The Scottish Government’s purchase of Glasgow Prestwick Airport
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When viewing this report online, you can access background data by clicking on the graph icon. The data file will open in a new window.
Key facts

- 6 weeks: The time available to the Scottish Government to decide whether to buy Glasgow Prestwick Airport.
- £25.2 million: How much the Scottish Government has budgeted so far to loan to Glasgow Prestwick Airport by the end of March 2016.
- £9 million: Loaned to Glasgow Prestwick Airport to January 2015.
- 1,810: Jobs directly or indirectly associated with Glasgow Prestwick Airport.
- £61.6 million: Glasgow Prestwick Airport's contribution to the Scottish economy.

- Price paid by the Scottish Government for Glasgow Prestwick Airport in November 2013.
- The time available to the Scottish Government to decide whether to buy Glasgow Prestwick Airport.
- How much the Scottish Government has budgeted so far to loan to Glasgow Prestwick Airport by the end of March 2016.
- Jobs directly or indirectly associated with Glasgow Prestwick Airport.
- Glasgow Prestwick Airport's contribution to the Scottish economy.
Summary

Key messages

1 Infratil decided to sell Glasgow Prestwick Airport in March 2012 owing to its declining commercial and financial performance and a change in business strategy. A number of potential investors showed interest in the airport, but none submitted a bid acceptable to Infratil and the last potential buyer withdrew interest in September 2013.

2 The Scottish Government bought Glasgow Prestwick Airport for a nominal price of £1 in November 2013 to protect jobs and safeguard what it considered to be a strategic infrastructure asset. Its purchase process was reasonable, given the tight timescale of six weeks. The Scottish Government’s business case identified the risks associated with the ongoing commercial viability of the airport, including a worsening economic outlook and the possibility of Ryanair withdrawing its flights. However, owing to time constraints it did not model them or include their impact in the financial forecasts for the airport.

3 The purchase business plan showed a positive financial return for the Scottish Government’s investment, although its predictions for future passenger growth were optimistic. We recalculated the financial return using less optimistic predictions for future passenger growth. This identifies that using less optimistic passenger growth forecasts would not have influenced the Scottish Government’s decision to buy the airport, and it could still reasonably expect a positive return on its loan funding. The eventual return achieved will depend on future developments, which could affect the airport’s sale price, passenger numbers and other assumptions.

4 The latest available business plan for the airport (May 2014) estimates a total loan funding requirement for Glasgow Prestwick Airport of £39.6 million up to the financial year 2021/22. Some £11.6 million of this funding is expected to cover losses from core trading activities, with the rest being used to clear an essential maintenance backlog and to cover capital expenditure. As at January 2015, the Scottish Government has provided Glasgow Prestwick Airport with a total of £9 million loan funding, and has committed to provide a further £16.2 million to the end of March 2016 if required. The total amount of loan funding is still uncertain owing to a number of new potential development opportunities for the airport that the Scottish Government is currently exploring.
Good governance arrangements are in place to monitor the airport’s ongoing business and financial performance. These include clear risk management and effective reporting on the airport’s business and financial performance. An audit and risk committee is also in place to ensure ongoing scrutiny of the airport’s operations.

Key recommendations

The Scottish Government is still assessing a number of potential future opportunities for Glasgow Prestwick Airport. These will take time to put into effect and it may be some years before it can achieve its aim of selling the airport back to the private sector. We will continue to monitor developments and will follow up this work at a later date to provide further information on the airport’s performance in subsequent years.

In the meantime, the Scottish Government and Glasgow Prestwick Airport should:

- ensure that there is a clear vision and strategy for Glasgow Prestwick Airport, which takes into account the airport’s future development potential and includes:
  - robust business and financial plans over the short, medium and long term, with clear assumptions, forecasts of the total loan funding required and an assessment of whether returns on loan investments are likely
  - a full evaluation of all potential risks, including the airport’s ability to repay its loan funding
  - a well-defined and regularly reviewed exit strategy, which identifies the timescale for selling the airport to the private sector
  - a commitment to provide regular updates to the Scottish Parliament to ensure the highest possible level of public accountability.

The Scottish Government and other public bodies should:

- use the checklist we have developed at Appendix 1 to help inform their approach to future investment decisions

- make sure that they have appropriate skills for the preparation of business cases. This should include the ability to challenge the findings provided by external advisers

- ensure for any future investment decisions that they fully evaluate all potential risks, quantify the impact these are likely to have, and include this impact in their financial projections.
Outline

1. Infratil decided to sell Glasgow Prestwick Airport in March 2012 owing to its declining commercial and financial performance and a change in business strategy. A partnership of public sector bodies worked with Infratil between December 2012 and September 2013 to identify potential private sector buyers. A number of potential investors showed interest in the airport, but none submitted a bid acceptable to Infratil and the last potential buyer withdrew interest in September 2013. To prevent its imminent closure, the Scottish Government bought Glasgow Prestwick Airport for a nominal price of £1 in November 2013.

2. The Scottish Government bought the airport through its executive agency Transport Scotland. It established TS Prestwick Holdco Ltd (Holdco) to oversee the airport on its behalf. Holdco bought all the shares in Prestwick Aviation Holdings Ltd which operates the airport through a number of subsidiary companies. The Scottish Government is providing the airport with loan funding, on which it is charging an EU reference rate of interest.

3. The Scottish Government’s long-term aim is to sell Glasgow Prestwick Airport back to the private sector, once it is financially viable. However, as the outcome of the airport’s future development opportunities is currently still uncertain, the Scottish Government has not yet set a timetable for doing this. The timeline of events since Infratil’s decision to sell Glasgow Prestwick Airport is summarised in (Exhibit 1, page 8).

About the audit

4. This audit assesses if the Scottish Government’s approach to the purchase of Glasgow Prestwick Airport was reasonable, considers the future plans for the airport’s development and the governance arrangements that have been put in place. Specifically, it looks at:

   - the factors taken into account by the Scottish Government when deciding to go ahead with the purchase
   - the quality of business and financial planning which informed the Scottish Government’s decision to buy the airport
   - how the plans for the future development of Glasgow Prestwick Airport have changed since the date of purchase
   - the governance arrangements such as systems for decision-making, effective management, policies and structures, scrutiny and clear roles and responsibilities, for overseeing the airport’s performance.

