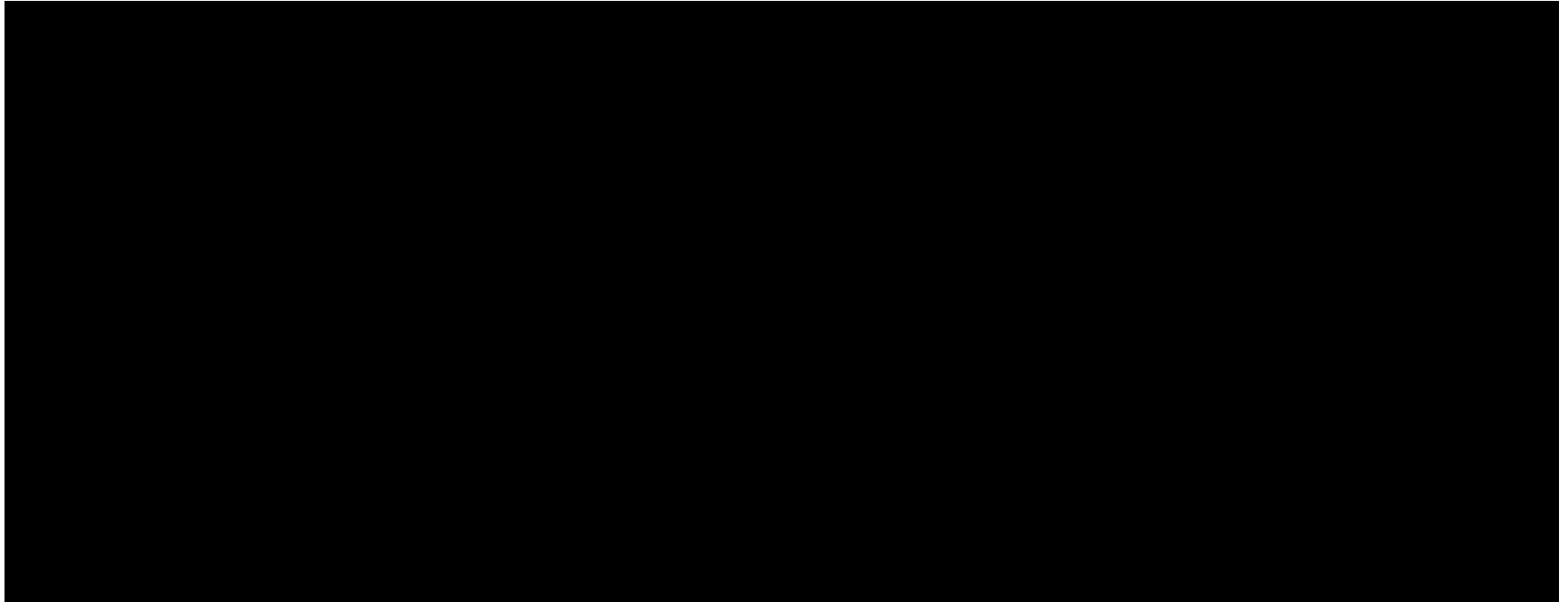
ICF Forecast: Scenario 2

NOMINAL (2/2)



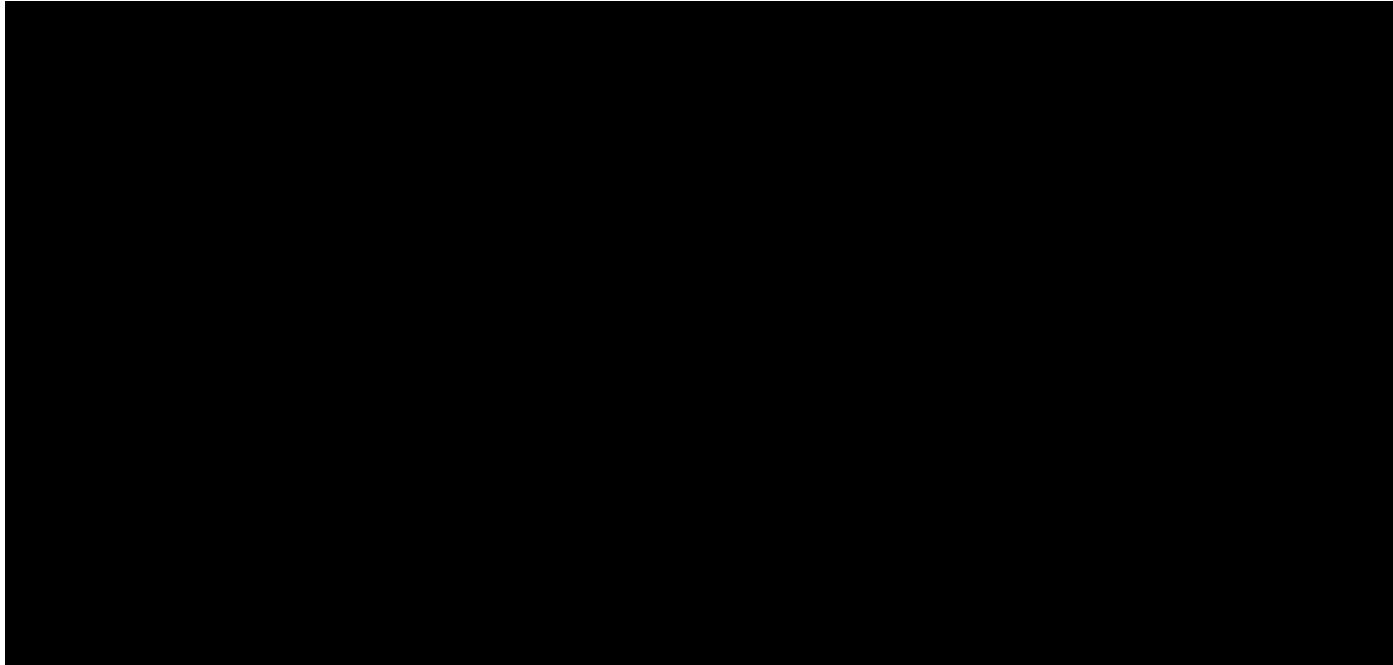
ICF Forecast: Scenario 3

NOMINAL (1/2)



ICF Forecast: Scenario 3

NOMINAL (2/2)



Operating Costs

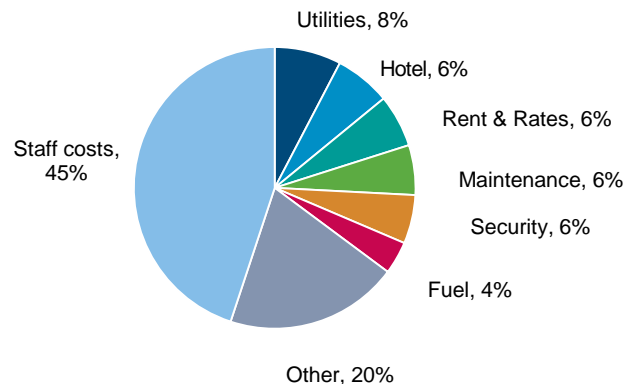


The majority of DTVA's costs are fixed and dominated by expenditure on staff

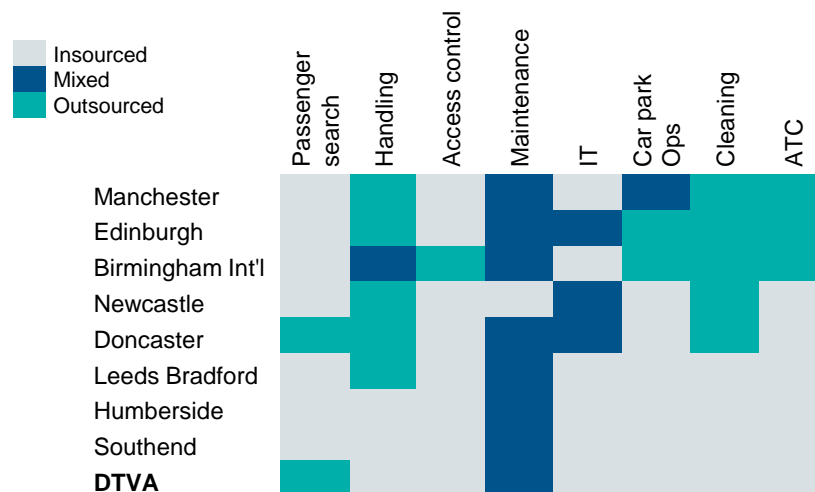
OVERVIEW

- In 2018, DTVA incurred £8.26m in operating costs.
- The chart to the right summarises the key breakdown of operating costs at the airport, showing that
- This shows that 45% of costs are related to staff costs.
- Of the remaining non-staff costs the largest items include:
 - Utilities costs for the provision of gas, electric and water. 59% of these costs are recharged to airport tenants.
 - Hotel costs associated with DTVA's running of its on-site airport.
- Most activities performed at DTVA are in-sourced, with airport employees responsible for cleaning, passenger handling, IT, and many other functions. Notably, security is outsourced.
- Further activities are provided by the Peel Group on behalf of the airport.

Breakdown of DTVA Operating Costs, FY18



Degree of Outsourcing, UK Airports

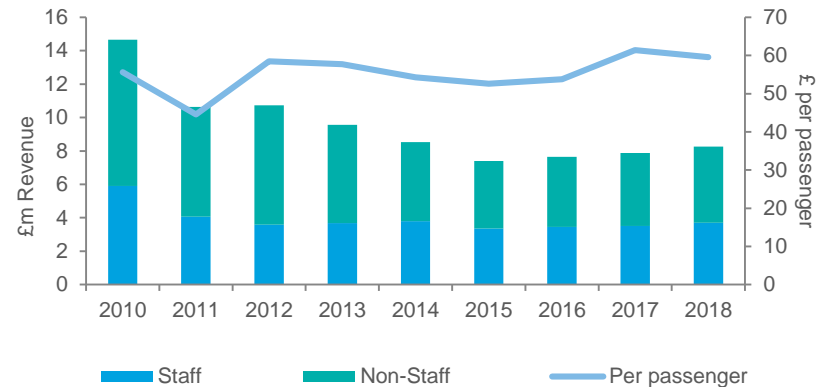


Costs have fallen in line with passengers with major savings coming from reduced staff and security costs

HISTORICAL PERFORMANCE

- DTVA incurred £8.26m in operating costs in 2018, a 4.8% increase on the previous year. This translates to just under £60 per passenger, a -3.0% decrease on the previous year.
- Since 2010 total operating costs have increased at an average annual rate of 6.9%. Passenger throughput decreased at an average annual rate of -7.7%, resulting in costs per passenger increasing at an average annual rate of 0.8%.
- This change has primarily been driven by:
 - Reduction in staff costs between 2010 and 2012 resulting in a 40% cost saving. Further reductions were made in 2015 when staff costs fell by 12%.
 - Security costs fell as passenger volumes declined, with costs falling from £1.1m to £460,000.
 - Airline route and marketing support have also fallen from £1.9m in FY08 to £400,000 in FY08 and have totalled less than £50,000 per annum since FY14.
 - Costs associated with the airport’s hotel business fell from £1.1m to £529,000 from 2010 to 2018.
 - Professional fees reduced from ~£600,000 in FY10 and FY12 to an average of £200,000 between FY13 and FY18.
 - The fuel operation was in-sourced in 2016 which saw the relevant costs increase notably.

Historical Operating Costs
(Year ending March, £m, Real 17/18)



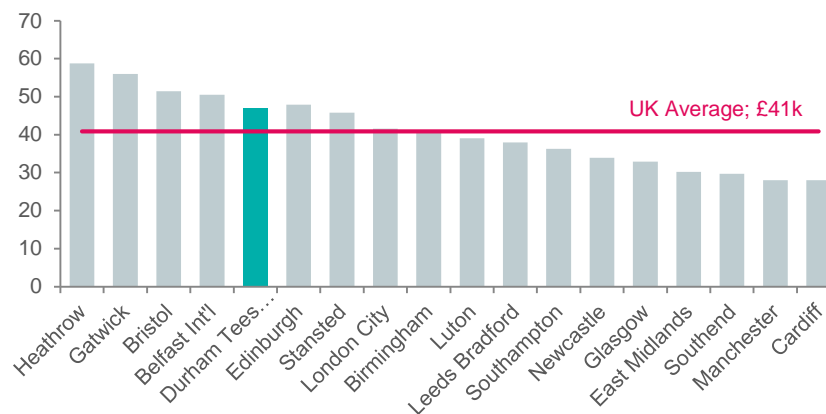
Inevitably, Durham's opex cost rate per passenger is high, but so is its staff cost per FTE

HISTORICAL PERFORMANCE

- With so few passengers, benchmarking the total rate of operating costs per passenger is unreliable. However, it is relevant to observe that the unit staff cost exceeds the UK average as shown above opposite.
- In a region with lower than UK average salaries, shown below, this cost rate is unusual.

