Airline Comments on the HAL RBP Update 1 Capital Plan:

Introduction

It is important that the capital plan represents the correct amount of capital expenditure required to execute the business priorities for the H7 regulatory period; the capital plan is a key input to the price control model that determines the RPI-X price path over the course of the regulatory period

HAL is remunerated based on efficient capital expenditure incurred over the course of the price control; excessive capital expenditure creates pressure on the airport charges, whilst insufficient capital expenditure could compromise the ability of HAL to deliver expected quality for customers

Capital efficiency incentives are set ex ante in advance based upon an integrated H7 business plan for the business over the whole regulatory period; these require capital allowances established as part of the price control to have concrete delivery objectives defined in advance, ensuring programmes are at a sufficient level of maturity to be accounted within the price control

Whilst the capital programme has flexibility within its structure, allowing new projects to arise as circumstances change, or removing existing projects should they become redundant, capital efficiency incentives would be rendered largely ineffective should a large portion of poorly defined capital be incorporated into the price control at the outset of H7

Instead, any large, additional capital requirements that emerge throughout the price control can be defined as they emerge, and the airport charge adjusted upward when incorporated, which is a more optimal solution for the efficient pricing of the economic model

The alternative is for the RPI-X price path to be rendered fundamentally meaningless, with inefficient and poorly defined capital expenditure incorporated, and capital rebates on unspent capital each year resulting in a saw-tooth airport charge: it is difficult to perform long-term planning against such a charge

This has important consequences for the notional company's financial model; if the notional company does not reflect reality, the capital requirements for the notional company become fictional; this has deeply adverse consequences for the restoration of the 60% level of gearing

Furthermore, the financeability analysis of the notional company becomes difficult to perform, should it have to finance additional capital expenditure in addition to restoring that notional level of gearing; we fear that with the addition of HAL's extreme level of dividends through H7 that the financeability of the notional company could become unduly difficult

Ultimately, the notional company does not have the capacity to support capital expenditure at these levels whilst it is absorbing the effect of the pandemic and lower passenger numbers during the recovery; we cannot tacitly support HAL's manipulation of the notional company's capital structure and / or its desire to pay excessive dividends throughout the H7 price control

Capital Plan

The Airline Community still believes that the capital plan in the RBP and Update 1 has lacked the requisite detail as set out by the CAA which has frustratingly led to difficulties in assessing its validity.

Whilst we agree that flexibility should be retained at the project level, particularly during the latter years of H7, integration across the other building blocks, specific targets and, therefore, justification on the proposals, is still not possible.

Since the publication of the RBP and Update 1, HAL have sought to engage with the Airline Community in the development of the capital plan through the existing capital governance forums; the continued use of which we are supportive of and to which the CAA have been party to.

Whilst we welcome such efforts, progress has been very limited. HAL have focussed efforts on its '1 pagers' which are little more than statements of intent and do not sufficiently address key questions that remain, including justifying levels of expenditure nor setting specific targets and measures it is seeking to achieve, for example The Commercial Revenues Programme one pager illustrated below:

Emerging Commercial Revenues Programme

Objective	Protects existing revenues and unlocks incremental revenue generation by delivering enhanced consumer outcomes.
Consumer Outcomes	**Consumers** I have an enjoyable experience at the airport **Consumers** An airport I want to travel from that offers me a good value choice of flights **Airlines** Heathrow provides efficient, reliable and affordable airport services **Investors** Heathrow delivers predictable and fair returns
Benefits	Increase revenues to reduce the airport charge Attract passengers and Cargo to Heathrow
Prioritisation	Fastest payback prioritised, IRR > 15%, greatest net contribution to the charge
Measures	Offers flights that I want Ease of access to the airport No. of towns/cities connected to Heathrow by public transport through no more than one interchange An Airport that meets my needs Enjoy my time at the airport Overall Satisfaction Customer Effort (Ease) Future Intent to use Heathrow Value for money of Overall Journey
Emerging themes	Cargo, Property, Digital Transformation, Surface Access, Retail & Media
Material existing business cases	Truck Call Forward Facility, Car Park Optimisation, e-Commerce, Media Digitisation, MSCP4
RBP Forecast Allocation (2018p)	Protect the Business - £100m, Crossrail £78m Win the Recovery £600m