5. We will follow up this work at a later date to provide further information on the performance of Glasgow Prestwick Airport in subsequent years, including updates to the development plans, total public money invested and whether the Scottish Government is obtaining value for money from its intervention.
# Exhibit 1
The timeline of events since Infratil’s decision to sell Glasgow Prestwick Airport

<table>
<thead>
<tr>
<th>Month</th>
<th>Event</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 2012</td>
<td>Infratil announced its intention to sell Glasgow Prestwick Airport.</td>
</tr>
<tr>
<td>December 2012</td>
<td>A multi-agency group worked with Infratil to secure a private sector buyer. The last interested private buyer withdrew.</td>
</tr>
<tr>
<td>October 2013</td>
<td>The Scottish Government examined the case for purchasing the airport. 8 October 2013: The Scottish Government entered into negotiations with Infratil to buy Glasgow Prestwick Airport. 18 November 2013: Scottish Ministers approved the case for the purchase of the airport. 22 November 2013: The Scottish Government bought Glasgow Prestwick Airport for £1.</td>
</tr>
<tr>
<td>November 2013</td>
<td>The Scottish Government appointed an interim chair and non-executive directors to an arm’s-length company, Holdco.</td>
</tr>
<tr>
<td>February 2014</td>
<td>The Scottish Government commissioned an aviation expert to prepare a revised business plan.</td>
</tr>
<tr>
<td>May 2014</td>
<td></td>
</tr>
<tr>
<td>July 2014</td>
<td>3 July 2014: Ryanair announced a reduced winter schedule from Glasgow Prestwick Airport. 15 July 2014: Glasgow Prestwick Airport was shortlisted as one of eight airports with a potential to become the first UK spaceport. 31 October 2014: Glasgow Prestwick Airport published its strategic vision, setting out potential opportunities for the long-term development of the airport.</td>
</tr>
<tr>
<td>November 2014</td>
<td>The Scottish Government appointed a new Glasgow Prestwick Airport chair.</td>
</tr>
<tr>
<td>December 2014</td>
<td>The Scottish Government begins process to appoint new non-executive directors to the airport group, Prestwick Aviation Holdings Ltd. Department of Transport is expected to publish results of the technical consultation process in spring 2015, along with bid requirements for the first UK spaceport.</td>
</tr>
<tr>
<td>Onwards</td>
<td></td>
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</tbody>
</table>

Source: Audit Scotland’s analysis of supporting documentation
During our audit we:

- reviewed key Scottish Government documents, including the business case and plan for the purchase, other information used to inform the purchase (such as due diligence checks) and plans for the development of Glasgow Prestwick Airport
- reviewed financial plans to identify key changes in assumptions since the purchase
- interviewed representatives from the Scottish Government (including Transport Scotland), Scottish Enterprise, Glasgow Prestwick Airport and South Ayrshire Council.

The report has three parts:

- **Part 1** outlines the events leading to the purchase of Glasgow Prestwick Airport
- **Part 2** examines the Scottish Government’s approach to the purchase
- **Part 3** sets out the events since the purchase and changes in the plans for the future development of the airport.
Part 1
Events leading to the purchase of Glasgow Prestwick Airport

Key message

1. Infratil decided to sell Glasgow Prestwick Airport in March 2012 owing to its declining commercial and financial performance and a change in business strategy. A number of potential investors showed interest in the airport, but none submitted a bid acceptable to Infratil and the last potential buyer withdrew interest in September 2013.

Infratil owned Glasgow Prestwick Airport between 2001 and 2013

8. Glasgow Prestwick Airport is situated approximately 30 miles south of Glasgow, near the coast in South Ayrshire. It was established in 1934 and has been a passenger airport since the 1940s. The airport covers 880 acres and includes a passenger terminal, car parking facilities, aircraft hangars, the second longest runway in Scotland and a designated railway station with rail connectivity to Glasgow and the rest of Scotland.

9. The airport’s ownership has changed over the years. In 2001 Infratil, a New Zealand based company, became the majority shareholder in a consortium that bought Glasgow Prestwick Airport from Stagecoach Group. In 2004 Infratil bought the remaining shares in the airport and became its sole owner.

10. During Infratil’s ownership the number of passenger routes increased. The airport also expanded its facilities for maintaining, repairing and overhauling airplanes and continued being a refuelling point for transatlantic military flights. With favourable weather conditions and particularly low levels of fog, it became a diversionary airport where flights due to land elsewhere could be diverted to in bad weather.

11. In the financial year 2012/13 Glasgow Prestwick Airport handled just under 10,000 tonnes of freight and over 1 million passengers. In addition to its passenger and freight operations, the airport generates income from a variety of other sources (Exhibit 2, page 11). Passengers using the airport affect income generated from commercial flights as well as other income sources such as fees from car parking and retail income. Together, these sources of income account for around a half of the airport’s total income.
Infratil decided to sell Glasgow Prestwick Airport in March 2012

12. Glasgow Prestwick Airport has been loss making for a number of years owing to the decline in passenger numbers and freight volumes, driven by the recent economic downturn. Passenger numbers fell by over half from a peak of 2.4 million in the financial year 2007/08 to 1.1 million in 2012/13. Freight volumes also fell by two-thirds from 32,000 tonnes in 2007/08 to 10,000 tonnes in 2012/13 (Exhibit 3, page 12).

13. According to the Scottish Government’s external advisers, the recent economic downturn has affected Glasgow Prestwick Airport disproportionately because:

- its passenger market share is almost entirely dependent on Ryanair which has significantly reduced the number of its flights using the airport
- of a trend in the freight market towards using wide-body passenger aircraft rather than dedicated freight airplanes.
Exhibit 3
Passenger numbers and freight volumes at Glasgow Prestwick Airport between the financial years 2007/08 and 2012/13

The airport’s passenger numbers and freight volumes decreased significantly between 2007/08 and 2012/13.

<table>
<thead>
<tr>
<th>Year</th>
<th>Passenger Numbers (millions)</th>
<th>Freight Volumes (thousands of tonnes)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007/08</td>
<td>0.0</td>
<td>0</td>
</tr>
<tr>
<td>2008/09</td>
<td>0.5</td>
<td>5</td>
</tr>
<tr>
<td>2009/10</td>
<td>1.0</td>
<td>10</td>
</tr>
<tr>
<td>2010/11</td>
<td>1.5</td>
<td>15</td>
</tr>
<tr>
<td>2011/12</td>
<td>2.0</td>
<td>20</td>
</tr>
<tr>
<td>2012/13</td>
<td>2.5</td>
<td>25</td>
</tr>
</tbody>
</table>

Source: Glasgow Prestwick Airport Ltd directors’ report and financial statements 2007/08 to 2012/13

14. Consequently, the airport’s market share in the Scottish Lowlands passenger market fell from 12 to 6 per cent between 2007/08 and 2012/13. Its share of the Scottish Lowlands freight market fell from 58 to 25 per cent over the same period.¹

15. Between 2007/08 and 2012/13, the total value of annual losses on core trading activities of Glasgow Prestwick Airport Ltd, the airport group’s main operating company, was £21.5 million.²³ 2012/13 accounts show a loss on core trading activities for the year of £5.4 million. This means the costs of operating the airport were greater than the income generated from those operations. According to the Scottish Government’s external advisers, Infratil decided to sell Glasgow Prestwick Airport in March 2012 owing to its declining financial performance, and a change in business strategy which saw it sell all of its investments in other European airports.⁴

A multi-agency group worked with Infratil to support potential private sector buyers

16. In December 2012, nine months after Infratil put Glasgow Prestwick Airport up for sale, a multi-agency working group (MAG) started working with Infratil to support potential private sector buyers. This is a good example of a number of public bodies working together to achieve a common goal. South Ayrshire Council chaired the MAG which consisted of the Scottish Government, Transport Scotland, Scottish Enterprise, Scottish Development International and the three Ayrshire councils (East, North and South Ayrshire).⁵

17. The MAG outlined the potential options for the airport’s future in March 2013. The main focus of the MAG and Infratil was to secure a ‘good investor’ that would keep the airport in operation, rather than close it and sell its assets. The
Exhibit 4
Glasgow Prestwick Airport Ltd’s financial performance between the financial years 2007/08 and 2012/13
The airport’s financial performance declined significantly between 2007/08 and 2012/13.

