



# Shetland Charitable Trust

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Our Ref: EMA/TA1/1

Date: 27 March 2012

Dear Sir/Madam

**Shetland Charitable Trust - Thursday 29 March 2012**

Please find attached the following papers in respect of the above meeting.

Yours faithfully

(signed) Dr Ann Black  
General Manager

## **ADDENDUM**

### ***For Decision***

Appendix A of the following items contains **CONFIDENTIAL** information

3. Viking Energy – Investment Budget.



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**REPORT****To:** Shetland Charitable Trust

Date 29 March 2012

**From:** Financial Controller

Report: CT1203016

**Viking Energy – Investment Budget****1. Introduction**

- 1.1 Viking Energy Partnership's application for consent under S.36 of the Electricity Act remains under consideration by Scottish Ministers. Outcomes of that process include consent, (or partial consent), a public local inquiry or a refusal.
- 1.2 This report considers the financial value of the Trust's investment in Viking Energy and the next steps in developing that investment, dependent on the Minister's decision.
- 1.3 More specifically, this report concerns (a) the investment required to take the project to the next stage beyond a consent approval or (b) maintaining the value of the Trust's investment whilst awaiting a determination by Scottish Ministers or (c) maintaining the Trust's investment value for an interim period whilst the implications of a PLI decision by the Minister are considered.
- 1.4 In the event that there is a determination by the Minister in which the consent application is refused then this report would be superseded by a subsequent report to a future Trust cycle.
- 1.5 To be clear, a decision by the Minister to consent the application would mean, barring anything unforeseen, that a large "Viking" windfarm consisting of up to 127 wind turbines will be built in Shetland's central Mainland. The exact number of turbines will depend on the detail of the Ministers' determination.
- 1.6 Shetland owns 50% of the overall Viking Energy project, with the other 50% being owned by SSE plc. 10% of Shetland's investment has been made by Viking Wind Ltd. A company called Quayle Munro has been engaged to provide an expert third party valuation of that investment and its future prospects. (Quayle Munro has had no previous involvement in the Viking project).
- 1.7 Quayle Munro is a specialist corporate financial advisory business and is based in Edinburgh and London. It has advised upon over

130 major transactions in the last five years with a total value in excess of £8 billion. Amongst recent relevant experience is a high profile valuation and transaction involving the Baillie Windfarm project in Caithness which was acquired by Statkraft(UK) from private developers.

- 1.8 Should the project be consented, the next stage is to prepare for a final investment decision (known as "financial close") which will include: finalising connection and transmission charging arrangements, procurement and construction contracts, turbine warranty and maintenance arrangements, long term trading arrangements for the outputs, debt arrangements/conditions, land arrangements and detailed ground investigation work and due diligences to underpin all these. This process is estimated to take up to 18 months – 2 years.
- 1.9 The "Shetland" side of the Viking Energy Partnership has, to date, invested £3.8 million directly in the business. This has been financed in line with respective shareholdings i.e. 90% or £3.42 million from Shetland Charitable Trust and 10% or £0.38 million from Viking Wind Ltd.
- 1.10 A valuation of these investments has been undertaken by Quayle Munro who presented to a Trustee Seminar on 26 March 2012. That work assigns a value range of £350k - £850k per MW to the "Shetland" half of it. To make clear, it is estimated that the SCT's current investment of £3.42 million should be worth upwards of £72 million ((i.e. 90% of £80 million) immediately post consent, assuming the full 127 turbine scheme were to be consented.
- 1.11 The valuation exercise extends beyond the consent stage to cover the other project milestones which are financial close and, thereafter, following procurement and construction into its ongoing operation & maintenance phase.
- 1.12 It is in the interests of the business and its shareholders to seek to maximise both capital value and future earnings potential.
- 1.13 Financial close is dependent upon finalising, in detail, the parameters listed above (in 1.8). Clearly those parameters, and subsequent milestones, can only be achieved through further investment in the business. The investment required to take the project towards financial close can be underpinned by the advance knowledge that it is expected to yield a further, significant increase in capital value. The expected increase in capital value is well in excess of the sums to be requested from shareholders.

## 2. Proposals

- 2.1 Should the project be consented, I will be recommending that Trustees agree a further investment budget of up to 90% of £7 million, i.e., £6.3 million, to take the project forward. This will require up to £700k of further investment to be agreed by Viking Wind Ltd.

