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Airports Commission : Discussion Paper
Transport Committee: Aviation Strategy ("the Report")

Introduction:

1. As an infrastructure project finance banker and consultant, I read with interest the Airports Commission "Airports Operations" Discussion Paper and the Transport Committee's Report, "Aviation Strategy", Volume 1, published last week.
2. This latter Report focuses much on the future of Heathrow, which represents the fulcrum around which the shape and future of UK airport operations rotates.

The Current Scenario:

3. In an ideal world, Heathrow is the wrong place to have an airport hub for London!! Given that the prevailing wind for London is from the West, then landing aircraft more often than not have to fly low and, on occasion, stack over large areas of population and commercial value.
4. It is well known that most flight accidents take place within a short radius of either landing or taking off. To date, Heathrow has been lucky, but sooner or later- not least, statistically, and either due to human error or third party intervention (e.g. terrorist attack from an urban site), - an air accident will arise with, quite possibly, significant loss of life and underlying property value. Expanding Heathrow under such circumstances, therefore, to many will be seen as foolhardy.

I noted that the Report seemingly ignored this safety issue.

[NB. I am not saying that Heathrow is unsafe, but any airport operation carries such risks in its operations, and it is unwise to maximise, rather than minimise, the impact should such risks materialise.]

- 5 In the Report comparisons were made between Heathrow and other European hubs, in particular, Paris (CDG), Frankfurt, Madrid and Schiphol (Neth.). None of these airports carry the same over-flight risks that apply to Heathrow. Hence, any comparison with such airports must needs be of limited value in this respect. Heathrow is the worst placed of any hub competitor!

- 5 interestingly, the role of Manchester as a hub, or mini-hub, was largely ignored by the Transport Committee Report. I disagree!

Commercial & Financial Structure:

- 6 The UK airport sector is a mix of publicly-owned (e.g. Manchester Airports Gp.) and privatised airports (e.g. Heathrow, Gatwick, etc.).
- 7 In comparison with European hubs, i.e. Paris (CDG), Frankfurt, Madrid and Schiphol (Neth.), only Heathrow is private (as is Gatwick, too). All the others, including Manchester, - at least in respect of the freehold land represented by the airport, - are either owned or controlled by the host or regional Government or a corporatized State agency.
- 8 As a consequence publicly-owned European airport agencies can take a holistic view when it comes to planning such facilities, i.e. the access infrastructure is part and parcel of the airport development. The result is that Heathrow's hub competitors have good national and urban road and rail connections on their doorstep.
- 9 Hence, the constraint for BAA/Heathrow is that they have no control over, nor obligation to finance, any development outside their fence (Sec 106 issues apart). Yet, for every £ spent inside BAA's Heathrow site, probably at least another £ has to be spent outside to facilitate and improve access. This is where privatisation can have its limitations. [The same issue can be found in the UK ports sector, too.].
- 10 A second difference between Heathrow and its hub competitors is that the commercial/financial hub/cities served by Heathrow's hub competitors are uni-centred, i.e. have one central commercial focal point. Whereas London, which is a diffuse collection of towns, comprises a multitude of focal points and, hence, business destinations, i.e. not just Canary Wharf! This affects the nature of the demand for, and ready availability of, access infrastructure.
- 11 A third differentiating feature is that Heathrow's hub competitors all have their terminals contiguous on site, whereas with Heathrow two are on the perimeter and three in the centre, accessed by a limiting 2 x 2-way tunnel. Visitors to Heathrow competitor hubs have much easier inter-terminal connections than Heathrow. [Is it not extraordinary that after the expenditure of building T5 there is no direct transit connection between T5 and T4?]
- 6 Hence, one concludes that, with respect to the location and structure of the site, Heathrow is at a significant disadvantage to its European hub competitors, Third Runway or not.

Corporate Structure

- 7 As Heathrow is private, it has to finance any new airport development within its boundary itself. Furthermore, it is a non-quoted company, so lies outside the normal governance and transparency of UK Stock Exchange companies, as was the case when BAA was privatised in July 1987.
- 8 The controlling shareholder in BAA/Heathrow, Ferrovial, albeit quoted on the Madrid Stock Exchange, is majority controlled by one Spanish family and their interests. [NB. many senior executive positions in the company are held by family members or their associates.]. Notwithstanding that BAA/Heathrow has paid no corporation tax in recent years**, it carries a significant portion of debt, so any significant fund-raising will put great strain on its finances.

