QUESTIONS TO: Glasgow Prestwick Airport (GPA) Limited

Background to the airport's changes of ownership

1. Can you please provide more details on the company that acquired the airport from BAA in 1991 and sold it to you in January 2001?

   In 1991 the newly-privatised British Airports Authority, BAA plc consolidated their portfolio of UK airports. Part of this was to move all transatlantic traffic departing from Scotland to Glasgow Airport, near Paisley, and sell Prestwick off to the private sector. In the early-to-mid 1990s passenger figures fell sharply with only freight traffic and a small number of charter flights using Prestwick on a regular basis. At this point the airport faced an uncertain future.

   1994 marked the beginning of a renaissance for the struggling airport. It took the shrewd move of building its own railway station on the existing Glasgow-Ayr line, which runs straight past the airfield. Then, Irish budget line Ryanair opened a route to the airport from Dublin. This led to another route to London the following year. The resulting rapid growth of European no-frills airlines in the late 1990s has seen Prestwick grow even larger than it had ever been in traffic terms under state ownership. Ryanair now serves 20 destinations from Prestwick - now one of their maintenance hubs - and other budget airlines have also moved into the airport.

   PIK Facilities (led by Matthew Hudson) (ultimate parent PIK Holdings Limited) acquired the assets of Prestwick Airport in 1992 from BAA.

   Stagecoach acquired 100% shareholding of Prestwick Aviation Holdings (ultimate parent of PIK Facilities Ltd) on 4 January 1998.

   Stagecoach sells to a consortium consisting of Infrastructure & Utilities NZ Limited (now Infratil Limited), The Special Utilities Investment Trust plc and Omniport plc on 22 January 2001.

2. Can you please clarify:
   a. when was the decision taken to build the railway station at GPA,

      Our review of the GPA archives has proved inconclusive in accurately determining the series of events leading to the ultimate decision to build the GPA Train Station. Our research has indicated that there were several proposals for constructing the station considered during the BAA management of the Airport. However, it appears that in the absence of a significant number of passenger flights to and from Prestwick, it was considered an unacceptable risk for BAA to take on the costs involved without a considerable contribution being made by the Council. The Council also took the view at this time that it would be inappropriate for them to contribute such large sum of public funds to a then failing airport.

      It would appear that even though there were no serious prospects of the Station being built, when the rail line between Paisley and Ayr was electrified in 1986, provision was made in the design of the overhead masts for the construction, at a future date, of a station in the near vicinity of the terminal building at Prestwick.

      When Prestwick International Airport was acquired by the PIK Limited consortium, a much more active programme of development appears to have been devised by the Airport management. It was under this management that the construction of the GPA station was undertaken. The construction completion date and some of the related documentation that we have been able to identify suggests that a decision to build the GPA station was made during the second half of 1992.

b. who took the decision to build the station,

Shortly after the purchase of the then Glasgow Prestwick International Airport ('GPIA') by Prestwick Aviation Holdings Limited ('PAHL') in 1992, a decision was made, by the then management, to construct a railway station along the existing Glasgow – Ayr train line to service the airport.

c. when the construction works started,

After entering into a long term lease with Railwaytrack PLC for the land adjacent to the Airport PAHL contracted to construct a railway station and pedestrian overpass which commenced in early 1993.

d. when the construction works finished,

The construction of the GPA Railway Station and Pedestrian Overpass was concluded in Autumn 1994.

e. when the station started operations.

Autumn 1994

3. On your website[1] it is mentioned that:

a. Infratil acquired a 67.3% interest in the airport in January 2001 for GB£14.8 million

Agreed

b. that the total purchase cost was £34.5 million

22/1/2001	67.3%	£14.800m
15/12/2003	10.0%	£6.025m
19/12/2003	22.7%	£11.700m (subsequently adjusted to £2.06 a share = £10,300,000 and finally purchased on 8 March 2004)

c. that the balance of equity, £7.2 million, was provided by the Special Utilities Investment Trust plc, a UK based utility investor, and consortium of Scottish business interests.

[1] See http://www.infratil.com/glasgow_prestwick_international_airport.htm

Agreed

d. that Infratil increased its holding to 100% in March 2004.

