

Economic Regulation of Heathrow Airport Limited (HAL) Challenges and opportunities

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Introduction to the CAA (UK)

- UK's specialist aviation regulator:
 - safety
 - security
 - airspace
 - international
 - airline licensing and the ATOL scheme for tour operators
 - consumer rights enforcement
 - **economic regulation and concurrent competition powers in relation to airport services**
- Civil Aviation Act 2012:
 - an economic regulation licence only applies to airports which meet a **Market Power Test** (currently only Heathrow and Gatwick – Stansted de-regulated in 2014)

Reasonable connectivity and a relatively competitive airport sector



- Most airports privately run, neighbouring airports separately owned
- 70% of UK population within 2hrs of at least 2 airports serving more than 5m passengers.
- World-class global connectivity, especially in the south east
- 5 large airports with catchment overlaps over London
- **Airlines optimise aircraft deployment across their increasingly pan-European and Global networks**
- **Commercial negotiations facilitate airlines' ability to exercise countervailing buyer power**
- But...
 - airports are differentiated businesses
 - airport charges represent a small part of ticket prices and airlines face switching costs
 - **capacity constraints especially in Southeast of England**

Heathrow airport ...

Heathrow today:

2 runways (Northern – 3,902m x 50m; Southern – 3,658m x 50m)

75 million passengers a year (2015)

180 destinations served – over 80 are long haul

84 countries connected to Heathrow

474,000 flight movements a year (2015) – an average of 1,300 a day

98% capacity – flight movements at Heathrow are capped at 480,000/year

1.5 million metric tonnes of cargo travel through the airport each year

2016 Skytrax Best Airport in Western Europe, World's Best Terminal, and Best Airport Shopping winner

Heathrow Terminal 5 has won Skytrax's World's Best Terminal Award 5 times

29% of the UK's exports (by value) travel through Heathrow each year – more than Southampton and Felixstowe shipping ports combined

HAL's charges are also relatively high ...



Shadow costs to consumers of not expanding are significant – less choice, higher fares, less resilience (circa £50 billion in present value according to the Airports' Commission)



Importance of constructive engagement ...

High level objectives ...

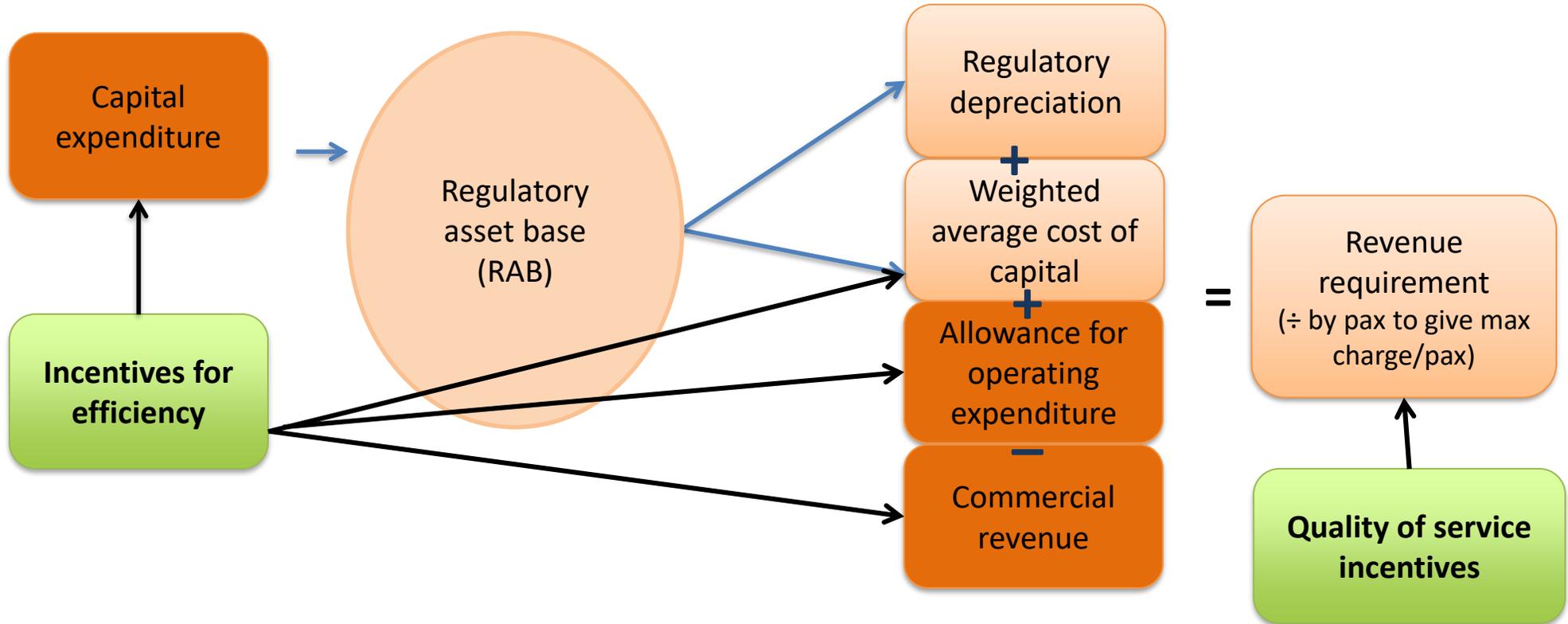
Our January 2017 consultation on priorities noted

