



Two appendices are included in this report which are not for publication under the Council's Access to Information Procedure Rules 10.4 (3)

Report of the Director of Development

Executive Board

Date: 4 April 2007

Subject: **LEEDS CITY COUNCIL'S SHAREHOLDING IN LEEDS BRADFORD INTERNATIONAL AIRPORT**

Electoral Wards Affected:

Citywide

Specific Implications For:

Equality and Diversity

Community Cohesion

Narrowing the Gap

Eligible for Call In

Not Eligible for Call In
(Details contained in the report)

EXECUTIVE SUMMARY

This report updates Members on the progress made with the sale of Leeds Bradford International Airport (LBIA) Limited through to the receipt and evaluation of the binding offers received.

Based on the offers received, officers are able to recommend a preferred and reserve bidder which, should Members select, should lead to the completion of a 100% disposal of the share capital in LBIA in April/May 2007.

1.0 PURPOSE OF THIS REPORT

- 1.1 To advise Members on the progress made with the sale of 100% of the share capital in the Leeds Bradford International Airport (LBIA) Limited and to gain Members' approval to the selection of a preferred and reserve bidder for the transaction to enable officers to complete the disposal.
- 1.2 This report is marked exempt from Call In on the basis that Leeds took the in principle decision to dispose of its shares in the airport on the 20 September 2006, which was subject to the Council's Call In procedures. The proposal in detail, which is contained in this report, does not vary from the decision in principle made by Executive Board on the 20th September 2006. Under the Leeds Constitution a decision may be declared as being exempt from Call In if it is considered that any delay would seriously prejudice the Council's or the public's interest. Members will be aware that this is a multi-party transaction involving five independent shareholders. Officers have been advised by our retained advisors (Ernst and Young) that there has to be a clear process for achieving finality to the sale proceedings and the absence of a tight transaction structure could be seriously prejudicial to the process and the shareholders' ability to achieve financial close and receive the optimum financial return for their shares.
- 1.3 Attached to this report are two confidential appendices which review the best and final offers made for the purchase of 100% of the share capital in LBIA Ltd. It is considered that the public interest in maintaining this information as exempt, outweighs the public interest in disclosing this information, as disclosure may prejudice the outcome of the disposal and the financial return to the shareholders. Accordingly, this information is marked as confidential as part of the Council's Access to Information Procedure Rules 10.4 (3).

2.0 BACKGROUND INFORMATION

- 2.1 Members will recall that on 20 September 2006 Leeds City Council agreed to participate in a 100% disposal of the share capital in LBIA Limited in conjunction with the other West Yorkshire districts. By 5 October 2006, all of the shareholders in the company had agreed to a 100% disposal. Specifically, the resolutions made by Executive Board on 20 September 2006 were as follows:
- (a) That approval be given to the proposal that Leeds City Council will, subject to the agreement of the other West Yorkshire Districts, participate in the disposal of 100% of shares in the Leeds Bradford International Airport Company and, subject to the agreement of the four other West Yorkshire districts, instruct officers to progress such disposal in a timely manner.
 - (b) That in the event that not all of the five shareholders agree to participate in a 100% disposal, Leeds City Council participate in a share disposal of 60% or more in the Airport Company, on the basis that Leeds City Council would sell 100% of its interest in LBIA.
 - (c) That officers of the five West Yorkshire districts draw upon the objectives detailed in the report to determine the criteria to be used in the future assessment of the submitted bids.

- (d) That approval, subject to proper consultation and compliance with legal requirements, be given to the proposal that bidders will be asked to implement pension arrangements that grant, for existing employees, fully equivalent pension benefits to the existing Local Government Pension Scheme and offer new employees, at the option of the new owner, membership of a final salary scheme, or a money purchase scheme.
- (e) That the proposal that bidders, as part of their submissions, be asked to explain their company culture with regard to staff retention, development and incentivisation be approved.
- (f) That any land owned by the five West Yorkshire districts which lies within the Airport's Operational Boundary be included with the disposal of the Airport Company, and that officers be given delegated authority to determine whether it is appropriate to also include other five districts' land which is in the vicinity of the Airport Operational Boundary in the disposal, subject, as always, to the requirement to achieve best consideration.
- (g) That a report seeking endorsement of the preferred bidder identified and the acceptance of the best and final offer made, to enable the transaction to be completed, be brought to a future meeting of the Board.
- (h) That the scale of the potential receipt that could accrue to the Council from a share disposal of Leeds Bradford International Airport be noted.
- (i) That approval be given to the Ernst and Young LLP scales of fees that will be incurred during the three phases of the disposal exercise and which will be charged to the purchaser upon completion of the transaction, and that the Director of Development be authorised to select that fee structure which best incentivises the consultants to optimise the disposal proceeds.

