Agenda Item
1

Shetland Islands Council

Harbour Board **26 November 2014**

Management Accounts for Harbour Board: 2014/15 – Projected Outturn at Quarter 2
F-051-F

Report Presented by Executive Manager - Finance	**Corporate Services**

1. Summary

1.1 The purpose of this report is to enable the Harbour Board to monitor the financial performance of services within its remit to ensure that Members are aware of the forecast income and expenditure and the impact that this will have with regard to delivering the approved budget. This allows the Board the opportunity to provide early instruction to officers to address any forecast overspends in order that the budget is delivered by the year-end.

1.2 This report is on the projected outturn position for the 2014-15 year as at the end of the second quarter for revenue and capital. The forecasts have been determined by Finance Services after consultation with the relevant Budget Responsible Officers.

1.3 The projected outturn position for Ports & Harbours Operations is an increase in income of £419k on revenue and an underspend of £273k on capital.

2. Decision Required

2.1 That the Harbour Board RESOLVE to review the Management Accounts showing the projected outturn position at Quarter 2.

3. Detail

3.1 On 11 December 2013 (SIC Min Ref: 109/13) the Council approved the 2014/15 revenue and capital budgets for the Council (including the General Fund, Harbour Account, Housing Revenue Account and Spend to Save) requiring a draw from reserves of £14.793m. This is still at an unsustainably high level and therefore it is vital to the economic wellbeing of the organisation that the budget is delivered, as any overspends will result in a further draw on reserves.

Revenue – Overall Forecast: Well on track G

3.2 The projected revenue outturn position for Ports & Harbours is an increase in surplus of £419k (18%) which means that they are on course to receive more income than their Council approved budget.

Capital – Overall Forecast: Well on track G

3.3 The projected outturn position on Ports & Harbours' capital project expenditure is an underspend of £273k (29%) which means that they are on course to spend less than their Council approved budget.

4. Implications

Strategic

4.1 Delivery On Corporate Priorities
There is a specific objective within the Corporate Plan to ensure that the Council is "living within our means" with a range of measures which will enable the Council to achieve financial sustainability over the next four years, and line up spending with priorities and continue to have significant reserves.

The Medium Term Financial Plan also includes a stated objective to achieve financial sustainability over the lifetime of the Council.

4.2 Community /Stakeholder Issues – None.

4.3 Policy And/Or Delegated Authority
Section 2.1.2(3) of the Council's Scheme of Administration and Delegations states that the Board may exercise and perform all powers and duties of the Council in relation to any function, matter, service or undertaking delegated to it by the Council. The Council approved both revenue and capital budgets for the 2014/15 financial year. This report provides information to enable the Board to ensure that the services within its remit are operating within the approved budgets.

4.4 Risk Management
There is a risk that revenue services and capital projects will not be delivered within the approved 2014/15 budget resulting in an additional draw on reserves, which is unsustainable. Failure to deliver the 2014/15 budgets may result in the Council failing to deliver its Corporate Plan and Medium Term Financial Plan.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial

The 2014/15 Council budget is not sustainable because it requires a draw on reserves in excess of the returns that the fund managers can make on average in a year.

For every £1m of reserves spent (in excess of a sustainable level) it will mean that the Council will have to make additional savings of £50,000 each year in the future as a result of not being able to invest that £1m with fund managers to make a return.

It is therefore vital that the Council delivers its 2014/15 budget, as any overspend will result in a further unsustainable draw on reserves which will have the long term consequences as explained above.

4.8 Legal – None.

4.9 Human Resources – None.

4.10 Assets And Property – None.

5. Conclusions

5.1 The projected outturn position for the services under the remit of the Harbour Board is an increase in surplus of £419k on revenue and an underspend of £273k on capital projects.

For further information please contact:
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List of Appendices
Appendix 1 – Projected Revenue Outturn Position 2014/15
Appendix 2 – Projected Capital Outturn Position 2014/15

Background documents:
SIC Budget Book 2014-15, SIC 11 December 2013
http://www.shetland.gov.uk/coins/submissiondocuments.asp?submissionid=15444

Harbour Board

1. Projected Revenue Outturn Position 2014/15

Description	Annual Budget 2014/15 £000	Projected Outturn 2014/15 £000	Budget v Proj. Outturn Variance (Adv)/ Pos £000
Ports Management	27	27	0
Sullom Voe	(428)	(331)	(97)
Scalloway	(178)	(533)	355
Other Piers	477	312	165
Terminals	(2,260)	(2,257)	(3)
Total Controllable Costs	**(2,362)**	**(2,781)**	**419**

An explanation for the main variances by service is set out below.

1.1 Ports Management – projected outturn breakeven G

1.2 Sullom Voe – projected outturn reduction of income of £97k (23%) G

This underspend mainly relates to a reduction in tanker numbers due to problems with Clair oil production.

1.3 Scalloway – projected outturn increased income of £355k (200%) G

This underspend mainly relates to increased income from plant hire and dues for the barge at Scalloway £200k and storage charge income £100k.

1.4 Other Piers - projected outturn underspend £165k (35%) G

This underspend is mainly due to increased annual dues, storage charges and fish landing dues at Cullivoe and Mid Yell £105k.

1.5 Terminals – projected outturn overspend £3k (0.1%) A

Harbour Board

2. Projected Capital Outturn Position 2014/15

Description	Annual Budget 2014/15 £000	Projected Outturn 2014/15 £000	Budget v Proj. Outturn Variance (Adv)/ Pos £000
Ports & Harbours	926	653	273
Total Controllable Costs	**926**	**653**	**273**

2.1 Ports & Harbours Operations – projected outturn underspend £273k (29%) G

The projected outturn variance relates to delays in Terminal works programme due to staffing changes.

Agenda Item
2

Shetland Islands Council

Harbour Board **26 November 2014**

Pilotage Accounts for Harbour Board: 2014-15 - Quarter 2 (April – September 2014)	
F-053-F	
Report Presented by Executive Manager - Finance	**Corporate Services**

1.0 Summary

1.1 The purpose of this report is to enable the Harbour Board to monitor the financial performance of the pilotage services provided by the Council.

1.2 This report is on the projected outturn position for the 2014/15 year as at the end of the second quarter. The forecasts have been determined by Finance Services after consultation with the relevant Budget Responsible Officers.

1.3 The projected overall outturn position shows an additional surplus of £9k against annual budget.

2.0 Decision Required

2.1 That the Harbour Board RESOLVE to review the Pilotage Accounts showing the projected outturn position at Quarter 2.

3.0 Detail

3.1 There is a requirement to prepare accounts relating to pilotage under Section 14 of the Pilotage Act 1987.

3.2 The details of what must be included in these accounts are set out in regulations (The Statutory Harbour Undertakings (Pilotage Accounts) (Regulations) 1988, SI 1988/2216).

The accounts must show the details of:

- revenue from pilotage charges and details of the use of pilotage exemption certificates; and
- total expenditure incurred in providing the service of a pilot, providing, maintaining and operating any pilot boats and administrative or other associated costs.

3.3 These accounts must be available for inspection by the public at the harbour authority's offices. Members of the public shall be able to buy a copy for a reasonable fee.

3.4 The Council is also under a duty to keep accounts in respect of the "harbour undertaking" in accordance with section 65 of the Zetland County Council Act 1974, (ZCC Act). Pilotage is part of the harbour undertaking and as such should appear in those accounts. Any surplus on the harbour undertaking is credited to the Reserve Fund set up under Section 67 of the ZCC Act.

3.5 The Pilotage Accounts for the period 1 April 2014 to 30 September 2014 are attached as Appendix 1.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities
This report contributes to the Corporate Plan by ensuring that good-quality information is provided regularly.

4.2 Community /Stakeholder Issues – None.

4.3 Policy And/Or Delegated Authority
Section 2.1.2(3) of the Council's Scheme of Administration and Delegations states that the Board may exercise and perform all powers and duties of the Council in relation to any function, matter, service or undertaking delegated to it by the Council; more specifically referred to in paragraph 2.7.

4.4 Risk Management – Failure to keep Pilotage Accounts would place the Council in breach of its legal duties.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial

4.7.1 The Pilotage Accounts for the first six months of 2014/15 show a reduction in surplus of £61k against year to date budget, which is due to profiling on Sullom Voe pilotage and boarding & landing dues.

4.7.2 The projected overall outturn position shows an additional surplus of £9k (10%) against annual budget. This mainly relates to minor underspends across administration and other expenditure, offset by additional Marine Officer overtime costs which were not budgeted.

4.8 Legal – The Council has statutory obligations to keep separate accounts in respect of the harbour undertaking and also separate pilotage accounts. Section 3(1) of the ZCC Act states that the harbour undertaking means "the harbour undertaking for the time being of the Council authorised by this Act". This means that the harbour undertaking must be considered only in terms of what the Council is authorised or duty bound to do under the ZCC Act. Pilotage is part of the harbour undertaking and income and expenditure is accounted for accordingly.

4.9 Human Resources – None.

4.10 Assets And Property – None.

5.0 Conclusions

5.1 This report presents the Quarter 2 Pilotage Accounts for 2014/15 to the Board for review. The projected outturn position is an additional surplus of £9k against budget.

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List of Appendices
Appendix 1 – 2014/15 Quarter 2 Pilotage Accounts

