

31st October 2017

Dear Colleagues

Decision - 2018 Airport Charges

I would like to thank you for your participation in the 2018 Heathrow Airport Charges Consultation process.

As you know, over the past decade Heathrow has invested £11bn to transform the airport. We have focussed on making Heathrow, as a European hub, more efficient and reliable for you our airline customers and on improving facilities for our passengers. We're delighted that these investments are resulting in significant operational improvements for our airlines. In 2017 to date, Heathrow has achieved record punctuality with 81% of flights departing within 15 minutes (2016: 79%), the baggage misconnect rate significantly improved to only 10 in every 1,000 bags (2016: 14) and made investments in new technology like Enhanced Instrument Landing Systems to boost resilience levels. Moreover, investing in the passenger experience is yielding tangible results for our passengers who have ranked Heathrow as the best airport in Western Europe for the past three consecutive years.

As we set out at the airline conference in March this year, we want to build on this momentum by continuing to work with all our airline customers to make the best use of Heathrow's scarce capacity. Throughout the consultation process we have been engaging with our airlines to explore how best we can adapt the airport's charging regime to achieve this and we have been guided by three overarching objectives:

Optimising Use of Scarce Capacity - Attracting More Passengers

Heathrow is one of the best connected hub airports in the world, with over 80 global airlines operating regular scheduled flights to over 220 destinations. The airport is permitted to operate up to 480,000 air transport movements per year and in 2016 its runways operated at 99% of this limit. Heathrow is near full capacity for air transport movements.

Within this capacity constraint, the remaining key driver for passenger growth is to increase the number of passengers on each plane. In other words, by maximising the average load factor. Growing passenger volumes will generate additional revenue for our airline customers as more direct and transfer passengers fill existing flights. It will also deliver better value for our airlines and passengers as higher volumes help us to keep future airport charges close to current levels even as we expand, as increased passenger numbers allow the sums that are recoverable through airport charges to be distributed over a greater number of users, resulting in lower charges on a per passenger basis.

Additionally, more passengers using Heathrow will drive higher commercial revenues. Commercial revenues play an important role in the way that Heathrow is economically regulated

under the single till framework as Commercial revenues reduce the charges cost base which in turn lowers the airport charges.

Environmental Commitments - Promoting Sustainability

At the same time, Heathrow is committed to helping local communities thrive and improving the quality of life for all those living around the airport as outlined in our sustainability strategy Heathrow 2.0. To minimise impacts on local communities, Heathrow wants to attract the quietest and most efficient aircraft to fly from Heathrow – reducing noise and emissions for our neighbours.

Supporting Domestic Connectivity

As the UK's only hub airport and global gateway, Heathrow must ensure that it creates the best conditions for communities across the UK to access the airport and the onward worldwide connections our airlines provide.

These objectives represent compelling public and general interest reasons to support the revised airport charges framework and we are pleased that many of our airline customers are supportive of our plans. As a result, Heathrow will amend the airport charges from 1st January 2018 to now include:

- £15 discount for UK domestic passengers to support domestic connectivity;
- Reduced minimum departure charge for UK services to support domestic connectivity;
- £10 discount on EU services to increase direct and transfer passenger volumes;
- 7% increase in environmental charges to attract the cleanest and quietest aircraft;
- Extended Night Period environmental charges;
- An increase in the non-EU departing passenger charge;
- A change in the application of the remote stand rebate; and
- Recovering the forecast maximum allowable yield for 2018 of £22.057 per passenger.

	2017	2018
Overall balance	Environment 29% Passenger 67% Parking 4%	No change
Passenger charge by destination	UK EU Non-EU	No change
Departing Passenger charges	EU load factor (-£5) UK connectivity (-£10)	EU load factor discount (-£10) UK connectivity discount (-£15) Non-EU (+£3.44)
Transfer passenger charge	25% discount	No change
Transit passenger charge	Charged as per transfer passengers	No change
Basis of landing	Movement	No change

Noise charge	New differentiated Chapter 14	No change
Parking charge	Separate free period and charge thereafter for narrow and wide bodied aircraft	No change
Minimum Departure Charge	All destinations £1,378.08	UK £761.40 All other destinations £1,378.08
Night Quota Period Charges	Between 00h00 and 03h29 (local time)	Between 23h30 and 06h00 (local time)
Remote Stand Rebate	Applied before Minimum Departure Charge	Applied after Minimum Departure Charge

Overall passenger charges at Heathrow have reduced by 4.7% in nominal terms over the course of Q6, whilst delivering a significant investment programme to transform the airport. We will continue to make appropriate capital investments in the airport throughout 2018 and as a result the charging regime will be set to allow Heathrow to recover the forecast allowable yield of £22.057 in line with the CAA's Q6 regulatory settlement.