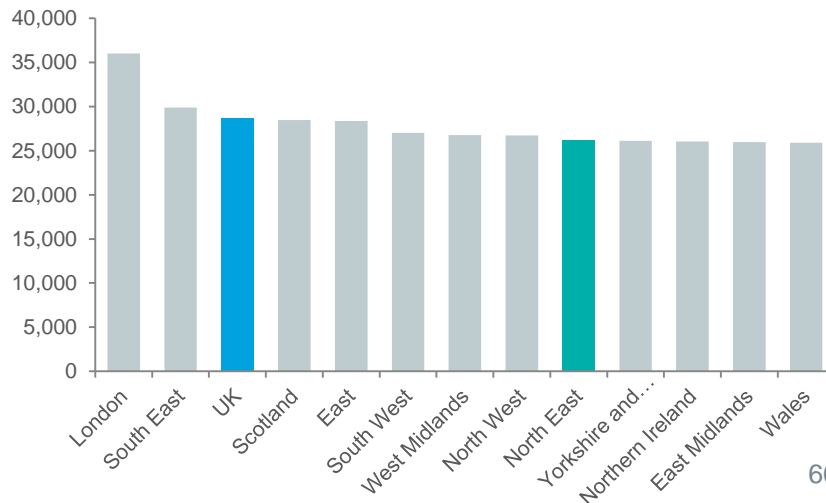
Benchmarking of Staff Costs at UK Airports

(£000s/FTE)



Median Full-Time Gross Annual Earnings

(£/FTE)



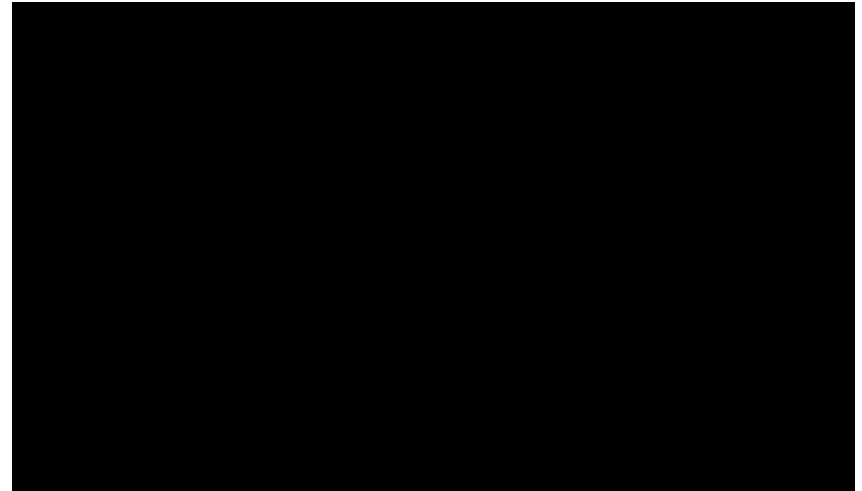
Sources: LeighFisher UK Airports Performance Indicators, Annual Survey of Hours and Earnings, 2017

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ICF forecasts a number of costs to remain constant in real terms, but a number increase with passengers

ICF OPERATING COSTS FORECAST

- We forecast a number of costs to remain constant in real terms, they are:
 - Aerodrome
 - Fuel to align with the same assumption for corresponding revenue
 - Professional fees
 - Hotel costs until FY21 when the airport operation is ceased and the costs reduces to zero
 - Bank charges and commission
- We do not include a contingency in our forecast
- Other operating costs vary with passenger throughput, or other assumptions as set out on the following pages and highlighted opposite



Operating costs forecast assumptions (1/2)

ICF OPERATING COSTS FORECAST

Business Area	Driver
[REDACTED]	[REDACTED]
Security	<ul style="list-style-type: none"> 50% elasticity to growth in passenger throughput
Cleaning	<ul style="list-style-type: none"> On the assumption that the cost of staff is included within Staff Costs, Cleaning forecast to grow at a 10% elasticity to growth in passenger throughput and 30% to floor area growth
[REDACTED]	[REDACTED]
Utilities	<ul style="list-style-type: none"> 10% elasticity to growth in passenger throughput and 50% to floor area growth
Rent and Rates	<ul style="list-style-type: none"> 50% to floor area growth, zero elasticity to passenger throughput, no allowance for real increases at tri-annual rate reviews
Insurance	<ul style="list-style-type: none"> 25% elasticity to floor area growth
Repairs & Maintenance	<ul style="list-style-type: none"> 10% elasticity to growth in passenger throughput and 30% to floor area growth

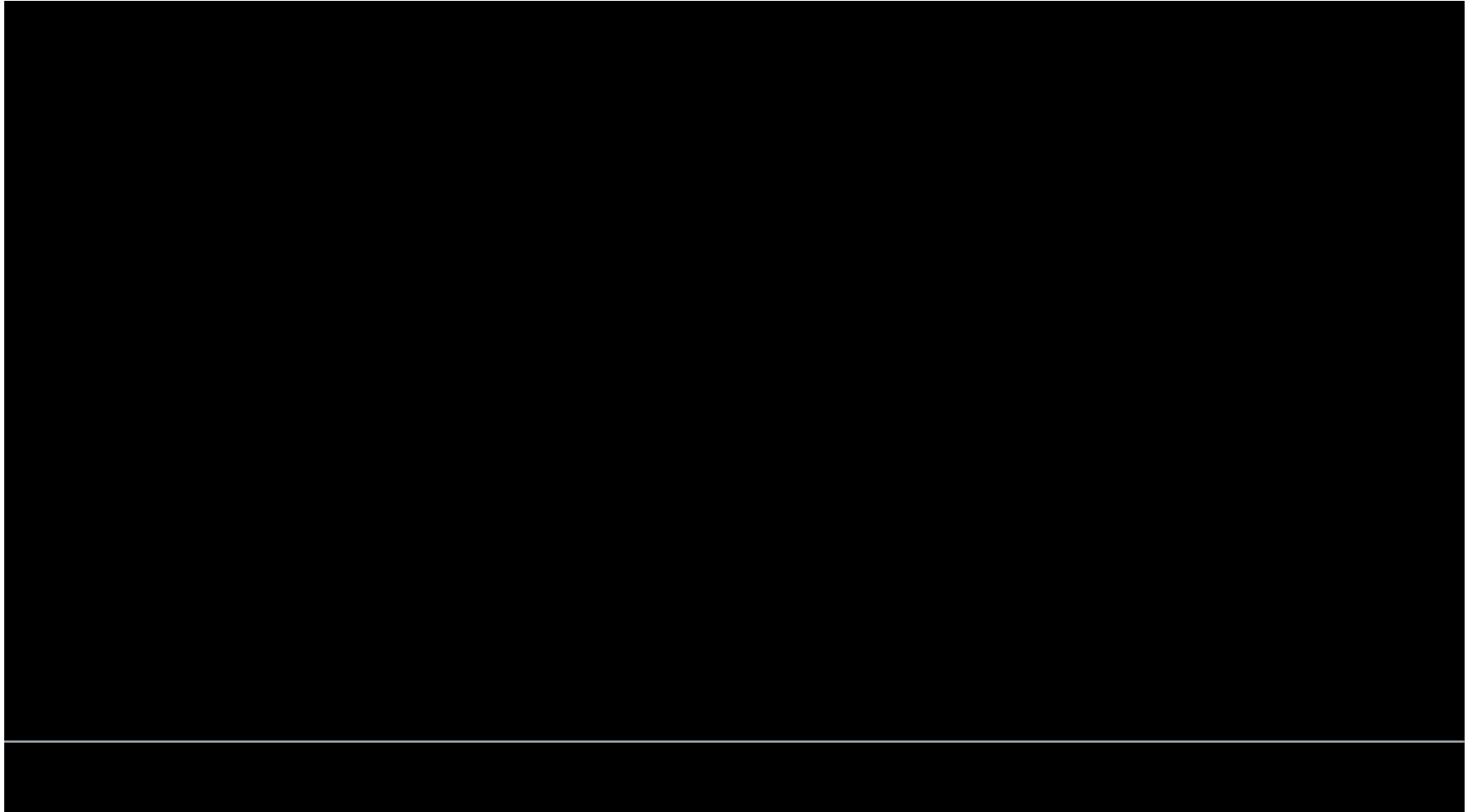
Operating costs forecast assumptions (2/2)

ICF OPERATING COSTS FORECAST

Business Area	Driver
Equipment	<ul style="list-style-type: none"> 10% elasticity to growth in passenger throughput
IT & telecoms	<ul style="list-style-type: none"> 20% elasticity to growth in passenger throughput and 5% to growth in FTEs
Airport PR and marketing	<ul style="list-style-type: none"> Constant in real terms in Scenario 1 For Scenarios 2 and 3, one-off increases of 10% in FYs 21, 22 and 23, followed by 10% reductions in each of FYs 24 to 28 inclusive. Constant in real terms thereafter.
Car Park	<ul style="list-style-type: none"> 30% elasticity to growth in passenger throughput
Intercompany Costs	<ul style="list-style-type: none"> Constant in real terms, but assumes that the cost currently paid to Peel replicates the same provision of services from the TVCA

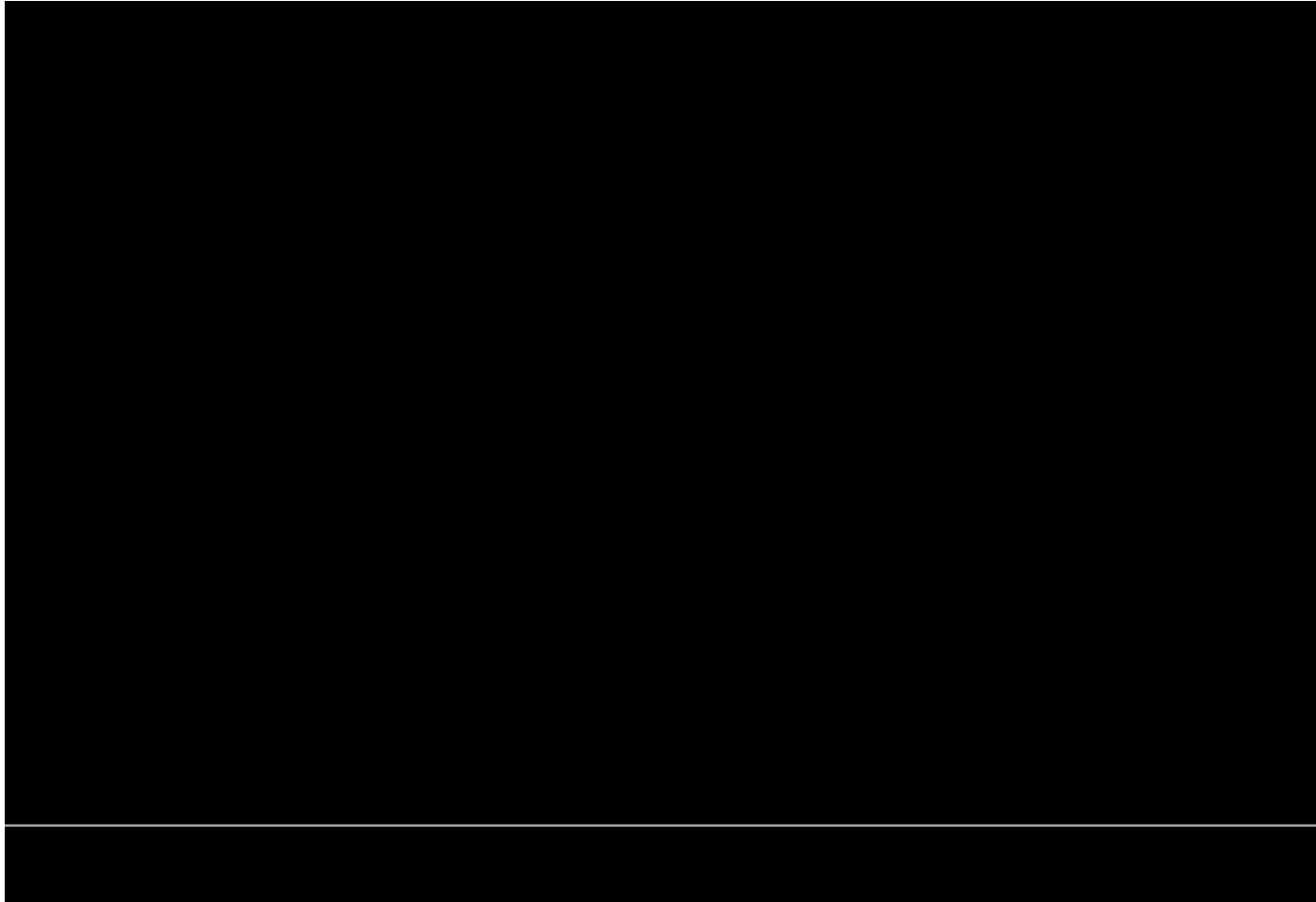
ICF Forecast: Scenario 1

NOMINAL (1/2)



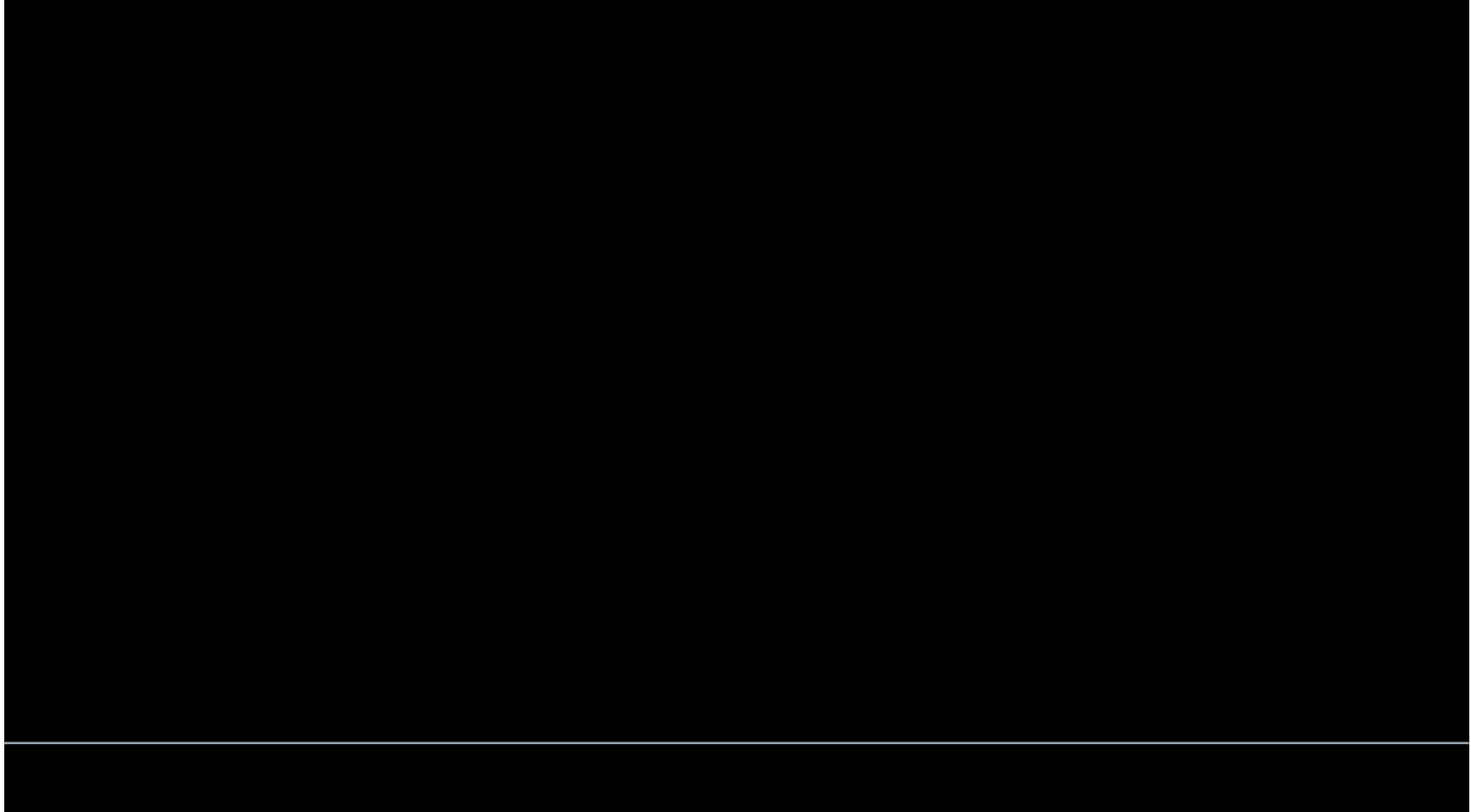
ICF Forecast: Scenario 1

NOMINAL (2/2)