'the airlines are concerned to ensure that there is clarity over the year-on-year pricing profile and want to see HAL's charges not rising by more than inflation in any year. HAL has responded to this by saying that as an early priority it wants to work with the airlines on design options to see whether such a pricing aspiration is possible'

And the detail of capacity expansion ...

Detailed discussions on precise runway location, runway length, terminal development and design, the phasing of capacity expansion, information on costs and efficiency (including benchmarking), passenger growth forecasts and strategies and so on

Utility style building block calculations used to determine HAL price control – but with very significant commercial revenues



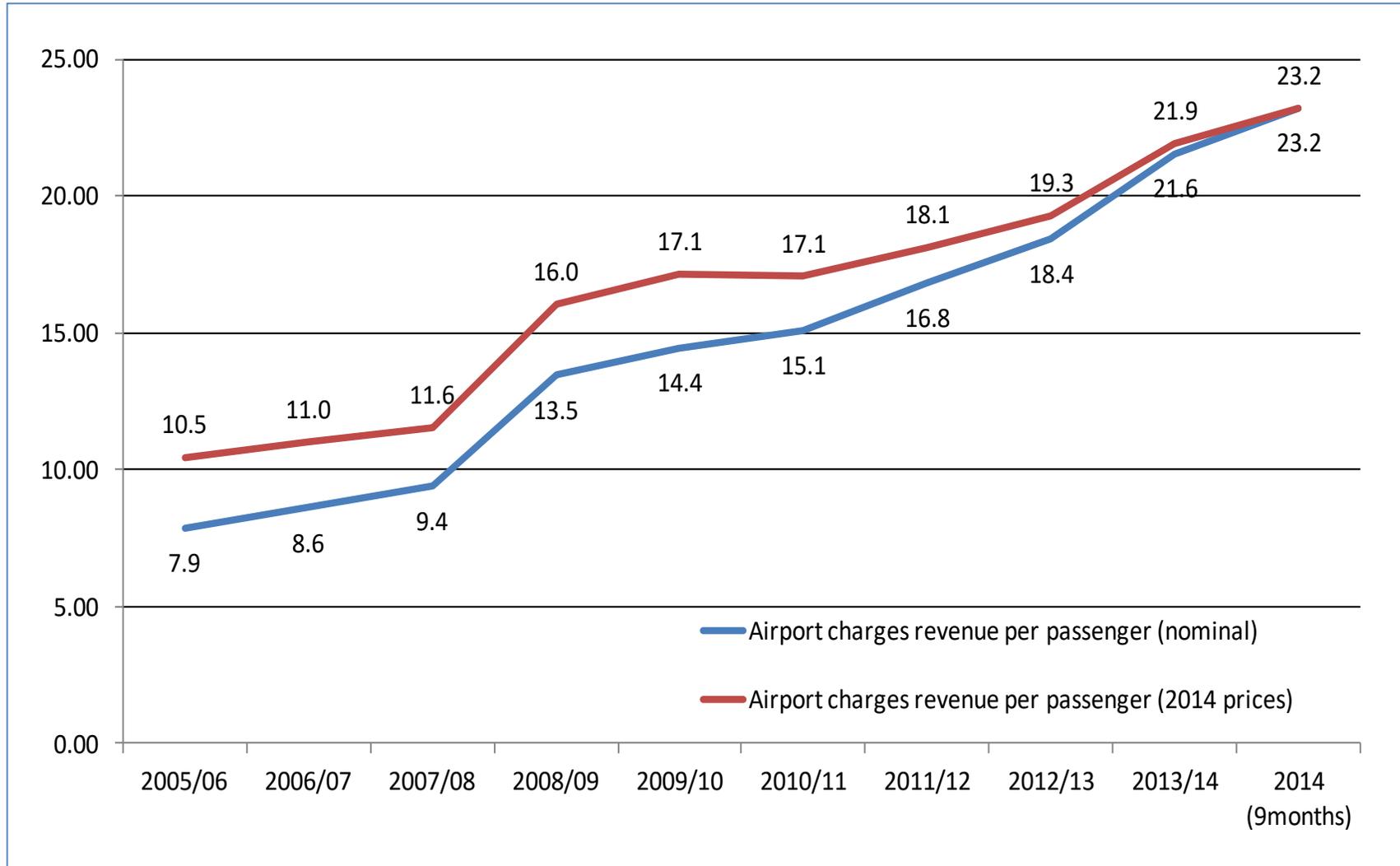
But capacity expansion is driven by longer-term economics and so we also need to consider questions of overall financeability and affordability

