

Heathrow Airport Limited
Annual report and financial statements
for the year ended 31 December 2016

Heathrow Airport Limited

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Heathrow Airport Limited

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Heathrow Airport Limited

Strategic report

Heathrow Airport Limited (the 'Company') owns Heathrow Airport ('Heathrow'). Until 31 August 2015, the Company was entitled to all receipts and income relating to Heathrow Express ('HEX') but the day-to-day operation of HEX was undertaken on behalf of the Company by Heathrow Express Operating Company Limited ("HEOC"), a subsidiary of the Company. On 1 September 2015, the beneficial ownership of the HEX business was transferred to HEOC which has operated since that date as a Train Operating Company on an arm's length basis.

The Company is an indirect subsidiary of Heathrow Airport Holdings Limited. The Company's financial activities are aligned with Heathrow Airport Holdings Limited and the wider Heathrow Airport Holdings Limited Group (the 'HAH Group') and also with the Heathrow (SP) Limited Group (the 'SP Group'), which is the intermediate parent undertaking of the smallest group to consolidate these financial statements.

The financial statements of Heathrow Airport Limited are prepared in accordance with United Kingdom Generally Accepted Accounting Practice – Financial Reporting Standard 102 ('FRS 102'). The accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

This strategic report is presented in five sections:

Business overview – an overview of the business model and strategy of the Company;

Management review – overview of the year ended 31 December 2016, along with the key factors likely to impact the Company in 2017;

Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2016 and analysis of the financial position of the Company as at that date. The Company's accounting and reporting policies and procedures are also considered;

Leadership and governance – description of the Board of Directors (the 'Board') of Heathrow Airport Holdings Limited and Committees of the Board which provide overall leadership to the HAH Group; and

Internal controls and risk management – outline of the HAH Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the HAH Group Executive Committee and Board.

Business overview

Heathrow's business model

Heathrow is one of the best connected hub airports in the world, with 81 global airlines operating regular scheduled flights to almost 200 destinations. Heathrow is the primary airport in the world's largest aviation market – demand to fly to and from London is 15% higher than the next largest city. With 75.7 million passengers in 2016, Heathrow is Europe's busiest and the world's seventh busiest airport.

Heathrow has maintained a strong focus over recent years on operational performance, improving the passenger experience and investing in new and upgraded facilities. Heathrow has invested approximately £11 billion transforming the airport over the last decade. The focus and investment has resulted in Heathrow Airport being named 'Best Airport in Western Europe' by Skytrax for the second consecutive year in 2016 and becoming the top performing major European hub airport in terms of overall passenger satisfaction.

Heathrow provides service to a range of market segments, including business and leisure travellers, direct and transfer passengers on long and short-haul routes, operated by a diversified range of major airlines. Heathrow is subject to economic regulation by the Civil Aviation Authority, which sets caps on the amount that Heathrow can charge airlines for using its facilities. This price setting mechanism provides significant cash flow predictability within each regulatory period, with the current regulatory period now ending December 2019 following its recent one year extension. As well as earning income from services to airlines, Heathrow also generates revenue from a variety of sources, including concession fees from retail operators, income from car parks, advertising revenue, the rental of airport premises, the provision of facilities and services and the Heathrow Express rail service.

Heathrow's strategy

Heathrow's strategy is focused on developing the airport's position from one of the best airports in Europe to one of the best in the world. Heathrow's vision is to give passengers the best airport service in the world.

To support and develop Heathrow airport's role as a hub, the Group will continue enabling the success of the major network airlines operating at Heathrow by investing in further capacity, operational flexibility and resilience at sustainable charges for airline customers.

For both local and transfer passengers, Heathrow is working continuously to make every journey better through improved service standards to ensure it remains passengers' preferred airport. Improving the passenger experience is supported by on-going investment in modern airport facilities and operating processes.

Heathrow Airport Limited

Strategic report *continued*

Business overview *continued*

Heathrow's priorities

Heathrow aims to deliver the best airport service in the world and has four strategic priorities going forward to help achieve this aim:

Mojo

To be a great place to work, Heathrow will help its people fulfil their potential and work together to lead change across Heathrow with energy and pride.

Transform customer service

To deliver the world's best passenger experience, Heathrow will work with the Heathrow community to transform the service it gives to passengers and airlines, improving punctuality and resilience.

Beat the plan

Aiming to beat the business plan for the current regulatory period and deliver a competitive return to shareholders by growing revenue, reducing costs and delivering investments efficiently.

Sustainable growth

To operate and grow Heathrow airport sustainably, now and in the future.

Heathrow's regulatory environment

Heathrow is subject to economic regulation by the Civil Aviation Authority ('CAA'), which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection.

The CAA sets the maximum level of airport charges for Heathrow, generally for five-year regulatory periods using a per passenger price cap mechanism known as RPI +/- X, which incorporates an allowed return on the Regulatory Asset Base ('RAB'). Heathrow's current regulatory period ('Q6') initially ran from 1 April 2014 to 31 December 2018. On 21 December 2016, the CAA issued a formal notice under section 22(6) of the Civil Aviation Act 2012 to modify the licence issued to Heathrow, by extending Heathrow's current regulatory period by one year so that it will end on 31 December 2019 and rolling over the current price control of RPI-1.5% for the additional year.

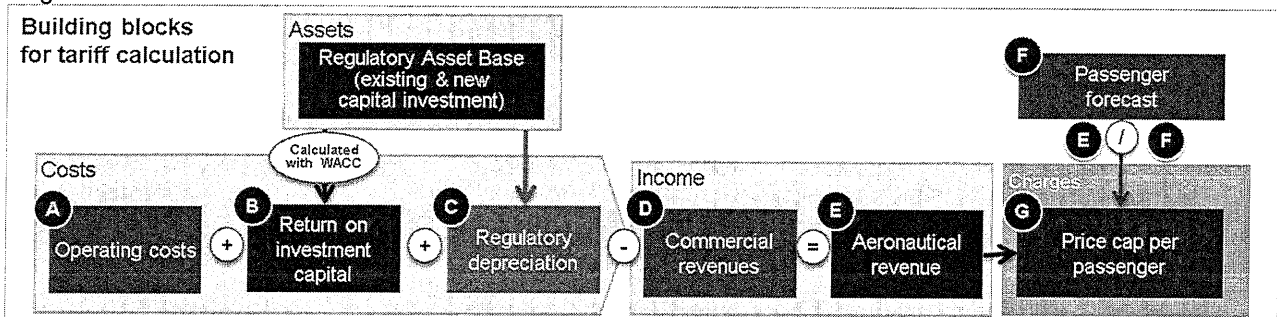
Heathrow's regulation is consistent with the economic regulation of other UK regulated industries (such as telecoms and the energy sector). This form of economic regulation is also sometimes referred to as incentive regulation, in that Heathrow has an incentive to outperform the price control by means of attracting more passengers, reducing operating costs or delivering higher commercial revenues than forecast. If the opposite is the case, then Heathrow has to absorb the cost or lower revenue. There is no adjustment for shortfalls in passenger numbers or additional costs (except where Heathrow incurs additional security costs, above an established threshold, when implementing new security directives imposed by the EU or the UK Government).

The Price Cap

The price cap for Heathrow is based on a RAB methodology using a "single till" building block approach. The single till takes into account revenue and costs from both aeronautical and non-aeronautical activities when setting the price caps for a regulatory period.

In setting the price cap, the CAA determines the regulated revenue requirement. This is calculated as the sum of forecast operating expenditure less other revenue plus the required return (using the cost of capital determined by the CAA) on the forecast RAB taking into account forecast capital expenditure, plus regulatory depreciation and plus or minus any profiling adjustment. The profiling adjustment is a mechanism used to smooth changes in charges that might otherwise occur as a result of major investments. The resulting aeronautical revenue requirement effectively amounts to the total income from airport charges.

This methodology for deriving the aeronautical revenue requirement can be represented by the following simplified diagram:



Heathrow Airport Limited

Strategic report *continued*

Business overview *continued*

Heathrow's regulatory environment *continued*

The Price Cap continued

Since the start of the current regulatory period, the maximum allowable yield (the amount of income generated from regulated airport charges on a per passenger basis) changes from 1 January each year by RPI minus 1.5%, based on RPI from the previous April.

In setting the price cap the CAA takes its own view of the scope for future efficiency savings, the appropriate level of capital expenditure and the rate of growth in demand for airport services.

While the price cap places a limit on the increase in the airport charges yield, Heathrow has the discretion on whether to price to the maximum permitted level. Therefore, Heathrow can choose to price charges below the cap. For example, if there is unused capacity, Heathrow could choose to set prices below the cap in order to stimulate demand.

The price cap takes certain elements into account in the maximum allowable yield. These include an adjustment for additional or reduced security costs as a result of new UK or European security directives; reductions where capital expenditure project milestones are not delivered; a 2017 business rates revaluation factor and a service quality rebate scheme. In addition there is a mechanism known as the "K factor" which is designed to correct for any under recovery (dilution) or over recovery (concentration) in airport charges compared to the annual maximum allowable yield per passenger. Under or over recoveries generally arise due to changes in passenger mix or average load factors compared to those forecast at the time prices were prospectively set for the relevant year.

Heathrow's income

Heathrow generates two primary types of income: aeronautical income, which is generated from fees charged to airlines for use of the airport's facilities, including passenger fees, landing charges and aircraft parking charges, and non-aeronautical income from a variety of sources, including concession fees from retail operators, direct income from car parks and advertising and income from other services supplied by Heathrow.

Aeronautical income

Aeronautical income reflects the charges levied by Heathrow on the airport's airline customers. These charges (tariffs) cannot exceed the regulated maximum allowable yield per passenger.

The tariff structure through which the aeronautical income is recovered from airlines includes three key elements:

Passenger fees

- Fees per passenger are based on the number of passengers on board an aircraft and are levied in respect of all departing passengers. There is no charge in respect of crew members working on flights.
- Three levels of charge based on route area: European, domestic and rest of world. Transfer and transit passengers benefit from a discount.

Landing charges

- Landing charges are levied for substantially all aircraft (with certain diplomatic and other flights being exempted). These are calculated in accordance with the certified maximum take-off weight of the aircraft and are banded into categories for aircraft weighing less than and those weighing more than sixteen tonnes, which includes nearly all commercial aircraft. These charges are adjusted, where applicable, in accordance with each aircraft's noise-rating, its emissions and the time of day, with landing charges being higher during peak traffic times than off-peak traffic times.

Parking charges

- Aircraft parking charges are levied for each 15 minute slot after 30 minutes (for narrow-bodied aircraft) and 90 minutes (for wide-bodied aircraft).

Non-aeronautical income

Heathrow generates non-aeronautical income from a variety of sources. These include concession fees from retail operators, direct income from car parks, advertising revenue and VIP products, the rental of airport premises such as aircraft hangars, warehouses, cargo storage facilities, maintenance facilities, offices and airline lounges, the provision of facilities such as baggage handling and passenger check-in. Until 31 August 2015, fare revenue from the operation of the Heathrow Express rail service was included in these sources and since this date track access fees in relation to the use of the Company's rolling stock and rail assets revenue is recognised in other income as property and other.

Infrastructure

The Group has invested £11 billion transforming Heathrow's infrastructure over the last decade, with £674 million invested in 2016 (2015: £627 million).

Heathrow Airport Limited

Strategic report *continued*

Business overview *continued*

Infrastructure *continued*

Runways

Heathrow airport has two parallel runways. These generally operate in 'segregated mode', with arriving aircraft allocated to one runway and departing aircraft to the other. The airport is permitted to schedule up to 480,000 air transport movements per year and in 2016 its runways operated at 98.6% (2015: 98.3%) of this limit.

Terminals

Each of Heathrow's four operational terminals is either new or recently refurbished. Terminal 2, which opened in June 2014, handled 16.5 million passengers in 2016 (2015: 16.7 million) and complements the award winning Terminal 5, which handled 31.9 million passengers in 2016 (2015: 33.1 million). Terminal 1 operations were discontinued in June 2015.

Heathrow airport's terminal capacity is currently estimated to be 85 million passengers per year.

Baggage systems

In parallel with the work on Heathrow's terminals, significant investment continues in Heathrow's baggage infrastructure. The underground automated baggage system between Terminal 3 and Terminal 5 is now fully operational, and the Terminal 3 integrated baggage system started operating in March 2015 and was fully operational in April 2016.

Cargo and mail carriers

Cargo and mail carriers are responsible for handling merchandise and packages at Heathrow airport, including delivery to cargo warehouses, customs procedures and clearance, aircraft loading and unloading, sorting and transport to the final destination. The bulk of cargo and mail at the airport is carried in the cargo holds of passenger flights rather than by dedicated cargo flights.

Certain cargo sheds at the airport are owned by third parties who lease space to cargo service providers. Heathrow also provides cargo sheds and other accommodation and facilities which are leased, or separately billed on a use basis, to cargo-service providers.

Heathrow Airport Limited

Strategic report *continued*

Management review

Review of the year

Heathrow saw excellent progress in 2016 towards its vision to give passengers the best airport service in the world. There was significant momentum in all four of its priorities: making Heathrow a great place to work, transforming the service to passengers and airlines, beating the business plan over the current regulatory period and winning support for expansion. These priorities are underpinned by a simple business logic that engaged people deliver great service which in turn delivers financial returns and Heathrow's licence to grow.

Heathrow's people are measurably more engaged. In the latest internal survey 78% of colleagues rated themselves engaged – up 10 points in 4 years. And Heathrow has been recognised as one of the top 30 UK companies in an annual national survey by The Sunday Times. Engagement efforts took many forms. All managers have participated in leadership and values training. Heathrow raised over £250,000 for the Duke of Edinburgh scheme with people participating in a range of community or personal challenges such as running the runway and a mass cycle race against a plane to New York. Heathrow signed a long-term partnership with Hong Kong airport, one of the world's leading hub airports, which includes long-term exchange of talented managers and in-depth peer reviews of core processes.

Heathrow is serving passengers better. Heathrow's people delivered the best ever result in the global Airport Service Quality survey of 4.19 in Q4 2016. This was supported by record baggage performance with 986 bags for every thousand passengers travelling as intended. Punctuality of flights also improved supported by airfield improvements, close work with airlines and innovative air traffic control. Skytrax's survey of over 16 million passengers yet again rated Heathrow the best airport in Western Europe and Terminal 5 the best airport terminal in the world.

In 2016, a record 75.7 million passengers flew through Heathrow, this was up 1.0% on 2015 and the sixth successive annual record. Major airlines added more seats per aircraft while also introducing cleaner, quieter and more efficient new generation aircraft such as the Boeing 787 Dreamliner and Airbus A350 to grow capacity at the airport. Airlines are also adding new destinations from Heathrow, with recent or imminent new long haul routes including Ahmedabad, Jakarta, New Orleans, Portland, Salt Lake City, San José (California), Santiago and Tehran.

Cost efficiency is as important to beating the plan as volume growth. Total cost efficiencies of over £500 million out of a target of £600 million to the end of 2018 have been secured. Savings were achieved in energy bills, key contracts and people costs. The latter included further reducing senior manager roles and increasing the proportion of people on new contracts. Over £200 million of incremental commercial revenue streams out of a target of £300 million have also been developed over the same period. Across the year revenue grew 0.2% to £2.8 billion and Adjusted EBITDA was up 5.2% to £1.7 billion. In addition, £1.6 billion in debt financing was raised in the year as Heathrow continues to capitalise on opportunities in the global debt capital markets.

The government supported expansion of Heathrow in October 2016. Expansion will connect all of Britain to the world, bringing up to 180,000 new jobs and £211 billion of economic growth across the UK. The decision was supported by a wide coalition built up over years. A new runway will be built to the north-west of the existing airport which will allow 260,000 more flights at Heathrow by 2030. Heathrow will also consult on adding 25,000 extra flights from 2021 on the existing runways, while reducing noise for local people, to give Britain a 'Brexit Boost' of jobs and growth as soon as possible. Heathrow is now working toward planning approval by 2020. Heathrow intends to deliver a world leading and ambitious airport that is affordable and financeable. It must also balance national and local economic gain with environmental impacts. Heathrow is seeking to deliver sustainable growth that ensures the careers of even more people, the growth of local communities and continued business success.

Passenger traffic

Heathrow's passenger traffic by geographic segment for the year ended 31 December 2016:

<i>Passengers by geographic segment (millions)</i>	Year ended 31 December 2016	Year ended 31 December 2015	Change ¹ %
UK	4.6	5.1	(9.6)
Europe	31.7	31.2	1.8
North America	17.2	17.3	(0.5)
Asia Pacific	10.8	10.5	2.8
Middle East	7.0	6.4	8.8
Africa	3.2	3.3	(4.1)
Latin America	1.2	1.2	1.4
Total passengers¹	75.7	75.0	1.0

¹ These figures have been calculated using un-rounded passenger numbers

For the year ended 31 December 2016, traffic grew 1.0% to a record 75.7 million passengers (2015: 75.0 million) on a total of 470,764 passenger flights (2015: 469,671). The 2016 leap year contributed over 0.2% to the growth. The average number of seats per passenger aircraft increased 1.3% to 211.5 (2015: 208.7) and the average load factor was slightly lower at 76.0% (2015: 76.5%). On eight separate days (2015: 5 days) over a quarter of a million passengers used Heathrow. 2016 was the sixth successive year of record traffic at Heathrow. Traffic increased early in the year, softened either side of the EU referendum and then ended the year strongly.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Review of the year *continued*

Passenger traffic *continued*

Passengers had even greater choice in 2016, with new airlines, new destinations and more seats available per flight. In March 2016, Garuda followed in the steps of Vietnam Airlines and Air China and became the latest airline to move services from Gatwick to Heathrow, bringing Jakarta as a new destination at Heathrow. Other new long haul routes introduced in 2016 were Ahmedabad, Salt Lake City, San José (California) and Tehran.

Intercontinental traffic was the key driver of traffic growth in 2016, increasing 1.7%, with more flights operated and more seats per flight. A380 long haul aircraft now account for up to 26 departures per day by up to nine airlines.

Intercontinental traffic growth was particularly robust on routes serving the Middle East where passenger numbers increased 8.8% reflecting more flights and larger aircraft, including additional A380 services from Emirates, Etihad and Qatar Airways and British Airways' relaunched Tehran service. Momentum in this region increased in the second half of the year. The rise in Asia Pacific traffic of 2.8% included substantial growth on existing routes serving Thailand, China, Vietnam and the Philippines and new services to Indonesia. In the first quarter of the year, increased services to North America supported continued traffic growth with this region although geopolitical and macro-economic factors saw traffic soften as the year progressed. Latin American traffic grew 1.4% mainly reflecting modest remaining year on year benefits from Avianca's route to Colombia launched in 2014. There should be a further boost to traffic with this region in 2017 given British Airways launch in January of a regular flight between Heathrow and Santiago in Chile. African traffic was lower partly reflecting Virgin Atlantic's schedule changes in 2015.

European passengers increased by 1.8% although short haul traffic overall was only marginally higher year on year with growth in continental European traffic, driven by British Airways increasing seat capacity, largely offset by reduced UK traffic principally due to Virgin Little Red ending operations in 2015.

Over a quarter of the UK's non-EU exports by value pass through Heathrow today. Cargo volumes passing through Heathrow increased 3.0% in 2016 to 1.54 million metric tonnes (2015: 1.50 million tonnes). There were particularly notable increases in cargo volumes on Hong Kong, China and Vietnam.

