

Heathrow Expansion

Financeability analysis
of CAA regulatory
model shortlist

15 JUNE 2026



FRESHFIELDS

 **Santander**
Corporate & Investment Banking

1.

**Introduction and
Executive Summary**



2.

Scope and Assumptions



3.

Evaluating Financeability



4.

**Models 1a, 2, 4a: Capital
governance, incentives and
procurement model package**



5.

**Model 3: Long-term regulatory
framework**



6.

**Models 4b, 5b and 7b: Models
that mandate arrangements for
introducing competition**



7.

Disclaimer



1.

Introduction and Executive Summary

1. Introduction

- 1.1 Heathrow Airport Limited (“**HAL**”) has asked Santander and Freshfields LLP to further evaluate the CAA regulatory model shortlist¹ from the perspective of their impact on the financeability of expansion at Heathrow Airport.
- 1.2 In this report we have developed our financeability analysis of the relevant regulatory models from our prior reports² in view of CAP3251 and the accompanying report by Centrus.³ Our conclusions in this report are consistent with our previous recommendation that the single Regulatory Asset Base (“the **RAB**”) with potential regulatory enhancements is the most suitable funding model to privately finance an expanded Heathrow at the most efficient cost.⁴

Executive Summary

2. Models 1a, 2 and 4a: Variations of the current framework

- 2.1 Models 1a and 4a are neutral to financeability. Although they both would introduce incremental governance and oversight mechanisms to the current regulatory framework that markets and rating agencies may view as marginally positive, neither model changes HAL’s underlying risk profile or financing proposition. Any financeability benefits from either model requires HAL retaining ultimate control and clear accountability for the procurement and delivery of expansion, without veto rights over HAL’s capital plans or procurement decisions for the CAA, airlines or other stakeholders or process-driven delays.
- 2.2 Model 2 has the potential to improve financeability through HAL’s existing single RAB-based framework by promoting capex efficiency, mitigating cost overrun and near-term cashflow risks, and capping exposure to major cost overruns in extreme downside scenarios. However, any benefit to financeability is contingent on the model being implemented in line with key assumptions, including clearly defined reopeners, proportionate incentives, and credible caps on HAL’s maximum exposure to major, uncontrollable or uninsurable cost overrun risks. Without government support to backstop such risks, it is unclear how HAL’s maximum exposure to major cost overruns could be capped, which would limit the model’s ability to improve financeability in practice.
- 2.3 The conclusions for these models are summarised in the table below.

Model	Conclusion	Assessment
Model 1a	Neutral to financeability provided that there are no veto rights that could introduce delay, as although the model promotes capex efficiency, it does not change HAL’s financing proposition.	
Model 2	Potentially positive to financeability by mitigating and capping cost overruns, but benefits to financeability only if there is an effective cap on extreme downside risk.	
Model 4a	Neutral to financeability as enhanced oversight of procurement does not materially alter HAL’s risk profile.	

¹ Heathrow capacity expansion – consultation on a shortlist of regulatory models’ CAP3251, May 2026.

² Funding an expanded Heathrow – Santander and Freshfields, 31 July 2025 and Financeability Analysis of CAA Regulatory Models – Santander and Freshfields, 20 January 2026.

³ Financeability Assessment of regulatory models for Heathrow Airport – Centrus, 6 May 2026.

⁴ Funding an expanded Heathrow – Santander and Freshfields, 31 July 2025.

3. Model 3: Long-term regulatory framework

- 3.1 Model 3.1b has the potential to improve financeability of expansion under HAL's single RAB, through having a long-term cost of capital determination for expansion activities identified within the single RAB which better aligns with the construction and early operations periods, greenfield project risk and equity investors' requirements for stable, long-horizon returns. This would create a clearer link between expansion-specific risks and returns under HAL's single RAB.
- 3.2 However, this assessment relies on crucial assumptions that this model will:
- (a) include a long-term determination of the cost of equity applicable to expansion activities, combined with a cost of debt allowance which is subject to a market-based reopener. The latter would provide flexibility to adjust debt allowances to evolving market conditions and raise debt progressively during expansion;
 - (b) preserve the existing five-year price control regime for business-as-usual activities ("BAU"); and
 - (c) not involve a second RAB or "dual RAB" SPV structure distinct from HAL's existing single RAB. By requiring a split of HAL's integrated operations between HAL and a new corporate structure which has no access to HAL's brownfield BAU assets, a "dual RAB" SPV structure would lead to less efficient financing, increased airport charges and reduced equity returns without support from HAL or government.⁵ Therefore, under this model the expansion activities identified for the purposes of the separate cost of capital determination would be a specific perimeter of assets relating to the expansion programme within HAL's single RAB.
- 3.3 Fixing the cost of debt applicable to expansion activities over the construction and early operations periods would not improve the cost and availability of long-term debt financing and could unduly restrict HAL's financing flexibility by forcing HAL to raise committed financing earlier than required, reducing the efficiency of its financing strategy.
- 3.4 It is unclear whether Model 3.3 has any potential to benefit financeability of expansion compared to HAL's existing regulatory framework as the model requires significant further development. Without government support measures, providing a guaranteed return level through the "collar" would risk increases to airport charges.
- 3.5 The conclusions for these models are summarised in the table below.

Model	Conclusion	Assessment
Model 3.1b	Positive to financeability provided it includes a long-term determination of the cost of equity applicable to expansion activities, combined with a cost of debt allowance which is subject to a market-based reopener.	
Model 3.3	Not possible to analyse in detail, until developed further. As currently described, no clear benefit to financeability compared to the existing regulatory framework.	

⁵ Funding an expanded Heathrow – Santander and Freshfields, 31 July 2025.

4. Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition

- 4.1 Models 4b, 5b and 7b are linked to the introduction of competition in relation to delivery, operation or procurement of expansion which the CAA may require alongside HAL's existing single RAB model.
- 4.2 Model 4b could be neutral to financeability, assuming that HAL retains clear control over procurement decisions and remains accountable for procurement and delivery outcomes. CAA intervention may impact financeability of the model negatively.
- 4.3 Model 5b may be appropriate for discrete, non-core assets where risks are separable and the required investor return is lower. However, it worsens financeability where applied to core, operationally integrated expansion assets such as a new terminal. While it may introduce additional third party capital, that capital is likely to be more expensive than financing based on HAL's single RAB model. Rating agencies may treat availability payments to the SPV for a core operational asset as debt-like payment obligations, weakening HAL's credit metrics and rating headroom.
- 4.4 Model 7b is expected to have the most negative impact on financeability of the competition-linked models and it materially worsens financeability of expansion. Direct competition for core airport operations would weaken HAL's revenue predictability and business risk profile underpinning its investment grade credit.
- 4.5 Additionally, the alternative developer would face construction, integration and demand risk without the benefits of predictable cashflows from established operations and a proven funding capacity. As a result, its cost of capital would be higher, reflecting greenfield construction risk, operational integration risk and demand risk. Additional third party capital would not improve financeability unless it delivered material cost savings sufficient to offset the higher financing costs. Centrus acknowledges the "higher delivery risks" associated with this model, the potential negative rating impact of introducing competition and notes the possibility of debt additionality becoming negative and equity attractiveness reducing where there is material spare capacity at Heathrow.
- 4.6 The conclusions for the competition-linked models are summarised in the table below.

Model	Conclusion	Assessment
Model 4b	Neutral to financeability if HAL retains control over procurement decisions and accountability for delivery outcomes remains clearly allocated.	
Model 5b	Worsens financeability for core, operationally integrated assets, as third party capital is likely to be more expensive than HAL's RAB-based funding and may create debt-like obligations for HAL.	
	Potentially neutral for discrete, non-core assets where risks are separable and investor return requirements are lower but may create debt-like obligations for HAL.	
Model 7b	Materially worsens financeability as direct competition weakens HAL's business risk profile and introduces higher-cost third party capital for a core integrated asset.	

2.

