

PERTH AND KINROSS COUNCIL**Strategic Policy and Resources Committee****29 November 2017****HARBOUR BUSINESS PLAN
PROGRESS UPDATE****Report by Depute Chief Executive, Chief Operating Officer****PURPOSE OF REPORT**

The purpose of this report is to update the Committee on the delivery of the Perth Harbour Business Plan in light of significant changes to ship movements and asks the Committee to consider the next steps.

1. BACKGROUND / MAIN ISSUES

1.1 As background information, a decision timeline is provided below:

- 12 February 2014 (SP&R 14/52): the Council agreed to market the Council's operational and land interests at Perth Harbour in order to gauge private sector interest in acquiring these. This helped inform the Council in reaching a decision as to how best to maximise the Harbour's contribution to the economic development of Perth & Kinross.
- 25 February 2015 (Council 15/100): the Council agreed that the market has been tested and found to present no financially attractive or strategically prudent proposition to the Council or wider economy. It was agreed that the marketing process be concluded at this stage and the Director (Environment) be instructed to develop proposals for an enterprise transformation programme for the Perth Harbour business within the Council's ownership. It was considered that transformation of the business within Council's ownership represented the best approach to safeguard this strategic asset for the future and achieve best long term value for the Council.
- 18 May 2016 (Council 16/222): the Council agreed the Perth Harbour Business plan and contents, agree to undertake a dredge of the River Tay to a depth of 5 Metres and that the Business Case be included within the Capital Budget.
- 22 June 2016 (Council 16/277): the Council agreed to allocate £870,000 towards dredging costs to be financed by prudential borrowing.
- 22 February 2017 (Council 17/84): the Council noted the progress made in the delivery of Perth Harbour Business Plan including projected financial position at 31 March 2017.

1.2 At their meeting on 3 August 2017, the Harbour Board considered the reduction of income generated over the past months which triggered a discussion on the viability of the business plan. The projected shortfall in income was reported to this Committee on 13 September 2017 (refer 17/279).

- 1.3 During that discussion, it was highlighted that the business plan had been based on high growth coastal shipping market conditions, which have now become much more uncertain due to Brexit and a changing trade environment.
- 1.4 Statistics published by the Department of Transport (UK major and minor ports, all freight traffic, by port and direction, annually: 1965 – 2016 - Updated 1 September 2017) indicate that freight traffic has considerably reduced over the period 2005-2016: 17% for major ports and 22% for minor ports. In Scotland, there were reductions of 14% for major ports and 24% for minor ports. The major port of Dundee has experienced a 56% reduction over the period and minor ports like Berwick, Wick, Scrabster, Scalloway, and Kyle of Lochalsh all experience reductions on already small traffic volumes. Shipping companies are facing challenging, volatile competitive conditions and are looking closely at cost reduction. Although dues have been discounted, Perth Harbour costs are higher than competitors.
- 1.5 One consequence of the reduction in overall ship movements is increased consolidation into larger size cargo transported by larger ships into major ports and, therefore, a reduction in the small/medium size ship traffic that Perth Harbour can attract as a minor port. In addition, the larger ship class is taller than small ship class and Perth Harbour is constrained by the height of Dundee Railway Bridge.
- 1.6 Specialist publications provide evidence that ports such as Inverness or Montrose, which are resisting decline, are doing so because they have access to windfarm trade or oil and gas contracts. Ports similar to Perth Harbour, such as Whitstable (Kent), have already decided to review their harbour functions focusing on non-cargo handling activities and have been successful in enhancing and developing their assets with wider social and economic benefits.
- 1.7 In light of the above information, the Board requested an update on the delivery of the business plan, which was considered by the Board on 23 October 2017. This report sets out the recommendations of the Board, following on from that meeting.

2. PROPOSALS

Current Business Plan (as approved on 18 May 2016)

- 2.1 The business plan presented the major issues and suggested a course of action to turn around the business at Perth Harbour to a self-sufficient business.

Financial Projections

- 2.2 The business case to support investment was positive and showed that with investment of £954,000 (including other operational investment in addition to dredging costs), the harbour could return to a break even position in 2020/21.
- 2.3 Based on the improved accessibility – 5 metres on Spring tides, projected profit and loss accounts would see the harbour at breakeven in 2020/21. The business case for a dredge at this level shows a significant increase in revenue based on a stakeholder forecast of 300% increase in annual turnover after 5 years, this was supported by a consultant's demand analysis.
- 2.4 The business case was based on sales projections provided by harbour users and stakeholders. It was further supported by a market demand analysis carried out on behalf of the Council by industry experts. The strongest projections show revenues rising to £355k in 2020/21. The income projections are based on growing existing cargoes (timber, aqua-feed, road salt), bringing back cargoes that have previously passed through Perth (cereals, cement and aggregates) and developing new cargoes (wood chip for bio-mass, refuse derived fuel).

