National Audit Office

Report
by the Comptroller
and Auditor General

Department for International Development

Realising the benefits of the St Helena Airport project

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What this investigation is about

1 This investigation considers the likelihood of the Department for International Development (the Department) and the St Helena Government realising the expected benefits of a project to build an airport on the island of St Helena. St Helena is a small self governing UK Overseas Territory in the middle of the South Atlantic. The island has been in economic decline for over 40 years and its population shrunk by 20% between 1976 and 2008, a trend which has since reversed. These factors, combined with the island's physical inaccessibility, have led to St Helena having a substantial budget deficit and long-term financial dependency on the UK government.

2 The government's long-standing policy is to meet the reasonable assistance needs of the United Kingdom's Overseas Territories, where financial self-sufficiency is not possible. This responsibility flows from international law including the Charter of the United Nations. It also flows from the shared history of the United Kingdom and its Overseas Territories and a political commitment to the wellbeing of all British nationals, and has been set out in government White Papers since the 1960s, most recently in the 2012 Overseas Territories White Paper.

3 The Foreign & Commonwealth Office has lead responsibility for the constitutional relationship between the UK and its 14 Overseas Territories. The Department provides financial and technical assistance to the three Overseas Territories which are eligible for official development assistance. The Government's aims for Overseas Territories are to ensure basic services, which in the case of St Helena includes maintaining access for its citizens, and to help them become economically self-sufficient. The second aim should reduce and eventually remove the need for subsidies from the UK government.

4 In 2015-16, the Department gave St Helena a subsidy of approximately £17 million to bridge the gap between the St Helena Government's domestic revenues and the costs of delivering its public services. It also provided further funding of £11 million for the Royal Mail Ship (RMS) St Helena (which currently provides the only regular cargo and passenger services to the island), to help attract skills and experience not available on the island, and for capital projects.

5 In line with this policy, the Department is funding a £285.5 million design, build and operate contract for an airport in St Helena to improve the island's accessibility, supporting development of its tourist industry. The Department anticipates that, if the airport boosts the tourist industry as projected, the additional income generated will help to revive St Helena's economy. The island will then become self-sufficient, no longer requiring a subsidy from the Department.

6 The airport is now built, and the St Helena Government had planned to start operating it in May 2016. In April 2016, the St Helena Government announced that further safety and operational work was required to address the impact of difficult wind conditions on landing aircraft safely. It therefore has delayed the airport's opening date. A revised date is yet to be determined. The RMS St Helena is not due to come out of service until July 2016, and therefore can be used up to that date. The Department, with the St Helena Government, is looking at alternative access options beyond this date.

"The main driver for development of an airport and the subsequent introduction of air access is the need to revive St Helena's failing economy and reduce St Helena's heavy and increasing dependence on UK budgetary support, provided that this can be delivered at an acceptable cost."

"The dearth of clear comparable precedents leads to high levels of uncertainty in the level of benefits that air access will deliver, and it must be accepted that this project is high risk."

The Department for International Development's business case for an airport on St Helena (2011)

7 Our previous work looking at the UK's High Speed Rail projects identified issues related to assumptions in the business case, for example, around projections for passenger numbers. We looked to apply the knowledge we gained from this work to the Department's business case for the airport.

8 Our investigation looks at the key assumptions in the Department's cost–benefit analysis to support its investment in the airport. We also consider the ability of the Department, in partnership with the St Helena Government, to realise the benefits from improved access to the island that they expect the airport will provide. We have focused on three areas:

- the realism of the assumptions in the Department's business case for the airport;
- progress with preparing the island for an increase in tourists; and
- projections for withdrawing the Department's subsidy to the St Helena Government in its business case for the airport.

9 Our investigation considers the likelihood of the Department and St Helena Government realising the benefits of the project. We do not conclude on whether the project offers value for money. Our investigation does not examine the procurement process for the project, which was the subject of a gateway review by the Major Projects Authority in January 2011.

10 Our methods are set out at Appendix One.

Key facts

£285.5m	£27.8m	4,100
cost to the Department for International Development of the design, build and operate contract for the airport (2011 to 2026)	total subsidy paid by the Department for International Development to the St Helena Government in 2015-16, excluding funding for the airport	number of inhabitants on St Helena

29,208	number of tourists projected to visit St Helena annually by 2042
150	number of tourist beds on St Helena in 2016
£246 million[1]	avoided cost of replacing the Royal Mail Ship St Helena (three times during the life of the airport)
£19.1 million /1.06	net present value/benefit–cost ratio for building the airport in St Helena stated in the 2011 business case
2043	year when the 2011 business case stated the Department for International Development could stop paying an annual subsidy to the St Helena Government

Note

1 At 2011 quarter 4 prices.

Summary

Key findings

The Department for International Development's objectives for the project

1 **The Department for International Development (the Department) supports St Helena financially through subsidies and other funding**. For 2015 16, the Department estimates that it will give the St Helena Government £16.7 million to fund the gap between its revenues and the costs of its public services. It will provide a further £2.7 million to run the Royal Mail Ship (RMS) St Helena, the only way to access the island. These subsidies are supplemented by funding to help the island attract the skills it needs (£1.6 million in 2015-16) and to fund capital projects (£7.2 million).

