# Assessment of Commercial Revenues - Gatwick Airport (Stage 3)

**Final Report**

Report

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# Disclaimer

Our work is produced for the Civil Aviation Authority for use in association with its consideration of Q6 price control arrangements for London Gatwick Airport and is not intended to be relied upon by third parties. Steer Davies Gleave accepts no liability for the use of this document other than for the purpose for which it was commissioned.

The projections contained within this document represent Steer Davies Gleave's best estimates. While they are not precise forecasts, they do represent, in our view, a reasonable expectation for the future, based on the most credible information available to us as of the date of this report. However, the estimates contained within this document rely on numerous assumptions and judgements and are influenced by external circumstances that can change quickly and influence income.

This analysis is based on data supplied by the client/collected by third parties. This has been checked whenever possible, however Steer Davies Gleave cannot guarantee the accuracy of such data and does not take responsibility for estimates in so far as they are based on such data.

# 1 Introduction

## Scope

1.1 Steer Davies Gleave was appointed by the Civil Aviation Authority (CAA) to support its assessment of commercial revenues at London Gatwick Airport as part of the price control arrangements for the forthcoming Quinquennium 6 (Q6) period (2014/15 – 2018/19 inclusive).

1.2 Previously we reviewed the commercial revenues projections in Gatwick Airport's Initial and Revised Business Plans, along with submissions provided by the consultants to the Gatwick Airport Airline Consultative Committee (Javelin Group and ACTM). Our Final Report was published in April 2013.

1.3 Subsequent to this and publication of the CAA's Initial Proposals for Q6 prices the following responses have been produced by Gatwick Airport and the airline community:

- Economic regulation at Gatwick from April 2014: CAA's initial proposals – Response from Gatwick Airport Ltd.
- ACC Response to CAA document: Economic regulation at Gatwick from April 2014: Initial proposals.
- Response to Steer Davies Gleave (SDG) Assessment of Commercial Revenues at Gatwick Airport (Javelin on behalf of Gatwick ACC).

1.4 This document is an update to our April 2013 Final Report and should be read in conjunction with it. We have considered the points made by stakeholders along with new evidence, and where relevant have proposed adjustments to the projections presented in our Final Report.

## April 2013 Steer Davies Gleave Projections

1.5 The commercial revenue per passenger projections we set out in our April 2013 Final Report are illustrated below. These represented a 'core' case in association with the capital investment programme for Q6 set out in the Gatwick Airport Revised Business Plan, in which the total revenues per passenger were projected to increase (in real 2011/12 prices) at a CAGR of 0.6% to the end of Q6:

TABLE 1.1 GATWICK AIRPORT Q6 'CORE' COMMERCIAL REVENUES PER PASSENGER (2011/12 PRICES)

| | Q5 | | Q6 | | | | |
|---|---|---|---|---|---|---|---|
| Category | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
| Retail | 3.48 | 3.56 | 3.68 | 3.52 | 3.69 | 3.68 | 3.82 |
| Car Parking | 1.11 | 1.08 | 1.09 | 1.06 | 1.02 | 1.00 | 1.00 |
| Property | 0.77 | 0.68 | 0.68 | 0.67 | 0.69 | 0.76 | 0.75 |
| **TOTAL** | **5.36** | **5.30** | **5.45** | **5.24** | **5.41** | **5.43** | **5.57** |

*Source: Steer Davies Gleave April 2013 Final Report*

1.6 We also identified a 'super stretch' opportunity amounting to an additional 5% in commercial revenues through Q6, which would be dependent on delivering a larger capital investment programme than assumed for the 'core' case (with the additional expenditure used for further increases in airside retail space) and the introduction of a forecourt drop off charge.

1.7 For its Initial Proposals the CAA used Steer Davies Gleave's 'core' revenue per passenger projections for Q6 in conjunction with the CAA's own forecasts of passenger traffic.

## Remainder of this Report

1.8 In the remainder of this Report we:

- Assess the responses raised by stakeholders (and their consultants) by key commercial revenue line;
- Address other issues where these do not relate directly to one revenue line (e.g. benchmarking);
- Based on our review of these comments set out any changes to our April 2013 commercial revenues projections.

1.9 In order to ensure consistency with our April 2013 Final Report all prices are given in 2011/12 real terms unless stated otherwise.

# 2 Response to stakeholder comments

## Introduction

2.1 This section sets out a summary of the comments made by stakeholders to the Steer Davies Gleave projections set out in our April 2013 Final Report, along with our assessment and response to those comments.

2.2 Steer Davies Gleave's revenue per passenger projections were in between the levels proposed by Gatwick Airport (which were lower) and the Gatwick ACC (which were higher). Although Gatwick Airport disagreed with our forecasts, these were closer to those of the airport than those of the airline community.

2.3 We address the comments and other relevant information in the following order:

- Summary of Stakeholder comments;
- 2012/13 Outturn;
- Capital Investment;
- Retail;
- Car Parking;
- Property; and
- Other Issues (Macroeconomic conditions, Benchmarking).

## Summary of Stakeholder comments

### *GAL Response*

2.4 Gatwick Airport disagreed with the Steer Davies Gleave projections across nearly the entire key product categories along with many of the assumptions used. The Gatwick Airport Revised Business Plan assumes that total commercial revenues in Q6 will be 5% lower than forecast by Steer Davies Gleave, based on Gatwick Airport's traffic forecast.

2.5 Gatwick Airport commented that in developing our forecasts we had failed to take a balanced view and cited three specific points as evidence of this:

- A belief that the Steer Davies Gleave projections take into account speculative opportunities while disregarding significant threats.
- A belief that the projections understate the negative impacts of structural trends in areas such as Bookshops and roll up Car Parking, where Gatwick Airport states that mitigation will stem the rates of decline without stopping them.
- A belief that our benchmarking of commercial revenues to that at other airports was simplistic. Gatwick Airport stated that caution should be used in employing benchmarks to judge performance.

2.6 Gatwick Airport also stated that Steer Davies Gleave had misunderstood the market in which the airport operates, citing the following factors:

- A view that we had over-estimated the current strength of travel retail.
- A view that we had under-estimated the extent of competition in the car parking market.
- A belief that we took an optimistic view of the opportunities from office rental demand.

***Airlines' Response***

2.7 In a number of respects the views of the ACC and its consultants were closer in alignment to our own.

2.8 However there were some important differences (for example in areas such as the effects of the Tobacco Display Act and car parking) which resulted in a significant difference in expected revenues. In overall terms the ACC and its consultants assumed that Q6 commercial revenues would be 8% higher than forecast by the CAA (whose projections are in turn drawn from Steer Davies Gleave's revenue per passenger assumptions and the CAA's own traffic forecasts). On a per passenger basis the ACC projected Retail revenues to be about 5-6% higher through Q6, whilst car parking revenues were anticipated to be about 9% higher by the end of Q6 (primarily because Steer Davies Gleave anticipates a fall in car parking revenues per passenger whereas the ACC's consultant, ACTM, assumed a flat real trend).

2.9 In most cases the views of the ACC accord with those of Javelin and ACTM and we therefore present their views below jointly as the response of the airlines.

***Steer Davies Gleave Analysis***

2.10 While the rest of this section sets out our views on matters of detail, below are some comments on the headline issues raised by stakeholders and in particular the challenges raised by Gatwick Airport.

2.11 **Strength of Travel Retail**: With the sector growing by 7% in 2012 (according to The Travel Retail Business Magazine) through to Heathrow Airport publicly announcing their retail revenue growth for the first 6 months of 2013 at +4.6%, it is difficult to be too pessimistic about the sector in which Gatwick operates. We therefore disagree with Gatwick Airport's view that we have overestimated the strength of Travel Retail in the UK.

- Javelin commented in their recent feedback how the "UK economy is entering a more stable period of slow but consistent growth with the risks of another recession being unlikely".
- Comments based on the recent performance of Travel Retail, when the UK macroeconomic performance has been weak, are likely to be non-representative of the Q6 period when slow but steady UK GDP growth is projected by most commentators.
- Rather than being used as an argument for changing forecasts Javelin feel this positive change provides additional confidence that the economy will not unduly hinder the potential identified.

- Javelin also added that at the time of writing their comments, the ONS had reported that during Q1 2013 the workforce has grown to its highest level since 1971 and that the number of jobless people in the UK claiming benefits had reduced to its lowest level for 2 years.
- The performance of the UK retail market has also continued to grow positively each month as indicated in the ONS/Mintel UK Retail Sales Change reports.
- Gatwick Airport quoted survey data indicating that 31% of UK holidaymakers plan to spend less next year. Even if true this may not prove to be representative of trends in Q6 as a whole, and in any case if 31% plan to spend less it follows that the majority - 69% - either plan to spend at least the same or more.

2.12 **Competition for on-airport Car Parking**: Gatwick Airport's decision to radically reduce its Initial Business Plan car parking revenue forecasts in its Revised Business Plan (a reduction of about 33% in revenue per passenger by 2018/19 from one forecast to the other) as a result of anticipated growth in off airport parking supply was carefully considered by Steer Davies Gleave. We believe that our forecasts in our Final Report recognise Gatwick's description of the current market albeit we do not entirely share their negative perspective.