Scope and Assumptions

5. Scope

- 5.1 The CAA regulatory model shortlist assessed in this report is:
- (a) Variation of the current regulatory framework: regulatory models 1a, 2 and 4a (which the CAA suggests could be combined as a package);
 - (b) Long-term regulatory framework: regulatory Model 3; and
 - (c) Approaches to facilitate competition: regulatory models 4b, 5b and 7b.
- 5.2 Our analysis considers these models from a financeability perspective only and does not consider any other aspects of the CAA's evaluation framework in CAP3251. We have further developed our analysis to support HAL and the CAA's ongoing assessments, using qualitative and quantitative evidence where possible.
- 5.3 This report focuses only on those models that the CAA has shortlisted for further evaluation. As the CAA notes, "[t]hese models are not mutually exclusive and can be complementary in providing benefits to consumers", therefore it may be that the CAA determines a combination of models is appropriate. While this report considers each regulatory model in turn and does not assess any combination of such models, evidently combinations which:
- (a) only feature models with the potential to improve or be marginally positive to neutral for financeability could be complementary to the overall financeability of expansion; and
 - (b) include models which worsen or have the potential to negatively impact financeability if key assumptions are not met would be detrimental to the overall financeability of expansion.

6. Assumptions

- 6.1 This report assumes that:
- (a) delivery of expansion, including an operational third runway, will cost approximately £33bn and modernising Heathrow will cost approximately £15bn, totalling approximately £49bn (including environmental mitigations) which will be financed privately by debt and equity investors without any financial support from government;
 - (b) HAL's regulated returns will continue to be determined on the basis of a real weighted average cost of capital (the "WACC") on its inflation-indexed single RAB;
 - (c) the assumptions set out in section 10 onwards in relation to each regulatory model are applicable and form the basis of each outcome stated. We have made these assumptions to assess the impact of the models on financeability of expansion meaningfully and do not express any view on whether such assumptions will be true in practice; and
 - (d) each model will apply as currently described by the CAA and "implemented in a reasonably effective form" (as assumed by the CAA and Centrus).

Evidence – Dialogue with Credit Rating Agencies

- Appreciating the CAA is unable to predict with certainty how credit rating agencies will react to their proposals, we held preliminary discussions with three leading rating agencies to understand their initial views on the CAA regulatory model shortlist and explain their views in this report.
- Although these discussions do not constitute formal guidance, they provide valuable early indications of the factors the rating agencies will likely consider important when assessing a model. Actual ratings assessments will depend on the details of each model.

Evidence – Indicative Modelling

- We acknowledge the CAA's observation that there are limitations on the availability of quantitative evidence for the models. However, where possible, we have developed our analysis of the regulatory models further using indicative modelling based on reasonable assumptions to show directional impacts of the relevant model on airport charges for expansion.
- Indicative modelling was conducted by adapting modelled "base case" assumptions in financial models prepared and made available by HAL (the "Base Case") on 23 July 2025.

3.

Evaluating Financeability

7. General Approach

7.1 In CAP3251, the CAA applies the criterion “raise sufficient finance” to assess each shortlisted model, noting that any regulatory model should support the raising of sufficient finance to enable the delivery of expansion (including the costs of environmental mitigations) at an efficient price. The CAA recognises that the regulatory framework must result in an “investable proposition” for shareholders and debt providers for expansion to be financeable.

7.2 In selecting and assessing its shortlist, the CAA used Centrus’ financeability assessment of the models.

7.3 Centrus identified five key financing considerations common to large construction projects and used these as its assessment criteria:

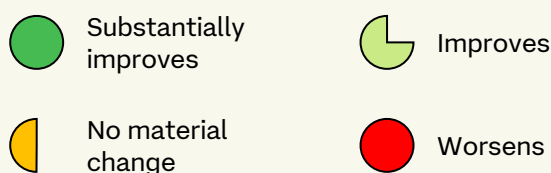
- (a) Scale: “[t]o achieve consumer benefits, any model needs to deliver benefits at scale to justify the investment of CAA’s time and resources. We will assess models based on their ability to add value at scale and achieve material impacts on financing i.e. ability to attract material amounts of incremental debt and equity to Heathrow expansion”;
- (b) Equity Attractiveness: “[w]e will review models from a holistic mainstream infrastructure investor perspective (Heathrow and/or potential new 3rd party greenfield project investors) – a good model would be one that is attractive to mainstream infrastructure investors without being detrimental to Heathrow’s investment case”;
- (c) Debt Additionality: “[w]e will assess financeability issues from a HAL perspective and from a 3rd party provider perspective, including credit ratings pressures – a good model is one that increases the overall availability & efficiency of financing”;

(d) Investor Familiarity & Deliverability: “[w]e will assess the familiarity of the regulatory framework model with investors and lenders and if and how quickly it can be adapted to Heathrow – a good model is one that has investor recognition and can be implemented to Heathrow within acceptable timescales”; and

(e) Demand & Construction Risk Allocation: “[w]e will assess to what extent each model allocates key demand and construction risks to/away from passengers – a good model is one that reduces risk to passengers or achieves value for money for any incremental risks allocated to passengers”.

7.4 Given the considerable overlap between the Centrus criteria and those which we previously developed in our financeability analysis of the CAA long-list⁶, clear alignment exists between the CAA, HAL and the respective advisers as to how the regulatory model should support financeability of expansion. Therefore, we do not review or revise any financeability evaluation criteria in this report.

7.5 Instead, we have highlighted the four **common themes** acknowledged collectively as key to financeability and, where possible, further analysed each shortlisted regulatory model in view of those themes. For consistency, we have used the CAA’s red, amber and green ratings shown below to score each of the models.



⁶ Financeability Analysis of CAA Regulatory Models – Santander and Freshfields, 20 January 2026

8. Common themes

8.1 Debt proposition:

The regulation of expansion should result in an investable proposition for debt providers. It should:

- (a) support debt finance being raised at an efficient cost throughout the life of the project to minimise financing costs for the entire expansion programme; and
- (b) enable debt finance to be raised at the material scale required.

Achieving and/or maintaining investment grade credit ratings, based on clear construction and demand risk allocation, is key to both objectives for HAL or future borrowers. Models aligned with clear market precedents for raising debt can also improve the confidence and familiarity of debt providers and rating agencies in the regulatory framework.

8.2 Equity proposition:

The regulation of expansion should result in an investable proposition for HAL's shareholders and/or potential new investors. It should ensure the most competitive cost of equity is achieved for the project as a whole by:

- (a) supporting predictable returns on equity commensurate with the risks faced by investors in expansion to attract private capital investment; and
- (b) enabling investment within acceptable timescales to not hinder or delay the expansion programme.

Models aligned with clear market precedents for attracting equity investment will improve the confidence and familiarity of investors in the regulatory framework.

8.3 Risk allocation:

The regulation of expansion should result in clear allocation of risks (demand, construction, financing risks) and responsibility for delivering expansion between parties.

8.4 Compatibility and deliverability:

The regulation of expansion should not be detrimental to HAL's existing financing from both equity and debt providers, including in terms of cost and availability. Any model must be able to be implemented within acceptable timescales to not hinder or delay the deliverability of expansion.

9. Indicative Modelling Approach

- 9.1 We acknowledge the CAA's observation that there are limitations to availability of quantitative evidence. Nevertheless, where possible, we have supplemented our qualitative assessment with indicative modelling to evaluate the principal drivers of financeability and illustrate the directional impact of different regulatory approaches.
- 9.2 The modelling was undertaken using HAL's Base Case financial model and focuses on the ability of the regulatory framework to support the raising of debt and equity finance at the scale required for expansion while maintaining investment-grade credit characteristics consistent with an "A-" rating. The assessment was conducted by reference to prevailing investment-grade rating thresholds and financing considerations relevant to large-scale infrastructure projects. Below are key highlights of the BAU assumptions:

BAU Assumptions

- The expansion will cost approximately £33bn and modernising Heathrow will cost approximately £15bn, totalling approximately £49bn.
- Heathrow develops the expansion under its existing funding structure.
- IG cost of debt assumed with no incremental commitment fees.

