Heathrow financing

Debt financing for tax avoidance

BAA plc takeover

- British Airports Authority privatised as BAA plc in 1987
- It owned Heathrow, Gatwick, Stansted, Glasgow, Aberdeen and Southampton airports
- Hostile takeover as FGP Topco in 2006
- Ferrovial Infraestructures SA 62%
- Caisse de depot ... Canada 28%
- Baker Street .... Singapore 10%

Post-acquisition financing

- BAA plc debt 25 June 2006 £2,861m
- FGP Topco's end year's debt £13,515m
- Acquisition of BAA added £10,654m to FGP Topco's debt
- Purchase price of BAA £10,277m
- Acquisition accomplished at no cost to Ferrovial's takeover consortium

Heathrow current ownership

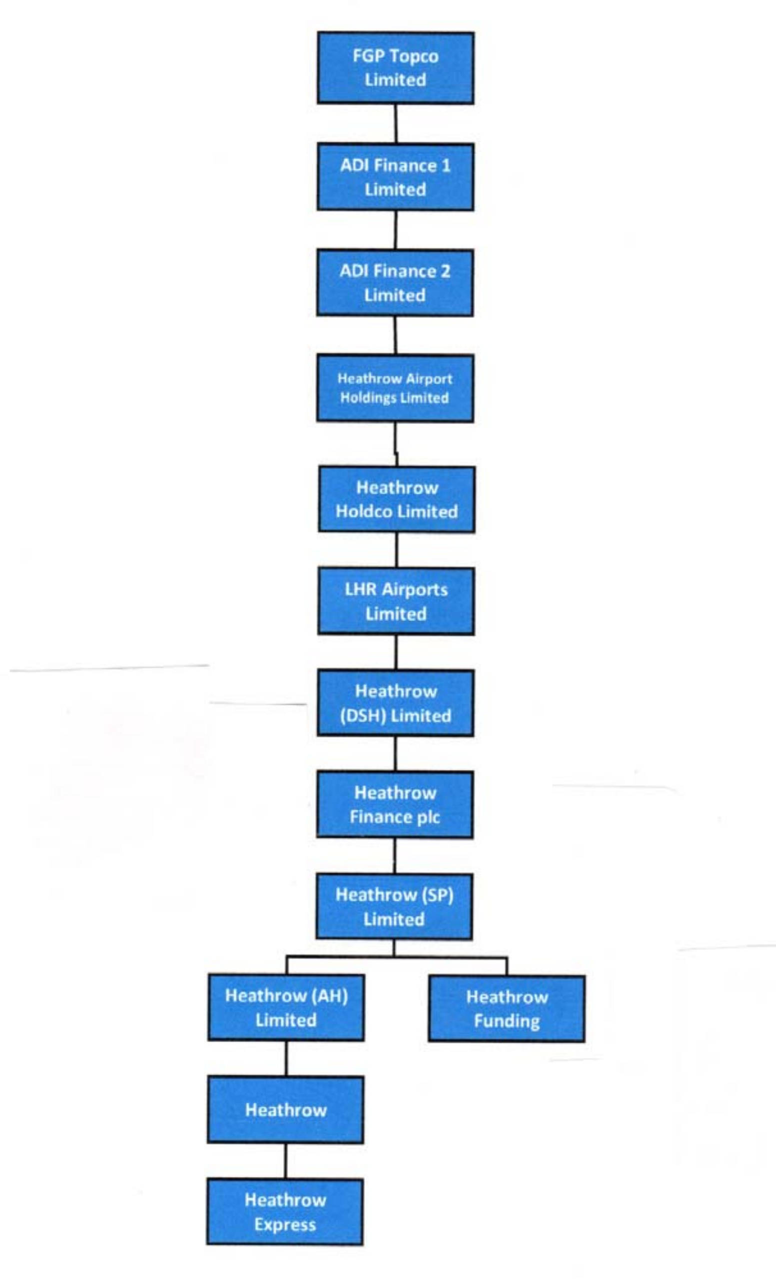
- The owner is **FGP Topco Limited**, a 90% foreign-owned holding company in which the accounts are consolidated.
- Ferrovial 25%
- Qatar Holding 20%
- Caisse de dépôt et placement du Québec 12.62%
- Government of Singapore Investment Corporation 11.20%
- Alinda Capital Partners 11.18%
- China Investment Corporation 10%
- Universities Superannuation Scheme 10%

Equity at end 2018

- Paid up shares £13.1 million
- Ferrovial was paid £522m for reduction in its holding from 62% - 37% to 25% raising share premium to £1,411m
- Total assets £18,722 million
- Liabilities £17,749 million
- Net assets £ 973 million
- Fair value of borrowings £16,963 million

There are 13 main companies in the group.