Background documents:
None

END

	Sullom Voe Year to Date			Scalloway Year to Date			Overall Year to Date			Overall Projected Outturn		
	Year to Date Budget	Year to Date Actual	Variance (Adv)/Fav	Year to Date Budget	Year to Date Actual	Variance (Adv)/Fav	Year to Date Budget	Year to Date Actual	Variance (Adv)/Fav	Annual Budget	Projected Outturn	Variance (Adv)/Fav
Charges in respect of :	£	£	£	£	£	£	£	£	£	£	£	£
Boarding & Landing	-214,580	-181,107	(33,473)	-5,509	-11,840	6,331	-220,089	-192,947	(27,142)	-458,975	-461,377	2,402
Pilotage Services provided as authorised by section 10(1) of the Pilotage Act 1987	-498,950	-450,539	(48,411)	-24,139	-31,888	7,749	-523,089	-482,427	(40,662)	-1,095,476	-1,095,476	0
Use of PEC issued as authorised by section 10(3) of the Pilotage Act 1987	0	0	0	0	0	0	0	0	0	0	0	0
TOTAL INCOME	**-713,530**	**-631,646**	**(81,884)**	**-29,648**	**-43,728**	**14,080**	**-743,178**	**-675,374**	**(67,804)**	**-1,554,451**	**-1,556,853**	**2,402**
Boarding & Landing	209,563	205,267	4,296	1,396	1,290	106	210,959	206,557	4,402	422,740	418,672	4,068
Pilotage	346,094	344,378	1,716	11,271	11,699	(428)	357,365	356,077	1,288	716,206	755,276	(39,070)
Sub-Total Employee Costs	**555,657**	**549,645**	**6,012**	**12,667**	**12,989**	**(322)**	**568,324**	**562,634**	**5,690**	**1,138,946**	**1,173,948**	**(35,002)**
Boarding & Landing	4,725	1,548	3,177	334	149	185	5,059	1,697	3,362	9,994	9,994	0
Pilotage	2,245	1,921	324	61	307	(246)	2,306	2,228	78	4,611	4,916	(305)
Sub-Total Supplies & Services	**6,970**	**3,469**	**3,501**	**395**	**456**	**(61)**	**7,365**	**3,925**	**3,440**	**14,605**	**14,910**	**(305)**
Boarding & Landing	41,906	26,744	15,162	3,848	2,921	927	45,754	29,665	16,089	103,544	94,817	8,727
Pilotage	1,256	401	855	13	0	13	1,269	401	868	3,223	2,512	711
Sub-Total Transport & Mobile Plant	**43,162**	**27,145**	**16,017**	**3,861**	**2,921**	**940**	**47,023**	**30,066**	**16,957**	**106,767**	**97,329**	**9,438**
Boarding & Landing	2,584	2,137	447	0	0	0	2,584	2,137	447	6,471	7,520	(1,049)
Pilotage	326	245	81	3	0	3	329	245	84	658	632	26
Sub-Total Property & Fixed Plant	**2,910**	**2,382**	**528**	**3**	**0**	**3**	**2,913**	**2,382**	**531**	**7,129**	**8,152**	**(1,023)**
Meeting Liabilities under Part III of the Act	0	0	0	0	0	0	0	0	0	0	0	0
Boarding & Landing	2,429	36,543	(34,114)	78	14	64	2,507	36,557	(34,050)	124,577	108,433	16,144
Pilotage	22,030	4,477	17,553	2,762	6,398	(3,636)	24,792	10,875	13,917	71,753	54,653	17,100
Sub-Total Admin and Other Costs	**24,459**	**41,020**	**(16,561)**	**2,840**	**6,412**	**(3,572)**	**27,299**	**47,432**	**(20,133)**	**196,330**	**163,086**	**33,244**
TOTAL EXPENDITURE	**633,158**	**623,661**	**9,497**	**19,766**	**22,778**	**(3,012)**	**652,924**	**646,439**	**6,485**	**1,463,777**	**1,457,425**	**6,352**
NET TOTAL	**-80,372**	**-7,985**	**(72,387)**	**-9,882**	**-20,950**	**11,068**	**-90,254**	**-28,935**	**(61,319)**	**-90,674**	**-99,428**	**8,754**

Agenda Item
3

Shetland Islands Council

Harbour Board **26 November 2014**

2015-16 Budget and Charging Proposals **Harbour Board**	
F-062-F	
Report by Executive Manager Finance	**Corporate Services**

1.0 Summary

1.1 The purpose of this Report is to enable the Harbour Board to consider the budget proposals for services within the Board's remit, which will in turn contribute towards ensuring that the Harbour Board meets the surplus target as set out in the Medium Term Financial Plan.

1.2 The summary budget proposals for the services under the remit of the Harbour Board is a surplus of £6.382m on harbour activity and £1.3m from the Total Gas Plant, split by activity area as follows:

Service	2015-16 Proposed Budget £000
Ports Management & Engineering	170
Sullom Voe	10,328
Scalloway	689
Terminals	804
Other Piers	371
Jetties & Spur Booms	2,294
Total Expenditure	**14,656**
Harbour Fees & Charges	(15,538)
Terminal Charges	(3,206)
Jetties & Spur Booms	(2,294)
Total Income	**(21,038)**
Net Surplus	**(6,382)**
Contribution from the Marine Fund	(138)
Contribution to the Reserve Fund	6,520
Balanced Budget	**0**

Service	2015-16 Proposed Budget £000
Total Gas Plant contribution	**(1,349)**

2.0 Decision Required

2.1 That the Harbour Board RECOMMEND to Policy and Resources and Council that they:

- approve the budget proposals for 2015-16 included in this report and Table of Dues (Appendix 1).

3.0 Background

3.1 The Council agreed its Medium Term Financial Plan on 2 July 2014 (min ref 49/14), which sets out an integrated budgeting and reserves strategy for the period 2014-2019.

3.2 As part of the budgeting strategy, Ports & Harbours Operations were provided with a target for 2015-16, as follows:

Directorate – Infrastructure Services	Revised Target 2015-16 (Surplus)/ Deficit £000
Harbour Activity	(6,519)
Total Gas Plant Contribution	(1,349)

3.4 By adhering to these Target Operating Budgets, Members will ensure that the organisation is now achieving a financially sustainable budget for 2015-16 with the use of reserves at a sustainable level.

3.5 The approach taken to develop these budget proposals was incremental budgeting, which means that the costs of each area were built up using existing budgets as the base-line. At all times ensuring activities are to be carried out in the most efficient way.

3.6 The proposed Table of Dues charging structure included in the budget proposals for Ports & Harbours is attached as Appendix 1.

4.0 2015-16 Budget Proposals

The following section describes the major changes proposed in the budget for 2015-16.

4.1 Harbour Activity

The Sullom Voe tanker charges have been increased by 6% and all other charges have been increased by 3%.

4.2 Total Gas Plant Contribution

It is anticipated that the gas throughput will start in 2015/16 and the income has increased accordingly;

5.0 Implications

Strategic

5.1 Delivery On Corporate Priorities – The budget has been produced to deliver the Directorate Plan which will contribute to meeting the Corporate Plan. The budget has also been produced bearing in mind the Corporate Plan's objectives of financial sustainability and balance across all sectors with efficient and responsive public services and a reduced reliance on the public sector.

5.2 Community/Stakeholder Issues –

5.2.1 The Harbour Users Panel A met on 31 October 2014 to consider the proposed Table of Dues to be levied at Sullom Voe. A representative of the Sullom Voe Terminal accepted that the increase in charges were due to a reduction in the number of tankers anticipated for 2015/16 from earlier predictions received. The Sullom Voe Terminal representative confirmed that at present there is a low dip in tanker numbers but that this will increase significantly over the next few years. He requested that the charges be reviewed when the volume increases.

5.2.2 The Harbour Users Panel B also met on 31 October 2013 to consider the Table of Dues to be levied at all piers and harbours. The Harbour Users representative was concerned at the above national inflation increase to all charges and a formal letter of objection was then received on this point. He was also concerned at the proposed level of charging for farmed fish landing which was increased by 62% two years ago. A letter of formal objection was also received on this point. An assessment was done with comparable ports on 2014/15 charges which is attached as Appendix 2.

5.2.3 As part of the Medium Term Financial Plan to achieve financial sustainability in 2015/16 for the Council, it was proposed that an increase of 3% would be required to be applied across all Council services, including harbour charges. The Council's piers are substantial assets and expensive to maintain and the income received from the use of these assets is low but is required to make a contribution to maintenance and any future investment.

5.3 Policy And/Or Delegated Authority – The Harbour Board has delegated authority under section 2.7.3 of the Council's Scheme of Administration and Delegations to consider all development proposals and changes of service level within the harbour undertaking, including dues and charges, and make appropriate recommendation to Policy & Resources Committee and the Council.

The Council approved the Medium Term Financial Plan on 2 July 2014. This set the parameters for the 2015-16 revenue budget and allocated the available resources amongst directorates. Approval of the revenue budget requires a decision of the Council, in terms of Section 2.1.3 of the Council's Scheme of Delegations.

5.4 Risk Management – The main risk for the Harbour Account is that the level of tanker throughput is insufficient to generate enough income to meet both revenue and capital expenditure. A failure to meet the target surplus will result in the Council utilising its reserves unsustainably.

5.5 Equalities, Health And Human Rights – None.

5.6 Environmental – The safe operation of the harbour by appropriately trained and competent staff is essential to the protection of Shetland's marine environment. Sullom Voe is designated by the European Commission as a Special Area of Conservation (SAC).

Resources

5.7 Financial – This report presents budget proposals that are consistent with the budget strategy included in the Medium Term Financial Plan. Any decision to recommend changes to the proposals in this report will result in an increased or decreased contribution to reserves, and may result in not meeting the targets in the Medium Term Financial Plan. This will require a formal amendment and be fully quantified in the Board's decision.

5.8 Legal – The proposals in this report will allow the Council to meet its statutory requirements and ensure that those services meet the appropriate legislative requirements.

The Council is required to stipulate separate charges for each of the chargeable elements of the consolidated charge. This is set out in Appendix 1 - Table of Dues. There is a requirement to publicise any changes to Harbour Dues six weeks before the implementation date of 1 April 2015.

The Harbour Board has delegated authority under section 2.7.2 of the Council's Scheme of Administration and Delegation to act as Duty Holder required by the Port Marine Safety Code and ensure that the necessary management and operation mechanisms are in place to fulfil that function. The Port and Marine Safety Code states at paragraph 4.1 that amongst other things:

for the purposes of the Code, the duty holder should ensure that the harbour authority discharges its responsibilities to:

- have regard to efficiency, economy and safety of operation as respects the services and facilities provided;
- take such action that is necessary or desirable for the maintenance, operation, improvement or conservancy of the harbour.

In addition, the duty holder must ensure that enough resources are available to discharge their marine safety obligations and set the level of dues accordingly.

5.9 Human Resources –None.

5.10 Assets And Property – A risk based approach will be taken for the management of property assets to minimise the deterioration and potential failure of assets over the life of the Medium Term Financial Plan. Where possible unused assets will be disposed of to reduce ongoing revenue costs and maximise capital receipts for the Council.

6.0 Conclusions

6.1 The proposals in this report meet the Target Operating Budgets as set out in the Medium Term Financial Plan for the services under the remit of the Harbour Board.

6.2 These proposals will enable the Infrastructure Directorate to deliver their Directorate Plan as well as to move towards meeting the requirements of the Medium Term Financial Plan in future years.

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List of Appendices

Appendix 1 – Table of Dues 2015/16
Appendix 2 - Comparable Charging for Farmed Fish Landing

END

SHETLAND ISLANDS COUNCIL
TABLE OF DUES TO BE LEVIED AT ALL SHETLAND ISLANDS COUNCIL PIERS, HARBOURS AND FERRY TERMINALS FROM 1ST APRIL 2015
(Harbours Act 1964)

"All vessels are expected to be adequately insured prior to entry to, and whilst within, harbour limits. The Harbour Authority reserves the right to refuse entry to uninsured vessels."

DEFINITION

1. Segregated Ballast Tanker

1.1 A tanker holding an International Oil Pollution Certificate showing the ship to have segregated ballast tanks in full compliance with Regulation 13 of MARPOL. In addition the ship must be operated in this manner.

CONSOLIDATED CHARGE

2. Consolidated Charge

2.1 The consolidated charge for segregated ballast tankers entering the Port of Sullom Voe will be £1.33 per gross tonne. This charge is made up of the following elements, ship dues, pilotage, mooring and boarding and landing.

Example - Consolidated Charge for segregated ballast tankers is made up of the following:

Shipping Dues	applied per visit	£0.99
Mooring Charge	applied per visit	£0.04
Pilotage Charge	applied (£0.11 x 2)	£0.22
B & L Charge	applied (£0.04 x 2)	£0.08
Total Consolidated Charge		£1.33

RATES AND CONDITIONS OF TOWAGE – SULLOM VOE AREA

3. Segregated Ballast Tankers/Other
Per Gross tonne per visit £1.17

4. Tariff - Towage

4.1 Cancellation

A charge of 10 per cent of the above rates will apply if tugs depart the tug jetty and are cancelled before making fast to vessel.

4.2 Aborted Berthings or Sailings

A charge of 50 per cent of the above rates will apply if a movement is unable to be completed after a tug or tugs have been made fast, or have commenced assistance.

