Funicular Business Case or Financial Basket Case?

Description

This post takes a further look at the longer costs and benefits of the funicular railway at Cairn Gorm as set out in Highland and Island Enterpriseâ??s Full Business Case (FBC) (see here) .

Table 3.2: Preferred option costs – FBC compared to OBC

	Cost presented in FBC (£'s)	Cost presented in OBC (£'s)	Variance (£'s)	Rationale
Funicular capital costs	£16.16 million	£14.6 million	£1.56 million	This reflects an increase in construction costs following a revised assessment based on the detailed designs (Balfour Beatty – July 2020), inclusion of CMSL project management resource during the capital phase and updated professional fees.
Additional Capital costs	£4.35 million	£5.2 million	-£0.85 million	This reflects the prioritisation of additional capital expenditure.
Operating company revenue costs (30 years)	£141.35 million	£142.8 million	- £1.45 million	This reflects a change in the operating model in the short term in response to COVID-19 (i.e. site closure and extension of the capital phase).
HIE revenue costs	£9.80 million	£9.6 million	£0.2 million	Updates to reflect revised estimates of HIE revenue costs.
CMSL project management revenue costs (30 years)	£2.55 million	-	£2.55 million	Additional resource has been included based on the findings of the lessons learned review.
Total	**£174.21 million**	**£172.2 million**	**£2.01 million**	

default watermark

OBC = Original Business Case FBC = Full Business Case CMSL = Cairngorm Mountain Scotland Ltd, HIEâ??s subsidiary.

What I failed to mention in my first post on the FBC back in October (see here) was the total estimated costs of repairing and running the funicular and associated operations over the next 30 years â?? assuming the repairs work (see here) â?? **Â£174.21m.** Averaged out over 30 years that comes to costs of **Â£5,806,666 a year.**

I thought it worth comparing that to the income earned at Cairngorm since the funicular was built. The table shows the turnover of Cairngorm Mountain Scotland Ltd and its predecessors since 2001, with the third column showing that turnover adjusted to 2019 prices using the Bank of Englandâ??s Retail Price Index Inflation calculator:

Accounting period	Turnover	Inflation adjusted	Key events/Notes
30/04/2001	Â£ 1,773,733	Â£3,008,058	

30/04/2002	Â£	1,639,015	Â£2,731,212	23rd December 2001 funicular opens
30/04/2003	Â£	2,636,431	Â£4,321,228	
30/04/2004	Â£	3,099,161	Â£4,936,904	
30/04/2005	Â£	2,976,470	Â£4,604,334	
30/04/2006	Â£	3,295,431	Â£4,957,724	
30/04/2007	Â£	2,818,138	Â£4,108,387	
30/04/2008	Â£	3,595,933	Â£5,026,805	HIE takes over CML
30/03/2009	Â£	3,223,461	Â£4,333,320	
30/03/2010	Â£	4,802,292	Â£6,490,215	
30/03/2011	Â£	5,175,500	Â£6,686,072	
30/03/2012	Â£	3,139,334	Â£3,854,972	
30/03/2013	Â£	4,388,402	Â£5,221,080	
30/03/2014	Â£	4,448,816	Â£5,136,856	
30/03/2015	Â£	4,331,828	Â£4,886,387	CML sold to Natural Assets Investment Ltd
31/12/2015	Â£	2,050,393	Â£2,290,208	9 month financial year
31/12/2016	Â£	4,749,982	Â£5,215,047	
31/12/2017	Â£	3,547,475	Â£3,760,013	
No accounts				Funicular ceases operate, HIE buys back CML
31/03/2020	Â£	1,165,836	Â£1,165,836	Accounts cover 16 months

default watermark

NB Bank of England Inflation calculator is by calendar year and, where the accounts use a different period, the Inflation Adjusted column is only an approximate illustration of current prices.