Transforming customer service

Heathrow delivered its best ever passenger service in 2016 with a record 84% of passengers surveyed rating their overall experience as 'Excellent' or 'Very Good' (2015: 81%). Heathrow has now achieved a score above 4.00 in the Airport Service Quality ('ASQ') survey directed by Airports Council International ('ACI') for twelve successive quarters culminating in its highest ever quarterly score of 4.19 in the fourth quarter of 2016. Heathrow has been ranked first among major European hub airports for service quality in this survey for ten successive quarters.

The high service standards have resulted in Heathrow being named 'Best Airport in Western Europe' for the second consecutive year at the Skytrax World Airport Awards. The award, voted for globally by passengers, came in addition to

Terminal 5 being named the world's 'Best Airport Terminal' and Heathrow 'Best Airport for Shopping' for the fifth and seventh consecutive years respectively. In addition, the new Plaza Premium Lounge in Terminal 2 was voted the world's best independent airport lounge in the same awards. For the first time, Heathrow received the prestigious accolade of 'Europe's Best Airport' (with over 40 million passengers) in the 2016 ASQ awards. Heathrow also received ACI Europe's Best Airport Award (with over 25 million passengers) for the third time. Heathrow's success was also recognised at the latest Frontier Awards where the airport won the categories of 'Operator of the Year' and 'Marketing Campaign of the Year by an Airport'.

Improvements to passengers' journeys through the airport continue. An additional escalator was opened in Terminal 5, improving operational flexibility and resilience. Passengers continue to enjoy efficient queuing to pass through security, passing through central security within the five minute period prescribed under the Service Quality Rebate scheme 97.0% of the time (2015: 97.4%) compared with a 95% service standard. The service quality regime penalty threshold was not triggered in 2016 in respect of any performance standard.

As part of the focus on increasing the resilience of operations, the final two of four new enhanced Instrument Landing Systems (eILS) were implemented at Heathrow. The eILS is based on new navigation technology and provides Heathrow with the capability to increase the number of aircraft that can land in low visibility giving improved safety, resilience and punctuality to airfield operations.

Heathrow had its busiest days ever in 2016 and achieved strong levels of service, with departure punctuality (the proportion of aircraft departing within 15 minutes of schedule) improving to 78.8% (2015: 78.1%). This reflects investments to improve operational resilience, including introducing time-based separation of aircraft on windy days in 2015. Further work on widening taxiways during 2016 to support increasing A380 operations also enabled more efficient use of the airfield. Baggage performance also improved significantly with the misconnect rate down to 14 bags per 1,000 passengers (2015: 17). The best ever monthly misconnect performance of 9 bags per 1,000 passengers was achieved in October 2016.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Review of the year continued

Beating the plan

Heathrow's business plan for the current regulatory period is intended to improve customer service, strengthen operational resilience and deliver an ambitious programme of cost efficiencies and revenue growth. Work continues to secure cost efficiencies and over £500 million of efficiencies have now been secured, out of the target £600 million for the period to the end of 2018. A three year pay offer was agreed in 2016 and further contract improvements have been secured with suppliers.

The benefits of investment in Terminal 5 retail outlets and new car parking capacity continue to flow through strongly with over £200 million secured out of the £300 million incremental commercial revenue target set for the regulatory period.

In March 2016, the CAA published its "Strategic Themes for the Review of Heathrow Airport's Charges (H7)" document. The document sets out the CAA's key milestones and details four key priorities for the next regulatory period (H7). The four priorities are 'empowering consumers and furthering their interests', 'incentivising the right consumer outcomes', 'increasing airport operational resilience' and 'promoting cost efficiency and financeability'. Heathrow responded to the CAA's consultation in April.

In addition, in July 2016, the CAA launched a consultation on the potential extension of Heathrow's current Q6 regulatory period in order particularly to reduce the risk that the process for agreeing the terms for the next regulatory period is sub-optimal due to uncertainty regarding potential new runway capacity. Following this process, on 21 December 2016, the CAA issued a formal notice to modify Heathrow's economic licence by extending Heathrow's current regulatory period by one year to 31 December 2019, rolling over the current price control of RPI-1.5% for the additional year.

Investing in Heathrow

In 2016, Heathrow invested over £650 million across the airport campus, improving the passenger experience and airport resilience, enhancing baggage resilience and working through a broad asset replacement programme. Passengers should benefit from improved baggage connection reliability following the opening of the Terminal 3 integrated baggage facility and see reduced baggage disruption as facilities are made more resilient. Security processes have been strengthened and made more efficient with more body scanners installed across terminals and additional automated immigration gates introduced. Also, passengers connecting through Terminal 5 should now experience an improved connection experience with the installation of an additional escalator.

The retail proposition at Terminal 4 is currently in the final stages of being significantly refreshed. The restaurant and bar group, Drake & Morgan opened their first airport unit, 'The Commission'. Terminal 4's luxury stores, such as Harrods, Burberry and Cartier, are also being redeveloped with five new luxury brands introduced, two of which are new to

Heathrow. The luxury retail redevelopment in Terminal 5 has now been matched by the introduction of an enhanced food and beverage offer.

Airfield improvements continue to meet increased A380 operations with taxiway widening projects and stand modifications substantially completed. Winter operations will benefit from improved de-icing facilities and enhanced runway landing systems should assist arrivals punctuality. The refurbishment and enhancing of the main road access tunnels into the central terminal area will be completed in the coming months.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Review of the year *continued*

Responsible Heathrow

Giving passengers the best airport service in the world relies on managing the airport responsibly. Responsible Heathrow 2020 is Heathrow's commitment to supporting the UK and local economies whilst managing its impacts on communities and the environment. Building on progress achieved through Responsible Heathrow, during 2016 Heathrow consulted with leading sustainability experts and NGOs, the airport business community and local stakeholders to develop a new sustainability strategy. The plan sets long term, ambitious goals which demonstrate Heathrow's commitment to being a leader in sustainability.

In 2016, Heathrow delivered a number of initiatives and commitments that lay the foundation for the launch of the new plan and for strong performance in sustainable growth at Heathrow.

Heathrow's Noise Action Plan adopted by Government sets out over 40 actions to manage noise impacts. As part of this, in August 2016, Heathrow launched its second Blueprint for Noise Reduction. Key elements include introducing lower charges for the quietest types of aircraft (Chapter 14), such as the A350. This will make Heathrow the first airport in the world to differentiate charges for such aircraft. Another world first, Heathrow launched xPlane; enabling local residents to access flight data specific to their location and carry out their own comparative analysis.

Reducing the impact of night flights is also a key aspect of the noise blueprint. As part of this, Heathrow strives to minimise the number of aircraft departures after 11.30pm. In 2016, there were 330 such departures. Finally, as part of planning for future expansion of Heathrow, it is proposed that the new runway is sited 1 mile further west than Heathrow's two existing runways to reduce the noise impact of aircraft on their final descent into the airport over central London. Heathrow aims to delay the start of early arrivals from 4.30am to 5.30am once planning approval for expansion is obtained.

Heathrow's 2016 blueprint for reducing emissions sets out a plan for working with partners to reduce emissions from aircraft, vehicles and buildings, as well as Heathrow's commitment to play its part in ensuring air quality limits in the local area are met. Progress has been made in several areas including increasing the range of electric vehicles in use on the airport and investing in infrastructure to help achieve Heathrow's aspiration to become an Ultra-Low Emission Zone (ULEZ). There are currently over 30 electric vehicles in the fleet or on order and approximately £400,000 was invested in 2016 to install electric vehicle chargers, with a further £1 million funding approved. During 2016, Heathrow also joined the Office for Low Emission Vehicles' Go Ultra Low Company initiative which requires large companies to convert at least 5% of their vehicles to electric by 2020.

Heathrow's energy footprint continues to shrink. The 2020 target of 6.5kWh per passenger was achieved in 2016, driven by the on-going reduction in electricity consumption due to Energy Demand Management works, such as installing nearly 100,000 LED lights across the airport, compared to 75,000 at the end of 2015. In 2016 Heathrow won the Onsite Energy Efficiency category at the Edie Environment and Energy Awards, in recognition of its energy efficiency programme which cut electricity use by 27GWh in 2015, as well as being shortlisted for the ACI Europe 2016 Eco-innovation Award.

Reflecting its commitment to be a responsible gateway to the world, in 2016 Heathrow became the first airport to sign the Buckingham Palace Declaration, a landmark agreement to shut down illegal wildlife trafficking routes. Heathrow also launched the Responsible Gateway Forum which works collaboratively with third parties including the Metropolitan Police, Border Force and specialist NGOs to tackle issues around the detection of and support for vulnerable travellers.

June saw the launch of Heathrow's Skills Task Force - an independent taskforce chaired by Lord Blunkett - to provide strategic advice and guidance in developing a comprehensive employment and skills strategy for the Heathrow area that will ensure the business, including its supply chain, has the skills needed to build and operate an expanded airport.

Finally, in 2016, "Sustainable Growth" became one of Heathrow's four strategic priorities, in recognition of its commitment to operate and grow the airport sustainably, now and in the future.

Heathrow Airport Limited

Strategic report *continued*

Management review *continued*

Review of the year continued

Expansion

On 25 October 2016, Heathrow welcomed the Government's decision to support its expansion and confirmed it will begin work to deliver the new runway that will connect all of Britain to the world, bringing new jobs and economic growth to every nation and region of the UK. A new third runway to the north west of Heathrow will deliver a world leading, ambitious and affordable plan which balances the huge national and local economic gain from expansion with the environmental impacts.

The Government's decision follows the unanimous and unambiguous recommendation of the Airports Commission in July 2015 after a two and a half year, £20 million study. A third runway will bring huge benefits to everyone in Britain, creating up to 180,000 jobs and £211 billion of growth across the country. As the UK charts a new course outside the EU, it will enable up to 40 new long-haul trading routes and support Britain's exporters to reach the fastest growing markets in the world. To give Britain a 'Brexit Boost' and unlock jobs and growth across the country sooner, Heathrow will consult on plans to bring in 25,000 extra flights per year from 2021.

In July 2016, the Civil Aviation Authority ('CAA') commenced consultation on the regulatory treatment of costs incurred in obtaining the development consent order ('DCO') required to proceed with expansion (so called 'Category B' costs). Heathrow currently estimates £250-300 million of such costs will be incurred primarily between 2017 and 2020. Following responses to its initial consultation, in November 2016, the CAA issued its final proposals in relation to these costs.

Subsequently, Heathrow's licence has been modified to enable it to recover up to £10 million per annum of Category B costs through aeronautical income shortly after they are incurred. The CAA's proposals on other aspects of Category B costs, to be finalised in February 2017, include mechanisms that allow (i) costs in excess of £10 million per annum to be added to the regulatory asset base ('RAB'), (ii) the regulatory cost of capital to accrue on the costs once added to the RAB, (iii) recovery of the costs following receipt of the DCO and (iv) risk sharing under which either 105% or 85% of costs added to the RAB will be recovered if the DCO is granted or not granted, respectively.

In January 2017, the CAA initiated consultation on its key priorities and timetable for the development of the regulatory framework for Heathrow's expansion and in particular, the regulatory treatment of costs and financing of the construction programme (so called 'Category C' costs). Four key priorities are expected to be considered: (i) the expansion scheme must be designed to promote the interests of consumers by engaging with airlines in a transparent and effective manner, (ii) cost estimates must be robust and their regulatory treatment must incentivise timely and efficient delivery of the project, (iii) Heathrow must develop proposals for efficient financing while the regulatory framework needs to be consistent with efficient financing, affordability and financeability and (iv) affordability and financeability principles must apply to both existing operations and new runway and capacity expansion. Responses to this consultation are due by 14 March 2017 and a further consultation on the regulatory framework is expected in June 2017. In addition, the CAA intends to publish an update on the business plan expectations and outcomes for the next regulatory period in April 2017.

In February 2017, the Government published its draft Airports National Policy Statement ('NPS') outlining its policy for Heathrow's expansion. The publication started a 16-week public consultation on the draft NPS. A number of planning requirements are being consulted on, which are reflected in Heathrow's plans, including providing compensation to communities affected by the expansion, purchasing properties affected by the scheme at a 25% premium, implementing measures mitigating noise including a six and a half hour ban on scheduled night flights, setting specific mode share targets to curb impacts on air quality and demonstrating the scheme can be delivered in compliance with legal requirements on air quality. A final version of the NPS is expected to be submitted to a vote in Parliament during winter 2017/18.

In addition, Heathrow will run the first of two public consultations later this year as it develops its DCO for submission to the Planning Inspectorate.

Key management changes

On 22 June 2016, Paul Deighton succeeded Sir Nigel Rudd as Chairman of the board of Heathrow Airport Holdings Limited.

On 10 November 2016, Heathrow announced Javier Echave as Chief Financial Officer, who had acted as interim Chief Financial Officer since the departure of Michael Uzielli in May 2016.

Heathrow Airport Limited

Strategic report *continued*

Financial review

Introduction

The following financial review, based on the financial statements of the Company, provides commentary on the performance of the Company's operations.

Basis of presentation of financial results

The Company has prepared its financial statements and financial review in accordance with FRS 102.

Summary performance

In the year ended 31 December 2016 the Company's operating profit before certain re-measurements was £1,011 million (2015: £915 million) and its profit after tax was £48 million (2015: £776 million).

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Excluding exceptional items and certain re-measurements		
Revenue	2,760	2,754
Operating costs before depreciation and amortisation	(1,080)	(1,157)
Adjusted EBITDA	1,680	1,597
Depreciation and amortisation	(669)	(682)
Adjusted operating profit	1,011	915
Net finance costs	(480)	(435)
Adjusted profit before tax	531	480
Tax charge on profit before exceptional items and certain re-measurements	(143)	(125)
Including exceptional items and certain re-measurements	388	355
Exceptional items	-	236
Gain on transfer of business to subsidiary	-	38
Fair value gain on investment properties	44	95
Fair value (loss)/gain on financial instruments	(474)	84
Tax credit/(charge) on exceptional items and certain re-measurements	64	(78)
Tax charge relating to change in tax rate	26	46
Profit on ordinary activities after taxation	48	776

Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation, certain re-measurements and exceptional items. For the year ended 31 December 2016, Adjusted EBITDA was £1,680 million (2015: £1,597 million) and EBITDA was £1,724 million (2015: £1,928 million). Management uses Adjusted EBITDA to monitor performance of the segments as it believes it more appropriately reflects the underlying financial performance of the Group's operations. On a monthly basis management review results, paying particular attention to the airport operations over which it exercises control on a day-to-day basis.

Certain re-measurements comprise fair value movements on investment properties, which are mainly market-driven and over which management has little influence; fair value gains and losses on financial instruments which are subject to external financial market fluctuations; tax associated with these items and the effects of changes in tax rates, which are set by statute.

Exceptional items are presented separately as they are material items of income or expense that are not expected to be incurred on a recurring basis and because of their size or incidence, merit separate presentation to allow an understanding of the Group's financial performance.

By isolating certain re-measurements and exceptional items, management believes the underlying results provide the reader with a clearer understanding of the performance of the Group, by concentrating on the matters over which it exerts influence, whilst recognising that information on these additional items is available within the financial statements, should the reader wish to refer to them.

Heathrow Airport Limited

Strategic report *continued*

Revenue

In the year ended 31 December 2016, revenue increased 0.2% to £2,760 million (2015: £2,754 million).

	Year ended 31 December 2016	Year ended 31 December 2015	Change
	£m	£m	%
Aeronautical	1,699	1,699	-
Retail	612	568	7.7
Other	449	487	(7.8)
Total revenue	2,760	2,754	0.2

Aeronautical

In the year ended 31 December 2016, aeronautical revenue was flat at £1,699 million (2015: £1,699 million) as Heathrow delivered better value for passengers and airlines with lower charges as average aeronautical revenue per passenger declined 1.0 % to £22.45 (2015: £22.67).

Traffic growth of 1.0% generated £16 million incremental revenue and yield concentration, due primarily to more long haul and origin and destination passengers and a greater proportion of departing passengers than expected also boosted year on year performance. These factors were offset by a lower maximum allowable yield due to the RPI -1.5% tariff formula, the non-recurrence of significant K-factor recovery in 2015 and adjustments to reflect lower capital expenditure than forecast in the original regulatory settlement.

Retail

In the year ended 31 December 2016, retail revenue increased 7.7% to £612 million (2015: £568 million). Retail revenue per passenger rose 6.7% to £8.09 (2015: £7.58).

	Year ended 31 December 2016	Year ended 31 December 2015	Change
	£m	£m	%
Duty and tax-free	138	128	7.8
Airside specialist shops	115	100	15.0
Bureaux de change	50	53	(5.7)
Catering	49	45	8.9
Other retail income	86	75	14.7
Car parking	114	107	6.5
Other services	60	60	-
Total retail revenue	612	568	7.7

Retail performed strongly in 2016 following the major redevelopment of luxury stores in Terminal 5 including new brands which have strengthened Heathrow's unrivalled airport shopping experience. Performance in duty and tax-free stores has continued to improve following extensive store refurbishment in Terminals 4 and 5. Catering has grown in the year as a result of new and refurbished outlets and increases in passenger participation. Car parking also performed well, with continued take-up of Heathrow's expanded car parking product range and successful yield management. Growth in retail income accelerated in the second half of the year, particularly in areas such as duty and tax-free and airside specialist shops, driven by the depreciation of sterling following the EU referendum in late June 2016. Redevelopment of luxury stores in Terminal 4 was largely completed in late 2016 and started contributing to overall retail performance.

Other

In the year ended 31 December 2016, other revenue fell 7.8% to £449 million (2015: £487 million).

	Year ended 31 December 2016	Year ended 31 December 2015	Change
	£m	£m	%
Other regulated charges	232	239	(2.9)
Rail passenger revenue	13	87	(85.1)
Property and other	204	161	26.7
Total other revenue	449	487	(7.8)

Other regulated charges reflect a pass through to airlines of Heathrow's costs in areas such as baggage system operations and maintenance and utilities so the year on year reduction reflects not only lower costs but better value for airlines. Performance elsewhere in other revenue reflects the separation of Heathrow Express from the results of the Company and additional property revenue supported by the opening of new independent lounges in Terminals 3 and 4.

Operating costs

In the year ended 31 December 2016, operating costs excluding depreciation, amortisation and exceptional items decreased by 6.7% to £1,080 million (2015: £1,157 million). Management excludes depreciation, amortisation and exceptional items from operating costs for the purposes of calculating Adjusted EBITDA.

Heathrow Airport Limited

Strategic report *continued*

Financial review *continued*

Operating costs *continued*

	Year ended 31 December 2016 £m	Year ended 31 December 2015 ¹ £m	Change % ²
Employment	349	361	(3.3)
Operational	257	243	5.8
Maintenance	164	175	(6.3)
Business rates	127	123	3.3
Utilities	72	90	(20.0)
Other	111	165	(32.7)
Operating costs before depreciation, and amortisation and exceptional items	1,080	1,157	(6.7)
Depreciation and amortisation	669	682	(1.9)
Exceptional items	-	(236)	n.m
Total operating costs	1,749	1,603	9.1

¹ For the year ended 31 December 2015, £11 million of costs previously included under 'Other' have been re-classified into 'Operational' to be consistent with current year disclosure.

² n.m. means not meaningful

Employment costs benefited from previously announced changes to the defined benefit pension scheme as well as take-up of voluntary severance programmes, lower new starter pay levels, lower headcount, automation and other workforce efficiencies, partially offset by higher costs for implementing organisational change. Higher operational costs reflect increased investment in operational resilience partially offset by improved service driving lower service quality rebates and savings from the renegotiated NATS contract for providing aerodrome navigation services. The rise in business rates reflects general national trends with Heathrow remaining one of the UK's highest business rate payers. Other costs reflect savings across consultancy, marketing and general expenditure.