5 Classification: Confidential Heathrow

This one pager on the £778m programme provides no detail on the scale of the benefits both in their estimated impact on future Revenues nor on their forecasted impact on the nine separate Measures quoted. Further we would note (as we have done previously in our responses) that the plan is not joined up and the one pager does not link the Commercial Revenues project to any agreed strategies. It is therefore not possible to evaluate this programme in terms of costs vs benefits and hence to say whether or not we are supportive of it in the H7 plan.

In general, the programme 1-pagers are lacking the level of detail (in terms of requirements, scope, deliverables, timescales, measures, costs and benefits) needed to enable us to assess the merits of each programme.

We have the following more detailed comments to make on Table 4 contained in the HAL paper **5.3 H7 Capital Plan Updates**: Section 5.3.3.2. The table is entitled "Updated Optimal Plan Portfolio".

Firstly on a positive note we would state that we like the overall structure that HAL have created to understand the component parts of the Capital Plan (ie the "Protect the Business", "Win the Recovery" and "Build Back Better" categories). However we still firmly believe that the overall plan is not appropriate for the level of passengers forecast by HAL in their central case (317m over H7, 17% less than in Q6). This passenger forecast is significantly below the passenger numbers experienced over the Q6 period, and yet the Capital Plan put forward by HAL aims to spend over a £1bn more over the H7 period than in Q6. We find this completely unjustifiable and undeliverable.

We would also strongly emphasise that the additional capital costs that HAL have outlined in the "Win the Recovery" and "Build Back Better" categories should only be proceeded with if the airlines agree that the time is right for that spend because it is clear that passenger numbers are recovering significantly faster than HAL have forecast.

We would note that we always remain open to projects that demonstrably enhance customer experience or capacity based on appropriate levels of demand.

The airline communities detailed comments on Table 4 are as below:

Protect the Business

Asset Management and Compliance:

Cargo Tunnel (HAL H7 Est: £167m):

The G3 for this project has already been approved (£45m). It is this approved amount that should be reflected in HAL's capital plan. We would recommend that this project is shown as circa £20m in H7 reflecting the remaining approved spend.

Runway Resurfacing (HAL H7 Est: £103m):

We agree with HAL that this project should be planned for in H7.

T4 HBS (HAL H7 Est: £50m, Airline H7 Est: £0m):

There are two independent baggage systems in T4 (each of which is capable of servicing all the T4 check-in areas. Currently only one system has had its HBS upgraded to the new standards. This projected spend is to upgrade the remaining system to the new standard so that there is resilience in T4. However previous work by HAL had shown that this work was not required for 2019 passenger volumes, and that resilience can be provided via an additional Opex solution. We therefore do not believe this spend is justified in the H7 period.

Main Tunnel (HAL H7 Est: £28m):

All approved G3 main tunnel investment (£86m) has been spent in Q6. This will not be adjusted until H8.

Cyber Phase 3 (HAL H7 Est: £16m):

E+W Campus Logistics and Compliance (HAL H7 Est: £24m, Airline H7 Est: £24m)

We have no comments on the both the above projects.

Other "Continue" investments <£10m (HAL H7 Est: £418m):

It is unclear what projects this total covers, for example where are the "Pause" and "Stop" projects from 2020 and 2021 that were impacted by Covid. We cannot provide any detailed comment or a revised estimated cost without further details.

Asset Mgmt Plans : (HAL H7 Est: £892m):

Cyber Technology Asset Mgmt Plans: (HAL H7 Est: £251m, Airline H7 Est: £251m):

The scope has not been defined for these projects so we have no comments to make on either project.