4.3 Push Up

A charge of £996 per tug per hour or part thereof will be levied if a tug or tugs are required to push-up on a vessel during periods of extreme weather conditions.

4.4 Escorting Charges/Shifting from one Jetty to another

Minimum charge of 3 hours	£996 per hour or part thereof

4.5 Standby Charge

A charge of £996 per tug per hour or part thereof will be levied if tugs are not used within an hour of order time.

4.6 Fire Fighting and Oil Dispersal Duties

Within the Terminal and approaches will be charged at a minimum of 3 hours at £996 per hour per tug thereafter plus cost of fire fighting foam and oil dispersant liquids.

4.7 Late Order Charges

A surcharge of 15 per cent may be charged if less than 12 hours notice is given in writing.

4.8 Bunker Charges

A bunker surcharge will be charged per tug movement, dependent on fuel costs (rates available on application).

4.9 Other

Charges for towage operations not listed above are charged on a case-by-case basis. Rates available on application at time of hire.

ALL TOWAGE UNDERTAKEN SUBJECT TO UNITED KINGDOM STANDARD CONDITIONS FOR TOWAGE AND OTHER SERVICES (REVISED 1986) COPIES OF WHICH ARE AVAILABLE ON REQUEST

SHIPS DUES

Conditions

1. Ship Dues shall apply to all vessels entering the limits of any of the Council's harbours except in circumstances mentioned at (2) and (3) below. These rates shall also be charged by way of berth rents where a Council pier is used in any location outside the Council's harbour areas. Vessels will be allowed to overstay the four-day period in port without additional charge if the harbour is closed, or if cargo/unberthing is suspended due to adverse weather conditions, or if the vessel is permitted to wait alongside until a second crude oil type becomes available. For the avoidance of doubt, if for operational reasons, the Terminal requires the berth to be vacated, then the above will NOT apply.

2. Ship Dues will not be levied on any vessel, which enters a harbour area in order to enable a pilot to board in difficult weather conditions, and subsequently has to depart as a result of the pilot not being able to board. Pilotage and Boarding and Landing charges will however apply in accordance with section 2 (ii) of the schedule of Pilotage Charges.

3. If a vessel is required to leave the harbour by the Harbourmaster for any reason unconnected with defects in the vessel, or the vessel's operation, no ship dues will be levied on the subsequent re-entry. Please note this concession does not apply to pilotage, boarding and landing or mooring boats.

4. An International Tonnage Certificate (1969) shall be produced to the Harbourmaster.

5. In calculating charges a fraction of a gross tonne shall be reckoned as one gross tonne.

6. Craft based at Sullom Voe and operated by the Oil Industry for the sole purpose of pollution control shall be exempted from Harbour Dues provided they occupy berths designated by the Harbourmaster. When berthed other than at a berth designated for the purpose by the Harbourmaster the full Harbour Dues will be payable.

7. With reference to the four-day period in section 1 above, the following times will be subtracted from the overall time in port:

   (a) Tankers that for operational reasons, are called to the pilot station in advance of bad weather conditions, a fixed period of 12 hours.

   (b) Tankers that are required to move berth for two or more types of crude oil, a fixed period of three hours per move.

8. Ships dues are inclusive of a fee for garbage waste disposal.

SCALE A - VESSELS PER ENTRY AND STAY PER FOUR-DAY PERIOD OR PART THEREOF

1. Vessels engaged in the provision of services, supply of materials or export of products from the Sullom Voe Terminal and the Gas Processing Plant

Per gross tonne	Segregated ballast tankers	£0.99
	Other	£0.89

2. Any other vessel calling at a Council Pier or Harbour

(a) Per gross ton	£0.50
(b) Barges - Gross Tonnage by calculation or certificate	£0.50
(c) Passenger vessels/Accommodation Barges – Long Term Rate (minimum 1 month stay – per GT per day)	£0.09
(d) Passengers disembarking per person - (tourist traffic/ Passenger liners only)	£2.61
(e) Vessels and barges working within the harbour limits in Yell Sound and not passing inward past number 5 buoy will be charged per gross tonne (Note: vessels transiting are not liable to charges)	£0.41
(f) Vessels (renewable devices etc) which have no GT assigned – Up to 40 metres – per 4 day period	£6.59 per metre
Rate for each metre in excess of 40 metres per 4 day Period	£4.39 per metre
(g) Minimum charge per entry in stay at any Pier or Harbour	£10.00
(h) All vessels trading regularly on inter –island services per GT per berthing	£0.07

3. Live Fish Carriers

Vessels carrying live fish can apply for an annual compound rate charge equivalent to 40 trips x gt rate.

4. Fish Feed Ships

Vessels regularly involved in the transport of salmon feed using SIC piers and harbours can apply for an annual compound rate charge equivalent to 40 trips x gt rate.

5. Vessels primarily engaged in the supply/operation or harvesting of farmed fish/farmed shellfish can apply for an annual rate based on the gt bands below:

Up to 15 gt	£217.74
16 gt to 100 gt	£435.48
101 gt to 150 gt	£2,177.43
151 gt to 200 gt	£3,042.81
201 gt to 300 gt	£4,354.84
301 gt to 400 gt	£5,806.46
401 gt to 500 gt	£7,258.07

6. Salmon Cages Launched and Floating in Harbour per 4 day period

Up to 70 Metre Cage	£43.64
70 Metre Cage	£44.00
80 Metre Cage	£51.14

90 Metre Cage	£57.56
100 Metre Cage and over	£63.95

SCALE B - COMPOUNDED ADVANCE ANNUAL CHARGES COVERING USE OF ALL COUNCIL PIERS AND HARBOURS

Movements within the harbour prior to successful application of annual compounded rates will be charged at published period rates. Evidence of third party liability insurance may be demanded by the Harbour Authority at any time. The Harbour Authority reserves the right to refuse entry to uninsured vessels.

1. Registered fishing vessels

a) Up to and including 8m overall length	£35.10
b) In excess of 8m overall length, per metre or part of overall length	£24.78

2. Vessels regularly providing services within a Council Harbour
(over 8 metres overall length) - per gross tonne per calendar month or part thereof £3.29

The compounded charge herein referred to shall cease to be applicable to any vessel continuously occupying a berth at a pier for a period in excess of 2 calendar months. Such vessels will then be liable for period dues as per Scale A.

A seasonal compound annual fee, payable in advance, will be charged for each pleasure craft berthed within a Harbour area, but not within an established Marina.

3. The following seasonal fee covers 1 April to 30 September, inclusive:

a) Exceeding 15m overall length	£119.02
b) Exceeding 10m and up to 15m	£87.31
c) Up to 10m	£55.53

4. Charge per calendar month between 1 October and 31 March inclusive, in addition to section 1 above:

a) Exceeding 15m overall length	£29.78
b) Exceeding 10m and up to 15m	£21.85
c) Up to 10m	£13.89

GOODS DUES

Conditions:

(i) Goods dues shall apply to all goods discharged or loaded over one of the Council's piers or handled in the fish market, or to any transfer of goods from craft to craft, craft to shore and from shore to craft which takes place within the limits of a Council harbour but which does not involve the use of a pier except as in (ii) below. Goods dues SHALL NOT apply to goods carried on scheduled ferry services operated or subsidised by the Council. Goods dues SHALL NOT apply in respect of oil or gas loaded into tankers over the oil jetties in Sullom Voe.

(ii) Salmon Farmers and Shellfish Farmers operating within or serviced from a harbour area but not making use of a Council pier or landing place are required to pay a due of £223.24 annually. Where a Council pier or landing place is used, the full tariff is applicable.

SCALE C - RATES ON FISHING GEAR

1. **Vessels storing nets on any pier, outwith designated net mending areas**

per net per day	£41.89

2. **However, where nets are stored in bins as provided by the Council the following bin rates apply:**

(a) per Glass Fibre Bin per annum	£150.96
(b) per Small Metal Bin (1.925m x 1.925m) per annum	£333.00
(c) per Large Metal Bin (1.925m x 2.60m) per annum	£375.60
(d) New Style Metal Bins (3.04m x 2.43m) per annum	£592.44

The above rates are inclusive of insurance and shall be applied to pro rata on a daily basis as appropriate.

Where insufficient bins are available to meet demand, charges are abated for nets left in the designated storage areas to those applicable to a large metal storage bin (No(d) as above) during the period until a bin is available.

3. **Charge for the use of designated net mending area where not paying compounded dues or landing dues on that visit -**

£89.31 per net for the first seven days, thereafter the rates for use of hard standing areas will apply

4. **Where excessive waste net materials are left behind after use of the net mending area vessels will be charged for collection and disposal of the materials.**

Minimum Charge per hour	£38.52

SCALE D - RATES ON GOODS

1.	**Fresh fish and shellfish** - per £1.00 value ad valorem	£0.025
2.	**Farmed Fish** - per tonne	£14.33
3.	**Farmed Shellfish** – per tonne	£4.57
4.	**Any fish or shellfish landed outwith a Council pier and stored in the Fish market:-** per £1.00 value ad valorem	£0.025

5. **Fishing vessels less than 15gt engaged in inshore fishing will be required to purchase a Landing Disc for 6 or 12 months as below:**

(a) 6 month disc (April to Sept)	£76.88
(b) 12 month disc (April to March)	£140.27

Vessels as above who land mackerel through Scalloway Fish Market will be eligible to apply for a 6 or 12 month disc as above.

NB This exemption will not apply to fish/shellfish being landed through the Fish Market other than as stated above.

6 **Fishermen, vessel owners and agents are advised that if the value of fish consigned through a Shetland Islands Council port is not declared within 1 calendar month of landing, a charge of £3.40 per box will be levied in lieu of the published dues**.

7.	**Vehicular Tractors, lorries, plant, motor cars and trailers** (any goods which they might be carrying will be charged separately in accordance with the table of due) per tonne	£8.19
8.	**Machinery** – per tonne	£4.10
9.	**Bulk Materials** Aggregates both coarse and fine, fertilisers, boulders and cement/sand - per tonne (bulk includes carriage in flexible intermediate bulk containers - FIBC's)	£0.22
10.	**Salmon Feed** - per tonne	£1.61
11.	**Salmon Nets** (from/to cages) per net	£24.71
12.	**Ice** – per tonne	£2.03
13.	**Fuel/Gas Oil/Diesel** – per tonne	£1.97
14.	**Live Animals**	£0.42
15.	**Any other goods not specified above**, per tonne	£2.10
16.	**Minimum charge on any one item**	£8.49
17.	**Water**	
	(a) per tonne	£2.10
	(b) Min Charge - Water	£10.98

18. **Electricity** - when electricity is supplied from the power bollards a minimum charge of £6.98 will apply over a seven day period.

Where staff are required outwith normal working hours to provide Water or Electricity an additional charge will apply. Rates available on application.