Agreed

4. Can you please confirm the above and:

a. explain the components of the difference between the £14.8 million figure and the £34.5 million total purchase cost.

Refer to 3b above – the website quotes a number of acquisition cost totals as a result of the NZD: GBP exchange rate in place at the time of the various reports. The investment is held in NZD hence the different values when it is translated into GBP at a point in time. Effectively £31,125,000 was paid solely for the shares with legal and professional, due diligence fees etc pushing the total acquisition cost to c£34.5m.

b. explain what part of the £34.5 million total purchase cost is attributable to acquisition of ownership rights over the station?

The purchase price was never apportioned specifically to each assets although the subsequent fair value exercise apportioned a prudent value of £2m to the station.

c. explain the basis for the £2.2m valuation of the station you mentioned at the meeting with ORR and First Scotrail on 29 March 2006. Does it represent the book value of the station in January 2001: if not, what was the book value at that time and what was the book value in March 2004? What was the actual purchase price paid by Infratil for the transfer of the station's ownership?

Please refer to the GPA Airtrain Proposal – Addendum dated 29 March 2006 which identifies that the original cost was £2,307,000 – which was carried in books at £2m valuation (if held at depreciated cost it would be in the books at £1,772,500). Please note that £2m valuation is lower of depreciated replacement cost and DCF (in this case DCF as we know the MEV to be c£3.5m).

d. clarify which company held the remaining 32.7% of equity in GPA before March 2004 when you increased your holding to 100%:

22.7% was held by Utilico Investment Trust
10.0% was held by Omniport plc

e. clarify the total payments by Infratil in March 2004 to increase its holding to 100% and which part of the payments are attributable to the transfer of station ownership to Infratil.

Detailed above however please note that there was no direct apportionment to the station. Fair value for accounting purposes unchanged at £2m.

Background to the station's construction

5. Can you please confirm if the total cost of building the station was £2,193,350 as claimed by First Scotrail. Can you also confirm the price base of this cost figure.

   Please refer to Annexure A - *Cost Report No. 5*, Professional Project Management Limited's estimate of the final cost of the station. The Cost Report indicates an estimated final cost of £2,337,980.

6. Can you please confirm that the funders of the station construction and the amount of their contributions are as claimed by First Scotrail in their S17 application.

   Our review of the GPA archives has been inconclusive however our best estimate is that funding committed to the project, net of the EC contribution in each case, is as follows:

Strathclyde Region	£375,000
Kyle and Carrick District Council	£300,000
Enterprise Ayrshire	£526,000
Glasgow Prestwick Airport	£400,000

   EC grants of 25% of the above amounts were granted, bringing the total cost of Phase 1 of the station's construction to £2,001,250. Cost overruns (shortfalls in funding) of £336,730 were funded by Glasgow Prestwick Airport, bringing the total project cost to £2,337,980. It would also suggest that Glasgow Prestwick Airport's total contribution was in the vicinity of £736,730.

   Annexure A further identifies that further delays from the sub-contractors due to difficulties with the piling, delays in the erection of the steelwork and problems with design details were likely to push the total cost to around £2.5m. While this is likely to have been the case, Glasgow Prestwick Airport does not have in its possession documents to confirm this.

7. Can you please explain in detail the contractual arrangements between GPA and the funders:

   It is clear that a significant number of complex legal agreements would have been required, as the GPA station was the first 'private' station to be constructed on the British Rail network for many years, and also the first to be constructed under the changed arrangements following the progressive implementation of the Government's franchising and privatization proposals.

   Glasgow Prestwick Airport no longer has these funding agreements in its possession. They have evidently been lost in the various changes in ownership that have occurred in the time since the station was constructed. However, we are not aware of any ongoing liabilities or obligations to the original providers of funding.