The table shows that in only two years, 2010 and 2011, did Cairngorm Mountain earn enough money to pay for itself according to HIEâ??s current cost projections. Both those years, as Alan Brattey showed

in his Analysis of Funicular Passenger Numbers, attracted exceptional numbers of skiers and snow boarders.

Even if one excludes both capital and management costs from this analysis and instead uses the projected **Â£141.35m** operating costs that HIE believe are needed to keep CML going over the next thirty years, those average **Â£4,711,000** a year. In only 9 out of the last 18 published accounts has Cairngorm Mountain earned, on an inflation adjusted basis, even that amount.

Now consider the Â£4.35m additional capital investment that has been agreed as part of the Funicular Business Case:

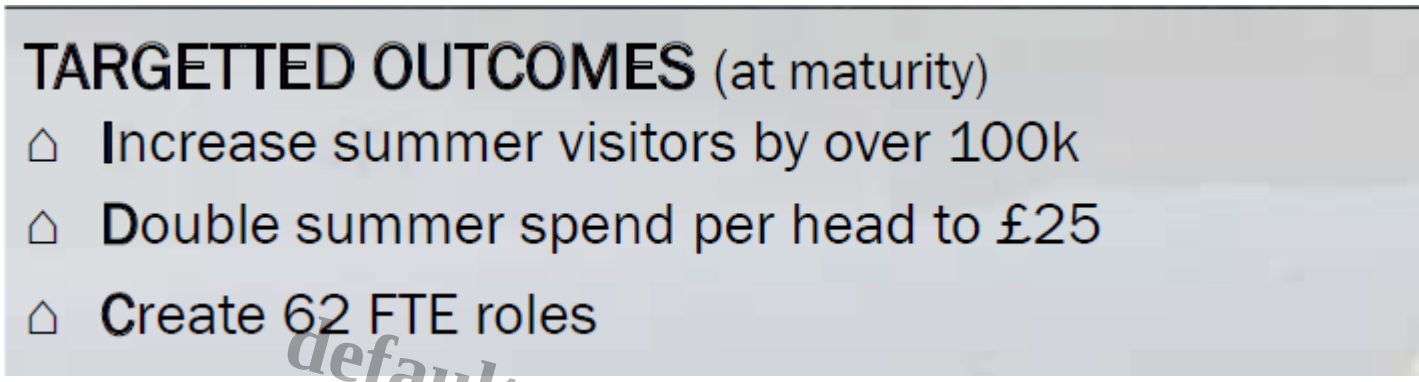
Table 5.2: High Priority Capital Investments

Cost Item	2020/21	2021/22	2022/23
Life extending - Day lodge *	[redacted]	[redacted]	[redacted]
Building improvements / upgrades - Ptarmigan			
Dilapidations			[redacted]
Existing tow infrastructure			[redacted]
Energy Efficiency audit			
Electrification of snow cannons			
Groundworks			
CCTV for Buildings			
Garage Facilities for Kassbhorers / Cannons			[redacted]
Ticket Machines & barrier			
Paths			[redacted]
Resurface & Draining at the Cas Car Park			[redacted]
Total construction cost			[redacted]
Contingency [redacted]%) **			[redacted]
Subtotal			[redacted]
Optimism Bias			[redacted]
Total			**£4,350,000**

Typical of HIEâ??s lack of transparency, all estimates of costs have redacted apart from the total at the bottom, so it is impossible to how much it proposes to invest on what. But none of the other income earners that have been proposed for Cairngorm, whether zip slides, tube slides or dry ski slopes are

included on the list. With snow lie in the Cairngorms projected to decrease (see here) and significantly less ski infrastructure on the hill than when the funicular was first built, the Full Business Case makes the Cairngorm Mountain business more dependent on the funicular than ever before.

It is not even clear from the FBC whether the Â£4.35m additional capital costs will allow for full refurbishment of the Ptarmigan. This was claimed, just four years ago (see here), to be crucial to reversing the drop in summer visitor numbers (as demonstrated by Alan Bratteyâ??s analysis).