- 9.3 The modelling considers a number of financial levers that are relevant to the financeability of expansion and which capture the economic substance of the shortlisted regulatory models. For this report, these include:
- (a) Capex: including exposure to cost overruns, disallowances and delivery risk;
 - (b) Incentives: covering the calibration of cost-sharing and risk allocation mechanisms;
 - (c) Cost of capital: assessment of debt pricing, credit rating sensitivities and required nominal returns on equity;
 - (d) Third party delivery and asset transfer structures: including the involvement of third parties in the delivery, ownership or operation of expansion assets; and
 - (e) Capital structure optimisation: including gearing levels, and the balance of debt and equity funding.
- 9.4 The main purpose of the modelling is to assess financeability. In particular, we have considered the extent to which different regulatory approaches support the funding of expansion using cost-efficient debt and equity while maintaining investment-grade credit characteristics. Consistent with this objective, the modelling has been used to assess the implications of each regulatory model for financing costs, access to capital and key credit metrics.
- 9.5 The modelling provides indicative context regarding the potential implications for airport charges. This is not intended to represent a pricing assessment, forecast or recommendation. It is used illustratively to demonstrate how different financing outcomes, including changes in the cost of debt, cost of equity or risk allocation, may ultimately translate into airport charges through the regulatory framework once costs are recovered. The actual assessment of any such components will need to be determined based on evidence at the relevant time.
- 9.6 Some of the regulatory models are not suited to quantitative analysis due to their nature or the current unavailability of sufficient implementation detail. In those cases, our assessment relies on qualitative financial analysis, relevant market evidence, infrastructure precedents and preliminary discussions with leading credit rating agencies. Accordingly, the modelling should be viewed as one component of the overall financeability assessment rather than a standalone determinant of the conclusions reached.

4.

Models 1a, 2, 4a:
Capital governance,
incentives and
procurement
model package

10. Overview

10.1 The CAA considers there is a “strong case for further developing the current regulatory framework and approach to capital governance” and proposes a package of three regulatory models to “enhance capital governance, improve incentive arrangements for capital efficiency and provide strengthened oversight of HAL’s procurement processes”. These models are intended to encourage capital efficiency and reduce cost overrun risk for the delivery of expansion under HAL’s current regulatory framework:

- (a) Model 1a: changes to capex governance processes;
- (b) Model 2: targeted adjustments to the existing incentive regime; and
- (c) Model 4a: enhanced scrutiny of HAL’s approach to procurement.

10.2 Model 1a: In CAP3251, the CAA indicates that it is minded to implement a new senior capital committee to oversee the capital planning and delivery process. The CAA described the key features of this model as follows:

- (a) the committee would be chaired by an independent person, potentially appointed by the CAA (following consultation with HAL and airlines), attended by senior representatives from HAL and airlines (and potentially other stakeholders, including consumer representatives) and supported by independent technical experts in planning, procurement and delivery of major infrastructure projects;
- (b) the committee would not have veto powers over HAL’s capital plans, delivery and approach to procurement nor use of HAL’s internal audit function. However, HAL would need to explain clearly to the committee where it chooses to deviate from the advice that the committee and its experts provide. HAL should retain responsibility for its capital planning and have appropriate incentives for timely delivery of an efficient capital plan;
- (c) there would need to be protections in place where HAL under-delivers against the required standards (e.g. new incentive arrangements and longer-term caps and budgets); and

- (d) HAL could be required to provide long-term plans for the committee to review (giving stakeholders the opportunity to interrogate alternative options).

10.3 Model 2: The CAA proposes that this model would involve changes to the existing capital incentives for efficiency and timely delivery of benefits to reflect the characteristics of specific programmes and projects. There are various options that the CAA is considering which include:

- (a) adjusting sharing rates for capex over and underspend differently between individual projects and programmes depending on the level of HAL’s exposure to outside risk;
- (b) limiting HAL’s exposure to extreme cost overspends that may undermine financeability (e.g. CAA could reduce HAL’s share of risks as cost overruns increase and/or cap the total possible level of cost overrun);
- (c) setting cost allowances and delivery obligations for complex or novel projects in stages, rather than at a single point in the process (at the Gateway 3 stage); and
- (d) a mechanism to adjust cost allowances, in addition to the existing change control process, including re-opening of allowances and use of specific cost indices, to provide additional flexibility.

10.4 Model 4a: The CAA proposes that this model would involve HAL retaining primary responsibility for its procurement activities but introducing additional mechanisms to:

- (a) review HAL’s procurement strategy;
- (b) monitor major tenders; and
- (c) provide observations or require HAL to further justify its approach, including if competition had not been used effectively.

10.5 Model 4a would not involve the CAA imposing a requirement on HAL to tender specified design and build contracts.

11. Model 1a: Changes to capex governance processes

Assumptions

11.1 Our evaluation assumes that capex governance of the expansion programme would remain streamlined under this model to avoid undue inefficiencies or delays, with HAL retaining control over decisions regarding its capital plans, delivery and approach to procurement for expansion (i.e. no veto rights which override HAL's control). Once implemented the model would enable effective early-stage expansion capex scrutiny and not hinder delivery of expansion. Any additional changes to the BAU capex governance programme would also avoid introducing further complexity to the existing regime and focus on creating a streamlined, proportionate and targeted capex governance framework.

Analysis

11.2 *Debt proposition:* We agree with the CAA and Centrus that it is not clear whether this model would materially improve the overall proposition for debt financing of expansion. Nevertheless, if implemented in line with the assumptions, the model has the potential to indirectly improve HAL's credit profile by supporting capex efficiency, mitigating cost overrun risk and increasing certainty of the guardrails governing the accrual of capex to HAL's single RAB (to be recovered through airport charges). Precedents such as Thames Tideway Tunnel demonstrate the market's familiarity with governance and alliance arrangements under which the company's board keeps ultimate control of the project.

11.3 Rating agencies took a neutral to marginally positive view of this model, on the basis that increased transparency, scrutiny and stakeholder engagement could improve execution, reduce information asymmetry and support cost discipline. However, the precise implications for HAL's credit profile will depend on the extent to which the model can lead to improved delivery outcomes in practice.

11.4 Notably, multiple agencies expressed concern around potential veto rights and governance arrangements negatively impacting the timeliness of delivery and increasing execution risk by reducing HAL's control over delivery.

11.5 *Equity proposition:* We agree with Centrus' conclusion, as repeated by the CAA, that this model would not have a clear impact on the overall proposition for equity investment in expansion. However, if implemented as we describe, this model may reduce downside risk for equity investors during the expansion programme by supporting capex efficiency, mitigating cost overrun risk and increasing certainty of capex accruing to the RAB – without jeopardising investors' familiarity and confidence in the current regulatory framework.

11.6 *Risk allocation:* We agree with Centrus that this model has the potential to marginally improve construction risk allocation via additional transparency, although overall it does not materially change the overall risk allocation of expansion from HAL under the current regulatory model.

11.7 *Compatibility and deliverability:* If the assumptions for this model prove true, it would not be detrimental to HAL's existing financing from both equity and debt providers given it adds to the current regulatory model. This model would also be straightforward to implement in a timely manner as it builds on the existing model, so should not cause barriers or delays to financing expansion.

11.8 Conclusions:

- (a) To provide any financeability benefits, the implementation of this model must respect those key conditions which we have noted above will be true – that the committee's processes should facilitate streamlined governance of the expansion capex programme from an early stage, with ultimate control and accountability retained by HAL and proportionate scrutiny of capex which does not cause undue obstructions or delays.
- (b) Therefore, it seems appropriate for the capex governance model to:
 - (i) concentrate oversight on the expansion programme only;
 - (ii) not include veto/blocking rights which blur HAL's accountability for delivery and risk introducing delays;
 - (iii) employ varied processes to scrutinise plans in a proportionate manner based on the size and type of capex project – for example, by involving independent experts for complex, high value and high-risk projects, enabling time-sensitive projects to be prioritised, and organising orderly reviews to avoid excessive procedural administration; and
 - (iv) have the flexibility to adapt on an ongoing basis for efficiency.
- (c) Initial discussions with rating agencies demonstrate that they view HAL's ultimate control over delivery of expansion as important for efficient capex governance.
- (d) Indicative modelling which applied capex cost overruns to HAL's Base Case from H8 onwards highlights the importance of capex cost control, since it showed capex to be the dominant driver of airport charges. Changes in total capex have the most significant impact on airport charges compared to other sensitivities (e.g. opex, cost of capital, incentives). This further emphasises the importance of implementing this model in a proportionate and cost-controlled manner.