2.13 During our review of Gatwick Airport's forecasts we sought opinion from APH, Holiday Extras and Meteor Meet and Greet (Vinci Park) in addition to reviewing Crawley Borough Council's Local Plan, which remains committed to the policy of permitting additional parking only within the Airport Boundary.

2.14 Crawley Borough Council carries out a "count" each year of authorised and unauthorised car park spaces in the area. The airport remains dominant with regard to both numbers of car park spaces and prime location close to Terminal buildings. The airport also benefits from strong distribution of its parking products, not only from its own booking site (as stated in Gatwick's response to the CAA, revenue was up by 11% for the 11 months to February 2013) but also through consolidators such as Holiday Extras.

2.15 In addition Gatwick Airport's ability to currently spend some £2.4 million per annum for on line marketing (comprising £2m on search engine marketing and £400k for CRM activity), enables Gatwick to be leader in the local parking market.

2.16 We have found no evidence either in the public domain or data provided by Gatwick Airport to suggest there will be unconstrained growth in off airport parking spaces during Q6. As stated in our Final Report, APH relocating its operation to a new site whilst retaining its old site for overflow purposes was as a result of a 6 year long planning appeal and is unlikely to set a precedent for further large scale off airport parking expansion.

2.17 In summary we recognise that Gatwick Airport faces competition from other parking providers – as it has always done – but we do not agree with the statement that we have under estimated the extent of such competition, and can find no evidence to suggest that there will be material change to the status quo in Q6.

2.18 **Office Rental Demand**: In developing our forecasts we consulted representatives of the Gatwick airline community, which is the group most likely to provide demand for office accommodation at Gatwick. While Crawley has significant office space, which provides competition to Gatwick, the balance of spare office stock at present (in the final period of Q5 as the UK economy is emerging from recession) is unlikely to provide a fair representation of Q6, when it is reasonable to expect that steady UK GDP growth will drive increased demand across the Crawley/Gatwick Airport area for office space especially towards the latter part of Q6. In addition Gatwick has been pursuing a strategy to remove its aviation related restriction on property lettings with the Local Authority and, if successful, this will widen its market opportunities.

## 2012/13 Outturn

***Steer Davies Gleave Analysis***

2.19 As the base year used in our Final Report, the amount of revenues earned in 2012/13 provides an important input to our Q6 projections. In our April 2013 Final Report we stated that we thought Gatwick's Revised Business Plan estimate of £188.5 million was reasonable, although there were risks of under- or over-shoot in the projections for individual product categories. The Revised Business Plan forecast represented growth of 1.4% versus 2011/12, expressed in nominal terms.

2.20 For this update we have referred to outturn data provided to us by Gatwick Airport for Retail, along with publicly available data in the Gatwick Airport Limited "Directors Report and Financial Statements" for 2012/13 to assess the actual change in nominal revenues versus 2011/12. This does not provide an exactly comparable set of results to those referred to by Gatwick Airport in its Revised Business Plan but we believe it can provide a reasonably accurate statement of the 2012/13 commercial revenues performance.

2.21 These sources indicate that Gatwick Airport earned £189.3 million in 2012/13 (net of retail and car parking expenditure).

2.22 For some categories (Property, Telecoms, Duty Free, Bureau, Car Parking) Gatwick Airport has made us aware of one-off accounting (and similar) effects in the 2012/13 figures. We have taken these into account when setting out our forecasts for Q6.

## Capital Investment

***Steer Davies Gleave Analysis***

2.23 Gatwick Airport has made some changes to capital projects as follows:

2.24 For **Retail**, at the time of writing our Final Report Gatwick Airport and the airline community had agreed on the North Terminal IDL expansion project having value engineered the capital costs from circa £180 million to £90 million and this remains the situation today.

2.25 It is unlikely that this project could be accelerated much further to deliver greater revenue in Q6 due to the complexity of the project and the fact that we are now half way through 2013.

2.26 Although we still believe that Gatwick Airport could sustain more space (based on benchmarks set out in our Final Report and the recent success in leasing units in

Gatwick South) we have not carried out a detailed survey of the airport to identify how space could be created and at what cost.

2.27 For **car parking** the potential new MSCP has been removed from Gatwick Airport's plans. This has since been supported by Gatwick's statement that they will not be providing any additional space during Q6 which we commented on in our Final Report. The last major space increase was the construction of the new MSCP at North Terminal (incremental 1,117 spaces) which became operational in 2011. Gatwick Airport were able to use this to upsell from North Terminal long stay to improve yields, an effect which will have been reflected in their revenues during 2011/12 and 2012/13 and an approach which we understand is still of course in operation.

2.28 There has also been some reconfiguration of existing space (long stay plus) to create more valet storage but no new constructed space. The benefit of increasing valet storage is accounted for in Gatwick Airport's historical performance and forecasts.

2.29 For **property** there is one project, at indicative stage, for a proposed aircraft maintenance hangar. The business case shows a three year rent free period meaning that it would not be income generating before 2018/19, provided that construction started in 2014. It is unlikely to have a meaningful impact in Q6 as it will be bespoke and we understand that there is no tenant currently identified.

### Retail: Duty Free

#### *GAL Response*

2.30 Gatwick Airport commented that we had understated the effects of the Tobacco Display Act (TDA) on Duty Free revenues, and had used point in time benchmarks that do not take into account underlying performance or the effects of the change in law.

2.31 Gatwick Airport also stated that they disagreed with our assumption that a different contractual arrangement might be struck with World Duty Free (or another operator in the Airside Specialist Shops category) in order to deliver additional margin in return for a longer concession term.

2.32 Gatwick Airport also highlighted the potential risk of WHO directives that could affect Duty Free income in addition to the impact of the TDA.

#### *Airlines' Response*

2.33 Javelin Group believed that the impacts of the Tobacco Display Act legislation had been overstated and that there was a lack of clear like-for-like evidence. In their opinion Gatwick Airport could mitigate the effects of the TDA by significantly reducing the space committed to Tobacco. Although there was a downside risk from the TDA, this was small, and could be mitigated (for example by introducing a minimum turnover guarantee for the retail space committed to Tobacco).

#### *Steer Davies Gleave Analysis*

2.34 Tobacco legislation is the single largest area of disagreement in the Retail area between Javelin (who assume that there will be negligible impact), Steer Davies

Gleave (-12% to -20% impact) and Gatwick Airport (-50%), with each party maintaining their position.

2.35 Our detailed analysis of the issue is provided in the April 2013 Final Report.

2.36 In addition we would add that the impact of the legislation to which all parties have expressed diverse views is that it will become less easy for passengers to buy tobacco products. This is a very different issue to reducing the size of the market as was experienced in 1999 with the abolition of intra EU duty free and in 2004 following EU enlargement to the EU. While the reduction in market size accruing from those changes understandably resulted in significant reductions to tobacco revenues, we understand that the impact of initiatives designed to make it harder for passengers to purchase has generally been more modest (for example through introduction of the Tobacco Advertising Promotions Act 2002). Further information is provided in our Final Report on Heathrow Airport's commercial revenues, published on the CAA's website.

2.37 It should be noted that the data covering this period for Gatwick Airport was requested at the time of developing our Final Report but was not available due to it covering a period prior to the new ownership of the airport.

2.38 In addition to the specific issue about the effects of the TDA we have also considered the potential initiatives under review by the World Health Organisation (WHO), ranging from the introduction of plain packaging (recently delayed having been anticipated from 2014) through to an outright ban on tobacco sales. We believe it is likely that there will be a complete ban in the long term but also think that such a move is very unlikely during Q6. The WHO are conducting a study to establish to what extent illicit trade in tobacco takes place within Travel Retail, and this study must be completed by 2017/18. The results of this study – if adverse – are seen by the industry as a potential tipping point leading to a ban on tobacco sales within the sector. The study has not yet started and will take some time to complete. Allowing for this, along with time to discuss and review its findings, and to introduce the necessary legislation, we believe a ban will not take place during Q6.

2.39 In summary, we see no compelling reason to amend our earlier projections for Tobacco revenues.

### Retail: Margins

*GAL Response*

2.40 Gatwick Airport disagreed with the Steer Davies Gleave assumption that additional revenues could be derived in Q6 through margin changes over and above those assumed in the Revised Business Plan.

2.41 They provided us with confirmation that the margin enhancements as a result of the twenty two new stores in the Gatwick South development have been included in the Revised Business Plan [✂].

2.42 Gatwick Airport also disagreed with our assumption that a different contractual arrangement might be struck with [✂] (or another operator in the Airside Specialist Shops category) in order to deliver additional margin in return for a longer concession term. Gatwick Airport disagreed with this opportunity on the grounds that it believes the extension of existing contracts to deliver margin improvements is too hypothetical [✂].

2.43 Gatwick Airport management have maintained their position on this issue when responding to the CAA's Initial Proposals and in recent discussions stated to us that they would never introduce anything along these lines, and would not advocate taking such an approach to their Board.

***Airlines' Response***

2.44 Javelin commented that margins can be improved and brought more in-line with industry standards through category management.