Significantly lower utilities costs particularly reflect a renegotiated contract for the provision of electricity distribution infrastructure services due to a combination of recurrent cost savings and a one-off credit of £14 million related to prior periods. A focus on energy demand management continues to drive savings in electricity consumption. For example, Heathrow is the first European hub airport to install LED lighting on all aircraft stands. The number of LED light installations across the Heathrow campus is approaching 100,000, compared to 75,000 at the end of 2015. Additionally, since Terminal 2's opening, Heathrow has generated around 5GWh of electricity on-site, from solar panels and a biomass renewable energy facility.

Operating profit

For the year ended 31 December 2016, the Company recorded an operating profit after exceptional items but before certain re-measurements of £1,011 million (2015: £1,151 million).

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m	Change %
Adjusted EBITDA	1,680	1,597	5.2
Depreciation and amortisation	(669)	(682)	1.9
Exceptional items	-	236	n.m
Operating profit before certain re-measurements	1,011	1,151	(12.2)
Fair value gain on investment properties	44	95	(53.7)
Operating profit	1,055	1,246	(15.3)

In the year ended 31 December 2016, Adjusted EBITDA (before certain re-measurements and exceptional items) increased by 5.2% to £1,680 million (2015: £1,597 million), resulting in an Adjusted EBITDA margin of 60.1% (2015: 68.0%). Depreciation and amortisation decreased to £669 million (2015: £682 million) mainly due to the decommissioning of Terminal 1 during 2015 and some Terminal 2 and 5 assets being reassessed in the year as having longer useful economic lives. This decrease is partly offset by the accelerated depreciation of Terminal 3 to reflect the Airport Masterplan.

Exceptional items

In the year ended 31 December 2016, there were no exceptional items charged (2015: £236 million credit) to the income statement.

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Pension scheme: change to terms	-	236
Exceptional pre-tax credit	-	236

Heathrow Airport Limited

Strategic report *continued*

Financial review *continued*

Exceptional items *continued*

In 2015, changes were agreed to the HAH Group's defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members which resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under FRS 102, and was classified as an exceptional item in the income statement. There is no immediate cash flow impact as a result of these changes.

Taxation

All Heathrow Group companies operate not only within the UK's tax laws, but also within the spirit of them and do not structure transactions in a way which gives a tax result contrary to the intentions of Parliament. All Heathrow Group company profits are subject to UK corporation tax.

The tax charge recognised for the year ended 31 December 2016 was £53 million (2015: £157 million). Based on a profit before tax for the year after certain re-measurements and exceptional items of £101 million (2015: £933 million), this results in an effective tax rate of 52.5% (2015: 16.8%).

Excluding the impact of the change in tax rate and certain re-measurements, the tax charge recognised for the year on ordinary activities of £143 million (2015: £125 million) results in an effective tax rate of 26.9% (2015: 26.0%). The tax charge is more than implied by the statutory rate of 20% (2015: 20.25%) primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief. Further details supporting these amounts are shown in Note 5 to the accounts.

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. Consequently the Company's significant deferred tax balances, which were previously provided at 18%, were re-measured at the future tax rate at which the Company believes the timing differences will reverse. This has resulted in a net reduction in the deferred tax liability and a corresponding net deferred tax credit of £26 million being recognised in the income statement.

In December 2016 and January 2017 the UK government published draft legislation on a new interest deductibility regime, in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). It has been announced that, be effective from 1 April 2017, interest deductions will be limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public benefit infrastructure exemption (PBIE). Whilst the legislation could impact the future tax charge of the Company, Heathrow expects to be largely protected from the 30% of tax based EBITDA cap through the use of the PBIE and GRR. The position will be clarified when the legislation is enacted later in 2017.

As a business, Heathrow has high infrastructure costs and of these a significant proportion now attracts no tax deduction. For those that do attract a tax deduction there is a timing difference between the accounting depreciation of these assets (the asset cost is charged to the income statement over the useful life of the asset as depreciation on a straight-line basis, which is not deductible for tax purposes) and the tax relief available for capital expenditure (capital allowances, being tax reliefs provided in law, spread over a number of years), this generates significant deferred tax liabilities within the Company, reflecting future tax payable once capital investment reduces.

Capital expenditure

In the year ended 31 December 2016, additions to fixed assets were £680 million (2015: £586 million). Capital investment is managed at an SP Group level where funding is raised through the Heathrow (SP) financing platform for capital projects which meet the appropriate investment appraisal criteria.

Capital transactions

On 6 December 2016, the Company capitalised its revaluation reserves by a bonus issue of 1,226,666,667 ordinary shares of 30p each. Following this transaction, the issued share capital of the Company was 2,802,236,984 ordinary shares of 30p each. On 16 December 2016, the Company reduced its nominal share capital from 30p to 0.35p, realising £830,863,266 which in law creates distributable reserves. The redeemable preference shares of the Company were redeemed on 16 January 2016 at £1.37 per share, uplifted for movements in RPI since issue.

Pension scheme

Heathrow operates a defined benefit pension scheme, the BAA Pension Scheme, which closed to new members in June 2008. At 31 December 2016, the defined benefit pension scheme, as measured under IAS 19, had a deficit of £79 million (2015: £104 million surplus). The £183 million change in the year is primarily due to net actuarial losses of £219 million, partly offset by contributions in excess of current service cost of £34 million, including £25 million for agreed deficit repair contributions.

The deterioration in the scheme actuarial position was driven by a fall in the net discount rate, particularly corporate bond yields which fell significantly following the EU referendum. As a result, Heathrow's IAS19 pension liabilities have increased by £822 million, whilst assets have increased by £603 million, partly offsetting the increase in liabilities and reflecting the value of having a significant proportion of the scheme's assets that perform in a manner expected to be consistent with key drivers of change in the scheme's liabilities.

Heathrow Airport Limited

Strategic report *continued*

Financial review *continued*

Pension scheme *continued*

In July 2016, the trustee of the BAA Pension Scheme concluded a formal actuarial valuation of the scheme. The valuation was carried out as at 30 September 2015 and took into account changes implemented to reduce the scheme's liabilities. These changes were the introduction of an annual cap on future increases in pensionable pay for active members and a reduction in both the accrual rate for future service and inflationary increases for those future service pensions whilst in payment. The valuation indicated a scheme deficit of £228 million calculated using the agreed actuarial assumptions. As part of the process, LHR Airports Limited agreed a reduction to its annual deficit repair contribution from £27 million to £23 million that is intended to eliminate the deficit by 2022. The process also resulted in a reduction in ongoing cash contributions from 33% to 23% of pensionable salary, consistent with the efficiency targets under the current regulatory settlement. The reduction in cash contributions into the scheme applied from 1 July 2016 and is estimated at £12 million per annum.

Recent financing activity

Heathrow continues to focus on maintaining a strong liquidity position and optimising its long-term cost of debt as well as ensuring duration, diversification and resilience in its debt financing. Heathrow's recent financing strategy has looked to balance certainty of term funding, particularly to meet £1.1 billion in debt maturities in the first quarter of 2017, with the cost of carrying substantial cash on balance sheet. This has been achieved partly by securing term debt with delays between commitment and drawing.

In 2016, Heathrow raised approximately £1.6 billion of debt financing globally from a diverse range of sources. In January 2016, it consolidated its presence in the Swiss franc bond market, raising CHF400 million in an 8 year public bond with a fixed rate coupon of 0.5%. In June 2016, a £350 million 3.75 year term loan was signed with an initial group of 5 banks which is expected to be drawn by the end of the first quarter of 2017. Also in July 2016, a £400 million, 33 year public bond with a fixed rate coupon of 2.75% was issued, extending Heathrow's maturity profile. In August 2016, a £90 million private placement from non-sterling sources which was signed in April 2016 was drawn and matures in 2032. In December 2016, a NOK1 billion private placement which was signed in July 2016 was drawn and matures in 2029. At Heathrow Finance, a £150 million, 12 year term loan agreed earlier in the year was drawn in December 2016. In addition, Heathrow Finance entered into £200 million in 7-10 year term loans which are expected to be drawn in 2017.

Given the strength of its liquidity position, Heathrow has cancelled £250 million of its £1.4 billion core revolving credit facilities. The maturity of these facilities has also been extended by a year to October 2021. Further, £130 million of its £750 million liquidity facilities have been cancelled as Heathrow continues to focus on the efficiency of its financing arrangements for itself and counterparties.

Heathrow repaid £300 million and €500 million (£434 million) bonds in March 2016 and October 2016 respectively. Also during 2016, £195 million of term loan facilities at ADI Finance 2 Limited were repaid which are being replaced by debt raised at Heathrow Finance as Heathrow evolves to a simpler debt capital structure.

Since the start of 2017, Heathrow has also repaid €700 million (£584 million) and CHF400 million (£272 million) bonds in January 2017 and February 2017 respectively. Heathrow currently expects to raise no more than £750 million in senior (Class A) term debt in 2017.

Financial ratios

The SP Group and Heathrow Finance continue to operate comfortably within required financial ratios. Gearing ratios under the SP Group's financing agreements are calculated by dividing consolidated nominal net debt by Heathrow's Regulatory Asset Base ('RAB') value. At 31 December 2016, Heathrow's RAB was £15,237 million (2015: £14,921 million).

At 31 December 2016, the SP Group's senior (Class A) and junior (Class B) gearing ratios were 66.7% and 78.2% respectively (2015: 67.5% and 78.7% respectively) compared with trigger levels of 70.0% and 85.0% under its financing agreements. Heathrow Finance's gearing ratio was 85.4% (2015: 84.9%) compared to a covenant level of 90.0% under its financing agreements.

In the year ended 31 December 2016, the SP Group's senior and junior interest cover ratios (the ratio of cash flow from operations (excluding cash exceptional items) less tax paid less 2% of RAB to interest paid) were 3.12x and 2.50x respectively (2015: 2.90x and 2.36x respectively) compared to trigger levels of 1.40x and 1.20x under its financing agreements. Heathrow Finance's interest cover ratio was 2.25x (2015: 2.12x) compared to a covenant level of 1.00x under its financing agreements.

Outlook

The early weeks of 2017 have been characterised by stronger than expected traffic volumes. Forecast Adjusted EBITDA for 2017 remains consistent with the guidance set out in the investor report published in December 2016 at £1,660 million.

Heathrow Airport Limited

Strategic report *continued*

Leadership and governance

The discussion in this section is extracted from the financial statements of Heathrow Airport Holdings Limited, since the functions of the Board and Board Committees of Heathrow Airport Holdings Limited are applied equally to this Company.

Board of Directors of Heathrow Airport Holdings Limited

The Board consists of the Chief Executive Officer, the Chief Financial Officer and Non-Executive Directors. Board Meetings are attended also by the Company Secretary. More than half of the board are Non-Executive Directors. The majority of the Non-Executive Directors are shareholder representatives. The remaining minority are independent Non-Executive Directors.

The Board determines the Heathrow Airport Holdings Group's long-term strategy, to ensure that the Group acts ethically and has the necessary resources to meet its objectives, to monitor performance and to ensure the Group meets its responsibilities as a leading airport company.

Board Committees

Audit Committee

The Audit Committee members include a chairman appointed by the Board of Directors and three shareholder Non-Executive Directors, who also attend the Board.

The Audit Committee is a sub-committee of the Board and its responsibilities include:

- considering the appointment of the external auditor, taking into account relevant ethical guidance and assessing the independence of the external auditor ensuring that key audit personnel are rotated at appropriate intervals (including overseeing the process for selecting the external auditor and making recommendations to the Board);
- recommending the audit fee to the Board for approval and pre-approving any fees in respect of non-audit services provided by the external auditor and ensuring that the provision of non-audit services does not impair the external auditor's independence or objectivity;
- discussing with the external auditor the nature and the scope of the audit and reviewing the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements;
- reviewing reports on the effectiveness of systems for internal financial control, financial reporting and risk management;
- monitoring the integrity of the financial statements of the Group and reviewing, and challenging where necessary, the actions and judgements of management, in relation to the interim and annual financial statements and any press release related to those statements; and
- reviewing Internal Audit reports to the Audit Committee on the effectiveness of the Heathrow Airport Holdings Group's systems for internal control, financial reporting and risk management.

Nomination Committee

The Nomination Committee members include the Chairman of the Board, an independent Non-Executive Director and four shareholder Non-Executive Directors who attend the Board.

The Nomination Committee is a sub-committee of the Board and its responsibilities include:

- identifying and recommending for the consideration of the Board all new appointments of independent Non-Executive directors; and
- ensuring a formal, rigorous and transparent procedure is followed for the appointment of new independent Non-Executive directors to the Board.

Remuneration Committee

The Remuneration Committee members include a chairman appointed by the Board, three shareholder Non-Executive Directors who attend the Board and one independent Non-Executive Director.

The Remuneration Committee is a sub-committee of the Board and its responsibilities include approvals of:

- the remuneration policy of the members of the Executive Committee and Senior Managers;
- the compensation packages of the members of the Executive Committee (other than the Chief Executive Officer) including salary, bonus, pensions and other incentive compensation;
- the contractual terms for the members of the Executive Committee and independent Non-Executive Directors;
- the design and terms of bonus plans including approval of off-cycle bonus payments outside bonus guidelines including sign on, retention and guaranteed bonuses;
- the design and terms of long-term incentive plans; and
- succession planning for the members of the Executive Committee.

Heathrow Airport Limited

Strategic report *continued*

Leadership and governance *continued*

Board Committees *continued*

Finance Committee

The Finance Committee members include a chairman appointed by the largest shareholder of FGP Topco Limited, the Chief Executive Officer, the Chief Financial Officer and a Non-Executive Director representing each shareholder entitled to appoint a director to the Board.

The Finance Committee is a sub-committee of the Board and also acts as a forum for obtaining consents required from the shareholders of FGP Topco Limited.

The Finance Committee is responsible for approving various matters relating to the Group's debt financing arrangements prior to their implementation including approval for:

- any prospectus or other listing document required in relation to the issuance of any capital markets instruments or any formal information memorandum in relation to borrowing by any member of the Group;
- the borrowing of any money or the assumption of any indebtedness by any member of the Group (including by way of the issue of securities) in excess of certain financial thresholds;
- the refinancing of any existing indebtedness in respect of any member of the Group in excess of certain financial thresholds;
- the making of any repayments of principal in addition to scheduled principal payments on any debt that may be owing by any member of the Group; and
- other than as required by the financing arrangements of any member of the Group, the making of any material loan or advance or giving of any guarantee, indemnity or provision of any credit, in each case in excess of certain financial thresholds.

Executive Committee

The Executive Committee consists of the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, the Chief Information Officer, the Chief of Staff and Group Company Secretary, the Chief People Officer, Expansion Director, Chief Commercial Officer, and Chief Strategy Officer.

The Executive Committee is the management committee of the Chief Executive.

The Executive Committee is responsible for, among other things, developing, reviewing and refreshing medium- and long-term Group business strategies, policies and development plans for Board approval, and agreeing short-term tactics and action plans to ensure their delivery.

Executive Risk Committee

The Risk Committee was set up during the year and is chaired by the General Counsel and Group Company Secretary and consists of the Chief Financial Officer, the Chief Operating Officer and the Procurement Director. It is responsible for reviewing the effectiveness of the risk management strategy and framework and for reviewing the principal risks. The Risk Committee is a sub-committee of the Executive Committee.

Sustainability and Operational Risk Committee

The Sustainability and Operational Risk Committee (formerly the Responsible Heathrow and Operational Risk Committee) is chaired by an independent Non-Executive Director, and its members include the Chief Executive Officer and three shareholder Non-Executive Directors who attend the Board.

The Sustainability and Operational Risk Committee is a sub-committee of the Board and its responsibilities include:

- reviewing and challenging the performance and conduct of the Group relating to operational risks and delivery of Sustainability goals.
- monitoring and challenging management over the effectiveness of the relevant internal control systems and having access to any audit or assurance report it considers relevant;
- reviewing and assessing management's response to significant operational incidents and having access to any accident and investigation report it considers relevant; and
- monitoring and challenging the appropriateness of Sustainability and operational risk assurance strategies and plans, the execution and results of such plans, and relevant communications.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management

Internal controls and risk management are key elements of the Group's corporate operations. Risk is centrally managed within the Group as part of Corporate Services provided under the Shared Services Agreement ('SSA') by a fully dedicated senior team. The Corporate risk management function, sets the strategy for risk management to provide the necessary framework to ensure that key risks are managed and embeds a sustainable risk management culture that views the execution of risk management processes and practices across Heathrow as a key enabler to Heathrow achieving its business objectives.

Of the four members of the Audit Committee all, including the Chair, are non-executive directors. Together they have appropriate competence in accounting and auditing.

Internal controls

The directors are responsible for the system of internal controls designed to mitigate the risks faced by the Group and for reviewing the effectiveness of the system. This is implemented by applying the Group internal control procedures, supported by a Code of Professional Conduct Policy, appropriate segregation of duties controls, organisational design and documented procedures. These internal controls and processes are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against material misstatements or loss.

The key features of the Company internal control and risk management systems in relation to the financial reporting process include:

- a group-wide comprehensive system of financial reporting and financial planning and analysis;
- documented procedures and policies;
- defined and documented levels of delegated financial authority;
- an organisational structure with clearly defined and delegated authority thresholds and segregation of duties;
- a formal risk management process that includes the identification of financial risks;
- detailed reviews by the Executive Committee and the Board of monthly management accounts measuring actual performance against both budgets and forecasts on key metrics;
- Audit Committee review of press releases and key interim and annual financial statements, before submission to the Board, scrutinising amongst other items:
 - compliance with accounting, legal, regulatory and lending requirements
 - critical accounting policies and the going concern assumption
 - significant areas of judgement;
- independent review of controls by the Internal Audit function, reporting to the AC; and
- a confidential whistleblowing process.

Risk management

Our aim is to gain a deep understanding of the principal risks we face at all levels of the business and to focus management attention on effective mitigation of these risks as well as a review of over-the-horizon emerging risks which may impact the business and strategy of Heathrow.

We are rolling out a Risk Road Map for 2017/18 and beyond which will focus on improving accountability for enterprise risk management at all levels and drive improvements in our risk culture. The Risk Road Map will cover all the key elements of an effective enterprise risk management framework including risk leadership, informed risk decision making, competency and risk skills, governance including timeliness and transparency of risk information and clarity of accountability for managing risks. We plan to assess and monitor our risk maturity across all key areas and drive improvements where required.

Principal risks

Our principal risks are aligned to our 4 strategic priorities as follows:

- to be a great place to work, we will help our people fulfil their potential and work together to lead change across Heathrow with energy and pride.
- to give passengers the best airport service in the world we'll work with the Heathrow community to transform the service we give to passengers and airlines, improving punctuality and resilience.
- to secure future investment we will beat the Q6 business plan and deliver a competitive return to our shareholders by growing our revenue, reducing costs and delivering investments more efficiently; and
- to grow and operate our airport sustainably, now and in the future.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

The principal risks identified by the Executive Committee are:

Business resilience

Business resilience risks can relate to Heathrow's assets, infrastructure, human or electronic processes or systems, the failure of which, by accident or deliberate act could result in prolonged periods of interruption to critical services/operations and passenger experience. There are a number of circumstances that can pose short-term risks to the normal operations at the airport such as shocks to the macroeconomic environment, terrorism, wars, airline bankruptcies, human health scares, weather conditions and natural disasters whose cause may be remote from Heathrow's location. These conditions can have a particularly significant impact where, due to operating close to full capacity, there is negligible spare capacity to utilise in recovering from some of the above conditions.