Modelling Evidence

Sensitivities

- Capex cost overrun of 10% from H8 onwards, allowing for charges to flex.

Key Conclusions

- Passenger charges increase by £2.00, highlighting the importance of capex cost control due to the sensitivity of airport charges to changes in total capex.

11.9 Score: Model may indirectly benefit financeability if implemented in line with the assumptions stated.



No material change

12. Model 2: Targeted adjustments to the existing incentive regime

Assumptions

12.1 Our evaluation assumes that this model would improve efficient management and delivery of the expansion capex programme through HAL's existing single RAB-based framework, through a flexible and proportionate incentives regime to reflect the characteristics and progression of individual projects and HAL's degree of control, incorporating clearly defined reopeners and caps to limit HAL's exposure to cost overruns. We also assume that the risk/reward balance will be fairly calibrated.

12.2 We also assume that this model is most effective if HAL's maximum exposure to extreme cost overruns would in effect be capped to shield against remote, high-impact, and uninsurable risks that the private market cannot adequately price or absorb. Supportive government measures would be needed to address such risks unless costs were recovered through charges.

Analysis

12.3 *Debt proposition:* We agree with the CAA and Centrus that this model could improve the overall proposition for debt financing of expansion by introducing greater regulatory flexibility (reopeners, cost caps, ex-ante allowance adjustments) that could improve confidence around extreme downside scenarios. We consider that the model could promote capex efficiency, mitigate cost overrun and near-term cashflow risks during the expansion programme and limit HAL's maximum exposure in extreme downside scenarios. As demonstrated by rating agencies' feedback, the protections for HAL against downside construction risk will be important to its ratings and ultimately to sustaining an efficient cost of debt.

12.4 It is not clear, however, how caps on HAL's maximum exposure to cost overruns caused by extreme, uncontrollable events would be guaranteed under this model without government support of some kind, or otherwise recovered through increases to charges.

12.5 Discussions with rating agencies focused on the extent to which the model's framework reduces HAL's exposure to construction risk, along with preserving incentives for efficient delivery. Clearly defined reopeners, caps on extreme cost overruns and mechanisms (such as longer-term allowances) to improve certainty of cost recovery were seen positively. However, the detailed design of a revised incentives framework would need to be scrutinised – including:

- (a) if HAL's downside exposure is greater than under the existing framework;
- (b) decision-making processes, timing of recoveries, whether the process is discretionary and how efficient costs are determined; and
- (c) one agency highlighted that where expenditure above certain thresholds is disallowed from the RAB, this could be particularly negative to credit metrics by creating immediate cash flow pressure from higher capex requirements and, if subsequently disallowed from the RAB, preventing future cost recovery through increased regulated charges.

12.6 While the agencies would generally focus on realistic downside scenarios rather than extreme tail events, they highlighted the importance to financeability of protections for HAL against major cost overruns in extreme downside scenarios and referenced market precedents (e.g. Sizewell C and Thames Tideway Tunnel) where government support measures were key to achieving investment grade ratings.

12.7 Indicative modelling which applied varied capex cost overruns (between 10% and 50%) to HAL's Base Case across H9 at an arbitrary 50/50% cost-sharing split also highlighted that:

- (a) cost-sharing can reduce the impact of moderate overruns on airport charges; but
- (b) in an extreme scenario, cost-sharing on its own is unlikely to adequately shield passengers from increasing airport charges or adequately protect Heathrow's financeability due to eroding the cashflow buffer under rating metrics.

Models 1a, 2, 4a: Capital governance, incentives and procurement model package



Modelling Evidence

Sensitivities

- Capex cost overruns of 10-50% from H9.
- Cost sharing set at an arbitrary 50/50% (indicative) instead of current 25/75% regime.

Key Conclusions

- Passenger charges increase by £0.68-£3.41 and FFO/Net Debt is eroded by 0.42%-1.17%.
- Cost sharing can reduce the impact of moderate overruns, but under extreme outcomes the impact becomes significant, eroding cash flow buffer.

12.8 *Equity proposition:* We agree with the CAA and Centrus that this model could enhance the overall proposition for equity investment in expansion by improving downside protection for investors and alignment between stakeholders. The incentives regime should incorporate features to increase certainty of cost recovery and protections against construction risk as highlighted by the rating agencies. A well-designed regime would improve investor confidence without jeopardising investors' familiarity with the current regulatory framework.

12.9 If this is not the case, we agree with Centrus' conclusion that increased exposure to cost risk could compress returns for investors. In particular, without government support of some kind, it is not clear how HAL's maximum exposure to major cost overruns caused by extreme, uncontrollable events would be capped under this model. In our view:

- (a) credible protections for shareholders to address remote, high-impact, and uninsurable risks are very important to attract equity investment (from existing or incoming equity investors); and
- (b) the regime must feature proportionate protections for HAL against cost overruns generally to prevent increases in HAL's cost of equity and pressure on charges.

12.10 *Risk allocation:* We agree with Centrus that this model can mitigate extreme construction risk (provided credible protections are incorporated into the model e.g. caps and reopeners), though higher

baseline cost-sharing "increases HAL's exposure to delivery performance and forecasting accuracy" (i.e. in our view, cost risk for HAL).

12.11 *Compatibility and deliverability:* This model would not be detrimental to HAL's existing financing from both equity and debt providers given it adds to the current regulatory model. This model would also be straightforward to implement in a timely manner, as it builds on the existing model, so should not cause barriers or delays to financing expansion.

12.12 *Conclusions:* While we do not comment on exact regulatory design, the implementation of this model through HAL's existing single RAB-based framework must meet the assumptions which we have described above to improve financeability of expansion – namely, that the incentives regime will:

- (a) preserve incentives for efficient delivery while protecting HAL against downside risks, by being flexibly and proportionately tailored to the characteristics and progression of individual projects and HAL's degree of control under the expansion programme only;
- (b) incorporate clearly defined reopeners, caps to limit HAL's maximum exposure in extreme downside scenarios and mechanisms (such as longer-term allowances) to improve certainty of cost recovery, each highlighted as positive by the rating agencies; and
- (c) provide a credible cap on HAL's maximum exposure to extreme cost overruns by addressing remote, high-impact, and uninsurable risks that the private market cannot adequately price or absorb.

12.13 We acknowledge that the CAA plans to consider appropriate mechanisms to provide protections for HAL against extreme outcomes in further detail, which will need to address limiting HAL's maximum exposure to such risks credibly without specific government support necessarily being available.

12.14 *Score:* Model can improve financeability if implemented in line with the assumptions stated.



Improves

13. Model 4a: Enhanced scrutiny of HAL's approach to procurement

Assumptions

13.1 Our evaluation assumes that decision-making powers and responsibility for procurement in connection with expansion would remain with HAL, and additional oversight mechanisms for the CAA through the current regulatory framework would be proportionate and targeted to major tenders for expansion projects only, not materially constrain or override HAL's procurement control (meaning no joint decision-making) nor cause undue delays.

Analysis

13.2 *Debt proposition:* We agree with the CAA and Centrus that this model would have limited impact on the overall proposition for debt financing of expansion. The introduction of CAA procurement oversight to the current regulatory regime would not result in any direct benefit to the cost of debt nor attract new financing, and any indirect assurance to debt providers of the efficiency of costs is limited to procurement plans. The example cited by Centrus of the Department for Energy Security and Net Zero's ("DESNZ") oversight of debt financing in the UK Carbon Capture, Usage, and Storage ("CCUS") market does not seem to provide a comparable market precedent, since it does not involve oversight of capex procurement. This precedent should be treated with caution when referenced to support the claim that debt providers are familiar with this model and to suggest it could be applied to HAL's procurement for expansion.