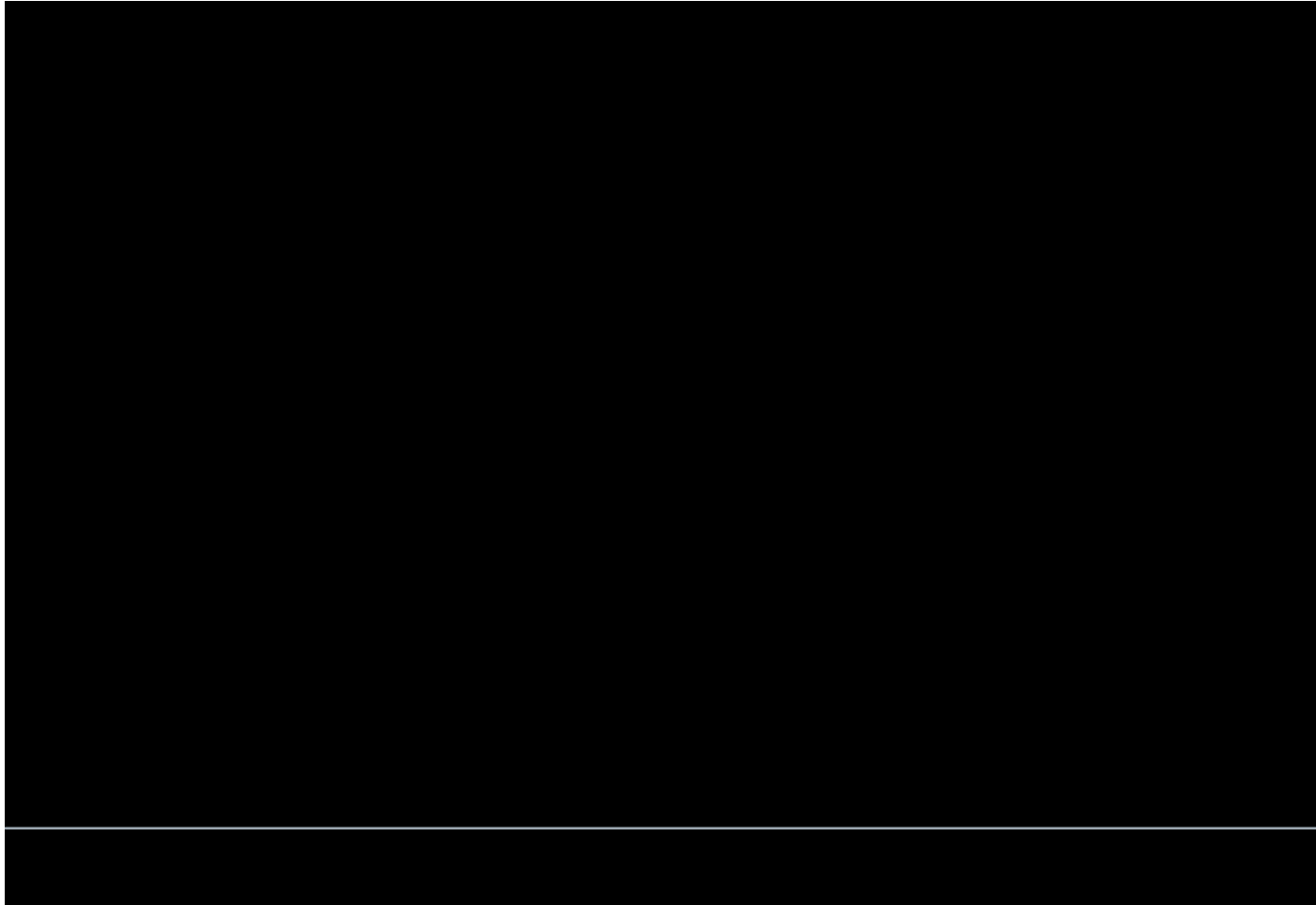
ICF Forecast: Scenario 2

NOMINAL (1/2)



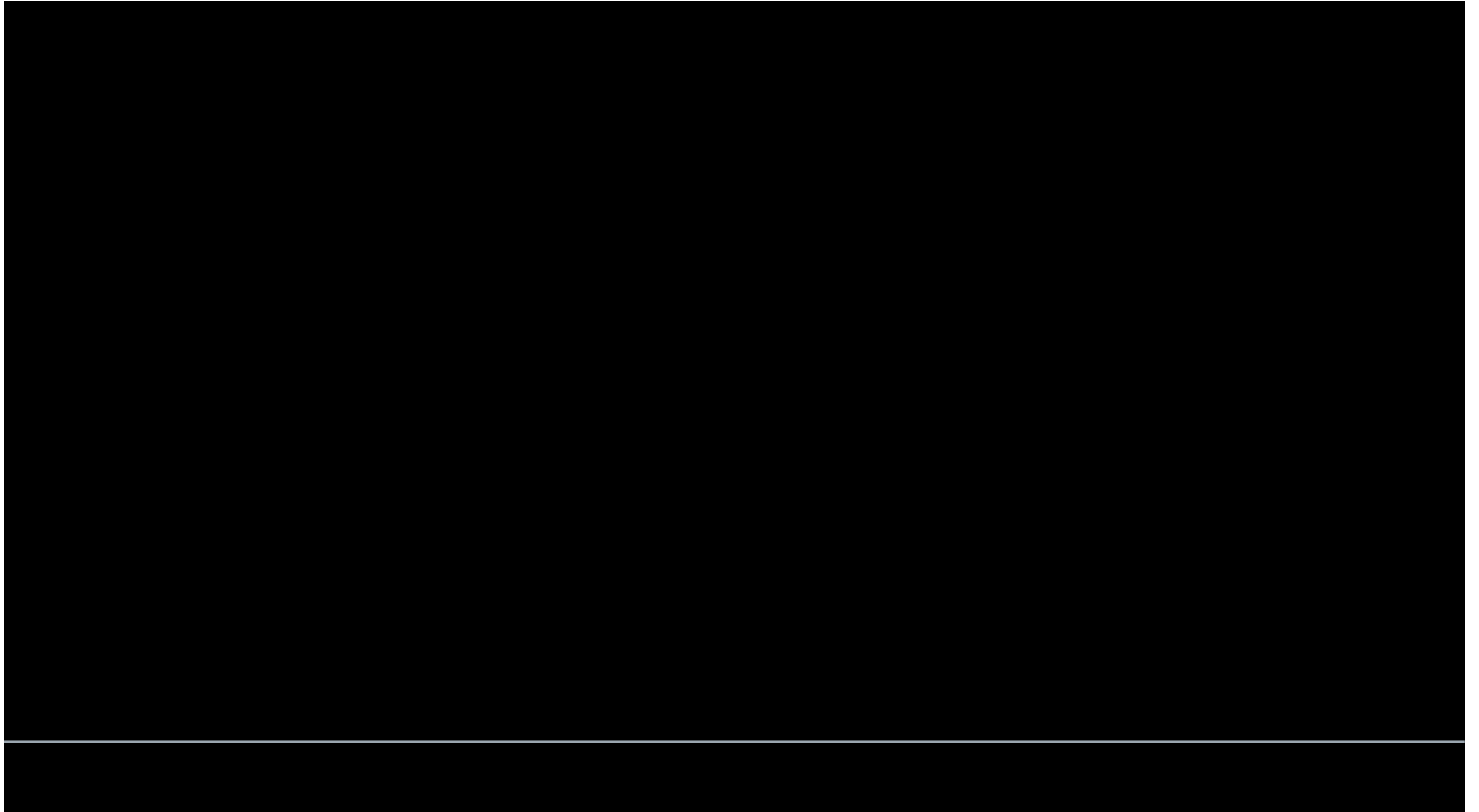
ICF Forecast: Scenario 2

NOMINAL (2/2)



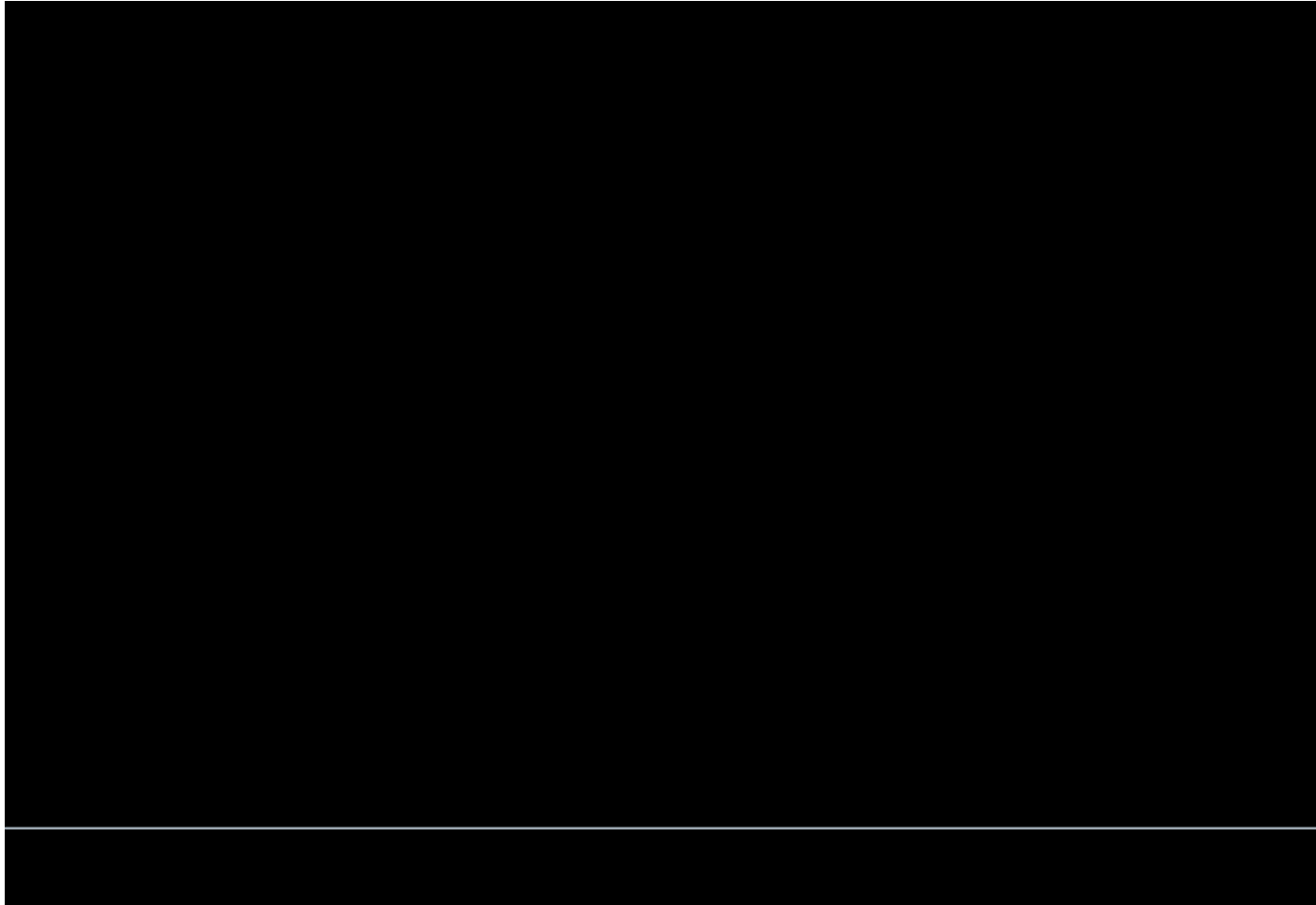
ICF Forecast: Scenario 3

NOMINAL (1/2)



ICF Forecast: Scenario 3

NOMINAL (2/2)



Source: ICF analysis

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Business Plan Forecast



EBITDA Summary: Scenario 1

NOMINAL (1/2)



EBITDA Summary: Scenario 1

NOMINAL (2/2)



EBITDA Summary: Scenario 1

NOMINAL



Source: ICF analysis

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EBITDA Summary: Scenario 1

REAL (1/2)



Source: ICF analysis

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EBITDA Summary: Scenario 1

REAL (2/2)



EBITDA Summary: Scenario 2

NOMINAL (1/2)



EBITDA Summary: Scenario 2

NOMINAL (2/2)



EBITDA Summary: Scenario 2

NOMINAL



Source: ICF analysis

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EBITDA Summary: Scenario 2

REAL (1/2)



EBITDA Summary: Scenario 2

REAL (2/2)



EBITDA Summary: Scenario 3

NOMINAL (1/2)



Source: ICF analysis

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EBITDA Summary: Scenario 3

NOMINAL (2/2)



EBITDA Summary: Scenario 3

NOMINAL



Source: ICF analysis

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EBITDA Summary: Scenario 3

REAL (1/2)



EBITDA Summary: Scenario 3

REAL (2/2)



Capital Expenditure



Scenarios 1 and 2 can be handled within existing infrastructure, but Scenario 3 will require investment