Prioritisation/Phasing: (see separate airline table at end of this document)

We have adjusted this task to maintain spend across the 5 years from 2022 levels.

iH7 Rollover

KAD, T5 TTS (HAL H7 Est: £29m, £28m):

We have no comments on the both the above projects.

T3 Ramp Up, T4 Ramp Up (HAL H7 Est: £19m, £7m):

T3 reopened in 2021 so we do not see the need for any additional spend in the H7 period that is not BAU asset management.

We do not recognise the term "T4 Ramp up" and are unclear what would be required to open T4 that is not part of the asset management plan.

T2 Baggage

T2 Baggage (Prolongation), T2 Baggage Solution Future H8 Solution Design (HAL H7 Est: £180m, £35m)

We have grouped both these projects as T2 Baggage under the "Protect The Business" category – as they both should be prioritised under the Airline Business plan as projects that should still be completed even with the low forecast passenger scenario under HAL's central passenger forecast case. We also believe there is a strong case for a challenge to be made to complete both these projects at an efficient level of spend.

Security Programme

Regulated Security, Security Transformation, Security Compliance (HAL H7 Est: £420m, £130m, £230m)

We have grouped all these projects as Security Programme under the "Protect The Business" category – as they should be prioritised under the Airline Business plan as projects that should still be completed even with the low forecast passenger scenario under HAL's central passenger forecast case. It is essential to the customer service levels at LHR that these projects be completed if passenger numbers are as forecast under the central passenger forecast. We also believe that there is a strong case for the large amount of capital spend planned under this programme to be reduced.

There are a total of 163 X-Ray machines at LHR across Passenger and Staff search areas and Control Posts as below:

	Central	Transfers	Staff	Total
T2	20	10	5	35
T3	23	8	4	35
T4	17	6	1	24
T5	36	3	7	46
Control Post's				23
Grand Total				**163**

So if we assume the £2m/ X-Ray machine + scanner cost per security lane as per the "B7680.02 Security Programme – Pilot Lanes Project" case for T5 "First of Type" business case, that equals £326m for 163 lanes…but the Central + Transfer Search machines will be replaced in a 2 for 3 ratio…so that total reduces to £244m. (The £2m per lane includes purchase and installation of all associated equipment).

This leaves >£500m to commission the machines, for infrastructure changes and to refine the software and working practices to deliver the correct flow rates. This level of project detail is not explained – despite the fact that the airline community has already funded a significant amount of Capital Expenditure on this programme previously and for pilot phases.

We do not fully understand the scope of this programme, the extent of infrastructure changes required and hence what has been assumed in these estimates is unclear. We cannot therefore effectively challenge the overall cost proposed. Again the programme 1-pager has not provided any quantifiable details on the breakdown of the costs by terminal or by function, benefits of the transformational element or any improvement in operational performance, customer satisfaction, resilience or opex.

We would note that there has been agreement in the OBR work for per passenger measurement to be introduced for H7, HAL have indicated a budget of £10m for this implementation. This budget should be included in the H7 capital plan.

Crossrail Contribution (HAL H7 Est: £78m):

We assume that this value is now fixed.

Efficient Airport : Tower Transformation (HAL H7 Est: £57m):

We believe this project should be moved to the "Protect the Business" category as it is a mandatory requirement to have a standby Tower facility.

This completes the airline view of projects that should be completed in H7 (under the HAL Central passenger forecast scenario). These projects total £2.1bn. Note this is an increase on the planned capital spend in the airline business plan submitted and reflects the increased costs of the Security programme (which we do not have sufficient detail on to properly understand).

Win the Recovery

Commercial Revenues:

Commercial Property Development (HAL H7 Est: £200m):

We believe that new property development is not safety, security or resilience. We therefore believe that we should evaluate each business case as required.

Surface Access Asset Replacement (HAL H7 Est: £192m):

It is unclear why this has not been included in the "Protect the Business" Asset Replacement/ Compliance category, but regardless of its position we believe that the programme can be delayed by at least one year to allow for the reduced passenger traffic forecast over the H7 period.