Source: Glasgow Prestwick Airport Ltd directors’ report and financial statements 2007/08 to 2012/13

MAG, supported by relevant internal and external advisers, also explored a range of other options in case there was no good investor to buy the airport. These included:

- the public sector buying the airport outright, or buying it and leasing it to an operator
- setting up a partnership between public and private sector to operate the airport
- dealing with the consequences of the airport’s closure.

It also considered different models for the airport’s future operation, such as it continuing as a passenger airport or as a freight-only airport without passenger services.

18. Reflecting the MAG’s aim to secure a good investor, the Deputy First Minister wrote to Infratil in February 2013 to outline a series of measures that the public sector could take to support a private sector buyer, subject to EU state aid rules. These outlined possible assistance from a number of different public sector bodies.
19. Glasgow Prestwick Airport was marketed unsuccessfully for 18 months. A number of potential investors showed interest in buying the airport but none submitted a bid acceptable to Infratil. The last potential private sector buyer withdrew interest in September 2013.

20. Faced with the imminent closure of the airport, on 8 October 2013 the Scottish Government announced its intention to enter into negotiations with Infratil to buy Glasgow Prestwick Airport. Infratil agreed to keep the airport in operation for a further six weeks to enable the Scottish Government to undertake the required due diligence and negotiate the purchase.
Part 2
The Scottish Government’s purchase of Glasgow Prestwick Airport

Key messages

1. The Scottish Government bought Glasgow Prestwick Airport for a nominal price of £1 in November 2013 to protect jobs and safeguard what it considered to be a strategic infrastructure asset. The Scottish Government’s purchase process was reasonable, given the tight timescale of six weeks. The business case identified the risks associated with the ongoing commercial viability of the airport, including a worsening economic outlook and the possibility of Ryanair withdrawing its flights. The Scottish Government considered these risks before it decided to buy the airport. However, owing to time constraints the business case did not model them or include their impact in the financial forecasts for the airport.

2. The purchase business plan showed a positive financial return for the Scottish Government’s investment, although its predictions for future passenger growth were optimistic. We recalculated the financial return using less optimistic predictions for future passenger growth. This identifies that using less optimistic passenger growth forecasts would not have influenced the Scottish Government’s decision to buy the airport, and it could still reasonably expect a positive return on its loan funding. The eventual return achieved will depend on future developments, which could affect the airport’s sale price, passenger numbers and other assumptions.

The Scottish Government bought Glasgow Prestwick Airport to prevent its closure

21. The Scottish Government considered the case for buying Glasgow Prestwick Airport over six weeks between 8 October and 18 November 2013. It bought Glasgow Prestwick Airport, with the Scottish ministers’ approval, for a nominal price of £1 on 22 November 2013. It did so to prevent closure of what it considered to be a strategic infrastructure asset, and to protect jobs and the local economy. The Scottish Government’s decision drew on an economic analysis commissioned by Scottish Enterprise in 2012 from York Aviation. The economic analysts concluded that:

- Glasgow Prestwick Airport’s total annual contribution to the Scottish economy was £61.6 million through a total of 1,810 jobs directly or indirectly associated with the airport.
• In addition, the airport’s influence accounted for around 5 per cent of activity in the wider aerospace and maintenance, repair and overhaul business sectors. The analysis outlined that this supported a further 320 jobs in Scotland and contributed £23.5 million more to the Scottish economy.

• In the local context (and included in the Scotland-wide figures), the airport contributed £47.6 million to the Ayrshire economy, through some 1,350 jobs directly or indirectly associated with the airport.

22. The Scottish Government estimated that overall some 3,200 jobs are directly or indirectly associated with the airport. It derived this figure by determining the number of people employed in aerospace companies in the vicinity of Glasgow Prestwick Airport and at the airport itself.

23. The Scottish Government considered that the rationale for bringing Glasgow Prestwick Airport into public ownership included:

• the airport’s contribution to the Ayrshire and the Scottish economy

• the potentially severe impact of job losses on an area which already suffers from high unemployment

• features that make Glasgow Prestwick a comparatively reliable airport, such as its long runway and favourable weather conditions

• the impact that closing Glasgow Prestwick would have on national and international air links to Ayrshire and Scotland

• the potential for Glasgow Prestwick Airport to have a positive future.7

The Scottish Government’s purchase process was reasonable, given the time constraints involved

24. Public sector bodies need to consider a number of key matters when undertaking investment appraisals. These include:

• establishing clear governance structures such as responsibilities, accountabilities, planning, reporting and scrutiny

• putting in place appropriate risk management arrangements

• preparing a business case to inform investment decisions.

25. It is also important that public bodies review the skills they have for the preparation of business cases, and consider the need to:

• use external advisers where there is insufficient knowledge within the organisation

• develop these skills further, including the ability to challenge the findings provided by external advisers.
The Scottish Government established appropriate governance arrangements for the purchase

26. The Scottish Government’s governance arrangements for the purchase were appropriate and included:

- a project board with overall responsibility for the purchase. Experience and skills of the project board members were relevant to the decision being made.

- a project team for managing the purchase which comprised relevant people with appropriate expertise (Exhibit 5, page 18) Project roles and responsibilities were clearly assigned to the individuals, including the internal and external advisers commissioned by the Scottish Government.

- the preparation of an appropriate project plan which identified:
  - the steps necessary to complete the purchase
  - the individuals responsible for each aspect of the purchase, including the project owner, the project sponsor, the project team and relevant internal and external advisers
  - a schedule of meetings for the project board, project team and advisory group
  - a clear timeline for the purchase (six weeks).

- the regular reporting of progress to the project board. The board met three times during the six-week purchase process and each time it received appropriate reports on the progress made.

- appropriate approval procedures for the purchase. The project board approved the purchase business case, which included the Accountable Officer’s approval in his role as chair of the project board. The Deputy First Minister, who received regular progress updates throughout the purchase process, gave the final approval a few days before the purchase. The MAG was not directly involved in the purchase process but the Scottish Government kept it informed of the progress.

27. The Scottish Government’s governance arrangements also included the development of a risk register for the purchase process. This included the expected key risks, and an evaluation of their likelihood and impact. Responsibility for the risks was clearly assigned to appropriate individuals and mitigating actions identified. The project board monitored these risks throughout the purchase process.