SCENARIO REQUIREMENTS OVERVIEW

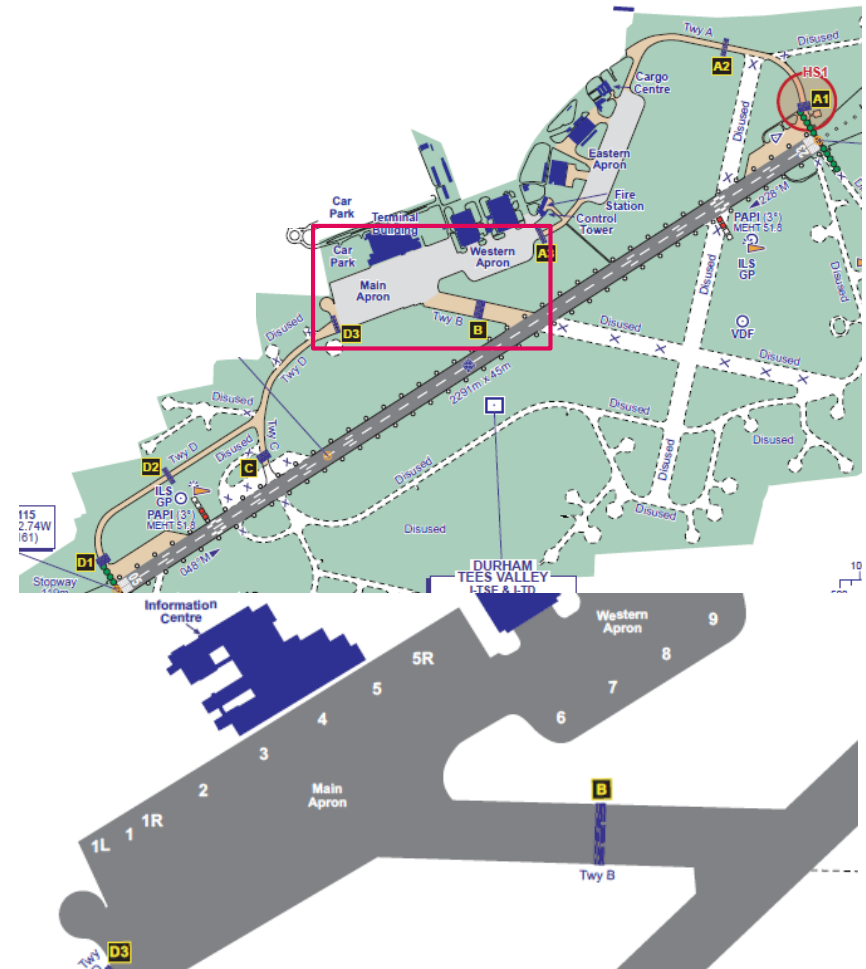
- Public information sufficient to form a definitive view of the requirements for capital expenditure, is somewhat limited, however, it is possible to make three observations:
 - Firstly, that the airport once handled close to 1 mppa and therefore it seems reasonable to assume that it could handle similar volumes without significant investment in additional capacity.
 - The 2014 DTVA Master Plan observes¹ that the existing terminal can accommodate “at least 900,000 passengers (with minor internal alterations)”.
 - Therefore, Scenarios 1 and 2 should not require significant capacity investment, only maintenance of the existing assets.
 - Secondly, DTVA spends around £500,000 in real terms per year on the operational cost “Repairs & Maintenance Costs”. Whilst there is a degree of fixity to this type of cost, it appears high against our expectation for purely operational maintenance expenditure.
 - Although we cannot be certain, we would assume that, with limited need for capacity/capital expenditure, Peel accounts for most, if not all, routine capital expenditure under this cost line.
 - Again, therefore, Scenarios 1 and 2 should not require significant increase in this operational cost item.
 - Thirdly, Scenario 3, increasing throughput above capacity and handling larger aircraft, will require investment in additional capacity and greater operational capability. Scenario 3 will also require higher routine maintenance expenditure as reflected in the previous operational expenditure forecasts.
- A few aspects of the existing infrastructure require investment to enable DTVA to facilitate Scenario 3, as discussed on the following pages.

The runway and main apron provide capacity for Scenario 3, but strengthening of Taxiway B is required

AIRFIELD

- The runway is 45m wide with declared take off runs of 2,291m. The width is standard and the length is similar to, or greater than, comparable airports, for example:
 - Newcastle: 2,329m
 - Leeds Bradford: 2,190m (longest declared¹)
 - Doncaster Sheffield: 2,893m
 - London Luton: 2,162m
- The runway has a declared strength (pavement classification number, PCN) of 70, allowing it to handle all narrow bodied aircraft. However, the main apron has a PCN of 47, which, although sufficient for most narrow bodied aircraft, limits the heaviest movements. Taxiway Bravo has a PCN of only 30, which will present an operational constraint to all significant Code C aircraft (including A320 and B737). The strength of Taxiway Bravo is a constraint and would require strengthening works under Scenario 3.
- Taxiway Alpha is only 10.5m wide and therefore unable to be used by most aircraft, which are required to use the 35m² wide Taxiway Bravo and back-track the runway. Back-tracking limits capacity, but is not a material constraint to the throughput forecast under Scenario 3.
- The main apron has capacity to accommodate 5 (and potentially up to 7) Code C aircraft, sufficient to handle Scenario 3 demand.
- DTVA operates with RFFS category 6, sufficient for most Code C aircraft, though notably not the B737-900.

Main Apron and Taxiway Bravo



Source: NATS

Notes: 1. Leeds Bradford's runway is 2,250m long.

2. Bravo exceeds the minimum required width of 23m.

Scenario 3 will likely require investment to expand the existing passenger terminal

PASSENGER TERMINAL

- Detailed information of the passenger terminal is not publicly available. An accurate assessment of its capacity cannot therefore be made with certainty. However, an inspection of Google Earth suggests that the plan area of the terminal is around 10,000m².
- The DTVA master plan states that the terminal could handle around 900,000 annual passengers. This capacity is broadly consistent with the plan area, but effective use of space may be able to accommodate more demand.
- Careful scheduling – subject to market demands – would also deliver greater capacity if flights are able to be scheduled to operate in sequence rather than simultaneously.
- Nonetheless, the demand forecast under Scenario 3 will at least require reconfiguration of the existing terminal and will likely require a modest extension. Subject to more detailed assessment, an expansion of around 2,000m² may be required.

Scenario 3 will require investment of £5-£10m to increase capacity and capability

CAPITAL COST ESTIMATE

- Expansion:
 - Scenarios 1 and 2 do not require expansion with forecast demand below historical capacity.
 - Scenario 3 notably requires strengthening of Taxiway Bravo and expansion of the passenger terminal.
 - We estimate that these works would cost around £6m, but it would be prudent to budget up to £10m to allow for other costs required to accommodate the growth (e.g. self-service kiosks, additional security lanes, expanded car parking, etc).
 - This cost would be incurred in financial year ending March 2021 to accommodate the increased demand in summer 2021.
- Maintenance:
 - As discussed previously, the current and forecast operational Repairs & Maintenance Costs” is greater than our expectation for purely operational maintenance and likely includes elements of capital maintenance also. No additional routine maintenance costs are therefore forecast to be required in any scenario.
 - Each scenario does require periodic maintenance of the runway and airfield pavements, likely to be around £5m every 15 years.



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**PROPERTY
CONSULTANTS**

**Durham Tees Valley Airport,
Darlington,
County Durham,
DL2 1LU**

**A report prepared by JK Property Consultants LLP
on behalf of**

Tees Valley Combined Authority

14 January 2019

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Appendices

Appendix 1	Brief of Instructions.
Appendix 2	General Principles Applying To All Valuations Undertaken By JK Property Consultants LLP.
Appendix 3	Lichfields Planning Context Report
Appendix 4	Turner & Townsend High Level Approximate Construction Estimates
Appendix 5	RICS – UK Economic and Property Market Overview
Appendix 6	Location Plan
Appendix 7	Site Plan
Appendix 8	Schedule of Tenancies at DVTA October 2018
Appendix 9	Comparable Land and Property Transactions:
Appendix 9.1	Residential Development Land Comparables
Appendix 9.2	Industrial, Distribution and Employment Land Comparables
Appendix 9.3	Residential Sales Comparables
Appendix 9.4	Industrial & Distribution Sales Comparables
Appendix 9.5	Offices Sales Comparables
Appendix 9.6	Industrial & Distribution Rental Value Comparables
Appendix 9.7	Offices Rental Value Comparables
Appendix 10	JLL Valuation of Southside Land July 2015

1.0 Terms of Reference

1.1 Addressee:

Tees Valley Combined Authority,
Cavendish House,
Teesdale Business Park,
Stockton-on-Tees,
TS17 6QY
For the attention of: Julie Gilhespie

1.2 Property Address:

Durham Tees Valley Airport, Darlington, County Durham, DL2 1 LU
(‘the Property’).

1.3 Reliance:

This report is confidential to the parties to whom it is addressed.

Our written consent will be required if at any stage it is intended to include the valuation report, or any reference thereto, in any prospectus, or circular, or other public document.

1.4 Tenure:

The property is understood to be held freehold.

1.5 Valuation Date:

14 January 2019

1.6 Instruction Date:

19 December 2018

1.7 Purpose of Valuation:

In accordance with our meeting, telephone discussions and subsequent emails a brief has been prepared and is attached at Appendix 1. We are instructed to provide you with a Report and Valuation as detailed in Appendix 1.

1.8 Basis of Valuation:

This valuation has been prepared in accordance with the Royal Institution of Chartered Surveyors Valuation – Global Standards 2017 (the ‘Red Book’) on the basis of Market Value and to the General Principles Applying to all valuations undertaken by JK Property Consultants LLP set out in Appendix 2.

Our total liability in respect of this Report shall not exceed £1,000,000 and in accordance with the exclusions and limitations of liability in our General Terms and Conditions of Business, or pre-agreed terms of engagement, or service agreement agreed between us.

No allowances have been made for any expense of realisation, for taxation (including VAT), which might arise in the event of a disposal and the property has been considered free and clear of all mortgages, or other charges which may be secured thereon.

1.9 **Inspection:**

Parts of the Property are inaccessible as airside of an operational airport and as green field land to the south of the airport. Other parts are let to third parties and access is not quickly arranged for the purpose of this report. You have also instructed that we do not make an inspection that would alert the present owners and whilst this has probably been superseded by the agreement on purchase price, a full and measured inspection is not appropriate until a basis of value has been agreed with the accountants to be appointed on the valuation of the ongoing business of the DTVA.

A drive by inspection of the ‘land side’ areas of the airport and a visit to a number of occupiers has been carried out on the 15, 17 and 21 August 2018.

Weather conditions were generally sunny and dry.

1.10 **Personnel:**

1.10.1 The valuation has been prepared by Kevan Carrick, B.Sc. (Est. Man.), FRICS. Member, JK Property Consultants LLP, RICS Membership Number 0049685.

1.10.2 We confirm that Kevan Carrick, the person responsible for this valuation is qualified in accordance with the RICS Valuation – Professional Standards and is an RICS Registered Valuer.

1.10.3 Support and information required to carry out this valuation has been provided by:

- Chris Coles, Director, Project Management, Turner & Townsend Project Management Limited;
- Geoff Brown, Area Manager, Turner & Townsend Project Management Limited;
- Mark Cullen, Associate Director, Turner & Townsend Cost Management Limited;
- Harvey Emms, Senior Director, Nathaniel Lichfield & Partners Limited;
- Phil Jones, Planning Director, Nathaniel Lichfield & Partners Limited;
- Andy Burge, Economic Strategy Assistant, Economic Strategy and Spatial Planning, Stockton-on-Tees Borough Council;
- David Grant, Managing Director, Durham Tees Valley Airport Limited; and
- Martin Waters, Head of Finance, Resources and Housing, Tees Valley Combined Authority.

1.11 **Status:**

We have acted as External Valuers, subject to any disclosure, in preparing this valuation.

1.12 **Disclosure:**

1.12.1 We are currently advising the Tees Valley Combined Authority future development options for the formulation of a Master Plan for the development of DTVA as an operational airport and transport hub. We are also in the process of advising on an exit if over the proposed 10 year period it is not possible to make the DTVA successful.

1.12.2 We have previously advised Darlington Council and the Tees Valley Combined Authority in the formulation of a strategic Master Plan for the development of another transport hub.

1.13 **Assumptions:**

1.13.1 Our Market Value as at today's date has been prepared on the Special Assumptions for each of the basis of value that are set out in our report, existing use value, development value and alternative use value. In addition, there are the following Special Assumptions that apply to all basis of value:

- We have not seen any title deeds, or reports on title in time to prepare this report and assume that the interest to be valued is freehold, without encumbrances that would materially affect value, but subject to the tenancies listed in the tenancy schedule;
- The Special Assumptions relating to condition of buildings, services, planning and environmental are set out in detail in the body of this report, but overall no tests or investigations have been carried out and the assumption is made that there are no material defects or costs to be incurred in support of our opinions of market value;
- There are planning restrictions of use that limit use to airport related uses for part of the DVTA area. A Special Assumption is made that local authorities will review these restrictions in the light of future growth opportunities on the airport site;
- There are circumstances where full information can not be made available in the time required in which to prepare this valuation and report. A Special Assumption is made that further and better information will be made available during the carrying out of due diligence for this purchase pre-contract and which confirms the assumptions made in arriving at our opinion of values;
- It has been noted that in a current development case finance is becoming challenging as banks withdraw offers of finance during the current period of the Brexit negotiations. This is affecting the confidence on which valuations are made but there is so far no tangible evidence as to how this will affect the prices payable. This disruption on financial, macro-economic, legal and political events makes the formation of opinions challenging. But the Special Assumption has been made that since this purchase is for a long-term investment to improve the economic performance of the area and to increase jobs that cyclical economic factors over the long-

term will not materially affect values on which our opinions are based. If an onward sale of the property is contemplated in the short to medium-terms the sale price might be difficult to achieve;

- We have excluded the assessment of any below ground abnormal and/or contamination costs/programme implications;
- We have assumed that services connections will be available at the boundary of the site at the capacity required for the proposed developments;
- We have excluded the assessment of any consequential works outside of the red line site boundary for. S278, S38 highway improvements and improvements in relation to any works secured through a S106 agreement;
- We have excluded the assessment of any noise abatement measures that may be required;
- We have excluded the assessment of any measures that may be required to address any environmental issues i.e. archaeology, landscape, ecology, air quality etc.;
- We have excluded the assessment of any upgrades that may be required to downstream facilities i.e. sewerage treatment plants;
- We have assumed the development will be delivered on a day one basis, in one continuous phase and no provision has been made overtime for either increased development costs, or for inflation in values;
- We have assumed the airport becomes viable and vibrant as a profitable ongoing business; and
- That no disclosure of our report will be provided to any third party without first seeking approval from us.

1.13.2 As the detailed investigation for purchase is carried out, some assumptions may be removed and further assumptions might need to be added to the above list, and thus the valuation adjusted according to the new facts discovered.

1.14 **Sources of Information:**

1.14.1 We have made investigations necessary to carryout our valuations in regard to values, planning and other matters.

- 1.14.2 We have not carried out building surveys, environmental risk assessments, site and building services investigations, planning or highway enquiries.
- 1.14.3 Site plans, which are not to scale, have been provided by DVTA Limited, Tees Valley Combined Authority and Stockton Council and from which stated site areas have been taken as read and no checks have been carried out. We have relied upon these plans and those stated areas in our valuations.
- 1.14.4 We have been provided with a Planning Context Report, shown at Appendix 3, for this valuation by Lichfields on which we have relied upon in our valuation.
- 1.14.5 We have been provided with high level approximate construction cost estimates by Turner & Townsend Cost Management Limited and which is provided at Appendix 4 and on which we have relied for this valuation.
- 1.14.6 We have been provided by George F White LLP with comparable sales and lettings particulars, provided in Appendix 9 and on which we have relied in arriving at our opinions of value.
- 1.14.7 We have been provided by DTVA limited a tenancy Schedule at October 2018 and which is provided at Appendix 8.
- 1.15 **Economic Overview:**
- 1.15.1 A copy of the most recent RICS UK Commercial Property Market Survey Q3 2018 report is provided at Appendix 5.
- 1.15.2 The North East Region of England of which the Tees Valley region forms part is a net exporter and the impact of uncertainty in the conclusion of a satisfactory Brexit agreement will adversely impact on confidence and thus demand for accommodation and investment.