But capacity expansion in west London is expensive ...

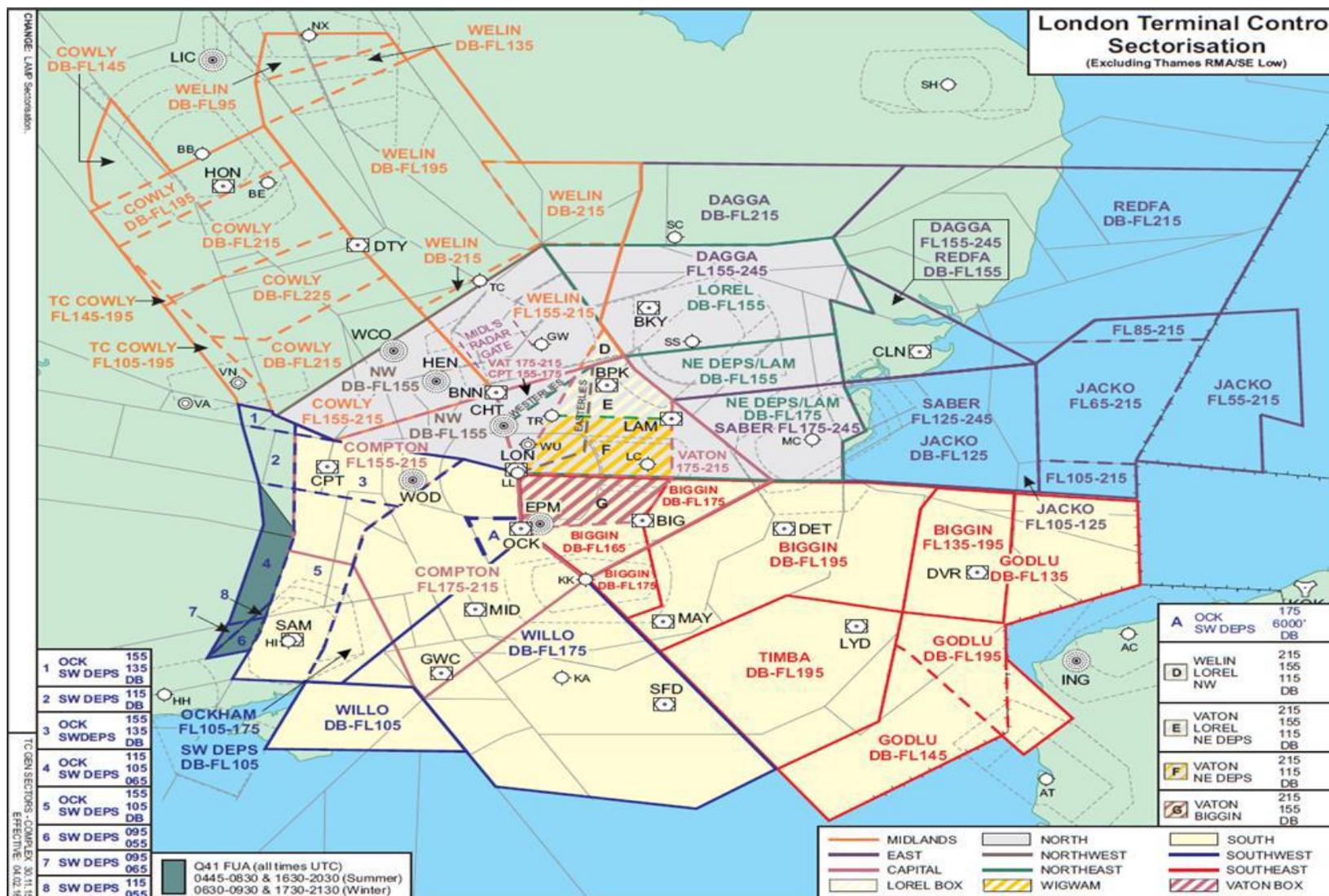


**Circa
£15 billion?**

Heathrow charges have been allowed to rise sharply reflecting investment in T5 and T2



It's not just about Heathrow - airspace reform is also vital



Policy challenges (1) ...