Surface Access Electrification and Development (HAL H7 Est: £65m):

Again we do not have sufficient details from HAL to understand the scope or benefits of this project. Is this EV charging and hydrogen filling stations? Regardless of scope we again believe that HAL should be challenged on the overall capital spend.

Retail and Media Development (HAL H7 Est: £63m):

We do not believe that the costs of this programme can be justified, so have assumed a 2022 level of spend across the H7 period.

Digital Transformation (HAL H7 Est: £55m):

Again we do not have sufficient details from HAL to understand the scope or benefits of this project. Regardless of scope we again believe that HAL should be challenged on the overall capital spend.

Cargo Development (HAL H7 Est: £25m):

We do not have sufficient details from HAL to understand the scope or benefits of this project, but this project should be included under Efficient Airport – rather than Commercial Revenues. Regardless of scope we again believe that HAL should be challenged on the overall capital spend.

Compass Relocation incl. APOC & Data Centre (HAL H7 Est: £39m):

The full business case for relocating from the Compass Centre needs to be shared and evaluated to determine whether it is viable and delivers a satisfactory return. Otherwise maintaining APOC and the Data Centres becomes part of the asset management plans. The previous Compass Centre incl. APOC move was £20m, this implies the Data Centre move is £19m. The APOC move cost is way too expensive, as is the cost for the data centre move.

T3 Automation and Future Automation (HAL H7 Est: £274m):

We support the delivery of automation, but are unclear as to what this project includes and therefore whether it has sufficient benefits to support the proposed level of spend. Clearly there are efficiencies to be gained from automation, but the total of £274m implies that there would be annual benefits of significantly in excess of £30m per annum to justify this case. We again believe that HAL should be challenged on the overall capital spend on this project.

Protect Revenues, Protect Efficiencies (HAL H7 Est: £100m, £100m):

We believe that these projects should be included the "Win the Recovery" section of the Capital plan, rather than Protect the Business, again without sufficient detail it is unclear of the benefits of these projects. Regardless of scope we again believe that HAL should be challenged on the overall capital spend

Build Back Better

Carbon, Sustainability

Decarbonising Ground Ops & landing/take off, **Enabling zero emissions aircraft, Decarbonising vehicles, Decarbonising heat and HV** (HAL H7 Est: £81m, £5m, £41m, £23m):

Due to the reduced demand under the whole H7 period as forecast in the HAL Central forecast we believe that all sustainability projects should be deprioritised - due to both a lack of passenger number to fund the capital spend and the reduced passenger numbers resulting in a reduced environmental impact.

Capacity

Western Campus Connectivity & Efficiency (HAL H7 Est: £35m):

Again due to the HAL Central forecast's passenger numbers being significantly below the 2019 level we believe this project can be slowed down over the H7 period with the remainder of the spend made in H8 when passenger numbers have grown past the HAL Central forecast.

Future Ready – Service, Resilience (HAL H7 Est: £115m):

Again we do not have sufficient details from HAL to understand the scope or benefits of this project.

Airspace Modernisation: (HAL H7 Est: £38m):

It is not clear this project is required in the “Protect the Business” category under the HAL Central passenger forecast (we have provisionally moved it to “Win the Recovery” and are considering whether this spend should be delayed to the latter part of H7). The airline community is still discussing this project and how it should be treated in H7.

