Global Infrastructure Investor Association
Investor Association
Promoting Private Investment in Infrastructure

Global Infrastructure Investor Association

Civil Aviation Authority - Heathrow price control review H7

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1. Introduction

Global Infrastructure Investor Association (GIIA) is the membership body for the world's leading investors in infrastructure, and advisors to the sector, who collectively represent nearly US$1 trillion of infrastructure assets under management across 66 countries. Our members are investing today to provide the smart, sustainable, and innovative infrastructure needed for our communities and economies to thrive.

The investor member base of GIIA is diverse and ranges from fund managers, pension funds, insurers, corporate investors and sovereign wealth funds (a list of GIIA members can be found at http://giia.net/membership).

In the UK, GIIA members are responsible for:

- 94.4% of total air passengers in the UK through investment in 19 airports worth £15bn.
- 2.2m freight tonnes per year through airports alone.
- Majority owners in Heathrow Airport and 7 of the top 10 European Airports.
- £27bn invested in 158 assets consisting of traditional energy and renewables.
- 16.2GW of installed capacity across a 210,000 km electricity and gas distribution network.
- £19bn invested in 12 water and wastewater assets servicing 33m UK customers.
- Supporting almost 120,000 jobs in the nation's privately owned ports.
- £10bn invested in telecoms providing 14m households with full fibre internet.

In addition to these vital sources of foreign direct investment, our research shows that more than 8.5 million UK pension pots are invested in UK national infrastructure via specialist infrastructure funds, helping to deliver a stable return for UK citizens in their retirement. In transport, renewables, utilities, digital and social infrastructure, GIIA members are investing across the UK to deliver the infrastructure needs of UK citizens and supporting the wider economy.

In relation to the consultation 'Economic Regulation of Heathrow Airport Limited: H7 Initial Proposals' published October 2021, we are keen to provide the perspective of institutional investors in infrastructure. This letter therefore acts as a high-level position statement on behalf of the institutional investor community on the issues raised in the paper and associated consultation questions.

By way of background, many of GIIA's members are exposed in various markets across many sectors and are not exclusively exposed to the airports sector in the UK.

2. Heathrow's importance as critical national infrastructure

As the UK's main hub airport, it is vital to ensure that Heathrow remains at the forefront of investment and global trade. Taking 2019 as a baseline, Heathrow was responsible for £188bn in UK trade in goods, which is 20.6% of the total, and 34.7% of non-EU trade, which is forecast to grow to over £204bn in 2025.[1] Furthermore, Heathrow is set to contribute £4.7bn towards

[1] Heathrow, Supporting a Global Britain – The Economic Impact of Heathrow Airport 2021, (URL)

the UK economy and support more than 140,000 jobs across its supply chain by 2025. [2] Additionally, the value per ton of cargo which goes through the airport is almost 80 times higher than the value of UK shipping routes.[3] Put simply, Heathrow is at the very heart of the 'Global Britain' agenda.

The significant role that Heathrow plays in the distribution of high value cargo also has and will have increasingly positive impacts across the UK's regions - and in particular, manufacturing intensive regions such as Wales, Midlands and the North-East. The ambition to secure new Free Trade agreements to cover 80% of UK trade over the next three years will see Heathrow play a critical role to quickly delivering new trading opportunities for UK businesses.

For example, Heathrow is uniquely placed to immediately deliver benefits if and when the UK joins the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) given that it facilitates 46.2% of trade in value with the current CPTPP members. Furthermore, Government analysis showed that a UK-US FTA could increase trade between the countries by £15.3bn. The value in 2019 of all trade between UK-US was £220bn, 40% of which passed through Heathrow.[4] The role that Heathrow plays as a major hub for connectivity and boosting foreign investment should not be undervalued.