***Steer Davies Gleave Analysis***

2.45 Having reviewed category margins against our own benchmarks and those set out in the initial Javelin report (22% for Specialist Shops) we believe there is clearly some opportunity to grow specialist shop margins generally and also to improve catering margins in the North Terminal, bringing them in-line with those achieved in Gatwick South.

2.46 Although there should be opportunities to improve margins on existing retail units as and when concession contracts are renewed, a developed airport such as Gatwick should expect to make greater progress when developing a new retail scheme and leasing through a competitive tender process i.e. the recent leasing of new stores in Gatwick South and the planned development in North Terminal.

2.47 We understand that the [✂] blended margin described by the airport for the Gatwick South new shops is heavily diluted [✂] and currently command a high proportion of the blended sales. As the airport develops through contract renewals and the planned expansion in Gatwick North, we would expect the blended margin to continue growing along the lines described in our Final Report.

2.48 Outside of these specific opportunities we believe another route to successfully delivering further increases in margin is for the airport to identify opportunities which are also value enhancing to the retailer. In our Final Report we used the example of offering contract extensions to some major operators, particularly those whose company value would benefit significantly [✂]. Company valuations are usually based on the EBITDA over the life of the contract so a five year extension [✂] would be of interest to a concessionaire, especially given the scale and strength of the Gatwick business. It should be noted however that this approach minimises the airport's flexibility and a forced exit further down the line might be more expensive. In reality we would expect the airport to develop a menu of opportunities to discuss with key concessionaires, with examples potentially including a relaxation to settlement terms (pay quarterly in arrears instead of advance) and relaxation on tax free pricing in selected product categories.

2.49 While we note Gatwick Airport's challenge to our proposal, we believe that it could be adopted assuming a single minded approach purely to benefit Q6 income. For the purpose of this review we propose no change to our forecast, where we have assumed [✂], although in practice this may be delivered through a combination of deals with other operators.

### Retail: Space

*GAL Response*

2.50 In our Final Report we set out the case for the potential development of additional retail space in addition to that already planned for Q6. We caveated our proposal by stating that ease and cost of delivering the space would need to be carefully evaluated. The proposal was presented as a ‘super stretch" target worth £13.2 million and is not part of the “core” projections presented in the CAA’s Initial Proposals.

2.51 Gatwick Airport management disagree that additional retail space should be provided over and above what is already planned. Their argument appears to rest on the fact that it has been difficult to reach agreement with the airlines on any retail expansion and in doing this they have discounted the benchmark data and rationale provided in Table 3.8 of our Final Report.

*Airlines’ Response*

2.52 Javelin stated that they do not see a significant enough increase in passengers to cause undue pressure on existing retail space, although their earlier comment around “forecast fall in sales per passenger should alleviate pressure on the current retail offer” is a little confusing as a reduction in sales per passenger is often caused as a result of there being insufficient space.

2.53 The Gatwick ACC noted that recent historical performance had been adversely impacted by the removal of space during construction works to improve the overall retail offer. They believed that recent revenue trends may therefore represent an unduly conservative point from which to develop projections for Q6.

*Steer Davies Gleave Analysis*

2.54 We continue to believe that the second busiest airport in the UK could support more retail space. However we recognise and understand the challenges of prioritising capital within the regulatory regime and do not propose any change to our recommendation that the development of further retail space (in addition to that planned and agreed with the airlines) be viewed as outside the “core” projections.

### Retail: Bookshops

*GAL Response*

2.55 Gatwick Airport stated that we had failed to grasp the threat to bookshop revenues, and that in their opinion our assumption for a flat real trend in Bookshop revenues per passenger through Q6 was unrealistic, with the underlying demand risk from technology changes being exacerbated by the fact that CPI is a driver for revenues rather than RPI.

2.56 Gatwick Airport have since told us that Bookshops revenue per passenger [✂], and that revenue per passenger [✂].

### *Airlines' Response*

2.57 Javelin commented that they believed that the impact on traditional products and sales channels from digital technology and ecommerce had been overstated, and instead pointed to opportunities from the introduction of new technological devices (that airport shoppers would wish to purchase) along with the shorter replacement cycles for such devices as new models emerge.

### *Steer Davies Gleave Analysis*

2.58 In the context of Gatwick the bookshops sector relates primarily to WH Smiths (WHS), who cover a general range of merchandise in addition to books. WHS created a Gatwick specific convenience retail brand "London News Company" which is now operating in both terminals with an additional outlet recently opened in Pier 2 to accommodate the increased passenger footfall.

2.59 We outlined in our April 2013 Final Report following an interview with WHS management how focused they are on making a success of this business despite the challenges they are facing. The WHS June 2013 Interim Trading Statement shows total sales for the group are running at minus 5% compared to last year and minus 6% like for like. In the same period the WHS Travel business has been flat when compared to 2012 and trading at -4% on a like for like basis, however gross margins have increased. The WHS outlook for the full year is "cautious about consumer spending but confident in the full year outcome". Their share price at the time of writing this report is around £7.70 compared with £5.50 12 months earlier, suggesting that shareholders support the management's direction and have confidence in their ability to deliver. We acknowledge that the share price has also benefited from the share buyback scheme and reliable dividends.

2.60 Specifically in the bookshop sector, Nielson book scan report recently reported that although book sales had declined over the past few years, in 2011 42% more books were sold in the UK than in 2001, excluding e-book sales. The Wall Street Journal recently reported that the annual growth rate of e-books slowed considerably last year with many commentators suggesting that the initial growth had been fuelled by the 'early adopters' and that e-books simply compliment traditional reading rather than acting as a substitute.

2.61 Gatwick Airport management have recently updated us with the specific Bookshops performance which for the 12 months to March 2013 was [✂] revenue per passenger year on year. [✂] the 3 months to June 2013 [✂], reflecting a movement towards the improvements we described in our Final Report.

2.62 2.62 We have made a minor adjustment to our forecast, primarily driven by changes in 2012/13 performance versus forecast, which now assumes a further small fall in revenue per passenger to £0.28 in 2013/14, remaining flat in real terms to the end of Q6.

## Retail: Catering

### *GAL Response*

2.63 Gatwick Airport did not agree with our assumption that space might be switched from Catering to Duty Free to create incremental revenues. They stated that such a move was not feasible and would not enhance the passenger experience.

*Airlines' Response*

2.64 Javelin did not comment on our Catering revenue projections but noted that the trade-off between (less profitable) catering space and (more profitable) airside retail space could be optimised through changes to the style of offer (e.g. more fast service options) and operational changes (e.g. introduction of new, faster, payment processes).

*Steer Davies Gleave Analysis*

2.65 Table 3.9 of our April 2013 Final Report sets out what we see as the mismatch in space between product categories. In our Final Report we proposed a 1% adjustment to the mix of space, reducing catering and increasing duty free by less than 300 $M^2$ from 2016/17.

2.66 From recent discussions with Gatwick Airport management it is clear that they do not agree with our proposal. However it also became clear that any exchange of space from catering in favour of duty free would be located on the mezzanine floor of both terminals, adjacent to the catering offer. We understand that the mezzanine floors, while penetrated by at least 50% of passengers, do not have the same penetration levels as those where the main duty free stores are located. While this space could therefore be considered as sub-optimal, it would benefit from passenger dwell time and the high proportion of leisure travellers who visit the catering areas before doing anything else.

2.67 Some of the potential downside to catering through the loss of space could be picked up through changing the product mix within catering, along the lines of the ideas suggested by Javelin.

2.68 We have considered the views put forward by Gatwick Airport and Javelin on this issue and on balance propose to reduce our forecast of the potential revenue stretch by 50%.

## Retail: Telecoms

*GAL Response*

2.69 Gatwick Airport disagreed with the concept that telecoms revenues could grow in line with passenger volumes.

*Steer Davies Gleave Analysis*

2.70 No further evidence has been offered by Gatwick Airport other than the point above.

2.71 Gatwick Airport's outturn revenues from telecoms were markedly lower in 2012/13. This was the result of accounting provisions made in relation to incomes owing from contracts previously held with BAA Group prior to Gatwick's separation. Gatwick Airport's Revised Business Plan forecast for telecoms assumes full recovery in 2013/14 of backdated income.

2.72 We did not specifically comment on Telecoms in our Final Report and think that the Revised Business Plan projections for this category are reasonable.

## Retail: Advertising

*GAL Response*

2.73 Gatwick Airport stated that their projections already indicate income per passenger growth of over 50% through Q6, so there was no evidence to support an assumed further increase above these levels during this period.

*Airlines' Response*

2.74 ACTM believed that there were additional areas at the airport that could be exploited for advertising income. ACTM also commented that inclusion of one of the 'top two' advertisers – Clear Channel or JC Decaux – could enable Gatwick Airport to benefit from the extension in the industry/client portfolio that they expect either of these companies would bring given their global reach.

*Steer Davies Gleave Analysis*

2.75 Although there is no agreement between Gatwick Airport management, Javelin and Steer Davies Gleave about the level of advertising revenue that could be generated at the airport, the size of financial difference between the respective viewpoints is not large.

2.76 In our April 2013 Final Report we proposed a £1.2m revenue uplift over Q6 phased in at £0.3m per annum from 2015/16.