28. The risk register focused solely on the purchase process. The Scottish Government’s business case identified risks associated with the ongoing commercial viability of the airport, including a worsening economic outlook and the possibility of Ryanair withdrawing its flights. However, owing to time constraints it did not model the impact or likelihood of these risks happening. In addition, the business case did not include the potential impact of these risks in the financial forecasts as part of considering the range of outcomes that might result from the purchase and operation of the airport. We examine this area further in paragraph 45.
Exhibit 5  
Governance structure for the purchase  
The Scottish Government established a clear governance structure for the purchase.

The Scottish Government’s business case generally followed HM Treasury guidance but could have included further evaluation of some areas.

29. A business case is used to inform decision-making by exploring all available options and making the case for change. It helps those making decisions understand whether the options have the ability to deliver the benefits they are trying to achieve and at what cost.

30. HM Treasury’s ‘Green Book’ guidance provides a framework for business case development in the public sector. It requires business cases to consider the strategic, economic, commercial, financial and management case for the investment. Following this model, a business case should be able to answer three basic questions:

- Where are we now?
- Where do we want to be?
- How are we going to get there?
The Scottish Government’s business case for the purchase generally followed HM Treasury’s guidance. It considered the strategic, economic, commercial, financial and management cases for the proposed purchase of Glasgow Prestwick Airport (Exhibit 6).

Exhibit 6
The essential elements of a business case outlined in HM Treasury’s five case model
The Scottish Government’s business case for the purchase generally followed HM Treasury’s guidance.

<table>
<thead>
<tr>
<th>HM Treasury model</th>
<th>Purpose</th>
<th>Glasgow Prestwick Airport business case</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strategic case</td>
<td>Sets out the rationale for the proposal and makes the case for a change at a strategic level.</td>
<td>Sets out the rationale for buying the airport, local context and how the airport has previously performed. It identifies relevant national and local strategies but does not demonstrate how purchasing Glasgow Prestwick Airport will support their delivery.</td>
</tr>
<tr>
<td>Economic case</td>
<td>Demonstrates how a spending proposal optimises public value. As part of this it assesses the economic costs and benefits of the proposal to society as a whole.</td>
<td>Identifies two options: purchase or ‘do nothing’ but does not explain how it ruled out other options. It considers that ‘do nothing’ would result in closure of the airport but lacks a full quantification of the economic benefits of keeping the airport open. It notes that this is because many of the impacts were difficult to quantify due to their nature. It therefore identifies and compares in qualitative terms the potential impact of the options on the airport’s contribution to jobs and the economy. It confirms investing in the airport could result in a positive return but the evaluation should have excluded all price inflation.</td>
</tr>
<tr>
<td>Commercial case</td>
<td>Evaluates whether the proposal is commercially viable.</td>
<td>Shows potentially attractive medium to long-term financial returns for the Scottish Government, with an eventual sale to the private sector once the airport has demonstrated its commercial viability. Confirms EU state aid rules have been considered.</td>
</tr>
<tr>
<td>Financial case</td>
<td>Appraises affordability and sources of funding over the lifespan of the scheme.</td>
<td>Outlines that the investment would be affordable over the appraisal period if the airport is bought for a nominal price of £1. Assesses the potential implications for the Scottish Government’s budget and concludes it could support the airport with loans within EU state aid rules.</td>
</tr>
<tr>
<td>Management case</td>
<td>Assesses whether the proposal can be delivered and sets out management responsibilities, governance and reporting arrangements.</td>
<td>Concludes that buying the airport is achievable. Sets out proposals for the governance arrangements and ongoing monitoring of the airport. It also outlines the steps necessary to complete the purchase.</td>
</tr>
</tbody>
</table>

Source: HM Treasury’s Green Book - Appraisal and Evaluation in Central Government
While we recognise the time constraints involved, the Scottish Government should have been clearer in the following areas:

- The business case only considered two options – purchase or ‘do nothing’. Under normal circumstances, we would expect a business case to consider a wider range of options. The Scottish Government considered only two options because others had already been ruled out through the earlier MAG work. In addition, Infratil made it clear to the Scottish Government that it was only willing to consider the purchase of the airport or its closure. However, the business case could have at least explained which other options were considered and the reasons for ruling them out. The Scottish Government considered that ‘do nothing’ would result in closure of the airport.

- The strategic business case states that the purchase fits with the Government Economic Strategy (2011) and local aspirations set out in South Ayrshire Council’s Single Outcome Agreement. It does not elaborate on how purchasing the airport will do this.

- The economic business case describes and compares the impacts of both options in qualitative terms but does not fully quantify the economic benefits. The Scottish Government attributed this to time constraints and the difficulty in quantifying intangible benefits such as comparative reliability of the airport. The business case states that purchasing the airport ‘will, however, allow such benefits to be realised which would not be the case if the airport closed’.

- The economic business case uses the HM Treasury’s discount rate of 3.5 per cent to identify the airport’s future cash flows. This approach is appropriate if inflation is excluded. The economic business case does exclude inflation from capital expenditure for the first ten years but it includes a 3.2 per cent annual general inflation rate in other costs and income. The Scottish Government acknowledged in the business case that the evaluation should have been adjusted for inflation, but it was unable to do this because it did not have access to the detailed financial model until after the purchase was completed (paragraph 41).

The Scottish Government made good use of external advisers

The Scottish Government made good use of external advisers to inform the decision to buy Glasgow Prestwick Airport. It commissioned appropriate due diligence checks prior to the purchase, for example to validate financial and commercial assumptions associated with buying the airport. External advisers also considered financial, legal, economic and insurance matters. This included preparation of the purchase business plan which supported the business case.

The Scottish Government also sought internal advice on whether the purchase of the airport complied with the Market Economy Investor Principle (MEIP) and therefore with EU state aid rules. The MEIP allows public authorities to give loans, guarantees, inject capital and otherwise be involved in commercial ventures, but at the same time they must behave in the same way as a private sector investor would behave in similar circumstances. In the case of loan funding, to be MEIP compliant, a public authority would need to charge an EU reference rate of interest on any loan provided.
35. The Scottish Government’s state aid unit provided a checklist to help assess whether the investment would comply with the MEIP. This represented a good analysis of the key legal issues which the project team needed to consider.

The purchase business plan demonstrated a positive financial return for the Scottish Government’s investment

36. The business case was supported by a business plan for the future operation of the airport. The Scottish Government commissioned external financial advisers to prepare the business plan at the time it was considering buying the airport, to test its future financial viability. The business plan included modelling a series of financial projections concerning the airport’s future income and expenditure over a 30-year period.