Where possible the Group seeks to anticipate the effects of these events on its operations and also maintains contingency plans to minimise disruption and passenger inconvenience working as necessary with those parties who have direct contractual responsibility. Through a series of programmes the Group seeks to keep a competent, flexible and motivated workforce that can respond to a changing business and operating environment. By driving engagement in its people the Group will achieve its goals and give excellent passenger service, avoid safety and security incidents, protect resilience and deliver successful change.

People

Heathrow employs around 6,500 colleagues and, in a complex business such as Heathrow's, there are risks associated with recruiting, screening, motivating, developing and training employees on a large scale, as well as rewarding appropriately and retaining critical talent and ensuring succession plans are in place.

Heathrow has strategies and policies in place to engage and motivate its colleagues so they are excited and challenged by their work environment, accountable and compliant with internal governance, policies and procedures. Heathrow provides great career opportunities, development and training, retaining talent and knowledge and preventing single points of failure.

Corporate social responsibility

Heathrow understands the importance to its business of the communities in which it operates, and through consultation and engagement seeks to ensure that their concerns are taken into account in the operation and planning of Heathrow. It may restrict opportunities to grow and threaten Heathrow's social license to operate if local communities do not believe the airport is managed responsibly or that its economic benefits are optimised without prioritising profits over the long-term interests of local communities.

Environmental risk has the potential to impact negatively upon Heathrow's reputation and jeopardise its licence to operate and to grow.

The Group undertakes procurement responsibly and encourages trade and employment opportunities for local communities. Progressive influencing of third parties, stakeholder engagement and community relations programmes are also established.

Proactive environmental management systems and employee training programmes are embedded within operations through clear environmental strategies and resource conservation initiatives. The Group works closely with a range of stakeholders to ensure that it reacts effectively to the challenges posed by the environmental agenda.

Operational risks to the delivery of Responsible Heathrow goals are reviewed and monitored by a separate committee of the Board.

Stakeholders

Poor interactions and relationships with key stakeholders including partners, suppliers and airlines could negatively impact passenger experience, airport operations, financial performance and Heathrow's reputation.

Heathrow aims to manage its contracts effectively and share with airport partners the information it may hold about their service providers. This is underpinned by robust and responsible procurement practices which consider the resilience and sustainability of suppliers before contracts are commenced with them, as well as frequent monitoring of their operational performance once they commence business with the airport.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

Legal, regulation and Compliance

Operations at Heathrow airport are currently subject to economic regulatory review by the CAA normally every five years. Its principal risks relate to changes in economic regulations, non-compliance with these and other regulations, licence conditions, financing covenants, contractual requirements and penalties for failing to comply with competition and relevant EU law. Failure to comply with laws and regulations can have far reaching consequences, including loss of licence, penalties, claims and litigation, reputational damage and loss of stakeholder confidence.

The risk of an adverse outcome from economic regulatory reviews is mitigated as far as possible by a dedicated project team which ensures full compliance with regulatory requirements, establishes a sound relationship with the regulator and advises the Executive Committee and Board on regulatory matters. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, reduces the risk of Heathrow breaching laws, regulations and contractual requirements.

Health and Safety

Heathrow has a statutory and moral responsibility to ensure that it safeguards the welfare and safety of its people, business partners and the public who may be affected by its activities. Heathrow recognises that a failure to exercise this responsibility effectively also risks operational disruption, inconvenience to passengers and long-term damage to its reputation.

Heathrow's Safety Management System includes risk assessment processes for all activities entailing significant risk and proportionate control measures employed to safeguard everyone impacted by the airport's business. Heathrow also operates robust asset management processes to ensure property and equipment remains safe. Governance, led by the airport's senior management teams, and assurance processes are used to ensure that controls around health and safety risks remain effective and continuous improvement is encouraged.

Security

Heathrow is responsible for ensuring that its assets, infrastructure, human and electronic systems and processes meet the minimum statutory requirements to protect aviation security, deliver high security standards and build confidence with regulators, airlines and passengers. It also needs to ensure that its assets, infrastructure, human and electronic systems are protected from theft, damage or intrusion.

Security risks, including cyber security and terrorism risks, are mitigated by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading edge security technology. Heathrow works closely with airlines and government agencies including the police building a framework to establish joint accountabilities for airport security and shared ownership of risk, thus ensuring security measures remain both flexible and proportionate to the prevailing threat environment.

Strategic direction and management of change

Heathrow airport is operating its runways at close to full capacity and failure to secure the necessary Development Consent Order, following a robust consultation process, for the third runway, for which Heathrow is the preferred choice of the UK Government, could lead to increased congestion, passenger delay and lack of opportunity for the UK.

Monitoring developments in the global aviation market and the levels of passenger satisfaction with different airports around the world provides input to the on-going relevance of the Group's strategy. The Group also needs to influence the pace and direction of changes to regulations, legislation, government policy, aviation and the wider economy and ensure that it does not lose airlines' support for expansion.

Heathrow recognises that failure to control key development costs and delivery could damage its financial standing and reputation. There are risks that projects fail to deliver to the agreed quality, specification, time and budget as well as risks that the benefits of change are not realised, return on investments not realised and transformation not delivered.

The planning process for all major national infrastructure projects in the UK sets out a number of steps that the Group needs to go through to obtain development consent to expand Heathrow: a National Policy Statement, a Development Consent Order and public consultation before a final decision is taken by the UK Government for the third runway. The Group's planning process has already begun and it is building an organisation and expertise to ensure this process runs smoothly. Heathrow will undertake extensive consultations with community groups and authorities at a local level and is an active participant in government consultations and other advisory groups.

The risk of unanticipated long-term changes in passenger demand for air travel could lead to a shortfall in revenue and misaligned operational capacity within Heathrow. Since it is not possible to identify the timing or period of such an effect, the Company carries out evaluations through a series of scenario planning exercises.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

Strategic direction and management of change *continued*

The regulatory framework requires formal engagement with airline customers. Helping manage the risk of adverse airline relations, all airlines are invited to be represented on engagement fora – e.g. joint steering groups. When feedback is sought or processes are measured, robust steps have been put in place to ensure confidentiality and neutrality of interpretation. In addition, key stakeholders are engaged on a joint planning basis which provides airlines with the opportunity to air views and share plans, thereby ensuring their on-going requirements are articulated and understood.

Heathrow mitigates project risks through adherence to a robust project process and by a system of assurance, consisting of project and programme reviews before approval and during construction. The process is continually improved incorporating lessons learnt and “best practice” distilled from knowledge sharing with other client programmes, expertise within its supply chain and guidance from professional bodies.

Financial stability

The Board approves prudent treasury policies and delegates certain responsibilities including changes to treasury policies, the approval of funding and the implementation of funding and risk strategy to the Heathrow Finance Committee. Senior management directly control day-to-day treasury operations on a centralised basis.

The treasury function is not permitted to speculate in financial instruments. Its purpose is to identify, mitigate and hedge treasury-related financial risks inherent in the HAH Group’s business operations and funding. To achieve this, the HAH Group enters into interest rate swaps, index-linked swaps, cross-currency swaps and foreign exchange contracts to protect against interest rate, inflation and currency risks.

The primary treasury-related financial risks faced by the HAH Group are:

- (a) Interest rates
The HAH Group maintains a mix of fixed and floating rate debt. As at 31 December 2016, fixed rate debt after hedging with derivatives represented 97.9% of the Group’s total external nominal debt
- (b) Inflation
The HAH Group mitigates the risk of mismatch between Heathrow’s aeronautical income and regulatory asset base, which are directly linked to changes in the retail prices index, and nominal debt and interest payments, by the issuance of index-linked instruments.
- (c) Foreign currency
The HAH Group uses cross-currency swaps to hedge all interest and principal payments on its foreign currency debt. The HAH Group uses foreign exchange contracts to hedge material capital expenditure in foreign currencies once a project is certain to proceed.
- (d) Funding and liquidity
The HAH Group has established both investment grade (at the Heathrow (SP) level) and sub-investment grade (at the Heathrow Finance level) financing platforms for Heathrow. The Heathrow (SP) platform supports term loans, various revolving loan facilities including revolving credit facilities, working capital facilities and liquidity facilities, and Sterling and foreign currency capital markets issuance. All debt is secured and can be issued in either senior (A-/A-) or junior (BBB/BBB) format. Covenants are standardised wherever possible and are monitored on an ongoing basis with formal testing reported to the AC, the Board and Executive Committee.

Although there can be no certainty that financing markets will remain open for issuance at all times, debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year.

Heathrow Finance has positive cash flows after capital expenditure and interest and expects to have sufficient liquidity to meet all its obligations in full, including capital investment, debt service costs, debt maturities and distributions, up to January 2018. As at 31 December 2016, cash and cash equivalents and term deposits were £666 million, undrawn headroom under revolving credit facilities was £550 million, committed term debt financing to be drawn after 31 December 2016 was £240 million and undrawn headroom under liquidity facilities was £620 million.

Heathrow Airport Limited

Strategic report *continued*

Internal controls and risk management continued

Principal risks *continued*

Financial stability *continued*

- (e) Counterparty credit
The HAH Group's exposure to credit related losses, in the event of non-performance by counterparties to financial instruments, is mitigated by limiting exposure to any one party or instrument.

The HAH Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short- and long-term credit ratings. Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with short-term credit ratings lower than A-2 (S&P)/F1 (Fitch). The HAH Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with a long-term credit rating below BBB+ (S&P)/BBB+ (Fitch).

On behalf of the Board



John Holland-Kaye
Director

Z j March 2017

Heathrow Airport Limited

Directors' report

The Directors present their annual report and the audited financial statements for Heathrow Airport Limited (the 'Company') for the year ended 31 December 2016.

Principal activities

The Company owns Heathrow airport and operated Heathrow Express ('HEX') for the period 1 January 2015 to 31 August 2015, the express rail service between Heathrow and central London. The Company was entitled to all receipts and income relating to HEX but the day-to-day operation of HEX was undertaken on behalf of the Company by Heathrow Express Operating Company Limited ("HEOC"), a subsidiary of the Company. Since 1 September 2015 the beneficial ownership of the HEX business was transferred to Heathrow Express Operating Company Limited as a Train Operating Company on an arm's length basis. The Company is entitled to revenue related to track access fees and income for other rail related assets.

A review of the progress of the Company's business during the year, the key performance indicators, internal controls, principal business risks and likely future developments are reported in the strategic report on pages 2 to 22.

No significant changes to the activities of the Company are expected in the foreseeable future.

Results and dividends

The profit after taxation for the financial year amounted to £48 million (2015: £776 million).

Dividends of £594 million were paid during the year (2015: £361 million). The dividend payments were utilised primarily to fund dividends to the Company's ultimate shareholders and to service external debt held by one of the Group's holding companies.

Directors

The Directors who served during the year and since the year end were as follows:

Ian Ballentine	(resigned 1 January 2017)
Stuart Birrell	
Normand Boivin	
Emma Gilthorpe	
Clare Harbord	(resigned 1 January 2017)
John Holland-Kaye	
Carol Hui	
Paula Stannett	
Michael Uzielli	(resigned 17 May 2016)
Javier Echave	(appointed 24 November 2016)
Andrew Macmillan	(appointed 1 January 2017)
Ross Baker	(appointed 1 January 2017)

Employment policies

As disclosed in note 2, although all the employees are legally employed by LHR Airports Limited, the Company makes all employment decisions.

The Company's employment policies are regularly reviewed and updated to ensure they remain effective. The Company's overall aim is to create and sustain a high performing organisation by building on the commitment of its people.

The Company has defined a set of guiding principles to ensure fair recruitment and selection. The Company continues to aim to recruit, retain and develop high calibre people and has talent and succession management programmes for managerial roles.

The Company is committed to giving full and fair consideration to applicants for employment. Every applicant or employee will be treated equally whatever their race, colour, nationality, ethnic or national origin, sex, marital status, sexual orientation, religious belief, disability, age or community background. The Company actively encourages a diverse range of applicants and commits to fair treatment of all applicants. The Company's investment in learning and development is guided by senior line managers who ensure that the Company provides the learning opportunities to support the competencies that are seen as key to the Company's success.

Disabled persons have equal opportunities when applying for vacancies, with due regard to their aptitudes and abilities. The Company has further procedures to ensure that disabled colleagues are fairly treated in line with the Equality Act (2010). Where employees have become disabled during the course of employment, the Company endeavours to ensure continuing employment through the arrangement of appropriate training.

Heathrow Airport Limited

Directors' report *continued*

Employee involvement and consultation is managed in a number of ways including employee surveys, team updates, briefings, road shows and an intranet. Collective bargaining takes place with the unions Unite, PCS and Prospect for those employee groups for which these unions are recognised. The Company is committed to managing people through change fairly.

Together these arrangements aim to provide a common awareness amongst employees of the financial and economic factors affecting the performance of their business. Bonuses paid to employees reflect the financial performance of the business. A Share in Success saver scheme in which eligible employees can save money which the company matches as a contribution in line with business performance has been in place since 2015. In addition, some senior management participate in a long-term incentive plan which also rewards based on group performance.

Donations

The Company's charitable donations for the year amounted to £2 million (2015: £2 million). The beneficiaries of charitable donations, the relevant amounts donated and the activities of these beneficiaries are as follows:

Hillingdon Community Trust (charity number: 1098235)	£1,000,000	Heathrow Airport Limited made a 15 year commitment ending 2017 to make an annual grant of £1 million to the Hillingdon Community Trust. The deed of gift to the Trust carries a requirement that grants must benefit the community in the southern part of the Borough of Hillingdon including Hayes (the wards of Botwell, Townfield and Pinkwell, West Drayton, Yiewsley and the Heathrow Villages).
LHR Airport Communities Trust (charity number: 1058617)	£700,000	Heathrow Airport Limited made a donation to the charity LHR Airport Communities Trust, an independently run grant-making charity which operates the Heathrow Community Fund. The fund also received income from the proceeds of noise fines collected by Heathrow. Through the fund grant programme the charity supports significant and positive change for communities near the airport, with a priority on funding projects linked to education, the environment and economic regeneration. The charity also supports airport staff volunteering and fundraising to improve their community for a cause they believe in.
Green Corridor (charity number: 1092093)	£5,000	Green Corridor offers young people the opportunity to expand their skills, experience and qualifications through land-based activities with the primary aim of reducing social exclusion in some of west London's poorest areas.
Dreamflight (charity number: 1117303)	£5,000	Provides children with serious illness or disability with their holiday of a lifetime.

Heathrow continued fundraising for the benefit of Oxfam during the year, which represented the fourth year of the charity partnership with Oxfam. In January 2017, Heathrow passed the fantastic milestone of having raised £1 million for Oxfam since the beginning of the partnership and in 2016, a total of £447,634 was raised.

Internal controls and risk management

The Company actively manages all identified corporate risks and has in place a system of internal controls designed to mitigate these risks. Details of the Company's internal controls and risk management policies can be found on pages 18 to 22 in the internal controls and risk management section of the Strategic report.

Financial risk management objectives and policies

The Company's financial risk management objectives and policies, including hedging policies, along with the Company's exposure to risk, can be found on pages 18 to 22 in the Internal controls and risk management section of the Strategic report.

Directors' indemnity

The Company's Articles of Association provide that, subject to the provisions of the Companies Act 2006, but without prejudice to any protection from liability which might otherwise apply, every director of the Company shall be indemnified out of the assets of the Company against any loss or liability incurred by him in defending any proceedings in which judgement is given in his favour, or in which he is acquitted or in connection with any application in which relief is granted to him by the court for any negligence, default, breach of duty or breach of trust by him in relation to the Company or otherwise in connection with his duties or powers or office.

Heathrow Airport Limited

Directors' report *continued*

Auditor

Pursuant to the provisions of section 485 of the Companies Act 2006, a resolution relating to the reappointment of the auditor Deloitte LLP will be proposed within the period set out in section 485 or, Deloitte LLP will be deemed re-appointed where no such resolution is proposed, following the period set out in section 485 in accordance with section 487.

Statement of disclosure of information to the Auditor

Each of the persons who is a director at the date of approval of this Annual report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the Director has taken all the steps that he/she ought to have taken as a director in order to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

On behalf of the Board



Javier Echave
Director

21 March 2017

Company registration number: 01991017

Heathrow Airport Limited

Directors' responsibilities statement

The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including Financial Reporting Standard 102 – "The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland" ('FRS 102'). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

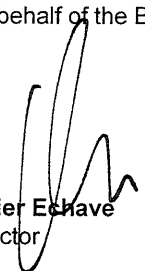
In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the Board



Javier Eschave
Director

21 March 2017

Heathrow Airport Limited

Independent auditor's report to the members of Heathrow Airport Limited for the year ended 31 December 2016

We have audited the financial statements of Heathrow Airport Limited for the year ended 31 December 2016 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity and the related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland".

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the Directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Heathrow Airport Limited

Independent auditor's report to the members of Heathrow Airport Limited for the year ended 31 December 2016



Jacqueline Holden FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK

2 March 2017

Heathrow Airport Limited

Income statement for year ended 31 December 2016

	Note	Year ended 31 December 2016			Year ended 31 December 2015		
		Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items ¹ £m	Total £m	Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items ^{1,2} £m	Total £m
Continuing operations							
Revenue	1	2,760	-	2,760	2,754	-	2,754
Operating costs	2	(1,749)	-	(1,749)	(1,839)	236	(1,603)
Other operating items							
Fair value gain on investment properties	7	-	44	44	-	95	95
Operating profit		1,011	44	1,055	915	331	1,246
Gain on transfer of business to subsidiary ²		-	-	-	-	38	38
Financing							
Finance income		152	-	152	140	-	140
Finance costs		(632)	-	(632)	(575)	-	(575)
Fair value (loss)/gain on financial instruments		-	(474)	(474)	-	84	84
	4	(480)	(474)	(954)	(435)	84	(351)
Profit before tax		531	(430)	101	480	453	933
Tax charge before change in tax rate		(143)	64	(79)	(125)	(78)	(203)
Change in tax rate		-	26	26	-	46	46
Taxation	5	(143)	90	(53)	(125)	(32)	(157)
Profit for the year		388	(340)	48	355	421	776

All results are from continuing operations.

¹ Certain re-measurements and exceptional items consist of: fair value gains and losses on investment property revaluations and disposals; gains and losses arising on the re-measurement and disposal of financial instruments, the effects of the changes in tax rate, exceptional items and the associated tax impact of these.

² Gain recognised on the transfer of the beneficial ownership of Heathrow Express ("HEX") and Connect businesses from Heathrow Airport Limited to Heathrow Express Operating Company Limited ("HEOC") on an arm's length consideration based on market valuation as of the 1 September 2016 for the transaction value of £38 million. HEOC received a right to operate the HEX and Connect business but the ownership of related fixed assets remained with HAL.

Heathrow Airport Limited

Statement of comprehensive income for the year ended 31 December 2016

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Profit for the year		48	776
Items that will not be subsequently reclassified to the consolidated income statement:			
Tax relating to retirement benefits ¹		-	(10)
Actuarial loss on pensions			
Gain/(loss) on plan assets ²	16	501	(101)
(Increase)/decrease in scheme liabilities ²		(688)	98
Tax relating to indexation of operational land		1	
Change in deferred tax due to tax rate change ³		6	8
Other comprehensive loss for the year net of tax		(180)	(5)
Total comprehensive (loss)/income for the year		(132)	771
Attributable to owners of the parent		(132)	771

¹ For the year ended 31 December 2015, related to a £50 million commutation payment for which the Company receives no tax relief.

² Items in the statement above are disclosed net of tax.


