

FAREHAM

BOROUGH COUNCIL

Report to the Executive for Decision

07 March 2022

Portfolio:	Policy and Resources
Subject:	Daedalus Financial Strategy
Report of:	Deputy Chief Executive Officer
Corporate Priorities:	A Dynamic, Prudent and Progressive Council

Purpose: To establish a financial framework for the operation and investment at Solent Airport and the wider Daedalus site, in support of the Council's Vision for Daedalus.

Executive summary:

The Council has an adopted vision and strategy for Daedalus, which not only sets the ambitions for Solent Airport, but also for unlocking the potential of the airfield's land and infrastructure assets for new commercial development. With the scale of investment required to deliver the Vision, a set of financial principles have been developed to assist with investment decisions and operational cost management.

A draft financial strategy has been prepared, (set out in Appendix A), and has been modelled over the medium term to assess the revenue and capital implications.

The forecasts indicate that operational activities at Daedalus have the ability of being financially sustainable in the longer term and providing a return to the General Fund for the investment made in the site.

Equally, it is anticipated that there are sufficient capital resources to support the proposed investment plan at Daedalus, although in the short term there will need to be some careful consideration of the implications of reinvesting capital resources in Daedalus for the operating position.

Recommendations:

It is recommended that the Executive:

1. Approves the draft Daedalus Financial Strategy, as set out in Appendix A;
2. Incorporates the strategy into the Council's Medium Term Financial Strategy at its next review.

Reason:

To ensure that the operations at Daedalus are financial sustainable, and that investment proposals are affordable.

Cost of proposals:

None.

Appendices:

A: Draft Daedalus Financial Strategy

Background papers: File of Working Papers

Reference papers: n/a

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Executive Briefing Paper

Date:	07 March 2022
Subject:	Daedalus Financial Strategy
Briefing by:	Deputy Chief Executive Officer
Portfolio:	Policy and Resources

INTRODUCTION

1. In March 2015, Fareham Borough Council acquired the Daedalus site. A Vision and Strategy for its regeneration was developed in the same year and this was further updated in 2018. The Vision is comprehensive and extends across the whole 369-acre site, incorporating not only the airport itself but also unlocking the potential of the airfield's land and infrastructure assets for new commercial development, providing clusters for aviation and non-aviation employment and skills, training and innovation activity areas alongside the Council's partners in the Solent Enterprise Zone. Specifically, the objective for the airfield was to attract more corporate and commercial aviation activities and to be financially self-sustaining.
2. Given the scale and ambition of the vision for Daedalus and Solent Airport, a set of financial principles have been developed to assist with investment decisions and cost management at the site.
3. This report sets out the draft financial strategy for Daedalus which, if approved, will be embedded in the Council's Medium Term Financial Strategy.

DAEDALUS FINANCIAL POSITION

4. The Council recognised that Daedalus is a very significant site, which presents great opportunities to deliver jobs, economic and skills growth, and public amenities, within the borough. To achieve this vision, a significant level of capital investment is required, and good progress has already been made in this regard, with Council-led developments totalling nearly £28m, including
 - Fareham Innovation Centre,
 - Runway improvements,
 - Business and General Aviation Hangars
 - Commercial Units at Faraday Business Park

5. Provision of site-wide infrastructure (roads, utilities, etc) has also enabled numerous third-party developments, including three education facilities, IFA2 and 3 new business units.
6. The Vision for Daedalus set an ambitious objective to achieve a self-sustaining financial position at Daedalus and, prior to the COVID pandemic, good progress was made towards achieving this goal. Like all services, the pandemic impacted on the financial performance at Daedalus, but by working with businesses throughout the pandemic period, the longer-term financial interests were protected with only one tenant ceasing to trade in that time.
7. The table, below, sets out the forecast financial position at Daedalus for the current year, together with the approved budget for 2022/23.

