

## **Plymouth City Airport – Response to Notice of Non Viability**

### **I. Introduction**

- I.1. The primary purpose of this report is to summarise the expert evidence and detailed due diligence that has been undertaken in informing Plymouth City Council's (PCC) response to Plymouth City Airport's (PCA) notice of closure, which Sutton Harbour Holdings Limited (SHH) formally served on PCC on 24 December 2010 (see 2 below).
- I.2. This report also seeks to assess the economic contribution of PCA to the Plymouth economy; to better understand its importance in the City's wider connectivity and to test the viability of different models of commercially sustainable aviation.
- I.3. Plymouth City Council has historically supported Plymouth City Airport including commissioning a business plan in 2007 to review the long term prospects of PCA which included supporting the sale of development land to improve airport infrastructure.

### **2. The role of the Council in assessing Airport Viability**

- 2.1 The role of the Council in considering PCA's notice of closure for non viability, along with the associated process, is clearly defined in the airport lease.
- 2.2 PCA is owned by SHH and is held on two related leases from the City Council for 150 years from April 2004. The Airport lease enables PCA to close the airport if it is not viable for its Principle Purpose. The Principle Purpose is clearly defined "*as a public airport providing passenger air services on a regular and commercial basis to members of the public*". The assertion of non viability must be supported by detailed financial evidence. In the event that the City Council and PCA disagree that the airport is not viable then the matter is referred to legally binding arbitration.
- 2.3 PCA served a Non-Viability Notice on the Council on 24 December 2010 which gives 12 months' notice of closure of the airport, on the grounds that the business is non-viable for its principle use under the Airport Lease. PCC needs to respond to the Notice as soon as practicable but in any event no later than the expiry of the Notice which will be on 23 December 2011.

- 2.4 The scope of the Council's response to the notice of closure is limited to considering if it agrees with PCA's reasons for stating that airport is not viable. In addition the consideration of viability relates only to the Principle Purpose only (see 2.1 above). The Council's decision must be evidenced based and is subject to a legally binding arbitration in the event of disagreement.
- 2.5 It should be noted that certain options considered in this report such as General Aviation (GA) operating at an unlicensed airfield and Mothballing fall outside the Airport's Principle Purpose and therefore are outside of the scope of the Council's consideration. In the case of GA there are no scheduled public services and in the event of mothballing there are no passengers at all.
- 2.6 If the Airport is found to be not viable for its Principle Purpose, then SHH are entitled to close the Airport. Under the terms of the lease the freehold and the long leasehold interests in the airport site will be merged and SHH will have control of the marketing and disposal of the site, subject to oversight by the Council. Once sold the airport proceeds are split in accordance with the provisions in the lease.

### **3. Background and Timeline**

- 3.1. In 1997 Plymouth lost its Heathrow connection operated by British Airways plc (BA) and therefore convenient access into a hubbing airport. SHH purchased the leasehold interest in PCA from (BA) in April 2000. BA served notice to terminate its air services in 2003 and SHH decided to set up its own airline company Air South West.
- 3.2. Plymouth City Airport is owned by Sutton Harbour Holdings Limited and is held on two related leases from the City Council for 150 years from April 2004.
- 3.3. PCA has not made a trading profit on air services since 2003, and has relied on inter-company loans from SHH in order to continue trading. In the last two full trading years (2010 and 2011) the company has, with the agreement of the City Council, generated capital receipts from the sale of surplus airport land which have funded its past trading losses.
- 3.4. On 8th July 2009, SHH obtained planning permission for 375 homes, 3,000 square metres of business units, a care home, associated parking and landscaping and various airside infrastructure works on 2 areas of surplus land at the end of redundant runway 06/24.

There was no provision for affordable housing, and other planning obligations were waived pursuant to Core Strategy Policy CS27. This land was subsequently disposed of most of to Cavanna Homes. Although many of the homes have been completed, and some of the Section 106 requirements met, or remain to be provided at a later date there remain a number of commitments outstanding.

3.5. In 2009 Flybe announced the introduction of a new service connecting Newquay to London Gatwick, directly competing with Air South West's existing Gatwick connection which also operated out of Newquay.

3.6. In May 2010 Air South West pulled out of the London City Airport due to a lower than anticipated customer demand and unsustainable losses.