We are confident that the changes outlined above represent a significant step forward in making the best use of the scarce capacity at Heathrow and will lead to tangible benefits for our airline customers, our passengers, our neighbours and communities across Britain.

Detailed explanations of these changes are outlined in the appendices below, and as always, both myself and my team remain available to answer any questions you may have.

Appendix 1 outlines each of the changes in more detail.

Appendix 2 documents the consultation process and responds to some of the main questions received from our customers through the consultation process.

Appendix 3 sets out the final prices effective from 1 January 2018.

Yours sincerely

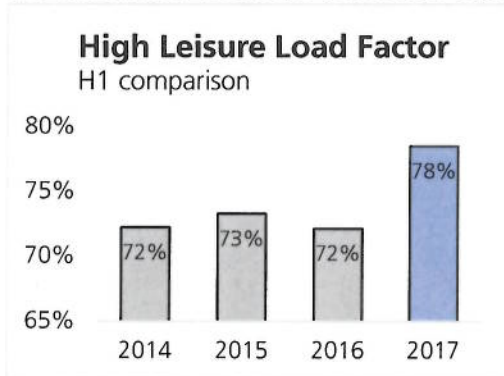


Ross Baker
Chief Commercial Officer

APPENDIX 1

Attracting More Passengers and Supporting Domestic Connectivity Discount on EU and UK routes

In 2017 we introduced a departing passenger discount of £5.00 for EU destinations to address an imbalance in the EU load factor compared to non-EU destination routes; over the past 6 years the imbalance between these two categories has been 7% on average.



Since the introduction of the discounts, Heathrow's EU leisure passenger volume has grown, reversing the decline seen in 2016. Our top EU leisure routes have grown by around 130,000 passengers year-on-year and has the strongest "high-leisure" load factor for three years; we can therefore reasonably determine that the discounts are contributing to the passenger growth in persuading passengers to fly through Heathrow.

However, the Heathrow EU load factor remains below the IATA global average of 80.31% reflecting the highly competitive EU leisure segment.

Year	EU load factor	Non-EU load factor	Difference EU vs Non-EU	Total Heathrow load factor
2011	71.10%	78.90%	7.80%	75.20%
2012	70.70%	80.10%	9.40%	75.60%
2013	71.70%	80.60%	8.90%	76.40%
2014	73.20%	79.70%	6.50%	76.60%
2015	73.50%	79.30%	5.80%	76.50%
2016	73.60%	78.10%	4.50%	76.00%
Average	72.30%	79.50%	7.20%	76.05%

Therefore, in order to optimise the use of the scarce ATM capacity by further increasing load factors, we will extend the EU load factor discount in 2018 by a further £5.00.

As the Heathrow charges represent a higher proportion of the average short-haul fare (on average 33% compared to 7% of a long-haul fare²) we reasonably expect a £5 discount on the EU departing passenger charge to drive additional volumes of such departures; whereas we reasonably expect a modest increase in the non-EU departing passenger charge to have a limited negative impact on the volumes of those departures, such that the increased EU load factor discount and its partial rebalancing through non-EU departing passenger charges can be expected to have a net positive impact on passenger numbers.

¹ https://www.icao.int/sustainability/Documents/Yearly%20Monitor/YearlyMonitor_2016.pdf

² Based on 2016 Airport IS average return fares for sample destinations

Passengers will benefit from a reduction in the “Passenger Service Charge” on their ticket breakdown; a family of four will see a reduction of £20.00 and we believe this will attract new passengers to travel from Heathrow.