2.77 ACTM had suggested involving some larger advertising specialists at the airport in order to extend the current industry/client portfolio. However, based on the current strategy and forecast for traditional advertising, it appears that Eye Corp is performing well and while competition is always an option, we do not believe that now is the right time to introduce another operator. However there may be good reason to involve a specialist agency in developing sponsorship revenues at this time as this can require different approaches to those of traditional advertising companies.

2.78 [✂].

2.79 While this, along with confirmation that the control tower is not available for such sponsorship, reduces the number of available assets for sponsorship we do not believe the projected level of advertising revenue stretch set out in our April 2013 Final Report to be onerous.

2.80 In summary we do not propose any changes to our Advertising forecast.

## Retail: One bag rule

*Airline Response*

2.81 Javelin commented that Gatwick Airport could highlight to non – Ryanair passengers that they had the opportunity to take one cabin bag and one bag of shopping on board an aircraft. Similarly shop and collect could alternatively provide passengers with the means to bypass this issue by collecting their shopping at Gatwick on their return.

*Steer Davies Gleave Analysis*

2.82 The Revised Business Plan assumed no changes to this and, while we believe there could be some upside from the development of "shop and collect" we have not revised our core forecast.

### Retail: e-commerce

*GAL Response*

2.83 Gatwick Airport stated that our assumption that e-commerce initiatives could generate up to £0.3 million per annum were not evidenced and ran contrary to recent discussions with the Wi-Fi provider at the airport to deliver a free service to users.

*Steer Davies Gleave Analysis*

2.84 Our forecast made no additional allowance for retail e-commerce initiatives.

### Revised Retail revenue forecasts

**2.85** We have updated our Retail revenue forecasts to reflect the analysis described above. These are presented on a per passenger basis in Table 2.1 along with our previous (April 2013) forecast and the Gatwick Airport Revised Business Plan projection.

**TABLE 2.1 REVISED Q6 NET RETAIL REVENUE FORECASTS (£ PER PASSENGER, 2011/12 PRICES)**

| | Q5 | | Q6 | | | | |
|---|---|---|---|---|---|---|---|
| **Year** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** | **2017/18** | **2018/19** |
| Steer Davies Gleave (April 2013) | 3.48 | 3.56 | 3.68 | 3.52 | 3.69 | 3.68 | 3.82 |
| Steer Davies Gleave (August 2013) | 3.45 | 3.56 | 3.68 | 3.51 | 3.68 | 3.67 | 3.82 |
| Gatwick Airport Revised Business Plan | 3.48 | 3.56 | 3.61 | 3.35 | 3.51 | 3.49 | 3.62 |

*Sources: Gatwick Airport (Revised Business Plan) and* Steer *Davies Gleave analysis*

### Car Parking

*GAL Response*

2.86 Gatwick Airport disagreed with our car parking revenue projections, citing the following key issues in particular:

- They did not agree with our view that long stay pricing was potentially not being optimised.
- They perceived a risk of continued decline in roll-up long stay traffic, whereas our projections assume upside opportunity from this segment from increasing roll up prices (rates at Gatwick are presently low compared to those at other key UK airports).

- They disagreed with the quantum of revenue assumed by Steer Davies Gleave as being potentially achievable from better enforcement of the no pick-up rule on the forecourts.
- They disagreed with the quantum of revenue assumed as being achievable through licence agreement charges to official 'meet and greet' operators. Gatwick Airport has assumed revenue of £0.2 million per annum versus our assumption of up to £1.2 million per annum.
- They also disagreed with the assumption that forecourt charging is in the passenger interest (and could therefore be introduced).

***Airlines' Response***

2.87 ACTM broadly agreed with most of the statements made by Steer Davies Gleave in our Final Report, but felt that Gatwick Airport could improve their short term Yield Management techniques without compromising average revenue per space such as offering last minute weekend deals during off peak.

2.88 ACTM also believed Gatwick Airport could gain a better understanding of the Gatwick parking customer through additional research.

2.89 ACTM commented that Gatwick should focus on more cross selling with third parties and further product differentiation (for example as at Privium Parking at Amsterdam Schiphol). ACTM suggested that Schiphol could provide a useful benchmarking of car parking opportunity.

2.90 However ACTM disagreed with Steer Davies Gleave on both the quantum and trend in car parking revenues per passenger expected for Q6, commenting that they expected revenue per passenger to remain close to £1.09 through Q6.

2.91 The differences in car parking revenue per passenger expectations for Q6 are summarised in Table 2.2.

**TABLE 2.2 COMPARISON OF CAR PARKING REVENUE PER PASSENGER FORECASTS (£ PER PASSENGER, 2011/12 PRICES)**

| | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|
| Gatwick Airport Revised Business Plan | 1.03 | 0.99 | 0.95 | 0.92 | 0.92 |
| Steer Davies Gleave (April 2013) | 1.09 | 1.06 | 1.02 | 1.00 | 1.00 |
| ACTM | 1.09 | 1.09 | 1.09 | 1.09 | 1.09 |

*Sources: Gatwick Airport Revised Business Plan, Steer Davies Gleave (April 2013 Final Report), Gatwick ACC*

***Steer Davies Gleave Analysis***

2.92 Given the range of issues debated by stakeholders we have presented our analysis under the following headings:

- Pre-book Long Stay parking;
- Decline in Long Stay roll up traffic;
- Enforcement of Pick Up into the Short Stay car parks;
- Off-airport Operator Licensing Scheme;
- Forecourt drop off charges;
- E-commerce initiatives; and
- Benchmarks.

*Pre - book Long Stay parking*

2.93 In its response to the CAA Gatwick Airport stated that Steer Davis Gleave had used over-simplistic single point benchmarking to suggest the airport was under-pricing long stay car parks during the peaks. Gatwick Airport claims to issue over 50,000 price points each day and as stated in its response to the CAA believes that decisions on whether to raise prices or not is a matter of judgement.

2.94 Although we have not had access to Gatwick's booking and Yield Management system, sample test bookings comparing products and pricing with those offered by Gatwick and key consolidators have been used below in addition to Steer Davies Gleave's own judgement and understanding of the local market in proposing opportunities to maximise pre-book income.

2.95 The findings show Gatwick to be price comparable with off Airport products and in some instances cheaper than off airport. Considering Gatwick's advantage of location, quicker transfer times and wider product range it is expected in peak times that Gatwick Airport could leverage more value from its parking portfolio particularly as key competing operators will also be space constrained at this time.

2.96 Gatwick Airport have recently told us that they do not raise/reduce price for their own sake but only where it optimises revenue. In our opinion yield management can be complex and a level of judgement applies, however it would seem Gatwick Airport may be missing revenue opportunities if the main off airport competition are confident enough to raise prices to Gatwick Airport's levels, or in some instances exceed Gatwick peak prices as shown below.

2.97 A sample test booking for the period 4th - 11th August conducted 10 days out from arrival at the car parks corroborated some of our earlier findings and showed that:

- APH, Airparks (two long established key competitors) for their Meet and Greet products are priced higher than Gatwick's Valet product by some £2.46 and £10.50 respectively for this peak week.
- Maple Manor, also offering Meet and Greet, are £7.60 cheaper for this period than Gatwick.
- Only two off airport Meet and Greet operators offered for sale by the main consolidators are substantially cheaper by some £20 for the week than Gatwick's Valet and Short Stay pre-book products.
- Gatwick Airport maintained in their response to the CAA's Initial Proposals that Gatwick's own Valet parking product is normally £3-5 higher than the key competitors Airparks and Maple Manor. As can be seen from the example above both Airparks and APH are higher for this peak week than Gatwick Airport.
- Gatwick Airport's Short Stay pre-book product is on offer some £3.29 cheaper than Valet for the week, with the key off Airport operators APH and Airparks offering Meet and Greet at higher price points.
- With respect to Long Stay parking at South Terminal, Gatwick is on offer for £74.03 with Airparks at £73.99 and APH at £69.92.

2.98 We have repeated this exercise for weekly periods commencing 31st August and also 5th September. The results, which we have shared with the CAA, provide a similar pattern to those presented above.

2.99 In our Final Report we assumed that 50% of the £2.9m income uplift over Q6 in our impact analysis could be derived from increasing prices during peak weeks, with the remainder of the income benefit coming from driving volume of pre-book parking products with greater marketing support during off peak weeks (with an increase in costs assumed).

2.100 Since publication of our Final Report we understand from both published trading figures and also from Gatwick Airport management that car parking revenue performance has improved from a combination of:

- Greater collaboration with consolidators (allowing them to sell both Valet and Short Stay pre-book).
- The increase in Valet capacity at North and South Terminals.
- The sale of a new pre-booked product – Park and Stay, Premier Inn.
- Aggressively pricing pre-book Short Stay particularly during winter months.

2.101 It should be noted that Steer Davies Gleave recommended in the Final Report (paragraph 4.38) that Gatwick Airport could work more collaboratively with its key consolidators. For example MAG at Manchester Airport has a policy for wide distribution of its parking products contributing to a higher spend per passenger (£2.16) than Gatwick.

2.102 In summary, based on the analysis above, we remain convinced that there are opportunities to increase prices at Gatwick for pre-booking in peak periods.

