

31 October 2014

Heathrow Airport Limited
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Dear Colleague

Decision - 2015 Airport Charges

I would like to thank you for your participation in the 2015 Heathrow Airport Charges Consultation process. The 2015 Airport Charges Consultation process began on 1 August 2014. Heathrow Airport Limited (“Heathrow”) held a formal consultation meeting on 19 September 2014 and received six formal written responses to its proposal.

This letter announces Heathrow’s decision, the rationale for its decision and explains how airline community responses have been taken into account in making our final decision.

Decision

We have carefully considered all airline and airline representative body responses on our price proposals, which include all the comments expressed at the consultation meeting and written responses.

Heathrow has come to a decision that it will recover the 2015 forecast maximum allowable yield of £22.627, which is a 6.1% reduction from the 2014 headline tariff yield¹.

Whilst deciding to recover the forecast maximum allowable yield, Heathrow has also decided that it will target the reduction in the landing charges tariffs to the quieter noise chapters. This means that Chapter 2, Chapter 3 (base and high) will remain at the 2014 level, while Chapter 4 (high, base and minus) will reduce. In addition, the remote stand rebate and minimum departure charge will remain at the 2014 level.

Finally, Heathrow has decided to maintain the existing structure of charges, and the changes to the individual tariffs maintains the structure of charges, that is, landing charges at 21%, passenger charges at 75% and parking charges at 4%. In addition the landing charges proportion between noise and emissions is maintained at 85% and 15% respectively. The following sets out Heathrow’s rationale.

Rationale for Decision

Heathrow’s decision to recover the maximum allowable yield reflects the CAA’s settlement for Q6 which was concluded after an extensive period of consultation with all parties. The pricing decision enables Heathrow to recover previous capital expenditure that has helped transform Heathrow Airport. It also supports Heathrow’s continued investment in the airport to meet passenger expectations.

¹ Tariff yield for July 2014 to December 2014.

The decision to target reductions in the landing charges across the quieter noise chapters (i.e. Chapter 4) enables Heathrow to provide further incentives for quieter aircraft and supports Heathrow's Noise Action Plan.

Structure of charges

Heathrow will be commencing a formal consultation on the future structure of airport charges during 2015 with any changes implemented in 2016. Ahead of the formal consultation process, Heathrow will be holding informal engagement sessions and the first informal engagement session will be held on Thursday 27 November 2014, full details are provided at the end of this letter.

Heathrow Airport Responses to Airline questions

I would now like to respond to each of the main themes from the airline community responses to our price proposals and how Heathrow has considered these comments in coming to our final decision:

(1) Airline Question: Despite the reduction in charges for 2015, Heathrow should price below the cap considering past increases.

Heathrow Response: Heathrow considers it to be appropriate and reasonable to recover the maximum allowable yield particularly where demand outstrips supply. The maximum allowable yield has been set earlier this year by the Regulator after an extensive consultative process on determining the Q6 price cap.

(2) Airline Question: How does Heathrow justify the 2015 forecast departing passenger mix for the 1% shift from O&D to transfer passengers when compared to the 2014 forecast.

Heathrow Response: The consultation document presented the 2014 forecast that was used to set airport charges for that year. The 2015 forecast is supported by the actual year to date passenger mix for 2014 and intelligence provided by individual carriers on their plans for 2015. A comparison to 2014 actuals is shown below.

Departing passenger mix % (shown to one decimal place)

	Forecast Jan-15 to Dec-15		Actual Jan-14 to Sep-14	
	O&D	Transfer	O&D	Transfer
Europe	33.1%	11.9%	33.6%	11.6%
Other	38.8%	16.2%	39.0%	15.8%

(3) Airline Question: Heathrow should change its structure:

- (i) Overall balance of charges to reflect a higher proportion to the passenger charges, if this cannot be done immediately, an equal reduction should apply to all tariffs.
- (ii) Remove the departing passenger charge differential between Europe and Other.

Heathrow Response: A review of structure of charges is a complex and lengthy process requiring a detailed consultative process with users. Heathrow cannot change the structure immediately without following due process and there are mandatory guidelines under the Airport Charges Regulation 2011 (ACR). The ACR requires proposed changes to be consulted with users no later than four months before coming into effect and no later than two months notice of the final decision before coming into effect. Therefore Heathrow will not be making any changes to the structure of charges.