The UK connectivity discount of £5.00 on top of the EU departing passenger charge will continue, meeting our commitment to the National Connectivity Task Force’s recommendation to encourage and protect domestic connectivity. This brings the total discount for UK passengers to £15.00 (UK connectivity discount of £5 and EU load factor discount of £10).

To align our minimum departure charge with our domestic connectivity commitments we are introducing a UK minimum departure charge of £761.40, the minimum departure charge for EU and non-EU destinations will remain at £1,378.08.

Environmental charges – Promoting Sustainability

Our Heathrow Sustainability 2.0 plan highlighted our objectives to make Heathrow and its surrounds a great place to live by delivering quality local air and respite for residents.

The decision represents an increase in environmental charges of 7% compared to 2017, designed to incentivise airlines to fly the quietest and most efficient aircraft to Heathrow, which supports our commitment to our neighbours to reduce noise and emissions and deliver improved air quality. For our airline customers, the best in class aircraft benefit from the lowest landing charges.

The revenue shortfall from the additional EU load factor passenger discount was originally proposed to be recovered through environmental charges, however we have responded to customer feedback that a more balanced approach is required and so we have taken the decision to recover this revenue through both environmental charges and the non-EU departing passenger charge. This increase of £3.44 to the non-EU departing passenger charge represents a much smaller proportion of the average long-haul fare (compared to the average short haul fare) and is reasonably expected to have a lower (net positive) impact on passenger demand. The resulting non-EU departing passenger charge remains lower than that effective in 2014.

To support delivering noise respite for our local communities, Heathrow is actively seeking to reduce the number of unscheduled, non-dispersed operations running late into the night quota period in line with the sustainability objectives and actions set out in Heathrow 2.0 and the Noise Action Plan. The Night Quota Period has therefore been extended to cover the hours of 23:30-06:00 (local time) giving our neighbours a longer period of noise respite.

Remote Stand Rebate

The remote stand rebate reflects that passengers using remote stands do not receive the same level of service as those using contact stands. The rebate also acts as a compensatory factor for the cost incurred by airlines to coach passengers from remote stands to the terminal. The decision changes the application of the rebate so that it applies irrespective of whether the minimum charge on departure has been reached or not.

Transfer Discount

The original consultation proposed to increase the transfer discount applied to departing passenger charges by 5% from 25% to 30% to further encourage such passengers at Heathrow in order to support the hub. However, most responses from our customers did not see the benefit of the increased discount and therefore the transfer discount remains at the current level of 25%.

APPENDIX 2

Consultation Process 2018

Our Airport Charges consultation proposal was published on 4 August 2017, followed by a consultation meeting on 19 September 2017. We requested that the airline community formally respond to the consultation proposal by 29 September and we received twelve formal responses to the original proposal.

Having assessed the responses received, we amended our consultation proposal on 11 October 2017. Our amended proposal continued to meet our growth, connectivity and environmental objectives. The amendment responded to customer concern at the circa 27% increase in environmental landing charges in the original proposal, instead recovering the EU discount through both environmental charges and the Non-EU departing passenger charge. The amendment also retained the transfer discount at the current level of 25% of the direct departing passenger charge, instead of increasing it to 30%. We have had due regard to the 9 responses to the amended proposal in reaching the final decision.

We have taken our decision with full regard to our legal and regulatory obligations and the impact of the potential changes. This decision meets Heathrow's objectives to optimise scarce capacity through passenger growth whilst incentivising the quietest and cleanest aircraft to operate at Heathrow to meet our environmental commitments. Domestic connectivity and passenger growth are incentivised through the reduction in EU departing passenger charges and the reduced UK minimum departure charge.

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: Heathrow should price below the cap. Despite the reduction in maximum allowable yield, Heathrow has the highest level of airport charges compared to other airports.

Heathrow Response: Heathrow considers it to be appropriate and reasonable to recover the maximum allowable yield that has helped transform Heathrow through an extensive investment programme which has seen investment in new terminals, world class baggage systems and enabled wide body growth, and the price is reflective of the wide-ranging consultation process on determining the Q6 price cap.

(2) Airline Question: Heathrow should absorb the shortfall in revenue from the introduction of the passenger charge discounts and not recover this through increased environmental charges.