2.0 Location

- 2.1 DTVA is within the Tees Valley conurbation and is located some 248 miles to the north of the City of London, and 159 miles to the south of the City of Edinburgh. The City of Newcastle upon Tyne is 41 miles to

the north with the City of Durham about 25 miles and the City of Sunderland 37 miles also to the North, with the City of York some 47 miles to the south. The market town of Darlington is about 5.4 miles to the west with the town of Stockton about 7.4 miles to the north-east and Middlesbrough approximately 11.4 miles to the north east and is shown in the Location Plan at Appendix 6.

- 2.2 DTVA is well served by the road infrastructure with good accessibility to local, regional and national trunk roads. Access to DTVA terminal is from the road junction of the A67 with the A66 providing good connectivity to primary north/south links serving the region with the A1M some 18 miles to the west giving access to the national road infrastructure and 10 miles to east the A19 with regional access by trunk road to Tyneside and Wearside to the north and through North Yorkshire to the south.
- 2.3 There is an excellent national rail, East Coast mainline Inter City service from London to Edinburgh calling at Darlington Bank Top station some 5.4 miles to the west, but there is a very poor rail service stopping at DTVA Halt, some 1 mile to the west the Allens West station provides a stop on the Bishop Auckland to Saltburn rail line.
- 2.4 Tees Port Docks provide sea connectivity approximately 17 miles to the east.
- 2.5 There are limited facilities in the surrounding area with the village of Middleton St George being about 2 miles to the west.

3.0 The Property

- 3.1 The overall site comprises some 817 acres and is shown verged red on the plan at Appendix 7.
- 3.2 The site is relatively level with the operational area comprising some 817 acres and laid out with runway, apron circulation areas and standing areas with operational buildings, including the terminal and control tower.
- 3.3 The area to the south of the runway is predominantly green field comprising an area of approximately 236 acres.

- 3.4 The area to the north of the runway comprises much of the ancillary buildings and other occupiers of airport use and none airport use, including office, manufacturing, hotels playing fields, motor homes sales area and playing fields with a total site area of around 145 acres, of which about 23.33 acres has received planning consent on which to develop 350 homes.

4.0 Economic Growth

- 4.1 The economic regeneration of a region linked with the drive for economic growth requires excellent infrastructure to get to, to move around within, and to exit the region with European and global connections.
- 4.2 The strategic economic plan for the region of Tees Valley has the benefit of the three existing transport gateway nodes, with future development plans:
- 4.2.1 Tees Port Gateway;
 - 4.2.2 Darlington Station connecting to the East Coast Main Rail Line, to be made HS2 ready; and
 - 4.2.3 Tees Valley Airport, to create a hub for inward investment.
- 4.3 It is understood that there is an intention to invest in DTVA and which is to establish a business growth and transport hub over a 10 year period. The economic development plan for the area around DTVA includes:
- 4.3.1 Support inward investment onto the airport site;
 - 4.3.2 Improve public transport links;
 - 4.3.3 Improved road links to expand the one hour catchment area for the DTVA;
 - 4.3.4 Link DTVA into local economic opportunities such as the South Tees Development Corporation;
 - 4.3.5 Simplify and streamline planning arrangements;
 - 4.3.6 Secure and develop the necessary local skills;

- 4.3.7 Seek to establish a Higher Education Partnership with Teesside University;
 - 4.3.8 Seek to establish with the MoD a joint military-civilian airport hub; and
 - 4.3.9 Seek the provision of infrastructure funding and share commercial risk to open up new business sites around the airport.
- 4.4 This strategy requires a Master Plan to ensure delivery of the objectives within a realistic time, and land ownership control is essential.

5.0 Planning

- 5.1 To assist this valuation report, Lichfields has provided a report on the planning context for the DTVA land and which is provided at Appendix 3.
- 5.2 The report deals with two options. The first is the development of a viable and successful airport. The second addresses the exit route should efforts not succeed to make the airport successful, and consideration is then given to the probability of creating a Garden Village for the sustainable and comprehensive development of the airport land for residential and ancillary uses in the long-term.
- 5.3 The first option of development for economic growth and job creation is supported by the national and local planning policies. There are businesses located at DTVA that are not directly airport related uses and further occupiers will find the location of the airport more favourable because of the infrastructure and accessibility. It is assumed for this valuation and report that the changes in planning policy will be implemented in the short-term to allow airport and non-airport uses and further economic development to happen more quickly. The Lichfield report demonstrates the national and regional policies that support the planned development of DTVA to achieve the desired success for economic growth and job creation.
- 5.4 The second option is based on the need for housing in the national context and government policy to create Garden Towns and Villages.

It will assist also in the provision of housing as the economic prosperity of the Tees Valley region improves overtime. The present owners have made the decision to close the DTVA by 2021 in any event. By their recent successful application for housing development on the 23.33 acres on the Northside of the airport they have set the precedent for further housing development on the DTVA land. The Lichfield report goes on to outline a framework for the development of the DTVA land as a strategic housing development location as a Garden Village in the longer term. And which has been adopted as the basis of an alternative use of the DTVA land for the purpose of this valuation.

6.0 Opportunities & Constraints

- 6.1 The Master Plan in preparation will consider the sustainability and environmental opportunities and constraints generated to carryout substantial investment in the growth of the economy and the creation of jobs in the region, including the impact on highways, services, site & ground conditions and environmental issues as set out below. This is considered against the baseline position taken from the previous work undertaken in 2004 when DTVA was significantly busier than at present.

7.0 Proposed Development

- 7.1 On purchase of the DTVA it is the intention of the Client to create a viable airport to support economic growth and job creation for the benefit of the region. In consequence, there are two potential scenarios for future development:
 - 7.1.1 The successful creation of a viable airport, with comprehensive development under an approved Master Plan; or
 - 7.1.2 The closure of the airport and the development of a suitable alternative use.Each of the scenarios is explained in further detail below.
- 7.2 The successful creation of a viable airport will result in the development of property for both airport and non-airport uses. This development will follow substantially 'Durham Tees Valley Airport – Master Plan to 2020 and beyond', April 2014, except for the 23.33 acres for the development of 350 houses the land for which will be

development for commercial purposes. We have expressed the opinion that the size and character of the development will create a viable transport hub, provided that the required infrastructure (see Paragraph 5.3) is completed in the near future and that the development is sustainable and creates a good brand of strong design and character, constructed of materials that provide a long-term low maintenance regime. The content of the proposed developments is summarised below:

Table 8.2: Development capacity and floorspace assumptions

Plan Proposals	Residential Units	Commercial GIA		Gross Jobs (FTEs)
		sq. m	sq. ft.	
Northside				
A1 Retail		2,025	21,797	85
B1 Business (Offices)		9,600	103,334	680
B2 (Industrial) / B8 (Warehouse)		16,820	181,049	240
B8 Hangars (Warehouse) / B2 (Industrial)		28,935	311,454	499
C1 Hotel (Extension)	60 beds	1,400	15,070	30
C3 Residential	400 units			n/a
D1 Non-Residential (Nursery)		925	9,957	22
Sui-generis (Showrooms)		2,650	28,524	32
Northside Total		60,955	656,454	1,588
Southside Proposals - Phase 1				
B1 Business (Offices)		3,386	36,447	339
B1 (supporting other B use)		6,984	75,175	582
B2 General (Industrial)		3,600	38,750	100
B8 Storage & Distribution (Warehouse)		162,733	1,751,643	2,034
Total - Phase 1		176,703	1,902,015	3,055
Southside Proposals - Phase 2				
B8 Hangars (Warehouse)		135,000	1,453,128	1,688
Total - Phase 2		135,000	1,453,128	1,688
Southside Phases 1 & 2 Grand Totals		311,703	3,355,143	4,743
Northside & Southside Grand Totals		372,658	4,011,257	6,331

Notes:

1. B1 Offices only:
Assume conversion from Gross Internal Area (GIA) to Net Internal Area (NIA) at 82.5%:

- a. Northside:
B1 Business (Offices) 7,920 sq. m / 85,250 sq. ft.
 - b. Southside:
B1 Business (Offices) 2,793 sq. m. / 30,069 sq. ft.
 2. Residential:
Assumptions on the number of house types, affordable/social and size in terms of bedrooms are to be made.
 3. Hotel:
Assume that the existing 3* standard is repeated when extended.
 4. Based on the Master Plan, Indicative Framework Plans at Appendix D.
- 7.3 In the event of the DTVA not being successful, and on closure the development of the whole of the DTVA land is assumed to be taken forward for comprehensive development and under a Master Plan for a Garden Village.
- 7.4 Lichfields Planning Context Report provided at Appendix 3 addresses in outline the planning criteria necessary to achieve these objectives and development.

8.0 Garden Villages

- 8.1 The activities of government since 2017 to promote Garden Villages are proving to be successful. They are seen as important in providing new locations for residential development meeting the future need for housing and where people want to live.
- 8.2 The government is not prescriptive and encourage each garden community to have its own clear and distinct sense of identity. This is achieved by setting clear expectations for the quality of the development and how this can be maintained (such as following Garden City principles). It is about creating vibrant, mixed-use, communities where people can live, work, and play for generations to come – communities which view themselves as the conservation areas of the future. Each will be holistically planned, self-sustaining, and characterful.
- 8.3 To be considered for government assistance, proposals for a new garden community must meet the criteria below:
- 8.3.1 The scale should make a significant contribution to close the housing supply gap and proposals of more than 10,000 will be prioritised. In the case of DTVA land, which taken at a density

of development of 15 houses per acre would produce some 12,000 houses.

- 8.3.2 The character of development should demonstrate exceptional quality or innovations, development on predominantly brownfield sites, being in an area of particularly high housing demand, or ability to expand substantially further in the future. The scale needs to be of a size that is largely self-sustaining and genuine mixed-use. This provision will also assist in promoting the economic development of the area in terms providing housing to attract new people for jobs as the economy expands and improves.
- 8.3.3 The DTVA proposal for a Garden village must also be a strategic fit to meet the long-term housing and economic growth in the area and be locally led. This local leadership is well demonstrated by: the Combined Authority's commitment and objectives for the area; can demonstrate the collaboration between of Stockton and Darlington Councils; will seek the support of Homes England; and will seek community engagement at the appropriate early stage of master planning.
- 8.3.4 It is recognised that a new garden community is a complex, long-term project, which will deliver homes over a number of decades. We consider that this can be addressed with confidence that proposals are deliverable, with an integrated approach to infrastructure, housing, business investment, employment and development.
- 8.3.5 Garden communities within the current programme receive a tailored package of Government support that includes resource funding, expert delivery advice from Homes England and cross-government brokerage to resolve barriers to delivery. Proposals must set out which aspects of the support package will best help enable delivery. Government will look to agree a package of support tailored to suit the scale and ambition of proposals.

9.0 Tenure

- 9.1 We have not been provided with a Report on Title but we assume that the Property is held freehold with a good and marketable title and is not subject to any unusual or especially onerous restrictions,

encumbrances, or outgoings that would adversely impact on our opinion of estimates of value.

- 9.2 We recommend that your legal advisors confirm our understanding to be correct and ensure that there are no further elements, restrictions or charges contained which are likely to have a detrimental effect upon the matter herein reported.

10.0 Tenancies

- 10.1 A Schedule of Tenancies at DVTVA October 2018 has been provided by DTVVA Limited and is shown at Appendix 8.
- 10.2 We have not been supplied with any tenancy documents and assume that the tenants have a full repairing and insuring type of liability either directly, or through the provision of a service charge payable by the tenant.
- 10.3 We assume further that there is no onerous liability that would adversely affect the amount of our opinions of the estimated value and recommend that your legal advisors confirm our understanding to be correct.

11.0 Highways

- 11.1 The proposed Master Plan identifies the following Highway impacts:
- 11.1.1 The capacity and operation of the surrounding highway network was extensively researched as part of the work undertaken in the lead in to the granting of the Northside and Airport Expansion planning permissions in 2007 and 2008 respectively. The analyses concluded that the highway network could accommodate the traffic from all of the developments, provided that minor improvement works were undertaken at two nearby A66 roundabouts; Morton Palms and Great Burdon; together with some localised carriageway edge works on the A67 between the then proposed access to Southside and the A67 roundabout access at DTVVA;
- 11.1.2 Access for the Southside is to be relocated from its original location on the A67 to the east of Urray Nook rail bridge,

reducing traffic the proportion of Southside traffic on the A67 between the previous and proposed accesses, (by around 10%). There will also be less traffic from the rest of the Master Plan area on this section than if the extant planning permissions were implemented;

11.1.3 Analyses show that the two roundabouts, on the A67 and with Yarm Road have sufficient capacity to accommodate the proposals. Furthermore, both have available highway land around them to enable small scale capacity improvements, should that be considered to be beneficial; and

11.1.4 The level of DTVA terminal activity proposed in the Master Plan for 2020 is not significantly higher than DTVA's current level of activity, which is significantly lower than its historic peak operation which occurred around 2006. The Master Plan therefore concludes that the proposals will have less of a traffic impact on the external highway network than with the extant planning permissions. It is therefore likely that some of the off-site highway improvements that were conditioned as part of the extant planning permissions may not be required to accommodate the traffic demands of the Master Plan. This will subsequently be examined in detail as part of future planning submissions.

11.2 We understand that there are no current highway proposals of a statutory nature that might have a detrimental effect on the value of the property.

11.3 We have assumed that there is a right of access between the DTVA land and all buildings and the adopted highway and accordingly the site enjoys unfettered pedestrian and vehicular access.

12.0 Services

12.1 With regard to services, the Master Plan identifies that:

12.1.1 The existing foul drainage system outfalls to the north-east of the airfield at Northumbrian Water's DTVA Works. This system will therefore need to be extended to accommodate the Northside development and approval has been obtained for

connections to serve the housing areas. Further negotiations will be required with Northumbrian Water with respect to subsequent developments; and

12.1.2 On the Southside there is no foul treatment infrastructure available and it is anticipated that a package treatment system will need to be installed to serve the developments. This would outfall into the new surface water drainage system and will be subject to detailed approval by the Environment Agency. Any future planning applications for the Master Plan proposals will be accompanied, where necessary, by flood risk assessments and drainage strategies.

