SPELTHORNE CONSULTATION RESPONSE TO CAP 1722 –
Economic regulation of capacity expansion at Heathrow: policy update and consultation

<u>Background</u>

Expansion of Heathrow Airport has critical implications for the borough of Spelthorne. We sit immediately to the south of the airport and many of the major road networks cross our borough. Spelthorne is working closely with Heathrow Airport Ltd (HAL) on the expansion plans at officer and Member level, both bilaterally and as part of the Heathrow Strategic Planning Group. We are actively involved in reviewing HAL's masterplan assembly options that have been prepared for discussion and feedback in advance of HAL's preferred option being developed for Consultation 2.

We commented on CAP 1658, and focused on the impact of HAL's proposals for a new Parkway within our borough serving up to 25,000 parking spaces, and its wider car parking strategy.

Spelthorne is heading up a Consortium which has put forward a light rail scheme to the DfT to access Heathrow from the south – called Southern Light Rail (SLR). Submissions were put in as part of the Market Led Proposals and Southern Rail Access to Heathrow Market Sounding exercises in 2018. On 19 December 2018, the DfT released its response to the Market Sounding exercise and have said that they 'should work with HAL to provide more direction to the market on minimum requirements that support their respective business cases' and that 'for promoters on non-heavy solutions, government should consider providing direction using these minimum requirements'. We will work with HAL to further define and develop our scheme.

In addition, we have also put forward SLR as part of HAL's Innovation Partners process, and submitted our high level business case under stage 2 of their process on 27 November 2018. We understand HAL will be advising bidders in January/February 2019 on whether they will proceed to the next stage.

<u>General comments</u>

We would fully endorse the view of the CAA that HAL need to provide "high quality and comprehensive information on costs and efficiency", that there should be greater certainty around the development of the masterplan and that there needs to be "a significant improvement" in terms of the information which has been provided to date. However, it is not clear from the document what steps the CAA would take if this improvement failed to materialise. These should be set out clearly so that all parties understand what action will be taken.

It is worth the CAA being aware that the concerns expressed by airlines about the paucity of information is mirrored by ourselves, and this is equally the case with our local residents associations. As a Council, we are very concerned that we are being drip fed information on a piecemeal basis so we never see the full picture. This diminishes our ability to fully understand and therefore challenge the masterplan process where it impacts on our communities. We would urge the CAA to challenge HAL robustly to ensure that its engagement is meaningful and meets the 'high quality' that the CAA expects.

Timetable and interim price control

Price control

Whilst we have no general comments on the top down approach for the interim price control, we note that the CAA plans to update the assumptions around three areas including commercial revenues. We do have some specific comments on the commercial revenues in relation to parking (as we as a borough will potentially be directly impacted by 25,000 additional parking spaces).

In the first six months of 2018, HAL accrued a parking income of £62m (£124m pa) on the c39,000 spaces they currently directly control. This compares to £105m in 2015, which at that time accounted for 16% of HAL's revenue income (according to the Review of Commercial Revenues Report prepared by Steer Davies Gleave). In the last three years HAL has seen a 15% increase in income received from parking revenue.

Of this £124m pa, we estimate that c.£110m will come from passenger parking as opposed to colleagues. As part of the expansion, we understand HAL is currently proposing that it takes direct control of a significantly greater number of parking spaces (a mix of parking they directly control and current 'third party' spaces e.g. Purple Parking). As part of its Surface Access Strategy, HAL is also looking to reduce colleague parking by 50% by 2040 (which will then be transferred to passenger parking). It is therefore reasonable to assume that the vast majority of the proposed spaces will be for passenger parking and will generate a significant revenue stream. We estimate that this could be around £300m pa using current prices. As such, there is a clear financial incentive for HAL to control as much parking as they can.

Firstly, the CAA need to understand the dynamics and ensure that it is captured appropriately through the relevant price control mechanisms.