³ The change in tax rate relates to deferred tax on pensions and investment property

Heathrow Airport Limited

Statement of financial position as at 31 December 2016

	Note	31 December 2016 £m	31 December 2015 £m
Assets			
Non-current assets			
Property, plant and equipment	6	11,306	11,248
Investment properties	7	2,200	2,156
Intangible assets	8	122	133
Investment in subsidiary	9	42	42
Retirement benefit surplus	16	-	104
Derivative financial instruments	14	-	8
Trade and other receivables	11	1,711	1,938
		15,381	15,629
Current assets			
Inventories	10	11	11
Trade and other receivables	11	703	291
Term deposits	12	125	550
Cash and cash equivalents	12	279	168
		1,118	1,020
Total assets		16,499	16,649
Liabilities			
Non-current liabilities			
Borrowings	13	(11,552)	(11,588)
Derivative financial instruments	14	(1,086)	(592)
Deferred income tax liabilities	15	(352)	(445)
Retirement benefit obligations	16	(114)	(28)
Provisions	17	(9)	(2)
Trade and other payables	18	(32)	(34)
		(13,145)	(12,689)
Current liabilities			
Borrowings	13	(1,080)	(1,002)
Provisions	17	(12)	(5)
Current income tax liabilities		(18)	(16)
Trade and other payables	18	(484)	(453)
		(1,594)	(1,476)
Total liabilities		(14,739)	(14,165)
Net assets		1,760	2,484
Equity			
Capital and reserves			
Share capital	19	10	473
Revaluation reserve	20	457	768
Retained earnings	21	1,293	1,243
Total shareholder's equity		1,760	2,484

These financial statements of Heathrow Airport Limited (Company registration number: 01991017) were approved by the Board of Directors and authorised for issue on 21 March 2017. They were signed on its behalf by:


Javier Echave
 Director


John Holland-Kaye
 Director

Heathrow Airport Limited

Statement of changes in equity for the year ended 31 December 2016

	Notes	Share capital £m	Revaluation reserves £m	Profit and loss reserve £m	Total £m
1 January 2015		473	665	936	2,074
Profit for the year				776	776
Other comprehensive income					
Tax relating to retirement benefits				(10)	(10)
Actuarial loss on pension					
Loss on plan assets				(101)	(101)
Decrease in scheme liabilities				98	98
Change in tax rate			8	-	8
Total comprehensive income		-	8	763	771
Transfer to revaluation reserve					
Investment property fair value movements ¹			95	(95)	-
Deferred tax on investment properties ¹			(18)	18	-
Deferred tax change in rate (investment properties and operational land)			16	(16)	-
Transfer between reserves			2	(2)	-
Total transfer to revaluation reserve		-	95	(95)	-
Transactions with owners					
Dividends paid	21	-	-	(361)	(361)
Total transactions with owners		-	-	(361)	(361)
31 December 2015		473	768	1,243	2,484
Profit for the year				48	48
Other comprehensive income					
Actuarial loss on retirement benefit schemes:					
Gain on plan assets				501	501
Increase in scheme liabilities				(688)	(688)
Tax relating to indexation of operational land			1		1
Change in tax rate			4	2	6
Total comprehensive income		-	5	(137)	(132)
Other movements					
Transfer between reserves - investment property fair value movements ¹	7		44	(44)	-
Deferred tax on investment properties ¹			(3)	3	-
Deferred tax change in rate (investment properties and operational land)			9	(9)	
Impairment recycled to income statement			2	-	2
Total other movements		-	52	(50)	2
Transactions with owners					
New shares issued	19,20	368	(368)		-
Reduction of nominal share capital from 30p to 0.35p	21	(831)		831	-
Dividends paid	21			(594)	(594)
Total transactions with owners		(463)	(368)	237	(594)
31 December 2016		10	457	1,293	1,760

¹ Movements in the valuation of investment properties recorded to the profit and loss account are transferred to the revaluation reserve with the associated deferred tax liability. Details of the amount of deferred tax associated to investment properties are in Note 15.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016

The principal accounting policies applied in the preparation of these financial statements of Heathrow Airport Limited (the 'Company') are set out below. These policies have been consistently applied to all the years presented, unless stated otherwise.

Statement of compliance

These financial statements have been prepared and approved by the Directors in compliance with Financial Reporting Standard ('FRS') 102 'The Financial Reporting Standard applicable in the UK and Republic of Ireland'.

The Company

The Company is a limited liability company incorporated in the United Kingdom and registered in England and Wales. The registered office is The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

Basis of accounting

The Company financial statements are prepared in accordance with FRS 102 and are presented on the basis of the historical cost convention, except for investment properties and derivative financial instruments which have been measured at fair value in accordance with FRS 102 and as permitted by the Fair Value Directive as implemented in the Companies Act 2006.

The financial statements are presented in Sterling and are rounded to the nearest million pounds (£m), except when otherwise noted.

The Company has adopted the following standards that are relevant to these financial statements instead of those of FRS 102:

- IAS 39 'Financial Instruments: Recognition and Measurement', as endorsed by the European Union ('EU');
- IAS 19R 'Employee Benefits' (revised 2011).

Individual entity financial statements

The Company has taken the advantage of the exemption provided by Section 400 of the Companies Act 2006 from the requirement to prepare consolidated financial statements as it is a wholly-owned subsidiary of FGP Topco Limited as it and its subsidiary undertakings are included in the consolidated financial statements of that company for the year ended 31 December 2016. The financial statements present information about the Company as an individual entity only and not as a group.

Primary financial statements format

The primary financial statements are prepared in accordance with FRS 102, as it applies to the Company financial statements for the year ended 31 December 2016, as per Section 301(A) under FRS 102.

The column 'certain re-measurements and exceptional items' in the income statement contains the following items:

- fair value gains and losses on investment property revaluations and disposals;
- derivative financial instruments and the fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship;
- exceptional items (see Note 3 for definition of exceptional items);
- the associated tax impacts of the items in (i), (ii) and (iii); and
- the impact on deferred tax balances of known future changes in tax rates.

Going concern

The Directors have prepared the financial statements on a going concern basis which requires the Directors to have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. The Company forms part of the Heathrow (SP) Limited group (the 'SP Group'), which is the smallest group to consolidate these financial statements, and the level at which financial risks are managed for the Company.

Consequently the Directors have reviewed the cash flow projections of the SP Group, of which the Company forms part, taking into account:

- the forecast turnover and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall SP Group liquidity position, including cash resources, the remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and its ability to access the debt markets.

Whilst the Company is in a net current liability position, as a result of the review, and having made appropriate enquiries of management, the Directors have a reasonable expectation that sufficient funds will be available to meet the Company's funding requirement for the twelve months following the date when the financial statements were authorised for issue.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Changes in accounting policy and disclosures

Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Company are as follows:

IFRS 9 Financial Instruments is effective for periods beginning on or after 1 January 2018. The Company has elected the option under FRS 102 to apply IAS 39 Financial instruments: Recognition and Measurement to its financial instruments and will elect to apply IFRS 9 once it becomes effective. The adoption of IFRS 9 may widen the ability to hedge account within the Group financial statements, with a resulting potential impact on the financial statements. The Group will continue to assess the impact of the standard on its portfolio of derivatives.

Segment reporting

Information reported to the Board for the purposes of resource allocation and assessment of segmental performance relates to the operations of Heathrow.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Company and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes and consists primarily of:

Aeronautical

- Passenger charges based on the number of departing passengers on departure.
- Aircraft landing charges levied according to noise, emissions and weight recognised on landing.
- Aircraft parking charges based on time parked and whether aircraft are wide or narrow bodied as provided.
- Other charges levied for passenger and baggage operations when these services are rendered.

Retail

- Concession fees from retail and commercial concessionaires at the airport are based upon reported revenue by concessionaires, taking into account contracted minimum guarantees where appropriate, and are recognised in the period to which they relate.
- Car parking income is recognised at the time of exiting the car park in accordance with operator management fee arrangements.

Other Regulated Charges ('ORCs')

- Usage charges made for operational systems (e.g. check-in desks), recognised as each service is provided.
- Charges related to passengers with restricted mobility and various other services recognised at the time of delivery.
- Other invoiced sales, recognised on the performance of the service.

Other

- Property letting rentals recognised on a straight-line basis over the term of the rental period.
- Proceeds from the sale of trading properties, recognised on the unconditional completion of the sale.
- Rail recharges from rail line operators, recognised in the period to which they relate.

Contributions

On occasion, the Company may receive grants to improve airport infrastructure considered to be in the best interest of the public. These are recorded as reductions in the cost of the property, plant and equipment to which they relate.

Exceptional items

The Company separately presents certain items on the face of the profit and loss account as exceptional. Exceptional items are material items of income or expense that, because of their size or incidence, merit separate presentation to allow an understanding of the Company's financial performance.

Such events may include gains or losses on the disposal of businesses or assets that do not qualify as discontinued operations, major reorganisation of businesses, closure or mothballing of terminals and costs incurred in bringing new airport terminal complexes and airfields to operational readiness that are not able to be capitalised as part of the project.

Additional details of exceptional items are provided as and when required as set out in Note 3.

Finance income

Finance income is recognised when it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably. Interest receivable is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the asset's net carrying amount on initial recognition.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until the asset is complete and available for use. Such borrowing costs are capitalised whilst projects are in progress.

Where assets in the course of construction are financed by specific borrowing facilities the interest rate relating to those specific borrowing facilities is used to calculate the amount to capitalise, otherwise an interest rate based on the weighted average cost of debt is used. Capitalisation of interest ceases once the asset is complete and available for use. Interest capitalised is then charged to the income statement as a depreciation expense over the life of the relevant asset.

All other borrowing costs, including costs incurred in respect of the maintenance of the Company's credit setting, are recognised in the income statement in the year in which they are incurred.

Internally-generated intangible assets

Development expenditure incurred in respect of individual projects is capitalised when the future economic benefit of the project is probable and is recognised only if all of the following conditions are met:

- the Company can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- the Company can demonstrate how the intangible asset created will generate future economic benefits;
- the Company has available the resources to complete the asset;
- the Company intends to complete that asset and has the future ability to sell or use the asset; and
- the development cost of the intangible asset can be measured reliably.

Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be held at cost less any accumulated amortisation and impairment. Amortisation begins when development is complete and the asset is ready for use.

This type of expenditure primarily relates to internally developed software and website projects and these are amortised on a straight-line basis over their useful lives of three to seven years. During the period of development, the asset is tested for impairment annually.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Purchased intangible assets (software costs)

Computer software costs principally relate to operating and financial software. These assets are amortised over a period of between four and fifteen years, based on the life of the relevant licence or other agreement. Amortisation for the year is charged on a straight-line basis, through operating costs. The assets are assessed for impairment whenever there is indication that the intangible asset may be impaired.

Tangible fixed assets

Operational assets

Terminal complexes, airfield assets, plant and equipment, rail assets and other land and buildings are stated at cost less accumulated depreciation and impairment losses. An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected. Any gain or loss arising on the de-recognition of the asset is included in the income statement in the period of de-recognition.

Assets in the course of construction are stated at cost less provision for impairment. Assets in the course of construction are transferred to completed assets when substantially all the activities necessary to get the asset ready for use are complete and the asset is available for use. Where appropriate, cost includes borrowing costs capitalised (see "Borrowing Costs" policy), own labour costs of construction-related project management and directly attributable overheads. Costs associated with projects that are in the early stages of planning are capitalised where the Directors are satisfied that it is probable the necessary consents will be received and the projects will be developed to achieve a successful delivery of an asset such that future commercial returns will flow to the Company. The Company reviews these projects on a regular basis, and at least every six months, to determine whether events or circumstances have arisen that may indicate that the carrying amount of the asset may not be recoverable, at which point the asset would be assessed for impairment.

The Government's decision and approval by the Board as a viable project decision in October 2016, in favour of expansion at Heathrow, was considered by management to be a trigger point for the expansion project to proceed. This was followed by management's announcement to apply for planning permission, in the belief that it is highly probable that expansion at Heathrow will be realised. As a result the Group has started to capitalise eligible costs as 'assets in the course of construction'.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Depreciation

Depreciation is provided on operational assets, other than land and assets in the course of construction, to write off the cost of the assets less estimated residual value by equal instalments over their expected useful lives as set out below:

	<i>Useful lives</i>
<i>Terminal complexes</i>	
Terminal building, pier and satellite structures	20 - 60 years
Terminal fixtures and fittings	5 - 20 years
Airport plant and equipment:	
Baggage systems	15 years
Screening equipment	7 years
Lifts, escalators and travelators	20 years
Other plant and equipment including runway lighting and building plant	5 - 20 years
Tunnels, bridges and subways	50 - 100 years
Airport transit systems	
Rolling stock	20 years
Track	50 years
<i>Airfields</i>	
Runway surfaces	10 - 15 years
Runway bases	100 years
Taxiways and aprons	50 years
<i>Rail</i>	
Rolling stock	8 - 40 years
Tunnels	100 years
Track metalwork	5 - 10 years
Track bases	50 years
Signals and electrification work	40 years
<i>Other land and buildings</i>	
Short leasehold properties	period of lease
Leasehold improvements	lower of useful economic life or period of lease
<i>Plant equipment and other assets</i>	
Motor vehicles	4 - 8 years
Office equipment	5 - 10 years
Computer equipment	4 - 5 years

In certain circumstances, the asset life may fall outside of the boundaries disclosed above.

Asset residual values and useful lives are reviewed and adjusted, if appropriate, at each reporting date.

Impairment of assets

The Company assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Company estimates the asset's recoverable amount. Where the asset does not generate cash flows independent of other assets, the recoverable amount of the cash-generating unit to which the asset belongs is estimated. Recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of a cash-generating unit exceeds its recoverable amount, the cash-generating unit is considered impaired and is written down to its recoverable amount.

Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation, is initially measured at cost and subsequently stated at fair value at the reporting date as determined by the Directors and supported by external valuations every year when the fair value can be reliably measured. Gains or losses arising from changes in the fair value of investment property are recognised in the income statement in the period in which they arise.

Gains or losses on disposal of an investment property are recognised in the income statement on the unconditional completion of the sale.

The revaluation reserve includes historic gains and losses on investment properties. Future gains and losses will be recognised in the income statement and transferred to the revaluation reserve. The gains and losses will remain in the revaluation reserve as a matter of course and will only be transferred to the profit and loss reserve as part of a capital reconstruction or on disposal of the investment property.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Company as a lessee

Finance leases, which transfer to the Company substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are charged directly against income. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term if there is no reasonable certainty that the Company will obtain ownership by the end of the lease term.

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Company as a lessor

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases and with the exception of investment properties discussed above, the assets are included in property, plant and equipment and depreciated over their estimated useful lives. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as rental income.

Investment in subsidiary

Investments are held as fixed assets and are stated at cost less impairment and reviewed for impairment if there are indications that the carrying value may not be recoverable.

Inventories

Raw materials and consumables consist of engineering spares and other consumable stores. These are valued at the lower of cost and net realisable value.

Deferred income

Amounts received prior to the delivery of goods and services are recorded as deferred income and released to the income statement as the services are delivered or when the goods are delivered.

Provisions

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation at the reporting date and are discounted, where material, to present value using a current, pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Restructuring

A restructuring provision is recognised when the Company has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the ongoing activities of the entity.

Home loss payment

A home loss payments provision is recognised where, an obligation arises during the year, as a result of a past event. The home loss payment provision is in respect of historic property purchases and related expenditures created in 2016 specifically in respect of Heathrow Expansion, following the Government's decision in October 2016.

Financial instruments

The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2016. The results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2016 and the Company is taking advantage of the exemption under the terms of FRS 102 from disclosing Section 11 and 12 disclosure requirements.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Financial instruments *continued*

Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at the lower of their original invoiced value and recoverable amount. Where the time value of money is material, receivables are carried at amortised cost. Provision is made when there is objective evidence that the Company will not be able to recover balances in full. Balances are written off when the probability of recovery is remote.

Investments

The Company has elected the option under FRS 102 to apply IAS 39 Financial Instruments: Recognition and Measurement to its financial instruments. Financial assets within the scope of IAS 39 are classified as financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, available-for-sale financial assets. The Company determines the classification of its financial assets at initial recognition.

On initial recognition, financial assets are measured at fair value, plus, in the case of investments not at fair value through the income statement, directly attributable transaction costs. After initial recognition, investments that are classified as 'held-for-trading' and 'available-for-sale' are measured at fair value. Fair value gains or losses on investments held-for-trading are recognised in the income statement.

Assets classified as 'loans and receivables' or 'held-to-maturity' are recognised in the statement of financial position at their amortised cost, using the effective interest method, less any provision for impairment.

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables' and are carried at amortised cost using the effective interest method. Non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intent and ability to hold-to-maturity are classified as 'held-to-maturity' and are carried at amortised cost using the effective interest method. For investments carried at amortised cost, gains and losses are recognised in the income statement when the investments are de-recognised or impaired, as well as through the amortisation process.

For investments that are traded in an active market, fair value is determined by reference to quoted market bid prices at the reporting date. For investments where there is no quoted market price, fair value is determined by using valuation techniques, such as estimated discounted cash flows, or by reference to the current market value of similar investments.

Purchases and sales of investments are recognised on trade-date being the date on which the Company commits to purchase or sell the asset.

Investments are classified as held-for-sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable, the asset is available for immediate sale in its present condition, management are committed to the sale and the sale is expected to be completed within one year of the date of classification. Assets classified as held-for-sale cease to be depreciated and are measured at the lower of carrying amount and fair value less selling costs.

A financial asset is derecognised when i) the rights to receive cash flows from the asset have expired or, ii) the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party.

The Company assess at each reporting date whether this is any objective evidence that a financial asset or group of financial assets is impaired.

Cash and cash equivalents

For the purposes of the balance sheet, cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less. For the consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts. Short-term deposits with an original maturity of over three months are shown within current trade and other receivables.

Cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments and bank overdrafts. Short-term deposits with an original maturity of over three months are shown within debtors due within one year.

Financial liabilities and reserves

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that provides a residual interest in the assets of a business after deducting all of other liabilities.

Trade and other payables

Trade and other payables are non-interest bearing and are stated at their fair value and subsequently measured at amortised cost using the effective interest method.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Amounts owed to Group undertakings

Amounts owed to Group undertakings are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings being novated or cancelled and re-issued, with a substantial modification of the terms, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, with any resulting gain or loss recognised in the income statement.

Borrowings from Company undertakings include the balance of the Borrower Loan Agreements ('BLAs') payable by the Company to Heathrow Funding Limited. Advances under the BLAs are secured and are issued on substantially the same terms as the bonds issued by Heathrow Funding Limited. The advances are carried at amortised cost with the interest expense recognised using the effective interest method. The nominal amount of the index-linked borrowings is accreted for the RPI component recognised within interest payable in the income statement.

Derivative financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. Derivative financial instruments novated from other companies within the Heathrow Airport Holdings Limited Group (the 'Heathrow Airport Holdings Group') are transferred at fair value prevailing on that date.

The Company does not apply hedge accounting in relation to any of its derivative financial instruments. Changes in the fair value of these derivative instruments are recognised immediately in the income statement, within fair value gains/(losses) on financial instruments. The interest payable and receivable on those derivatives are recorded at their gross amount in interest payable and interest receivable in the income statement, respectively. Derivatives that do not qualify for hedge accounting and which are not held for trading purposes are classified on the balance sheet based on their maturity.

Accounting for changes in credit risk

Accounting standards require that the fair value of financial instruments reflects their credit quality, and also changes in credit quality where there is evidence that this has occurred. The credit risk associated with the Company's derivatives is updated quarterly based on current market data.