Accessibility and storage

- 2.5 Analysis of the present accessibility to Perth Harbour indicated that only 26% of tides were accessible for a typical vessel over a sample 27 week period, supporting the argument that additional dredging to increase channel depth and widen the “window” for shipping movements would open up additional business opportunities .
- 2.6 It was considered that a dredge to 5.0m (+0.8m) would have a significant impact on the usability and competitiveness of Perth Harbour. However, there were also a number of risk factors to consider: borrowing costs, actual strength of the market, inability or difficulty to obtain consents to dredge including gas & oil pipelines and the need to dredge in Port of Dundee waters.
- 2.7 Harbour users indicated that the lack of storage space at Perth Harbour was critical and provision of laydown storage or parking on the site of the former Harbour End Store (now demolished) would support the business case.

Governance, Management and Staffing

- 2.8 A new governance and management structure was required together with the establishment of a Board. As well as high level governance, new operational and commercial management arrangements were required.

Sales and Marketing Strategy

- 2.9 A proposed sales and marketing strategy was presented. This has been designed with stakeholders and customers built around partnership working with a strong emphasis on relationship building. This element of the plan was vital but would have limited impact without the other recommendations being implemented. Likewise the communication of Perth Harbour being open for business and a pro-active mind-set would be required to gain value from any other investments.

Business Plan update

- 2.10 This section provides an update on each delivery area of the Business Plan.

Financial projections

- 2.11 An updated projected financial position to 31 March 2018 based on projected traffic is provided in appendix 1. An estimated net loss of £216,850 (£238,000 in 2016/17) is projected.

Moderate growth scenario (scenario A)

- 2.12 A revised financial projection for future years after dredging is also provided based on a projected traffic increase described as moderate growth (scenario A). It is important to note that this scenario is based on an optimistic growth trend (+400% in traffic over 5 years to 2021/22) against the current overall cargo coastal shipping market growth reduction trend.
- 2.13 The following assumptions have been made:

Expenditure

- All costs to increase by 2% per year
- Costs include £50,000 rental costs for a warehouse
- No replacement of depute Harbour Master between Nov.17 - March 18: £20,000 savings
- Additional overtime due to shift patterns
- Additional marketing costs of £7,500 in 17/18 and thereafter
- Loan Charges - The dredging which should start in 2018/19, and estimated to be completed in 2018/19, is charged to the Harbour as Prudential Borrowing. These charges are over a 10 year period, with the final year charge being in 2028/29. These charges vary between approx £90K to £100 k per annum over the 10 year period (£12,500 in the first year).
- Capital Charges – the harbour capital charges relate to the Harbour wall (borrowing over 30 years, with 16-18 years left), dredging in 2004/05 (borrowing over 30 years, with 18 years left), the Harbour boat (borrowing over 20 years, with 11 years left). The annual depreciation charge on the harbour is currently about £55K per annum.
- No inflation has been built in.