3.7. ASW was latterly the only scheduled airline operator serving Plymouth and was sold by SHH in November 2010 after making trading losses due to competition on its main service to Gatwick. The purchaser Eastern Airways subsequently withdrew the Gatwick service and has recently announced that it will cease all services from Plymouth from 14th September 2011 and that the ASW brand will cease to exist with effect from 30th September 2011.

3.8. The last scheduled flight left Plymouth however on July 28th. This is because Air South West has ceased operations over August due to radar issues.

#### **4. Actions to Support the Airport and Air Services.**

4.1. The Airport is a strategic asset and PCC has remained in close dialogue with SHH over the past 2 years as it became increasingly clear that the airport was becoming under financial pressure. In seeking a long term commercially sustainable future for the airport the following activities were undertaken, working closely with the City Council's aviation advisors Mott MacDonald's:

- Detailed expert consideration of Public Service Obligations and Aviation White Papers.
- Specialist advice on unsuccessful OFT ruling into anti competitive behaviour.
- Commercial approach to 16 potential airlines to operate services from PCA.
- Dialogue with new potential airport operators.
- Discussions with the CAA on licensing and safety issues.
- Exploratory discussions with neighbouring authorities and airports operators.
- Meetings with SHH and Eastern Airlines.
- Letters/communications and discussions with Ministers, GOSW and the RDA.

4.2. The airport has also received significant historical support from the public sector including a £3.7m grant from the RDA in 2004 towards road and runway improvements. In addition through the sale of development land in 2010 Plymouth City Council made a significant financial contribution, contributing its share of the capital receipt, to support the airports operations and upgrade.

## **5. Sutton Harbour Holdings - Notice of Non Viability.**

5.1. On 24 December 2010 the owner of PCA, Sutton Harbour Holdings plc wrote to PCC informing it, that in its opinion, there was no longer a viable business and 12 months notice was given of its intentions to cease operations.

5.2. The principle reasons for the non viability conclusion reached by SHH as stated in the non viability notice (supported by detailed financial evidence) were:

- A loss before tax of £798,000 was recorded on trading activities FY 2009/2010.
- A loss before tax of c. £462,000 was recorded in the period 1 April 2010 to 30<sup>th</sup> September 2010.
- Significant ongoing losses were forecast to FY 2012.
- A steady decline in passenger numbers resulting from increased competition.

## **6. Plymouth City Council –Evidence to Inform Response to Non Viability**

6.1. In order to inform the Council's response to PCA's non viability notice the City Council has commissioned 2 studies:

- Plymouth City Airport – Economic Study into Air Services for Plymouth by Berkeley Hanover Consulting Ltd.
- Plymouth City Airport – Financial Due Diligence Report by Grant Thornton.

6.2. The Economic study was jointly commissioned with the Plymouth Chamber of Commerce and Industry. The Aims of the report were threefold. Firstly to review the context and recent history of PCA. Secondly to establish the importance of PCA to the local economy including inward investment. Thirdly, to establish the aviation options available for the continuation of airport activities on the current site and to assess the financial implications including risks of each option.

The Economic Study includes a survey of 25 major companies operating in Plymouth which between them account for 60% of the City's workforce.

6.3. Berkeley Hanover are internationally recognised aviation consultants and economists with experience working with Heathrow, Farnborough, Cape Town, Johannesburg, Gatwick and Dubai airports. In addition they were the lead aviation economist for the SW aviation study that fed in the 2003 Aviation White Paper and have worked with several local authorities.

6.4. The Financial Due Diligence report was commissioned by Plymouth City Council to *“gain an understanding of the key profit drivers for PCA and historical trends in trading; form an assessment of the underlying financial performance and to assist the Council with considering the validity of the Non Viability notice submitted by PCA”*. Grant Thornton is a blue chip internationally recognised accountancy practice with 4000 UK employees.

## **7. Financial Due Diligence**

7.1. Grant Thornton highlight a number of key issues in coming to a conclusion:

- PCA's revenue has been largely dependent on one customer (Air South West). Revenue declined due to the termination of services to London City and London Gatwick Airports in May 2010 and January 2011 respectively.
- Air South West has provided PCA with notice that all flights will cease to and from PCA on 14 September 2011. This will leave PCA with no regular scheduled services.
- The Cost base of PCA is broadly fixed in nature due to the high levels of regulation imposed by the Civil Aviation Authority.
- PCA is restricted in terms of the size of aircraft it can accommodate, with Exeter and Newquay both having considerably longer runways.