Heathrow Response: Heathrow carried out an extensive consultation process on the structure of charges commencing in November 2014 and concluding in July 2015 with revised charges taking effect 1 January 2017. One of the objectives of the structural review was to improve

environmental performance and as a result a greater emphasis was placed on noise and emission charges. The design of the structure of charges with the introduction of passenger discounts results in environmental charges acting as the balancing factor to ensure Heathrow recovers the regulated price cap. However, we responded to customer concerns that the proposed 27% increase in environmental charges was high and amended our proposal to recover the revenue through a mixture of both environmental charges and the Non-EU departing passenger charge.

(3) Airline Question: Increasing passenger discounts to UK destinations and EU destinations has not been justified and is discriminatory.

Heathrow Response: Heathrow is permitted to set airport charges that differentiate between airport users based on relevant, objective and transparent criteria and may vary airport charges for reasons relating to the public and general interest, including reasons relating to the environment. Heathrow considers that measures to address the imbalance between EU and non-EU load factors, and thereby optimise use of Heathrow's scarce resource, are justified in the public and general interest. In particular, as explained above, optimising use of capacity helps to keep airport charges lower than they would otherwise be for the benefit of all airport users.

The 2017 discounts were brought in to maximise the use of the scarce available capacity, i.e. to drive efficient use of assets in the public and general interest and to respond to the Domestic Connectivity Task Force recommendations. Prior to the implementation of the 2017 prices many EU and domestic routes were flat or declining year on year. The 2017 prices reversed this decline. We have seen the market respond to the 2017 discounts and that's why we have extended these further in our 2018 charges.

The full details of the discounts and justifications were set out in Heathrow's Airport Charges Consultation Document – 2018.

(4) Airline Question: Can Heathrow show how these prices and discounts relate to the cost of providing these services? This decision looks like cross-subsidisation between traffic segments to the disadvantage of long haul operators. How will users, particularly those paying more under the new proposals benefit in the medium term from them?

Heathrow Response: Heathrow values all airline customers and seeks to create the optimum conditions for growth for all carriers. Long haul carriers connect the UK to key markets around the globe, without which Heathrow would not be the leading hub airport it is today. As a hub, the success of short and long haul routes at Heathrow are interdependent, and growing underperforming market segments benefits all airport users, and ultimately flows to lower charges on a per passenger basis.

As stated in the response to question 3 above, Heathrow may set differential airport charges for reasons relating to the public and general interest based on relevant, objective and transparent criteria. In setting its airport charges, and having due regard to its core objectives (to optimise the use of scarce resources, support UK Growth and promote sustainability), Heathrow seeks to maintain a careful balance between all airlines to the benefit of all passengers and users. Heathrow's investment in airport infrastructure is designed to benefit both short haul and long-haul carriers who have mixed requirements given the type and size of aircraft as well as differing passenger numbers per aircraft.

As explained above, it is anticipated that, in the medium term, long haul providers will benefit from the EU passenger discounts through (i) net higher passenger volumes at Heathrow (through increased load factors on EU flights with minimal impact on non-EU load factors), leading to (ii) increased commercial revenues and an associated reduction in the sums to be recovered through airport charges in future regulatory periods, and (iii) reduction in average charges per passenger owing to the larger user base.

(5) Airline Question: what impact has the structure of charges changes implemented on 1 January 2017 have had on traffic and how much additional traffic is expected with the new proposals?

Heathrow Response: Since the introduction of the discounts, Heathrow's EU leisure passenger share volume has grown, reversing the decline seen in 2016. Our top EU leisure routes have grown by around 130,000 passengers year-on-year and has the strongest "high-leisure" load factor for three years. As the Heathrow charges represent a higher proportion of the average short-haul fare (on average 33% compared to 7% of a long-haul fare) it is a reasonable expectation that such a discount will have a positive impact on passenger numbers.

(6) Airline Question: how would Heathrow deal with changes (i.e. lowering) to its average yield within the regulatory period as a consequence of Heathrow's expected traffic effects from its charges proposals?

Heathrow Response: Heathrow will set its airport charges so that they are compliant with our Licence Conditions set out by the CAA. Heathrow will set its charges based on the latest information available for traffic movements and will not exceed the permitted level of airport charges.