37. The financial projections were based on three separate scenarios – upside, base case and downside. The upside scenario represented a more optimistic view of the airport’s prospects, while the downside scenario took a less optimistic view. All scenarios assumed continued growth in passenger projections, with significant increases in the first five years. The external advisers used the base case financial projections to prepare the business plan. The base case financial projections were informed by a series of assumptions including:

- forecasts of growth in passenger number. Passenger growth assumptions were lower than those of major passenger aircraft manufacturers (Boeing and Airbus) but higher than the Department for Transport’s UK aviation forecasts.

- Projected increases in freight volumes, which were broadly in line with general aviation industry forecasts.

- increased levels of capital expenditure in the first few years after the purchase to clear a maintenance backlog. Once this is cleared, capital expenditure estimates are similar to historical levels.

- property advisers’ recommendations on the timing and value of receipts from the sale of surplus airport property.

38. Overall, the base case financial projections indicated that:

- the total loan funding requirement from the Scottish Government would be £21.3 million in the eight years up to April 2022.

- the airport was estimated to first report a profit from core trading activities in year four (2017/18) after the purchase, when annual income would exceed expenditure for the first time. However, continuing Scottish Government’s investment would be required to cover the airport’s capital expenditure until the financial year 2022/23.

- the airport was expected to start generating positive operating cash flows (when cash receipts are greater than cash payments) in the same financial year (2022/23), and would then be in a position to start repaying Scottish Government loans and interest.

- the Scottish Government could achieve a positive financial return over the 30-year period, once the money it receives from the eventual sale of the airport is included.
In other words, providing that the base case assumptions and financial projections are correct, and assuming that a five-year record of positive cash flows is needed before the airport could be sold, the purchase business plan indicated that:

- the airport could be returned to profitability and sold in around 14 years (2027/28)
- the Scottish Government could expect the airport to repay its loan funding and associated interest charges over the 30-year period if it didn’t sell the airport earlier.

The Scottish Government is charging an EU reference rate of interest on the loan funding it is providing to the airport

A key requirement for the Scottish Government in deciding whether to provide Glasgow Prestwick Airport with loan funding was the need to comply with MEIP and EU state aid rules regarding the interest rate charged. These require the Scottish Government to charge interest rates which generate a financial return that is at least equivalent to what a private sector investor would seek from a similar investment. The European Commission (EC) sets out a method for setting interest rates in accordance with state aid rules. The Scottish Government used this to assess the airport’s credit worthiness (Exhibit 7)

**Exhibit 7**

**EU framework for the assessment of credit worthiness**

The Scottish Government used this framework to decide what interest rate it should charge the airport.

<table>
<thead>
<tr>
<th>Credit rating category</th>
<th>Collateralisation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High</td>
</tr>
<tr>
<td>Strong (AAA-A)</td>
<td>0.6%</td>
</tr>
<tr>
<td>Good (BBB)</td>
<td>0.75%</td>
</tr>
<tr>
<td>Satisfactory (BB)</td>
<td>1%</td>
</tr>
<tr>
<td>Weak (B)</td>
<td>2.2%</td>
</tr>
<tr>
<td>Bad/financial difficulties (CCC and below)</td>
<td>4%</td>
</tr>
</tbody>
</table>

Notes:
1. Credit rating is an assessment of the borrower’s ability to repay the loan. A borrower with a poor credit rating history may still be able to obtain a loan but the interest rate charged may be higher to reflect the increased risk associated with its ability to repay the loan.
2. Collateralisation is where a borrower pledges an asset as an alternative to loan repayment in the event of defaulting on the loan. Collateralisation of assets provides lenders with assurance against default risk. A borrower with a ‘high’ collateralisation rating is considered to have sufficient assets to cover at least 70 per cent of the loan provided.

Source: Official Journal of the European Union
41. The assessment of a potential borrower’s credit rating and level of collateralisation is a matter of judgement for the lender. The Scottish Government assessed the airport’s credit rating as ‘weak’ and the level of collateralisation as ‘high’. This meant that the Scottish Government added 2.2 per cent to the EC base rate, giving the current interest rate of 3.24 per cent. If the Scottish Government had assessed the airport’s credit rating as ‘bad/financial difficulties’ due to its recurring deficits, this would have increased the interest rate to 5.04 per cent. However, advice from its external aviation expert provided reassurance that 3.24 per cent would ensure compliance with EU state aid rules by being at least equal to the rate a commercial investor would seek.

Future passenger growth forecasts are optimistic
42. At the time the purchase was being considered, the financial advisers provided the Scottish Government with the financial projections required for the preparation of the business case. However, the Scottish Government did not request the detailed spreadsheets supporting these financial projections until after the purchase. This meant that the Scottish Government staff could not review the financial advisers’ detailed workings, or make appropriate adjustments to the business case if necessary. Our review of the purchase business plan identified a number of issues which we outline in the following paragraphs.

43. The financial projections in the business plan were heavily dependent on increased passenger numbers, especially in the first five years. Assumptions on the number of passengers using the airport affect income generated from commercial flights as well as other income sources such as fees from car parking and retail income. Together, these sources of income account for around a half of the airport’s total income. This means that any changes to the number of passengers using the airport are likely to have a major impact on its overall income, and potentially whether the Scottish Government achieves a financial return from its investment.

44. The base case scenario identified average annual increases in passenger numbers of 10.2 per cent in each of the first five years and 1.8 per cent thereafter to year 30. Passenger growth assumptions over the 30-year period were lower than those of major passenger aircraft manufacturers (Boeing and Airbus) but they were higher than the Department for Transport’s UK aviation forecasts of between one and three per cent per year.

45. The Scottish Government has assumed higher passenger growth on the advice of its aviation experts. It believes that Glasgow Prestwick Airport has more potential for growth than the Department for Transport’s UK aviation forecasts, partly based on a renewed management focus towards expanding the airport.

46. The airport currently relies on Ryanair as its single passenger carrier, and the risk of Ryanair relocating its flights and maintenance depot to another airport was not fully modelled in the purchase business plan. The downside scenario in the business plan made some assumptions around a potential reduction of Ryanair’s presence at the airport, but it still assumed an overall growth in passenger numbers (over 30 years, an average growth of 3.34 per cent per year). While the business case states that the airport is not viable without Ryanair, the potential withdrawal of Ryanair could have been modelled in the downside scenario.
47. We have used financial modelling to test the effect of less optimistic assumptions in passenger growth numbers using a range of different scenarios. In particular, our financial modelling uses the Department for Transport’s UK aviation growth forecasts, plus an additional allowance for growth in the airport’s market share. This provides annual passenger growth assumptions ranging from one to six per cent.

48. Our modelling indicates that, at the 90 per cent confidence limit, the airport’s rate of return would exceed the interest rate of 3.24 per cent (Appendix 2). Our analysis shows an average rate of return over 30 years of 5.5 per cent, within a range of 1.4 to 7.7 per cent. If the Scottish Government had assessed the airport’s credit rating as ‘bad/financial difficulties’ rather than ‘weak’, the interest rate would increase to 5.04 per cent. Our modelling still suggests that, at the 75 per cent confidence limit, the airport’s rate of return would have exceeded this higher rate. However, in coming to this assessment, we were unable to take into account the airport’s reliance on Ryanair as its single passenger carrier.