3.0 MAIN POINTS

3.1 The Sale Process

- 3.1.1 Following the resolution of Executive Board, the sale of LBIA was formally advertised in the Financial Times on 14 November 2006. As expected, a significant level of interest was received from wide of range of prospective purchasers on an international basis. In total, more than 60 Expressions of Interest were made from established airport operators, private equity organisations, investment banks, infrastructure management companies and other investors.
- 3.1.2 The Expressions of Interest resulted in 16 consortia making pre-qualification submissions. These submissions required organisations amongst other requirements to demonstrate their:
 - financial capability to participate in a transaction of this size. Specifically, organisations had to demonstrate that they had net assets or funds under management of at least £100m, or an appropriate credit rating.
 - quality as a prospective operator of LBIA by stating their past experience of developing an investment of this type, their strategic rationale for wishing to purchase LBIA and a statement on the organisation's ability to add value to the airport's future development.

- 3.1.3 In accordance with the delegated authority afforded by Members and following a detailed evaluation of the 16 pre-qualification submissions by Ernst & Young LLP and DLA Piper, the Project Board selected 9 bidders for the indicative bid phase of the transaction.
- 3.1.4 On 11 December 2006, the nine organisations selected were asked to submit indicative bids and complementary business plans. These organisations were provided with an Information Memorandum outlining the current operation of the business and management's projections for its future development. In addition, specialist transport consultants, Halcrow, assisted the airport's management to review and revise the airport's business plan to 2016. LBIA management's business plan was also provided to the 9 selected bidders for this phase of the transaction. Indicative bid submissions were required by 11 January 2007. Following the submission deadline, indicative bids were further evaluated by Ernst & Young LLP and DLA Piper and, again in accordance with the delegated authority afforded by Members, five bidders were selected by the Project Board to submit binding offers.
- 3.1.5 The five organisations selected and presented in alphabetical order were:
- ABN AMRO-Infrastructure, an infrastructure fund of the Dutch investment bank, with Faros Investment Partners, a specialist airport management company. This bidder also has strategic support from the First Bus Group.
 - Barclays Private Equity infrastructure fund (who have held an interest in Luton Airport in the past) with Churchill Airports, a specialist airport management company.
 - Bridgepoint infrastructure fund, who were involved in the original privatisation of Birmingham International Airport.
 - Regional and City Airports led by Balfour Beatty, who recently bought Exeter Airport with infrastructure fund Galaxy, and airport operators Koln Bonn and AerRianta.
 - TBI, who have interests in Luton, Cardiff and Belfast International airports and are 90% owned by Abertis, a large Spanish transport and infrastructure group based in Barcelona who have airport interests in the USA and Latin America.
- 3.1.6 The five shortlisted bidders identified above were provided with financial, legal and technical Vendor Due Diligence (VDD) reports by PricewaterhouseCoopers (PwC), which were procured by Leeds City Council on behalf of all of the shareholding authorities. Although commissioning this piece of work by PwC the shareholders have no control over the content of the due diligence report, as this is prepared on a totally objective basis by PwC for the benefit of the bidders. This information was disclosed to the shortlisted bidders to enable them to make binding offers with sufficient information, based on an understanding on how the business works currently and its opportunities to develop in the future. In addition, all shortlisted bidders had been afforded the opportunity for accompanied tours of the airport facilities which included a presentation on the future of the Airport by its Managing Director and the opportunity for a question and answer session with the senior management team.
- 3.1.7 Binding offers were received on 7 March 2007 and evaluated prior to their consideration by the Project Board for the transaction on 14 March 2007.