Secondly, we would point out that the existing cap of 42,000 parking spaces (a condition of the Terminal 5 permission) should remain in place and must not be extended.

Thirdly, we would want to ensure that any extension to the interim price control adequately captures any uplift in parking income. We therefore support the CAA's view (para 1.22) that the longer the interim arrangement remains in place the stronger the case is that assumptions should be re-opened to ensure that the 'price control would properly share efficiency gains' (i.e. HAL should not benefit from increased parking income at the expense of consumers).

Finally, we want the CAA to recognise that the potential financial benefit to be gained by HAL from the additional parking income would be at the expense of local residents in Spelthorne, and the village of Stanwell in particular.

Timetable and price control business plan

Spelthorne notes that the CAA is proposing to delay the date by which HAL need to provide their price control business plan to the CAA to the end of December 2019. We assume this is on the basis that the master planning process does not slip any further back. The CAA also needs to recognise that HAL has made it very plain to local authorities and other bodies that the CON2 exercise in June 2019 will relate to a *preferred masterplan*. HAL has advised it may be subject to change right up until the

DCO is submitted. It is therefore not at all clear to us how HAL can provide a business plan in December 2019 which has a sufficient degree of certainty built in to it to be robust. We can only assume that the CAA is suggesting that flexibility is built in to cover this eventuality? And in that case what level of confidence can the CAA expect to have in agreeing a price control business plan which will almost certainly be subject to price changes further down the line. Airlines, consumers and the public must have confidence that whatever is agreed in terms of 'price' will not then be eroded over time before the scheme progresses through the DCO process. It is not entirely clear what mechanisms will be put in place to effectively challenge any cost increases after the price control business plan has been agreed, and what penalties (if any) will be put in place.

We are pleased to note that the CAA expect HAL "to consult carefully with airlines…to ensure that these plans appropriately reflect the views of airlines". It has proved not to be the case so far in our experience.

A broader point we would wish to make on the business case is around the need for clarity about what is covered under 'business as usual' (BAU). We understand the cost of the expansion and use of the runway is £15bn but that the overall cost of £30bn also includes business as usual refreshes over a longer period in time. This could cover works over a much longer period of time that the adjoining local authorities would have very little influence over even though they could significantly impact their local communities. The works covered under the 5 year BAU plan need to be made clear and explicit to everyone.

Promoting economy and efficiency

The Council agrees that the consumers' interests should not be adversely affected by "inefficient costs". We would also agree that the level of control should not be such that the CAA mandates particular projects. Any licence obligations should be worded in such a way that they can clearly hold HAL to account and absolutely ensure that it conducts its business effectively and economically.

There is a concern that because HAL passes on costs to the airlines under the Regulated Asset Base (which is then transferred to the passengers) that there is insufficient incentive to come forward with an expansion proposal which meets the requirements of the ANPS in the most cost effective manner.

We are aware of just one small example where a tightening up of the licencing obligations could bring about a reduction in costs. We understand that HAL apportion a cost of £63k per parking space which seems incredibly high compared to the £11 – 14k per space which is regularly delivered by the open market in commercial developments. The CAA must look at a range effective measures to ensure HAL reduce their prices rather than recoup via the airlines (and thus pass on to the consumer). A formal licence condition will provide more certainty than relying on the commercial pressure of the airlines on HAL to drive efficiencies, and this recommendation must be acted on.

We would wholeheartedly support the CAA's suggestion that the licence condition should be expanded to promote economy and efficiency in 'the operation, maintenance and timely development of Heathrow" as the current licence only gives the CAA limited scope to take action between price control reviews (e.g. it cannot correctly capture the uplift in parking revenue which is referred to above). This will ensure that HAL looks at costs for the 'day to day' as well as the expansion proposal.

We would also support the CAA’s suggestion that if the obligation were introduced for the interim price control that it must include preparing the DCO with *full regard* to the ANPS and to ensure the expanded airport is economical and efficient both in terms of delivery (capital), but also operations (revenue). Both of these should be introduced now, alongside and as part of the interim price control period review.