49. This means it is highly likely that the Scottish Government’s return on its investment over the 30-year period would still be more than the interest rate of 3.24 per cent currently charged to the airport on the loan funding. In other words, providing that all other base case assumptions are correct, using lower passenger growth assumptions would not have influenced the Scottish Government’s decision to purchase the airport and it could still reasonably expect to receive a positive return on its loan funding from a mix of:

- excess cash generated by the airport once its cash receipts exceeds its cash payments
- the money it would receive from the eventual sale of the airport back to the private sector.

50. However, the Scottish Government’s eventual return on its investment will depend on future developments, which could affect the airport’s sale price, passenger numbers and other assumptions. We review these developments in the next part of this report.
Key messages

1. The latest available business plan for the airport (May 2014) estimates a total loan funding requirement for Glasgow Prestwick Airport of £39.6 million up to the financial year 2021/22. Some £11.6 million of this funding is expected to cover losses from core trading activities, with the rest being used to clear an essential maintenance backlog and to cover capital expenditure. As at January 2015, the Scottish Government has provided Glasgow Prestwick Airport with a total of £9 million loan funding, and has committed to provide a further £16.2 million to the end of March 2016 if required. The total amount of loan funding is still uncertain owing to a number of potential new development opportunities for the airport that the Scottish Government is currently exploring.

2. Good governance arrangements are in place to monitor the airport’s ongoing business and financial performance. These include clear risk management and effective reporting on the airport’s business and financial performance. An audit and risk committee is also in place to ensure ongoing scrutiny of the airport’s operations.

The revised business plan forecasts that the Scottish Government will have to provide more funding to the airport

51. After the purchase of Glasgow Prestwick Airport, the Scottish Government commissioned an aviation expert to prepare a revised business plan for the airport to:

- revise the assumptions in the purchase business plan
- further explore opportunities for the airport’s future development.

52. The revised business plan, prepared in May 2014, forecasts a total loan funding requirement of £39.6 million up to the financial year 2021/22, compared to £21.3 million in 2022/23 in the purchase business plan. Some £11.6 million of this funding is expected to cover losses from core trading activities, with the rest being used to clear the essential maintenance backlog and to cover capital expenditure. The revised business plan indicates that the airport is expected to first report an operating profit in year five (2018/19) after the purchase. It forecasts it will start generating positive operating cash flows in the financial year 2021/22, one year earlier than in the purchase business plan (Exhibit 8, page 26).
**Exhibit 8**
Comparison of the key projections between the purchase business plan and the revised business plan

The revised business plan assumes a higher Scottish Government loan funding requirement, lower passenger growth forecasts in years one to five and higher passenger growth forecasts in subsequent years.

<table>
<thead>
<tr>
<th>Projection</th>
<th>Purchase business plan (November 2013)</th>
<th>Revised business plan (May 2014)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total loan funding</td>
<td>£21.3m in April 2022</td>
<td>£39.6m in April 2021</td>
</tr>
<tr>
<td>The first year of a positive operating cash flow</td>
<td>2022/23</td>
<td>2021/22</td>
</tr>
<tr>
<td>The first year of profit from core trading activities</td>
<td>2017/18</td>
<td>2018/19</td>
</tr>
<tr>
<td>Year 1-5 average annual passenger growth rate</td>
<td>10.2 per cent</td>
<td>6.5 per cent</td>
</tr>
<tr>
<td>Year 6-30 average annual passenger growth rate</td>
<td>1.8 per cent</td>
<td>2.6 per cent</td>
</tr>
</tbody>
</table>

Note: The total loan funding requirement is the point at which the airport is forecast to require no further loan funding. Thereafter, the airport is forecast to start generating a positive cash flow, enabling it to start repaying the loan capital plus interest charges.

Source: Purchase business plan, November 2013 and revised business plan, May 2014

53. According to the revised business plan, Scottish Government loan funding will be required until April 2021 to support the airport’s operating losses and capital expenditure (Exhibit 9, page 27). No new loan funding is forecast to be required after this year. At this point, the airport is forecast to be generating a positive operating cash flow, sufficient to cover its capital expenditure and to start repaying its loan. The Scottish Government will then need to consider when the airport could be returned to the private sector. It could either wait for the airport to repay all of its loans from its operating cash surpluses, or for it to repay any outstanding loan from cash received when the airport is sold. However, this will depend on future development opportunities for the airport which could affect both the total amount of Scottish Government loan funding required, and the timing of any sale.

54. Overall the assumptions in the revised business plan are similar to the purchase business plan. The main differences between the business plans are additional capital expenditure and lower passenger growth predictions in the years soon after the purchase:

- An additional £10.7 million is forecast for capital works over the first five years of the revised business plan to clear the essential maintenance backlog and on a number of airport development projects. From year six onwards, the annual capital expenditure is still expected to be higher than that in the purchase business plan.

- The revised business plan includes lower increases in passenger numbers over the first five years. It forecasts a 6.5 per cent growth each year compared to the 10.2 per cent growth in the purchase business plan. Annual growth of 2.6 per cent is forecast thereafter, which is higher than the 1.8 per cent forecast in the purchase business plan (Exhibit 8). The revised passenger growth assumptions reflect new information which came to light after the purchase. We are unable to disclose this information as it is commercially sensitive.
Exhibit 9
Operating and capital loan funding requirements as a proportion of total Scottish Governments funding

The revised business plan expects loan funding will be required from the Scottish Government each year until the financial year 2021/22, the first year of the airport’s positive operating cash flow. The amount of outstanding loans begins to fall from 2021/22.

Funding to cover capital expenditure
Funding to cover losses from core trading
Accumulated total loan funding

Note: Positive cash flow is used toward capital expenditure costs from the financial year 2018/19 onwards.
Source: Audit Scotland review of the revised business plan

55. The revised business plan’s passenger growth forecasts are still higher in each of the first five years compared to the Department for Transport’s UK aviation forecasts of annual growth of between one and three per cent. Most major UK airports achieved passenger growth between November 2013 and October 2014, but Glasgow Prestwick Airport’s passenger numbers fell by 15.2 per cent (Exhibit 10, page 28) In contrast, the 25.8 per cent increase in the airport’s freight volumes during the same time period is significantly higher than the expected 7.5 per cent annual increase outlined in the revised business plan (Exhibit 11, page 28).

Good governance procedures are in place to monitor the airport’s ongoing business and financial performance

56. The Scottish Government has established TS Prestwick Holdco Ltd (Holdco) to oversee the airport on its behalf. Holdco bought all the shares in Prestwick Aviation Holdings Ltd which operates the airport through a number of subsidiary companies:

- Glasgow Prestwick Airport Ltd as the main operating company of Glasgow Prestwick Airport.
- Prestwick Airport Ltd as a property company providing infrastructure and facilities to the operating company and the users of the airport.