3.1.8 As previously agreed by the Executive Board, the binding offers have been evaluated against the shareholders' established objectives for this transaction, with an 80% weighting on financial considerations and 20% on socio-economic/employment considerations as outlined below:

	Evaluation Parameter		Maximum Score
1.	Financial Considerations	(a) Financial Offer	70
		(b) Transaction Certainty	10
2.	Business Plan and Pension Commitments	(a) the extent, scope and relevance of investment projects (in particular, over the next five year period)	8
		(b) the extent, scope and relevance of proposals for the growth in passenger traffic and development of new routes and destinations	8
		(c) the deliverability of pension commitments	4

3.1.9 Up to 15 marks could be deducted based on the legal submission – in particular the comment on and extent of changes proposed to the Share Purchase Agreement.

3.1.10 Following a full evaluation process, the officer Project Board for the transaction has recommended a preferred bidder and a reserve bidder for shareholder approval. The outcome of the evaluation process is detailed in the confidential Appendix 1 with the bidders identities withheld at this time due to the significant commercial sensitivity attached to this transaction. The identification of the bidders will be circulated at the meeting.

3.2 Transaction Structure

3.2.1 This transaction has been structured to enable prospective purchasers to bid for LBIA Ltd as a cash and debt free company. The new purchaser will have an unencumbered debt position and thereby have a free hand to be able to gear the level of borrowing by the company to a level that they consider to be appropriate. All existing loans, debentures and pension deficits are to be settled by the incoming purchaser, although the cost of doing this will be netted off against the receipt due to the local authority shareholders.

3.2.2 The airport company currently has nine loans from the Public Works Loans Board through the auspices of Leeds City Council with maturity dates ranging from 2013 to 2023. The current sums outstanding are £4.6m. In addition to this sum, an early repayment premium will also be due at a cost of approximately £1.4m.

- 3.2.3 LBIA also has 6 debenture loans from the West Yorkshire districts amounting to £1.5m which started in 1987. These debentures mature between 2007 and 2013.
- 3.2.4 From the pension perspective, LBIA has admitted body status with the West Yorkshire Pension Fund. However, once the sale of 100% of the share capital in the company has taken place, this admitted body status will have to cease. Under the tender conditions, the new owner is required to put in place from completion of the sale a replacement pension scheme for existing employees which is certified by the Government's Actuary Department to provide equivalent benefits.
- 3.2.5 The exact scale of the pension deficit will not be fully determined until a closing actuarial valuation for the fund has been finalised. Officers are advised that the final deficit value could take up to a year from financial close to be fully understood. Notwithstanding this point, an initial actuarial estimate was requested by the Project Board and commissioned by the West Yorkshire Pension Fund in February 2007. This initial valuation indicates that the scale of the likely deficit is estimated to be £5.5m assuming that the existing shareholders act as a "guarantor" for the pension deficit. By acting as "guarantor" the shareholders will be agreeing to meet any further shortfall in the LBIA pension fund, in proportion to their existing shareholding, over and above the initial payment of £5.5m highlighted above. For clarity, by acting as "guarantor", the shareholders would have primary and sole liability for these shortfalls. In the absence of the shareholders agreeing to act as "guarantors" the West Yorkshire Pension Fund has indicated that the estimated payment that they would require to cover the deficit in the fund is likely to be c£16m taking account of the longer mortality rates which are likely to apply from April 2007. In determining a one-off payment of c£16m the West Yorkshire Pension Fund will consider a "worst case" scenario and in so doing, could well result in an over-payment by the shareholders. It is therefore not recommended by the Project Board. The airport company also makes compensatory added years payments to the West Yorkshire Pension Fund of circa £45,000 pa. Once the sale has been completed, one of the shareholders will need to meet these ongoing payments to the West Yorkshire Pension Fund and actuarial advice indicates that a lump sum of approximately £800,000 will be needed to meet the annual payments. It is proposed that Leeds City Council agrees to meet this payment on behalf of the other shareholders on the basis that it receives an appropriate lump sum payment from the gross receipt to meet these costs.
- 3.2.6 In addition to the potential pension deficit above, there are six former airport security staff, who were transferred under TUPE to Group 4, who currently are members of the West Yorkshire Pension Fund. Once the transaction has completed, these employees will cease to be members of the West Yorkshire Pension Fund. If LBIA has a legal obligation to meet any pension deficit there could be a further call on the gross offer made for the share, unless another satisfactory solution is agreed. However, at this stage and in the context of the scale of this transaction, the potential deficit/surplus is likely to be small and assuming that shareholders act as guarantor the surplus is currently estimated at £0.145m.