13.3 Rating agencies viewed this model as a governance change rather than a change able to materially improve HAL's credit, taking a neutral to marginally positive view on the basis that its implementation would not impede HAL's control over decision-making.

13.4 As with Model 1a, the main theme from multiple agencies was that HAL's control of and accountability for delivery of expansion must be aligned under this model, otherwise it could create risk of delays to the project delivery.

13.5 *Equity proposition:* We agree with the CAA and Centrus that this model would only have a

marginally positive / limited impact on the overall proposition for equity investment in expansion. Although the model could introduce stricter procurement discipline, any indirect assurance to investors of the efficiency of costs is limited to procurement plans. Furthermore, as above, the example of DESNZ's oversight of debt financing in the UK CCUS market is not a comparable market precedent, and so we do not consider that investors would be familiar with this model and its proposed application to HAL (and therefore cannot assume that investors will view the oversight positively).

13.6 *Risk allocation:* We agree with Centrus that construction and delivery risk remains with HAL unless more risk can be transferred to contractors via this model. Overall, this model does not materially change the risk allocation of expansion from HAL under the current regulatory model and may only improve transparency and mitigate risk around contractor performance and delivery.

13.7 *Compatibility and deliverability:* If the model is implemented in line with the assumptions, it would be implementable without detriment to HAL's existing financing from both equity and debt providers given it adds to the current regulatory model. If the assumptions for this model are true in practice, we would also not anticipate implementation to cause considerable barriers or delays to financing expansion.

13.8 *Conclusions:* To be neutral in its impact and avoid any negative impact on financeability, the implementation of this model into the current regulatory regime must respect key assumptions – that the CAA's oversight should preserve responsibility and streamlined decision-making by HAL for procurement in connection with expansion, by being proportionate and targeted to major expansion project scopes only, causing no material constraints to or overriding HAL's control (meaning no joint decision-making), and avoid undue delays. This is particularly important given the lack of comparable market precedents for this model and the potential for debt or equity investors to view additional regulatory oversight as unwelcome without new expertise and resource within the CAA.

13.9 *Score:* Model is neutral to financeability if implemented in line with the assumptions stated.



No material change

5.

Model 3: Long-term regulatory framework

14. Overview

14.1 In CAP3251, the CAA considers that amendments to its current approach of five-year price controls to introduce certain longer-term commitments “could reduce unnecessary uncertainty and prevent any undue upward pressure on HAL’s cost of capital”. In the CAA’s view, a longer-term regulatory framework has “the potential to improve both the cost and availability of finance for expansion, since it better aligns key elements of the price control framework with the longer-term financing arrangements necessary to support expansion”. In CAP3251, the CAA explored five possible options and selected two approaches to progress further:

- (a) Model 3.1b: a long-term determination of the cost of capital for expansion applied to a separate “expansion RAB”, with redeterminations of the “business-as-usual cost of capital” every five years; and
- (b) Model 3.3: a “cap and collar” mechanism to set a maximum and minimum level of return that investors would be allowed to recover over the longer term.

14.2 Model 3.1b: The CAA proposes that this model would involve (a) a long-term determination of the cost of capital applicable specifically to expansion activities and (b) the existing redeterminations of the cost of capital applicable to business-as-usual activities remaining every five years. The CAA assumes that the other elements of the current price control would continue to reset every five years and acknowledges that further analysis is required to determine the approach for implementation.

14.3 Model 3.3: The CAA proposes that this model would involve setting upper and lower bounds for the returns that investors can expect to earn during the period of the expansion scheme (that is, for the construction period and an operations phase) – allowing for “a degree of discretion in redeterminations of the cost of capital to reflect new information” while reducing “the level of uncertainty in respect of lifecycle returns overall”. It would involve the CAA setting:

- (a) a maximum lifecycle return that investors are permitted to earn (the “cap”); and
- (b) a minimum lifecycle return that investors are guaranteed to receive (the “collar”).

14.4 If returns were to fall outside of the cap or collar, a further layer of risk-sharing could potentially apply, either to overall realised returns or through targeted components of those returns (such as capex or opex) depending on how incentive or cost-sharing mechanisms are structured. The mechanism could also potentially include a “gain share” arrangement in the event that the sale value of expansion assets exceeded a pre-agreed threshold. As with Model 3.1b, the CAA acknowledges further work is needed to determine how to implement the arrangements most appropriately, while also guarding against the risks of inappropriate and asymmetric benefits to investors at the expense of consumers. This model was not expressly considered by Centrus.

15. Model 3.1b: A long-term cost of capital commitment specific to expansion

Assumptions

15.1 Our evaluation assumes that this model will:

- (a) include a long-term determination of the cost of equity applicable to expansion activities, combined with a cost of debt allowance which is subject to a market-based reopener. The former would align to the construction and early operations periods and reflect the higher risk profile of expansion compared to BAU, while the latter would provide flexibility to adjust debt allowances to evolving market conditions and raise debt progressively during expansion;
- (b) preserve the existing five-year price control regime for BAU activities; and
- (c) not involve a second RAB or “dual RAB” SPV structure distinct from HAL’s existing single RAB. By requiring a split of HAL’s integrated operations between HAL and a new corporate structure which has no access to HAL’s brownfield BAU assets, a “dual RAB” SPV structure would lead to less efficient financing, increased airport charges and reduced equity returns without support from HAL or government.⁷ Therefore, under this model the expansion activities identified for the purposes of the separate cost of capital determination would be a specific perimeter of assets relating to the expansion programme within HAL’s single RAB.

Analysis

15.2 *Debt proposition:* We agree with the CAA that this model would improve the overall proposition for debt financing of expansion by creating “a clearer link between expansion-specific risks and returns”, with a cost of debt allowance which is subject to a market-based reopener, to support an efficient financing strategy during the construction and early operations periods. Since assets with material construction or greenfield risk typically price debt at a premium (to compensate debt providers for greenfield construction risk, schedule risk and cost overrun risk) compared to operational assets, a flexible cost of debt allowance can adjust to any such premium during these periods.

15.3 In our view, it is not correct that fixing the cost of debt applicable to expansion activities over the construction and operations periods would improve the cost and availability of long-term debt financing for HAL. We acknowledge this may be the case for a third party developer in need of raising significant committed debt financing upfront for construction (i.e. by “locking in” a cost of debt and providing visibility on financing costs). However, in HAL’s case it could cause unnecessary cost risk (given expansion activities will be exposed to more volatility than BAU) and limit HAL’s optionality for raising debt finance for expansion (since HAL would align its funding objectives with regulatory assumptions made at the project’s outset).

15.4 This result could:

- (a) incentivise HAL to raise committed financing earlier than required to “lock in” forecasted financing costs consistent with the regulatory allowance (incurring debt financing costs earlier compared to a strategy of raising debt progressively under HAL’s established investment grade financing platform); and
- (b) inadequately reflect additional debt financing need as the expansion project evolves, since incremental financing may need to be raised in market conditions that materially differ.

15.5 Therefore, for this model to work, we have assumed that the cost of debt allowance would not be fixed on a long-term basis but instead subject to a market-based reopener – balancing the benefit for debt providers of regulatory certainty and predictability of returns with HAL’s proven ability to adapt its financing strategy to raise long-term debt at scale in varied market conditions.

15.6 Rating agencies flagged the need to balance certainty of regulatory allowances carefully with sufficient flexibility to adapt to changing market conditions and ensure assumptions do not become outdated. The predictability of the existing regime was viewed as an important strength. However, this needs to be accompanied by periodic reviews, reopeners and clear adjustment mechanisms to update assumptions.

⁷ Funding an expanded Heathrow – Santander and Freshfields, 31 July 2025.