*Decline in Long Stay Roll -Up Traffic*

2.103 In its response to the CAA's Initial Proposals Gatwick Airport disagreed with Steer Davies Gleave's assertion that Long Stay roll up prices could be increased. The data Gatwick provided showed that the roll –up decline as a percentage of revenue appearing to be levelling off between 2011 and 2012 and although still expected to continue to decline it would be largely in the longer stay 4 day and over market where the switch to pre-book will continue.

2.104 It was assumed in our Final Report that an increase in the current roll-up rate of £13 per day could be achieved as it is in the main used by less price sensitive customers and in particular is used by Business users as an alternative to the Short Stay product of £35 per day or £55 for 2 days.

2.105 Comparative daily roll up rates at other leading UK airports are currently as follows:

- £16 Stansted.
- £22 Heathrow.
- £25 Birmingham.
- £28 Manchester.

2.106 Interestingly at Manchester Airport "Turn Up and Park" is presented on their web site as a discreet product highlighting the convenience factor of just turning up, recognising there is a market for this customer sector too.

2.107 In a response provided to us by Gatwick Airport in February 2013 in relation to our questions about long stay price increases airport management told us that they will be looking at the roll up price point for the 1-3 day length of stay market and reviewing prices in the context of a) short stay roll up prices, b) long stay pre-book prices and c) off airport long stay pre-book prices.

2.108 This review of roll up pricing has not yet taken place but in our opinion there are clearly opportunities to balance the roll up rates across the parking portfolio to grow revenues in this sector. For example at Edinburgh Airport (which is also owned by GIP) there is a higher price point in Long Stay for 1-3 days roll up of £15 and 4 days or more is £12.

2.109 Gatwick Airport have recently told us that the trend for decline in Long Stay continues. This is understood, however we argue that the additional £100k revenue per annum Steer Davies Gleave we have attributed to Long Stay roll up can be delivered from restructuring the roll up tariffs as described above i.e. by increasing rates for 1-3 day stays.

2.110 Based on our assessment of the latest evidence we continue to believe an increase in price for long stay roll up is achievable and our forecast for this item remains unchanged.

*Enforcement of Pick Up into the Short Stay Car Parks*

2.111 Gatwick Airport's website advises "London Gatwick has always offered customers the ability to be dropped off on the forecourt free of charge. We would advise all pick up or meeting of passengers is carried out from the short stay car park".

2.112 Enforcement of "no waiting" commenced in July 2013 and is carried out by traffic wardens supplemented by APCOA Marshalls. Our observation of the new arrangements has highlighted inadequate signage on approach to car parks and forecourts and leaflets are being handed to those customers who are accessing the forecourt either in error or evading the new rules which clearly state "Gatwick Airport will now be strictly enforcing the policy of drop off only on its forecourts. We believe that a more robust approach by Gatwick Airport could be adopted, in particular directed at repeat commercial offenders such as mini-cabs and unlicensed off airport meet and greet operators who we expect would pass the car park charge onto the customer anyway.

2.113 In the immediate term consideration could be given to improving the current 'no pick up' enforcement regime on the terminal forecourts with additional advance electronic and road applied signage from roundabout (at both Terminals) on approach to the car parks/forecourts to ensure pick up traffic is safely directed into the car parks. In the longer term we consider that Gatwick could consider either a controlled system for the forecourts (allowing a short grace period if deemed necessary) using ANPR (as used at Luton Airport) or some other cash tolling/electronic toll collection system if more appropriate, or integrate drop off and pick up into the short stay car parks (which would result in some reconfiguration at ground floor level and to entry and exit plazas). This has however been achieved at Edinburgh and Stansted Airports effectively and a grace period or discount system for regular users can be applied if required, coupled with the option for free drop off/pick up in the long stay car park.

2.114 Gatwick Airport's indication when we met them in July 2013 of likely revenue this year from the enforcement of pick up into the short stay car parks was in the region of £400k as opposed to the £800k per annum we assumed in our Final Report for the Q6 period. This was based on three weeks of operation and given to us as a verbal estimate.

2.115 They have subsequently informed us of a revised expectation for Pick Up revenue of £100k for the year, with enforcement costs of £360k per annum, giving a net negative financial impact of £260k over the year. This assessment is based on Short Stay roll up revenue in July. They have commented that even with increased marshalling costs off-airport approved operators are complaining the scheme is under-resourced with regard to enforcement.

2.116 Our observations highlight the requirement for Gatwick Airport to consider a more robust approach to these issues in the early months of the scheme including if required, physical changes to the forecourts to reduce operating costs.

2.117 We have reviewed our forecasts using the following assumptions:

- Two passengers per car factor (Gatwick Airport assume 2.5 passengers per car but based on our experience of the market we believe this may be an overstatement).
- The new £3 (£2.83 in 2011/12 prices) charge for up to 30 minutes.
- Successful enforcement assumed (70%).

2.118 This results in a modification to our income forecast for this item of about -1%. Our revised revenue forecast over Q6 is now £3.8m (based on Gatwick Airport's traffic forecast). Throughout the year this would equate to about 95 additional cars per hour (if it is assumed this volume is concentrated in 8 peak hours per day).

2.119 We have assumed that Gatwick Airport would not have introduced this initiative if the short stay parks were not capable of handling this additional volume of traffic.

*Off Airport Operator Licensing Scheme*

2.120 The Off Airport Licensing scheme was introduced from 1 July 2013 and is distinct from the enforcement activities described above.

2.121 Based on three weeks of data Gatwick Airport believes that the scheme will provide incremental revenue of £300k per annum and a maximum of 15 operators will be licensed out of potentially up to 50 operators. These include some operators with bussing services already licensed.

2.122 Gatwick Airport believes that our forecasts are too optimistic and has provided calculations to support their argument in their response to the CAA's Initial Proposals. At the time of compiling our Final Report we were told by Gatwick Airport that they had not included licensing fees in their Business Plan and could therefore not provide us with the charging criteria.

2.123 Having assessed Gatwick Airport's calculations in support of their 2018/19 estimates of income, our view is that the key fifteen operators will predominantly choose the forecourt rather than the short stay car parks at the higher transaction fee of £6. If only fifteen are able to be licensed (due to meeting the criteria Gatwick and Trading Standards have applied to the scheme) we have assumed that the remaining unlicensed operators will still choose to operate their business from the car park passing costs onto the customer, so in both instances Gatwick Airport will receive incremental revenue.

2.124 Gatwick Airport will be obliged to continue to enforce pick up activity into the car parks in order to justify the licensing scheme and the investment the off airport operators have made in complying with the licence criteria.

2.125 Based on the evidence now available we have revised our forecast of revenue from off airport licencing, assuming an initial period to establish the protocol and enforcement regime. Our key assumptions are:

- 1.4% of the total passengers at Gatwick use off airport meet and greet.
- Average of 2 passengers per car.

- Success of the scheme: 50% of off airport operators meeting the licensing criteria will be licensed in 2013/14, increasing to 100% by the end of Q6.
- Current licence fee charges implemented by Gatwick Airport of £6 (£5.66 in 2011/12 prices) for forecourt use and £3 (£2.83 in 2011/12 prices) for car park use remain flat in real terms through Q6.
- 70% select the designated forecourt option and 30% the designated areas within the short stay car parks.

2.126 The effect of these changes is to reduce our original forecast for this item by about 4% or circa £200k.

*Forecourt drop off charges*

2.127 The sum of £6m per annum in respect of forecourt charging has not been included in the "core" forecast set out in our Final Report.

2.128 Gatwick Airport maintains that at the present time it is their strategy to continue to offer free drop-off on the forecourt. This is for customer service reasons and they believe it is not evident that charging for forecourt access would be feasible given space constraints.

2.129 The ACC although not advocating the introduction of forecourt charging agreed with Steer Davies Gleave that there is potential for Gatwick Airport to generate new revenues from drop-off charges.

2.130 Having considered the respective responses we do not propose that forecourt drop off charges are added to our "core" forecasts.

*E-commerce initiatives*

2.131 In our Final Report the assumption that car park related e-commerce equivalent can be developed to 0.5% of parking revenues is based on comparison to other airports which offer additional service related products such as lounges, security, car wash, insurance and bureaux de change.

2.132 We recognise that Gatwick Airport currently has challenges issues with its Wi-Fi proposition, as described to us by airport management. Notwithstanding this we still believe that e-commerce income driven by pre-book parking is achievable and propose no change to this part of our forecast.

*Benchmarks*

2.133 We have given further consideration to ACTM's suggestion of Amsterdam Schiphol as a benchmark. Given the range of airports provided in Gatwick Airport's own benchmarking report (produced by AT Kearney and described later in this report) we believe that it is reasonable to consider whether the parking performance and approach at Amsterdam has lessons that could be relevant to Gatwick.

2.134 The 2012 annual report and accounts for Amsterdam Schiphol show that the airport earned revenues of circa €3.3 per departing passenger (equivalent to about 17% higher than Gatwick).

2.135 One of the factors contributing to the increase in parking revenue at Schiphol in 2012 was the introduction of Short Stop parking zone for fast meet and greet where after an initial grace period there is a charge of €2 per 13 minutes compared to €1 per 13 minutes in their standard short stay product, Short Stay Visitor parking.