The combined "Shetland" sum of up to £7 million will be dependent upon a matching sum being approved by SSE plc. This new investment would be required to take the project through to financial close. A detailed budget is attached as the confidential Appendix A.

Quayle Munro expects the "Shetland" half of the business to have a capital value of up to £194 million at financial close (i.e. a total valuation of up to £388 million assuming the full 127 turbines were to be consented). Whilst these increases in pre-construction capital value are significant, they are expected to be dwarfed by future, post construction, revenue streams. It is clear that long term financial value on investment is best achieved by seeing the project through to full production.

- 2.2 Should there be a delay to a consent decision, I will be recommending that Trustees agree an interim investment budget of approx 6% of £6.3 million i.e. up to £360,000. This will protect the Trust's existing investment by ensuring sufficient continuity and cash flow for the business to continue to operate efficiently until a decision is made by Scottish Ministers on the consent application. Whilst a Ministerial decision is expected soon, it is important that the value of the Trust's investment to date, and the potential for that investment to grow substantially, is protected in the meantime. Again, to be clear the relevant investments would also be required from Viking Wind Ltd and SSE.
- 2.3 Should the Minister decide to call a PLI then I will be recommending that Trustees agree an interim investment budget of up to £360,000 until the full implications of any PLI decision can be evaluated and reported to a future Trust cycle. This would protect the Trust's existing investment in the interim.
- 2.4 Spend against investment budget is not charitable. When Trustees make an investment they expect to get the capital back (over time) and make a suitable return. Any investment by a charity needs the approval of HMRC as a "qualifying" investment. HMRC have formally accepted that the Trust's investment to date of £3.42 million in the project approval stage of the Viking Energy project is a qualifying investment. Quayle Munro's valuation of that investment as being worth something in the region of upwards of 21 times the original sum, in the event of a consent for the full 127 turbines, will help in discussions with HMRC should Trustees be minded to agree my recommendation to invest up to £6.3 million in taking the project to the next milestone or £360,000 should a determination be delayed or should the Minister's decision be to call a PLI (pending more detailed evaluation of the implications of a PLI decision).
- 2.5 Should the Minister decide to refuse consent then this report and its recommendations will be superseded by a report to a future Trust cycle.

### **3. Background**

- 3.1 Trustees have received various updates on the project since the Trust took it on in 2007. Appendix B is a diary of these updates.

### **4. Project Structure**

- 4.1 Trustees have agreed to a change in the Shetland Partner, to be Viking Energy Shetland LLP to protect the Trust's favourable tax position as a charity owning a share of a potentially profitable project. Trustees have also agreed that the central joint venture vehicle should change from Viking Energy a general partnership to Viking Energy LLP. An LLP is more attractive to potential providers of bank finance as it has the ability to grant a floating charge over the assets of the windfarm.
- 4.2 In light of the above, the JV business has begun a process towards re-structuring itself and preparing for further changes, including possible changes to its governance arrangements. This process will be reported to Trustees in a future cycle. One of these proposed changes is the development of what are called Management Services Agreements to bring in the appropriate technical and business expertise to finance, procure, construct, maintain and operate a JV windfarm business of the scale envisaged.

### **5. Financial Implications**

- 5.1 Trustees have heard from Quayle Munro that achieving consent for the Viking Energy windfarm immediately means that the £3.8 million invested to date by the Shetland partner (90% from this Trust) is valued at somewhere upwards of £80 million.
- 5.2 Quayle Munro have indicated that at the next key milestone, readiness for contractual close, the Shetland share of Viking Energy should be valued at up to £175 million. The project team estimate that it will take around 18 months to reach the next milestone with the Shetland share of the project budget required being £7 million, with 90% of that figure coming from this Trust, £6.3 million. A breakdown of this figure is contained in Appendix A.
- 5.3 I will recommend that Trustees agree to invest to take the project through to the next milestone. Further decisions on whether to finally commit to contracts for turbines, civil engineering, project finance and many more will need to be made at that point. Further investment decisions will require to be made at future dates for example when the JV is required to make decisions on the project.
- 5.4 In the event of a delay in determination of the application for consent or if there is a decision that a PLI should be conducted then I will recommend that an interim investment budget of up to £360,000 is approved. This will allow the Trust's existing investment, and its potential future value, to be protected until a decision is taken or until the implications of a PLI decision can be considered and reported to a future Trust cycle.