However, Heathrow will be commencing a formal consultation on the future structure of airport charges during 2015 with any changes implemented in 2016. Ahead of the formal consultation process, Heathrow will be holding informal engagement sessions.

(4) Airline Question: Can Heathrow explain how the development capex adjustment works and how any underspend will be accounted for.

Heathrow Response: Capital investment at Heathrow is subject to a two tier approach, where capital investment is either classified as Development or Core to reflect the maturity of individual projects. Core capex constitutes scope, time, risk and cost that is well defined, where a solution has been developed and a delivery strategy is in place. Development capex projects have a lower definition of scope, schedule, risk and cost than Core projects. Projects transition from Development to Core status at Gateway 3 in Heathrow's project process when scope, time, risk and cost are defined to an appropriate level with governance provided through the Capital Portfolio Board (CPB).

A Development capex adjustment is applied to airport charges to ensure that Heathrow only recovers a return on Development capex that is actually used. Adjustments down to the maximum allowable yield will be required where Development capex expenditure is lower than included in the Q6 settlement and adjustments up to the maximum allowable yield will be required where Development capex is higher than included in the Q6 settlement.

The adjustment is calculated using the return allowed in the Q6 settlement (5.35% WACC) and any variance to capex transitioning from Development to Core compared to the Q6 settlement. The Development capex adjustment calculation is set out in Heathrow's Licence granted by the CAA².

Heathrow is required to make a forecast of what it anticipates will transition from Development to Core in setting 2015 charges. It is anticipated that all the Development capex in the Q6 settlement for the two years to 2015 will transition to Core, therefore no

² Economic regulation at Heathrow from April 2014: Notice granting the licence, Part C, page 86.

adjustment to the maximum allowable yield is required. However, if actual projects transitioning from Development to Core deviates from the settlement, either up or down, this will be adjusted through the k factor.

Full details of this mechanism and the transition of projects can be made available through the CPB.

(5) Airline Question: Heathrow should maintain the noise chapter charge ratio by applying equal price reductions across Chapter 4 noise charges.

Heathrow Response: Heathrow has considered this but has decided to target the price reductions in the landing charges across the quieter noise chapters by focusing the reduction in price on Chapter 4 base and Chapter 4 minus. Heathrow considers this further incentivises quieter aircraft and supports Heathrow's Noise Action Plan.

Appendix 1 sets out the final prices effective from 1 January 2015.

Engagement session

Heathrow will be holding an informal engagement session on the future structure of charges on Thursday 27 November 2014.

Details of the informal engagement session are as follows:

Date: Thursday 27 November 2014
Time: 12:00 to 14:00
Location: Heathrow Academy
Newall Road
Hayes
Middlesex
UB3 5AP

Please let us know if you would like to attend by contacting airline_relations@heathrow.com

Finally, I would like to thank you again for your participation in this consultation process. We are committed to working with the airline community and look forward to the discussions on the review of the structure of airport charges.

If you would like further information or clarification, please contact me directly or Chris Butler, Chris_Butler@heathrow.com

Yours sincerely



Brian Woodhead
Commercial Director

Appendix 1

**HEATHROW AIRPORT
AIRPORT CHARGES 2015
(effective 1 January 2015)**

**Final
2015
£ GBP**

Charges on Landing	
Peak	
Chapter 2	8,802.15
Chapter 3 high	8,802.15
Chapter 3 base	2,934.05
Chapter 4 high	1,745.76
Chapter 4 base (equivalent)	1,430.35
Chapter 4 minus	836.20
Super Night Peak	
Chapter 2	22,005.38
Chapter 3 high	22,005.38
Chapter 3 base	7,335.13
Chapter 4 high	4,364.40
Chapter 4 base (equivalent)	3,575.88
Chapter 4 minus	2,090.50
Emissions charge (per kg)	8.57
ANS charge	
per ATM	80.53
Per Metric tonne	1.08
Charge on departing passengers	
Europe - Destination	29.59
Other - Destination	41.54
Europe - Transfer	22.19
Other - Transfer	31.16
Europe - Transit	22.19
Other - Transit	31.16
Remote Stand Rebate (All paxs)	-5.15
Minimum charge	1,406.00
Charges on aircraft parking	
Narrow bodied	21.36
Wide bodied	51.26