

ISSUER COMMENT

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Heathrow Finance plc

Credit profile unaffected as third runway project overcomes latest legal challenge

On 1 May 2019, the UK High Court rejected a legal challenge against plans for the expansion of Heathrow airport. Campaigners including, amongst others, some London councils and environmental charities brought the legal action against the UK Government on the basis of the alleged severe environmental and noise impact deriving from construction of a third runway at the airport. Heathrow's expansion and the associated construction of a third runway received parliamentary approval in June 2018, with 415 votes in favour, and 119 against. With today's High Court decision, which can however potentially be appealed, Heathrow's expansion clears another hurdle in the context of a project which the Government estimates will deliver economic benefits to passengers and the wider economy worth up to £74 billion, by boosting the UK's connections to and enabling increased trade with the rest of the world.

The construction of a third runway remains strategically important for Heathrow, which currently operates at capacity, given the limit imposed on the number of air traffic movements that can take place at the airport. The planned expansion would allow Heathrow to continue to operate as a hub and reinforce its status as the main airport in London, the largest and most valuable aviation market in the world. Nevertheless, it is still too early to fully determine the precise credit implications of the runway construction project for Heathrow Finance plc (HF, Ba1 stable), the holding company for Heathrow airport, as important elements in the final risk allocation, such as the total quantum and phasing of expenditure, any conditions attached to the planning consents or regulatory decisions with respect to the timing and the pace of increases in airport charges, are still unknown at this stage.

More generally, we see the High Court ruling and the clearance of the latest legal case against the third runway as broadly credit neutral for HF, as the benefits of operating an expanded airport are counterbalanced by the challenges of managing and delivering a sizeable project at an estimated cost of around £14 billion. Heathrow has, nonetheless, experience in successfully managing and delivering large and complex capital expenditure projects, such as the construction of Terminals 5 and 2, and has also been able to implement increases to its aeronautical charges in the past without noticeably affecting passenger throughput.

The High Court ruling does not mean, however, that the construction of Heathrow's third runway can commence. Heathrow plans to hold further public consultations on the project in 2019 and submit a Development and Consent Order application in mid-2020. The Planning Inspectorate, an executive agency of the UK Government in charge of providing

recommendations and advice on a range of land use planning-related issues, will review the merits of the scheme and submit a recommendation to the Secretary of State for Transport, who has the authority to grant the planning sign-off. We do not expect the final sign-off, which must be obtained before the expansion can take place, until 2021 at the earliest.

Given the lengthy approval process related to Heathrow's third runway, the body responsible for economic regulation of Heathrow's applied charges, the Civil Aviation Authority (CAA), has extended the current price control period to give an opportunity to reflect any decision on runway capacity expansion in the new settlement. The current regulatory period has therefore been extended by three years to the end of 2021. The CAA is still developing its thinking around the appropriate regulatory arrangements that should apply in the next regulatory period in the context of the major expansionary investment taking place.

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