7.2. The report goes on to highlight that *“PCA is a loss making business that has relied on long term funding and one off income such as property sales in order to remain solvent”*. Significant competition from FLYBE is highlighted as a significant contributing factor to the lack of PCA's profitability. Until the sale of development land in FY 2010, the airport had been funded by Sutton Harbour through intercompany loans.

### 7.3. Conclusions

- The report concludes that *“given the current commercial operating environment and the fact Management has explored all appropriate opportunities of attracting new customers, a fundamental change in how the airport operates would appear necessary in order to generate sustainable profits”*.
- The report also clearly states that Grant Thornton has *“not noted any operating costs that appear inappropriate in the context of the Company’s operations and its CAA operating requirements”*.
- The report states that PCC should, in responding to the notice of non viability, consider *“an options analysis for the airport...based on operating with a different CAA category”*. Grant Thornton acknowledges this activity is being undertaken as part of the Berkeley Hanover economic study.

## 8. Economic Study into Air Services

8.1. Berkeley Hanover highlight the following key issues in coming to a conclusion (references in italics are direct quotes from the study):

### 8.2 Context

- PCA’s loss of the Heathrow connection in 1997 signalled the beginning of the decline in the strategic importance of the airport. This decline was accelerated by the loss of the Gatwick connection in 2011.
- PCA’s passenger traffic peaked at 125,000 in 2009. The 2011 passenger forecast will be less than 50,000.
- In 1995 PCA accounted for 5% of all passengers in SW airports (Bristol, Exeter and Newquay). In the period 1995 to 2010 passengers through SW airports trebled where PCA remained static. As a result PCA’s share of passengers dropped to 1.4% and with the loss of Gatwick will drop below 1%.
- The short runway severely restricts aircraft types and therefore the size of the potential aviation market available to Plymouth. The report states *“whatever decisions are taken now the long term future for PCA as a commercial airport would appear very limited.”*

### 8.3 The Economic Importance of PCA

- Given the range of alternatives for London, European, international and UK regional connectivity the economic importance of PCA has declined and represents a very small element of connectivity to and from Plymouth.

- Business travellers have adapted to the loss of Heathrow and are now adapting to the loss of Gatwick. The actual usage of PCA by local companies is very low.
- There is no evidence that the declining importance of PCA has detrimentally effected inward investment. The report states “*We cannot identify any evidence that the closure of PCA would have a significant impact upon future inward investment decisions*”.
- Direct employment associated with the airport is estimated to be c.100 jobs.

#### 8.4 **Connectivity**

- In interviewing Plymouth’s largest 25 companies (accounting for 60% of the City’s workforce) the report states that Businesses have a preference for rail connectivity and improved rail services; specifically the report states “*for Plymouth businesses, the Plymouth to London services were reported to be satisfactory but there was great dissatisfaction with the London to Plymouth early morning services*”.
- The report concludes “*given the range of alternatives for London, European, international and UK regional connectivity, the loss of the already diminished PCA services is not expected to reduce Plymouth businesses overall competitiveness*”.

#### 8.5 **PCA Options**

- The study assessed the following 5 options.
  - 1) The Continuation of PCA in its present mode (option 1).
  - 2) A licensed airport for 19 seater scheduled service aircraft (option 2).
  - 3) An unlicensed airfield with no scheduled services (option 3).
  - 4) Mothballing the airport (option 4)
  - 5) Closure of PCA (option 5)

- The risks of each option are assessed below:

Option	Description	Financial Implications	Financial Risk and Exposure for PCC	Financial Risk to Airport Operator
1	Status quo: scheduled services with 50 seater aircraft (RFFS5)	At least £1 million/year subsidy – commercially unviable	<b>High</b>	
2	Highly limited scheduled services (2/3) largely with 19 seater aircraft (RFFS3) with a few 50 seater aircraft (RFFS4)	With military presence, modest surplus, without military deficit £150,000/year – unlikely to generate acceptable commercial returns	<b>Medium/High</b>	
3	General aviation unlicensed airport: no scheduled services, up to 9 seater charter	With military presence in surplus, without military barely cost covering	<b>Low</b>	
4	Mothballing	£150,000/£250,000 pa maintenance and security	<b>Low/Medium</b>	<i>Not applicable</i>
5	Closure	£50,000/£100,000 initially plus £20,000 pa security	<b>Very Low</b>	<i>Not applicable</i>