3.2.7 Given that the scale of the shortfall payment that will be required will not be known for some 6 to 12 months after the sale has been completed, it is proposed that the shareholders deposit sufficient funds to cover the estimated shortfall in an escrow account which will be controlled by the shareholders' legal advisors, DLA Piper and the purchaser's legal advisors. Once the final amount due to meet the pension deficit is known, the required payment will be made to the West Yorkshire Pension Fund from the escrow account with any remaining balance being distributed back to the shareholders in proportion to their previous shareholding. Should the funds placed in the escrow account be insufficient to meet the deficit payment due then each shareholder will have to make up the shortfall from their resources, again in proportion to their previous shareholding. It is proposed that the shareholders place £7.5m in an escrow account to meet the pension deficit payment and enter into a legal agreement with the West Yorkshire Pension Fund to act as guarantor for any further pension shortfall in proportion to their previous shareholding.

3.3 Share Purchase Agreement

3.3.1 The sale of the airport and the shareholders' residual interest in its name and operation as an international airport will be governed by the Share Purchase Agreement for this transaction and proposed Special Share rights (see below). There are a number of aspects to this agreement to bring to Members' attention in terms of:

- Covenants;
- Special Share;
- Warranties;
- Completion arrangements;
- Additional consideration;
- Overage; and
- Pensions

3.3.2 **Covenants** – Members will recall that the shareholders' objectives included a requirement that the name of the airport remains as Leeds Bradford International Airport and also that it continues to operate as an international airport. Accordingly, in summary, the purchaser will covenant that:

- the airport will at all times operate under the name 'Leeds Bradford International Airport or Leeds Bradford Airport' and no other names
- the airport maintains at all times sufficient services and facilities at the airport to enable it to continue to operate as an airport for the entry and departure of international air traffic.

3.3.3 **Special share** – The primary mechanism through which the five district councils will govern the adherence to the covenants identified above will be through the retention of a special share, which will be held in trust for the five district councils in proportion to their current shareholding. This special share will allow a representative of the five district councils to attend any future board meeting of LBIA Ltd where there is a proposal to breach the covenants identified and will reserve a right of veto over any such proposals.

- 3.3.4 **Warranties** - As part of any transaction of this nature it is normal for the vendor to provide the purchaser with a series of warranties associated with the sale of share capital in the company. With respect to this transaction the potential scope of the warranties and other related provisions involving any residual liability for the current shareholders are summarised in Confidential Appendix I.
- 3.3.5 **Completion arrangements** – As part of the completion process, all of the existing non-executive directors of LBIA Ltd who make up the Board of Directors of the company will have to resign along with the external auditors of the airport. This is standard practice in transactions of this nature.
- 3.3.6 **Additional Consideration** – Provisions have been included so that material third party disposals of shares of assets will trigger additional consideration for the existing shareholders if they take place within a three year period from completion. The sharing percentage for the existing shareholders are 50% in the first year and 25% for each of years 2 and 3.
- 3.3.7 **Overage** – Appropriate overage provisions have been included in relation to certain areas of land which are not currently within the operational boundary of LBIA but are nevertheless owned by LBIA. These overage provisions are not triggered by defined airport related development.
- 3.3.8 **Pensions** – Each bidder has committed to establishing at completion a GAD approved defined benefit pension scheme for existing employees. Further details are included in Confidential Appendix I.

3.4 **Land Transfer**

- 3.4.1 As previously agreed by Executive Board, the land held by the five districts which sits within the UDP operational boundary of LBIA has been included as part of the disposal. Accordingly, this land, shown pink on Plan A will be transferred into the airport company at completion. For stamp duty purposes, the market value of the sites have been independently assessed, by Lambert Smith Hampton, to be £792,000. However, this value does not constitute an additional consideration over and above the final price for the shares in LBIA on the basis that the land has already been marketed as part of this disposal transaction and all offers have been received on that basis. Appropriate overage provisions have also been provided for.
- 3.4.2 Officers have also considered the status of the option land (coloured pink on Plan B) and its relationship to the short to medium terms development plans for the Airport including drainage requirements, long stay car parking and the potential for a second hotel development. On the basis that the retention of this land by the five districts could prejudice the current or planned development proposals of LBIA, it was considered to be in the Council's best interest at the time of this sale to offer a two year option to the preferred bidder to purchase the sites coloured pink on Plan B. Again the sites are offered at rates independently assessed by Lambert Smith Hampton at a gross value of £2.973m plus RPI, with appropriate overage mechanisms in place to protect any future development gain for uses in addition to those currently permitted. Any decision by the purchaser of the Airport Company to exercise the option will generate this further capital receipt for the shareholders in addition to the price bid for the company.