Alternative delivery arrangements

As a Council, we are leading a consortium which is promoting a Southern Light Rail scheme. Southern Light Rail (SLR) links Staines-upon-Thames to Heathrow. The scheme provides a complementary service which links into existing transport networks, and with a 54 month programme it can be operational before the third runway. A new parkway facility will be provided for air passengers near Heathrow which would mean HAL would not need to provide all the proposed 25,000 parking spaces immediately north of Stanwell Village. It also gives the opportunity for the economic benefits of an expanded Heathrow to be distributed more widely in the local area.

SLR has been designed to help meet HAL’s modal shift requirements at the outset (even before the third runway is operational), reduce congestion, and provides a positive solution to pollution and air quality issues around Heathrow (far more so than a 25,000 space car park). It will help HAL to meet the requirements as set put in the ANPS. HAL’s own modelling on the existing two runways indicates SLR would deliver a 6.2% modal share for point to point air passengers. It meets all the tests that HAL have set as part of their Innovation Partners process (it aligns with their strategic objectives, regulatory and the planning constraints and supports the operation of a single hub airport).

Crucially, it is a Category 1 Market Led Proposal with private sector backing (no government money or guarantee is required). This sets it apart from all other southern rail proposals which rely on government support (access track charges etc). As such, there would be no requirement for HAL to fund the light rail infrastructure outside of its red line (it pays only for its station) and therefore it would not need to pass these charges on the airline and then on to consumers. The cost of SLR is c£400m which is around one third of the cost of the heavy rail solution (Heathrow Southern Rail). The only requirement is that the route of the SLR within the red line to the Terminal is identified in the Regulated Asset Base. As a light rail solution the land take will be minimal if it takes an overland route. However, there is also scope for it to be placed underground.

The SLR is currently being considered by HAL as part of the stage 2 process under the Innovation Partners. We are looking to work with HAL to develop our scheme further and the recent DfT announcement we help us to move forwards with this.

We wanted to bring the scheme to the attention of the CAA as HAL have advised that it is not their current intention to undertake a costs benefit analysis of the preferred masterplan scheme (e.g. test out alternative options to establish that their preferred scheme is the best solution). That being the case, if the SLR is not ‘preferred’ by HAL there is no way currently that this more cost effective solution could be ‘brought out into the open air’ or formally considered as part of the cost equation. The consumer (via the airlines) could therefore conceivably end up paying for a much more costly solution.

As an example we have suggested to HAL that it is not necessary for the car park which are currently located on the Bath Road to be relocated if a new terminal building were to be located alongside T5 instead of immediately south of the new runway. This would reduce their costs considerably as they would not need to build new large scale Parkways to accommodate all their suggested parking requirements. The CAA need to ensure that a robust mechanism is in place whereby it can effectively challenge HAL on options that have been discounted before a final decision is made on the business plan for expansion. It is not sufficient for HAL to be asked retrospectively to justify a course of action (as appears to have been the case with the stance they have taken on the Arora scheme without providing any substantiated evidence).

Surface access

In terms of the CAA's surface access policy, we would agree that it is not in the consumers' interests to pay for surface access schemes that are not required for capacity expansion or for the efficient operation of the airport – our SLR scheme does not require the consumer to pay. We would also agree that surface access costs must be subject to efficiency, affordability and financeability costs – which is why we have requested that any options not put forward by HAL in their preferred master plan are nevertheless subject to review and scrutiny by the CAA with these costs in mind. Without doing so it is unclear how the CAA can be satisfied that HAL has 'convincing' plans for surface access which deliver the most 'efficient solution', and that the parking element of the strategy in particular is 'efficiently costed and provides value for money' (para 4.13). The cost of our SLR scheme at £400m, for example, would appear to compare very favourably to a 25,000 space car park where the spaces cost (according to HAL) £65k each to build which equates to £1.6bn.

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