	£'s	Forecast position 2021/22	Budget 2022/23
Airside Activities			
- Income (incl. service charges recovered)		(1,070,420)	(1,208,480)
- Expenditure		1,394,750	1,500,190
NET Expenditure		324,330	291,710
Non-Airside Activities			
- Income (incl. service charges recovered)		(948,640)	(734,180)
- Expenditure		477,280	601,550
NET Income		(471,360)	(132,630)
OVERALL POSITION (inc)/exp		(147,030)	159,080

8. As can be seen, the current financial year indicates a small surplus being achieved, largely reflecting receipt of rental income for the duration of the IFA2 development. While the 2022/23 budget indicates a small in-year deficit, this assumes that the Council will dispose of at least one income-generating asset in the year. As a result, while service income reduces, the resulting capital receipt would be available for new capital investment, or for investing in treasury funds to generate a long-term interest stream.

DAEDALUS FINANCIAL STRATEGY

9. The wide range of opportunities, and risks, associated with Daedalus mean that the financial performance could generate a significant financial benefit to the Council, and could equally create a revenue or capital burden on the Council's financial resources.
10. In developing the financial strategy for Daedalus, the following guiding principles have been applied:-
 - a) The Council will recognise the three distinct elements of Daedalus in shaping the strategy; these being the Airside activities, Business Park activities, and Community facilities.
 - b) While there may be variations from year to year, Daedalus should be financially self-sustaining in both capital and revenue terms over the long term. This will ensure that activities at Daedalus (other than community facilities) are not a financial burden on the General Fund and council tax.

- c) Applying the “user pays” principle, the cost of airside operations should be recouped through airside fees and charges, as far as reasonably possible. It is, however, recognised that the airside activities are likely to require some ongoing financial support from non-airside activities.
 - d) Non-airside activities are recognised as a corporate investment asset, and should therefore generate a return for the General Fund as well as sufficient income to offset any ongoing airside deficit
 - e) Capital investments in Daedalus infrastructure/facilities should be funded from available capital resources generated from the Daedalus site.
 - f) Prudential borrowing could be available to finance commercial property investments at Daedalus, where they meet the appropriate criteria.
 - g) All capital expenditure will be subject to a robust business case and risk assessment.
11. These principles have been used to develop the draft Financial Strategy, set out in Appendix A. The aim of the strategy is to provide a financial framework within which decisions can be made to enable the necessary investment in the strategic site while protecting the overall financial position of the Council

FINANCIAL IMPLICATIONS

12. The strategy principles have been applied to the current and future operations at Daedalus to assess whether a longer-term sustainable position can be achieved. The results are set out in the table below.

£000's	Budget 2022/23	Forecast 2023/24	Forecast 2024/25	Forecast 2025/26
Airside Activities				
- Income (incl. service charges recovered)	(1,208)	(1,263)	(1,315)	(1,369)
- Expenditure	1,500	1,512	1,524	1,538
NET Expenditure	292	249	209	169
Non-Airside Activities				
- Income (incl. service charges recovered)	(734)	(878)	(860)	(860)
- Expenditure	601	529	541	553
NET Income	(133)	(349)	(319)	(308)
OVERALL POSITION (inc)/exp	159	(100)	(110)	(139)
<i>Note: Investment interest growth due to plot/asset sales</i>	+(87)	+(113)	+(113)	+(113)

13. The forecast takes account of assumed site development, growth in usage of the facilities, as well as assumed plot and building sales. It also assumes a steady increase to full occupation of commercial property over the strategy period.

14. As previously noted, the forecast also takes account of an assumed building sale in 2022/23, which results in a short-term reduction in income (thus producing a small net deficit in year). This will be mitigated in part through retaining the balance of Daedalus capital receipts and investing them in longer term treasury funds, to increase the Council's investment income.
15. This forecast demonstrates that the site as a whole is affordable and has the ability to generate sufficient resources to support the ongoing operations and maintenance as well as a reasonable prospect of achieving a return on investment in the longer term.
16. Separate modelling has been undertaken to assess the availability of capital resources to support continued investment to deliver the vision for Daedalus. Capital forecasting is inherently more challenging as assumptions are made in relation to plot and property sales, which are heavily influenced by market pressures and demands. It also takes account of the potential to recover costs in part through service charge arrangements, which reduces the demand on the Council's resources but conversely impacts on tenants' total occupation costs where charges are levied.