12.1.3 It is assumed that the cost for this work will be met through public expenditure.

13.0 Site & Ground Conditions

13.1 The Master Plan identifies the following:

13.1.1 Parts of the Master Plan area are currently agricultural land. Previous assessment has shown this land to be no better than grade 3b (in accordance with the DEFRA Agricultural Land Classification system) and is therefore not the “best and most versatile” agricultural land. This is not considered to be a significant impact;

13.1.2 The site lies within Flood Zone 1, which has the lowest probability of flooding. The surface water from the additional hard standing areas for the Master Plan proposals would be drained via new main carrier drains. The principle of the design of these drains was established as part of the planning permission for Durham Tees Valley Airport Expansion;

13.1.3 The existing drainage infrastructure would be used where appropriate, with new drainage infrastructure constructed to accommodate the increased flows from the proposed developments; and

- 13.1.4 Where feasible, SUDS would need to be used to provide partial attenuation of the peak discharge flows and improve the quality of water discharging to local watercourses.

14.0 Environmental Issues

- 14.1 Other environmental issues identified within the Master Plan include ecology, heritage, noise and landscaping, are set out below:

14.1.1 The Masterplan site includes no ecological designations that would preclude development. Habitat losses resulting from the development of Northside and the main runway are considered to be negligible and the Southside proposals incorporate extensive areas of landscaping including a range of habitat types to ameliorate the impacts of the proposed development;

14.1.2 Previous assessment work has indicated that the Southside area does have the possibility of archaeological remains, in particular the site of Newsham Grange and a ridge and furrow system. These have been assessed to be locally important and are unlikely to constrain future development as minimal upstanding earthworks survive;

14.1.3 The area to the north west of the terminal building and the Southside Phase 2 will require an archaeological investigation to accompany any future planning applications and appropriate mitigation will be defined where necessary;

14.1.4 There are no designated heritage assets (listed buildings, conservation areas or scheduled ancient monuments) within the Master Plan area. The nearest listed buildings to the Master Plan area are Middleton Hall (to the west of Oak Tree), and St George's Church and Featherstone House to the south of the Master Plan area. There is also a Conservation Area at Middleton One Row;

14.1.5 On the north side of the Master Plan area buildings assessed as of local interest include several WWII aircraft hangars, the former officers' mess, now the St George Hotel, as well as a control tower and various other ancillary technical and mess buildings and structures. There is the potential that each of

these buildings, of local interest, will be affected by the development, but could be reduced through mitigation;

14.1.6 On the Southside of the Master Plan area, two small WWII retractable gun emplacements, known as Pickett Hamilton Forts were identified as being of regional heritage interest. The gun emplacements could be accommodated within or relocated as part of future development;

14.1.7 There will be impacts on buildings of local cultural heritage interest, although these are not envisaged to create any major impact, which mitigation could not address;

14.1.8 Taking into account the reduction in passenger traffic from 2004 levels, no additional impacts are anticipated with respect to operational noise as a result of the Masterplan proposals. However, the proposed residential development (23.33 acre site) and new hangars west of the terminal will need to allow for noise mitigation resulting from increased industrial and business traffic, especially for properties on the edge of developments; and

14.1.9 DTVA is located on a lowland plateau in an area of landscape character that is undistinguished, open and of ordinary landscape quality. There is little visual connection between the valley of the River Tees and the adjacent lowland plateau. Structural landscaping measures are proposed around the external boundaries of the development to both screen the development and integrate the scheme into the surrounding landscape character.

15.0 Environmental Impact of Master Plan Objectives

15.1 If the passenger numbers increase to circa 2 million per annum by the end of the 10-year period, as advised by aviation industry consultants by TVCA, then this could have a significant material impact on the localised infrastructure and where further improvements will be required. It is recommended that the next phase be the formulation of a revised Master Plan, currently in preparation, assesses the full environmental effects, impact, cost and programming for such improvements. Should the planned improvement in passenger traffic

prove not to be successful those infrastructure improvements will benefit the development of a Garden Village.

- 15.2 Wider infrastructure improvements will be required, including the provision of a super-fast broadband system to make the site highly attractive to meet the needs of occupiers and to ensure that the site provides for the requirement of the revolution in digital technology and communication.

16.0 Market Overview

- 16.1 The Bank of England, Agents' summary of business conditions - 2018 Q4 reports;

“Property markets

Investor demand for commercial real estate was concentrated in warehousing and distribution, and demand from foreign investors for developments in UK cities remained solid.

Housing market activity weakened, partly due to increased uncertainty about the economic outlook.

Commercial real estate

Investor demand for UK commercial property remained modestly ahead of supply, reflecting a search for yield and the low supply of available stock in many areas. Investor appetite was weakest for retail properties, where vacancy rates continued to pick up, with demand most buoyant for distribution sheds and warehouses, in part reflecting the structural shift to online retail.

Contacts reported that investor demand for prime retail and office properties in London had held up better than expected. And demand from foreign investors for developments in major UK cities remained good. However, there were also growing concerns about the impact of Brexit on the commercial property market, and there were signs that development activity was starting to weaken, with some projects being delayed or put on hold.

Contacts in the property sector continued to report limited UK warehousing capacity for stockbuilding ahead of Brexit, though some capacity was likely to become available after Christmas. Some

contacts reported rising rents for bonded warehouses and refrigerated storage in south east England.

Housing market

Estate agent contacts reported a general weakening in activity levels in the housing market, as the usual autumn pickup in activity failed to materialise in a number of regions. Although the stock of houses for sale remained low, contacts indicated that demand was also falling.

For example, there had been an increase in the number of purchases falling through due to uncertainty among potential buyers. More viewings were required before a sale could be achieved. And buyers were taking longer to reach a decision to purchase.

In addition, the difference between asking prices and offered prices had widened. Housing activity in southern England was muted, which contacts said was due to uncertainty among buyers and sellers, who were postponing transactions until after EU withdrawal.

Demand for new-build homes remained stronger outside London, although housebuilders reported having to offer more incentives and undertake more viewings in order to complete sales. Labour shortages continued to constrain supply.

Mortgage activity was mostly concentrated in refinancing deals and homeowners moving from floating-rate deals to fixed-rate loans, with mortgage tenors often increasing to five years.

Contacts said that subdued demand for mortgages, combined with the entry of new lenders to the market, had resulted in intense competition. In turn, this has led to tighter pricing and improved availability of higher loan to value and loan to income mortgages, as challenger banks competed for higher-risk loans in order to grow market share.”

- 16.2 A similar sentiment is identified in the RICS UK Economic and Property Market for Q4 2018 report provided at Appendix 5.
- 16.3 Overall the market demand is slowing and the provision of finance from banks for development is becoming tighter as the time extends over which the Brexit settlement is taking. Whilst the value of the pound against the euro and dollar has fallen and would normally result

in increased exports and a measure of improved economic activity enjoyed by the Tees Valley region as a relatively large manufacturing region this has not yet shown in the demand for accommodation, or increased rent and improved property values.

- 16.4 Global and private finance for infrastructure projects and investment is available provided a comprehensive presentation and justification for an effective partnership with the public sector is available.
- 16.5 The planned development of a viable airport business has a 10 year programme and should it be necessary to implement the exit strategy of the development of a Garden Village a further 20 to 30 year programme for development. Over this long-term programme the economy will go through a number of cycles, with periods of slower economic activity and other times of economic growth, with windows of opportunity for investment. Thus overall, a vision for development linked with a long-term delivery programme is essential to achieve success.

Local Market Overview

- 16.6 The impact of Brexit is having an adverse effect in the local market with: reduced retail spend in local shops diverting to some extent to a digital retail revolution; increased demand for industrial and distribution units; and a flattening of demand for office space. Generally, investment is not occurring, other than in the residential sector.
- 16.7 The development and commercial land market in Tees Valley Combined Authority area has suffered through the economic recession. Whilst generally the country has recovered from recession and market conditions improved the land and development markets in Tees Valley continue to struggle, although we are informed that there is increasing demand from potential occupiers and investors following the success of devolution and the policies being pursued.
- 16.8 In general terms the historical performance of the property market in the North East region has shown that values have lower peaks and deep troughs of activity relative to other regions. Further, the regional property market appears to have been quicker to enter recession but with improving economic conditions, slower to respond, relative to the

national property market. With the impact of structural change in the factors of economic activity in the region there has been a marked decline in values compounded by the impact of the global economic recession.

- 16.9 With the economic and fiscal policy of the present government, linked with the changes in governance and the focus to rebalance the economy of the regions, there is greater confidence and interest from investors and developers to invest in development activity but which interest is constrained by a perception of risk relating to the cost of holding empty property until an occupier is found.
- 16.10 In this region, with the exception of residential properties, the value of commercial properties tends to be less than the total costs of development. It will be necessary to structure a planned programme of action and investment to achieve viable development and to ensure that the market operates in a manner that does not depend upon financial support from government. Without this strategic approach attracting investors and accelerating development will be problematic.
- 16.11 Government are encouraging the building of more houses and this presents an opportunity to secure an alternative use for the overall airport site in the event that DTVA operation is considered not to be viable.
- 16.12 We note that TVCA are currently considering options for the potential delivery of Garden Villages. This site could be considered as part of a long-term strategy for accelerated housing delivery alongside economic growth aspirations for Tees Valley.
- 16.13 We are of the opinion that there is no shortage of land available for commercial development. Much of the land available for commercial use is on previously used, or 'brownfield' sites. The challenge is to overcome the risks and costs of preparing the land by improvement with infrastructure and/or remediation and overcoming abnormal ground conditions that increase the risks, time and cost of bringing land forward for construction.
- 16.14 This report assumes that the DTVA land identified requires no remediation, abnormal costs, infrastructure and services requirements and that the site is readily available for development without incurring

unnecessary delay and costs in preparation for construction. The exception to this is the need for investment in new access to release development opportunities to the Southside of DTVA and on which further advice is required. It is assumed further in this valuation that the cost of all necessary infrastructure releasing access to the Southside of DTVA will be met by the public sector and not from the development value generated.

- 16.15 The development of commercial property in the present market is dependent upon occupiers being ready and able to commit to purchase, or acquire a lease for occupation. Developers and their funders will not commit to speculative development unless there is confidence that an occupier can be readily found and without incurring long periods of holding costs for vacant property. To overcome this stasis in the market and to encourage development some local authorities are adopting the risk of developer, either by carrying out direct development, or taking an overarching head lease that guarantees the developer and funder a long-term stable income on which finance can be secured. This guarantees rental income and enhances the end value of the developed property, which in turn encourages investors as the purchaser. Whilst this is helpful in the short-term to kick-start a challenging property market it is not recommended for the long-term without having a growth plan in place to allow the open market to operate without support.
- 16.16 Linked with the above comments and to ensure that demand is improved, a robust marketing plan is required for the region, the local area and the developed property in DTVA by which to attract inward investors and other occupiers. In particular a Unique Selling Point needs to be made that there is an ideal opportunity to develop a strategic transport hub to create sufficient demand in the market from airport related users, as well as others, particularly in freight handling for logistical and passenger usage, to create the vibrancy of use, but this will not in our opinion generate a premium of value from such use and proximity to DTVA.
- 16.17 Research and example have shown that development around transport hubs, such as an airport, has a better chance for success given the location and activity. DTVA has not achieved the desired growth over the last few years and is not perceived by the market to be a vibrant

and active transport hub. The achievement of values to make the development proposed both viable and attractive to occupiers will require a step change in the perception of DTVA. This will require an approach for regeneration of the area, including investments in the infrastructure, the kick-starting of development by speculative development and an effective marketing plan.

- 16.18 Demand from house builders for green-field land continues across the region, with sales reflecting the market sentiment expressed by the Bank of England. Government policy in relation to reduced stamp duty and Help to Buy is also underpinning the market in this region. In the immediate area to Durham Tees Valley Airport there is a large amount of house building currently and house builders will be cautious in relation to the commencement of further development to ensure that returns on investment are maximised.
- 16.19 House builders have lost confidence in the purchase of large strategic sites following Chancellor Phillip Hammond announcing in November 2017 the intention to reclaim land that was not developed quickly enough, the government response that the Land Capture Review will recommend that councils are 'able to strip landowners of large portions of profits from the sale of their land', and Sir Oliver Letwin's review of build out rates. This currently leaves the public sector to take leadership in the delivery of large scale strategic housing land.
- 16.20 Caution is expressed that construction of the recent planning consent for residential development of 350 houses on the 23.33 acres periphery of DTVA is likely to frustrate, or delay the development of DTVA and its ancillary uses. Similarly, the site to the entrance at Yarm Road and St Georges Way recently sold to Esh Group should be managed to provide a gateway to the DTVA site.

17.0 Method Statement

- 17.1 Our instructions are to advise on the purchase price based on the market value of the DTVA land on three bases:
- 17.1.1 The existing use value of the operational airport; and
- 17.1.2 An alternative use value assuming the DTVA ceased operation.

17.2 The existing use value of the operational airport is made up of three parts:

17.2.1 Income flow from rents receivable arising from the several leases listed in the Tenancy Schedule at Appendix 8, which basis of value is that of investment value, defined by the RICS Valuation – Global Standards 2017:

Investment Value: ‘the value of an asset to a particular owner or prospective owner for individual investment or operational objectives’; and

17.2.2 Other land with development potential being the remainder of land not operational airport land, or land and property let to third parties (see item 18.2.1 above) being the basis of market value where there is the prospect of additional value being created or obtained in the future, which will be through a Master Plan currently being formulated:

Market Value: ‘the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.’; and

17.2.3 The operational buildings and facilities of the DTVA on a cost approach, discounted to arrive at the depreciated replacement cost, this approach is most appropriate in liaison with the firm of chartered accountants the client is intending to instruct and which valuation will be based on the assumption of a profitable ongoing concern.

The opinion of value on existing use of the land and property assets comprising the business of DTVA can not be completed without including a value for those operational land and buildings and this opinion is therefore only part of the complete position and should be taken as an interim amount until the final position can be concluded in consultation with the appointed accountants with whom we will liaise.

- 17.3 The alternative use for the DTVA land, should closure of the airport occur, is based on the long-term development of a Garden Village. The basis of value adopted is that of market value, with the prospect of development where there is no current permission for that development but assuming the probability that planning consent is granted and the land sold to third parties for development.
- 17.4 The approach to valuation has been taken on the following bases:
- 17.4.1 The comparable sale value of land for similar uses, in the case of land capable of development for the proposed Master Plan;
- 17.4.2 The investment value of an income stream from the properties let on the lease terms and strength of covenant of the several tenants; and
- 17.4.3 For the alternative use as development for a Garden Village, based on comparable land values for residential use discounted over the period until the sale proceeds are estimated to be receivable and make deduction, so far as feasibly possible at this early stage, for the costs of adapting the land for the proposed use. The assumption is made that the preparation for the implementation of this alternative use will start within five years of the date of this valuation, in anticipation of the closure of DTVA
- 17.4.4 The residual value appraisal of the land taking into account the estimated total development values, less the total development costs of the uses proposed in the Master Plan.
- 17.5 Adopting these methods of valuation will result in different figures as to price. This arises from differing factors that are taken into account when addressing each basis. A judgement is then made, having regard to the circumstances of the case, as to the reasonable price a potential seller of the DTVA land would take in the open market.

