

To:	Public Accounts Committee
From:	Neil Pakey - CEO of Shannon Commercial Properties (formerly Shannon Development)
Re:	Briefing Paper on 2013 Annual Accounts of the Shannon Free Airport Development Company Limited for the Public Accounts Committee prior to attendance at a meeting on 9th October 2014.
Date:	2nd October 2014

In this briefing paper, an overview is provided on:

1. Current status of Shannon Development within Shannon Group
2. Historical Status of Shannon Development
3. Transition of Shannon Group plc
4. Overview of financial results for the year ended 31 December 2013
5. Property portfolio and impairment recorded in 2012 accounts
6. Looking to the Future

1. Current status of Shannon Development within Shannon Group

Shannon Development (the "Company") has been renamed Shannon Commercial Enterprises Limited trading as Shannon Commercial Properties and is engaged in commercial property management and development. Shannon Commercial Enterprises Limited now a wholly owned subsidiary of Shannon Group plc. Shannon Heritage, previously a subsidiary of Shannon Development, remains a subsidiary of Shannon Commercial Properties.

Following the enactment of the State Airports (Shannon Group) Act, Shannon Group plc was incorporated on 29th August 2014. On 5th September 2014, following the transfer of shares under the Act, the Company became a subsidiary of Shannon Group plc.

Shannon Group plc is a commercial semi-state company comprising four strategic business units. These business units combine property ownership and management activities of Shannon Commercial Properties, together with the activities of Shannon Airport, Shannon Heritage and the International Aviation Services Centre (IASC). Shannon Group plc has a commercial mandate for the sustainable development and management of the Airport, the property portfolios of the Airport and Shannon Commercial Properties, the development of Shannon Heritage's visitor attractions and

revenues and development of an internationally recognised aviation services centre. Its mandate is set out in the Shannon Act 2014.

Shannon Commercial Properties continues to work closely with Enterprise Ireland and IDA Ireland as a commercial property company providing property for letting and sale to clients of these agencies. Shannon Airport Authority and Shannon Heritage also work closely with Fáilte Ireland and Tourism Ireland in a joint effort to secure international visitors to the Shannon region and Ireland.

By far the largest business park in the Company's property portfolio is the Shannon Free Zone. It is the largest multi-sector business park in the Atlantic corridor. This business park was established in the 1960s and grew significantly during the following decades on the back of its tax designation. It was focused primarily on manufacturing and assembly activities during that period. 89% of the buildings in the business park were constructed prior to 1990. Significant investment is required to bring the estate to the standards required in Ireland of today.

Under the regional development remit, the Company developed technology parks in Tralee, Co Kerry, Ennis Co. Clare, Thurles, Co. Tipperary, Birr, Co Offaly and the National Technology Park in Limerick. In the depressed property market of today, the valuations of many of these properties is significantly less than their initial acquisition and construction cost.

Other than Shannon Free Zone and the technology parks, the Company holds properties in over 50 other locations in the Shannon region. Many of these properties were developed when the Company had a regional development remit and constructed in locations to enable enterprises create employment locally. Today many of these properties are in poor condition, are vacant and also require significant investment.

One of the Company's key goals is the redevelopment of its commercial property portfolio in the region around Shannon Airport and other key strategic locations. Work has already begun in upgrading some existing buildings at Shannon Free Zone and redevelopment opportunities for the Zone are also currently being evaluated.

The vision for Shannon Group plc is for a revitalised Shannon Airport encompassing not only the Airport and its passenger and industrial aviation activities but also a broad-based aviation related industry cluster centred on the Airport and on the adjacent Shannon Free Zone lands. Shannon Commercial Properties strategy is to manage, develop and re-invest in its properties on a commercial basis. The Company also focuses on the significant non-aviation related client base in Shannon and the Shannon Region as a basis to grow its property activities.

Neil Pakey was appointed CEO of Shannon Airport on 10 June 2013 and appointed CEO of Shannon Development on 1 September 2013. On 5 September 2014, he became CEO of Shannon Group plc. The senior management team of Shannon Development left during 2012 and 2013 as part of the reorganisation of the Company. During 2014, the management team were assembled and David McGarry was appointed CFO of Shannon Airport on 1 February 2014 and CFO of Shannon Group plc on 5 September 2014. Ray O'Driscoll was appointed Managing Director of the Property Division of Shannon Group on 23 April 2014.

2. Historic Status of Shannon Development

Shannon Development, a regional development agency, was established in 1959 as a non-commercial semi-state body with the responsibility for the development of industry and tourism in the Shannon region. Over the years the remit of the Company has changed.

In 1988, the Company was given responsibility for the promotion and development of all aspects of industry and tourism in the Mid-West region together with West and South Offaly. This was in addition to industrial development at the Shannon Free Zone.

In 1990, the enterprise role for foreign direct investment for the region (with the exception of Shannon Free Zone) transferred to IDA Ireland with the role and functions of indigenous enterprise in the Shannon region (with the exception of Shannon Free Zone) transferring to Enterprise Ireland in 2006.