. . . . including an explanation for each contribution of the following:

a. whether the contributions were all grants, i.e. no repayment of the contributions in any form to the funders from GPA is implied;

Please refer to 7 above.

b. whether any interest payment (or other ongoing payment) was due from GPA to the contributors as a consequence of their contributions;

Please refer to 7 above.

c. whether the contributors received any ownership rights or any other legal right over the station as a consequence of these contributions;

Our research, while inconclusive, supports the view that no ownership rights or any other legal right over the GPA station were given to any of the identified contributors. The Due Diligence conducted at the time of IAEL's acquisition of GPA did not identify any legal interests in the GPA station facility.

d. whether the contributions were conditional on any binding requirement made by the contributors (e.g. on the use of the asset, on its future transfer to other parties etc.);

Please refer to 7 above.

e. the risk sharing arrangements behind these contributions, e.g. if the contributors shared any of the output risks, financial risks etc.

Please refer to 7 above

The contractual arrangements between the Franchisee and GPA for the use of the station

8. Can you please explain in more detail all the different contractual arrangements regarding access to the station (e.g. the Travel Scheme agreement, the revenue share agreement, the "free rail travel for 6 months" arrangements) which were entered between GPA, the then franchisee ScotRail Railways Limited ('SRL') and any other parties (e.g. SPTE) after the construction of the station.

Access Agreement

A *Station Access Agreement for Operators of Passenger Services for Prestwick International Station* ('Access Agreement') was entered into between GPIA Limited and ScotRail Railways Limited ('SRL') on 23 July 1998.

This agreement gave the passenger service operator, i.e. SRL, access to railway station to allow them to run a train service to and from PIK for an Access Fee of ZERO.

It also places an obligation on GPIA Limited to maintain and insure the railway station. There is a detailed list of required Station Amenities and Services annexed to the agreement.

The original agreement expired on 1 December 2004 however an agreement amending this date was executed between the new passenger service operators, First ScotRail Limited and GPIA Limited on 8 December 2004 to allow the parties sufficient time to negotiate the terms of a new agreement.

Discounted Travel Scheme Agreement (‘DTA’)

An additional agreement, commencing on 26 September 1999, was entered into between PIK Facilities Limited, SRL and Strathclyde Passenger Transport Executive that set up a system of discounted railway tickets for those passengers flying in or out of GPIA.

The basis of the agreement was that SRL agreed to discount fares by 50% for passengers holding a valid ticket in or out of GPIA. In addition, for newly introduced airline services passenger were able to travel on the train free of charge if they were using the new service during the first six months of its operation.

PIK Facilities received 36% of the revenue collected by SRL from airline ticket holders using the train service to and from GPIA.

ScotRail Railways Limited Franchise

As of 16 October 2004, SRL’s Franchise as the passenger service operator for the Railroad system in Scotland was transferred to First ScotRail Limited (‘FSR’).

Under *Section 220* and *Schedule 21* of the *Transport Act 2000*, the original GPIA Access Agreement was protected as a ‘Primary Franchise Asset’ for the term of the contract (now extended to the execution of a new agreement).

Unfortunately the DTA was not protected by Section 220 of the *Transport Act 2000,* and in a letter dated 3 September 2004 SRL served a Notice of Termination of this agreement on GPIA effectively terminating the agreement on 16 October 2004. This appears to be a valid notice. This Agreement was also not protected by the terms of the new Franchise agreement entered into by FSR although GPA has subsequently learnt that a commitment to the discounted travel aspects of this agreement (as detailed above) were imposed on the new Franchisee FSR but not the revenue sharing component.

In particular, for each contractual arrangement please include details on:

a. The parties involved:

Access Agreement

Between

Glasgow Prestwick International Airport Limited as Station Facility Owner, and

Scotrail Railways Limited as Beneficiary

Discounted Travel Scheme

Between *Scotrail Railways Limited,* and

PIK Facilities Ltd, and

Strathclyde Passenger Transport Executive

b. Which parties could terminate the contract:

Access Agreement

The ability of the parties to terminate are derived from *clause 8* of the Access Agreement and are limited to:

a. material breach by either party; and
b. the expiry date; and
c. closure of the station

Discounted Travel Scheme

The ability of the parties to terminate are derived from *clause 11* of the DTA which states;

'Any of the parties to this scheme may terminate this agreement upon thirty (30) days prior written notice to the other parties.'

c. The risk allocation resulting from the contract:

Discounted Travel Scheme Agreement

Essentially the vast majority of the risk allocation resulting from these contracts fell on GPIA. GPIA's ability to receive a revenue stream from operation of its Airtrain facility was derived from the terms of the DTA. As identified above, GPIA received 36% of the revenue collected by airline and airport users adopting to use the Airtrain service to and from the Airport.