SCALE E - RATES FOR USE OF HARD STANDING AREA

1. Outdoor Storage

(a) Short Term - per square metre per day	£0.22
(b) Long Term (min 120 days) - per square metre per day	£0.09

NB: (Long Term Storage rates only apply on receipt of a written request)

2. Warehouse – Indoor Storage, Scalloway

(a) Short Term – per square metre per day	£0.30
(b) Long Term (min 120 days) - per square metre per day	£0.10

NB: (Long Term Storage rates for Warehouse will only apply on receipt of a written request)

3. Trailers/Containers parked on Harbour property not engaged in loading/discharging of goods (unless a request for long term Storage is received) shall be liable for the following charge:

(a) per day	£4.90
(b) Minimum charge	£6.99

4. Scalloway Harbour – Bulk Cargo Shipments

However, to avoid any delay to the ship when bulk cargo is being handled e.g. sand, aggregate, limestone etc., the consignee/shipper shall be assigned an area of the quay for stock piling purposes at the rate of 400m² per 1000 tonnes. The shipper shall be responsible for clearing up the designated area after the total cargo has been shipped. One week (7 days) per cargo will be allowed free of hard standing storage fees. Any cargo remaining after one week will attract hard standing storage dues at the above rate.

5. Salmon Cages under Construction

(a) Storage of parts before construction commences – as hard standing rate above.

(b) Whilst construction takes place - £77.04 per day plus hard standing charge

Charges for building aquaculture cages in harbour waters will be based on the area times an assumed GROSS TONNAGE. Therefore charges will be levied as per Scale A plus hard standing charge for parts.

CHARGES FOR HARBOUR CRAFT AND PLANT

A daily hire rate for any of the following plant can be negotiated at time of hire.

6. Craft/Equipment based at Sullom Voe

(a) Hire of the Sullom Spindrift/ Sullom Shoormal/ Sullom Spray per hour or part thereof	£378.83
(b) Hire of the Sullom 'A', 'B' or 'C' per hour or part thereof	£134.30
(c) Hire of Sullom Shearwater per hour or part thereof (Subject to availability)	£134.30
(d) Hire of Fork Lift Truck	£43.71

7. Hire of the Marine Travel Lift

(a) Lifting a boat out of the water and placing on a trailer or onto the set down area including use of equipment and provision of Hoist Driver and banksmen	£489.25
(b) Lifting a boat from a trailer or set down area and lowering into the water including use of equipment and provision of Hoist Driver and banksmen	£489.25
(c) Cancellation charge if lift delayed over one hour	£128.75

(d) Set Down area charge – 180m2 for £37.08/day for days booked

(e) Over-stay first 7 days – day rate + 50% per day

(f) Over-stay second 7 days – day rate + 100% per day

(g) Over-stay after 14 days – day rate + 200% per day

Hire subject to availability of equipment and staff and acceptance of the Terms and Conditions of Boat Hoist Service. These can be found on the Ports website *<u>www.shetland.gov.uk/ports/</u> or by contacting Ports and Harbours Reception at port.reception@shetland.gov.uk*

8. Craft/Equipment based at Scalloway

(a) Hire of Scalloway Harbour Launch per hour or part thereof	£93.82
(b) Hire of the Scalloway Harbour Launch to assist berthing per hour or part thereof	£178.71
(c) Hire of Fork Lift Truck per hour or part thereof	£43.71
(d) Hire of power washers per hour or part thereof	£20.10

SCALE F – MISCELLANEOUS CHARGES

1. Attendance of Officers and Administrative Support

(a) This charge is levied on all parties responsible for the incident , jointly and severally, when Officers of the Harbour Authority attend oil pollution incidents to investigate the cause and/or supervise the clean-up and for any other appropriate recharges	£85.28 per officer per hour or part thereof
(b) Administrative Support	£38.44 per hour or part thereof

2. Security

(a) A security / administration surcharge is applicable to all vessels, not belonging to the Authority, that are required to report to the Harbour Authority under ISPS regulations and that are not on annual dues.	£61.00 per visit
(b) A security / administration surcharge is applicable to all vessels, not belonging to the Authority, that are required to report to the Harbour Authority under ISPS regulations and have paid annual dues.	£61.00 per year

3. Access

Gangways - where available and supplied

(a) per day	£36.49
(b) per week	£109.48
(c) Personnel access control barriers - where available per day. *Long Term Rates available on request.*	£3.66

4.

Fenders	£67.00 each per day

SCALE G – SHIP-TO-SHIP TRANSFER OF OIL

1. Ship-to-ship transfers of oil at a Sullom Voe Terminal jetty, excluding bunker transfers:

(a) Import vessel(s) per gross cargo tonne	Free of Charge
(b) Export vessel	£0.40

The above includes Ship Dues/Pilotage/Boarding and Landing/Mooring/Normal Towage. Any other services will be charged as detailed in the Table of Dues.

For each STS operation up to three hires of the Harbour Launch will be allowed free of charge, thereafter the full hourly/part thereof hire charge for Harbour Craft will apply.

2. Where an export tanker loads crude ex shore tankage before or after a ship-to-ship transfer:

(a) Import vessel(s) per gross cargo tonne	Free of Charge
(b) Export vessel per gross tonne	£0.40
(c) Export vessel will be moved once	Free of Charge

Thereafter the export vessel will attract Ship Dues/Pilotage/Boarding and Landing/departure towage, as published, and any other harbour charges as detailed in the Table of Dues.

3. Hire of craft to transfer hoses and fenders to/from vessels involved in Ship-to-Ship operations:

(a) Deployment of materials £1086.25 (includes hire of vessel/s up to 3 hours). Hourly rate of hire thereafter £329.60 per vessel.
(b) Retrieval of materials £706.58 (includes hire of vessel/s up to 2 hours). Hourly rate of hire thereafter £329.60 per vessel.

Note: Above figures do not include hire of any shore cranes.

SULLOM VOE HARBOUR AREA
SCHEDULE OF MOORING RATES

1. At any one of the oil loading jetties, per mooring operation:

(a) per Gross Tonne	£0.04

2. A 'mooring operation' shall be any occasion on which the services of one or more mooring boats are required for the purposes of mooring. Where a vessel is required to shift from one jetty to another the above rates will apply for each separate mooring.

(a) At any other jetty - per mooring boat per hour or part thereof	£138.21
(b) At any jetty but not requiring a mooring boat - per hour or part thereof	£63.89

SULLOM VOE HARBOUR AREA
SCHEDULE OF PILOTAGE CHARGES
(PILOTAGE ACT 1987)

1. The following charge is payable for piloting a vessel inwards or outwards in the Harbour Area and for each piloted movement within the harbour:

(a) per gross tonne	£0.11
(b) Minimum charge per act of pilotage	£170.32

2. A charge of £100.54 per hour or part thereof shall be applicable in the following cases:

(i) When a pilot is requested for the departure, moving or arrival of a vessel and the vessel fails to move or arrive within one hour of the stated time of departure, move or arrival;

(ii) When a pilot is requested and the requirement is cancelled after the pilot has set out to undertake pilotage;

(iii) For detention aboard ship of a pilot by request of the Master, Owner or Agent and no pilotage service is being rendered, and

(iv) When a pilot is in attendance on board a vessel berthed alongside during periods of severe weather.

3. Vessels, which are being towed, by a vessel under pilotage and any vessel being led within the Harbour Area by a vessel which is under pilotage shall pay pilotage dues as if the pilot were on board.

4. Marine Officers of the Shetland Islands Council undergoing training may from time to time accompany the pilot but such trainees shall not be considered to be assistants to the pilot and no extra charge shall accrue to any vessel in respect of such trainees.

5. An International Tonnage Certificate (1969) shall be produced to the Harbourmaster.

6. In calculating pilotage charges a fraction of a gross tonne shall be reckoned as one gross tonne.

SULLOM VOE HARBOUR AREA
SCHEDULE OF BOARDING AND LANDING CHARGES
(PILOTAGE ACT 1987)

1. **For each act of pilotage undertaken every vessel shall pay a boarding fee or a landing fee of:**

(a) per gross tonne	£0.04
(b) Minimum charge per act of pilotage	£170.32

2. **If the pilot launch is detained under any of the circumstances as mentioned in paragraph two of the scale of charges for pilotage a charge shall apply as follows:**

For each hour or part thereof	£378.83

3. When a helicopter is used to board or land the Pilot all charges incurred in respect of aircraft usage, including abortive missions, will be charged to the ship's account. In addition, as a launch is required for safety cover, the normal boarding and landing fee will be charged.

4. An International Tonnage Certificate (1969) shall be produced to the Harbourmaster.

5. In calculating charges a fraction of a gross tonne shall be reckoned as one gross tonne.

6. Vessels which cannot provide regulation boarding equipment and in particular those with forward leading accommodation ladders, may receive or land their pilots by helicopter, if a helicopter is available. In such cases all charges incurred in respect of aircraft usage, including abortive missions will be charged to the ships account.

7. Special rates are applicable for the performance of duties outside those normally associated with pilotage and these are available on request from the Executive Manager / Harbourmaster – Ports and Harbours Operations.

The Shetland Islands Council reserve the right to apply discretionary rates to any charge in the Table of Dues on application.

SCALLOWAY HARBOUR AREA
SCHEDULE OF PILOTAGE CHARGES
(PILOTAGE ACT 1987)

1. The following charge is payable for piloting a vessel up to and including 300 GrossTonnes inwards or outwards in the Pilotage District, to or from either an anchorage, buoy or berth and for each piloted movement within the harbour:

Per act of pilotage	£41.58

2. The following charge is payable for piloting a vessel 301 GrossTonnes and over, inwards or outwards in the Pilotage District, to or from either an anchorage, buoy or berth and for each piloted movement within the harbour

Per gross tonne	£0.13

3. A charge of £42.83 per hour or part thereof shall be applicable in the following cases:

(i) When a pilot is requested for the departure, shifting or arrival of a vessel and the vessel fails to move or arrive within one hour of the stated time of departure, shift or arrival;

(ii) When a pilot is requested and the request is cancelled after the pilot has set out to undertake pilotage, and

(iii) For detention aboard ship of a pilot by request of the Master, Owner or Agent and no pilotage service is being rendered.

4. Vessels that are being towed by a vessel under pilotage and any vessel being led within the Pilotage District by a vessel, which is under pilotage, shall pay pilotage dues as if the pilot were on board.

5. Marine Officers of the Shetland Islands Council undergoing training may from time to time accompany the licensed pilot but such trainees shall not be considered to

be assistants to the pilot and no extra charge shall accrue to any vessel in respect of such trainees.

6. An International Tonnage Certificate (1969) shall be produced to the Harbourmaster.

7. In calculating charges a fraction of a gross tonne shall be reckoned as one gross tonne.

8. Special rates are applicable for the performance of duties outside those normally associated with pilotage and these are available on request from the Executive Manager/Harbourmaster - Port Operations.

SCALLOWAY HARBOUR AREA
SCHEDULE OF BOARDING AND LANDING CHARGES
(PILOTAGE ACT 1987)

1. For each act of pilotage undertaken every vessel shall pay a boarding fee or a landing fee of:

£93.82 per hour or part thereof for use of the pilot cutter plus, outside normal working hours, there shall be an additional charge for labour involved. Rates available on application.

2. If the pilot launch is detained by virtue of any of the circumstances in paragraph three of the scale of pilotage charges, a charge shall apply as follows:

For each hour or part thereof	£93.82

3. An International Tonnage Certificate (1969) shall be produced to the Harbourmaster.

4. In calculating charges a fraction of a gross tonne shall be reckoned as one gross tonne.

The Shetland Islands Council reserves the right to apply discretionary rates to any charge in the Table of Dues on application.