- 1. What assurances can we give airlines on affordability and what assurances can we give government on deliverability/financeability?**
- 2. How do we make reasonable projections over the LT and what can we say about the allocation and management of risks?**
- 3. How will the cost of capital change with capacity expansion (the RAB may increase from £15bn to £30bn)?**
- 4. What tests and measures should we adopt to help decide whether equity investors will find investment sufficiently attractive?**
- 5. How do we ensure cost estimates are reasonable/efficient?**
- 6. How do we increase the power of incentives for capital expenditure without unduly increasing the cost of capital?**

Policy challenges (2) ...

7. What about commercial revenues and passenger traffic?

8. How do we ensure shareholder interests (Ferrovial owns 25% of HAL) do not distort competition in the supply chain?

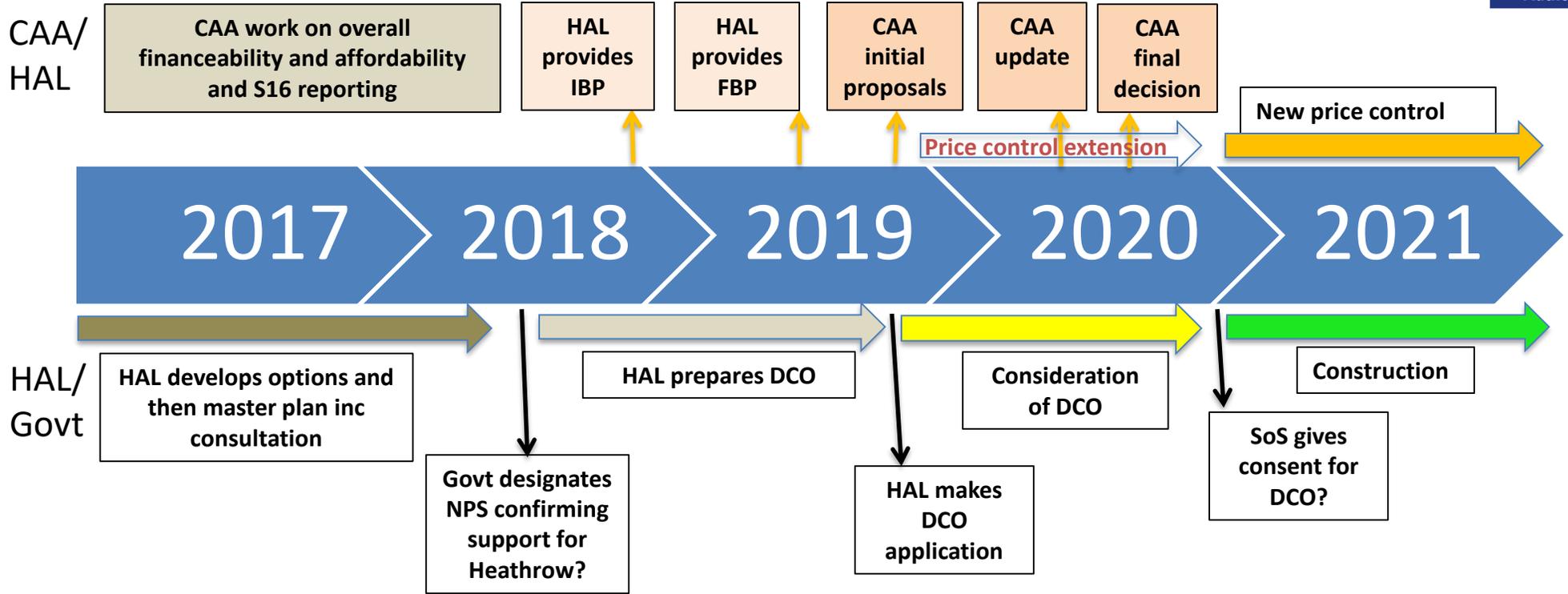
9. How do we ensure that HAL makes best use of a competitive supply chain rather rely on the RAB and passing risks to airlines?

10. What should we do about financial resilience (there is no special administration regime for HAL)?

11. When do airlines represent the interests of passengers and when are they too focused on their narrower commercial interests?

12. What should we do about costs that may need to be incurred ahead of planning consent?

Process and timetable: alignment with the political and planning process...



➤ NPS requires parliamentary approval with a vote in the House of Commons expected in the summer of 2018



THANK YOU – ANY QUESTIONS?