3.5 The Completion Process

- 3.5.1 Subject to the Executive Board agreeing to the preferred and reserve bidders recommended in this report, on the advice of Ernst & Young officers will seek to achieve completion of the sale before the end of April 2007 as a means of maintaining sufficient competitive tension in the sale process, but in any event will seek to affect completion as soon as is practically possible.
- 3.5.2 Members will recall that LCC has entered into an indemnity agreement with the other shareholders covering the apportionment of fees should the sale not be progressed or be significantly delayed. Consequently, should LCC, in the absence of a shareholder majority, decide to withdraw from this sale process or does not act in a timely fashion which results in the disposal not proceeding, then this authority would be liable for all of the abortive fees expended on this exercise which are outlined in Confidential Appendix II.
- 3.5.3 To enable the completion process to run smoothly a number of work streams will need to be completed. These are:
- **Final Vendor Due Diligence** – in order to give sufficient comfort to the preferred and reserve bidders on due diligence matters associated with the airport, the existing due diligence work is in the process of being updated, again by PwC, and specific financial, legal and technical work also undertaken to resolve bidder queries.
 - **Confirmation of Bid Price** – Once the preferred and reserve bidders have been notified of their selection, they will be given access to the final vendor due diligence reports and the most sensitive commercial information held by the company and it is intended that they be given six working days to confirm their bid price. As part of this process, there is the possibility that in order to ensure the best terms are achieved, the reserve bidder may become the preferred bidder and officers will seek to complete the sale on that basis. This mechanism, which is outlined in Confidential Appendix I, is a key part of maintaining the competitive tension in the completion process.
 - **Completion adjustment** – A working capital adjustment exercise will be monitored by Ernst and Young LLP. This process will ensure that appropriate movements of working capital between the date of a proforma balance sheet (the reference point for the binding bid phase) and the sale being completed are taken into account. Members are asked to note that as a consequence of this process, the final sale price will inevitably vary to some degree due to the normal movement of cash or other working capital in and out of the business on a daily basis.
 - **Executing the sale** – subject to the completion processes identified above running smoothly, it is proposed that nominated officers and deputies representing each of the five shareholders will be given delegated authority to execute the sale of the airport to the preferred or reserve bidder based on the best and final offers presented in this report. For Leeds City Council it is proposed that delegated authority for completing this transaction be given to the Chief Executive, with the Chief Asset Management Officer acting as the nominated deputy.

- **Apportionment of residual liabilities** – An agreement will be entered into between the five districts to regulate the apportionment of liability in relation to any claims that may be made under the share purchase agreement or other legal documents relating to the sale.

3.6 **Communication of this decision**

3.6.1 Given the significance of this decision and the fact that the decision to sell is being decided by five independent shareholders, it is important that the communication of the preferred and reserve bidder is appropriately managed. In particular, it is recognised that airport staff will have an understandable interest to know the identities of the preferred and reserve bidder and it is not considered appropriate to learn the identities of the preferred and reserve bidders through the media. Accordingly, in light of the potential for some shareholders to conclude their deliberation on this matter on the evening of 4 April 2007, the following communication timetable is proposed for Wednesday, 4 April 2007:

TIME	ACTION
09.00 pm	The preferred and reserve bidder informed of their selection
09.30 pm	The identity of the preferred and reserve bidder is communicated by the airport company to the airport staff
10.00 pm	A joint media statement, prepared by LCC on behalf of and approved by the shareholders, is released

3.6.2 For the avoidance of doubt, the information disclosed on 4 April 2007 will include the name of the preferred bidder and the name of the reserve bidder.

