



THE HIGHLANDS AND ISLANDS STRATEGIC TRANSPORT PARTNERSHIP

## AIR SERVICES NETWORK

### REPORT TO HITRANS BOARD

16 APRIL 2004

#### Background

1. The Enhanced Air Network Proposal, based on the Aviation and Travel report of February 2003, has been the subject of detailed analysis since last September, in terms of economic benefits, cost estimate review, and PSO specification. The aim has been to build on the support that the network received last year (It is included in the Scottish Executive's Partnership Agreement as a high level commitment which will be fully evaluated; it has been supported by the House of Commons Transport Committee; and it is included in the aviation white paper "the Future of Air Transport in the UK"), and to target summer 2005 for the commencement of PSO services.

#### Economic Benefits

2. The **economic appraisal** of our 2003 Air network proposal, commissioned jointly by HITRANS and Scottish Executive from Steer Davies Gleave in October 2003, is largely complete. The final report will be available by the end of April and a draft summary will be circulated at the meeting. The report is favourable and is showing a positive benefit. At 2010 it is predicting a benefit to cost ratio of 1.66, and a benefit cost to government ratio of 2.45. At 2020 these predicted benefit ratios are higher. There are some concerns, and these are being checked. The appraisal is predicting a significant level of displacement of car traffic from ferries of about £3.5 million per annum. It is also suggesting a £5 million per annum profit incentive to the successful PSO operator (10% of annual income). These would be on top of the £12 million per annum PSO subsidy calculated by Aviation and Travel.
3. The contract with Steer Davies Gleave states that the final report is to be presented to the Board and officials of the Scottish Executive. A date needs to be set for this presentation early in May so that the report is formally lodged with the Executive for verification.

#### Review of cost estimates

4. As agreed at the October Board, Aviation and Travel have been commissioned to review the estimated capital and revenue expenditure requirements of the network. **Revised Capital Costs** are:

Essential		Highly Desirable	
Dalcross apron	£1m	Sumburgh runway	£10m
Oban Code 2C licence	£1.9m	Inverness radar	£2.5m
Broadford upgrade	£3.5m	Stornoway lighting	£3.5m
Oban lighting	£2m		
Tiree lighting	£1m		
Barra runway	£4.5m		
Barra lighting	£1.5m		
<b>Total</b>	<b>£16.4m</b>	<b>Total</b>	<b>£16m</b>

5. The Oban Code 2c costs are being met by Argyll and Bute, HIE and ERDF. The Broadford costs are proposed to be met by the private operator, subject to ongoing negotiation. All other capital will have to be met by HIAL through the annual grant from the Scottish Executive with any ERDF and other assistance. It is important that capital cost lead time does not delay the operation of the network. Therefore in the bundling exercise below, it is recommended that the Skye, Oban, Tiree and Barra bundle is kept separate for a later PSO phase. Temporary arrangements could be made to handle the mid day congestion of aircraft at Dalcross by using the short cross runway until capital is available to extend the apron
6. **Revenue costs at HIAL airports** have been reviewed regarding the additional opening hours required by the network. These costs of £2.2 million per annum will be recovered almost immediately by the extra revenue generated by the network. This has been reported to the HIAL Board for confirmation.
7. The estimated **costs of operating the new network** have been criticised by Loganair. At a meeting in November, Scott Grier suggested that these costs would be £13 million per annum more than the Aviation and Travel estimates, making a total annual subsidy requirement of £25 million when the network is operating at 70% average load factor. He thinks that the system will need more standby aircraft; more crew because flying hours using turbo prop aircraft in remote areas will be significantly less than the EU norm of 700 hours per crew per annum; and he thinks maintenance costs are underestimated. A meeting was held with Eastern Airways in February, a turbo prop airline operating in the region, to take another opinion on operating costs.
8. The conclusions that we have reached from these meetings is that we must reduce the estimated crew flying hours. The EU average includes jet aircraft which are not so stressful to operate. Also we must allow for a further standby aircraft and reduce the aircraft utilisation hours. However we believe that the Loganair figures are too high because they are based on operating the network from Glasgow, over-nighting crews rather than recruiting them locally, and centralised maintenance. They are also based on high aircraft lease rates.
9. As a result of these meetings A&TC have reviewed their operating cost model, and have produced a sensitivity analysis. They have increased the subsidy estimate in appendix 19 of their February 2003 report by £1.5 million. Their new estimated annual subsidy requirement at 70% average load factor is £13.5 million. This is still low in comparison with annual subsidies to other modes in Scotland.

## PSO Specification

10. Aviation and Travel consultants were also commissioned last October to draw up a **route bundling strategy** for the network. Our visit to DGTren last summer, and the Cranfield report on Norwegian PSO practice, indicated that it will not be possible to have one PSO for the network. Therefore A&TC have recommended dividing the network into four geographically based bundles which would each be tendered separately for PSO. These are:
  - ? Shetland comprising 5 daily rotations from Sumburgh to Aberdeen; 3 rotations to Inverness; 2 to Edinburgh; and 2 to Glasgow via Kirkwall.
  - ? Orkney comprising 5 daily rotations from Kirkwall to Aberdeen; 3 to Inverness; and 2 to Edinburgh. This bundle will also serve Wick with 2 rotations to Glasgow; 2 to Edinburgh; 1 to Aberdeen and 1 to Inverness
  - ? Western Isles comprising 4 daily rotations from Stornoway to Glasgow; 5 to Inverness; 2 to Edinburgh (note the mid day Edinburgh bmi jet service is not included in the PSO); and 1 to Aberdeen. This bundle will also provide 2 rotations from Benbecula to Glasgow and 1 to Inverness; and 2 rotations from Barra to Glasgow.
  - ? Argyll and Highland comprising 3 daily rotations Campbeltown to Glasgow; 3 from Islay to Glasgow; 2 from Oban to Glasgow and 1 from Oban to Inverness; 2 from Skye to Edinburgh; 3 from Inverness to Glasgow and 3 Inverness to Edinburgh.
11. Justifications and Specifications for these four PSO bundles have been drafted.
12. At our meeting in February we questioned whether the bmi service from Edinburgh to Stornoway could be legally omitted from the PSO bundle. Cranfield was asked for an opinion on this issue. George Williams concludes "On the basis of legal advice from John Balfour and the experience of PSO operations throughout the EU and EEA countries, it would seem unwise to pursue the idea of seeking to obtain PSO designation for morning and evening weekday services between Edinburgh and Stornoway, while bmi continues to provide a mid day rotation on a commercial basis."
13. Therefore the way forward, in order to have PSO services operating by summer of 2005, is to phase in the network. The route bundles based on Shetland and Orkney/Wick should be the first phase. The Western Isles bundle should exclude the Stornoway to Edinburgh/Aberdeen and the Barra to Glasgow routes to avoid legal conflict with the bmi service and to await the new Barra runway. The recently announced Barra to Glasgow PSO will continue for the next three years with beach landing. The Argyll and Highland bundle needs to await decisions on capital expenditure at Skye Oban and Tiree. The current Campbeltown and Tiree PSOs will continue, and the Coll and Colonsay PSO will be negotiated separately by Argyll and Bute Council.

14. The implications for subsidy by proceeding in this phased way have still to be calculated.

**Next steps**

- ? A formal request should be sent to the Scottish Executive to proceed with applications for PSO for the Shetland, Orkney and revised Western Isles bundles, as described above, in terms of the justifications and specifications already drafted.
- ? A meeting should be requested with the Minister to press for early consideration of this request.

Howard Brindley  
April 2004