SUMMARY CAPITAL POSITION £000	2022/23	2023/24	2024/25	2025/26	2026/27
Forecast Capital Resources available	6,277	847	4,921	1,424	1,124
Daedalus Investment Programme	-1,300	-2,600	-1,000	-200	-1,000
Shortfall (-) / Surplus (+) Capital resources	4,977	-1,753	3,921	1,224	124
<i>Cumulative shortfall (-) / surplus (+)</i>	<i>4,977</i>	<i>3,224</i>	<i>7,145</i>	<i>8,369</i>	<i>8,493</i>
Revenue Shortfall to be Funded (prior to investment interest growth)	-272	-272	-272	-272	-272

17. An important point to note from the capital forecasting is the interplay between capital and revenue resources. Typically, the forecast capital receipts are achieved from the sale of income generating assets, and therefore each sale has the effect of reducing revenue income. This can be partly offset by placing the receipt in treasury funds to generate interest and mitigate the impact, but this would limit the ability of the Council to deliver its investment plan for the site.
18. Careful consideration will therefore be required when assessing asset and plot sales, to ensure that the decision does not create an unaffordable revenue pressure, or equally does not undermine the ability to fund future capital investment plans.
19. Forecast indicates enough resources to fund the investment plan in the longer term, but this would leave insufficient balance for treasury investments. If the revenue position were protected, then the investment plan would need to be deferred, or alternative revenue/capital source found in the short term.

CONCLUSION

20. The Council has set an ambitious vision for Daedalus, and the extensive financial modelling undertaken has demonstrated that the site has the ability to achieve a financially sustainable position in revenue terms. It is also clear that there are sufficient capital resources in the longer term to finance the capital investment plans at Daedalus, although this is heavily affected by market sentiment and demand for plots and units at Daedalus.

21. The short-term forecast indicates that there is a competing pressure between protecting the revenue position and providing enough capital resources to fund the proposed investment plan. Decisions will therefore need to prioritise these issues or identify alternative sources of income (capital or revenue), to achieve all element in the desired timeframe.

Enquiries:

For further information on this report please contact Caroline Hancock, Finance Manager.
(Ext 4589)

Daedalus Financial Strategy

Purpose

The purpose of this document is to set out a framework that will determine the Council's approach to managing the financial implications of its interest in the Daedalus site, reflecting the ongoing revenue position and capital investment requirements both on the airside and non-airside areas.

Overarching Strategy

The overarching principle is that the Council's interest in the whole Daedalus site should make a sustained positive contribution to the Council's overall financial position. As a minimum, the revenue costs associated with operating and investing in Daedalus should be cost neutral to council taxpayers.

AIRSIDE ACTIVITIES

Airport Operations

It is recognised that airport operations will always run at a deficit. However, the cost of operating the airport will be offset in the following ways:-

- Fees and charges for airport users, set at a level which reflects the aviation market, and are commensurate with the facilities available and location of the airfield on the South coast;
- Service charges for airport tenants;
- Net rents from airside properties.

Any residual cost of airport operations, including ad-hoc repairs and maintenance, will be funded net income from non-airside activities.

Airside commercial property

Rents derived from airside property will be set at market levels, commensurate with the standard and quality of the buildings.

- The first priority for rental income will be to repay the Council's cost of financing the capital investment in the airport (including the financing of the hangars/buildings).
- The second priority for rental income will be to offset any operating costs incurred by the Council that cannot be recovered through service charges, including any "ownership" costs of the airport (such as hangar marketing costs).
- The balance of airside property rents will be available to finance the cost of repairs, maintenance and new airside infrastructure investment.
- Once sufficient contribution to airside operating and investment plans, the balance of revenue will be treated as a corporate income source, like all other commercial property.

Airside tenants will pay an airside service charge, that will seek to recover full airport estate costs, and will be calculated in line with professionally recognised service charge protocols. This will also provide for contributions to a Sinking Fund where that is deemed appropriate.

Investment in Airside Infrastructure

The following principles will apply when considering investment in new airside property and infrastructure.