Farmed Fish Landing - Charging at Comparable Ports 2014/15

Port / Area	Council	Ad valorum	Per tonne	Comments
Shetland Islands Council	Y		£13.91	
Orkney Islands Council	Y		£2.53*	
Western Isles	Y		£5.00	
Highland Council	Y		£4.60	
Moray Council	Y	2.5%*		Discount on volume
Aberdeenshire Council	Y	2.5%*		Discount on volume
Torbay	Y	2.5%*		Includes berthing fee
Cornwall Council (incl Newquay)	Y	2.57%*		
Scarborough & Whitby	Y	4.0%*		
Lerwick		2.5% 0.05% live salmon		Some bulk discounts
Scrabster		2.0%*		
Fraserburgh		2.5%*		
Peterhead		2.5%*		
Ullapool			£6.50	
CMal harbours	Government			Charges based on vessel size
Falmouth				Charges based on vessel size
Bridlington		2.0%*		

* No specific rate for farmed / live fish.

Note that there are no publically available figures for:
Wick
Forth Ports
Aberdeen
ABP Ports
Great Yarmouth

Agenda Item

4

Shetland Islands Council

Harbour Board **26 November 2014**
Policy & Resources Committee **26 November 2014**

Sella Ness Port Operation – Financial Modelling	
F-074-F	
Report Presented by Executive Manager – Finance	**Corporate Services**

1.0 Summary

1.1 As part of the work undertaken on the Long Term Financial Plan, a specific piece of financial modelling has been completed to estimate future surpluses from the Sella Ness Port (the "Port") operation.

1.2 The initial results estimate that if the Port is managed carefully from a financial point of view, it would make a net contribution to the Council's Reserve Fund over the period 2014-2050.

1.3 However, based on an initial comparison between the likely future surpluses generated from retaining the Port, and the cash flows that could be generated if the Port was sold with the proceeds invested with fund managers, the latter option represents a better financial outcome for the Council.

2.0 Decision Required

2.1 That the Harbour Board RECOMMENDS that the Policy & Resources Committee RESOLVES to approve that a further report be presented in 2015 upon completion of the additional work required in order to provide the Council with updated and more robust financial modelling.

3.0 Detail

3.1 The Medium Term Financial Plan was independently reviewed during 2013 by SOLACE Enterprises. One recommendation that came out of this work was that the Council should undertake a Long Term Financial Planning exercise. Over the past 12 months the Finance Service has been leading on preparing this piece of work which will be presented to Council on 3 December 2014.

3.2 One important strand of the work was to undertake a financial modeling exercise on the future cash-flows of the Port in order to determine the level of surplus that it could contribute to funding Council services in the future.

3.3 It is not possible to place significant reliance on a forecast of future revenues up to 2050 as a result of the number of variables and external factors that could impact upon it. However the exercise provides an indication of the likely future direction of the Port if it continues to operate as it currently does into the future. It also highlights the financial risks around continuing to operate the Port.

3.4 The model has been reviewed by SOLACE Enterprises Ltd which has confirmed that the model is competent. The model has also been reviewed by officials at Scottish Government who also commented that the model was technically sound. However, a key piece of feedback from the Scottish Government was that the income data entered into the model relies on information from BP and it would be beneficial to contract a private oil and gas analyst to provide an independent view on future throughput projections for the Sullom Voe Terminal (SVT).

3.5 This work has been commissioned, and upon its completion the future throughput projections will be worked through the financial model.

The Approach

3.6 The financial model covers the period 2014-2050, which matches what the industry has indicated is the remaining lifetime of SVT.

3.7 There are a number of key assumptions in the financial modelling as set out below –

- The Port and associated assets remain 100% owned and operated by Shetland Islands Council;
- Jetties 1-4 remain a BP funded assets;
- Assumes that BP continues to require a 24 hour a day, 7 day a week operation for the remaining life of the Port, and therefore staffing levels remain at the same level;
- The terms and conditions of the Sullom Voe Agreement remain unchanged;
- Harbour dues are increased by inflation each year;
- All capital investment estimated to 2050 is fully included in the model;
- Employee costs and operating costs are inflated annually;
- Used BP estimates for tanker numbers up to 2025/26 and then a straight line reduction each year until there are none in 2050;
- Decommissioning of the Port will cost the Council £13 million.

3.8 The financial model was prepared in Spring 2014 and has been discussed with the oil industry formally at a Sullom Voe Association meeting in May 2014.

3.9 The model has subsequently been externally reviewed, but will require to be fully updated once the independent throughput projections have been obtained.

3.10 SOLACE Enterprises Ltd also undertook a review of different options for the Port based on the financial model – attached at Appendix 1.

3.11 After this initial report had been produced, the Executive Manager – Finance explained that in the event of an outright sale, the proceeds would be invested with fund managers and the Council would use the 7.3% average annual investment return to supplement service expenditure. As a result SOLACE Enterprises Ltd produced a second supplementary report – attached at Appendix 2.

3.12 In addition the financial modelling exercise, Finance Services commissioned SOLACE Enterprises Ltd to undertake a company valuation exercise to determine what a fair value sales price would be for the Port. The calculation was based on the cash flows in the financial model, and are therefore subject to change if the independent throughput projections differ significantly from those provided by BP.

3.13 The assumption made on the sales option is that the proceeds would be invested with the Council's fund managers, and the Council would seek to make an annual return.

The findings

3.14 SOLACE Enterprises Ltd estimate that the Port has a sales value of £71.7m based on the information in the financial model.

3.15 The table sets out the future cash flows (in today's prices) available to fund services in the period to 2050 under the financial model for continuing to operate the Port and under the scenario of selling the Port and investing the sales proceeds with fund managers.

	Financial Model – Continue operating Port in current format	**Sell the Port and invest the proceeds**
Total Net Positive Cash Flows (NPV) to 2050	£101.8 million	£197.9 million
Annual average amount	£2.8 million	£5.3 million

3.16 Further work is required to refine the assumptions and update throughput projections, but the difference in future available cash between the two scenarios is £96.1 million.

3.17 Expressed another way, it will cost the Council £2.5m per year for the next 37 years for the right to operate the Port, as opposed to selling it.

3.18 Therefore, it would take a significant change in assumptions for the exercise to show that retaining the Port is the most financially beneficial approach that the Council could take.

The Conclusions

3.19 The initial conclusions from this first piece of work is that it would be financially beneficial for the Council to sell the Port if it could achieve the fair value valuation.

3.20 Further work is required to sharpen the financial modelling so that there is better quality information on which Members can make a decision about the future of the Port

3.21 The sensitivity analysis undertaken on the Port financial modelling highlights the high level of volatility in this industry, with small changes in assumptions leading to significant changes in future net cash flows.

3.22 The modelling highlights the level of financial risk associated with the ongoing running of the Port as a result of the size of the future cash flows that were modelled in relation to the size of the Council's net general fund budget of around £110 million. The total cash flows in the model total £1.36 billion which is 12 times the entire annual budget of the Council. Therefore relatively minor variations against the assumptions in the model could have a big impact on the general fund which relies on the Port's forecast surpluses.

3.23 Further information on risk is set out in the risk management section of the report.

4.0 Implications

Strategic

4.1 Delivery On Corporate Priorities
The decision over the future of the Port will have significant financial implications and have a bearing on future funding levels available to fund services in line with corporate priorities.

4.2 Community /Stakeholder Issues – The Council has had initial discussions on the model with the oil industry, Scottish Government and shortly the UK Government. Further engagement will be necessary once the financial model has been updated early in 2015.

4.3 Policy And/Or Delegated Authority
The Harbour Board has responsibility for providing strategic oversight in relation to all aspects of the Council's harbour undertaking. The Policy and Resources Committee has delegated authority for securing the control and proper management of the financial affairs of the Council.

4.4 Risk Management
There are no risks arising directly from this report, but the early work undertaken highlights a number of risks around this exercise and also around the Council's operation of the Port.

The financial modelling exercise

4.4.1 The obvious risk is around the imperfect information that will be available to Council when it takes a decision whether to retain the Port, and in what form, or sell the Port.

4.4.2 If the Council decided to sell the Port it is possible that the actual performance of the Port could be better than forecast meaning that a) the Council could have achieved a higher sales value and b) the Council may have been financially better off by retaining the Port.

4.4.3 If the Council decided to keep the Port based on the financial modelling exercise, the actual performance of the Port could be significantly poorer than forecast, meaning the Council was worse off as a result of maintaining ownership of it.

Key Financial Risks arising from operating the Port

4.4.4 Throughput – the single biggest factor in the financial model is the amount of income that the Port will generate from the Council based on the Port's throughput. This is a volatile source of income as a result of the numerous factors that influence it, none of which the Council has any ability to control at all. For example, oil prices, the rate at which new technology is developed to make extraction profitable, the potential for increased FPSO to market transfers thereby avoiding the SVT will all impact on throughput levels.

4.4.5 Operating model – the Port's operating model requires a 24/7 operation using specialist staff. This is expensive and has the potential to become more so in future if staff need to be brought into Shetland to provide the service.

4.4.6 Capital investment required – significant sums of capital investment are required in order to keep the Port operational into the future. However, because of the uncertainty around future profitability, there is no guarantee that an investment return will be made on any capital expenditure.

4.4.7 Losses in the later years of operation – the model indicates that the Port will operate at a loss in later years as reducing throughput and tanker movements mean the falling income is insufficient to cover the fixed costs of operating the Port. It is unclear how significant these losses might be so the Council carries a risk that they may be greater than have been budgeted for.

4.4.8 Reinstatement Costs – again the model estimates what the costs of reinstatement of the site might be for the Council, but again there is a lack of clarity around this, which presents the financial risk that the costs might be higher than budgeted for in the model.

4.4.9 Litigation – if operational accidents occur there is a potential for the Council to suffer financial loss as a result of litigation.

Key Non-Financial Risks arising from operating the Port

4.4.10 Environmental – if an environmental accident occurred the Council could be held responsible, both legally and with the public, for damaging Shetland's natural environment.

4.4.11 Workforce issues – there are a number of workforce issues regarding the Port such as terms and conditions of staff, succession planning and industrial action issues. Also, due to the nature of the work, there is the potential for serious injury or death of staff employed by the Council.

4.5 Equalities, Health And Human Rights – None.

4.6 Environmental – None.

Resources

4.7 Financial - There are no direct financial implications arising from this report for noting. However, upon completion of further work in early 2015, the Council will have sufficient information to start to form a view on the approach that it wishes to take with regard to the future of the Port. There will be significant financial implications as a result of any decision owing to the large amounts involved.

One key point that should be made is that the Port does not exist to provide services to the public. It should therefore not be treated like any other Council service like the ferries service. Instead it should be treated as a business with its sole purpose being to make an investment return for its owners – the Council. Therefore any decision as to whether to retain or sell the Port or whether to make future investment of capital should all be based on the principles of profitability.

The cost of the SOLACE consultancy was £9,174 for the 2 reports. This was met from within the 2014-15 Finance Service budget.

4.8 Legal – None arising directly from this report.

4.9 Human Resources – None.

4.10 Assets And Property – None.

5.0 Conclusions

5.1 Early indications suggest that the Council would be financially better off in the future if it were to sell the Port at fair value rather than continue to operate it into the future.

5.2 This course of action would also reduce the amount of financial and non-financial risk that the Council faces currently by operating the Port.