2.136 We have also reviewed publicly available car parking revenue data from MAG, whose Manchester Airport provides, in our opinion, a relevant UK-based comparator to Gatwick given its size and traffic characteristics.

2.137 In 2011/12 MAG's airports earned £2.17 per two way passenger from car parking operations. Although data is not provided for individual airports, Manchester Airport accounts for over 75% of MAG's total revenues, and it is reasonable to assume that parking revenue per passenger at the airport is likely to be close to the MAG average.

2.138 Both Amsterdam and MAG provide examples of medium to large sized airports with significant car parking estates that operate in a competitive market. Both airports deliver substantially higher parking revenues per passenger from these operations than is earned by Gatwick.

2.139 While the current level of car parking revenues per passenger at Gatwick reflects the nature of the local market and its competitive context, we now believe that the examples from Amsterdam and MAG provide evidence in favour of a higher revenue per passenger projection for car parking than provided in the Final Report.

*Revenue per Space*

2.140 Increases in car parking revenues relative to those we previously proposed would be consistent with higher revenues per space.

2.141 Table 2.3 sets out Gatwick Airport's Revised Business Plan's total net car parking revenues divided by total spaces (of which we understand there are likely to be approximately 34,000, of all product types, during Q6). It shows revenue per car parking space declining from 2014/15 to 2017/18.

**TABLE 2.3 GATWICK AIRPORT Q6 REVENUE PER SPACE**

| Indicator | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|---|
| Car Parking Revenue (£m, 2011/12 prices) | 36.1 | 35.4 | 34.2 | 33.3 | 32.6 | 33.0 |
| Revenue per space (£, 2011/12 prices) | 1,061 | 1,041 | 1,007 | 978 | 960 | 972 |
| YoY% change | -5% | -2% | -3% | -3% | -2% | 1% |

*Sources: Gatwick Airport (Revised Business Plan) and Steer Davies Gleave analysis*

2.142 For a historical comparison, we understand that at the end of 2010/2011 Gatwick had circa 32,600 spaces, generating net revenue of about £1,128 per space (in 2011/12 prices).

2.143 We understand it is Gatwick Airport's intention to maximise the use of existing car park space over this period and to manage the peak periods with contingency "overflow" space. We would therefore not expect revenue per space to decline at this rate. In our opinion any additional passenger demand over this period will mostly need to be met on airport as there is no hard evidence to suggest there will be a proliferation of legitimate off airport space to adequately service additional demand.

2.144 There are underlying trends including continued switch to pre book and declining length of stay impacting on the parking category that may make it difficult to increase revenue per space. However we expect that the revenue per space could be largely protected by either raising prices or accommodating additional parking customers by block parking in part of the long stay car parks as was common practice a few years ago on airport and is customary off airport.

### Revised Car Parking revenue forecasts

2.145 We have revised our car parking revenue per passenger forecasts to reflect the analysis described above. The updated results are presented in

2.146 Table 2.4 along with our previous (April 2013) forecast and the Gatwick Airport Revised Business Plan projection.

**TABLE 2.4 REVISED Q6 CAR PARKING REVENUE FORECASTS (£ PER PASSENGER, 2011/12 PRICES)**

| | Q5 | | Q6 | | | | |
|---|---|---|---|---|---|---|---|
| **Year** | **2012/13** | **2013/14** | **2014/15** | **2015/16** | **2016/17** | **2017/18** | **2018/19** |
| Steer Davies Gleave (April 2013) | 1.11 | 1.08 | 1.09 | 1.06 | 1.02 | 1.00 | 1.00 |
| Steer Davies Gleave (August 2013) | 1.17 | 1.11 | 1.13 | 1.10 | 1.07 | 1.04 | 1.04 |
| Gatwick Airport Revised Business Plan | 1.11 | 1.06 | 1.03 | 0.99 | 0.95 | 0.92 | 0.92 |

*Sources: Gatwick Airport (Revised Business Plan) and Steer Davies Gleave analysis*

### Property

#### *GAL Response*

2.147 Gatwick Airport does not agree with the CAA's Property projections and advocates that its Revised Business Plan projections are reasonable. Their view is that to maintain the status quo in Q6 will be a sufficient challenge, in ensuring that no new voidage occurs, and that to expect any increases over the revenues forecast in the Revised Business Plan is unachievable.

2.148 Gatwick Airport's case draws on the following key concepts:

- The UK macroeconomic position and the state of the national property market.
- Airline mix changes at Gatwick (reducing the demand for accommodation).
- Local planning restrictions on the letting of space at the airport for non-aviation related purposes.

- Competition from property units in Crawley.

2.149 Specific points raised by Gatwick Airport include the following:

- The airline mix has continued to favour the low cost carriers. As a general principle, these carriers' demand for property space is considerably lower than that of a full service carrier. Airport management also told us that carriers such as British Airways are embracing technology changes in the pursuit of lower operating costs at airports, and this too is impacting on their demand for accommodation at Gatwick.
- They believe that Concorde House will be void for the entirety of Q6.
- They do not believe that any new space will be let during Q6 within the ramp accommodation sector and again assert that to maintain current levels of occupancy and achieve the level of revenues projected in the Revised Business Plan will be a sufficient challenge.
- They believe that the loss of Pier 1 ramp accommodation will give a net reduction in space of 3,500 sq. ft., and also argued that we had misunderstood the reference to Pier 5 refurbishment.
- They also stated that it is unlikely that the new hotel operators will reach the threshold to trigger a turnover related payment within Q6.
- Finally Gatwick Airport expressed concern that we had converted the property income to a per passenger basis in our Final Report, arguing that Property revenues are not driven by passenger demand.

***Airlines' Response***

2.150 Some of the Gatwick airlines provided input to Steer Davies Gleave before we reported to the CAA. The Gatwick ACC broadly supports the CAA's Property projections and has offered no further comment. We understand that Property was not within the scope of the ACC's consultants.

***Steer Davies Gleave Analysis***

2.151 For its Initial Proposals the CAA adopted Steer Davies Gleave's proposals in full regarding Property which were based on a combination of further income from re-letting of office and ramp voids, ad-hoc contractors' accommodation, plus additional turnover-related income from hotels.

2.152 We address Gatwick Airport's comments below.

2.153 **National property market:** This has shown some improvement in specific pockets especially relating to offices, however overall there has been very little rental growth in the past 18 months to the south of the M25. Nevertheless this performance has coincided with the generally weak UK economy, and may not necessarily be a strong indicator of trends in Q6 if, as predicted by many commentators, the economy reverts to a steady growth path.

2.154 **Aviation related user restriction:** We understand the limitations these restrictions impose. However we are aware from earlier discussions with airport management that Gatwick is already vigorously pursuing opportunities to have this restriction lifted as soon as possible.

2.155 **Office accommodation**: We maintain that Concorde House is unlikely to remain void for the entirety of Q6 assuming the building is made available for occupation:

- Gatwick Airport's Revised Business Plan commentary for Property in Q6 states "The crew reporting move to Atlantic House has also required extensive decanting from Atlantic House, and will leave Concorde House void from Jan 2013, whereupon it will be re-let to commercial tenants." Gatwick Airport's Initial Business Plan commentary also stated that allowance had been made for "major reinvestment in Concorde House".
- We are aware that Gatwick Airport has found alternative uses for the former office premises Norfolk House and Longbridge House, both of which are being reincarnated as hotels, which has substantially reduced the amount of office premises available at Gatwick. We do not concur with Gatwick Airport's view that Concorde House, which is a significant asset, will simply be left unoccupied throughout Q6.
- In the absence of an alternative use proposal, it is entirely reasonable to assume that the building will be re-let in some form at some point during Q6. In our discussions with airport management, during the preparation of our Final Report, it was suggested to us that an alternative use for Concorde House was being sought. As a consequence we believe that an income stream should be attributed to the building during the Q6 period. In our projection we have allowed for a period for refurbishment prior to a phased re-occupation.
- With Gatwick Airport stating that no new office accommodation will be built until the early 2020's, and with reduced availability of offices through the loss of both Norfolk House and Longbridge House, we believe that Concorde House can take up any latent demand following its planned refurbishment in 2014.
- We assess that re-letting Concorde House may take some time and now believe that it would be reasonable to assume a 12 month void period following completion of refurbishment, with phased occupation starting in 2016/17.
- At a more macro level the office market in the South East is strengthening slightly according to recent reports by Colliers, Knight Frank and CBRE. These all predict a modest, albeit patchy, growth in rents south of the M25 early in Q6, whilst independent property forecasts from CBRE indicate the office market in the South East improving more strongly from 2015.
- In view of the latest independent property forecasts, the current economic climate, and the largely stagnant local property market, we have revised our forecast for the re-letting of Concorde House to a more modest assumption of phased occupation of 25% in 2016/17, 50% in 2017/18 and 75% in 2018/19.

2.156 **Ramp Accommodation:** While we acknowledge that airline moves and consolidations in Q5 led to a reduction in occupancy levels in the ramp, these have largely been completed. Take up of space in the Segro owned units in the cargo area for general ramp purposes for example, suggests that demand exists for accommodation at a competitive price.