- *Airside property:* Supported by a full business case, investment proposals must be affordable, provide a return on investment within acceptable timeframes (e.g. not more than 50% of the assets useful life) and align with the Council's "cautious" risk appetite to commercial property.
- *Airside Infrastructure:* Also supported by a full business case, all proposals will clearly articulate the initial cost of the investment, the impact on operating costs and the potential to generate further revenue.
- Where airside investment is funded by prudential debt finance, then it must be fully self-sustaining (i.e. through new revenue generation or through airside property rental surpluses) and will be limited to the capitalised value of forecast net airside surpluses.
- The Council may consider using capital receipts to invest in airside infrastructure, but the extent of this will be limited to the value of capital receipts generated at the Daedalus site. Use of capital receipts for such projects will be considered alongside other corporate capital priority schemes in other services (such as community and leisure facilities) when the annual capital programme is approved.

NON-AIRSIDE BUSINESS PARKS AND FACILITIES

Non-airside activities

Beyond Solent Airport, the Daedalus site includes business parks, education and innovation space, community space and the associated infrastructure.

Community uses

Community spaces (such as play areas, Daedalus Common, Gate Guardian, etc) will be managed as part of the relevant portfolio, such as Community, or Streetscene. As such they do not fall within the remit of the Daedalus Financial Strategy.

Investment in non-Airside Property and Infrastructure

The general principle is that investment in non-airside commercial property is treated in the same way as FBC's wider commercial property portfolio. This means that net rents generated from non-airside property will reside within the General Fund Commercial Estates Service.

- Rents derived from commercial property will be set at market levels, commensurate with the standard and quality of the buildings.
- Rental income will be used to cover the Council's full cost of financing the capital investment in the non-airside estate, and will also offset any operating costs incurred

by the Council that cannot be recovered through service charges, including any “ownership” costs of the airport (such as commercial property marketing costs).

- Non-airside property rents will not be ring-fenced for reinvestment in the Daedalus site.
- Supported by a full business case, new property investment proposals must be affordable, provide a positive return on investment within acceptable timeframes and must align with the Council’s “cautious” risk appetite to commercial property. (For example, rental property may need to achieve a payback period of not more than 50% of the assets useful life).
- Also supported by a full business case, infrastructure investment proposals will clearly articulate the initial cost of the investment, the impact on operating costs and the potential to generate further revenue.
- Council-led development will only be considered where there is clear, evidenced, demand in the market, and the approach to letting or disposal of units will be driven by market conditions in order to minimise the Council’s risk profile.

Disposal of land and property interests in the business parks

There will be circumstances where the Council decides to dispose of parcels of land, or particular properties, at Daedalus. When this is considered appropriate, disposal will be treated in the same way as all other council-owned property interests.

- Land and property disposals at Daedalus will be at prevailing market rates.
- Capital receipts derived from the disposal will be recognised as a corporate capital resource, available to finance all aspect of the corporate capital programme and will not be ring-fenced for any specific site or purpose.
- New capital investment in Daedalus may draw from capital receipts but will be evaluated alongside other corporate projects in the General Fund when the Council approves the capital programme annually.

THE CORPORATE PICTURE

Treasury Management

The Council’s capacity to borrow money to finance new development is finite, and this is approved each year within the Treasury Management Strategy. Consequently, an overview of borrowing capacity is maintained, to ensure that the Council does not breach its borrowing limits and its debt-financing capacity is appropriately reflects the demands from all portfolio services (such as leisure services, housing, etc)

So, notwithstanding the viability of any proposal at Daedalus, it is recognised that the corporate borrowing capacity may constrain the Council’s ability to invest further in new developments at Daedalus.

Reporting

Monitoring and reporting the financial performance at Daedalus will reflect the principles within this strategy, recognising the Airport cluster, (non-airside) business park cluster and the overall performance across the site.

Financial monitoring will also recognise the obligations of the Council, in relation to the original acquisition agreement with the Homes and Communities Agency at the time. This includes overage obligations if financial performance exceeds pre-determined levels.

Strategy Review

Daedalus is a key Council-owned site, and the scale of investment there is significant. This strategy will therefore form a key pillar to the Council-wide Medium-Term Finance Strategy, and Capital Strategy, and as such will be kept under periodic review. This may lead to a greater focus on generating capital resources, or alternatively revenue income, depending on the needs of the Council.