Embedded derivatives

As required by IAS 39 embedded derivatives are assessed on the initial recognition of the underlying host contract. Where the economic characteristics and risks of the embedded derivative are closely related to the economic characteristics and risks of the host contract, no bifurcation of the embedded derivative from the host contract is undertaken.

Shared Services Agreement ('SSA')

All employees of the Company are legally employed by LHR Airports Limited. LHR Airports Limited also legally sponsors the defined benefit pension schemes while Heathrow Airport Limited incurs all employment related costs.

Following the disposal of Aberdeen, Glasgow and Southampton airports in December 2014 the Directors reassessed the Company's relationship with LHR Airports Limited, given that the sole operating airport is now Heathrow and noted the following:

- The SSA states that the operating entities, being only Heathrow Airport Limited, are responsible for pension costs on LHR Airports Limited's retirement benefit schemes;
- The Company is responsible for funding the retirement benefit schemes, paying employer contributions directly to the pension scheme; and
- Although employees remain legally employed by LHR Airports Limited, the Company makes all employment decisions. LHR Airports Limited is no longer considered to be providing a service, in relation to employees to the Company but is acting as an agent.

Consequently, from 1 January 2015, all employment related costs and the disclosures pertaining to the defined benefit pension scheme are presented in the financial statements of the Company as though it were principal.

Employment costs

The Company incurs the cost of people which are contractually employed by LHR Airports Limited but provide services to the operation of the airport. Employment costs include wages and salaries, pension costs, medical costs and redundancy payments, as well as any other associated expenses properly incurred by the employees of LHR Airports Limited in providing the services.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Centralised services

LHR Airports Limited is considered to be continuing acting as principal in relation to the services of the HAML Board and Ferrovial advisory services. These costs are recharged to Heathrow Airport Limited (the only remaining airport party to the SSA) with a mark-up of 7.5%. Other services are paid for and sourced directly by Heathrow Airport Limited, either without the Company's involvement or on a pass through fixed mark up only basis (agent). This judgement has been reached following consideration of whether the Company is exposed to the majority of the risks and rewards associated with the centralised services provided by LHR Airports Limited.

Pension costs

The Directors have determined, after taking into account the Shared Service Agreement, employment relationships and the funding risk associated with the schemes, that Heathrow Airport Limited now acts as principal in relation to these schemes. As a result, from 1 January 2015 the Company has recognised an external asset or liability, in relation to the schemes, on its statement of financial position, as non-current under the caption of Retirement benefit surplus/obligations within Debtors and Creditors respectively instead of an intercompany liability. Additionally, it is now considered appropriate for the Company to record actuarial gains and losses on the external scheme within other comprehensive income rather than the income statement. There was no impact on cash or net assets in 2015 as a result of this change as it was not considered to be a change in accounting policy as the change arose as a result of the disposal of the NDH1 Group in December 2014. Consequently there was no restatement of financial information in the prior year.

The cost of providing benefits under the defined benefit plan is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of the defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in profit or loss on a straight-line basis over the vesting period or immediately if the benefits have vested. When a settlement or curtailment occurs, the obligation and related plan asset are re-measured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long-term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year. The difference between the expected return on plan assets and the interest cost is recognised in the income statement as other finance revenue or cost.

Re-measurements, comprising actuarial gains and losses, the effect of an asset ceiling and the return on the net defined benefit liability (excluding amounts included in net interest) are recognised immediately in other comprehensive income in the period in which they occur. Re-measurements are not reclassified to the income statement in subsequent periods.

The defined benefit pension asset or liability in the balance sheet comprises the total for each plan of the present value of the defined benefit plan obligation (using a discount rate based on high-quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net benefit pension asset is restricted to the sum of any unrecognised past service costs and the present value of any amount the Group expects to recover by way of refunds from the plan or reductions in future contributions.

Contributions to defined contribution schemes are recognised in the income statement in the period in which they become payable.

Current and deferred taxation

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income. In this case, the tax is recognised in other comprehensive income.

Current tax liabilities are measured at the amount expected to be paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the balance sheet date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

In accordance with FRS 102 Section 29 timing differences, deferred tax is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements.

Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

Heathrow Airport Limited

Accounting policies for the year ended 31 December 2016 *continued*

Current and deferred taxation *continued*

Deferred taxation is determined using the tax rates and laws that have been enacted, or substantively enacted, by the balance sheet date and are expected to apply in the periods in which the timing differences are expected to reverse.

Share capital

Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs allowing for any reductions in the par value. Where shares are issued above par value, the proceeds in excess of par value are recorded in the share premium reserve.

Preference shares

Preference shares are classified as liabilities when in substance the shares and the related dividends have terms similar to liabilities and not share capital. Features that indicate that presentation as a liability is appropriate include dividends that are payable for a fixed or determinable amount at a fixed or determinable future date and where redemption is at a predetermined amount and date or at the option of the preference shareholder and not at the discretion of the Company. Where presentation as a liability is considered appropriate, the associated dividend expense is shown within interest in the profit and loss account.

Dividend distribution

A dividend distribution to the Company's shareholder is recognised as a liability in the Company's financial statements in the period in which the shareholder's right to receive payment of the dividend is established.

Foreign currency

The Company financial statements are presented in Sterling, which is the Company's functional currency.

Transactions denominated in foreign currencies are initially recorded in the entity's functional currency applying the spot exchange rate using the exchange rates prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into Sterling at the rates of exchange ruling at the reporting date. Differences arising on translation are charged or credited to the income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Related party disclosures

The Company is exempt under the terms of FRS 102 from disclosing related party transactions with entities that are wholly-owned subsidiaries of the FGP Topco Limited Group. Under FRS 102 it is also exempt from providing certain other disclosures regarding key management personnel.

Cash flow statement

The ultimate parent entity in the UK is FGP Topco Limited, a company registered in England and Wales.

The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2016. The results are also included in the audited consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2016 (intermediate parent entity and the smallest group to consolidate these financial statements). Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of accounting standard FRS 102 (1.12 (b) and (e)).

Heathrow Airport Limited

Significant accounting judgements and estimates for the year ended 31 December 2016

In applying the Company's accounting policies management have made judgements and estimates in a number of key areas. Actual results may, however, differ from the estimates calculated and management believes that the following areas present the greatest level of uncertainty.

Critical judgements in applying the Company's accounting policies

Capitalisation

Management are required to make judgements in relation to the capitalisation of costs. This relates to both when amounts may begin to be capitalised, where there may be doubt about planning consent or the ultimate completion of the asset, and in relation to the nature of costs incurred. Examples where judgement has been exercised in the year include capitalised interest, where judgement is exercised in relation to the applicable interest rate and the assessment of assets in the course of construction, including expansion costs, projects on hold and operational activities where judgement is exercised to determine costs that are directly attributable to the assets under construction.

Agent versus Principal

The presentation of certain costs including employment costs and pension costs which are a contractual obligation of LHR Airports Limited are presented as Operating costs of Heathrow Airport Limited in the 2016 financial statements following assessment of which entity is principal in relation to these transactions. This judgement is described in the accounting policies and is based on the balance of risks and rewards between group companies.

Key sources of estimation uncertainty

Fair value of derivative financial instruments

The fair value of derivative financial instruments is calculated using a discounted cash flow approach and using inputs based on observable market data. Judgement is used to determine the recovery rate and associated reduction in credit risk of super senior ranking derivatives. Details of the carrying value and sensitivities are available in Note 13 and 14, respectively.

Investment properties

Investment properties are fair valued by CBRE Limited, Chartered Surveyors. The valuations are prepared in consideration of FRS 102 and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations are carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) is capitalised using yields derived from market evidence. This market evidence also takes into account planned transaction and use of the property (for example the future expansion). Approximately 80% (2015: 80%) of the investment properties comprise airport car parks and airside assets that are considered less vulnerable to market volatility than the overall market. Independent valuations are obtained for all investment properties. Further details are available in Note 7.

Pensions

Certain assumptions have been adopted for factors that determine the valuation of the Group's liability for pension obligations at period end and charges to the income statement. The factors have been determined in consultation with the Group's actuary taking into account market and economic conditions. Changes in assumptions can vary from period to period as a result of changing conditions and other determinants which may cause increases or decreases in the valuation of the Group's liability for pension obligations. The objective when setting pension scheme assumptions for future periods is to reflect the expected actual outcomes, other than the discount rate which must be set by reference to the yield on high quality corporate bonds with a term consistent with the obligations. The impact of the change in assumptions on the valuation of the net financial position of the Group pension scheme is recorded as a net actuarial gain or loss and is reflected in the statement of comprehensive income. Further details are available in Note 16.

Impairment of investment in subsidiary

Where there are indicators of impairment of individual assets, the Company performs impairment tests based on fair value less costs to sell or a value in use calculation. The fair value less costs to sell calculation is based on available data from similar assets or observable market prices less incremental costs for disposing of the asset. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from the budget for a period in which the cash flows are can be reliably estimated (for example the end of a concession agreement) and do not include restructuring activities that the Company is not yet permitted to include or significant future investments that will enhance the asset's performance of the cash generating unit being tested. The recoverable amount is most sensitive to the discount rate and track access charges used for the discounted cash flow model as well as the expected future cash flows and the growth rate used for extrapolation purposes.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016

1 Segment information

As described in the accounting policies on page 33 to 41, the Company's operating revenue segments are aeronautical, retail, other regulated charges and other income.

The performance of these segments are measured on a revenue basis, before certain re-measurements and exceptional items.

The reportable segments derive their revenue from a number of sources including aeronautical, retail, property and facilities (including property income and utilities income), other regulated charges ('ORCs') and other products and services (including rail income for the year ended 31 December 2015) and this information is also provided to the Board on a monthly basis.

Table (a) details total revenue from external customers for the year ended 31 December 2016 and is broken down into aeronautical, retail, property and facilities, ORCs and other in respect of the reportable segments. No information in relation to inter-segmental revenue is disclosed as it is not considered material. Also detailed within table (a) is Adjusted EBITDA which is earnings before interest, tax, depreciation, amortisation, certain re-measurements and exceptional items.

Table (b) details comparative information to table (a) for the year ended 31 December 2015.

Table (c) details depreciation and amortisation, fair value adjustments and profit and loss on disposal by reportable segment.

Section (d) details revenue and non-current asset information by geographical segment.

Table (a)	Segment revenue				Total external revenue £m	Adjusted EBITDA £m
	Aeronautical £m	Retail £m	ORCs £m	Other £m		
Year ended 31 December 2016						
Heathrow	1,699	612	232	217	2,760	1,680

Reconciliation to statutory information:

Unallocated income and expense	
Depreciation and amortisation (table (c))	(669)
Operating profit (before certain re-measurements and exceptional items)	1,011
Fair value gain on investment properties (certain re-measurements) (table (c))	44
Operating profit	1,055
Finance income	152
Finance costs	(632)
Fair value loss on financial instruments (certain re-measurements)	(474)
Profit before tax	101
Taxation before certain re-measurements	(143)
Taxation (certain re-measurements)	90
Taxation	(53)
Profit for the year	48

Revenue of £908 million was derived from a single external customer and has been included within the aeronautical and other segments.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

1 Segment information *continued*

Year ended 31 December 2015	Segment revenue				Total external revenue £m	Adjusted EBITDA ² £m
	Aeronautical £m	Retail £m	ORCs £m	Other £m		
Heathrow	1,699	568	239	116	2,622	1,517
Heathrow Express ¹				132	132	80
Continuing operations	1,699	568	239	248	2,754	1,597
Reconciliation to statutory information:						
Unallocated income and expense						
Depreciation and amortisation (table (c))						(682)
Operating profit (before certain re-measurements and exceptional items)						915
Exceptional items						236
Fair value gain on investment properties (certain re-measurements) (table (c))						95
Operating profit						1,246
Gain on transfer of business to subsidiary						38
Finance income						140
Finance costs						(575)
Fair value gain on financial instruments (certain re-measurements)						84
Profit before tax						933
Taxation before certain re-measurements and exceptional items						(125)
Taxation (certain re-measurements and exceptional items)						(32)
Taxation						(157)
Profit for the year						776

¹ Until 1 September 2015, the Company was entitled to all receipts and income relating to HEX, the express rail service between Heathrow and central London, but the day-to-day operation of HEX was undertaken on behalf of the Company by Heathrow Express Operating Company Limited, for which a management fee was charged and included within 'Intra-group charges' in operating costs (Note 2). Since 1 September 2015 the beneficial ownership of the HEX business is transferred to Heathrow Express Operating Company Limited as a Train Operating Company on an arm's length basis. The Company is entitled to revenue related to rail access fees.

² Adjusted EBITDA is earnings before interest, tax, depreciation, amortisation, certain re-measurement and exceptional items.

Revenue of £903 million was derived from a single external customer and has been included within the aeronautical and other segments.

Table (c)

	Year ended 31 December 2016		Year ended 31 December 2015	
	Depreciation & amortisation ¹	Fair value gain ²	Depreciation & amortisation ¹	Fair value gain ²
	£m	£m	£m	£m
Heathrow	669	44	(635)	95
Heathrow Express	-	-	(47)	-
Total	669	44	(682)	95

¹ Includes intangible amortisation charge of £36 million (2015: £35 million).

² Reflects fair value gains on investment properties only.

(d) Revenue and non-current asset information by geographical segment

Heathrow Airport Limited is domiciled in the UK. All revenue from external customers comes from the UK which for the year ended 31 December 2016 was £2,760 million (2015: £2,754 million). The breakdown of the major components of total revenue from external customers is shown in tables (a) and (b) above.

Non-current assets excluding derivative financial instruments were £15,381 million (2015: £15,621 million). There were no non-current assets held outside the UK (2015: £nil).

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

2 Operating costs

Operating costs comprise:

	Year ended 31 December 2016 £m	Year ended 31 December 2015 ¹ £m
Employment		
Wages and salaries	300	298
Social security	30	27
Pension	37	54
Other staff related costs	21	20
Own staff costs capitalised	(39)	(38)
	349	361
Operational	257	243
Maintenance	164	175
Rates	127	123
Utilities	72	90
Other	111	165
Operating costs before depreciation, amortisation and exceptional items	1,080	1,157
Depreciation and amortisation		
Property, plant and equipment	633	647
Intangible assets	36	35
	669	682
Operating costs before exceptional items	1,749	1,839
Exceptional items (Note 3)	-	(236)
Total operating costs	1,749	1,603

¹ For the year ended 31 December 2015, £11 million of costs previously included under 'Other' have been reclassified into 'Operational' to be consistent with current year disclosure.

Rentals under operating leases

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
<i>Operating costs include:</i>		
Land and buildings ^{1,2}	17	35
Other ³	15	16
Total rentals under operating leases	32	51
Property lease and sub-lease charges – minimum lease payments	14	12

¹ The Company leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The amounts above are stated net of discounts.

² A significant portion of the operating rental costs relates to electricity supply equipment at the airport leased on agreement with UK Power Networks Services Limited ('UKPNS').

³ Others mainly comprises of wayleaves and easements.

Auditor's remuneration

Audit fees and non-audit fees for the Group for the current and preceding financial years were borne by the Company.

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Fees payable to the Company's auditor for the audit of the Group's annual accounts		
Audit of the Company's ultimate parent and its subsidiaries, pursuant to legislation ¹	0.4	0.4
Total audit fees	0.4	0.4
Fees payable to the Company's auditor and their associates for other services specific to the Group		
Audit related assurance services	0.1	0.1
Other assurance services	0.1	0.2
Total non-audit fees	0.2	0.3
Total fees	0.6	0.7

¹ Fees payable to the Company's auditor for the audit of the Company's annual accounts was £53,000 (2015: £51,000).

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

2 Operating costs *continued*

Employee information

The Company has 5,938 employees (2015: 6,104). The Directors note that although the employees remain legally employed by LHR Airports Limited, the Company makes all employment decisions. Consequently, employee numbers for those providing services to the operation of the airport are reported in the financial statement of the Company and not in the financial statements of LHR Airports Limited.

Directors' remuneration

	Year ended 31 December 2016 £'000	Year ended 31 December 2015 £'000
Aggregate emoluments ^{1,2}	4,243	4,343
Value of Company pension contributions	212	454
Termination benefits	-	4
	4,455	4,801

¹ For the year ended 31 December 2016 salaries and benefits include salaries, allowances, Directors' fees, Company pension contributions, accrued bonuses and amounts payable under long-term incentive plans ('LTIP').

² £1,650,000 of bonus was paid in cash in 2016 (2015: £1,528,000).

John Holland-Kaye, Javier Echave and Michael Uzielli, until his resignation on 17 May 2016, were directors of a number of companies within the Heathrow Airport Holdings Group, including LHR Airports Limited, during the year. Their remuneration for the year ended 31 December 2016 was disclosed in the financial statements of Heathrow Airport Holdings Limited. The directors do not believe it is possible to accurately apportion their remuneration to individual companies based on services provided and therefore their remuneration is not included in the numbers above.

The Directors participate in various Long Term Incentive Performance Cash Plans. In respect of the Plans, a cash amount is granted which could vest in future periods contingent on achieving or surpassing Adjusted EBITDA, return on equity and other operational targets over a three year period. The Directors' remuneration includes £843,000 payable in 2017 (2015: £596,000 paid in 2016) in respect of the 2014 LTIP Plan after certain targets were met over the three year period from 2014 to 2016. As the financial performance in respect of the 2015 and 2016 Plans is so uncertain at this stage, no value in relation to these awards is included above.

	Year ended 31 December 2016 £'000	Year ended 31 December 2015 £'000
Highest paid director's remuneration		
Aggregate emoluments ^{1,2}	952	993
Value of Company pension contributions	27	27
	979	1,020

¹ For the year ended 31 December 2016 salaries and benefits include salaries, allowances, directors fees, Company pension contributions, accrued bonuses and amounts payable under long term incentive plans ('LTIP').

² £447,000 of bonus was paid in cash in 2016 (2015: £400,000).

The highest paid director also participates in various Long Term Incentive Performance Cash Plans. In respect of the Plans, a cash amount is granted which could vest in future periods contingent on achieving or surpassing EBITDA, Return on Equity and other operational targets over a three year period. The Directors' remuneration includes £186,000 payable in 2017 (2015: £128,000 paid in 2016) in respect of the 2014 LTIP Plan after certain targets were met over the three year period from 2014 to 2016. As the financial performance in respect of the 2015 and 2016 Plans is so uncertain at this stage, no value in relation to these awards is included above.

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Number of directors who are members of a:		
Defined benefit pension scheme	2	2
Defined contribution pension scheme	4	5

No directors (2015: none) exercised share options during the year in respect of their services to the Heathrow Airport Holdings Group and no shares (2015: none) were received or became receivable under long-term incentive plans.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

3 Exceptional items

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Pension past service credit: change to terms	-	236
Total operating exceptional items		236
Tax (charge)/credit on exceptional items	-	(45)
Total exceptional items after tax	-	191

Pensions

In the year ended 31 December 2015, the Company agreed changes to the defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members which has resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under IAS 19, and is classified as an exceptional item in the income statement. There was no immediate cash flow impact as a result of these changes.

4 Financing

(a) Net finance costs before certain re-measurements

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Finance income		
Interest receivable from group undertakings ¹	144	134
Interest receivable on external derivatives not in hedge relationship	-	1
Interest on deposits	4	5
Net pension finance income	4	-
	152	140
Finance costs		
Interest payable to group undertakings ²	(642)	(566)
Interest on bank borrowings	(14)	(8)
Interest payable on external derivatives not in hedge relationship ²	-	(10)
Facility fees and other charges	(9)	(7)
Dividend payable on irredeemable preference shares ³	(1)	(1)
Net pension finance costs	-	(4)
Unwinding of discount on provisions	(1)	(1)
	(667)	(597)
Less: capitalised borrowing costs ⁴	35	22
	(632)	(575)
Net finance costs before certain re-measurements	(480)	(435)

¹ These amounts relate primarily to interest accrued on balances due from Heathrow (SP) Limited (Note 13).