15.7 In addition, rating agencies were not concerned by the suggestions of a separate cost of capital determination for expansion activities, provided the framework is clear and revenues support capex, opex and financing requirements. Sizewell C was also referenced as precedent for a longer-term framework with periodic reopeners.

15.8 Therefore, although Heathrow expansion is unique due to its scale and mixed brownfield/greenfield risk profile, we agree with Centrus that debt providers would be somewhat familiar with this model given precedents like Sizewell C involve similar regulatory features.

Example – Sizewell C⁸

- The Sizewell C RAB framework includes a Cost of Debt Adjustment Mechanism (“**CDA**”) which operates annually during the Pre-Post Construction Review (“**Pre-PCR**”) phase and is designed to remunerate the licensee for movements in the cost of borrowing driven by changes in the financial markets, while also incentivising the licensee to manage its debt costs and borrow efficiently in the Pre-PCR phase. Similarly, if the licensee is accessing debt financing from public sector sources, and the cost of that debt varies, the CDA will remunerate the licensee for those movements.
- The CDA reopener allows Ofgem to adjust the private debt incentive sharing factor and/or the original reference point periodically throughout the Pre-PCR phase, if required.
- Ofgem has recognised that the CDA mechanism has been explicitly designed around creating a regime that allows Ofgem to discharge its financeability duty effectively.

15.9 *Equity proposition:* We agree with the CAA and Centrus that, if this model is implemented in line with the assumptions, it would improve the overall proposition for equity investment in expansion. A long-term determination of the cost of equity applicable to expansion activities identified within the single RAB would better align with the extended timeline for delivery, return-on-equity requirements reflecting the greenfield project risk associated with expansion activities, and mainstream infrastructure investor targets for long-horizon stable rates of return-on-equity. This is also demonstrated by Sizewell C as a relevant precedent.

Example – Sizewell C⁹

- Under the Sizewell C RAB framework, Ofgem expects that all risks during the Pre-PCR phase that may impact on the cost of capital would be remunerated through the Initial Weighted Average Cost of Capital (“**IWACC**”) set by the Secretary of State prior to revenue commencement.
- The IWACC will be used to remunerate the licensee for financing the capital cost of the project through the Pre-PCR phase.
- The IWACC will remain fixed throughout the duration of the Pre-PCR phase up to the PCR.
- The Pre-PCR phase covers the construction and commissioning of the nuclear licence.

⁸ Our approach to the Economic Regulation of Sizewell C.

⁹ Our approach to the Economic Regulation of Sizewell C.

- 15.10 *Risk allocation*: We agree with Centrus that this model does not materially change the risk allocation of expansion from HAL. However, certainty around cost risk allocation could improve if the framework establishes clear reopener mechanisms (especially for exogenous factors such as market rates).
- 15.11 *Compatibility and deliverability*: Provided this model's implementation does not disrupt HAL's existing regulatory regime for BAU, it would not be detrimental to HAL's existing financing from both equity and debt providers. This model would also be straightforward to implement in a timely manner as it builds on the existing model, so should not cause barriers or delays to financing expansion. However, an efficient and orderly process would be needed to develop and agree the regulatory framework for this model between stakeholders and the CAA.
- 15.12 Ongoing assessment of whether its structure would require technical amendments to HAL's existing financing arrangements to accommodate the new regulation would also be needed as the framework develops.
- 15.13 *Conclusions*: To improve financeability of expansion by (i) aligning with equity investors' requirements for stable, long-horizon returns reflective of greenfield project risk, and (ii) avoiding constraining HAL's debt financing strategy, this model should feature a long-term determination of the cost of equity applicable to expansion activities, combined with a cost of debt allowance which is subject to a market-based reopener.
- 15.14 *Score*: Model can improve financeability if implemented in line with the assumptions stated.



Improves

16. Model 3.3: A cap and collar mechanism on returns over the longer term

16.1 The CAA acknowledges that further work is needed to determine how to implement the arrangements for this model, which was not considered by Centrus. Without additional details about its structure and level-setting for a cap and collar, we cannot analyse this model in detail at this stage. However, in view of market precedents and the CAA's statements in CAP3251, we can make some observations.

(a) It is unclear whether this model as currently described could offer any incremental financeability benefit compared to the existing regulatory framework's cost of capital determination, incentives regime and traffic risk-sharing mechanisms (as may be amended under models 2 and 3.1b).

(b) Rating agencies would look for clear mechanisms which reduce downside risk to HAL while preserving predictable cashflows, as well as focus on trigger events, timing of recoveries, interaction with future price control reviews and whether the overall framework remains clear and predictable.

(c) As demonstrated by limited market precedent, to provide a guaranteed level of return for investors (the "collar"), this model would involve increases to airport charges to meet that level, unless otherwise backstopped financially by government support.

- (d) The "cap" on returns under this model would not seem to provide any incremental benefit beyond the effect of the existing WACC regime, but could weaken the equity proposition if set too low. This would need to be carefully considered to avoid damaging the equity proposition for expansion as details are developed further.
- (e) Without comparable precedents in the UK airport sector, the incorporation of this model into the existing RAB framework could also create complexity and delays to financing for expansion, with little obvious benefit. Ofgem's regime for interconnectors is an unsuitable precedent for regulating expansion, as explained below.

Example – Ofgem's cap/floor regime for interconnectors¹⁰

The cap and floor regime has been used by Ofgem in the electricity interconnector sector which aims to "incentivise developers to deliver interconnector capacity by limiting developers' exposure to electricity market price risk".

The regime sets a "cap" and "floor" on revenues over a 25-year period. Over 5-year assessment periods:

- if revenues are below the "floor" a top-up payment is made to the licensee by consumers through the charges regime, with the cost recovered from users of the GB transmission system and ultimately borne by electricity consumers; and
- if revenues exceed the "cap" the licensee pays back those returns to consumers through the charges regime.

As increases to charges are borne by electricity users across Great Britain, the increase for each individual consumer is very small (and in the context of the energy sector, has a similar effect to direct government support). However, in HAL's context, increases in airport charges across a smaller consumer-base would have a more significant impact and risk pushing downside risk on to airlines and consumers to potentially unmanageable levels, unless separate government support was available to support the collar.

¹⁰ [Interconnector Cap and Floor Regime Handbook](#).

6.

Models 4b, 5b and 7b:
Models that mandate
arrangements for
introducing
competition

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



17. Overview

17.1 The CAA considers that “greater reliance on competitive forces could have significant advantages in terms of promoting efficiency and protecting consumers” and shortlisted three models to examine further:

- (a) Model 4b: mandate design and build contract;
- (b) Model 5b: design, build and operate; and
- (c) Model 7b: direct competition for airport operation services.

17.2 Model 4b: The CAA proposes that, under this model, it would have the power to require HAL to tender competitively for the combined design and build of certain packages of works. The packages of works would be specified by either HAL, the CAA or an independent capital governance process and there would be regulatory oversight over the development and implementation of the contracts. However, HAL would retain ownership and operational responsibility throughout, and would bear ultimate responsibility for selecting, managing and coordinating contractors.

17.3 Model 5b: The CAA proposes that, under this model, a competitively procured third party partner would design, build, finance and operate a new asset on HAL’s behalf for a set concession term under a Direct Procurement for Customers (“DPC”)-style contractual structure. However, HAL would retain “responsibility for ownership and ultimate responsibility for financing, and for managing and coordinating contractors”.

17.4 Model 7b: The CAA proposes that this model would introduce direct competition between HAL and a third party developer, where the third party developer designs, builds, finances, owns and operates an asset such as a new terminal. The alternative developer would directly provide services to airlines and recover its revenues from them, in direct competition with HAL. The third party would need to be able to acquire the necessary land to support its development of airport infrastructure (e.g. through applying for and being granted a Development Consent Order, which the CAA does not consider an insurmountable obstacle to the development of this model).