2 **The Department has clear objectives for its investment in an airport on St Helena**. The Department's aims for the airport are to maintain access and, by increasing tourism, investment and population growth, to lead to St Helena becoming financially self-sufficient. It anticipates that this will in turn remove the need for a subsidy from the UK. The Department also expects the airport to generate what it describes as non-quantified social benefits, such as improved access to healthcare. The Department recognised that it was uncertain whether the St Helena Government would deliver on its commitments in order to maximise the benefits that could be derived from air access.

The Department's business case

3 **The Department's decision to go ahead with the project to build an airport on St Helena was based on a business case which considered different sea and air access options**. These included continuing to fund access to the island by sea, via successive replacements of the RMS St Helena. In October 2011, the Secretary of State approved the business case to build and then operate an airport on the island. The direct cost to the Department of the project was estimated at £285.5 million – to design, build and operate (for 10 years) the airport.

4 **The Department's cost–benefit analysis for the airport showed a positive outcome in terms of investing in the airport**. The Department's analysis considered the cost of constructing the airport and then operating it for the 40 years, together with the cost of constructing facilities to store and distribute fuel. It also quantified benefits such as not replacing RMS St Helena, an increased number of tourists and therefore spending, and a growth in tax revenues for the St Helena Government from increased economic activity. The Department described the project's net present value (of £19.1 million) and benefit cost ratio (of 1.06) as 'relatively modest' however.

5 **The Department strengthened its case for proceeding with the airport when it considered non-monetised benefits**, such as reversing the decline in the island's population, access to improved medical services, and improved employment prospects. These benefits were identified by consultants commissioned by the Department and the St Helena Government. The Department concluded that "it was reasonable to assume a large net positive outcome for the project" when unquantifiable costs and benefits are taken into account. However, its own consultants concluded that the risks of these benefits not maturing were 'considerable'.

6 **The Department forecast that it would stop paying its annual subsidy to reduce the St Helena Government's budget deficit in 2043, assuming the airport opened in 2016**. The Department's business case include provisions for other financial support – such as other capital projects – up to 2079.

7 **The Department's cost–benefit model for the project is particularly sensitive to two assumptions – the number of tourists who will visit the island once the airport opens and the amount they will spend.**

- The Department's business case presented data for the growth in tourism on four other islands. We applied these rates of growth to the Department's model. If St Helena followed the trajectory of three of the four cases, its net present value would be positive; only if it followed the fourth case would it be negative. But the Department's business case explains that none of the four are clear comparators and that there remain high levels of uncertainty about how tourism might grow on St Helena.
- If spending per tourist per day is £195 (a maximum amount based on the Department's inquiries on the island in April 2016), estimated benefits exceed estimated costs. If spending per tourist per day is £82 (the minimum amount), estimated costs exceed estimated benefits.

8 **The Department's business model assumed that there would be sufficient flights and accommodation for the tourist numbers projected in the business case**. The business case refers to the airport's capacity for increased flights in line with the Department's projections for tourist numbers. However, it did not consider the availability of accommodation for the tourists once they arrived.

Preparing the island for tourism

9 **The Department agreed to finance the airport subject to the St Helena Government implementing reforms to open the island to inward investment and increased tourism**. This included changes to its tax regime and to its policy on land disposals. In 2010, the Department and the St Helena Government signed a Memorandum of Understanding setting out their commitments and responsibilities. In 2012, the Department concluded that the St Helena Government was making 'generally good' progress against its targets in the Memorandum.

10 **The St Helena Government's ability to attract investment to support a growth in tourism has, to date, been limited**. In 2014, the Department concluded that the island's investment culture was not conducive to larger investments, and identified a number of investment risks. For example, the island did not have a proven track record of attracting tourists. A similar review in 2015 was generally more positive about the investment climate but still aired concerns.

11 **St Helena has sufficient accommodation for the number of tourists projected to visit in the first six years of the airport's operation in terms of bed numbers (assuming visitors are spread evenly over the year and that they do not stay for more than a week)**. But the St Helena Government recognises that it needs to improve the quality and type of accommodation on offer. It is looking to add to the stock of existing tourist accommodation by building a 30-room hotel. It aims to have this ready by the middle of 2017.

The Department's potential future liabilities

12 **The Department could incur additional costs as a result of delays to the opening of the airport**. The Department and the St Helena Government are currently considering options for addressing the impact of difficult wind conditions on landing the aircraft safely. The Department has not yet forecast the additional cost of each option.

13 **The Department's estimates show that its subsidy to the St Helena Government will be less than had it decided to replace RMS St Helena**. The Department has estimated that the total subsidy it will pay between 2011 and 2043 (the year work on the airport started and the year it estimates that it will no longer pay a subsidy) is £667 million. In comparison, its estimated total subsidy over the same period would be £834 million had it decided to commission successive replacements of RMS St Helena instead.

14 **The Department is underwriting the cost of the air service for the first three years of its operation**. The Department told us that, in order to attract interest in operating the air service from South Africa to St Helena, it had to cover the risk that demand was less than capacity for the first three years of the service's operation. The Department's potential liability in the first year of the airport's operation is £1.9 million.

Conclusion

15 Given the limited number of precedents for building an airport in a remote location such as St Helena, estimating the likely costs and benefits of a project such as this is an inherently difficult task. The Department's estimate of the total subsidy it will pay the St Helena Government between 2011 (when work on the airport started) and 2043 (when it forecasts its annual subsidy will end) is £667 million. Sensitivity analysis shows that the year in which the Department stops paying an annual subsidy, and the total paid, will depend on whether the estimates of, for example, tourist numbers and tourist spend are exceeded or missed.