## **6. Observations**

- 6.1 Before achieving consent, any investment by the Trust could be considered as speculative. HMRC (and Trustees) accepted that this was a reasonable investment for the Trust to make, taking into account the risks involved and the size of the investment (£3.42 million) relative to the Trust's overall portfolio (c. £220 million).
- 6.2 Should consent be achieved, the past investment in this project by the Trust of £3.42 million will be confirmed as a successful one. Quayle Munro estimate that each £1 investment would be worth upwards of £21.
- 6.3 Should the project be consented, Trustees are being asked to invest a further £6.3 million to take the project to the next milestone. Clearly, the level of risk would have gone down significantly, as it would now be a consented project and an asset with considerable value. The further investment of up to £6.3 million would take the total investment up to around £10 million, just under 5% of the Trust's portfolio. The Trust has other investments of this order of size: £7 million in the new offices at the North Ness (through SLAP); £8 million in the re-development of Scatsta Airport (through SLAP); £20 million in commercial property funds (the Trust itself, managed by Schrodgers); and £23 million in the land at Sullom Voe Oil Terminal (the trust itself). Overall, assuming that Quayle Munro's estimates of value are in the right "ball park" further investment in Viking Energy would be financially attractive.
- 6.4 The implications of a delay in the consent determination, of the decision being to hold a PLI or a decision to refuse the application are covered earlier in this report.

## **7. Recommendations**

- 7.1 I recommend that, should the Viking project be consented, Trustees note the financial success of their investment to date in Viking Energy, and agree to invest up to a further £6.3 million to take the project through to the next milestone.
- 7.2 I recommend that, should there be a delay in the consent determination by the Minister, or if his decision is to hold a PLI, Trustees agree an interim budget of up to £360,000 to provide sufficient continuity and cash flow to protect its current investment until a determination is achieved or until the implications of a PLI can be fully evaluated and reported to Trustees.
- 7.3 I recommend that should there be a decision by the Minister to refuse the consent application that the recommendations of this report be superseded by a subsequent report to a future Trustee meeting.





## APPENDIX B

CT1203016

Date	What	Subject	Who
26/03/2012	Seminar	Valuation	Quayle Munro
12/03/2012	Update by email	General	Ann Black, Chief Executive
19/01/2012	Update by email	General	Ann Black, General Manager
26/09/2011	Update by email	General	Ann Black, General Manager
06/07/2011	Report	Investment Budget	Financial Controller
24/03/2011	Presentation	Project Finance	Richard Simon-Lewis Lloyds Banking Group
24/03/2011	Progress Report	General	Financial Controller Aaron Priest
04/10/2010	Briefing Note	Project Finance	Financial Controller
29/09/2010	Presentation Q&A Session	Addendum launched	David Thomson Aaron Priest
24/06/2010	Update Report & Drawdown Report	Finance & Administration	Financial Controller
21/06/2010	Project Update & Q&A Session	General	Aaron Priest
11/02/2010	Presentation	Finance	Richard Simon-Lewis Lloyds Banking Group
03/11/2009	Presentation and Update report	Construction experience	Morrison Construction And Ecological QS
17/09/2009	Presentation	Project Finance SSE Experience	Philip Soden, SSE
01/09/2009	Reception	General	Ian Marchant, SSE
06/08/2009	Seminar	General	Aaron Priest
02/07/2009	Seminar	General	Aaron Priest

**APPENDIX B**

CT1203016

18/03/2009	Drawdown report	Finance	Financial Controller
08/12/2008	Presentation	Ecology/Peat	David Thomson
	Presentation	Economics	Stephen Kerr, Avayl
13/11/2008	Verbal Update	General	Financial Controller Aaron Priest
24/10/2008	Investment report	General	Financial Controller
11/09/2008	Presentation	General	David Thomson
	Presentation	SSE position	Simon Heyes, SSE
17/09/2007	Report	Up to £3m investment decision	Financial Controller
23/08/2007	Workshop	Finance	Brandon Rennet, SSE