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



18. Model 4b: Mandate design and build contract

Assumptions

18.1 Our evaluation assumes that the relevant works packages would be specified with appropriate recourse to relevant industry expertise and the CAA would not direct HAL's ultimate procurement decisions or the selection of contractors. We also assume HAL would continue to own and operate the relevant assets and finance their construction under the existing single RAB framework (with contractor payments recovered by HAL through allowed revenues).

Areas of caution in relation to Model 4b

- Our evaluation assumes that the CAA's involvement under Model 4b would be clearly limited in its scope to assurance and oversight of HAL's procurement approach. There is value in adopting competitive tendering where it is proportionately applied and optimises cost and benefit considerations.
- The position is more nuanced if this model strays into a high degree of control or veto rights for the CAA, allowing it to direct procurement decisions and selection of contractors. We therefore assume that HAL would retain clear responsibility for selection, financing and delivery of works procured by contractors through competitive tendering.
- Were that to prove different in practice, we would expect any joint directions by the CAA and HAL to be supported by a clear evidential basis, strict and transparent governance and commensurate risk-sharing framework to mitigate against the risk of procurement decisions outside of HAL's control that turn out to be sub-optimal for overall delivery.

Analysis

18.2 *Debt proposition:* We agree with the CAA and Centrus that the model is broadly neutral in terms of its impact on the overall proposition for debt financing of expansion, given it would not materially improve either access to or the cost of new debt. Rating agencies would consider the execution risk, which is likely to be neutral if appropriate guardrails are in place that do not blur accountability and responsibility.

Areas of caution in relation to Model 4b

- If the CAA's role were to move beyond procurement assurance and into directing HAL's procurement strategy, this could create additional complexity for both delivery accountability and rating agency assessment.
- It has the potential to blur accountability for overruns and create misalignment between responsibility and control, and potentially impose a procurement strategy that does not reflect a clear process and methodology for planning and executing capex. This would be viewed negatively by the rating agencies.

18.3 *Equity proposition:* We agree with Centrus that the investment structure remains unchanged, so the model should be broadly neutral for equity investors. We would, however, qualify the suggestion that the model might improve investor confidence through "CAA buy in" to procurement.

18.4 In practice, CAA involvement would only provide comfort that there has been additional oversight of the procurement tender process, which is not something on which we would expect equity investors to place material weight. Equity investors would conduct their own due diligence on large procurements and would rely on this to underwrite their investment case. They may derive some benefit if the model improved cost recoveries through airport charges over the long-term, but it would not be sufficient to change investors' equity return requirements.

Areas of caution in relation to Model 4b

Any marginal benefit of this model could be outweighed by the risk that investors view it as limiting HAL's flexibility and blurring accountability over key procurement decisions, unless HAL retains clear control over procurement.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



18.5 *Risk allocation*: We agree with Centrus that this model does not materially change the allocation of construction, demand or financing risk, though they acknowledge the potential for “ambiguous accountability” where the CAA is more directive on procurement. If the CAA mandates competitive tendering for HAL’s procurement of a package of works while HAL remains responsible for delivery and construction risk (e.g. cost overruns, delays, interface failures or contractor underperformance), accountability could become blurred.

18.6 Unclear risk allocation would weaken the general investment proposition if investors, debt providers and rating agencies are not convinced that HAL has full control over decisions for which it bears the risks. Therefore, our assessment assumes that HAL retains control over procurement decisions under this model to protect financeability.

Areas of caution for Model 4b

If this model allowed the CAA to direct or materially influence procurement for any asset of its choosing, the allocation of cost overrun risk should reflect that intervention. HAL should remain accountable for risks genuinely within its control and any joint decision-making by the CAA and HAL should be subject to risk-sharing.

¹¹ [\\$3.5B AirTrain Newark Replacement Re-Forms After Bids Blew Budget \(Engineering News-Record\)](#), 16 January 2026.

For LaGuardia, see: [Delta Air Lines Inc. & LGA Airfield Reconfiguration Team Has Early Finish on \\$2.8B Airport Project \(Engineering News-Record\)](#), 19 November 2025.

For Newark Terminal A, see: [\\$2.7B Newark Airport terminal opens \(Construction Dive\)](#), 24 January 2023.

Other international airports¹¹

- While the CAA cites Istanbul New Airport, La Guardia Airport, Newark Liberty International Airport and Changi Airport as precedents for this model, these do not show that mandating competitive tenders for design and build contracts for a privately financed, privately operated airport would deliver better cost outcomes. Each is a state-owned or government-controlled airport for which controlled competitive tendering is a government-mandated requirement and their outcomes have been mixed.
- Newark AirTrain – Authorised in 2019 at \$2.1bn as a single design-build-operate-maintain contract to transfer construction and operational risk. However, the 2022 bids substantially exceeded the budget, forcing the Port Authority to abandon the model and break up the packages. The project is now going to cost approximately \$3.5bn with first service not expected until 2030.
- Newark Terminal A – Opening was delayed from its 2022 target into the following year, with only 21 out of 33 gates being completed. Competitive design and build tendering did not guarantee on-time delivery and reinforces that delivery risk and capability are what drive outcomes.
- LaGuardia Delta Airfield Reconfiguration – The \$2.8bn airfield reconfiguration was delivered on schedule through phased construction that kept gates open throughout the 7-year build. In contrast to the above examples, this shows that a competitively tendered “build only” package can deliver well.
- The Port Authority of New York and New Jersey received contradictory outcomes across these projects, showing that delivery and execution capability drive results rather than the mandating of competitive tenders.

John F. Kennedy International Airport

- Another relevant example is John F. Kennedy International Airport. Recent developments around its competitively tendered New Terminal One saw Moody’s revise its outlook to negative in May 2026, after the first phase was delayed and concerns were raised about the project proceeding without signed airline agreements.
- This demonstrates that mandated procurement is no guarantee against increased delay, cost and offtake risk that harm financeability.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



18.7 *Compatibility and deliverability:* If implemented in line with the assumptions, this model would be compatible with HAL's existing financing from both equity and debt providers since:

- (a) it does not involve asset transfers, revenue carve outs or changes to security and the associated contractual payments would be recoverable through allowed revenues to protect covenant ratios; and
- (b) under its control, HAL would ensure the design and build contracts comply with HAL's covenants.

If the assumptions for this model are true in practice, we would also not anticipate implementation to cause considerable barriers or delays to financing expansion.

18.8 *Conclusions:* To be neutral in its impact and avoid any financeability detriment, the implementation of this model must respect key assumptions – that the CAA mandate does not override HAL's control of procurement decisions and that accountability for procurement and delivery outcomes remains clearly allocated to HAL.

18.9 HAL would retain ownership, financing and operational responsibility throughout, and would continue to bear ultimate responsibility for managing and coordinating its contractors and the underlying contracts (which equity and debt providers are proven to be comfortable with). The fundamental risk profile underwritten by debt and equity investors would be unchanged, and any benefits of the model would be confined to procurement outcomes rather than extending to the cost of capital, the recovery of costs through the allowed revenues or HAL's overall risk exposure.

18.10 If Model 4b extended beyond procurement assurance into CAA control over procurement strategy, it would create misalignment between accountability and decision-making control which rating agencies would view negatively. This would negatively affect financeability unless a clear regulatory framework governing cost recovery, cost-sharing and risk allocation was established.

18.11 *Score:* Model is neutral to financeability if implemented in line with the conditions stated; by contrast, more control over procurement and blurring of accountability could negatively impact HAL's profile.



No material change

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



19. Model 5b: Design, build, operate

Assumptions

General assumptions

19.1 Our evaluation assumes that:

- (a) the third party would raise its own limited recourse debt financing and equity investment through a special purpose vehicle (“SPV”) to fund the design, build and operation of the relevant asset for a set concession term;
- (b) HAL would remunerate the third party (calculated to compensate its financing costs and required equity returns) through availability and/or performance-based payments which HAL would recover through its existing RAB-based model through airport charges, provided the asset meets pre-agreed performance and availability standards. The third party would not bear passenger demand risk and instead HAL would remain exposed to passenger volumes;
- (c) an end of concession payment would need to be paid by HAL to the third party, generally resulting in a relatively outsized value compared to annual capex; and
- (d) the third party’s performance during the concession period would not cause operational issues.