There are 4 finance companies, one of which, Heathrow Funding Limited is in Jersey



Post-acquisition airport sales

- Competition and Markets Authority ordered sale of all airports but Heathrow
- Ferrovial now has shares in Denver, Heathrow, Glasgow, Aberdeen and Southampton airports
- Ferrovial's Jorge Gil is CEO of the UK ones and signs off Heathrow's accounts

Profit and Loss Reserves

- Each of the main group companies has a profit and loss reserve (2018 not all published yet)
- The total of the amounts in the reserves is £22+ billion

Retained Earnings	£million	£million	£million
	2016	2017	2018
FGP Topco	2,303	1,801	1,695
ADI Finance 1	1,114	1,617	1,713
ADI Finance 2	1,504	1,812	1,810
HAH	2,871	2,914	2,912
Holdco	3,830	3,307	
LHR Airports	-48	47	
DSH	932	413	392
H Finance plc	284	1,078	1,124
SP	3,001	2,647	3,233
AH	5,076	5,076	5,076
H Funding	-72	-71	
H Airport	1,293	1,472	
H Express	30	31	
Total	22,118	22,144	

Debt financing

- Heathrow's capital projects are financed by debt
- Rather than draw from the £22+ billion in the profit and loss reserves, the financial costs of the borrowings and losses on financial instruments can be set against the operating profits
- This has put FGP Topco in losses for 6 of its twelve years, not only avoiding corporation tax but gaining net tax credits

Public Infrastructure Exemption (PIE)

- Heathrow claims to be infrastructure and valid for a PIE giving it exemption from the allowable 30% limit of interest deduction from its operating profits.
- Over its 12 years FGP Topco has set its financial costs of borrowing against its operating profits to gain £693m tax credits
- The text below is extracted from the annual report of its finance subsidiary ADI Finance 1 Limited 2018

In November 2017 the Finance (No.2) Act 2017 received Royal Assent, giving effect to a new interest deductibility regime. This regime is in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). As a result of the new legislation, from 1 April 2017, interest deductions are limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public infrastructure exemption (PIE). FGP Topco Group is to a large extent protected from the 30% of tax based EBITDA cap therefore no material interest disallowance has been reflected in the 2018 tax credit (2017: nil).

Corporation tax instead of tax credits?

- Equity to be raised and reliance on debt reduced
- Limits to be set on finance costs able to be set against operating profits (30% with no PIE)
- Chancellor's Autumn Statement 2016 is pledged to stop offshore withholding tax avoidance
- Offshore bond issuance to be progressively replaced by bonds issued onshore as they mature so that withholding tax will be paid.
- Long-term bonds to be redeemed before maturity

Borrowings

- Around 82% of FGP Topco's £14 billion borrowings amounting to £11.5 billion are in bonds issued by Heathrow Funding Limited in Jersey
- Prospectuses absolve the bondholders from paying withholding tax and if having to pay it are compensated.
- Savings in withholding tax of 20% of the £11.5 billion of bonds issued in Jersey from interest paid to bondholders of ca. £7 billion over 12 years amounts to perhaps around £1.1 billion
- This may be the main tax advantage in offshore bond issuing and interest may be paid offshore

Operating profits offset by finance costs

- In 2016 FGP Topco Limited's operating profit of £1.049 billion was offset by finance costs of £1.231 billion and by other costs to give a loss of £182 million
- The 2016 tax credit thereby amounted to £70 million
- The net tax credits over 2007 to 2018 totalled £693 million.
- Taxes of £97m and £70m were paid in 2017 and 2018

Dividends

- Sums nominated as ‘dividends’ were passed up the chain of subsidiary companies
- They mostly augmented subsidiaries’ profit and loss reserves.
- The 2016 FGP Topco Limited dividend amounting to £325 million was paid by issuance of bonds, term notes and other financing.
- From 2007 to mid 2019 the total of dividends paid out of debt amounted to £4.12 billion
- The Heathrow Funding 2018 prospectus (Page 9) allows “... *proceeds of bond issuances and of loan drawings ... to enable the payment of dividends ...”*

FGP Topco Limited

- Analysis of 12 years of its accounts shows:-
- £4.12 billion paid in dividends
- £7 billion interest paid on bonds
- £1.1 billion saved on withholding tax?
- £693 million net tax **credits**

FGP Topco Limited		2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Totals
Dividends	£million	£ -	£ -	£ -	£ -	£ -	£ 240	£ 555	£ 1,075	£ 300	£ 325	£ 525	£ 500	£ 600	£ 4,120
Interest payments	£million	£811	£813	£501	£457	£ 444	£ 487	£ 589	£ 597	£ 631	£ 608	£ 563	£ 533		£ 7,034
Tax credits	£million	-£ 7	-£ 6	£117	£245	£ 243	£ 119	£ 149	-£ 45	-£ 25	£ 70	-£ 97	-£ 70		£ 693
Withholding tax avoided £million															£ 1,125