5.3 Further work is required to ensure that any future decision made by the Council is based on the most robust evidence available. Therefore a further report will come forward in 2015 which will include updated and more robust financial modelling.

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List of Appendices
Appendix 1 – Review of Sullom Voe Financial Projections & Options – An independent appraisal by SOLACE

Appendix 2 – Practical Considerations of Status Quo v Sale Option for Sullom Voe – A brief supplementary report by SOLACE Enterprises

Shetland Islands Council

Review of Sullom Voe Financial Projections & Options

An Independent Appraisal by SOLACE

May 2014

SOLACE ENTERPRISES

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Contents

Background and Overview

1. Shetland Islands Council (SIC) owns the Harbour/Port at Sella Ness which is the prime area of tanker activity for the oil terminal at Sullom Voe operated by British Petroleum (BP). The Company have recently given a 35 year commitment to the terminal right through to 2050.

2. The Council operates a Harbour Account with all surpluses generated transferred to the Reserve Fund. The renewed commitment by BP has led the Council to revisit its in-house financial model - calculating income and costs over this longer period.

3. While the surpluses generated from this income stream are substantial, SIC has to be mindful of the time when the terminal eventually reaches the end of its useful life, surpluses turn to deficits and decommissioning costs need to be incurred to reinstate the site to its original condition. This will involve the removal of all jetties and man made structures.

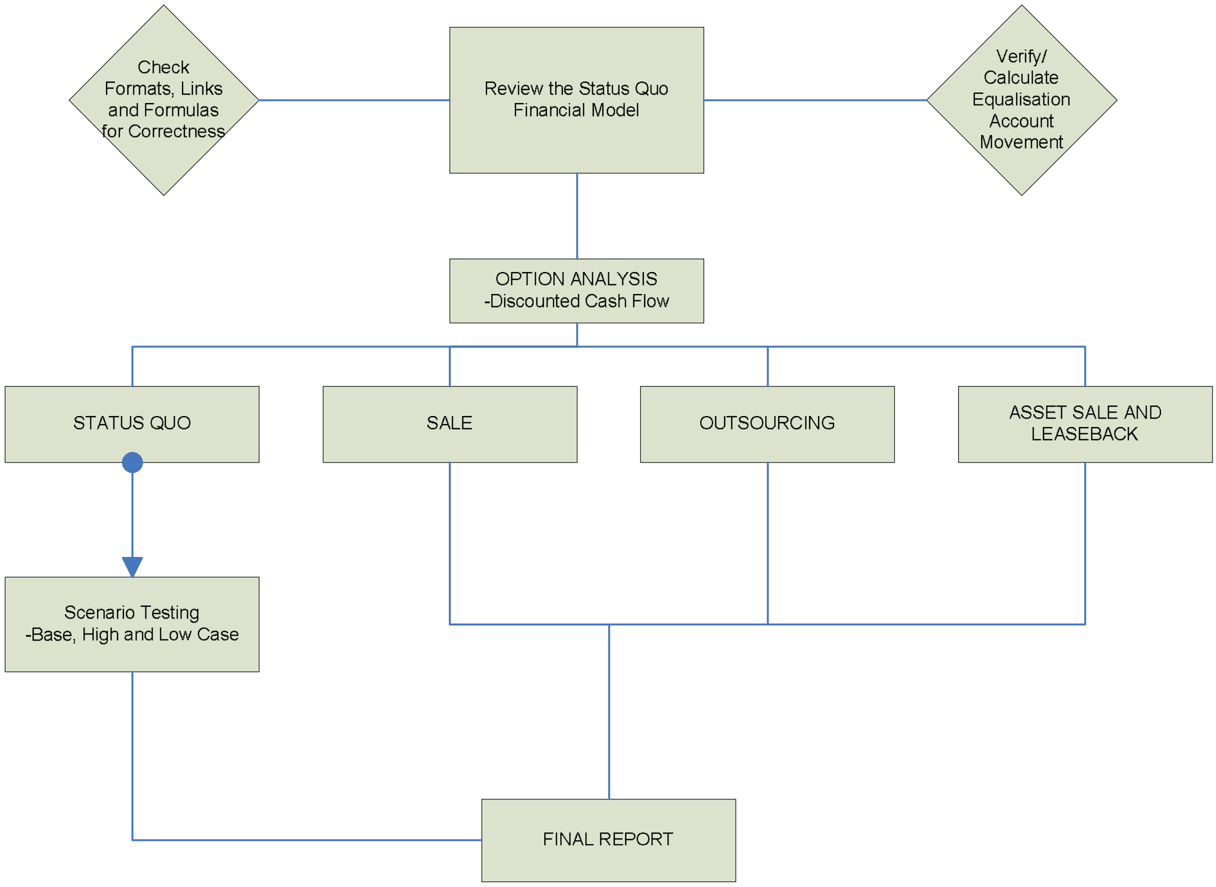
4. SOLACE have been commissioned to independently appraise SIC's in-house model to ensure it is robust and correctly provides for equalisation adjustments to balance out early year surpluses with later year deficits.

5. A requirement also exists to consider other options such as a full commercial sale or outsourcing arrangement. The financial impact of these alternatives is to be calculated to establish the "tipping point" when the Port is no longer worth retaining under the existing status quo (24/7) method of operation.

1. Methodology and Work Carried Out

1.1 All our work was carried out off-site. We were sent an electronic version of the Council's in-house financial model for scrutiny and appraisal. The model is made up of a number of linked workbooks.

1.2 Our work always follows a structured methodology. This is shown in visual form below.



1.3 Our first objective is to make sure the in-house model is arithmetically and formulaically correct and its inputs and assumptions are correctly assembled. Any potential changes are highlighted as part of the SOLACE review including the preparation of a revised version of the financial calculations.

1.4 Thereafter, we converted the in-house model to a commercial discounted cash flow (DCF) format to allow the calculation of a net present value (NPV) for comparison with alternative options. Sensitivity calculations were also carried out on the status quo model in this presentational form to test the robustness of the existing operational arrangement to changes in key assumptions.

1.5 The aim of this approach is to show in clear financial terms – using recognised investment appraisal techniques – the likely long-term commercial value of the Port and NPV thresholds when the status quo is no longer the best forward looking financial outcome for SIC.

2. Review of Council's Existing Financial Model

Review of Model integrity

2.1 The model produced by SIC is essentially the BASE case. Our initial work involved checking its basic operation – namely, it was free from errors, all formulas worked as they should and it produced sound arithmetical outputs.

2.2 The model consists of 10 workbooks;

- "Assumptions" – key assumptions made;
- "Sullom Voe" – summary income and expenditure from 2014/15 till 2050/51 ;
- "Capital Financing" – Outstanding debt for the new tugs spread over 30 years and capital costs fully held in the year of replacement;
- "Inflation Factors" – a list of inflation and capital financing rates;
- "SV Pivot on 1415 – 1718 Data" – Pivot Table summaries of budget data;
- "Employee costs Overall Infl Calc" - Employee costs for 2014/15 with and without inflation;
- "1415 to 1718 Data" – ledger database with 2014/15 budget and forward estimate information;
- "RPI CPI" – Historical data (with notes) on the various different inflation indicators published by the Office of National Statistics;
- "Tanker Inc Calc Sheet" – detailed calculations of Tanker Export (Harbour Charges), Schiehallion Tanker Imports income, Towage Charges and Miscellaneous Income; and
- "SV Assets" – a list of asset book values from SIC's general ledger.

2.3 Arithmetically the model is completely correct. All formulas and links work and are free from error. We used the Excel formula auditing tool to ensure this is the case – particularly with the tanker income calculations. We can therefore conclude total surpluses in the period 2014/15 to 2050/51 of £87,603,574 are correctly derived based on model inputs.

2.4 In addition to the arithmetical check, we also carried out a detailed analysis of the inputs used to arrive at the gross accumulated surplus figure mentioned above. Our review focused on the main "Sullom Voe" summary worksheet as subsidiary worksheets linked to the main totals contained here. The results of this "line by line" analysis are shown in the table below.

Model Line Heading	Comment
INCOME	
Tanker Traffic	Tanker traffic income correctly linked from "Tanker Inc Calc Sheet." Overall totals agree. Inflation at 2.7%.
Marine Fund	Marine fund based on long term inflation factor of 2% throughout.
Harbour Agreement Throughput	Harbour Agreement throughput correctly linked from "Tanker Inc Calc Sheet" but no inflation uplifts appear to have been applied – fixed income in the agreement. It is based on average tanker income over the last 4 years.
Jetty Maintenance Income	Jetty Maintenance Income reduces each year by 1/36th of the 2014/15 income. No inflation. But same numbers also included in expenditure so neutral effect overall.
Other (rentals, Hire Charges etc)	Other income inflated at 2.7% throughout (same as tanker traffic income). Inflation applied to 2014/15 total but the modelling does not recognize the reduced other income per the pivot table for 2015/16, 2016/17 and 2017/18 (and hence subsequent years).
EXPENDITURE	
Employee Costs	Employee costs inflation 1.7% throughout. Employee costs inflated forwards with the exception of the Lump Sum Pension contribution for the Shetland Towage staff which is included as £2m in 2014/15 and £1.6m in 2015/16 then removed as no further contribution should be required. Base salary value before inflation £5,851,906 (this is different from the base budget at "Employee costs Overall Infl Calc." which shows £6,093,629 – a difference of £241,723 - £343,531 with inflation).
Operating Costs	Operating costs increase by 2.7% inflation. However, 2015/16 – 2017/18 (and subsequent years) do not

	recognise higher level of cost as shown on the pivot table worksheet.
Jetty Maintenance Operating Costs	Same figures as income - net effect neutral
Financing Costs	Financing costs at 4%. This is a prudent level for Public Works Loan Board (PWLB) borrowing if required. We calculate capital and interest borrowing on new tug costs over 30 years at 4% is £695,343. Original Entries simply divide outstanding debt by 30 then 4% is added (interest only). The other items of expenditure incurred in the year of replacement should be uprated for inflation – not charged at the financing rate of 4%.
PROVISIONS/EQUALISATION	
Provision for Decommissioning Costs	Provision for decommissioning costs £13M. This is sourced from the Medium Term Financial Plan (MTFP) for 2012-2017. The "Assumptions" worksheet says this figure is "…difficult to quantify and has no real basis," although the MTFP suggests a formal estimate is available.
Provision for Equalisation in Future Years	Manual provisions are made in the profitable years to build up cover for later years of expected losses. The overall effect is neutral – it is a smoothing adjustment over the life of the Port.

2.5 We are unsure of the reasoning behind the capital financing calculations (and again it may be perfectly legitimate) but the only externally financed expenditure appears to be for the new Tug boats. This is charged to the main account on an interest only basis of 4% - no principal repayment element is included. In addition, new capital expenditure looks to be funded from income in the year of expenditure – in other words without external financing. Despite this, the "Capital Financing" workbook says "All to be funded by external borrowing at 4% interest over 30 year period."

2.6 Also, some of the figures are not completely in line with pivot table information driven from the budget and estimate database. There may be perfectly good reasons for this although we have prepared our own version of the model adjusting for these potential changes (and also capital financing costs) – this can be found at Appendix A. A comparison of our adjusted results and the Council's original results are shown in the table.