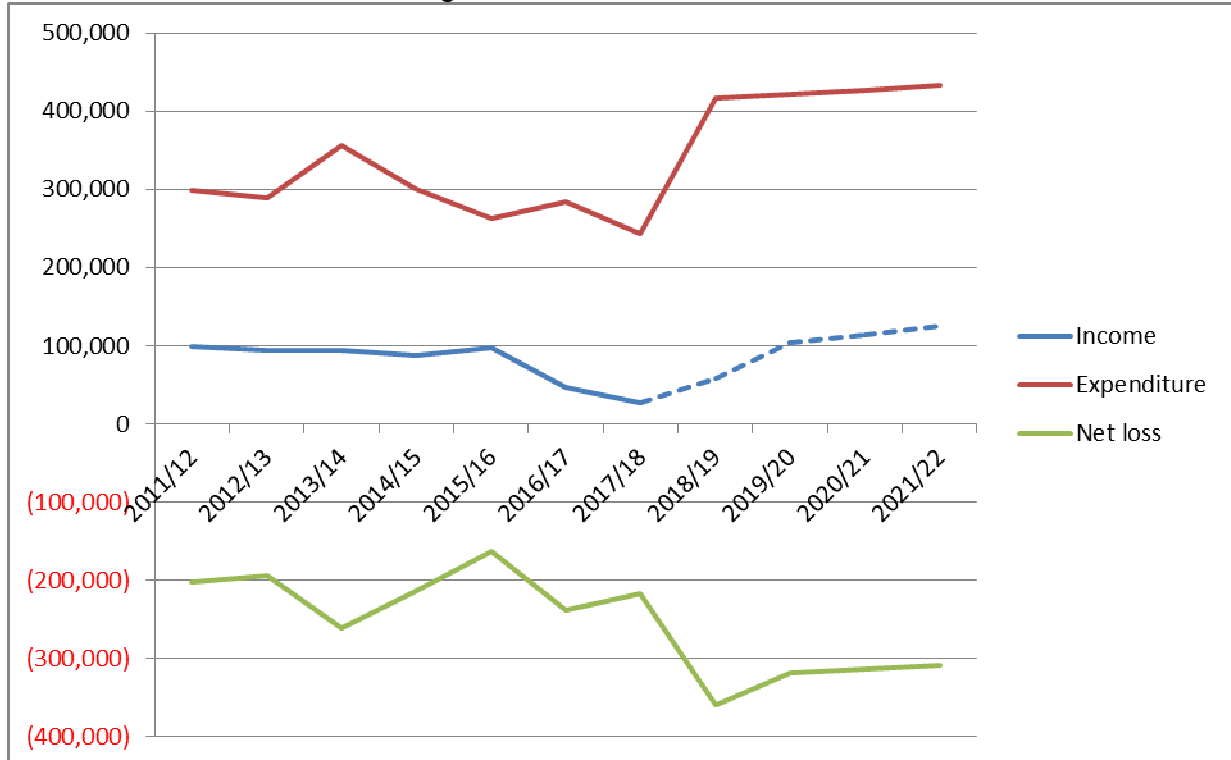
Anticipated Income

- Year 1 (2017/18): current forecast - 20 ships - av.gt 1600 - Shore dues discounted for baryte and aggregate
- Year 2: 38 ships including 30% fish meal traffic back and new traffic at discounted price
- Year 3: 71 ships including new aggregate traffic (CTLR), 50% fish meal traffic, additional baryte traffic and increased traffic
- Year 4 and subsequent years based on 10% increase in income from traffic
- No increase in tariff
- Minimal income from other sources

2.14 It should be noted that in light of national reduction in small ship movements, these estimates look to be highly unlikely.

2.15 Based on the above projections, the harbour would not return to a break even position before 2034/35. It is important to note that current Prudential Borrowing principles will not allow an extension to the repayment period over the asset depreciation period. This means that repayments have to be contained within a 10 year period which is considered as the depreciation period for the dredging. The following table shows level of expenditure, income and net loss under scenario A:

Scenario A – Moderate growth



High growth scenario (scenario B)

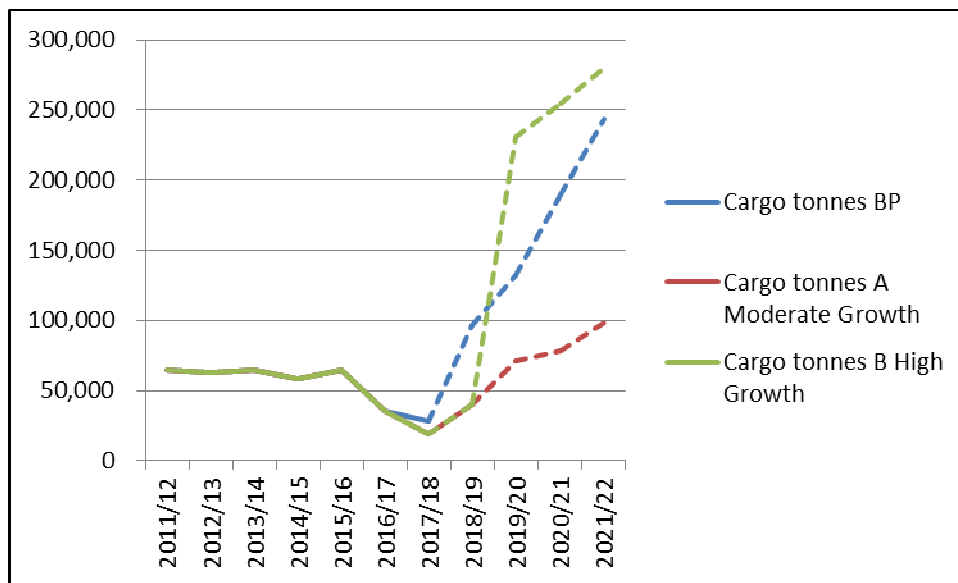
- 2.16 A revised financial projection for future years after dredging is also provided based on projected traffic increase described as high growth (scenario B). It is important to note that this scenario aims to match as closely as possible the approved business plan with a return to a break even position in 2023/24.
- 2.17 The harbour would have to attract in addition to the above projections (scenario A), 160,000 additional tonnes of cargo equivalent to an additional 100 ships (average 1600t) or 1,300% traffic increase and income of £204,000 with revenues rising to £372,400 in 2021/22. This would be in line with approved business plan projections, but will be unachievable due to the current market conditions and the current Harbour traffic. This raises serious concerns about the viability of the approved business case. The level of traffic needed would be the level of traffic generated by Inverkeithing or Stornoway minor ports and 52% of Dundee port traffic.