These two main companies in turn own share capital in further subsidiaries supporting their operations.
Exhibit 10
Comparison of passenger numbers at UK airports between November 2012 – October 2013 and November 2013 – October 2014
Passenger numbers at Glasgow Prestwick Airport fell by 15.2 per cent in the first year since the purchase.

Source: UK Civil Aviation Authority, December 2014

Exhibit 11
Comparison of freight volumes at UK airports between November 2012 – October 2013 and November 2013 – October 2014
Freight tonnage at Glasgow Prestwick Airport increased 25.8 per cent in the first year since the purchase.

Source: UK Civil Aviation Authority, December 2014
57. The structure of Prestwick Aviation Holdings Ltd and its group of subsidiaries has remained unchanged since the Scottish Government’s purchase of the airport (Exhibit 12) The Scottish Government considers that changing the structure would not yield any benefits. However, as a new ultimate parent company, Prestwick Aviation Holdings Ltd prepared consolidated (group) accounts for the first time in the financial year 2013/14. Previously the accounts were consolidated under Infratil Airports Europe Ltd. For financial, policy and administrative purposes, Transport Scotland has agreed with HM Treasury that Holdco should be classified as a public corporation.

Exhibit 12
Governance structure of Glasgow Prestwick Airport group and its relationship with the Scottish Government
Holdco bought all the shares in Prestwick Aviation Holdings Ltd which operates the airport through a number of subsidiary companies.
58. Scottish ministers appointed an interim chair and non-executive directors to Holdco who were in place from the day of the purchase. They subsequently appointed a new non-executive chair in November 2014, who is also the chair of the airport group. Scottish ministers are now in the process of appointing new non-executive directors of Holdco and of the airport group. The Holdco model was recommended to the Scottish Government by the senior adviser and is similar to that adopted by the Welsh Government after its purchase of Cardiff Airport in March 2013, and the Scottish Government’s own experiences of overseeing public corporations, such as the David MacBrayne Group. The Auditor General for Wales is conducting his own examination of the Welsh Government’s purchase and ownership of Cardiff Airport and expects to publish his report in spring 2015.

59. The Scottish Government has established arrangements for monitoring the airport’s business and financial performance, and for managing risks. Transport Scotland is responsible for monitoring corporate and strategic risks associated with the airport on behalf of the Scottish Government. A comprehensive risk register is also in place for the airport group, and this is used to manage risks at the operational level. The airport’s management has identified key risks, assessed their likelihood and potential impact and clearly assigned responsibility for each risk to responsible individuals.

60. The Scottish Government’s arrangements for the approval of the airport’s strategic, corporate and operational plans are clearly set out in the Management Statement and Financial Memorandum for Holdco and its subsidiaries. In addition to the approval processes, the Management Statement sets out the broad framework within which Holdco and its subsidiaries operate. The Financial Memorandum sets out certain aspects of the financial framework in greater detail and this includes the terms and conditions of loan funding.

61. The airport group presents a comprehensive set of papers at each Holdco board meeting, including finance and business development reports. Holdco has also established an audit and risk committee to ensure ongoing scrutiny of the airport’s operations.

The Scottish Government has so far committed to provide £25.2 million in loan funding to Glasgow Prestwick Airport

62. To January 2015, the Scottish Government has provided the airport with a total of £9 million loan funding. Of this, the Scottish Government provided the airport with £4.5 million between November 2013 and 31 March 2014, and £4.5 million in 2014/15 so far. The airport is expected to receive further loan funding of £6.2 million in 2014/15 and £10 million in 2015/16. This funding is a mixture of working capital support, to allow the clearance of a backlog of essential maintenance and to cover capital expenditure, such as the modernisation of terminal facilities. The levels of loan funding provided to date are in line with the forecasts set out in the revised business plan for the same period.

63. The Scottish Government has not set a limit on the overall loan funding it may have to provide. The Scottish Government plans to approve the amount of loan funding required in any one year through the approval of the airport’s business plan for that year. In deciding whether to provide additional loan funding, the Scottish Government will need to reassess the airport’s ability to deliver its business plan and to repay its loans, either through ongoing operations or through the sale of its assets.
64. Glasgow Prestwick Airport has not yet started repaying the loan funding it has received from the Scottish Government. Repayment of the loan capital and interest charges will start once the airport is demonstrating a positive operating cash flow. This means that the timing and value of loan repayments is currently uncertain. To comply with EU state aid rules, the Scottish Government is charging an EU reference rate of interest (paragraphs 40 and 41). The interest will continue to grow and the airport will continue to owe this to the Scottish Government until the airport is able to make cash repayments.

65. The 2013/14 accounts for Glasgow Prestwick Airport show a loss from core trading activities for the year of £3.9 million, which is in line with the loss forecast in the revised business plan. Overall loss from operating activities for the airport group was £4.2 million. The amount of loan funding provided to date exceeds the value of the airport’s assets (£4.8 million). However, the assets are valued on the basis of a functioning, underperforming airport. The Scottish Government expects this value to increase once the airport becomes financially viable.

New developments are likely to affect the total amount of loan funding required

66. Since the revised business plan was completed in May 2014, there have been further developments which are likely to affect the future of Glasgow Prestwick Airport. In July 2014 Ryanair announced a reduced winter schedule of 13 return flights a week, 29 fewer than in 2013. Subsequently it has also opened a base at Glasgow International Airport, moved its Dublin route there and announced a number of new routes or an increased number of flights on the existing routes from Glasgow International Airport. Since passenger numbers influence around a half of the airport’s income, fewer flights in winter increase the airport’s reliance on its performance in the summer months. The Scottish Government is monitoring the risks that this presents to the airport’s financial viability.

67. Also in July 2014, the UK Government announced its intention to designate a site in the UK to become the first UK spaceport for launching commercial space flights from 2018 onwards. It identified eight potential sites for the spaceport, six of these in Scotland. Glasgow Prestwick Airport is one of these six sites. The UK Department for Transport has now completed its consultation on the technical criteria which the UK Civil Aviation Authority identified as critical for a spaceport location. It is expected to publish the results of the technical consultation process in spring 2015, along with the bid requirements.

68. In October 2014 Glasgow Prestwick Airport published the ‘Strategic Vision’ for the airport which is a combination of the aviation expert’s revised business plan from May 2014 and the airport’s identification of other factors that may play a critical part in its future business strategy.

69. The strategic vision sets out a number of potential opportunities for the long term development of the airport, including the potential for the airport to achieve UK Spaceport status and other types of business diversification (Exhibit 13, page 32). It states that ‘securing the UK Spaceport status would provide transformational opportunities for the airport and for the aerospace sector in Ayrshire, Scotland and the UK.’

70. The strategic vision also explores other future opportunities that could benefit the airport’s financial viability. For example, the Scottish Government expects
Exhibit 13
Opportunities for the longterm development of Glasgow Prestwick Airport outlined in the strategic vision
Opportunities for the longterm development of the airport include the potential for the airport to achieve UK Spaceport status and other types of business diversification.