- In considering these options the study states “*The retention of any financial risk by PCC in any of these options is difficult to justify and the willingness of prospective new airport operators to assume total financial risk at any level of airport operations needs to be robustly tested and validated*”.
- Option 1 is rejected due to the requirement for a revenue subsidy in excess of £1m/annum (plus significant capital investment) and therefore is clearly not commercially viable.
- Option 2 is identified as medium to high risk due to the requirement to find an airport and airline operator willing to operate a Category 3 airport at full commercial risk and with sufficient critical mass to break even.
- Option 3 appears financially viable but is outside of the Airport’s Principle Purpose (see 1.1 to 1.4 above) defined in the lease. This is due to the fact that such a facility will have no scheduled public passenger services. As a result option 3 is not a consideration when responding to the non viability notice.



- Option 4 is also outside of the scope of the airports Principle Purpose and has significant risks associated with CAA derogations as well as an annual cost of up to £250,000 with no associated income. As a result option 4 is also not a consideration when responding to the non viability notice.

## 8.6 Conclusions

- The Study concludes that *“at its current level of operation, PCA and its air services are no longer of material importance to the vast majority of companies operating in and around the City”*.
- The study concludes that *“it could be possible to operate a very limited scheduled airport or a general aviation airfield that could be broadly cost covering, though the likelihood of commercial profitability is very low to non-existent”*.
- The study concludes that *“in the absence of any meaningful positive economic contribution to the City of Plymouth, we are unable to identify an economic rationale for PCC to underwrite the commercial risks involved in maintaining any scale of airport operations at PCA”*.
- The Study concludes that *“the provision of better rail connections from and to London is viewed as a higher connectivity priority that the continuing availability of a diminished PCA”*.
- The Berkeley Hanover Concludes that *“alternative uses of the site would enhance the mid to long term growth rates of economic development in the corridor”*

## 9. Category 3 Airport Soft Market Testing

9.1.A category 3 airport is identified as a potential option (option2) in the Berkeley Hanover Study. A category 3 airport is a licensed airfield for smaller aircraft (up to 19 seats) which has lower levels of cost due to lower levels of CAA regulation (e.g. fire cover).

9.2.Berkeley Hanover suggests that a Category 3 airport might break even with the following assumptions: a 19 seat aircraft operating 4 times / day, an airport operator prepared to take all the commercial risks of operation (including future capital requirements), the retention of FOST, the retention of all existing commercial activity and the imposition of a passenger tax.

9.3.The study identifies this option as medium or high risk due to the difficulty of securing an airport operator, the difficulty in attracting airlines, the likelihood of an ongoing public subsidy and the difficulty in generating passenger revenues.

9.4. Whilst the possibility of a commercially viable airport with a Category 3 licence seems remote, the City Council felt it was important to commission an additional piece of evidence following receipt of the Berkeley Hanover study to understand if there was demand in the market from airline and airport operators willing to operate Plymouth Airport with a category 3 or Category 4 license without public subsidy.

9.5. The City Council therefore commissioned Oriens Advisors Ltd in July to undertake a soft market testing exercise to look at the private sector appetite to operate a category 3 or Category 4 airport that could safeguard PCAs future on a commercial basis. The brief posed the following questions:

- Are there any airlines which independently or collectively would be willing to establish immediately and without ongoing financial subsidy a network of air services, sufficient to make the airport commercially sustainable?
- Are there any potential airport operators, who would be able to commit quickly to take over the running of PCA and provide sufficient financial investment to meet any future licensing, operational and development funding?

9.6. The City Council recognised this work significantly overlapped that of Mott MacDonald's in 2010 (see 4.1) but it was felt that the importance of the issue merited a second cross checking analysis to ensure proper due diligence.

9.7. Oriens identified and investigated commercial interest from 12 potential airlines and 17 potential airport operators capable of operating reduced cost category 3 or category 4 airport operations.