Scenario B – High Growth



- 2.18 Cargo volumes have declined considerably over the last 10 – 15 years. The number of vessels calling annually has declined from 300 to around 20. What once was a diversified cargo base has diminished from 280,000t to only 33,000t, now reliant on timber and baryte. The following graph provides actual and projected information on cargo (export/import in tonnes) for each scenario and in the approved business plan:

Cargo volume



Accessibility and storage

- 2.19 The current project plan projects that the dredging will take place in the Spring 2018 and be completed before the Summer 2018.
- 2.20 The Marine Scotland License application has been being submitted. By January 2018, the Marine Scotland License should be issued with clarity on possible conditions which could be imposed such as environmental surveys or possible stakeholders' objections.
- 2.21 The dredging contract tender is ready to be issued. However, early consultations have highlighted some conditions could significantly increase costs and/or choice of contractor. Based on our Project Management Consultant's advice, it is recommended to wait for the license to be issued before publishing the tender. The tender assessment process would be completed thereafter and provide clarity on dredging costs which are currently only estimated. At that stage, the financial projections would have to be updated.
- 2.22 Works to re-instate the former Harbour End Store site have been assessed and current quotes to create a laydown/storage area are much higher than estimated. However, an expenditure of £50,000 to rent a nearby warehouse has been included in the financial projections to address the issue of lack of storage identified in the business plan.

Governance, Management and Staffing

- 2.23 A new governance and management structure has been established. Pilotage capacity has been increased sustaining the pool of pilots. However, two key staff recently recruited have now resigned to pursue other career opportunities. Although transitional arrangements have been put in place to sustain operational activities and pilotage is secured, recruitment has previously been a challenge and would be a challenge once again. The level of wages offered by the Council are not competitive with the private sector, in addition, working patterns have proved to be difficult to manage within the current Council's policies.
- 2.24 To meet the requirements of the Port Safety Maritime Code, it is proposed to appoint an Interim Harbourmaster. The Investment Manager will take direct responsibility for commercial development and for the dredging project with the support of the Project Management consultant.

Sales and Marketing Strategy

- 2.25 A strong emphasis has been put on relationship building through the Harbour Users Group and an 'open for business' and pro-active mind-set has been developed over the past year including a new website, event attendance and professional networking. This was led by the Harbourmaster, who has a significant industry experience with the support of the Invest in Perth team.
- 2.26 However, to date this has not led to increased cargo coastal shipping traffic. Other ports similar to Perth Harbour have been successful in retaining, enhancing and developing their assets beyond cargo coastal shipping with wider social and economic benefits. In addition to cargo coastal shipping, other commercial opportunities have been explored such as using the Harbour as a base for specific fleets or passenger traffic. Some interests have been noted. If such opportunities were taken forward, it could offer an alternative business model which may require to review the current harbour operations and may not need a dredging of 5m. It might be beneficial to test the market to develop this alternative business model.

3. CONCLUSION AND RECOMMENDATIONS

- 3.1 The Harbour Business Plan was approved in May 2016. Since then, a number of assumptions have changed which require us to review its viability. The coastal shipping market which was supposed to provide the income to pay back the investment is reducing across the UK and the period of repayments of prudential borrowing would have to extend significantly beyond an acceptable depreciation period. Indeed, the current model may never pay back.

3.2 In light of these changes to the approved Business Plan, it is recommended that the Strategic Policy and Resources Committee:

- (i) Instruct the Depute Chief Executive (Chief Operating Officer) to explore other commercial opportunities outwith cargo coastal shipping
- (ii) Instruct the Depute Chief Executive(Chief Operating Officer) to report to this Committee or the Council later in the financial year.
- (iii) Note the transitional Harbour operational arrangements until March 2018 including the appointment of an Interim Harbourmaster
- (iv) Note that the Marine Scotland license application has been submitted in October 2017
- (v) Postpone the dredging contract tender publication until the Marine Scotland License is issued (January 2018)
- (vi) Continue engagement with stakeholders to mitigate risk in terms of costs and timescale.