18.0 Definitions

- 18.1 This is an advisory report to assist in the purchase of the land comprising DTVA. It is not to be adopted as an asset valuation within the meaning of the RICS Valuation – Global Standards 2017 (the ‘Red

Book’) but for consistency of approach the following definitions have been adopted:

- 18.1.1 Market Rent (MR) – The estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and willing lessee on appropriate lease terms in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion (see IVS 104 paragraph 40.1);
- 18.1.2 Market Value (MV) – The estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion (see IVS 104 paragraph 30.1);
- 18.2 Material Uncertainty – Matters that may give rise to material valuation uncertainty. Express attention is drawn to, and comment made on, the issues at the valuation date that make the development at DTVA viable and the specific risk of achieving viability of the proposed developments in the Masterplan deliverable;
- 18.3 Special Assumption – An assumption that either assumes facts that differ from the actual facts existing at the valuation date, or that would not be made by a typical market participant in a transaction on the valuation date;
- 18.4 Special Purchaser – A particular buyer for whom a particular asset has a special value because of advantages arising from its ownership that would not be available to other buyers in a market; and
- 18.5 Valuation Date: is the date of this report.

19.0 Market Commentary

- 19.1 There is no shortage of land available for commercial development, or indeed for residential development in the Tees Valley region. Much of this land available is on previously used, or ‘brownfield’ sites. The

challenge is to overcome the risks and costs of preparing the land by improvement with infrastructure and/or remediation and overcoming abnormal ground conditions that increase the risks, time and cost of bringing land forward for construction.

- 19.2 This report assumes that the development land identified for development within the Master Plan in preparation, or for a Garden Village, requires no remediation, abnormal costs, infrastructure and services requirements and that the site is readily available for development without incurring unnecessary delay and costs in preparation for construction. The exception to this is the need for investment in a new road access to release development opportunities to the Southside of DTVA and on which further advice is given.
- 19.3 Reference has been made in paragraph 17.15 of the need to have a regeneration development plan to attract investors and occupiers.
- 19.4 Linked with the above comments a robust marketing plan is required for the region, the local area and the developed property by which to attract inward investors and other occupiers. In particular, a Unique Selling Point needs to be made that there is an ideal opportunity to develop a strategic transport hub and air-passenger traffic to create sufficient demand in the market from airport related users, particularly in freight handling and passenger usage, to create the vibrancy of use, but this will not in our opinion generate a premium of value from such use with proximity to DTVA.
- 19.5 Research and example have shown that development around transport hubs, such as an airport, has a better chance for success given the location and activity. DTVA has not achieved the desired growth over the last few years and is not perceived by the market to be a vibrant and active transport hub. The achievement of values that are necessary to make the development proposed both viable and attractive to occupiers will require a commitment to investment in infrastructure, development and the achievement of a step change in the perception of DTVA.

20.0 Development Issues

- 20.1 Carrying out development is high risk, which is mitigated by seeking to identify all those variable factors that have an adverse impact upon

the timing, programme and cost of construction. Before any development is commenced it is advisable to identify fully the costs of preparing the land for development including remediation, abnormal foundation requirements, site infrastructure including the need to increase the capacity of services necessary to fully use the properties to be developed.

- 20.2 The risk is further extended by making a judgement as to the likelihood of finding occupiers, when this is likely to occur and the rent or value that is achievable. Should there be a delay in finding an occupier the developer's profit is eroded by the cost of holding the property vacant, these costs can include: security, maintaining services and heating, insurance and empty property rates.
- 20.3 There are two variable factors in determining the price payable for land for the purpose of development. One is to fix the developers profit, usually taken at 20% of the total development value for speculative development. This produces the residual amount attributable to the payment for the land, less the costs of purchase such as legal, surveyors and Stamp Duty Land Tax. The other is to fix the price at which the landed is to be bought and determine whether the desired level of developer's profit is achievable in the market place. In this case we have adopted the residual amount attributable to the payment of the land. We have then, at this early stage of the development process, attempted to identify all of those matters that will determine the total development value and the total development costs, excluding the land. It is clear that the present total commercial development value falls well below the total development costs and a planned approach is necessary to grow demand and values to make development viable overtime.
- 20.4 The above is attributable to a single building development. Where, as in the case of the Master Plan for DTVA, there are a number of buildings within the overall development scheme the more complex develop appraisal is required. Normally, phasing is factored into the development programme and a discounted approach is taken, plus the addition of interest over the time taken for the development, offset by the interest earned from lettings and sales. In this case, because of the paucity of information available, a single day residual valuation approach has been adopted without phasing and other than normal

interest charges on the assumption it is a hypothetical single building event. As the development proposals are formulated so the development and appraisal can be refined to meet the particular circumstances.

- 20.5 In dealing with the multi-building phased development of this character it is usual that the first phase of development is of low value and high risk; and that the final phase of development, if successful, is of high value and low risk. It is therefore important to recognise this when considering the procurement of development and in particular a development/funding partner.
- 20.6 It has been assumed that the development of hangar space is not commercial property related but is Airport specific and is an integral part of developing viable business of airport operation. Thus hangar space has been excluded from the estimate of value and costs reported herein.

21.0 Land, Capital & Rental Values

21.1 Land

21.1.1 Housing: the summary of land transactions in the area in the recent past has produced sale prices that range from £166,667 to £562,142 per acre over the last four years; see Appendices 9.1 and 9.3. We are informed that the sale of land of around 23.33 acres by DTVA to Miller Homes for the 350 house development on the DTVA land achieved a sale price of £5 million, equivalent to £214,316 per acre. This appears to be low and has regard to the higher incidence of construction costs and lower house sale prices because of proximity to an operational airport. We are told that this sale has been halted with the proposed sale of DTVA to the client and thus is not a valid comparable. In contrast, the sale of 11.91 acres of land for 148 houses at Green Lane, Yarm at a price £295,768 per acre achieved in April 2017 is the nearest appropriate comparable of similar character for Garden Village style land, and has been adopted but rounded up to £300,000 per acre, before making a deduction for quantum.

21.1.2 Industrial & Distribution: there is a small range of relevant land sales, see Appendices 9.2, 9.4 and 9.6:

- Yarm Rd, Darlington £359,801 per acre, which is for a car showroom and which is discounted;
- Fabian Rd, Middlesbrough £220,176 per acre; and
- West of Tursdale Rd, Bowburn £221,744 per acre for a 90 acre site.

21.1.3 The above are better sites in terms of location and uses. This contrasts with the generality of the market for employment land sales within the Tees Valley region where sales are between £40,000 and £50,000 per acre. All of these figures relate to relatively small sites and the sale of areas the size of which is being contemplated for development of DTVA will be heavily discounted because of quantum. The JLL report of July 2015 (Appendix 11) adopts a figure of £50,000 per acre for commercial land values and whilst I agree with their assessment of existing agricultural use value, I am of the opinion that commercial land value held for development is more in the order of £40,000 per acre, because of the quantum of land involved.

21.1.4 Offices: there are no comparables on land sales that assist, and usually such sales are part of the overall price for employment land and or industrial/distribution land in out of town locations in the area.

21.2 **Capital**

21.2.1 Housing: the comparison of sale price per square foot is shown in Appendices 9.1 and 9.3. Since the proposed Garden Village style development is not yet planned and the capacity of development unknown it is not considered appropriate to adopt a residual valuation approach and this information is discounted because of too much uncertainty.

21.2.2 Industrial & Distribution: it is likely that the size of units for disposal will be between 5,000 and 20,000 sq. ft. Consideration has been given to capital sale prices within this range and whilst

the information is wide ranging those transactions relating to the locality have been chosen, see Appendix 9.4:

- 5,000 to 10,000 sq. ft. there are two old units in Stockton sold in March 2017 at £45.80 sq. ft. & February 2018 £31.53 sq. ft.; and
- 10,000 and 20,000 sq. ft. there are two units one at Stockton and the other Darlington sold at £33.85 sq. ft. and £41.22 sq. ft. respectively.

A capital value of £40 per sq. ft. has been adopted as appropriate for the site and character of development.

21.2.3 Offices: the relevant comparable capital value cases from the information in Appendix 9.5 are:

- Falcon Court at £53.36 sq. ft. ;
- Lockheed Close Stockton at £56.47 sq. ft. ;
- Wetherby Close Stockton at £98.14 sq. ft. shows an 8.29% initial yield; and
- Northgate Darlington £157.05 sq. ft. showing 9.03% initial yield.

These are very wide ranging and deal with buildings ranging from 11 years to 98 years of age. Adjusting for a new building but discounting the Northgate transaction as being of a town centre location a rate of £125 sq. ft. is adopted.

21.3 Rental

21.3.1 Housing: no rental value evidence has been applied and capital sales are assumed.

21.3.2 Industrial & Distribution: Appendix 9.6 shows the comparable for asking rentals for new build in the Stockton area are being quoted at £6 per sq. ft. for sizes between 5,000 and 10,000 sq. ft. A figure of £6 per sq. ft. has been adopted for the development appraisal but a rental of in excess of £7 per sq. ft. is likely to be required to achieve a viable development.

21.3.3 Offices: the comparable evidence shown in Appendix 9.7 shows that between 2015 and 2016 office rents in Darlington, Stockton and Middlesbrough were achieving between £8.61 and £9.98 per sq. ft. for 10 year lease, some with mid-term breaks, for 5,000 to 10,000 sq. ft. of space. In contrast new space will

require a rental in excess of £18 per sq. ft. to achieve a viable and profitable development.

22.0 Valuations

22.1 Continued Operational Airport

22.1.1 The value of the existing use of the airport is in two parts: the value of the income stream of rentals; and the unused land for which there is a development potential and these are addressed below.

Value for Existing Use

22.1.2 The estimate of the value for existing use of the airport in this report deals solely with the value of the non-operational airport land and buildings. That is: the income received from third parties in relation to the terminal, hotel and properties let on the ‘land-side’ of the airport and which is done on an investment basis of valuation; the 23.33 acres of land for which planning permission has been granted for housing and is taken at the contracted sale price to Miller Homes of £5,000,000; and the existing agricultural use value of the land at the Southside of the airport, the subject of a valuation by JLL, July 2015 and a copy of which is provided at Appendix 10 and reported at £1,160,000, with which we agree and consider to be still current in the present market. There remains to be valued the ‘airside’ of the airport operations such as the control tower and other land and building assets necessary for the carrying out of the function of the airports operations. The value of these operational assets need to be done in consultation with the accountants to be appointed by our client and might take the form of a Depreciated Replacement Cost basis of value, provided a satisfactory profitable ongoing business can be established.

22.1.3 The valuation on an investment basis is:

Table 23.1.3 Value of rental income

Description	Amount £
Gross Rental Income as Oct 2018 tenancy	576,666

schedule		
Less management @10%	<u>57,767</u>	
Net Income	518,999	
Years Purchase @ 8%	<u>x12.5</u>	
Gross Value of rental income	6,487,493	
Less acquisition fee legal and surveyor @ 1.5%	<u>97,312</u>	
Value before Stamp Duty Land Tax		6,390,180
Stamp Duty Land Tax		
First £150,000	nil	
Next £200,000 @ 2%	4,000	
Remainder £6,040,180 @ 5%	<u>302,009</u>	
Total Stamp Duty Land Tax		<u>306,009</u>
Estimated Value of Land & Buildings let to third parties		<u>6,084,171</u>

22.1.4 The total Existing Use Value, incorporating the investment basis of value from paragraph 23.1.3 is:

Table 23.1.4 Existing Use Value

Description	Amount £
Investment basis as paragraph 23.1.3 above	6,084,171
Housing development land	5,000,000
Land at Southside for agricultural use	<u>1,160,000</u>
Total Estimated Existing use Value	<u>12,244,171</u>

22.1.5 I round this estimate for existing use to £12,250,000 (twelve million, two hundred and fifty thousand pounds), as an interim amount and subject to the addition of the estimated value of the ‘airside’ land and buildings. The increases the figure reported on the 14 December 2018 email as a the result of an amended Tenancy Schedule received from DTVA Limited showing and increase from £542,940 to £577,666 in the gross annual rental income.

Value of Land with Development Potential

22.1.6 On the assumption that DTVA continues to trade successfully there is a potential increase in value of the land available for development.

22.1.7 The approach adopted is to consider each constituent part of the site: annual income from existing tenancies; the availability of the ‘housing’ land of some 23.33 acres on the Northside of the airport for commercial development and not housing development; and the development of land at the Southside of the airport, conditional on the construction of an access road not paid for from the assets of DTVA i.e. by government funding. This approach adopts to a certain extent the Master Plan of 2014 without the additional land not in the ownership of DTVA.

22.1.8 It is clear that non-residential development in the Tees Valley is likely to prove difficult, given the negative ‘gap’ between the higher cost of development and the lower development value, based on a development appraisal applying current market rental and capital values. The approach taken to assess the potential market value of the DTVA land available for development is based upon comparable sale figures for commercial land. I have explained my adoption of the amount of £40,000 per acre at paragraph 22.1.3 above and apply in this case, on the basis of uses not being restricted to airport use.

Description	Amount £
Value of income see table 23.1.3	6,084,171
Value of ex-housing land	23.33 acres
@ per acre	<u>40,000</u> 933,200
Value of Southside Commercial development land	120 acres
@ per acre	<u>40,000</u> <u>4,800,000</u>
Value of land with development potential	<u>11,817,371</u>

22.1.9 I round this estimate for existing use to £11,850,000 (twelve million, two hundred and fifty thousand pounds), as an interim amount and subject to the addition of the estimated value of the ‘airside’ land and buildings.

22.1.10 These estimates should be reviewed when further information is made available through the process of due diligence.

22.2 Closure of DTVA and Development as a Garden Village

22.2.1 To arrive at the value of the DTVA land on an alternative use basis an assumption has been made that the DTVA will close after 10 years and that there is the probability of obtaining planning consent for a Garden Village, in the longer term, as previously explained.

22.2.2 There has not been a sale of land of this size in the recent past on which to make an assessment of value by direct comparison. The large national house builders operating in the region would normally approach an option to purchase by offering the existing use value, plus 50% of the improved value of the land on receipt of planning consent for housing.