3.6.3 The bid prices for the preferred and reserve bidders **will not** be disclosed at this time.

3.7 **Implications For Council Policy And Governance**

3.7.1 Should Members agree to participate in the disposal of 100% of the share capital in Leeds Bradford International Airport, Leeds City Council will no longer have any representation on the Board of the airport company or influence on its operation over and above the rights granted by the special share detailed in paragraph 3.3.3 and through its statutory and regulatory functions.

4.0 **RISK MANAGEMENT**

4.1 Given the scale of this transaction, there are a number of risks for Members to be made aware of.

4.2 Until such a time as the sale is completed, there remains a risk that the transaction may not complete. Should this situation arise, the shareholders would be liable for the fees incurred in proportion to their shareholding and outlined in the confidential Appendix II of this report.

4.3 Given the significant commercial sensitivity attached to this transaction, there is a risk that the disclosure of the financial offers made could seriously impact on the financial return to the shareholders.

- 4.4 Should the disposal be completed, there is the risk that the new owner is not able to deliver their business plan and investment proposals, which in turn could have a negative impact on the future vitality of the airport as a business. Leeds Bradford International Airport has always operated within a commercial environment and in theory has always been exposed to business risks of this type.

5.0 CONCLUSIONS

- 5.1 The marketing of LBIA Ltd has demonstrated that there is significant interest in the purchase of the airport company. The competitive sale process that has been undertaken on behalf of the shareholders has produced a number of high quality bids which have all outlined proposals for capital investment into the airport's infrastructure and produce a receipt which represents a very high multiple of the current earnings of the company.
- 5.2 On the basis of the bids received, a preferred and a reserve bidder has been recommended to Members.

6.0 RECOMMENDATIONS

- 6.1 Members of Executive Board are recommended to:
- 6.1.1 approve the disposal of all of Leeds City Council's share capital in Leeds Bradford International Airport Ltd as part of a 100% share disposal of the airport company to bidder E.
- 6.1.2 authorise the Chief Executive or the Chief Asset Management Officer as the nominated deputy, to complete the transaction in the form outlined in the confidential appendices that are attached to this report.
- 6.1.3 approve that £7.5m from the disposal is placed in an escrow account to meet the potential cost of the pension deficit of Leeds Bradford International Airport Ltd once it leaves the West Yorkshire Pension Fund.
- 6.1.4 approve that the same escrow account meets the potential cost of the pension deficit for security staff transferred under TUPE to Group 4 on the basis set out in the Confidential Appendix 1.
- 6.1.5 approve that Leeds City Council, in conjunction with the other shareholders, acts as one of the "guarantors" underwriting any further pension deficit shortfall in proportion to its previous shareholding and meets the other pension obligations outlined in paragraph 3.2.5 of this report.
- 6.1.6 note the requirement for all non-executive directors of the airport company to step down as part of the transaction process and recommend that Full Council authorises the Chief Executive to effect the removal of the non-executive directors before the transaction completes.
- 6.1.7 approve the proposal set out in paragraph 3.3.3 that a special share is held by Leeds City Council in conjunction with the other four West Yorkshire councils for the purposes outlined in the report.

- 6.1.8 note that, in line with previous delegations, the land held by the five shareholders identified in pink on Plan A is to be sold to the airport company as part of the disposal transaction with overage provision.
- 6.1.9 note that, in line with previous delegations, the end purchaser will be offered a two year option to purchase the land shown pink on Plan B at a value of £2.973m plus RPI with overage provision.
- 6.1.10 authorise the Chief Asset Management Officer to approve the terms of a legal agreement to be entered into with the other shareholders to determine how the apportionment of the residual liabilities will be managed after the signing of the share purchase agreement.
- 6.1.11 authorise that in the event that the preferred bidder changes their bid in a manner which results in the reserve bidder's bid being more economically advantageous, delegate authority to the Chief Executive, with the concurrence of the Leader of the Council, to take any action necessary to secure completion of the disposal in the circumstances outlined in paragraph 4.3 of Appendix I of this report.
- 6.1.12 approve the communication proposals outlined in paragraph 3.6.1.

Background Papers

Outline Business Plans and Pension Proposals of the binding offers of the five shortlisted bidders (these documents have been marked as "confidential" under the Council's Access to Information Rules 10.4 (3)).