Expansion capital requirement

- Airports Commission Table 11.2 estimates:-
- Capital needed for runway £17.6 bn, and surface access costs £5 bn (TfL reckons £18.6 bn)
- With cost inflation of 10% since 2014 and with £18.6m surface access costs, plus £5 bn for new terminal and freight depot, the the capital requirement over 2020-2025 is around £50 bn

Core capital and asset replacement requirements

- Core capital of £13.4 bn, asset replacement of £16.5 bn spread over 30 years from 2020 to 2050 is £1bn/annum

Improved passenger and freight handling required

- Heathrow has dropped its planned new terminal from its project
- Regardless as to whether the runway will be built an additional terminal to handle greater numbers of passengers per flight is needed
- Robotised new freight depot required to match increased wide-belly tonnage

Major added expenses

- Tunnelling the M25
- Re-routing of perimeter roads
- Removal and replacement elsewhere of Energy-from-Waste plant
- Removal and replacement of BA's Waterside complex
- Removal and compensation for owners of hotels, factories and offices
- Compensation for Harmondsworth community destruction

Contractors progress payments

- £50 bn to be paid over 5 years
- If contractors paid by raising debt, interest charges of 5%/annum estimated @ £7.5 bn
- During runway construction interest costs of £1.5 bn/annum are not payable from current operating profits of £1bn/annum
- Core capital and asset replacement will cost £1 bn/annum

Heathrow's Revenue

- ***Aeronautical income***

- **Aeronautical income reflects the fees charged by Heathrow to the airport's airline customers.**

- ***Passenger charges* are based on the number of passengers per aircraft and levied in respect of all departing passengers.**

- ***Landing charges* are levied for substantially all aircraft. These are calculated by the certified maximum take-off weight and adjusted with each aircraft's noise-rating, emissions, and the time of day**

- ***Parking charges* are for aircraft.**

- ***Non-aeronautical income***

- ***Non-aeronautical income* is generated from *fees* from retail operators, income from car parks, advertising, VIP products, the rental of airport premises such as aircraft hangars, warehouses, cargo storage facilities, maintenance facilities, offices and airline lounges, the provision of baggage handling, passenger check-in and fares from Heathrow Express rail service.**

Additional airport charges (1)?

- Debt at commissioning of runway, surface access, terminal and freight depot would be £57.5 bn (with accumulated interest of £7.5 bn), assuming current borrowings redeemed by P&L reserves
- Core capital + asset replacement - £1 bn/annum
- Interest on debt = £3 bn + £1 bn = £4 bn/a
- Revenue with 50% extra traffic by say 2035 just £4.5bn with £1.5bn operating profit and £1.5 bn available for interest
- Overall revenue needs to raise to £7 bn/annum

Additional airport charges (2)?

- 2018 Aeronautical revenue £1,745m
- 2018 Retail + Other revenue £1,129m
- Regulation boosts aeronautical revenue only
- 2035 Revenue required is £5.5bn Aeronautical + £1.5bn Other = £7bn
- Airport charges £5.5bn/130m = £42/Px
- Airport charges to be raised by say 90% from £22 to £42 per passenger

Prospective revenue during construction

- If, airport charges are held at current level and Heathrow's traffic grows (as currently without the runway) @ 3%/annum **and** the current debt is cleared by emptying the P&L reserves, from 2019 to 2025 the accumulated profit before tax is only ca. £2.5 bn and insignificant
- If the revenue is curtailed by access interference by construction work there will be little accumulated profit

CAA Regulation

- CAA builds Regulatory Asset Base (RAB)
- Seven RAB ‘building blocks’ produce a price cap per passenger
- Price cap limits airport charges
- IAG’s CEO argues that the cap is too big
- Heathrow’s charges are 65% over European hubs
- CAA is building new RAB for the expansion starting from end of 2019

Funding the runway and expansion

- The CAA price cap takes into account revenue, operating costs and return on capital expenditure.
- The Regulatory Asset Base (RAB) makes debt raising attractive and the price cap too high and uncompetitive
- Funding the runway and terminal expansions by debt is not acceptable to the airlines as it will mean additional airport charges

Additional airport charges

- From 2007 to 2018 the airport charges have risen from £8 to £22 per passenger
- CAA and DfT have undertaken not to raise charges immoderately
- At Transport Commission’s hearings airlines refused to pay additional airport charges
- Expansion unable to proceed without increased charges

Runway not needed

- The progressive deployment of bigger aircraft is making the third runway unnecessary
- Average passenger numbers per flight of 255 will provide 50% more passengers without it
- The ultimate target of 130 million passengers a year can be reached with 290 average passengers per flight without the third runway
- Airlines will not pay for a runway they don’t need
- Improved passenger and freight handling will be needed to facilitate bigger arrivals and departures

My Conclusion

- Heathrow's debt financing needs reform
- Expansion requires higher airport charges
- There is no need for a third runway
- Better handling facilities required for the arrival and departure of bigger aircraft