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1. IMPLICATIONS, ASSESSMENTS, CONSULTATION AND COMMUNICATION

Strategic Implications	Yes / None
Community Plan / Single Outcome Agreement	Yes
Corporate Plan	Yes
Resource Implications	
Financial	Yes
Workforce	Yes
Asset Management (land, property, IST)	Yes
Assessments	
Equality Impact Assessment	Yes
Strategic Environmental Assessment	Yes
Sustainability (community, economic, environmental)	Yes
Legal and Governance	Yes
Risk	Yes
Consultation	
Internal	Yes
External	None
Communication	
Communications Plan	None

1. Strategic Implications

Community Plan / Single Outcome Agreement

- 1.1 The Community Plan/Single Outcome Agreement 2013 – 2023 lays out five outcomes focussed strategic objectives which provide clear strategic direction, inform decisions at a corporate and service level and shape resources allocation. They are as follows:
- (i) Giving every child the best start in life
 - (ii) Developing educated, responsible and informed citizens
 - (iii) Promoting a prosperous, inclusive and sustainable economy
 - (iv) Supporting people to lead independent, healthy and active lives
 - (v) Creating a safe and sustainable place for future generations
- 1.2 This report relates to objective (iii) by maximising and enhancing economic development opportunities to the benefit of businesses and local communities, encouraging new business creation and growth of existing businesses through Harbour operations.

2. Resource Implications

Financial

- 2.1 Capital – an allocation of £874,000 has been agreed as part of the capital programme as prudential borrowing. However, the report stresses that the coastal shipping market which was supposed to provide the income to pay back the investment is reducing across the UK and the period of re-payments of the prudential borrowing would have to extend significantly beyond an acceptable depreciation period of 10 years or could possibly not be repaid at all.
- 2.2 Revenue – The harbour has a revenue loss of £237,973 in 2016/17 and a projected loss of £216,850 in 2017/18.

Workforce

- 2.3 There are no immediate workforce impacts. However, two posts are currently vacant with interim transitional arrangements in place.

Asset Management (land, property, IT)

- 2.4 Asset Management issues arising from the operations of the Harbour are detailed in the report.

3. Assessments

Equality Impact Assessment

- 3.1 Under the Equality Act 2010, the Council is required to eliminate discrimination, advance equality of opportunity, and foster good relations between equality groups. Carrying out Equality Impact Assessments for plans and policies allows the Council to demonstrate that it is meeting these duties.
- 3.2 The information contained within this report has been considered under the Corporate Equalities Impact Assessment process (EqIA) and has been assessed as **not relevant** for the purposes of EqIA.

Strategic Environmental Assessment

- 3.3 The Environmental Assessment (Scotland) Act 2005 places a duty on the Council to identify and assess the environmental consequences of its proposals.
- 3.4 The information contained within this report has been considered under the Act. Pre-screening has identified that the PPS will have no or minimal environmental effects, it is therefore exempt.

Sustainability

- 3.5 Under the provisions of the Local Government in Scotland Act 2003 the Council has to discharge its duties in a way which contributes to the achievement of sustainable development. In terms of the Climate Change Act, the Council has a general duty to demonstrate its commitment to sustainability and the community, environmental and economic impacts of its actions.
- 3.6 The information contained within this report has been considered under the Act. The proposals will enhance socio economic and economic development opportunities to the benefit of businesses and local communities.

Legal and Governance

- 3.7 The Head of Legal and Governance Services and the Head of Finance has been consulted on these proposals and there are no legal implications.

Risk

- 3.8 There are two key risks associated with the proposed programme.
- (i) Risks associated with the Dredging contracts and possible conditions attached to the Marine Scotland license issued. This risk will be managed by The Environment Service Senior Management Team. External advisers have been recruited to engage early with key stakeholders. The Harbour Board takes an active role in managing the programme. The dredging contract has been postponed to understand better the risks associated with BP and Shell Pipelines.
 - (ii) Risks associated with coastal cargo shipping reduction and the income reduction with possible non-repayment of prudential borrowing. This risk will be mitigated through robust financial assessment and exploration of other commercial opportunities.

4. Consultation

Internal

- 4.1 The Head of Finance and the Head of Legal and Governance Services have been consulted in the preparation of this report.

5. Communication

- 5.1 The recommendations from the report will be communicated to stakeholders and the press through the Board and the media team.

2. BACKGROUND PAPERS

No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above report.

3. APPENDICES

Appendix 1 – Financial Projections