HIEâ??s case for extending the Ptarmigan

default watermark

What is extraordinary about the FBC is the about turn: it makes no attempt to pretend that the funicular can ever, Ptarmigan or not, attract significantly increased numbers of visitors:

Table 5.10: Visitor and income per option

Option	Steady State Visitors per annum			
	Skier Days	Non-ski Winter	Summer	Total
Option 1a	0	0	0	0
Option 1b	30,000	12,142	26,197	68,340
Option 2a	30,000	36,060	70,171	136,231
Option 2b	30,000	36,060	70,171	136,231
Option 3a	30,000	45,075	87,714	162,789
Option 3b	30,000	45,075	87,714	162,789

The figures presented above are exclusive of financial costs (e.g. inflation).

While other options apart from 3a, which was approved by HIE and the Scottish Government, can be is worth noting the figures are demonstrably flawed. The number of skiers carried by a funitel (option same as a funicular yet HIE quotes 30,000 for all options.

If anything, the table underestimates likely visitor numbers. In the five years until operations were suspended in 2018, the funicular carried an average of 191,248 compared to a projected 162,789 visitors per annum. Again, HIE have not explained how they have worked out their projections, but the 30,000 skier numbers presents a significant drop on past figures (as contained in Alan Bratteyâ??s analysis). The table confirms that HIE effectively see no future snowsports at Cairn Gorm and suugests

that the recent investment in the snow factory (the cost of moving the snow factory to a better location is not included in the capital costs) and new beginners area is at best a distraction.

The low projected visitor numbers may be also an attempt by HIE to protect itself from future embarrassment and enable it to claim success if higher numbers of visitors than officially anticipated turn up.

Taking the projected costs and income together, the result is a net **Â£73.09m** operating loss for Cairngorm Mountain over the next thirty years:

Table 5.14: Net Present Value per option

	Net Present Value (30 Years)	GVA (30 Years)
Option 1a	- £16.03 million	£10.77 million
Option 1b	- £76.22 million	£96.20 million
Option 2a	- £107.80 million	£158.97 million
Option 2b	- £99.84 million	£154.34 million
Option 3a	- £73.09 million	£161.73 million
Option 3b	- £65.13 million	£157.09 million

default watermark

Note: the net economic impacts presented are at a national level

Net Present Value is a way of working out profitability at current prices. GVA = Gross Value Added

Although the HIE Board when approving the FBC in July (minutes here) recommended that *â??a clear and readable draft of the business case should be prepared for publicationâ?•,* what appeared was couched in jargon, repetitive and abstruse. It is no wonder people have failed to recognise the financial implications of Option 3a which the HIE Board and the Scottish Government have approved.

I am not against â??public subsidyâ?• for services that contribute to the common good. The way the FBC justifies the large operating loss is by claiming it is offset by Gross Added Value, all the indirect benefits that might flow from the repair of the funicular and its ongoing subsidy to the economy. The FBC does not explain how the claimed figure of Â£161.73 GVA is derived but does state it includes national benefits (like attracting skiers to Scotland as stated in the SE Group report in 2018?).

We know that ALL investment, public or private, has positive knock on effects for the economy. This is why Keynes stated it was better for government to pay people to dig holes in the ground than do nothing in a recession. It is possible therefore that HIE may have worked out the GVA figure of Â£161.73m, which offsets the net loss of Â£73.09m of operating the funicular, to produce a net alleged benefit of Â£88.64m, by using standard economic multipliers rather than any specific analysis of the likely impact. That interpretation is reinforced by several statements in the FBC that the investment will contribute to the recovery from Covid-19. So would paying people to dig holes in the ground, that does not make the proposal sensible.

There is NO attempt in the FBC to assess whether this large amount of money might not have greater impacts if invested in others things, whether at Cairngorm (e.g ski lifts), Speyside or the HIE area more widely. That is a complete abdication of responsibility by both HIE and the Minister responsible, Fergus Ewing, when government spending continues to be constrained.