(7) Airline Question: The Conditions of Use should not be a unilateral agreement, instead should be agreed bi-laterally with individual airlines.

Heathrow Response: The COU reflects standard industry practice, and are the only terms by which airlines can operate at Heathrow. The unilateral nature is reasonable and appropriate given multiple stakeholders and it is not possible to operate from Heathrow under any other terms.

(8) Airline Question: Increasing environmental charges will not significantly change airline behaviour but will limit current plans to up-gauge aircraft due to higher charges on larger aircraft. Can Heathrow introduce a MTOW-based charging system or base landing charges on noise levels rather than noise margins?

Heathrow Response: The environmental charges are aimed at supporting longer term strategic goals in relation to fleet mix. The CAA's CAP1596 report quotes Heathrow's 2020 target of at least 60% Chapter 14 aircraft and considered this as potentially not ambitious enough. Differential charges have been in place for several years which we would consider is a clear indication of our strategic approach to apply higher charges to those aircraft that achieve lower cumulative margins relative to Chapter 3.

The system seeks to encourage best in class noise performance and is based on certified noise levels which is designed to ensure a level playing field. There are a number of challenges that arise from an actual noise level based system not least the number of variables involved if it is to drive best in class performance; annoyance is not only linked to absolute noise levels but also frequency.

(9) Airline Question: There are already existing levels of management and control on night movements including the Night Quota Period, Quota Count, Effective Perceived Noise in decibels, Heathrow Local Rule 1 and the Voluntary Scheduling Restrictions. Further penalties on night movements impact operational robustness and Heathrow is placing airlines in a position where they have to make trade-offs between operational resilience and the airline's own costs.

Heathrow Response: Heathrow is committed to reducing the impact of night flights and the extension of the Night Quota Period is part of a package of measures. We have specific responsibility under UK governmental policy and the EU Noise Directive to take steps to reduce impact of night flights between the hours of 2300-0700 because of the associated health effects. We will review the CAA recommendations as part of the Noise Action Plan consultation in 2018 in which we encourage all airlines to participate.

(10) Airline Question: Can Heathrow revisit the liability clauses in the Conditions of Use?

Heathrow Response: The liability provisions included in the Conditions of Use are consistent with those at other UK and international airports and similarly worded provisions have also been approved by the UK courts. We offer the use of our facilities and services at Heathrow Airport to all airlines equally on the terms and conditions set out in our published Conditions of Use and an airline indicates unconditional acceptance of those terms and conditions by choosing to use the airport. We do not consent to any airline operating on terms different to those set out in our Conditions of Use.

APPENDIX 3

	Final 2018 £ GBP	Final 2017 £ GBP
Charges on Landing		
Peak		
Chapter 3	8,831.66	8,274.00
Chapter 4 High	2,523.33	2,364.00
Chapter 4 Base	2,271.00	2,127.60
Chapter 14 High	1,766.33	1,654.80
Chapter 14 Base	1,261.67	1,182.00
Chapter 14 Low	757.00	709.20
Super Night Peak		
Chapter 3	22,079.15	20,685.00
Chapter 4 High	6,308.33	5,910.00
Chapter 4 Base	5,677.50	5,319.00
Chapter 14 High	4,415.83	4,137.00
Chapter 14 Base	3,154.18	2,955.00
Chapter 14 Low	1,892.50	1,773.00
Emissions charge	15.96	15.42
Charges on Departing Passengers		
Origin and Destination		
European charge with dual discount <i>(with EU load factor and UK connectivity discount)</i>	13.72	19.13
European charge with single discount <i>(with EU load factor discount)</i>	18.72	24.13
Other	44.34	40.90
Transfer and Transit		
European charge with dual discount <i>(with EU load factor and UK connectivity discount)</i>	10.29	14.35
European charge with single discount <i>(with EU load factor discount)</i>	14.04	18.10
Other	33.26	30.68
Remote Stand Rebate	-4.00	-4.00
Minimum charge - UK destinations	761.40	1,378.08
Minimum charge - Other destinations	1,378.08	1,378.08
Charges on aircraft parking		
Narrow bodied	22.13	21.82
Wide bodied	53.11	52.37