In May 2012, the Government announced the decision to restructure Shannon Development and place it alongside Shannon Airport (now owned by Shannon Airport Authority plc, which separated from the Dublin Airport Authority on 31st December 2012), to become part of a new semi-state company known as Shannon Group plc with a commercial mandate.

Arising from this decision, the enterprise functions in relation to indigenous and foreign direct investment in the Shannon Free Zone transferred to Enterprise Ireland and IDA Ireland respectively in 2013. The tourism functions and related employees of Shannon Development, including Regional Tourism Offices (excluding Shannon Heritage), transferred to Fáilte Ireland in May 2013.

3. Transition to Shannon Group plc

3.1 Steering Group and Task Forces

Following the announcement in May 2012 to establish Shannon Group plc, the Government appointed a Steering Group in June 2012. The Steering Group was charged with bringing forward proposals for the implementation of the Government decision on restructuring the State Airports and Shannon Development and the re-alignment of tourism and enterprise support functions in the region. The Steering Group included senior officials from those Departments as well as the Departments of Finance, Public Expenditure and Reform, and Environment, Community and Local Government.

There were also two Task Forces announced, an Aviation Business Development Task Force and a Change Management Task Force, both of which reported to the Steering Group.

The Task Forces interacted closely with the Steering Group and considered, as appropriate, issues which impacted on the work of both Task Forces. A number of working groups were set up by the Task Forces to assist in the process. Both Task Forces issued reports with recommendations in November 2012.

In December 2012, after reviewing this output, the Government decided to separate Shannon Airport from the Dublin Airport Authority by the year end. This paved the way for the formation of Shannon Group plc.

3.2 Transfer of Functions and Employees

The Steering Group in conjunction with the Company commenced the process of transferring functions and employees to other agencies at the end of 2012.

To enable the smooth transition of employees to the other agencies, a process was independently facilitated by Brendan Duffy and involved Shannon Development and relevant Government Departments. The process reached agreement on outstanding issues on pensions, terms and conditions etc. for employees transferring to other agencies and for those remaining with Shannon Development/Shannon Group plc.

In addition to the activities and employees transferring to Fáilte Ireland, Enterprise Ireland and IDA Ireland, employees also redeployed to some Government agencies/civil service and others employees chose to exit under a Voluntary Early Retirement/Voluntary Redundancy (VER/VR) scheme. Employees working on the management and development of property transferred with Shannon Development to become part of Shannon Group plc.

Shannon Development employees transferred to the following during 2012/2013:

- 23 employees transferred to Fáilte Ireland
- 6 employees transferred to Enterprise Ireland
- 4 employees transferred to IDA Ireland
- 25 employees redeployed to other Government agencies/civil service e.g. Revenue Commissioners.
- 33 employees availed of a VER/VR scheme
- 22 remained with Shannon Development (employees relocated to their Shannon Airport base in December 2013)

4. Overview of results for the year ended 31st December 2013

The Company recorded in its Income and Expenditure Account an overall Deficit for the Financial Year 2013 of €1.569m, versus a Deficit for 2012 of €41.213m.

The Company recorded an Operating Deficit in its Income and Expenditure Account for the year to 31 December 2013 of €4.25m. This compares with a recorded Operating Deficit of €42.589m for the year to 31 December 2012.

The most significant item in the Accounts of 2013 and 2012 is the €32.9m impairment and write off of fixed assets. The significant deficit in 2012 is primarily due to the making of exceptional impairment accounting provisions of €32.9m against the recorded book values of certain property

assets, compared to their depreciated historical cost. This is in line with the Company's accounting policies. The background to and the basis of these impairments is outlined in section 5 below. Similar impairments were not recorded in the 2013 accounts. A summary of the Income and Expenditure Account is as follows:

	31 December 2013 €'000	31 December 2012 €'000
Total Income	27,509	29,603
Total Expenditure	(26,062)	(32,368)
Impairments	(188)	(32,871)
Depreciation	(5,509)	(6,953)
Restructuring Costs	(1,001)	0
Group Operating Deficit	(4,250)	(42,589)
Profit on sale of Assets/Investments	4,973	2,749
Net Interest Expense/Tax	(1,291)	(1,373)
Deficit for the Year	(1,569)	(41,213)

The operating deficit in 2013 of €4.25m comprises a continuing operations part (i.e. Property and Heritage activities) and discontinued operations part reflecting the transfer of Enterprise and Tourism Development remits to other State agencies. In breaking this down, the operating deficit on "discontinued" activities amounted to €2.117m. This reflects the cost of funding the enterprise and tourism activities prior to transfer to other agencies and mainly consists of the employee costs for these activities prior to transfer. These costs will not be incurred by Shannon Commercial Properties in 2014. The other part of the operating deficit includes a deficit on "continuing activities" of €2.133m which is after deduction of depreciation/impairment of €5.697m. VER/VR costs of €3.4m were paid out during the year and were funded by an Exchequer vote allocation which is included in grant income in the accounts. Grants of €1.7m were paid to industries in 2013.