Source: Glasgow Prestwick Airport Strategic Vision, October 2014

Further economic benefits to accrue to the airport should the Smith Commission’s recommendation to devolve responsibility for setting Air Passenger Duty (APD) to Scotland be implemented. The airport is also considering potential opportunities to become a hub for EU emergency disaster relief programmes, for training commercial pilots and engineers, and as a centre of excellence in aviation engineering. In addition, it will co-host the 2015 Scottish Airshow.

Development of these options will take some time and may result in the Scottish Government providing the airport with additional loan funding. They are still to be captured in a new business plan. The Scottish Government is clear that any additional loan funding support will need to be charged at an EU reference rate of interest, and based on a robust business plan which demonstrates that a positive financial return is likely. The Scottish Government considers this will ensure that any further investment complies with the MEIP.

The Scottish Government’s longterm aim is to sell Glasgow Prestwick Airport back to the private sector once the airport is viable. Owing to the uncertainties
around the future development opportunities, the Scottish Government has not yet set a timetable for this. It is important that its plans for the airport include regular consideration of its ongoing financial viability, and a well-defined exit strategy covering a variety of possible scenarios. The Scottish Government recognises that the longterm opportunities could take some years to take effect if they are realised.
1 UK Civil Aviation Authority.

2 Loss on core trading activities is an operating loss where the costs of operations are greater than the income from those operations. This does not include any loss on investments or the effect of interest and taxes. It also excludes non-cash items such as depreciation and revaluation of fixed assets.

3 The other main company of the airport group is Prestwick Airport Ltd which is a property company providing infrastructure and facilities to the airport and its users. Between 2007/08 and 2012/13 Prestwick Airport Ltd reported profits on core trading activities totalling £10.8 million over the six-year period.

4 Infratil also sold Lübeck airport (Germany) in January 2009 and Manston Airport (UK) in November 2013.

5 Scottish Development International (SDI) is a joint venture with partnerships that include the Scottish Government, Scottish Enterprise, Highlands and Islands Enterprise, Business Gateway Scotland and TalentScotland.


7 Scoping paper to the Deputy First Minister, 3 October 2013.


9 Capital expenditure is money used by a company to buy or upgrade physical assets such as property, industrial buildings or equipment. This expenditure can include everything from repairing a roof to building a brand new asset.

10 Profit from core trading activities is an operating profit where income from operations exceeds the costs of those operations. This does not include any profit earned from investments or the effects of interest and taxes. It also excludes non-cash items such as depreciation and revaluation of fixed assets.


12 Air Passenger Duty (APD) is an excise duty (tax) levied on the carriage of passengers from UK airports. The tax rate is currently set by the UK Government at Westminster.
## Appendix 1

**Checklist of key considerations in investment decisions**

Based on the audit of the Scottish Government’s purchase of Glasgow Prestwick Airport, we have developed this checklist for use by the public sector in considering future investment decisions.

### Checklist

- **√ Establish appropriate governance arrangements:**
  - Set up a project board, made up of people with the relevant expertise (including financial), to oversee the development of a business case and the purchase process.
  - Agree clear lines of responsibility, leadership and ownership.
  - Set up reporting arrangements for regular progress reporting.
  - Prepare a project plan for investment which identifies key steps for the purchase process.
  - Prepare a communication plan that considers how to inform and potentially involve stakeholders in the project.
  - Outline steps to be carried out after the purchase such as transitional arrangements and a change in ownership.

- **√ Make sure that appropriate skills are in place in the organisation and commission relevant external advice and expertise as applicable**

- **√ Undertake option appraisal.**
  - Create a long list of options and shortlist those that could deliver investment objectives for further analysis.

- **√ Carry out due diligence.**
  - Financial and commercial due diligence such as the analysis of recent and current financial performance, operating information and contracts, condition of assets and potential future issues.
  - Legal due diligence.
  - Insurance due diligence.
  - Environmental due diligence.

- **√ Identify all potential risks associated with the investment and prepare a risk register.**
  - Identify the impact and likelihood of each risk, mitigating actions and ownership for the risks.
  - Ensure that all liabilities are understood and risks associated are managed or mitigated.
Checklist (continued)

✓ Undertake an assessment of state aid.
  • Seek expert advice.
  • If there is a risk the decision to invest may be considered state aid, compatible state aid cover should be sought which may require notifying the Commission in advance of approval.

✓ Prepare a business case for investment, using HM Treasury’s Green Book guidance.
  • In the strategic case set out the rationale for the proposal and demonstrate how the investment supports local and national policies and strategies.
  • In the economic case assess the economic costs and benefits of each of the options to society as a whole.
  • In the commercial case evaluate commercial feasibility of the options.
  • In the financial case prove affordability and identify sources of funding.
  • In the management case demonstrate whether the investment can be implemented and identify management responsibilities and reporting arrangements.
  • Set out clear investment objectives and aims.
  • Evaluate costs, benefits, dependencies, risks and how the shortlisted options contribute to investment objectives.
  • Assess future projections in detail in a variety of possible scenarios and determine a well-defined exit strategy.
  • Undertake an equality impact and sustainability assessment.
  • Complete the business case by selecting a preferred option.

✓ Obtain necessary approvals for the selected option (including Ministerial approval if applicable) and complete negotiations on terms of investment.

✓ Plan independent project assurance review (e.g. gateway review) at each key stage.

✓ Review and evaluate the project after its completion to identify areas for improvement as well as what worked well. Share best practice and lessons learnt.
We used financial modelling to test how less optimistic assumptions in passenger growth than those outlined in the purchase business plan would affect the likely return from the Scottish Government’s investment in Glasgow Prestwick Airport. The results show it is highly likely that, at the time the Scottish Government was considering the purchase, the return on its investment would still be more than the interest rate of 3.24 per cent which the Scottish Government is currently charging the airport (paragraphs 47-49).

To perform our financial modelling we used software which simulates a range of different scenarios to determine how likely a result will occur. It runs simulations many times to obtain the distribution of likely results. We have used this to test the effect of less optimistic assumptions in passenger growth on the potential return on the Scottish Government’s investment.

The chart shows the distribution of the likely results with assumed passenger growth of between one and six per cent. Each bar represents a different rate of return on the Scottish Government’s investment. The height of the bars represents the number of times the same result is likely to occur.
The results show that the airport’s rate of return is higher than the interest rate of 3.24 per cent in more than 92 times out of 100 that the simulation is run. The analysis shows an average rate of return over 30 years of 5.5 per cent, within a range of 1.4 to 7.7 per cent. Even if the Scottish Government had assessed the airport’s credit rating as ‘bad/ financial difficulties’ rather than ‘weak’, the airport’s rate of return would exceed the higher interest rate of 5.04 per cent in more than 76 times out of 100 that the simulation is run.