2.157 Our assessment of the rental prospects for ramp accommodation has been informed by data provided to us by Gatwick Airport. At the end of 2010/11 and 2011/12 the void % was 21% and 18% respectively. Table 2.5 shows the projected void % levels along with the outturn for 2012/13:

**TABLE 2.5 GATWICK AIRPORT VOID RAMP ACCOMMODATION**

| Year | Total Sq. Ft. | Voids % | Comments |
|---|---|---|---|
| 2012/13 | 75,996 | 15.7 | |
| 2013/14 | [✂] | [✂] | |
| 2014/15 | [✂] | [✂] | [✂] |
| 2015/16 | [✂] | [✂] | |
| 2016/17 | [✂] | [✂] | |
| 2017/18 | [✂] | [✂] | [✂] |
| 2018/19 | [✂] | [✂] | |

*Source: Gatwick Airport Limited "Voids and Total sq. ft."*

2.158 The data suggests that the amount of ramp space available will be increased in 2014/15 over that currently available, a move which Gatwick Airport will presumably make in order to secure a commercial return.

2.159 From Gatwick Airport's statements, it would appear that they are expecting to increase passenger numbers and provide new ramp space in Pier 6 with no new uptake of that space, but only a reallocation from existing occupations. We think such high void levels for this space seem unlikely even in the current market, and, as stated and confirmed by our discussions with airlines earlier in the year, space is being taken elsewhere, albeit at lower rents, to fulfil the demand that there is. This may indicate that revision of rental charges for this accommodation by Gatwick Airport could enable it to reduce its voids, increase property income and reduce its rates liability.

2.160 **Contractors Accommodation:** [✂]. However in our view for Gatwick Airport to assume that there will be no additional income derived from the letting of contractor's accommodation, given the capital programme that the airport wishes to pursue, seems inconsistent. We have assumed a modest [✂], i.e. £100k per annum, as an annual amount going forward, will be replaced by other lettings.

2.161 Our findings on ramp and contractors accommodation are consistent with those supporting our forecasts in the Final Report and we therefore propose no change in these areas.

2.162 **Hotels:** Gatwick Airport has stated that it is unlikely that the new hotel operators will reach the threshold to trigger a turnover related payment within Q6. We believe that this assumption is unduly pessimistic especially given the apparent success of the recently opened Premier Inn at North Terminal.

- The number of actual on-airport hotels, as opposed to those located close to Gatwick but requiring a shuttle bus, is very limited giving these two new hotels a significant advantage.
- Furthermore, the new hotels provide a different product offer to those hotels already on site.
- The CAA has raised passenger forecasts for Q6 above those proposed by Gatwick in its FBP. This, in turn, should increase the potential demand for hotel accommodation and make it more likely that the two new hotels will achieve income levels greater than the guaranteed minimum rent.
- [✂] respectively, we anticipate that the turnover payments for each of these hotels will be realised earlier in Q6 than previously forecast.

2.163 Where we have expressed property revenue in per passenger terms this has been provided on a comparative basis relative to the other commercial revenues lines. We acknowledge that property income is not in its totality driven solely by passenger numbers. However we do believe that parts of the sector (e.g. hotels) have a direct link to traffic, and there are also less direct (but still important) linkages to traffic for the other sectors.

2.164 Taking into account all of the information now available we consider it reasonable to make a small downwards adjustment to the property revenue forecasts provided in our Final Report. The changes still result in an increase to property revenues versus Gatwick Airport's Revised Business Plan, albeit that the composition of the revenues has been amended to reflect the currently stagnant office market offset by improved hotel turnover forecasts.

- For Concorde House, Gatwick Airport acknowledges in earlier reports that efforts will be made to re-let this building. A 2 year void for refurbishment and re-letting and a phased re-occupation seems an appropriate assumption to maintain.
- For ramp accommodation, Gatwick Airport's pricing policy should be addressed to ensure that it does not continue to lose tenants to the adjoining property estate, which will help to address the voids.
- For contractors' accommodation, we believe there is scope to let further areas of otherwise vacant space as Gatwick Airport has already successfully demonstrated that it is able to do.
- For hotels, we believe that the new on-airport hotels fill a gap in the existing market and it is reasonable to expect that they will attract sufficient demand within Q6 such that the threshold for a turnover related element will be triggered ahead of the original forecast.

### Revised Property revenue forecasts

2.165 We have made minor revisions to our property forecasts to reflect the analysis described above. For ease of comparison these are presented on a per passenger basis in Table 2.6 along with our previous (April 2013) forecast and the Gatwick Airport Revised Business Plan projection.

**TABLE 2.6 REVISED Q6 PROPERTY REVENUE FORECASTS (£ PER PASSENGER, 2011/12 PRICES)**

| | Q5 | | Q6 | | | | |
|---|---|---|---|---|---|---|---|
| Year | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
| Steer Davies Gleave (April 2013) | 0.77 | 0.68 | 0.68 | 0.67 | 0.69 | 0.76 | 0.75 |
| Steer Davies Gleave (August 2013) | 0.73 | 0.68 | 0.68 | 0.67 | 0.69 | 0.75 | 0.75 |
| Gatwick Airport Revised Business Plan | 0.77 | 0.68 | 0.67 | 0.66 | 0.66 | 0.71 | 0.69 |

*Sources: Gatwick Airport (Revised Business Plan) and Steer Davies Gleave analysis*

### Other Issues: Macroeconomic conditions

*GAL Response*

2.166 In their response to the CAA' s Initial Proposals Gatwick Airport commented that performance in the travel retail sector is closely correlated to external economic factors and market retail conditions, although slightly more resilient than high street retail.

2.167 Gatwick Airport's response provides a number of economic and consumer confidence survey statistics which together paint a scenario of weak current activity. The "downbeat" nature of Gatwick Airport's view of travel retail was also repeated by management in a recent meeting we had with them to discuss their feedback to our forecasts.

*Airlines' Response*

2.168 In contrast to position set out by Gatwick Airport, Javelin believed that a triple dip recession was unlikely and that this provided underlying confidence in the opportunity to grow sales through Q6.

2.169 Javelin believed that Q5 alone represented a conservative backdrop on which to base an assessment of prospects for Q6, and questioned whether a longer historical period might provide a better base for the revenue forecasts.

2.170 They also commented that they now saw less potential downsides in the economy. They restated their Retail and Advertising revenue per passenger forecasts in 2011/12 prices, advocating growth from £3.92 per passenger (2014/15) to £4.02 in 2018/19. For comparison the equivalent projections in our Final Report were £3.68 (2014/15) and £3.82 (2018/19).

*Steer Davies Gleave Analysis*

2.171 In reviewing the data and views on travel retail provided by Gatwick Airport it is noteworthy that these all relate to the current and recent historic position rather than Q6 itself. Indeed, all of the market performance data presented on page 66 of their response to the CAA's Initial Proposals refers to performance in 2013 only.

2.172 In our opinion it is important that an assessment of commercial performance in Q6 is not unduly influenced by negative sentiment reflecting the weak economic conditions that the UK experienced in 2012 and the patchy performance to date in 2013 (albeit very recent media statements such as those from the Bank of England point to a more positive outlook). Instead the assessment should reflect valid and independent forecasts of key activity indicators for the Q6 period, especially as Gatwick Airport themselves have stated the important of such external economic indicators.

2.173 Table 2.7 presents the April 2013 IMF GDP forecasts for the UK and Eurozone, along with the March 2013 OBR forecast for UK GDP. These represent two of the leading macroeconomic indicators referred to in Gatwick Airport's response.

**TABLE 2.7 KEY ECONOMIC INDICATORS**

| Year | UK GDP (IMF) | UK GDP (OBR) | Eurozone GDP |
|---|---|---|---|
| 2012 | 0.2% | 0.2% | -0.5% |
| 2013 | 0.7% | 0.6% | -0.3% |
| 2014 | 1.5% | 1.8% | 1.1% |
| 2015 | 1.8% | 2.3% | 1.4% |
| 2016 | 1.9% | 2.7% | 1.6% |
| 2017 | 2.1% | 2.8% | 1.6% |
| 2018 | 2.5% | N/A | 1.6% |

*Sources: Office for Budget Responsibility Economic and Fiscal Outlook(March 2013), IMF World Economic Outlook (April 2013)*

2.174 While the recent weak economic performance cannot be disputed, it can be seen from the IMF figures that expectations for the Q6 period mark a very different trend, with UK and Eurozone GDP growth anticipated to average 2.1% and 1.6% per annum respectively during the 2014-2018 period according to the IMF.

2.175 The OBR projections for UK GDP indicate growth averaging 2.4% during 2013-2017.

2.176 Our review of Gatwick Airport's projections has focused on the individual product areas and in particular on specific issues, such as the impact of the TDA, which can be readily isolated and quantified than considerations of macro level effects. However we believe that the arguments put forward by Javelin about the potential strength of the economy in Q6 have merit and are potentially more relevant than the view set out by Gatwick Airport which appears to focus primarily on the recent historical period plus prospects for the rest of 2013 (only).

2.177 As with any set of projections it is likely that there will be over - and under-forecasts through Q6 at the individual product category level. However in aggregate our updated forecasts provide a higher set of revenue per passenger projections than before which we assess now more closely reflect the likely macroeconomic and market conditions through Q6.