At the time that the DTA was executed the number of overall passengers at GPIA was 593,368. That number has now risen to 2.3 million passengers for this year. It should be noted that given the highly competitive environment it would have been impossible at the time the DTA was executed to have been able to forecast such a significant rise in passenger numbers and accordingly as the revenue was directly link to the number of users of the Airtrain, GPA would have borne significant risk arising out of this contract. By contrast the risk borne by SRL and the Strathclyde Passenger Transport Executive was minimal and limited to the minor increases in operating costs associated to stopping at the GPA station on a train line that they were already servicing.

Access Agreement

The Access Agreement referred to above, and which has been in operation since July 1998, was seen as an agreement that was running in parallel to the DTA and accordingly the effective compensation for the zero access charge contained in the Access Agreement was the revenue derived from the DTA. This is especially true when you consider that the Access Agreement, although failing to generate revenue, imposed significant operational and regulatory obligations on GPA that resulted in ongoing operating costs to GPA. If, therefore, you consider the Access Agreement in isolation, the total risk allocation sits with GPA who are obliged to keep the station operating, for the duration of the agreement, with zero revenue.

d. The relationship with any other contractual arrangement (e.g. is the Travel Scheme agreement an “umbrella” agreement which contains all the others?)

Refer to Requisition 8 above

e. An estimate of the financial value of the contract for GPA (i.e. the amount of money GPA has received each year as a consequence of the contract being in place):

Annexure B highlights the fact that at the commencement of the Travel Discount Scheme (1999), GPA was likely to have received a Gross contribution from the AirTrain Facility of approximately £103,839. If this agreement had not been terminated by FSR it would represent approximately £1.9 million worth of Gross Revenue to GPA in 2016 (the expected termination date of the proposed Access Agreement). This figure compares sharply to the FSR proposal which would see Gross contribution peaking at £X (deleted). While the GPA proposal peaks at £668,957.

The FY02 – FY06 figures are actual figures while the revenues identified prior to this date are estimates based on the actual passenger numbers over this period. When reviewing these figures, it should be noted that the FY2005 and FY2006 Gross Revenues are affected by the termination of the Travel Discount Scheme on 16 October 2004.

f. How the revenues generated by the contract were used, and in particular what proportion of these revenues was used to recover costs directly related to the station construction and management (e.g. financial costs of its construction; maintenance, repairs and renewals costs at the station, etc.):

As the individual assets of the airport are not separated for accounting purposes, the revenues received from the AirTrain facility were pooled with other airport revenues. It is, however, clear that given the passenger numbers prior to 2002 the revenues received from the AirTrain would not have covered the operating costs associated to the facility. Accordingly, GPA would have been forced to fund the difference using revenues derived from other airport assets.

A further discussion of the economics of a low cost airport is contained in the GPA AirTrain Proposal – Addendum dated 1 May 2006 under the heading ‘*Treatment of Grant Funding’.* Of particular relevance is the passage stating;

> *FSR have argued that IAEL should, in effect, subsidise the cost of the rail operation due to the benefits it provides by bringing passengers to the airport. In response, Infratil makes the following points:*

- *The economics of low cost airports rely on revenues from non-aeronautical activities to assist meet the very significant fixed costs of running the airport infrastructure.*
- *Low cost airport operators without market power are generally unable to charge airlines significantly more than marginal cost. This pricing is economically efficient and sustainable if there are other areas that revenue can be earned to meet fixed costs.*
- *Fees from ground transport access to the airport, including car parking, rental cars, taxis, buses and trains make up a significant proportion of the available funding to meet the fixed costs of the airport.*

g. Whether the contract is still in place or has been terminated - and in the latter case when it was terminated and by which party.