² These amounts relate mainly to interest due on the Borrower Loan Agreement ('BLA') advances and back-to-back derivatives not in hedge relationship with Heathrow Funding Limited and interest on the loan from Heathrow (AH) Limited (Note 13)

³ Dividend payable for the year ended 31 December 2016 was 4.55p per share (2015: 4.49p per share)

⁴ Capitalised interest included in the cost of qualifying assets arose on the general borrowing pool and is calculated by applying an average capitalisation rate of 4.89% (2015: 5.20%) to expenditure incurred on such assets.

(b) Fair value (loss)/gain on financial instruments

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Interest rate swaps	(124)	41
Index-linked swaps	(350)	43
Fair value (loss)/gain on financial instruments	(474)	84
Net finance costs	(954)	(351)

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

-5 Taxation

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
UK corporation tax		
Current tax charge at 20% (2015: 20.25%)	(46)	(40)
Group relief payable	(54)	(54)
Under provision in respect of prior years	(1)	(5)
Deferred tax		
Current year credit/(charge)	40	(107)
Prior year (charge)/credit	(18)	3
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	26	46
Tax charge on profit on ordinary activities	(53)	(157)

The tax charge on the Company's profit before tax differs from the theoretical amount that would arise by applying the UK statutory tax rate to the accounting profits of the Company for the reasons as set out in the following reconciliation:

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Profit on ordinary activities before tax	531	480
Reconciliation of the tax charge		
Tax calculated at the UK statutory rate of 20% (2015: 20.25%)	(106)	(97)
Adjustments in respect of current tax of previous years	(1)	(5)
Adjustments in respect of deferred tax of previous years	(4)	3
Non-deductible expenses	(32)	(26)
Tax (charge)/credit before certain re-measurements and exceptional items excluding change in UK corporation tax rate	(143)	(125)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	26	46
Tax (credit)/charge on certain re-measurements and exceptional items	64	(78)
Tax charge on profit on ordinary activities	(53)	(157)

The tax charge recognised for the year ended 31 December 2016 was £53 million (2015: £157 million). Based on a profit before tax for the year after certain re-measurements and exceptional items of £101 million (2015: £933 million), this results in an effective tax rate of 52.5% (2015: 16.8%).

Excluding the impact of the change in tax rate and certain re-measurements, the tax charge recognised for the year on ordinary activities of £143 million (2015: £125 million) results in an effective tax rate of 26.9% (2015: 26.0%). The tax charge is more than implied by the statutory rate of 20% (2015: 20.25%) primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. Consequently the Company's significant deferred tax balances, which were previously provided at 18%, were re-measured at the future tax rate at which the Company believes the timing differences will reverse. This has resulted in a net reduction in the deferred tax liability and a corresponding net deferred tax credit of £26 million being recognised in the income statement.

In December 2016 and January 2017 the UK government published draft legislation on the new interest deductibility regime, in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). It has been announced that the new corporate interest restriction will be effective from 1 April 2017 and interest deductions will be limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public benefit infrastructure exemption (PBIE). Whilst the legislation could impact the future tax charge of the Company, Heathrow expects to be largely protected from the 30% of tax based EBITDA cap through the use of the PBIE and GRR. The position will be clarified when the legislation is enacted later this year.

Other than these changes there are no items which would materially affect the future tax charge.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

6 Property, plant and equipment

	Note	Terminal complexes £m	Airfields £m	Plant and equipment £m	Other land and buildings £m	Rail £m	Assets in the course of construction £m	Total £m
Cost								
1 January 2015		10,688	1,537	871	131	1,404	993	15,624
Additions		-	-	-	-	-	554	554
Borrowing costs capitalised	4	-	-	-	-	-	22	22
Disposals		(70)	-	(29)	-	-	-	(99)
Transfer to Intangibles		-	-	-	-	-	(29)	(29)
Transfer to completed assets		581	201	13	56	44	(895)	-
31 December 2015		11,199	1,738	855	187	1,448	645	16,072
Additions		-	-	-	-	-	666	666
Borrowing costs capitalised	4	-	-	-	-	-	35	35
Disposals		(479)	(13)	(56)	(1)	-	-	(549)
Transfer to intangible assets		-	-	-	-	-	(13)	(13)
Reclassification		36	-	-	-	(36)	-	-
Transfer to completed assets		104	20	28	24	-	(176)	-
31 December 2016		10,860	1,745	827	210	1,412	1,157	16,211
Depreciation								
1 January 2015		(3,144)	(341)	(311)	(46)	(433)	-	(4,275)
Depreciation charge		(459)	(46)	(86)	(9)	(47)	-	(647)
Disposals		70	-	28	-	-	-	98
31 December 2015		(3,533)	(387)	(369)	(55)	(480)	-	(4,824)
Depreciation charge		(464)	(46)	(70)	(10)	(42)	-	(632)
Disposals		479	13	56	1	-	-	549
Transfer to intangible assets		(1)	-	3	-	-	-	2
31 December 2016		(3,519)	(420)	(380)	(64)	(522)	-	(4,905)
Net book value								
31 December 2016		7,341	1,325	447	146	890	1,157	11,306
31 December 2015		7,666	1,351	486	132	968	645	11,248

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value at 31 December 2016 of £12 million (2015: £11 million).

Assets in the course of construction

The major balances in assets in the course of construction are the Asset Management programme to replace depreciated assets, the Baggage programme projects to enable the processing of check in and transfer baggage in a single facility and the Airport resilience programme.

Borrowing costs capitalised

During the year ended 31 December 2016, borrowing costs of £35 million were capitalised (2015: £22 million). Capitalised borrowing costs were calculated by applying an average interest rate of 4.89% (2015: 5.20%) to expenditure incurred on qualifying assets.

A tax deduction of £35 million (2015: £22 million) for capitalised borrowing costs was taken in the year. Subsequent depreciation of the capitalised borrowing costs is disallowed for tax purposes. Consequently, the capitalised borrowing costs give rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

7 Investment properties

	Note	Airport investment properties £m	Assets in the course of construction £m	Total £m
Valuation				
1 January 2015		2,045	9	2,054
Additions		7	-	7
Revaluation		95	-	95
Transfer to completed assets	6	9	(9)	-
31 December 2015		2,156	-	2,156
Revaluation		44	-	44
31 December 2016		2,200	-	2,200

Investment properties were valued at fair value at 31 December 2016 by CBRE Limited, Chartered Surveyors (2015: CBRE Limited, Chartered Surveyors).

All valuations were prepared in consideration of FRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence.

The Company has historically had a low level of void properties.

Investment properties are let on either full repair and insuring leases, under which all outgoings are the responsibility of the lessee, or under tenancies, where costs are recovered through a service charge levied on tenants during their period of occupation. This service charge amounted to £1 million (2015: £1 million) for which a similar amount is included within operating costs.

Historical cost

The historical cost of investment properties and land held for development as at 31 December 2016 was £672 million (2015: £673 million). The prior year comparative of £673 million has been restated to reflect the correct calculation of historical cost after taking into consideration a prior period capitalisation from the revaluation reserve.

8 Intangible assets

	£m
Cost	
1 January 2015	177
Additions	25
Transfers from property, plant and equipment	29
Disposals	(4)
31 December 2015	227
Additions	14
Transfers from property, plant and equipment	13
Disposals	(2)
31 December 2016	252
Amortisation	
1 January 2015	(63)
Charge for the year	(35)
Disposals	4
31 December 2015	(94)
Charge for the year	(36)
Disposals	2
Transfers from property, plant and equipment	(2)
31 December 2016	(130)
Net book value	
31 December 2016	122
31 December 2015	133

All intangible assets relate to capitalised computer software costs. These software costs principally relate to operating and financial software.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

9 Investment in subsidiary

	31 December 2016	31 December 2015
	£m	£m
Cost at 1 January	42	4
Addition ¹	-	38
Cost at 31 December	42	42

¹ Addition to cost of investment in subsidiary on the transfer of the beneficial ownership of Heathrow Express ("HEX") and the Connect business from HAL to Heathrow Express Operating Company Limited ("HEOC") on an arm's length consideration based on a market valuation as of 1 September 2015 for the transaction value of £38 million. HEOC received the right to operate the HEX and Connect businesses but the ownership of the fixed assets remain with HAL.

Subsidiary	Nature of business	% of share capital held	Class of share
Heathrow Express Operating Company Limited	Railway Operator	100	Ordinary shares of £1 each

Heathrow Express Operating Company Limited, a company registered in England and Wales, operates the express rail service between Heathrow and central London. The registered address of the company is The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

In the opinion of the directors, the aggregate value of the shares in the subsidiary undertaking is not less than the aggregate amount at which they are stated in the Company's statement of financial position. Investments are held as fixed assets and are stated at cost less impairment and reviewed for impairment if there are indications that the carrying value may not be recoverable.

10 Inventories

	31 December 2016	31 December 2015
	£m	£m
Raw materials and consumables	11	11

The total amount of inventories consumed in the year was £6 million (2015: £6 million). There is no material difference between the statement of financial position value of inventories and their replacement cost.

11 Trade and other receivables

	31 December 2016	31 December 2015
	£m	£m
Non-current		
Amounts owed by group undertakings – interest bearing ¹	1,685	1,916
Prepaid debt fees ²	5	6
Prepayments	16	16
Other receivables	5	-
	1,711	1,938
Current		
Trade receivables	200	173
Less: provision for impairment	(1)	(1)
Trade receivables – net	199	172
Prepayments	23	28
Amounts owed by group undertakings – interest bearing ³	255	
Amounts owed by group undertakings – interest free ⁴	26	24
Interest receivable	1	1
Interest receivable from group undertakings ⁵	196	52
Other receivables	3	14
	703	291
Total trade and other receivables	2,414	2,229

¹ Amounts owed by group – interest bearing represents a loan receivable from Heathrow (SP) Limited. It has a fixed interest rate of 7.57% pa and is repayable on 29 December 2026.

² Prepaid debt fees largely relate to financing fees paid on facilities not yet drawn and are amortised over the term of the facility.

³ Amounts owed by group undertakings – interest bearing represents a loan receivable from Heathrow (AH) Limited. Interest accrues on the outstanding amount at 6 month LIBOR + 60bps and is repayable on demand.

⁴ Amounts owed by group undertakings – interest free largely relate to external payments received by LHR Airports Limited under the Shared Service Agreement on behalf of Heathrow that will be remitted in due course.

⁵ Interests receivable from group undertakings relate primarily to interest accrued on balances due from Heathrow (SP) Limited.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

12 Cash and cash equivalents and term deposits

	31 December 2016	31 December 2015
	£m	£m
Cash at bank and in hand	9	6
Short-term deposits	270	162
Cash and cash equivalents	279	168
Term deposits	125	550
Cash and cash equivalents and term deposits	404	718

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates and is subject to interest rate risk. The fair value of cash and cash equivalents approximates to their book value.

13 Borrowings

	31 December 2016	31 December 2015
	£m	£m
Current		
Secured		
Bank loans	36	39
BLA advances from Heathrow Funding Limited	856	740
Unsecured		
Due to group undertaking	-	35
Total current (excluding interest payable)	892	814
Interest payable	4	1
Interest payable – owed to group undertakings	184	187
Total current	1,080	1,002
Non-current		
Secured		
BLA advances from Heathrow Funding Limited	11,151	11,241
Bank loans	62	97
Term note – 3.77% £100 million due 2026	100	100
Term note – 2.63% £80 million due 2030	80	80
Term note - 3.160% £90 million due 2032	89	-
Term note – 2.97% £70 million due 2035	70	70
Total non-current	11,552	11,588
Total borrowings	12,632	12,590

The table below analyses the contractual maturity of the Company's borrowings falling due after more than one year:

	31 December 2016	31 December 2015
	£m	£m
One to two years	964	855
Two to five years	1,843	1,729
Over five years	8,745	9,004
	11,552	11,588

Borrowings from group undertakings

Heathrow Funding Limited, a fellow subsidiary company, raises funds from external sources through the issuance of external bonds and use of external derivatives. The proceeds raised are distributed to the Company under the terms of the BLAs.

Advances under the BLAs are secured and are issued on substantially the same terms as the bonds issued by Heathrow Funding Limited, taking into consideration certain of the related hedging instruments. Interest rate swaps, index-linked swaps and cross-currency swaps are entered into by Heathrow Funding Limited to hedge the SP Group's exposures. Interest rate and index-linked derivatives are mainly passed through to the Company as back-to-back derivatives, or otherwise incorporated into the related BLAs. Cross-currency swaps are packaged with external non-sterling debt and passed through to the Company under the BLAs.

During the year, following new bonds issued by Heathrow Funding Limited, further advances were made to the Company for £825 million (2015: £1,017 million), net of transaction costs. In the same period, the Company made repayments of £734 million (2015: £619 million). The effective interest rate on the BLA advances varies between 1.09% and 7.40% (2015: 1.09% and 7.40%). The unsecured loan from Heathrow (AH) Limited bears an interest rate of 7.57% per annum.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

13 Borrowings *continued*

Facilities

All of the facilities are carried at amortised cost.

The Company had £1,500 million undrawn committed borrowing facilities available as at 31 December 2016 (2015: £1,475 million). In addition, as at 31 December 2016, there was an overdraft limit up to a maximum net overdraft balance of £10 million (2015: £10 million).

Securities and guarantees

The Company, Heathrow Express Operating Company Limited, Heathrow (SP) Limited and Heathrow (AH) Limited (together, the 'Obligors') have granted security to Deutsche Trustee Company Limited (in its capacity as the 'Borrower Security Trustee', for itself and as trustee for the Borrower Secured Creditors) over their property, assets and undertakings to secure their obligations under various financing agreements. Each Obligor has also guaranteed the obligations of each other Obligor under such financing agreements.

BAA Pension Trust Company Limited, as a trustee from time to time of the BAA Pension Scheme, is a Borrower Secured Creditor and ranks equally in an amount up to £284 million with senior (Class A) debt.

The Company and Heathrow Express Operating Company Limited have provided a guarantee and indemnity in favour of Lloyds Bank plc (in its capacity as the Borrower Account Bank) in respect of each other's obligations under the Borrower Account Bank Agreement and associated financing agreements.

14 Derivative financial instruments

	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2016				
Non-current				
Interest rate swaps ¹	3,006	-	(552)	(552)
Index-linked swaps ²	3,981	-	(534)	(534)
	6,987	-	(1,086)	(1,086)
Total	6,987	-	(1,086)	(1,086)
31 December 2015				
Non-current				
Interest rate swaps ¹	2,913	-	(405)	(405)
Index-linked swaps ²	3,523	8	(187)	(179)
	6,436	8	(592)	(584)
Total	6,436	8	(592)	(584)

¹ £3,006 million (2015: £2,913 million) notional value of interest rate swaps relate to back-to-back hedges with Heathrow Funding Limited.

² £3,981 million (2015: £3,523 million) notional value of index-linked swaps relate to back-to-back hedges with Heathrow Funding Limited.

Derivative financial instruments at fair value

The Company enters into derivative transactions, principally interest rate swaps, index-linked swaps and foreign exchange contracts. The purpose of these transactions is to manage interest rate, inflation and currency risks arising from the Company's operations and sources of finance. The Company does not apply hedge accounting in relation to any of its derivative financial instruments.

Interest rate swaps

As at 31 December 2016, the total notional amount of back-to-back interest rate swaps was £3,006 million which had a mark-to-market liability of £552 million (2015: £2,913 million notional with a mark-to-market liability of £405 million).

Index-linked swaps

Index linked swaps have been entered into in order to economically hedge debt instruments and RPI linked revenue and the Regulated Asset Base ('RAB'). Heathrow Funding Limited has entered into index linked swaps with external counterparties which have been issued to the Company as back-to-back hedges and the total notional amount of back-to-back index linked swaps was £3,981 million which had a mark-to-market net liability of £534 million (2015: £3,523 million notional with a mark-to-market net liability of £179 million).

Financial instruments at fair value by category

All of the Company's financial assets and financial liabilities that are held at fair value are classified as derivative financial instruments, and are disclosed above.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

14 Derivative financial instruments *continued*

Treasury risk management

The Company's financial risk management objectives are aligned with Heathrow Airport Holdings Limited and with Heathrow (SP) Limited, which is the level at which financial risks for the Company are managed. The treasury policies of the SP Group have been disclosed in the internal controls and risk management section of the Strategic report in its statutory annual report and financial statements.

Fair value estimation

The fair value of financial instruments that are not traded in an active market (such as derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available and rely as little as possible on entity specific estimates.

Specific valuation techniques used to value financial instruments include:

- market prices for credit spreads based on counterparty's credit default swap prices and the Company's bond spread;
- the fair value of interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves; and
- other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

15 Deferred income tax

The net movement on the deferred income tax account is as follows:

	2016 £m	2015 £m
1 January	445	392
(Credited)/charged to income statement	(48)	58
(Credited)/charged to other comprehensive income	(45)	1
Transfer of deferred tax liability through intercompany	-	(6)
31 December	352	445

Analysis of the deferred tax balance is as follows:

	2016 £m	2015 £m
Excess of capital allowances over depreciation	307	286
Retirement benefit obligations	(21)	14
Other timing differences	(5)	(6)
Derivatives	(149)	(78)
Revaluation of investment property to fair value	187	195
Tax on rolled over gains	8	7
Operational land	25	27
	352	445

Provision has been made for deferred taxation in accordance with FRS 102. Of the £352 million liability at 31 December 2016, we expect a £34 million increase in the next 12 months (excluding any reversal arising from future fair value adjustments, as these cannot be estimated).

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. As a result, the Company's deferred tax balances, which were previously provided at 18%, were re-measured at the rate at which the Company believes the timing differences will reverse. This resulted in a reduction in the net deferred tax liability of £26 million, with £26 million credited to the profit and loss account. There are not considered to be any other known items which would materially affect the future tax charge.

16 Retirement benefit obligations

The Company has applied the requirements of the standard IAS 19 'Employee Benefits (Revised 2011)' ('IAS 19R') for the year ended 31 December 2016. The total cost of defined contribution pension arrangements are fully expensed as employment costs.

Characteristics of the LHR Airports Limited related liabilities

LHR Airports Limited operates a defined contribution pension scheme for all employees who joined the Company after 15 June 2008. The HAH Group has no further payment obligations once the contributions have been paid.

The HAH Group's primary UK defined benefit pension fund is a self-administered defined benefit scheme (the 'BAA Pension Scheme' or the 'Scheme') now closed to new employees. As required by UK pension law, there is a Pension Trustee Board that, together with LHR Airports Limited, is responsible for governance of the Scheme.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

16 Retirement benefit obligations *continued*

Characteristics of the LHR Airports Limited related liabilities continued

The employer's contributions are determined based on triennial valuations conducted on assumptions determined by the Trustee and agreed by LHR Airports Limited. The defined benefit obligation or surplus is calculated quarterly by independent actuaries.

In July 2016, the trustee of the BAA Pension Scheme concluded a formal actuarial valuation of the Scheme. The valuation was carried out as at 30 September 2015 and took into account changes implemented to reduce the Scheme's liabilities. These were the introduction of an annual cap on future increases in pensionable pay for active members and a reduction in both the accrual rate for future service and inflationary increases for those service pensions whilst in payment. The valuation indicated a scheme deficit of £228 million calculated using the agreed actuarial assumptions. As part of the process, LHR Airports Limited agreed a reduction to its annual deficit repair contribution from £27 million to £23 million that is intended to eliminate the deficit by 2022. The process also resulted in a reduction in ongoing cash contributions from 33% to 23% of pensionable salary, consistent with the efficiency targets under the current regulatory settlement. The reduction in cash contributions into the Scheme applied from 1 July 2016 and is estimated at £12 million per annum.