3. Investment in LHR since privatisation

Independent air transport rating organisation, Skytrax, found that 40 out of 100 of the world's major airports globally were either fully or partially privatised and 62% of those are now included in the 100 world's best airports[5]. Private investment made into European airports totalled €53bn from 2007-2017, investment which was critical to increasing airport capacity throughout Europe to 168m passengers per year among the top 21 airports.[6]

Furthermore, since GIIA's member Ferrovial became a partner in Heathrow airport in 2006, they, and Heathrow's other investors, have invested over £12bn into projects which have transformed and modernised the airport such as Terminal 5, Terminal 2 and the world's largest integrated baggage system which drove Heathrow to becoming the busiest airport in Europe and seventh busiest in the world by passenger numbers.[7]

Private capital investment has been critical to Heathrow's continued dominance and is a key driver of its projected growth through the 2020's. The airport is expected to contribute around £5bn per year to the UK economy at a time when the UK is seeking a strong economic recovery to the pandemic, to reposition the country as an international trading partner post Brexit, and also to deliver on the challenge of meeting Net Zero by 2050.[8]

Private investment has enabled Heathrow to climb the rankings to being rated as one of the top 10 airports by passengers worldwide from being one of the worst.[9] It has also become a global leader in service delivery and has been able to innovate and invest in critical technologies which have allowed it to simultaneously decrease prices whilst delivering

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[2] *Ibid*
[3] *Ibid*
[4] DIT, UK-US Free Trade Agreement 2020 (URL)
[5] CAPA, Airport Privatisation: varied successes as IATA take aim, 2018 (URL)
[6] *Ibid*
[7] Ferrovial, Heathrow Airport 2021 (URL)
[8] Heathrow, Supporting a Global Britain – The Economic Impact of Heathrow Airport 2021, (URL)
[9] Heathrow (SP) Limited, results for the 9 months ended 30th September 2021 (2021), URL

passenger savings of over £600m.[10] This has delivered a direct benefit to passengers and a clear premium for airlines who operate at the airport.

However, to be able to pursue this sort of investment in the post-pandemic era, Heathrow requires a commitment from its regulator, the Civil Aviation Authority (CAA), that any new investment will bring with it fair returns to its investors. It is worth noting for context that the success that the airport has achieved in recent years has come at the same time as Heathrow's investors have received negative returns in real terms over the last 15 years.[11]

A review of airport charges in 2017[12] showed that airports carrying more than 30million passenger per annum (mppa) increased their charges by 3.5 - 6.1%[13] between 2009-16. However, when accounting for inflation, the revenues from these charges per passenger saw a decrease of 4.3% per annum between 2014-19.[14] Moreover, landing charges per unit saw an even greater decrease by 4.8% per annum over the same period.[15] Heathrow has also seen decreases in these areas. Since privatisation in particular, costs have fallen for passengers by 16%, airport charges reduced by 14% while commercial revenues per passenger are up by only 7%.[16]

As the UK seeks to use regulation to attract and drive private investment in a range of new infrastructure projects, the signals and decisions by the CAA on the UK's hub have a direct impact. The CAA proposals for the range of airport charges per passenger over the next five-year price control period represent a missed opportunity to secure high levels of investment into London Heathrow Airport during the price review period and beyond.

4. Effect of the pandemic on LHR

It is hard to overstate the devastating impact that the Covid-19 pandemic has had on the whole of the UK Aviation sector, including Heathrow. Fewer than 4 million people travelled through Heathrow in the first six months of 2021, a level that would have taken just 18 days to reach in 2019[17]. Overall, the effects of the pandemic and associated travel restrictions have resulted in losses at Heathrow amounting to over £3.4bn to date[18]. This has come at the same time as the airport has received little Government financial support and continues to bear the largest business rates bill in England of over £120m – all against the contrast of EU hubs which have either had regulatory adjustments or further state support from their public ownership structures.

Despite these significant losses, Heathrow's owners have worked tirelessly to remain open since the onset of the pandemic and the airport has continued to serve as a vital link in UK supply chains, even as revenue from passenger numbers has plummeted. Cargo flights increased by 409% during this time, carrying critical medical supplies such as ventilators, medicines and food supplies which were able to be delivered to those most in need within the UK[19]. Furthermore, 40% of the UK's pharmaceutical products such as medicines,

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[10] *Ibid*
[11] Heathrow (SP) Limited, results for the 9 months ended 30th September 2021 (2021), URL
[12] Study was conducted in 2017 by Steer Davies Gleave, *Support study to the ex-post evaluation of Directive 2009/12/EC on Airport charges*
[13] Iata, CEG – Effective Regulation of Airport Market Power 2018 (URL)
[14] ACI Airport Economic Survey, n=850 (URL)
[15] ACI Airport Economic Survey, n=775 (URL)
[16] Heathrow, Initial Business Plan 2019, (URL)
[17] Heathrow Press Release -July 2021 (URL)
[18] Heathrow (SP) Limited, results for the 9 months ended 30th September 2021 (2021), URL
[19] Heathrow, Heathrow Remains Open 2020, (URL)

vaccines and respirators are currently imported through Heathrow. Heathrow is an integral piece of critical UK infrastructure.