### Other Issues: Commercial Revenues Benchmarking

#### *GAL Response*

2.178 In their response to the CAA's Initial Proposals Gatwick Airport presented the results of a benchmarking study by AT Kearney ('Global Competitive Benchmarking for Airports') in support of their projections.

2.179 Gatwick Airport told us that they view the benchmarking as authoritative and noted that it showed that the airport was close to the high end of the benchmarks in terms of commercial revenues per passenger.

#### *Steer Davies Gleave Analysis*

2.180 The report provides some interesting findings but we do not agree that it necessarily provides justification for the quantum of revenues provided in the Revised Business Plan (i.e. that there may not be further upside). Our rationale is as follows:

- The report appears to be essentially an airport cost benchmarking study with limited coverage of commercial revenues.
- Earlier in the process Gatwick Airport indicated to us that they felt our choice of benchmark airports was incorrect and that we should use comparators from second airports serving major European population centres. To our knowledge Gatwick is by far the largest such airport of this type in Europe and in our view this comparison could be distorted by questions of comparative airport scale.
- Our comments on the AT Kearney comparators are as follows:
  - The panel is based on 32 European and Asian benchmark airports. They are not listed by name but it is interesting that it includes a sample of Asian airports when Gatwick Airport had earlier informed us that they felt benchmarks based on their nearest neighbour, Heathrow, were inappropriate. Although Gatwick has now been in GIP ownership for several years, much of the structure of its commercial activities retains echoes of that inherited from BAA (e.g. there is some commonality in the mix of concessionaires) and we continue to believe that Heathrow provides a reasonable comparator (while not necessarily being the one 'key' comparator).
  - Without the list of airports it is not possible to gauge the relative 'commerciality' of the respective peers and the extent to which they aspire or are motivated to grow their commercial revenues. Regarding GIP ownership we anticipate that Gatwick is likely to be at the more 'commercial' end of the spectrum, reflecting the likely investment return requirements of its owners.

- Commercial revenue per passenger is a function of many factors including traffic mix, passenger profile, airport environment, and airport efficiency. Without the list of airports we do not know the extent of the risk that the sample is biased towards a particular type of airport.
- Based on airport size it can be seen that Gatwick is towards the top end of the peer group. The panel includes a 50 mppa airport (which we assume is either Frankfurt or Madrid based on considering the aircraft movement range as well), either of which is a leading hub airport, with strong connecting traffic flows, and therefore not necessarily a strong comparator to Gatwick. The bottom end of the spectrum is an airport with 5 mppa.
- The proportion of connecting passengers shown for Gatwick is at the low end of the spectrum. In contrast Gatwick has the highest share of LCC passengers, in a range which measures from 3% to 49%.
- Gatwick is towards the top end of the range in terms of non-aviation revenues (€8/passenger) but it is noteworthy that this is still 20% below the highest value in the panel (€10/passenger). Even if there was no growth in revenue per passenger at the highest rated airport this suggests that it would be a number of years before Gatwick, assuming Steer Davies Gleave's trajectory of anticipated revenue growth, attained top position in the ranking. We note that Gatwick's ranking in the AT Kearney set is broadly similar to that in the LeighFisher's '2011 Airport Performance Indicators' benchmarking report which shows that Gatwick's non-aeronautical revenues per passenger are about 17% higher than average.
- This point also reflects a wider issue with the interpretation of benchmarks in that there can be a natural bias towards assuming that performance will tend towards the middle of a range, close to the average, when in contrast the targets of the private owners of airports may demand a higher level of performance than this. The data set does not tell us which airports are privately owned versus state operated, but we imagine that a more limited set based on private ownership only might show a higher average level of commercial revenues per passenger.
- Given the data provided in the panel, which suggests that Gatwick's market position and size is different from others in the benchmark set, it does not surprise us that Gatwick's commercial revenues per passenger are not at the average level of the comparator benchmarks.

# 3 Conclusions

### Revised Assumptions

3.1 Based on our review of the comments made by stakeholders, and taking into account new data, we propose the following changes in "impact" assumptions compared to those set out in our April 2013 Final Report.

- Retail:
  - **Catering space assigned to Duty Free:** reduction of 50% compared to the impact provided for this item in our Final Report.
- Car Parking:
  - **Enforcement of pick up into Short Stay car parks**: 1% decrease in impact for this item compared to our Final Report.
  - **Off Airport Operator Licensing Scheme:** 4% reduction in impact compared to our Final Report.
- Property
  - **Concorde House:** 1/3rd reduction in the impact compared to our Final Report.
  - **Hotels:** 190% increase in impact compared to our Final Report.

3.2 Table 3.1 sets out the effect of these "impact" changes, expressed in terms of revenue per passenger compared to our Final Report projection. The impacts of the changes in car parking enforcement and licensing assumptions are negligible on a per passenger basis and are therefore not presented in this table.

**TABLE 3.1 "IMPACT" CHANGES VERSUS APRIL 2013 STEER DAVIES GLEAVE FORECASTS (£ PER PASSENGER, 2011/12 PRICES)**

| Category | Change | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|---|
| Duty & Tax Free | Catering Space | 0.00 | 0.00 | -0.03 | -0.03 | -0.02 |
| Catering | Catering Space | 0.00 | 0.00 | 0.01 | 0.01 | 0.01 |
| Property | Concorde House | 0.00 | 0.00 | -0.01 | -0.01 | -0.01 |
| Property | Hotels | 0.00 | 0.00 | 0.01 | 0.01 | 0.01 |

*Source: Steer Davies Gleave analysis*

3.3 We have also rebased our forecast to take into account the actual outturn reported in certain product categories in 2012/13 except for Telecoms and Property where the reported performance was impacted by accounting and related provisions, and/or other one-off effects. We have also not rebased Bureau.

3.4 The rebasing of the Duty Free forecast nets off a one-off effect of £0.1 million in 2012/13 reported to us by Gatwick Airport.

3.5 The car parking figures have been rebased, but as part of this change we have also netted off a one-off effect of £0.4 million in the 2012/13 outturn (as advised to us by Gatwick Airport).

3.6 Table 3.2 sets out the overall effect of these rebasing changes, expressed in terms of revenue per passenger compared to our Final Report projection, for those product categories where such changes have been implemented.

**TABLE 3.2 REBASING CHANGES (£ PER PASSENGER, 2011/12 PRICES)**

| Category | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|---|---|
| Duty & Tax Free | -0.01 | -0.01 | -0.01 | -0.01 | -0.01 | -0.01 | -0.01 |
| Airside Specialist Shops | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 | 0.02 |
| Bookshops | -0.01 | -0.01 | -0.01 | -0.01 | -0.01 | -0.01 | -0.01 |
| Catering | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 | 0.01 |
| Landside Specialist Shops | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Advertising | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Other Retail | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Car Parking (net) | 0.05 | 0.05 | 0.05 | 0.05 | 0.04 | 0.04 | 0.04 |

*Source: Steer Davies Gleave analysis*

### Updated Forecasts

3.7 Table 3.3 presents our updated "core" revenue per passenger forecasts for the Q6 period which take into account the changes described above.

**TABLE 3.3 STEER DAVIES GLEAVE Q6 UPDATED "CORE" COMMERCIAL REVENUE FORECASTS (£ PER PASSENGER, 2011/12 PRICES)**

| Category | 2012/13 | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | CAGR Q6 |
|---|---|---|---|---|---|---|---|---|
| Duty & Tax Free | [✂] | [✂] | [✂] | [✂] | [✂] | [✂] | [✂] | [✂] |
| Airside Specialist Shops | 0.49 | 0.57 | 0.64 | 0.62 | 0.55 | 0.59 | 0.70 | **2.3%** |
| Bookshops | 0.29 | 0.28 | 0.28 | 0.28 | 0.28 | 0.28 | 0.28 | **0.2%** |
| Bureau | [✂] | [✂] | [✂] | [✂] | [✂] | [✂] | [✂] | [✂] |
| Catering | 0.55 | 0.56 | 0.54 | 0.53 | 0.59 | 0.58 | 0.66 | **5.2%** |
| Landside Specialist Shops | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 | **-3.3%** |
| Telecoms | 0.02 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | 0.05 | **-1.8%** |
| Advertising | 0.16 | 0.14 | 0.21 | 0.23 | 0.22 | 0.22 | 0.22 | **0.3%** |
| Other Retail | 0.16 | 0.17 | 0.17 | 0.17 | 0.16 | 0.16 | 0.15 | **-2.9%** |
| **Total Net Retail Income excl. Car Parking** | **3.45** | **3.56** | **3.68** | **3.51** | **3.68** | **3.67** | **3.82** | **1.0%** |
| Car Parking (net) | 1.17 | 1.11 | 1.13 | 1.10 | 1.07 | 1.04 | 1.04 | **-2.1%** |
| Property | 0.73 | 0.68 | 0.68 | 0.67 | 0.69 | 0.75 | 0.75 | **2.6%** |
| **Total Commercial Revenues** | **5.34** | **5.35** | **5.49** | **5.28** | **5.44** | **5.47** | **5.61** | **0.6%** |

*Sources: Gatwick Airport (2012/13 actuals), Gatwick Airport Revised Business Plan (restated by Steer Davies Gleave), Steer Davies Gleave analysis*

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