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the rules of the Scheme. In addition, LHR Airports Limited provides post-retirement medical benefits to certain pensioners.

Amounts arising from pensions related liabilities in the Company's financial statements

The following tables identify the amounts in the Company's financial statements arising from its pension related liabilities. Further details of each scheme (except defined contribution schemes) are within sections a) and b).

Income statement - pension and other pension related liabilities costs

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Employment costs:		
Defined contribution schemes	10	8
BAA Pension Scheme	27	46
	37	54
Finance (income)/charge - BAA Pension Scheme	(5)	3
Total pension costs	32	57

Other comprehensive income – (loss)/gain on pension and other pension related liabilities

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
BAA Pension Scheme	(219)	(5)
Unfunded schemes	(7)	1
Actuarial loss recognised before tax	(226)	(4)
Tax credit on actuarial loss	39	1
Actuarial loss recognised after tax	(187)	(3)

Statement of financial position – net defined benefit pension (deficit)/surplus and other pension related liabilities

The net deficit or surplus of the LHR Airports Limited retirement benefit schemes, being the BAA Pension Scheme, Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical Benefit Scheme, are recognised within non-current assets or non-current liabilities if the pension schemes are in a surplus or deficit position respectively. The net surplus or deficit is presented below for the current and previous four financial years.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

16 Retirement benefit obligations *continued*

(a) BAA Pension Scheme

Statement of financial position – net defined benefit pension (deficit)/surplus and other pension related liabilities continued

	31 December				
	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Fair value of plan assets	3,975	3,288	3,274	2,867	2,791
Benefit obligation	(4,054)	(3,184)	(3,473)	(2,960)	(2,894)
(Deficit)/surplus in BAA Pension Scheme	(79)	104	(199)	(93)	(103)
Unfunded pension obligations	(29)	(22)	(24)	(22)	(24)
Post-retirement medical benefits	(6)	(6)	(6)	(6)	(6)
Deficit in other pension related liabilities	(35)	(28)	(30)	(28)	(30)
Net (deficit)/surplus in pension schemes	(114)	76	(229)	(121)	(133)
Company share of net (deficit)/surplus in pension schemes	(114)	76	(229)	(106)	(115)

The Heathrow Airport Holdings (“HAH”) Group operates one main defined benefit pension scheme for its UK employees, the BAA Pension Scheme, which is a funded defined benefit scheme with both open and closed sections. The Scheme closed to employees joining the Group after 15 June 2008. The Scheme’s assets are held separately from the assets of the HAH Group and are administered by the trustee.

The value placed on the Scheme’s obligations as at 31 December 2016 is based on the full actuarial valuation carried out at 30 September 2015. This has been updated at 31 December 2016 by KPMG LLP to take account of changes in economic and demographic assumptions, in accordance with IAS 19R. The Scheme assets are stated at their bid value at 31 December 2016. As required by IAS 19R, the Company recognises re-measurements as they occur in the statement of comprehensive income.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

16 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

Analysis of movements in plan assets and defined benefit obligations

	2016	2015
	£m	£m
Fair value of plan assets at 1 January	3,288	3,274
Income statement:		
Interest income on plan assets	124	118
Administration costs	(2)	(2)
Other comprehensive income:		
Re-measurement gain/(loss) (return on assets in excess of interest income on plan assets)	603	(125)
Cash flows:		
Employer contributions (including benefits paid and reimbursed)	59	73
Members' contributions	5	6
NDH1 Group commutation payment ¹	-	50
Benefits paid (by fund and Group)	(102)	(106)
Fair value of plan assets at 31 December	3,975	3,288
Defined benefit obligation at 1 January	(3,184)	(3,473)
Income statement:		
Current service cost	(25)	(46)
Past service gain ²	-	236
Interest cost	(120)	(121)
Other comprehensive income:		
Experience gains	53	-
Re-measurements of defined benefit obligation:		
arising from changes in demographic assumptions	2	-
arising from changes in financial assumptions	(877)	120
Cash flows:		
Members' contributions	(5)	(6)
Benefits paid (by fund and Group)	102	106
Defined benefit obligation at 31 December	(4,054)	(3,184)

¹ In the year ended 31 December 2015, a commutation payment of £50 million was made as a result of Aberdeen, Glasgow and Southampton airports (the 'NDH1 Group') disposal on 18 December 2014.

² In the year ended 31 December 2015, the HAH Group agreed changes to the defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members. The changes resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under IAS19, and are classified as an exceptional item in the income statement. There is no immediate cash flow impact as a result of these changes.

For the year ended 31 December 2016 there were experience gains of £53 million (2015: £nil).

The net actuarial loss before tax of £219 million (2015: £5 million net loss) resulted from a loss on change in assumptions of £875 million (2015: £120 million gain), partially offset by the actual return on assets being £603 million (2015: £125 million lower) in excess of the income statement credit and experience gains of £53 million due to completion of the latest actuarial valuation of the BAA Pension Scheme.

The actuarial loss on change in financial assumptions is mainly attributable to a decrease in the net yield of 1.25% over the year, based on a single equivalent discount rate assumption of 2.75% and an RPI inflation assumption of 3.45%. The discount rate used has decreased from 3.8% in 2015 to 2.75% in 2016. International Accounting Standard 19 (IAS 19) requires that this discount rate should be derived from the yield on 'high quality corporate bonds' of duration consistent with liabilities of the scheme. The discount rate is based on a full yield curve approach, but at 31 December 2016 was refined to a "single agency approach" where the yield curve is constructed from the Merrill Lynch corporate bond universe, using the AA yield curve.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

16 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

The single agency approach typically increases the discount rate in current market conditions, but the extent of the increase can vary over time. At the point we changed to this approach the effect on the discount rate was to reduce it by 0.2pp.

Analysis of fair value of plan assets

	31 December 2016	31 December 2015
	£m	£m
Fair value of plan assets		
Equity	476	644
Property	118	114
Bonds	1,095	1,032
Cash	153	112
LDI	1,583	1,048
Other	550	338
Total fair value of plan assets	3,975	3,288

At 31 December 2016, the largest single category of investment is a liability driven investment mandate, with a value of £1,583 million (40% of the asset holding at 31 December 2016). The purpose of the Scheme entering into this mandate is to reduce asset/liability mismatch risk. At 31 December 2015, the largest single category of investment is an interest rate and inflation hedging mandate, with value of £1,048 million (32% of the asset holding at 31 December 2015).

LDI holdings are portfolios of interest rate and inflation derivatives which are intended to protect the Scheme from movements in interest rates and inflation, so that the fair value of this element of the portfolio moves in the same way as the fair value of Scheme's obligations.

Analysis of financial assumptions

The financial assumptions used to calculate Scheme assets and liabilities under IAS 19R were:

	31 December 2016	31 December 2015
	%	%
Rate of increase in pensionable salaries	1.90	2.00
Increase to deferred benefits during deferment	2.70	2.50
Increase to pensions in payment:		
Open section	3.35	3.15
Closed section	3.45	3.25
Discount rate	2.75	3.80
Inflation assumption	3.45	3.25

The assumptions relating to longevity underlying the pension liabilities at the reporting date are in line with those adopted for the 2015 actuarial funding valuation, and are based on standard actuarial mortality tables with an allowance for future improvements in longevity. The assumptions are equivalent to a life expectancy for a 60 year old male pensioner of 27.0 years (2015: 27.3 years) and 29.3 years (2015: 29.7 years) from age 60 for a 40 year old male non-pensioner.

The expected rate of inflation is an important assumption for the salary growth and pension increase assumptions. A rate of inflation is 'implied' by the difference between the yields on fixed and index-linked government bonds.

As required under IAS 19R, interest income on the plan assets is calculated by multiplying the fair value of the plan assets by the discount rate discussed above.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

16 Retirement benefit obligations *continued*

(b) BAA Pension Scheme *continued*

Sensitivity analysis of significant assumptions

The following tables present a sensitivity analysis for each significant actuarial assumption showing how the defined benefit obligation would have been affected, before and after tax, by changes in the relevant actuarial assumptions that were reasonably possible at the reporting date.

	(Decrease)/increase in defined benefit obligation	
	Before tax £m	After tax £m
Discount rate		
+0.50% discount rate	(396)	(329)
-0.50% discount rate	459	381
Inflation rate		
+0.50% inflation rate	373	310
-0.50% inflation rate	(328)	(272)
Mortality		
Increase in life expectancy by one year	148	123

The sensitivity analysis is based on a change in one assumption while holding all other assumptions constant, therefore interdependencies between assumptions are excluded, with the exception of the inflation rate sensitivity which also impacts salary and pension increase assumptions. The analysis also makes no allowance for the impact of changes in gilt and corporate bond yields on asset values. The methodology applied is consistent to that used to determine the recognised pension liability.

The total contributions to the defined benefit Scheme in 2017 are expected to be £50 million for the Group. The levels of contributions are based on the current service costs and the expected cash flows of the defined benefit Scheme. The Group estimates the present value of the duration of the Scheme liabilities on average fall due over 19 years (2015: 19 years).

(b) Other pension and post-retirement liabilities

LHR Airports Limited also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the Scheme rules. The unfunded pension obligations amount to £29 million (2015: £22 million) and are included in the statement of financial position.

In addition LHR Airports Limited provides post-retirement medical benefits to certain pensioners. The present value of the future liabilities under this arrangement is £6 million (2015: £6 million) and this is also included in the statement of financial position. The value of these unfunded pensions has been assessed by the actuary using the same assumptions as those used to calculate the Scheme's liabilities.

17 Provisions

	Reorganisation costs £m	Home loss payment £m	Other £m	Total £m
Current	5	-	-	5
Non-current	-	-	2	2
1 January 2016	5	-	2	7
Charged to income statement	12	-	1	13
Utilised	(5)	-	(1)	(6)
Expansion - assets	-	7	-	7
31 December 2016	12	7	2	21
Current	12	-	-	12
Non-current	-	7	2	9
31 December 2016	12	7	2	21

Reorganisation costs

These are costs associated with the Company's reorganisation programmes primarily relating to restructuring processes designed to reduce the size and costs of overhead functions. The charge relates to severance and pension payments associated with the reorganisation programme being carried out during 2016 and continuing into 2017.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

17 Provisions *continued*

Home loss payment

Between 2005 and 2011, the Company entered into a number of agreements to buy residential properties in the original third runway blight area. The purchase price for these properties included a deferred 10% payment ("deferred payment") which is settled in cash when planning consent is obtained. In October 2016, the Government announced its decision in favour of expansion at Heathrow and following board approval, a public statement was issued by the Company stating its intention to apply for planning consent, making it probable that the Company will be required to pay the deferred payment in the future. As a result, during the year ended 31 December 2016, the Company recorded a provision for the deferred payment equal to the amount it expects to pay of £7.5 million.

Other

These provisions relate to insurance claims liability from incidents which occurred at Heathrow airport.

18 Trade and other payables

	31 December 2016	31 December 2015
	£m	£m
Non-current		
Preference shares	23	23
Other payables	9	11
	32	34
Current		
Deferred income	30	30
Trade payables ¹	165	145
Other tax and social security	8	7
Group relief payable	54	54
Other payables	8	8
Capital payables	121	122
Amount owed to group undertakings – interest free ²	71	56
Amount owed to group undertakings – interest bearing ³	27	31
	484	453

¹ Trade payables are non-interest bearing and are generally on 30-day terms.

² Amounts owed to group undertakings – interest free largely relate to external payments made by LHR Airports Limited under the Shared Services Agreement on behalf of the Company.

³ Amounts owed to group undertakings – interest bearing relates to an interest bearing loan with Heathrow Express Train Operating Company Limited with an interest rate of Bank of England base rate + 1.5%

19 Share capital

Called up, allotted and fully paid

	Number	£m
Ordinary shares		
1 January 2016	1,575,570,317	473
Bonus issue ¹	1,226,666,667	368
Capital reduction ¹	-	(831)
31 December 2016	2,802,236,984	10

¹ On 6 December 2016, the Company capitalised its revaluation reserves by a bonus issue of 1,226,666,667 ordinary shares of 30p each. Following this transaction, the issued share capital of the Company was 2,802,236,984 ordinary shares of 30p each. On 16 December 2016, the Company reduced its nominal share capital from 30p to 0.35p, realising £830,863,266 which in law creates distributable reserves.

Preference shares¹

1 January and 31 December 2016

100,000 preference shares – redeemable of £1 each ²	-	100,000
21,960,014 preference shares – irredeemable of £0.01 each	219,600	219,600

¹ Recorded within creditors (refer to Note 18).

² The redeemable preference shares were redeemed by the Company on 16 January 2016 at £1.37 per share, uplifted for movements in RPI since issue.

20 Revaluation reserve

The revaluation reserve records gains and losses on investment properties and operational land. For movement during the year refer to the statement of change in equity.

	£m
At 1 January 2016	768
Transfers from profit and loss reserve	54
Impairment recycled to income statement	2
Bonus issue of shares	(368)
Tax relating to indexation of operational land	1
At 31 December 2016	457

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

21 Retained earnings

Retained earnings relates to historical profits and losses of the Company, dividends distributions and transactions with shareholders. For movement during the year refer to the statement of change in equity.

	Note	£m
At 1 January 2016		1,243
Profit for the year		48
Actuarial loss on retirement benefit schemes	16	(226)
Tax credit on actuarial loss	16	39
Change in tax rate		6
Transfers to revaluation reserve		(54)
Capital reduction		831
Dividends paid	22	(594)
At 31 December 2016		1,293

22 Dividends paid

During the year ended 31 December 2016, the Company paid dividends of £594 million to Heathrow (AH) Limited comprising £76 million on 22 February 2016, £65 million on 11 March 2016, £83 million on 23 June 2016, £136 million on 22 July 2016, £124 million on 16 September 2016 and £110 million on 21 December 2016. (2015: £361 million to Heathrow (AH) Limited, comprising £33 million on 27 February 2015, £80 million on 4 March 2015, £83 million on 30 June 2015, £75 million on 24 July 2015 and £90 million on 16 December 2015).

23 Commitments and contingent liabilities

Non-cancellable operating lease commitments – Company as a lessee

Total future minimum rentals payable as at the year end are as follows:

	31 December 2016		31 December 2015	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	14	26	12	42
Within two to five years	25	98	29	156
After five years	7	436	10	592
	46	560	51	790

The Company leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Company also leases plant and machinery under non-cancellable operating leases.

A significant portion of the commitments classified as 'other' relates to electricity supply equipment at Heathrow leased on agreement with UK Power Networks Services Limited ('UKPNS'). The lease expires in 2083. The amounts disclosed are the total estimated charges under the agreement including both the actual lease commitment and the significant maintenance element of the fee payable to UKPNS as neither the Company nor UKPNS are able to split the base fee between a 'capital' and 'maintenance' charge. The commitment has been discounted at the Company's incremental borrowing rate. Other commitments have decreased from £790 million to £560 million in 2016 due to the change in assumptions used to calculate the net present value of the commitment under the UKPNS contract.

Non-cancellable operating lease commitments – Company as a lessor

Total future minimum rentals receivable as at the year end are as follows:

	31 December 2016	31 December 2015
	Land and buildings £m	Land and buildings £m
Within one year	92	95
Within two to five years	205	291
After five years	1,709	1,745
	2,006	2,131

The Company uses a number of different leasing and contractual structures depending on the type and location of the investment property. Typically in multi-let offices and industrial premises a standard indefinite tenancy is used, which is terminable by the tenant on three months' notice at any time. However, it is common for the accommodation to remain let or be quickly re-let should it be vacated. For larger, stand-alone premises, e.g. cargo sheds, longer leases of multiples of three years are used. Car rental facilities are operated under concession agreements subject to minimum guaranteed payments and the amounts are included above. Public car parks are covered by a single management contract.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

23 Commitments and contingent liabilities *continued* *Commitments for capital expenditure*

	31 December 2016 £m	31 December 2015 £m
Contracted for, but not accrued:		
Baggage systems	157	67
Terminal restoration and modernisation	173	53
Tunnel refurbishment	8	21
IT projects	28	17
Capacity optimisation	33	14
	399	172
Other projects	16	29
	415	201

The figures in the above table are contractual commitments to purchase goods and services at the reporting date. Capital expenditure for the Q6 regulatory period from 1 April 2014 to 31 December 2018 is currently forecast to be £2.9 billion. The capital programme may increase to up to £3.3 billion, in line with the regulatory settlement. This is subject to further scoping of the remaining individual projects and approval of the corresponding business cases. The capital programme is primarily focused on maintenance and compliance related projects, together with sustaining and improving the passenger experience. The capital plan for the period includes a £1 billion programme of asset management projects and a project to implement latest generation hold baggage screening equipment to comply with EU directive. Capital spend in 2017 is forecast to be in the region of £730 million.

Other commitments

Following the Government decision in October 2016 for Heathrow as preferred option for expansion, the Company recognises that up to 64 residential property owners could exercise their right under the previous scheme for which bonds were issued, to redeem those bonds at some point in the future. The Company's best estimate of the total payment is £21m based on a valuation in accordance with the terms set out in the bond contract, and assumes all 64 bondholders will exercise their option to sell. The option to sell is contingent on planning permission for the third runway, therefore no provision has been recognised.

Heathrow Airport Limited has a commitment to pay £87 million in 2018 to the Department for Transport in relation to the Crossrail project in return for a service commitment for Crossrail to operate services to Heathrow for 15 years. It is expected that the amount will be included in the Regulatory Asset Base.

Contingent liabilities

The Company has contingent liabilities, comprising letters of credit, performance/surety bonds, performance guarantees and other items arising in the normal course of business amounting to £1 million at 31 December 2016 (2015: £1 million).

The Company, Heathrow Express Operating Company Limited, Heathrow (SP) Limited and Heathrow (AH) Limited (together, the 'Obligors') have granted security over their assets to secure their obligations under their financing agreements. Each Obligor has also provided a guarantee of the obligations of the other Obligors.

BAA Pension Trust Company Limited is a Borrower Secured Creditor and has a right to receive up to approximately £284 million out of the proceeds of enforcement of the security granted by the Obligors, such right ranking *pari passu* with the senior (Class A) creditors to the Obligors.

The Company and Heathrow Express Operating Company Limited have provided a guarantee in favour of Lloyds bank plc as Borrower Account Bank in respect of their liabilities under the Borrower Account Bank Agreement.

Heathrow Airport Limited

Notes to the Company financial statements for the year ended 31 December 2016 *continued*

24 Ultimate parent undertaking and controlling party

The immediate parent undertaking of the Company is Heathrow (AH) Limited, a company registered in England and Wales.

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (25.00%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly-owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. and Alinda Airports L.P. (11.18%) (investment vehicles managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (10.00%) (wholly-owned by the Universities Superannuation Scheme).

The Company's results are also included in the audited consolidated financial statements of Heathrow (SP) Limited for the year ended 31 December 2016, which is the parent undertaking of the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of Heathrow Finance plc and Heathrow Airport Holdings Limited for the year ended 31 December 2016.

Copies of the financial statements of FGP Topco Limited, Heathrow Airport Holdings Limited, Heathrow Finance plc and Heathrow (SP) Limited may be obtained by writing to the Company Secretarial Department at The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW.

25 Subsequent event

On 23 February 2017, the Board approved the payment of a £83.8 million dividend to the Company's parent, Heathrow (AH) Limited.