Refer to Requisition 8 above

Calculation of the charge

9. Can you please provide an estimate of the total costs per annum incurred by GPA in relation to the station construction and management, including:

a. Any costs related to financing the construction of the station (e.g. interest charges etc)

As has been previously noted, the Airport was acquired as a whole for a total purchase price of £34.5 million. Assuming the proportion of the purchase price allocated to the station was £2 million, this equates to an annual interest charge of £116,000 of the total monies borrowed from Infratil at their rate of borrowing.

b. Operating costs at the station after its construction and ideally up to the last financial year (providing the basis for the estimate)

Please see Annexure C which identifies a breakdown of operating costs for the last three years.

c. The costs of maintenance, repairs and renewals of assets at the station after its construction and ideally up to the latest financial year (providing the basis for the estimate and ideally the schedule of any past maintenance, repairs and renewals work at the station)

Please see Annexure C which identifies a breakdown of operating costs for the last three years.

10. Can you please provide an estimate of the total costs per annum which GPA expects to incur in each year over the station's remaining asset life related to its construction and management, including:

a. Any outstanding costs related to the financing of the station construction (e.g. outstanding interest charges etc):

Please refer to 7 above

b. Future expected operating costs per annum (providing the basis for the estimate):

Please refer to the section entitled '*Costs of Ongoing Obligations in relation to the GPA Facility'* in the GPA Airtrain Access Agreement proposal dated 29 March 2006.

c. Future expected costs of maintenance, repairs and renewals of assets at the station over the station's remaining asset life (providing the basis for the estimate and ideally the schedule of future expected maintenance, repairs and renewals work planned for the period)

Please refer to Annexure D

11. Can you please specify:

a. how the financing, operating, maintenance, repairs and renewals costs that you have either incurred in the past or you expect/plan to incur in the future at the station have informed the calculation of your proposed £637,616 + RPI Access Charge; and

Please refer to the section entitled '*Costs of Ongoing Obligations in relation to the GPA Facility'* in the GPA Airtrain Access Agreement proposal dated 29 March 2006.

However please note that the financing, operating, maintenance, repair and renewal costs make up £X (deleted) of the total access charge. These costs were calculated by taking the average of the total operating costs for the previous three financial years. As the operating costs of the station are primarily fixed (insurance, for example, makes up £x (deleted) and x (deleted)%, of operating costs), extrapolating the historical costs of operating and maintaining the station is considered the best method to calculate an accurate forward-looking cost estimate.

This is supported by Annexure E which is an estimate of the annual operating costs for the GPA Facility of £x (deleted) back in 1994.

b. what proportion of the proposed charge will remunerate these financing, operating, maintenance, repairs and renewals costs that you have either incurred in the past or you expect/plan to incur in the future for the station.

The proposed GPA Access Charge will be used to remunerate the financing, operating, maintenance, repairs and renewals costs as and when they arise. As the Capital Expenditure Table will identify there are significant repairs and components of asset renewal that must be addressed as a matter of urgency. The program of immediate works, estimated to be in the vicinity of £700,000 is budgeted to be carried out over the next two years.

The ORR guidance on how to calculate the appropriate Access Charge and our subsequent adoption of this approach was intended to ensure that the an appropriate level of allowance is made for the financing, operating, maintenance, repairs and renewal costs

12. Can you please list and explain all the reasons why you think the risk profile of GPA railway station is different from that of the market as a whole or any other similar asset.

In our calculation of the weighted average cost of capital (WACC) for Glasgow Prestwick Airport's Rail station, the component ß is a measure of the relative risk of holding a particular company's stock (or an asset) versus the market portfolio (or any other similar asset). Our estimate of 1.1 (which First

ScotRail appear to agree with in their submission to the Regulator dated 20 April 2006) is based on our current risk sharing arrangements.

The December 1999 periodic review document assumed that Railtrack's asset ß was equal to 1.1 to 1.3 based on 50% gearing and assuming that the structure of charges is broadly cost effective. Due to the identified differences in risk (particularly the high level of operational gearing), this is 0.1 to 0.3 (i.e. 10% to 30%) higher than the comparable betas assumed by the Office of Gas and Electricity Markets (OFGEM) for electricity distribution and by the CC for water and sewerage. It is also consistent with the range assumed by the MMC for BAA. It is noted that it is important for the Regulator to be confident that his assumed cost of capital is sufficient to enable Railtrack (or indeed Glasgow Prestwick Airport) to attract new debt or equity finance. This implies that Glasgow Prestwick Airport Rail station's ß should be higher than one.