Why would HIE commit itself to this long-term drain on its resources?

In their report on HIEâ??s management of Cairngorm Mountain and the funicular published in June (see here), Audit Scotland endorsed HIEâ??s decision to outsource CML in 2014 to the outfit known as â??Natural Retreatsâ?• stating:

â??The appraisal confirmed that a private operator was the preferred option. Over a 25-year period, it was expected to achieve the lowest cost and highest income for HIE, and it was the only option projected to deliver a positive financial return.â?•

default watermark

The whole disastrous outsourcing exercise to Natural Retreats was effectively justified by Audit Scotland on the grounds that HIE had a public duty to secure a positive financial return. Just a month later, at their Board Meeting in July, HIE abandoned that approach completely, showing it was hogwash, and agreed to commit to an ongoing financial loss.

Having had their budget slashed from Â£71.7 to Â£58.2m by the Scottish Government over the last two years (see here), one might think it strange that HIE would make such a long-term agreement. You would be right, they are not. It is the Scottish Government that has agreed to foot most of the Â£73.09m bill.

â??All costs are subject to full additional funding from Scottish Government. This also assumes, as previously confirmed by the Scottish Government, that Â£8.5m proceeds from the sale of a HIE asset will be made available to support Cairngorm activity in additional to normal business as usual capital spend of Â£300k per annum.â?•

The Â£8.5m refers to the proceeds of the sale of the highly profitable Centre for Health Science in Inverness. As an aside, the disposal of profitable assets and investment instead in unviable enterprises like the funicular is unfortunately helping to give public run enterprises a bad name.

The decision also appears to be contrary to European rules on state aid which the Scottish Government has stated it is committed to observing elsewhere (e.g the collapse of Bifab (see here)). The section of HIEâ??s Business Case that deals with state aid fails to explain how they can justify treating Cairngorm Mountain differently:

State Aid



In state aid terms, the issue is how can the Scottish Government justify favouring its own operation at Cairn Gorm over other ski centres and tourist attractions? In the case of snowsports, while Cairn Gorm has received huge sums of money for very little benefit, the other ski centres have been fobbed off with the odd grant here and there.

default watermark

In political terms, besides appearing a crude attempt to buy votes by the local MSP and Minister responsible, Fergus Ewing, (its crude because the money could be spent in much better ways on Speyside), he has committed the Scottish Government to making long-term budgetary commitments that would be unthinkable elsewhere. I cannot think of any other business or enterprise in Scotland that has been given such long-term guarantees of funding by government. Indeed, most organisations in receipt of public funding are forced to budget from one year to the next and live from hand to mouth. But not Cairngorm Mountain Scotland Ltd.

What needs to happen?

The Scottish Parliamentâ??s Audit and Public Scrutiny Committee, considered Audit Scotlandâ??s report on HIEâ??s management of the funicular shortly before (see here) HIE published the FBC for its repair. The timing doesnâ??t appear a coincidence, HIE appears to have deliberately delayed publication of the report, approved back in July, until after the hearing. The case, however, is still open to the Audit Committee. I hope they will now call on both HIE and Fergus Ewing to explain both the financial basis of their decision but also the reasons why the funicular failed and whether the Â£16.16m they intend to spend on repairing it is likely to work.

To provide independent verification of the facts, the Scottish Parliament could call on engineers from Balfour Beatty, the main contractors, and the other design engineers to explain whether they believe the repairs will work and why they appears to have failed to offer any guarantees for the work they are undertaking.

Beyond this, with Audit Scotland apparently incapable of offering the independent scrutiny that is required, it appears that only a full Public Inquiry, in which officials and politicians are required to give evidence under oath, will ever get to the bottom of why Cairngorm Mountain has been subject to such disastrous management and for so long.

Category

1. Cairngorms

Tags

1. CNPA
2. funicular
3. HIE

Date Created
January 16, 2021
Author
nickkempe

default watermark