9.8. The principal conclusions of Oriens analysis were:

- Although there exist a range of airlines capable of operating from a downgraded Plymouth airport. None were in a position to make firm commitments to establish services on commercial terms, within required timescales and with sufficient scale to make the economics of operating the airport viable.
- Whilst given greater time, it might be possible to achieve a modest route network, the uncertainty and costs associated with doing so, would present a substantive risk to the Council
- There is insufficient critical mass of profitable routes.

- It is highly unlikely a private airport operator would consider investing in PCA as an independent entity unless PCC were willing to enter into some form of under-writing.

9.9 Oriens state “*there is no evidence of a commercially viable future for PCA that can be put in place in the short term or without some form of capital or revenue subsidy to enable longer term options to be explored. And even these options must be recognised as presenting high implementation risks*”.

## **10. Plymouth City Council – Response to SHH Non Viability Notice.**

10.1. In detailed and careful consideration of the expert evidence provided by Berkeley Hanover, Grant Thornton and Oriens Advisors; it is the assessment of Plymouth City Council that Plymouth City Airport is not viable for its Principle Purpose “*as a public airport providing passenger air services on a regular and commercial basis to members of the public*”. The rationale for this decision is set out below:

1. PCA provides no significant or material economic value to the City at its current level of operations. Travellers have been migrating to other airports and other modes of travel ever since air links to Heathrow were lost in 1997.
2. There is no evidence that the closure of PCA would lead to any significant derogation of connectivity for the business community, or would result in any less inward investment than with PCA as currently operating.
3. There is no economic case for public investment in PCA.
4. There is evidence from Berkeley Hanover highlighting the potential for higher employment and productivity to be gained from alternative uses of the airport site.
5. There is no model of public air service operation, even with smaller aircraft, that will operate without public subsidy. Neither are there any airport operators that would take over PCA and keep the airport open without public subsidy.
6. We have soft market tested using Mott MacDonald’s and Oriens advisors demand for a commercially viable reduced cost airport (Category 3 or 4) and found no interest.
7. In terms of the previous operation of PCA, there are no material areas of concern in relation to its trading accounts or the application of funding.

8. Owing to its relatively fixed operating costs, but diminishing trading income, PCA is now non-viable for its principle use as defined in the Airport Lease.
- 10.2. It should be noted that all 3 expert studies have independently concluded that there is no real possibility of PCA becoming a commercially sustainable operation.
- 10.3. It is therefore recommended, on the basis of the expert evidence derived from the 3 reports outlined above, and legal advice (internal) that the Council should accept the notice of non-viability served by PCA on 24 December 2010 and that there is no legal basis for challenge.

## **11. Flag Officer Sea Training and Emergency Services**

- 11.1. The City Council has been in dialogue with Flag Officer Sea Training (FOST) and the Plymouth Primary Care Trust to understand their usage of PCA and what the impact of the closure would be upon their operation
- 11.2. Discussions have been held with FOST, PCA and PCC to understand, in the event of closure, whether the helicopter movements associated with Flag Officer Sea Training (FOST) and Air/Sea Rescue flights (all under military control) could continue until the airport site is authorised and required for redevelopment purposes.
- 11.3. These discussions will now be taken forward in detail over the coming months and before PCA closes on December 24<sup>th</sup> to see if a temporary solution can be found. It is understood that contingency plans are in place in the event of closure of PCA.

## **12. Planning Position**

- 12.1. A consequence of the findings from the economic study into air services for Plymouth Airport is that its commercial airport role is now uncertain, and that it will be some time before the airport's future can be decided.
- 12.2. Because the airport currently falls within the Derriford and Seaton AAP area, this uncertainty would mean significant delays in progressing the AAP through to adoption, which in turn would unduly delay a number of very significant

development proposals in this area. In order to avoid these problems it is recommended that the area covered by the Derriford & Seaton Area Action Plan is amended to exclude Plymouth Airport, so that the AAP's proposals, all of which can be progressed independently of any decision about the future of the airport, can be taken forward and delivered without delay.

- 12.3. In considering the future of the airport itself, this issue is considered of such strategic significance that it would be more appropriate to prepare future options for the airport as part of the Core Strategy Review, which is being initiated during 2011. Cabinet on 12th July 2011 supported the instigation of the Core Strategy Review and the continuation of the existing policy framework for the land at Plymouth airport.