5. Covid-19 related RAB adjustment

Despite the aforementioned losses since the onset of the pandemic, recent regulatory determinations have failed to prioritise the need to protect future investment at Heathrow and have created regulatory uncertainty in the perception of Heathrow as an investable proposition in the eyes of international infrastructure investors. Recent research conducted by GIIA, which surveys investors from across the globe, found that the largest barrier to investment in Europe, including the UK, are political instability and an unattractive regulatory regime[20]. The same research identifies that in terms of market sentiment towards airports, the sector sits 15th out of 19 categories of infrastructure investment opportunity.

One of the key objectives of the Regulated Asset Base (RAB) model, under which Heathrow is regulated, is to create long-term incentives for private capital to invest in assets and increase service levels in the interests of end users. One of the basic principles of the model is the acknowledgement that investors are entitled to receive a fair return and recover the cost of past investments. Over the years since privatisation, the RAB model has helped to deliver successful projects like the T5 expansion.

Covid-19 has shown, however, that current interpretations of the RAB framework, in particular the balance of risk and reward, are not fit for purpose, evidenced by the initial adjustment to Heathrow's RAB of £300m representing less than 10% of the losses incurred since the start of the pandemic.

This imbalance in risk and reward will ultimately affect both the perception of the UK airports sector as an investable proposition, not just in the near term but over the next 5-10 years and beyond, as well as ultimately passing costs on to end-users. Without regulatory predictability and the appropriate balance of risk and reward, consumers will pay more for lower service levels over time thus undermining the overall objectives of economic regulation.

Additionally, the adjustment sets a dangerous precedent for investment in the UK more generally, right at the point in time when the UK Government, (including BEIS, DIT, and the Office for Investment) are working hard to create an attractive inward investment environment in the UK, culminating in the UK Global Investment Summit in London in October – something which is also at the heart of the UK's need to achieve Net Zero.

The challenge that the proposal in the H7 methodology poses to the perception of the RAB as a stable and predictable regulatory model, should be particularly concerning for the UK Government as it seeks to promote the RAB model to investors for many billions of pounds of investment in new nuclear projects and in other infrastructure sectors across the UK. We know that GIIA members have already expressed to BEIS and Treasury their concerns with the nuclear RAB model in light of Heathrow's inability to recover the cost of its past investments.

6. Airport debt and creditworthiness

Even before the onset of the pandemic and the risks that has presented to airports, airport balance sheets have been severely strained. This makes debt significantly more expensive and difficult to raise as credit rating agencies reassess the creditworthiness of airports like Heathrow and the overall prospects for the sector. Airport gross debt overall has increased significantly because cost reduction necessarily could not keep pace with traffic and revenue

[20] GIIA, Infrastructure Pulse, Europe and the Americas Q4 2021, 2021 (URL)

decreases over time – but it is important to note that Heathrow's net debt has remained flat throughout the pandemic.

At the same time, the covid crisis is making airports a fundamentally riskier proposition for equity investors which structurally changes how regulators need to assess the risks of airport infrastructure such as at Heathrow. Left unaddressed, the unavoidable consequences of Covid will be more costly airport investment at the UK's main hub, with adverse consequences for airport customers and the wider economy. The question for regulators is what they can do to mitigate the consequences of Covid in ways that leave airports like Heathrow in a better position to address future challenges to the benefit of airlines, passengers, and the wider economy.

7. Summary

The airport sector is very capital-intensive in nature which means that the service that Heathrow can provide 5-10 years from now will depend on decisions taken in the very near-term, including regulatory decisions on the acceptable range for airport landing charges to be set at.

The decision by the CAA on the acceptable range for airport landing charges to be set at therefore carries with it long-term risks to future investment, stability and operational efficiency of the UK's major hub airport and should be considered against the backdrop of the huge levels of investment made since privatisation, the resulting high performance of the airport in the eyes of consumers, and against the significant losses incurred as a result of a once-in-a generation pandemic event.

8. Contact Details

For more information about GIIA and the contents of this submission please contact

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