Profit on the sale of assets of €4m was earned during the year. This was generated on the sales of 11 properties, the largest being the sale of land and buildings at the University of Limerick and the sale of a warehouse building in the National Technology Park, Limerick. Separately, a profit on sale of investments yielded €947k. Restructuring costs of €1m were spent on the reorganisation of the Company and transition to the Shannon Group plc. €6m in capital expenditure was invested in property and tourism assets, with the largest investment being spent on the King John's Castle upgrade.

The Company is debt free with a cash balance of €12m at the end of the year, increasing from €7m at the end of 2012.

5. Property portfolio and impairment recorded in 2012 accounts

5.1 Due Diligence/Property Valuation

Following the Government's decision in May 2012 to restructure Shannon Development and prior to the formation of the Shannon Group plc in September 2014, a due diligence exercise and property valuation exercise was completed on the business and balance sheet of Shannon Development.

A tender process was undertaken to appoint a firm to complete the due diligence and property valuations. The property review was completed in December 2013 by external independent valuers.

5.2 Process undertaken by Valuers

All buildings and land were attributed a value and these values were applied across the portfolio, having regard to market data and comparable transactions. The rates were applied according to the property's location, type, size, use, tenancies and condition. Current vacancy rates in the properties and average unexpired lease terms across the property portfolio were also used to arrive at a valuation.

5.3 Results of Property Valuation

(i) Background

The Government announced its decision in May 2012 to re-organise Shannon Development by changing its mandate from a non-commercial state body to a commercial semi state company to be a subsidiary of the proposed Shannon Group plc. This involved the property and heritage activities being retained in the Company and the enterprise development and tourism development responsibilities being transferred to other State agencies.

On account of this formal announcement to re-organise the Company, a property valuation was completed in December 2013. A number of factors led to the identification of impairments:

- the continued downward pressure in property prices in the Shannon region in the years prior to and during 2012;
- the vacancy rate was high at c.57% in the portfolio;
- the low unexpired average lease term remaining in the portfolio;
- the relative poor condition of much of the properties;
- the low prospects for sale and letting of those properties on a commercial basis;

The due diligence exercise and related property valuation review carried out identified significant impairment in the values of part of the property portfolio when compared to depreciated historical cost.

The board of the Company noted these indicators of impairment of the property portfolio during 2012 and 2013 when carrying out a review of the Company's fixed assets i.e. its properties as required by Financial Reporting Standard 11 (Impairments of Fixed Assets and Goodwill) (FRS 11) which is in line with Irish Generally Accepted Accounting Principles adopted by the Company. Under FRS 11 detailed impairment reviews are required if events or changes in circumstances indicate that the carrying value of the fixed assets may not be recoverable.

(ii) Result of impairment reviews

As a result of these impairment reviews, 49 industrial buildings and 61 industrial land holdings were identified as requiring a write down in value when compared to net book value. The value of the write down was €32.9m and this was recorded in the 2012 Accounts.

This represents an accounting provision rather than a cash loss, as very few of these assets have been sold.

As the 2012 statutory audit was not completed when the valuation process commenced, it was agreed with the C&AG that any impairments arising from the review should be included as a deduction in the Income and Expenditure Account when preparing the 2012 Accounts.

(iii) Change in classification of assets going forward

The properties of the Company were historically held as fixed assets for use by the Company primarily for economic and regional development, not held for investment.

Due to the change in remit of the Company under Irish Generally Accepted Accounting Principles, the change in use of the property assets is required to be reviewed. In the context of the future mandate of the Company, the property assets would be reclassified from tangible fixed assets (accounted for under Financial Reporting Standard 15) to be Statement of Standard Accounting Practice 19 Investment Properties (accounted for under SSAP 19). This is not a change in accounting policy but a change in the classification of properties.

(iv) Market value exceeding carrying value

Arising from the valuation, there were 43 industrial land holdings and 363 buildings where the total market value exceeded the total carrying value of the assets by €39m. In accordance with the accounting policies of the Company, this was not reflected in the 2012 Accounts and accordingly no increase in the Income and Expenditure Account or in carrying book value of these related property assets was recorded.

On the creation of the Shannon Group plc in September 2014 with its statutory approved mandate as a commercial semi-state company, the property portfolio of the Company now falls to be treated as Investment Properties under SSAP 19 rather than Fixed Assets under FRS 15 as noted above. At

this date, as the Company's mandate has formally changed by statute, the revaluation upwards on the portfolio will be recorded in the books of the Company.

A note was included in the 2012 Accounts setting out this important fact:

"43 industrial land holdings and 363 buildings where the total market value exceeded the total carrying value of the assets by €39m. This is not reflected in the financial statements as the Company adopts a depreciated historical cost accounting policy"

6. Looking to the Future

Shannon Group is firmly focused on fulfilling its objective of securing a sustainable future for the all of its operations and being a catalyst for economic growth for the West of Ireland. The full Shannon Group team has now been assembled and they have a collective determination to seek out and maximise the potential of all business opportunities and drive growth and profitability in all areas of the Group's activities.