CATEGORY	COUNCIL (£)	SOLACE (£)	DIFFERENCE (£)	REASON
Income Extract Other income (rental, hire charges etc)	**(6,794,879)**	**(5,434,515)**	**(1,360,364)**	SOLACE version uses reduced income in "SV Pivot in 1415-1718 Data" for 2015/16, 2016/17, 2017/18 and then subsequent years too.
Expenditure Extract Operating Costs	**223,506,423**	**237,960,376**	**(14,453,953)**	Council version does not take into account higher level of costs shown in "SV Pivot in 1415-1718 Data" for 2015/16, 2016/17, 2017/18 and thereafter.
Financing Costs	**37,450,779**	**20,860,280**	**16,590,499**	Capital repayment element of Tug Debt included in SOLACE version (small rounding difference)
Capital Costs incurred in year	**0**	**33,567,275**	**(33,567,275)**	Capital Expenditure inflated at 2.7% for SOLACE version (assumes financed from in-year Cashflow rather

TOTAL Expenditure Difference	**260,957,202**	**292,387,931**	**(31,430,729)**	than external borrowing at 4%) Small rounding difference exists.
(Surplus)/Deficit Difference	**(87,603,574)**	**(54,812,480)**	**(32,791,093)**	Small rounding difference exists.

2.7 This is a substantial difference and requires the Council to take a look at the relevant income and expenditure headings and satisfy itself existing entries are correct or make the changes we have used in our own version of the model. For the purposes of all the detailed NPV calculations shown in section 3 – we have used our version.

Verification of Equalisation Account Adjustments

2.8 The adjustments made in the SIC model manually set aside a provision from early year's profits to be released when losses are incurred from 2039/40 onwards. The provision calculations have been correctly made.

2.9 An earmarked, formal equalisation account reserve should be created for this purpose in order that movements can be formally monitored. From our experience elsewhere, it is usual for such reserves to be cash-backed and interest added as the size of the fund grows. This could also possibly be a reasonable model to follow for decommissioning costs too, in order to mitigate against the effects of inflation.

2.10 In the SOLACE version, manual adjustments are made in the same way as the original to arrive at a neutral position after 37 years but taking into account the lower surpluses generated.

Overall View of the In-House Model

2.11 In terms of arithmetic operation, the SIC model is correctly constituted and properly calculates income, expenditure, provisions and surpluses/deficits over the life of the Port. It is fit for purpose in terms of a monitoring system and for updating the MTFP.

2.12 In terms of key inputs, we have identified some differences we believe need further investigation as they have a materially influential effect on financial outcomes. There may be a good reason for SIC proceeding with existing numbers; however we have used calculations from this point forward using our own adjusted version of the model. If it subsequently transpires the original SIC entries should continue to be used, then we are happy to recast the NPV models accordingly (and our report outputs).

3. Review of Options

Approach to Comparing Options

3.1 As commercial options, in addition to the status quo, are part of the review, we have used appropriate DCF techniques to compare the likely financial consequences of different courses of action. DCF techniques require all the entries to be in cash only – in other words, non-cash entries such as provisions are ignored – although when the provision is expended it will be included in the year of expenditure. Capital financing is also not included in the main model as the discount factor is deemed to account for financing requirements.

3.2 An additional worksheet is added to each of the option models ("Cash Funding") showing financing and cash generated over 37 years. This is a calculation used in commercial appraisal to show financing in a very pure form - based on all deficits being funded from additional borrowing and all surpluses used to repay debt. Summarising, it shows cumulative Cashflow (positive and negative) over the period and in real terms too.

3.3 As Cashflow is inflated, all surpluses or deficits in the main "Sullom Voe Model" worksheet are discounted at a nominal rate (not adjusted for inflation). The Government's nominal rate is typically 6% (real is 3.5%) although it is normal to try and use rates more applicable to the organisation being appraised – for example long term weighted cost of capital rates. All the options from the Council's perspective use 5.75% - this being the Fund Manager return rate and representative of the opportunity cost of using capital as well as more in line with reduced rates for longer term projects (>30 years) involving greater uncertainty.

Status Quo Option and Related Sensitivity Testing

<u>BASE Case</u>

3.4 The Council's existing model (BASE case) is converted to a DCF commercial Cashflow with a resultant NPV. This is shown at Appendix B. Inflation rates used are the same at the original SIC version.

3.5 The 37 year NPV is £103,172,212. The real terms cumulative cash at the end of

37 years (see “Cash Funding” worksheet) is £274,349,435. These results show the commercial value of the Sullom Voe asset to the Council. It is clear the Port is a valuable income generator to SIC.

3.6 The cash funding calculation is based on an investment rate of 5.75% and a borrowing rate of 4%. Outstanding debt of £12,085,364 for the Tug boats is included as an initial, existing deficit.

<u>LOW case</u>

3.7 We subjected the Base case to a number of adverse sensitivities (Appendix C). The scenario calculations are shown in the model under What If Analysis – Scenario Manager. All the figures can be returned to the BASE case if needed so individual scenarios can be tested. Relevant workbooks are:

- “Sullom Voe Model”;
- “Capital Financing”;
- “Tanker Inc Calc Sheet” ; and
- “Cash Funding.”

3.8 Scenarios include; reducing inflation for income but increasing for employee costs, doubling de-commissioning costs, adding £10M of capital expenditure for SIC taking on BP funded assets, lower tanker numbers and less favourable borrowing and investment rates.

3.9 Doubling decommissioning costs and increasing capital expenditure by £10M have limited sensitivity. The effect of discounting mitigates any decommissioning cost expenditure as it is far off into the future.

3.10 Lower inflation combined with lower tanker numbers are highly sensitive factors. The Appendix C default shows the position if inflation reduces to 2% (and increases to 2% for employee costs) and tankers numbers reduce from 90% to 80%. All other assumptions stay the same.

3.11 As can be seen, the NPV reduces to £56,671,326 and cumulative cash balances also reduce to £75,926,085 in real terms (based on less favourable borrowing and investment rates).

3.12 As a matter of interest, with all adverse factors applied, the NPV becomes £43,856,879 with a cash balance of £40,869,692 after 37 years in real terms.

3.13 While the Port is still profitable (despite a number of adverse factors), the high sensitivity to inflation and tanker number throughput requires regular monitoring.

HIGH Case

3.14 We flexed the BASE case model using higher inflation (but lower inflation for employee costs) and tanker numbers at 95% of capacity. We also took the opportunity to increase Harbour dues above inflation (gross 3.7% which is +0.7% above the assumed inflation rate) from 2035/36 onwards (when traffic levels start decreasing).

3.15 These default results are shown at Appendix D and again are underpinned by scenario planning in the following workbooks.

- “Sullom Voe Model”;
- “Tanker Inc Calc Sheet” ; and
- “Cash Funding.”

3.16 The Appendix default NPV is £133,132,178 and real terms cumulative cash balances at the end of 37 years are £405,022,818 (more favourable borrowing and investment rates are used for the cash funding workings). If tanker numbers are increased to 100%, then the NPV rises even further to £150,095,178 (real terms cash balances of £458,753,955).

3.17 Our analysis indicates tanker number remain highly sensitive to changes followed by inflation uplifts. Harbour due increases above inflation on their own from 2035/36, have limited impact.

Overall View on Sensitivity

3.18 Key areas of sensitivity are the inflation rates driving income and costs and tanker throughput numbers. Values over the course of 37 years are resilient to capital expenditure requirements including decommissioning costs owing to the likelihood of being incurred way off into the future. We suggest close monitoring continues of inflation and tanker numbers in order that adverse trends are identified early and planned for. This will ensure the MTFP always uses the most reliable future estimates underpinned by good business intelligence.

Outright Sale

Commercial Buyer Perspective

3.19 A key requirement of this report is to calculate the point at which a sale may be more beneficial than retention. In order to do this, we need to calculate the Port’s commercial worth.

3.20 Normally when assets deliver an income stream over a long period, business valuations are not made on the basis of asset values alone. The value to any buyer goes beyond this and is based on the cash that can be generated by the acquisition over the long-term.

3.21 Sullom Voe would be valued in this way by a buyer. The income and expenditure over the 37 year period would be assessed using DCF techniques to arrive at an NPV which is the discounted sum of all surpluses and deficits in future years represented at today's values. It is normal practice for the NPV to be the purchase price.

3.22 We have therefore prepared a Cashflow from the perspective of a potential buyer. This is shown at Appendix E. Assumptions are slightly different from the Council model as a buyer would look to negotiate on the basis of standard discount rates (6%), long-term inflation at lower rates for income (and higher rates for employee costs) and more than likely would have to borrow to finance the purchase. The buyer would also seek to introduce additional risk factors into the model to reduce the overall NPV.

3.23 In the example shown, we assume a sale would conclude at the end of year 3 (2016/17 financial year). A buyer would look to deduct from any sale proceeds, the NPV value of the Cashflow in these 3 intervening years. On this basis, the NPV sale price of £87,103,144 would be reduced by £15,360,258 to arrive at a potential sale price of £71,742,885 (after a small rounding difference). This is shown at worksheet "Cash Funding" and lists the cash funding profile based on 100% borrowing of the purchase price. It also shows net payback after 8 years.

<u>Same Sale Terms; Council Perspective</u>

3.24 We also replicated the position from the Council's point of view based on the same potential sale price of £71,742,885. This can be seen at Appendix F.

3.25 If this sale price is achieved, the NPV is £76,434,060 with real terms closing cash of £191,778,152. The model assumes any cash proceeds would be invested at an average 5.75% throughout.

3.26 We also ran a scenario test through the model to establish the selling price SIC would need to achieve to make it worth considering selling the Port – NPV being at least the same as the NPV for the status quo option. This is contained in the "Sullom Voe Model" What If Analysis – Scenario Manager – Commercial Sale = Status Quo Tipping Point.

3.27 Our calculations indicate the sale price would need to be at least £103,363,661 before it was worth considering an outright sale of the Port.

Outsourcing

3.28 We then examined the assumed position if the Council retained the Port assets but outsourced the delivery management – staff and operations to a private sector provider. With the strategic importance of the Port and the size of operation, full scale outsourcing (assets and operations – like a franchise) has not been considered at this stage. That is not to say such a deal could not be agreed but it would require considerable due diligence and expense because of the anticipated complexity. If the feasibility of outsourcing is progressed by SIC, then it would be worthwhile to assess the benefits of all outsourcing options at that time.

3.29 Outsourcing is a global discipline both in the public and private sectors and involves organisations tasking an outside agency to deliver a service previously operated in-house. It started primarily with back office functions such as Finance and Information Technology (IT) but now extends to front line service delivery too. In the UK, outsourcing is commonplace in the English public sector but has received little appetite in the same sector in Scotland.

3.30 Typical business commercial outsourcing involves a set payment each year as part of a long-term agreement to operate the delivery operation. It usually involves the achievement of efficiency targets with savings to be passed back to the Council. The provider will look to generate profits from the arrangement by reducing ongoing costs and improving performance.

3.31 Quite simply, outsourcing involves the externalisation of the previous in-house service for a fee. It is usual the fee paid to the third party deliverer has inflation increases built in along with efficiency gains. For example, while the annual agency/outsourcing fee may increase at say CPI/RPI annually, there may be a requirement to a return a set % of efficiency savings too.