Airline View and Comments

* indicates a "Paused" Project
Green = "Continue" Project

Portfolio	Sub-Portfolio	Investment	H7 RBP Update #1 - 2018p 2022	2023	2024	2025	2026	H7
PTB	**Asset Management & Compliance**	**Subtotal, *of which:***	**230**	**266**	**268**	**266**	**245**	**1,275**
	Defined Scope:	*Cargo Tunnel*	*20*	*0*	*0*	*0*	*0*	***20***
		Runway Resurfacing	*2*	*51*	*51*	*0*	*0*	***103***
		T4 HBS	*0*	*0*	*0*	*0*		***0***
		Main Tunnel	*0*	*0*				***0***
		Cyber Phase 3	*16*					***16***
		E&W Campus Logistics and Compliance	*18*	*7*				***24***
		Other "Continue" investments <£10m	*100*	*165*	*78*	*75*		***418***
	Scope not yet defined:	*Asset Mgmt Plans*	*194*	*136*	*177*	*190*	*195*	***892***
		Cyber & Technology Asset Mgmt Plans	*31*	*58*	*62*	*51*	*50*	***251***
		Prioritisation/Phasing	*-150*	*-150*	*-100*	*-50*	*0*	***-450***
	iH7 roll-over	**Subtotal, *of which:***	**41**	**16**	**0**	**0**	**0**	**57**
	Scope not yet defined:	*KAD*	*21*	*8*	*0*			***29***
		T5 TTS	*20*	*8*				***28***
		T3 Ramp Up	*0*	*0*				***0***
		T4 Ramp Up	*0*	*0*				***0***
	T2 Baggage	**Subtotal, *of which:***	**10**	**35**	**45**	**55**	**70**	**215**
	Scope not yet defined:	*T2 Baggage (prolongation)*	*10*	*35*	*45*	*45*	*45*	***180***
		Future T2 Baggage - H8 solution design				*10*	*25*	35
	Security Programme	**Subtotal, *of which:***	**50**	**110**	**205**	**64**	**5**	**434**
		Regulated Security	*40*	*80*	*100*	*24*		***244***
		Security Transformation	*10*	*30*	*75*	*10*	*5*	*130*
		Security Compliance			*30*	*30*		*60*
	Carbon, Sustainability	*Airspace Modernisation*	2	3	14	14	5	***38***
	Crossrail Contribution		**39**	**39**				**78**
	Efficient Airport	*Tower Transformation*	**4**	**17**	**36**			**57**
	Subtotal Airline Plan		**375**	**486**	**568**	**399**	**325**	**2,153**
WTR	**Commercial Revenues**	**Subtotal, *of which:***	**10**	**70**	**94**	**102**	**124**	**400**
	Scope not yet defined:	*Commercial Property Development*			*0*	*0*	*0*	***0***
		Surface Access Asset Replacement			*52*	*64*	*76*	***192***
		Surface Access Electrification & Development	*2*	*24*	*14*	*12*	*13*	***65***
		Retail & Media Development	*3*	*23*	*14*	*12*	*11*	***63***
		Digital Transformation	*3*	*11*	*10*	*12*	*19*	***55***
		Cargo Development	*2*	*13*	*3*	*3*	*5*	***25***
	Efficient Airport	**Subtotal, *of which:***	**0**	**5**	**35**	**50**	**50**	**140**
	Scope not yet defined:	*Compass Relocation incl. APOC & Data Centre move*	*0*	*0*				***0***
		T3 Automation & Future Automation		*5*	*35*	*50*	*50*	***140***
	Protect Revenues		10	25	25	20	20	***100***
	Protect Efficiencies		10	25	25	20	20	***100***
	Proritisation / Scope / Cost Estimate Challenge		-6	-26	-39	-68	-77	***-216***
BBB	**Carbon, Sustainability**	**Subtotal, *of which:***	**0**	**0**	**0**	**75**	**75**	**150**
	Scope not yet defined:	*Decarbonising ground ops & landing/take off*				*41*	*41*	***81***
		Enabling zero emissions aircraft				*3*	*3*	***5***
		Decarbonising vehicles				*21*	*21*	***41***
		Decarbonising heat and HV				*11*	*11*	***23***
	Capacity	**Subtotal, *of which:***				**10**	**25**	**35**
	Scope not yet defined:	*Western Campus Connectivity & Efficiency*				*10*	*25*	*35*
	Future Ready - Service, Resilience					**50**	**65**	**115**
	Total Optimal Plan		**399**	**586**	**708**	**658**	**627**	**2,978**

Red Text indicates airline changes to the HAL Optimal Plan.