22.2.3 The estimate of existing use to apply to this purchase is calculated in table 23.2.3 below

Table 23.2.3 Estimate of Existing Use Value on rental income from land and buildings let to existing tenants, excluding airside properties

Description	Amount £
Income as Tenancy Schedule Oct 2018	576,666
Less airside income:	
Terminal	81,075
Hanger 1	39,450
Hanger 2	175,500
Hanger 360	106,242
Building 40	<u>20,750</u>
	<u>423,017</u>
Income producing Northside properties	153,649
Add St George Hotel revenue £595,000	
provision for annual rent @ say 8%	<u>47,600</u>
Gross rental income say	201,249
Less management and other outgoings @ 10%	<u>20,125</u>
Estimated net income say	181,124
Years Purchase @ 8%	<u>x12.5</u>
Estimated investment value of income from lettings	2,264,049

22.2.4 There is no criteria by which to make a judgement of the scale and content of an alternative and fully development Master Plan by which to assess the net developable area, nor for any hard and soft infrastructure (i.e. schools and health care etc.). An approximation has been made that the gross development area is some 817 acres. Whilst a broad average of purchase price of £300,000 per acre may be adopted for the gross developable area of housing, a discounting is applied:

Table 23.2.4 Calculation of Estimated Purchase Price for DVTA Land on Basis of Alternative Use

Description	Amount £
Price per acre	300,000
Less, net to gross development area @ 10%	<u>30,000</u>
Price per gross development area:	270,000
Less quantum @ 20%	<u>54,000</u>
Net price per acre	216,000
Total site area acres	<u>817</u>
Gross land price	176,472,000
Less,	
Clearance provision say	£5,250,000
Professional fees say 15%	£ 787,500
Planning costs say	£2,500,000
Contingency say	<u>£1,462,500</u>
	166,472,000
Less overage payment to landowner @ 50%	<u>83,236,000</u>
Gross payment for land	83,236,000
Adjusted to present day costs Present Value £1 for 20 years at 3.5%	<u>0.5025659</u>
Price for DTVA on alternative use	41,831,575
Add investment value of existing use (see para.23.2.3)	<u>2,274,049</u>
Total price	44,105,624
Legal fees say 0.5% of £44,105,624	£200,000
Valuation fees say 0.1%	<u>£40,000</u>
Gross price before purchasers costs	<u>240,000</u>
	43,865,624
Stamp Duty Land Tax Up to £150,000	nil

Next £100,000 @ 2%	£2,000	
After £250,000 on balance of £39,750,000 @ 5%	<u>£1,987,500</u>	<u>1,989,500</u>
Estimated Purchase Price		<u>41,876,124</u>

22.2.5 The estimated value of the DTVA land assuming an alternative residential use in the character of a Garden Village I have rounded to the order of say £42,000,000 after allowing a period of 10 years to make the airport viable and for a reasonable period in which to achieve planning consent.

22.2.6 It is also unlikely that a single house builder would be willing to purchase such a large area of land as a strategic purchase, given the timescale of waiting to see if the airport will achieve viability and costs of preparation and planning before development can be considered. The purchase of DVTA land is more of a strategic purchase for either a large corporate organisation such as Peel Holdings plc the majority shareholder of DTVA, or the public sector such as Homes England, or an enterprising regional body, such as the Mayor/Combined Authority.

22.3 The amounts of the estimated values for development based on development appraisals result in significant negative figures, as is expected in an area where rents and capital value are lower than the cost of development. The regeneration initiative must be carried out in conjunction with a plan for growing values and this is dependent upon increasing the demand for space through a cohesive and comprehensive marketing plan.

22.4 The cost of constructing a new access road to release the development potential of the Southside site is assumed to be funded by regional economic regeneration sources. If the Southside development is dependent upon a self-funding access road then the present estimated negative value would be increased significantly.

23.0 Conclusion

23.1 Our instructions first ask if the purchase price for the DTVA land at £40,000,000 (forty million pounds) is a fair market value: on the basis of the assumptions that we have made, we are of the opinion that an estimate of the present market value of the DTVA land is in the order

of £42,000,000 (forty two million pounds) on the basis of alternative use in twenty years and on the probability of obtaining planning consent for a Garden Village style housing development.

- 23.2 The purchase of DTVA is to create transport hub by the development of a vibrant and viable airport business. Initial advice has been given on the formulation of a Master Plan for that hub. As an economic regeneration initiative investment is required to improve the infrastructure and to change perception of a failing airport operation. This will require further investment in the marketing of the opportunity, the attraction of public and private sector investment and occupiers. The objective will be to grow values sufficiently to make development viable and attractive to by the private sector as investors and developers.
- 23.3 The existing use and development values for a transport hub are based on the premise that the use of the DTVA land will not be restricted to airport use only. Further, that a planned programme of activity will be put in hand to complete the formulation of a Master Plan for delivery as a priority.
- 23.4 The client has indicated that a period of 10 years will be allowed by which to achieve this regeneration initiative for economic growth and job creation. After which, if not successful, the land can be developed for housing in the character as a Garden Village. It is considered that present government policy encourages and indicates that there is a probability of achieving planning consent for this approach and on which the alternative use value, that substantiates the purchase price has been based. It is important that time be allowed prior to the expiry of 10 years to begin the process of obtaining consent for the development of housing in the Garden Village concept.

24.0 Disclosure

- 24.1 In accordance with our standard practice we must state that this report is confidential to the party to whom it is addressed and no responsibility is accepted to any third party for the whole or any part of its contents. If our report and opinion is disclosed to persons rather than the addressees of this Report the basis of the valuation should be stated.



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22.2 Neither the whole nor any part of this report or any references thereto should be included in any published document, circular or statement, nor published in any way without the prior written approval of the form and context in which it may appear.

A handwritten signature in black ink, appearing to read 'Alan C', enclosed within a thin black rectangular border.

JK Property Consultants LLP

14 January 2019

Appendix 1

Brief of Instructions Scoping Document – Land Valuation Report Required to Support Acquisition of DTVA

Our advisers are requested to prepare a full valuation report which values all land currently owned by Durham Tees Valley Limited on the bases set out below:-

Valuation	Assumptions
1. Value for existing use as an Airport but under TVCA ownership	Need to consider all potential planning uses available and airport operational land and buildings, the latter will require liaison with the appointed accountants and bring in item 4 below.
2. Value when commercial development improvements (as envisaged by Business Plan) are completed at year 10.	Define what it is that to be developed in the first 10 years as described in the Business Plan. This will incorporate:- <ul style="list-style-type: none"> • internal roads • station development • road from A67 to Southside • normal infrastructure support for infrastructure on Northside • TVCA being prepared to make commercial investment.
3. Value if airport should close	Present this to predominantly housing subject to agreement on the planning criteria.
4. Depreciated Replacement Cost valuation	If required by appointed accountants - see item 1 above

The valuation report must expressly state the assumptions on which each valuation is based.

The above sentence will be incorporated and is part of the directions issued in the RICS Valuation - Global Standards 2017- 'The Red Book' on which the valuation and report will be based.

Reference will also be made to conform to the Treasury Green Book.

General Principles Applying to all United Kingdom Valuations Undertaken by JK Property Consultants LLP

It is our objective to provide a professional and efficient valuation service to all of our clients. In the interests of establishing clear terms of reference at the outset we believe that it is important that we should fully understand the requirements of our clients and the purpose and basis of the valuations that they commission and that clients should understand the usual limitations to the services offered. We are pleased to discuss such variations, where appropriate, and to arrange the provision of extended or additional services, such as site, building or structural surveys if required.

The following General Principles apply to all valuations and appraisals undertaken by JK Property Consultants LLP in the UK unless it is specifically agreed otherwise in confirming instructions and so stated within the main body of the report. The General Principles themselves will normally be included as an appendix to the report but will nonetheless comprise as a part of the conditions of our engagement.

1. RICS Appraisal and Valuation Standards “The Red Book”

Valuations and appraisals will be carried out in accordance with the RICS Appraisal and Valuation Standards (“The Red Book”), by valuers who conform to its requirements, and with relevant regards to statutes or regulations. Compliance with The Red Book is mandatory for Chartered Surveyors in the interests of maintaining high standards of service and for the protection of claims.

2. Confirmation of Instructions.

In order to comply with The Red Book, instructions must be confirmed with clients in writing. In addition to the matters specifically referred to below the purpose, timetable, extent of and limitations to the valuation service are subject to such an agreement.

3. Valuation Basis.

Properties are valued individually and valuations and appraisals are carried out on a basis appropriate to the purpose for which they are intended and in accordance with the relevant definitions, commentary and assumptions contained in The Red Book. The basis of valuation will be stated in the body

of the report and the definition will usually be included with these General Principles.

4. Title and burdens.

We do not read documents of title although, where provided, we consider and take into account of matters referred to in solicitor's reports or certificates of title. We would normally assume, unless specifically informed and stated otherwise, that each property has good and marketable title and that all documentation is satisfactorily drawn and that there are no unusual outgoing, planning proposals onerous restrictions or local authority intentions which affect neither the property nor any material litigation pending.

5. Disposal Costs and Liabilities.

No allowance is made in our valuation for expenses of realisation or for taxation which may arise in the event of a disposal and our valuation is expressed as exclusive of any VAT that may become chargeable. Properties are valued disregarding any mortgages or other charges.

6. Sources of Information.

We rely upon the information provided to us, by the sources listed, as to details of tenure and tenancies (subject to 'Leases' below), planning consents and other relevant matters, as summarised in our report. We assume that this information is complete and correct.

7. Boundaries.

Plans accompanying reports are for identification purposes only and should not be relied upon to define boundaries, title or easements. The extent of the site is outlined in accordance with information given to us and/or our understanding of the boundaries.

8. Planning, Highways and Other Statutory Regulations.

Enquiries of the relevant Planning and Highways Authorities in respect of matters affecting the property, where considered appropriate, are normally only obtained verbally, and this information is given to us, and accepted by us, on the basis that it should not be relied upon. Written enquiries can take several weeks for response and incur charges. Where reassurance is required on planning matters, we recommend that formal written enquiries should be undertaken by your lawyers who should also confirm the position with regards to any legal matters referred to in our report. We assume that the properties have been constructed, or are being constructed, and are in accordance with the appropriate consents and that there are no outstanding statutory notices.



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We assume that the premises comply with all relevant statutory requirements including fire and building regulations.



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Appendix 3

Lichfields Planning Context Report



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Appendix 3

Turner & Townsend – High Level Approximate Construction Estimates



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Appendix 5

RICS UK Economic and Property Market Overview

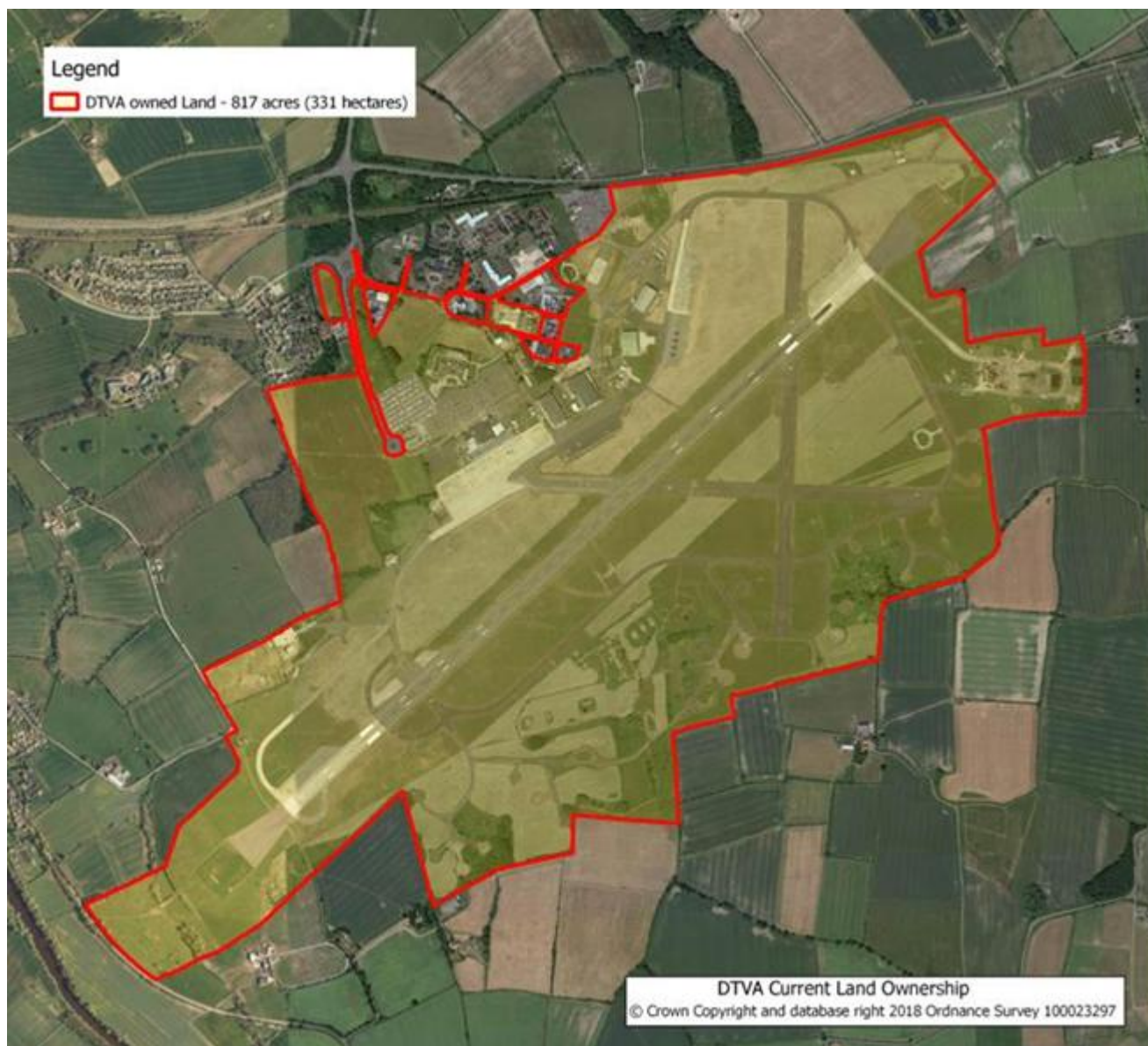
Appendix 6

Location Plan



Appendix 7

Site Plan





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Appendix 8

Schedule of Tenancies at DVTA October 2018



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Appendix 9

Comparable Land and Property Transactions



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Appendix 10

JLL Valuation of Southside Land, July 2015