3.32 At Appendix G, we have assumed an outsourcing deal could be agreed at the end of year 3 (the same timescale as the outright sale option). In terms of the model, only employee and operational costs are affected. In reality, jetty maintenance operating costs would also be included but for the purposes of the model they are treated as neutral.

3.33 While provision is made for efficiency discounts, none are employed – efficiency gains for the Council are deemed to come from the provider being able to limit the impact of inflation for operating costs at a level below what the Council could achieve. This is deliberate as our intention is find the "tipping point" where the retention option may no longer be viable for SIC.

3.34 The model at Appendix G assumes the Council could still generate income at the prevailing RPI but limit operating costs to 0.7% less than this rate. Even on this modest basis, an NPV is generated over 37 years of £105,407,152 and a real terms cash balance of £280,810,451. This is similar to the status quo position.

3.35 Our analysis suggests potential outsourcing of operational delivery may have financial merit. SIC could retain the income generating assets of the Port but potentially mitigate the cost risk of an in-house workforce and 24/7 operation.

3.36 Our basic calculations show a broad equivalent NPV as the status quo even accounting for high set-up costs and no efficiency payback (other than being able to mitigate the effects of inflation and its impact on SIC). Even introducing a 1% efficiency gain per annum, greatly increases the NPV value – it is very sensitive to change. This suggests scope exists for sizeable savings although we recognise finding an appropriate provider who can deliver the same standards (or higher) at lower cost, is key to a successful arrangement.

3.37 Outsourcing is deemed to cost the same to implement as a straight sale and assumed to be in place by the end of 2016/17. The timescale and set-up costs recognise public sector outsourcing is always expensive, time consuming and fraught with Union issues regarding future pay, conditions and pensions.

Sale and Leaseback

3.38 Another option we considered is the sale and leaseback of existing assets to a Finance House – operational delivery would remain with the Council. It is expected land and major assets such as Tug boats etc may be of interest to financial institutions especially owing to the long income generation period of 37 years.

3.39 Again, our intention is to find the point where the benefits of the option may outweigh the status quo in financial terms. To find an approximate match the following assumptions were made in the model at Appendix H.

- Sale value set at 50% of existing asset ledger cost;
- Inflation and discount factors same as other Council focused models;
- Lease payments set at 5% of capital value each year and increased in line with inflation (2%) – assume CPI.
- Asset sale at end of 2016/17 and arrangement costs assumed to be 25% of outright sale/outsourcing models – estimated at £250,000 before inflation. In reality, would expect costs to be much less.
- Council retains income and delivery operation – assets sold to Finance House in return for making lease payments over 30 years.

3.40 It is assumed a lower sale value will be achieved than simply the net book value on the asset ledger as most assets are operational with heavy use. It is recognised that this may be more than offset by Sullom Voe land value that currently only shows a nominal £22 value in the ledger.

3.41 Not much information exists on typical arrangement fees for sale and leaseback deals principally because the deals are commercially sensitive. We have deliberately overstated the expected cost and timescale in order to be prudent and provide ample time for negotiations.

3.42 The 37 year NPV of the model is £104,028,657 with real terms cash balances of £276,882,603. This indicates a 30 year sale and leaseback arrangement is similar in financial terms to the status quo if sale proceeds of at least £20M (current prices) can be secured from the arrangement and lease payments do not exceed 5% of the capital proceeds. Moreover, inflation should not exceed a rate such as the long term CPI rate of 2%.

Summary Comparisons and Overall View

3.43 Our results indicate the status quo option is financially advantageous to SIC especially when compared against the outright sale model.

3.44 However, financial advantages (potentially) can be matched when considering alternatives such as outsourcing and asset sale and leaseback. These options may be worth investigating further beyond these initial tentative calculations, although realistic consideration will be dependant on finding suitable partners who are willing to get involved/invest.

3.45 Our calculations in summary form are shown below.

Option	NPV (£)	Real Terms Cash Balance (£)	Option V Status Quo "Tipping Point"
Status Quo (BASE)	103,172,212	274,349,435	NPV based on existing SIC assumptions (adjusted by SOLACE).
Outright Sale	76,434,060	191,778,152	Sale proceeds need to be in excess of £103M to make an outright sale worthwhile.
Outsourcing of Operations	105,407,152	280,810,451	Income generating assets retained but operation outsourced with

			0.7% annual inflation "efficiency"
Sale and Leaseback	104,028,657	276,882,603	SIC retain operation but sell assets. Capital receipt of at least £20M needs to be secured. Lease payments must not exceed 5% of capital sum and increases limited to long-term CPI of 2%.

4. Conclusions and Recommendations

Conclusions

4.1 In terms of arithmetic operation, the SIC model is correctly constituted and properly calculates income, expenditure, provisions and surpluses/deficits over the life of the Port. It is fit for purpose in terms of a monitoring system and for updating the MTFP.

4.2 We have identified some differences between our version of the model and the Council's. They need further investigation as they have a material effect on the financial outcome over the 37 year period.

4.3 Adjustments made in the SIC model use an equalisation account to set aside provisions from early years profits to provide for later year losses. The provision calculations have been correctly made.

4.4 The status quo option generates considerable Cashflow for SIC but is vulnerable to changes in inflation and tanker number throughput.

4.5 A number of options were considered and compared against the status quo on a commercial DCF basis. On a straight comparison of retention v outright sale, sale proceeds would need to be in excess of £103M to make it worthwhile contemplating disposal. Based on existing Cashflow and business valuation practices, a sale value of this level is unlikely to be achieved.

4.6 However, fairly modest terms for outsourcing and sale and leaseback options appear to deliver similar financial outcomes to that of the status quo. These options could be investigated further taking all factors into account – not just financial terms.

Recommendations

4.7 The differences between the Council and SOLACE versions of the model should be examined closely and changes made if necessary to the Council version in order that the MTFP accurately represents income from the Port.

4.8 Consideration should be given to creating an earmarked, equalisation account reserve so movements can be formally monitored. It is usual for such reserves to be cash-backed and interest added as the size of the fund grows. This approach could also be extended to provide for future decommissioning costs.

4.9 Detailed calculations involving the status quo model, indicate key sensitivity in terms of inflation (and the relationship between income and cost inflation) and tanker number throughput. Continued close monitoring of inflation and tanker numbers is needed to ensure adverse trends are identified and planned for. This will ensure the MTFP always uses the most reliable future estimates.

4.10 Based on our calculations, the status quo still makes perfect financial sense for SIC. The income from this source will continue to bring many financial benefits over the coming years.

4.11 Nevertheless, our preliminary work here suggests either outsourcing or sale and leaseback arrangements may offer a better payback if generous terms can be agreed (our "tipping point" calculations use modest assumptions of the likely financial benefits). In terms of outsourcing, this may mean efficiency gains being passed back in the form of lower management fees. In the case of sale and leaseback - a higher cash sum for existing assets that can be invested at high rates of return (5.75%). If SIC intends to explore this further, then some basic informal steps can be taken now to identify potential partners or investors. If this proves fruitful, then a formal feasibility study or outline business case should be considered to test viability.

4.12 Any feasibility study or business case should investigate option variations. For example, outsourcing can take many forms depending on how it is structured. This includes the operation of assets as well as service delivery - much like a long-term franchise agreement. The various permutations should be explored if the Council decide to take further steps in this area.

Shetland Islands Council

Practical Considerations of Status Quo v Sale Options for Sullom Voe

A Brief Supplementary Report by

SOLACE ENTERPRISES

June 2014

Likely "Real World" Decision Making when Considering Retention v Sale

OVERVIEW

1. This report is supplementary to our recent analysis on the various financial outcomes for the Port at Sullom Voe.
2. It arises from discussions and subsequent emails with the Chief Financial Officer of the Council.
3. The original main report presented the results of potential options on a commercial basis. This used the concept of Net Present Value (NPV) and Discounted Cash Flows (DCF) to arrive at a value for each option presented at today's values. The advantage of this approach is it allows options to be considered on a consistent basis so the most financially advantageous decision can be selected.
4. While the approach is robust, sound and in line with commercial investment appraisal techniques, it does not take a "real world" view of how the various returns will be invested in Shetland Islands Council (SIC).
5. Therefore, we have undertaken some additional work to establish the financial outcomes of comparing the Status Quo v Sale options based on how surpluses will be invested by SIC.
6. Two specific aspects have been brought into the overall financial picture:-
   - **Status Quo Option**: Assume surpluses from the Harbour Account are spent in full in the year in which they are generated; and
   - **Sale Option**: If the Port is sold for c£72m, proceeds would be invested with fund managers to generate an average return on capital of 7.3%. Of the 7.3% generated each year, 2.5% is set aside for inflation, and the balance (equivalent of 4.8% return on capital each year) would be spent. Also, the Council wouldn't spend any of the c£72m sale proceeds.
7. The revised modelling work uses a slightly higher discount rate of 7.3% (in line with the return on capital rate) and 2.5% for real terms calculations.

STATUS QUO OPTION: SURPLUSES SPENT IN FULL

8. A revised Appendix B model has been produced showing the NPV position if all surpluses generated are spent in the year they are earned (this includes "spend" on the creation of an Equalisation Account). On this basis, a negative NPV of £14.5m arises (see worksheet "Sullom Voe Model"). The NPV represents the discounted value of cash deficits arising from 2039/40 onwards totalling £154.1m.

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9. In terms of the funding position (see worksheet "Cash Funding" in Appendix B), it's effectively neutral for the Council. No interest is receivable as surpluses are spent as they are earned. No interest is payable as it is assumed the Equalisation Reserve will be utilised to finance deficits in later years. In reality, the situation is more complex, but a simple position is outlined here for ease of calculation.

10. Cash Investment in Council services is £101.8m over the period in real terms (includes adjustments for future deficits funded from the Equalisation Account).

11. A list of assumptions is also contained in the "Cash Funding" worksheet along with calculations of the investment in Council services (expressed in cash and real terms).

SALE OPTION: PROCEEDS RETAINED BUT 4.8% NET FUNDS MANAGER RETURN SPENT

12. A revised Appendix F model highlights if the Port is sold for £71.7m and proceeds are invested with fund managers to generate an average return on capital of 7.3%. Of the 7.3% generated each year, 2.5% is set aside for inflation cover, and the balance - equivalent of 4.8% return on capital each year – is spent on Council services. Moreover, the Council wouldn't spend any of the £71.7m in capital – in other words it is retained in real terms value.

13. In contrast to the status quo, a positive NPV is generated of £12.2m. This approach also allows for a real terms investment of £126.2m in Council services while retaining the real terms value of the original sales proceeds (£71.7m).

14. Again, worksheets "Sullom Voe Model" and "Cash Funding" contain the relevant detail and assumptions made.

CONCLUSION

15. These latest calculations take the previous financial outcomes and consider the results in the context of the "real world" workings of the Council.

16. On the basis of likely reality and on purely financial terms - selling Sullom Voe, investing the proceeds and spending the net investment return (after inflation proofing) on Council services, results in a better financial outcome than retaining the Port and spending all annual surpluses on services.

17. As the Council intends to use an Equalisation Reserve to provide for future deficits, the cash impact is neutral on the status quo basis over the period.

18. In contrast, the sale option is able to fund Council services in real terms of

£126.2M over 37 years (against £101.8m for the status quo) while retaining a real terms cash balance of £71.7m throughout (the original value of the sale proceeds).