### **13. Rail Connectivity**

- 13.1. Berkeley Hanover through their business survey found that rail travel was favoured over the Gatwick air link due to greater convenience and better reliability. Improved rail connectivity was also prioritised by businesses and a need for improved train services clearly identified.
- 13.2. For Plymouth businesses, the Plymouth to London early morning services were reported to be satisfactory but there was great dissatisfaction with the London to Plymouth early morning services used by visiting business partners.
- 13.3. Good access to Plymouth from London early in the morning (e.g. 7am) with a fast train is deemed a basic requirement for the City's overall connectivity, particularly in the absence of a convenient air service to/from the South East. It is also clear that wi-fi access on trains is a high priority for the business community.
- 13.4. Following the appointment by the Council last week of consultants to undertake an Economic Study into Rail Services for Plymouth the City Council and partners are now developing the case for better and more regular rail connectivity, services and infrastructure provision. This will involve lobbying DFT ministers on these matters and preparing the evidence base to inform the DFT of the requirements to be included in the ITT for the new Great Western franchise. The aim being to enable all trains between Plymouth and London to take 2 hours 45 minutes and to secure a daily 7am departure from London Paddington.

## 14. Impact on Economic Strategy

- 14.1. Plymouth's Local Economic Strategy was published in October 2006 and sets out a highly ambitious agenda for growth with targets for the creation of 42,000 new jobs by 2026, raising Gross Value Added (GVA) to the national average by 2016, together with a wide range of employment, participation, business growth, knowledge, economy and skills goals that would assist in achieving these ambitions.
- 14.2. There are no doubts that connectivity for a City such as Plymouth is vitally important and efficient transport connections are vital for the facilitation of economic growth and this is clearly recognised in the Economic Strategy, Local Transport Plan and Core Strategy.
- 14.3. However our findings from the Berkeley Hanover report make it clear that PCA has failed to capture the significantly higher levels of traffic set out in the York Aviation study. Whilst PCA did have the potential in the 1990s to capture significantly higher levels of traffic it appears that other elements of connectivity have effectively provided alternative services to meeting both the needs of domestic and international travel. The study states *"The importance of PCA has diminished dramatically and currently represents a very small element of connectivity to and from Plymouth. Business travellers have previously adapted to the loss of Heathrow and are now adapting to the loss of Gatwick."* *"Our research confirms that companies have adapted to the declining role of PCA and the recent use of PCA by local companies has been very low.*
- 14.4. The Berkeley Hanover report also found that none of the companies interviewed had *"indicated the existence of PCA and its services had been a factor in the decision to proceed with inward investment (decisions)"*
- 14.5. The Berkeley Hanover report also states alternative uses of the PCA site will, in their opinion, will drive growth rates faster than the current use.
- 14.6. The City Council is continuing to drive forward the implementation of the economic strategy through the Plymouth Growth Board and recently appointed Heart of the South West LEP. Connectivity issues will continue to be addressed through initiatives to improve digital connectivity, lobbying on rail connectivity, inward investment and marketing activity.

## **15. Recommendations**

- 15.1 The Council accept the Notice of Non-Viability dated 24 December 2010 that PCA Limited/Sutton Harbour Holdings Limited wish to close Plymouth City Airport for its principal use of providing public commercial air services.
- 15.2 The Council enter into discussions with PCA Limited/Sutton Harbour Holdings Limited with the aim of securing continued use of the airport for FOST and search and rescue on a temporary basis whilst future options are considered.
- 15.3 To amend the area covered by the Derriford & Seaton Area Action Plan so as to exclude Plymouth Airport, as identified in the report, and to incorporate this change in a revised Pre-Submission Draft of the AAP for further consultation.
- 15.4 Until such time as the Core Strategy Review (Plymouth Plan) is submitted for public examination, instruct officers to continue to apply the Council's current planning policies and guidance for Plymouth Airport, including:
  - Adopted Core Strategy: Area Vision 9 (2) and Vision Diagram, Strategic Objective 14 (Delivering Sustainable Transport), Policy CS27 (Supporting Strategic Infrastructure Proposals) and Policy CS28 (Local Transport Considerations)
  - Interim Planning Statement 16 (Plymouth Airport)
- 15.5. Instruct officers to work with partners to develop the case for better and more regular rail connectivity and infrastructure provision; lobbying ministers on these matters and preparing the evidence base to inform the DFT of the requirements to be included in the ITT for the new Great Western franchise.

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