*[** One might ask how have shareholders been kept happy over recent years, i.e. since 2006, when it was bought by Ferrovial et al.? Unfortunately, the underlying corporate structure of the group and the accounts are multi-layered and somewhat opaque!! There are 10 corporate layers between Heathrow, as the CAA licensed airport, and the shareholders. It is quite possible that much of the equity is held via shareholder loans/sub-debt, minimising corporation tax. This is a common structure in many UK privately-owned, public service utilities.]*

- 9 As Heathrow has to fund both terminals and runways/aprons itself, it is at a significant disadvantage financially to its European hub competitors, who enjoy the support of a “landlord model”, whereby the runway/aprons and access infrastructure are funded by, in effect, government-supported debt, with the terminals funded in similar manner or as private sector concessions, e.g. PFI/PPP.
- 10 A further disadvantage for Heathrow is that for many such airports the cost for access infrastructure plays a subordinate role in the overall expenditure envelope, as they are located outside centres of population.
- 11 In fact, the additional costs associated with environmental and social remediation and adjustments to the current access infrastructure for a Third Runway could far outweigh the costs for BAA/Heathrow for the Runway itself.
- 12 Finally, in the context of completely new airports, from my 30 years experience of working internationally on the financing of transport infrastructure projects**, I am not aware of any new major international airport with any form of hub-type operations, which has been totally funded (i.e. for terminals, runways, and aprons) with private sector capital. Government grants, loans or concessionary funds have been required to fund the cement and concrete of runways and aprons! Add to this the access infrastructure component, which also invariably is funded from the public purse.

*[** I have given more than 100 3-4 day Training Courses to governments, banks, etc. around the World on this topic over the last 4 years].*

Costs & Data

- 13 Attempting to get a handle on the costs associated with the various options for expanding airport capacity is quite a challenge! The comments as made in para 63 in the Report demonstrate the difficulties that arise and wide variance that exists, - why cost estimates can be “commercially sensitive” in such scenarios, when so much state funding support is obviously required, I know not. In summary, there seems to be no commonly agreed estimate of costs for the range of options identified.
- 14 More specifically, the Oxera Study, on which the Report is based, claims (ref Table 4.1, p. 69) that the “Total” cost for the Third Runway is £8-9 bn (2012 prices), including all costs within the Heathrow boundary (i.e. runways, aprons, terminal upgrades, etc.) and costs associated with social, environmental and access infrastructure development and/or remediation.
- 15 This estimate was based on an updated (for inflation) figure taken from the 2007 DfT Study, “UK Air passenger Demand and CO2 Forecasts”.
- 16 However, this latter DfT Study obtained its data from the April 2002 Halcrow Study for the DTLR, “SERAS Stage Two: Appraisal Findings Report” and the DfT “The Future Development of Air Transport – South East Consultation Document”. !!
- 17 To make matters even more complicated, - and muddled!, - the 2002 SERAS and DfT Studies arrived at their cost estimates, as expressed in present values or 2002 prices, using the old Green Book criteria of a discount rate of 6% ‘real’ for assessing future costs, i.e. excluding the impact of inflation or finance.
- 18 The subsequent 2007 DfT Study, which estimated the Third Runway option at £7.8 bn (2006 prices; ref. Table 4.1, p.89), up from £4-5bn in 2002, used a discount rate of 3.5% ‘real’, plus an Optimism Bias multiple of 44% (as per the Green Book post-2003), - an analytical tool which is unique to HM Government!!.
- 19 The Oxera (2012) estimate used an updated assessment of the 2007 DfT Study cost estimates, with an optimism bias multiple ranging between 6 and 66% (ref. p. 70). When assessing the financial attractiveness of the Heathrow options for investors, Oxera seemingly used the same data but with a discount rate of 9% nominal (i.e. post-inflation!!)!!
- 20 Overall, the current Oxera cost estimates for the range of options have significant flaws, not least because of:-
 - the use of (some) data which might be at least 10 years old, updated as may needs be by inflation or some other indices;
 - a fine mix of ‘real’ and ‘nominal’ data being used in assessing present values/prices (cf. West Coast Mainline assessment); and
 - the lack of transparency as to the actual costs which may be incurred, or excluded.

21 As a result, the cost estimates and conclusions in the Report cannot be relied upon.

22 To add to this melée, there is no one set of comprehensive data for all options, which all stakeholders have agreed to. Estimates have been prepared by the DfT, CAA, BAA, British Airways, etc.. It would be helpful to decision-making, if one set of data for all options could be agreed.

Conclusion:

- If one started with a clean sheet of paper, Heathrow is not where one would place a major airport, never mind a hub.
- The arguments that London needs one major hub, not two or even three, are weak. The demographic structure of London suggests that it could be best served, not least because of the current infrastructure, by having multiple hubs.
- The airline business is constantly changing and, in recent times, consolidating. Heathrow, where British Airways represents 40-50% of the traffic, is hardly a hub for non-BA airlines, nor will be for the foreseeable future. Hence, the arguments for a multiple hub structure for London are strengthened.
- Given the above, plus the social and environmental damage created by building Runway Three, prudent planning would suggest that the optimum way forward is to:-
 - maximise the use of Heathrow within its current boundaries;
 - expand Gatwick with a second runway when legally permissible;
and
 - consider wider development of Stansted.
- An HS2 link via Heathrow under the above scenario seems of doubtful value against the associated incremental costs.
- The opportunity to build a Thames Estuary Airport, notwithstanding any merits, was lost in the 1960-70's and is too high a financial risk to adopt as a concept today.
- A few more bridges over the Thames within the M25, - we have built none, at least at new sites, since the invention of the motorcar, - would also help the flow of traffic around the metropolis!!