Describing core asset assumptions, e.g. a terminal

19.2 When applied to a terminal, which is considered as a core, operationally integrated asset for expansion, we also assume:

- (a) multi-year construction period for a terminal, with funding sourced and committed at the outset;
- (b) given the nature of the asset, and the fact that the terminal cannot become operational until construction is complete, no revenue would be generated prior to the terminal opening;

- (c) based on cross-sector market evidence, the third party SPV would have a higher cost of debt and higher equity return requirements than HAL’s existing RAB-based model (increasing the all-in cost of capital relative to HAL). Complex projects with greenfield construction risk have three key similarities which would apply to a terminal development:
 - (i) higher nominal equity return requirements, often in the mid-teens or above, reflecting the complexity of a project such as a new terminal asset (i.e. material greenfield construction risk and a long construction horizon);
 - (ii) higher financing costs because the SPV would need committed capital from day one to support an investment grade financing at scale, before the terminal is operational and generating revenue; and
 - (iii) a distinct debt premium during construction compared to operational periods; and
- (d) HAL would require contractual step-in rights or similar protections in an extreme downside scenario (e.g. insolvency of the third party), given the operational importance and integration of a terminal asset within HAL’s wider airport operations.

Distinction – Discrete non-core assets

- The assumptions in paragraph 19.2 above would not apply for DPC-style arrangements applied to discrete, non-core and less capital-intensive assets, if a third party can bid to design, build, finance and operate such an asset at competitive rates relative to HAL.
- This is viable if the third party can attract debt and equity financing on competitive terms and where an asset can be separated (underpinning the SPV’s limited recourse financing) from HAL’s complex system. The benefit to end users will depend on the attractiveness of the bid relative to HAL’s WACC.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



Analysis

19.3 *Debt proposition:* We agree with Centrus and the CAA that a DPC-style model could bring incremental debt capacity for expansion through new relationships with debt providers. However, incremental debt capacity does not, by itself, improve whole-system financeability if the all-in cost of that debt is more expensive than HAL's own RAB-based financing.

19.4 As explained above, for a core asset like a new terminal at Heathrow, a third party SPV's cost of debt would be higher than HAL's cost of debt because:

- (a) the SPV would price debt at a premium of approximately 100–150 basis points reflecting greenfield construction risk, compared to HAL's financing terms reflecting its existing brownfield business;¹² and
- (b) the SPV would require significant committed debt upfront to achieve an investment-grade financing structure at scale or some form of regulatory backstop that creates certainty around funding (e.g. Thames Tideway Tunnel), ultimately incurring funding costs (through commitment fees) earlier than if the asset were financed by HAL's established investment grade financing platform (where funding costs would only be incurred as and when required due to benefit of an already well-proven debt platform).

19.5 The SPV's higher financing cost would need to be remunerated through the contractual payments paid by HAL and ultimately recovered by HAL through airport charges.

19.6 Rating agencies are likely to assess a DPC-style structure by reference to the established features of that model, including HAL's payment obligations, the role of the SPV and the extent to which the asset remains critical to HAL's regulated airport operations. Where HAL is required to make long-term, fixed or broadly fixed payments to an SPV for a core operational asset, agencies may treat those obligations as debt-like (which Centrus also acknowledges), particularly where HAL is seen as ultimately responsible for delivery.

19.7 Through discussions with rating agencies, we understand that this treatment could arise either through a gross-up of HAL's balance sheet for availability-based or end-of-concession payments, or through consolidation of the project and SPV debt onto HAL's balance sheet. Either approach would weaken HAL's credit metrics and rating headroom where the asset is core to HAL's operations and HAL is expected to guarantee delivery of the project in practice.

19.8 This concern is separate from the SPV's own credit profile. Centrus recognises that the SPV would likely be rated no better than HAL, and potentially one notch below HAL, which is a view also shared by the rating agencies, meaning it may raise more expensive debt than HAL could achieve itself while still creating adverse credit implications for HAL, implicitly increasing charges to end users.

19.9 On this basis, we do not agree with the CAA's conclusion that impacts on HAL's credit rating and risk profile can be managed through appropriate contract structuring and risk transfer.

Distinction – Discrete non-core assets

- We agree with Centrus' statement that Model 5b has relevant precedent in the context of DPC-style arrangements for discrete, non-core and less capital-intensive assets, including United Utilities' HARP, which recently reached financial close and has a contract value of approximately £3bn.
- However, as Centrus acknowledges, the model remains untested in the UK airport sector for projects above £1bn scale, and implementation to date has been slow despite existing projects being lower value than a new Heathrow terminal.
- As a result, in comparison to discrete, non-core assets, market practice to date does not show that debt providers are sufficiently familiar with this model to support cost-efficient debt financing at the material scales required for core operational assets like a new Heathrow terminal.

¹² Market evidence based on Santander experience consistently shows a construction risk to carry a pricing premium of 100-150 basis points.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



19.10 *Equity proposition:* We agree with the CAA and Centrus that a long-term availability-based revenue stream from a high-profile Heathrow asset is likely to be attractive to global infrastructure funds and strategic investors. However, the presence of investor appetite does not address the more important question of the price at which that capital would be provided, and how that cost would ultimately flow through to HAL and consumers.

New equity:

19.11 The attractiveness to incoming equity investors is achieved by providing the third party SPV with a stable contractual revenue stream, while HAL retains passenger demand risk and assumes long-term payment obligations. However, due to the complexity of developing a new core terminal, third party investors would expect a higher nominal return on equity than HAL, potentially in the mid-teens or above, to compensate for greenfield construction risk, operational interface risk and the absence of an established brownfield asset base. This would increase the SPV's all-in cost of equity compared to HAL, which would feed directly into the size of the SPV's availability-based payments from HAL and risk increasing costs for consumers.

Modelling Evidence

Model 5b Assumptions

- Third party SPV develops and raises funding for a portion of terminal capex which would be suitable for DPC.
- Funding sourced and committed on day one.
- 25-year concession period with availability payments starting in 2039. End of concession payment assumed 25 years later.
- Third party funding costs up to 150bps higher than BAU and gearing of up to 75%.

Sensitivities

- Availability payment adjusted to achieve equity target nominal returns of 15–20%.

Key Conclusions

- The financial impact on airport charges of delivering an asset through this model depends on the third party's nominal IRR targets.
- Modelling a DPC style fee using 15-20% target nominal IRRs results in airport charges ranging between £0.82–3.17 higher.
- At the higher nominal IRR ranges, more than 30% capex saving would be required to offset the charge increase.

Distinction – Discrete non-core assets

- For discrete, non-core assets, the risk profile is likely to be materially different. Assets such as car parks are more separable from Heathrow's core airport operations, have fewer operational interfaces, and are less critical to the overall resilience and functioning of the airport. As a result, third party investors may be willing to accept a lower target nominal IRR than would be required for a complex, integrated terminal asset.
- On the analysis above, even an equity nominal IRR of c.10-15% could be sufficiently attractive for investors in a non-core asset such as car parking, while still resulting in a lower overall charge outcome.
- This supports the view that alternative delivery models may be more appropriate for separable, non-core assets where construction and operational risks can be more clearly allocated, and where the required investor return does not result in higher overall costs for HAL or consumers.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



Existing shareholders:

19.12 For HAL's shareholders, the impact of this model depends on whether availability-based and end-of-concession payments to the third party can be fully recovered through airport charges in a way that preserves HAL's regulated returns. Based on discussions with rating agencies, other DPC projects have benefited from clearer or automatic pass-through of such payments. However, this may be more complex for Heathrow given the nature and integration of the asset, meaning the credit and equity impact for HAL is less certain and could be negative if recovery is delayed, incomplete or subject to regulatory discretion.

19.13 Rating agencies noted in our discussions that they have not seen a DPC-style structure applied to an asset with demand risk of the nature and scale of Heathrow, where the third party is insulated from passenger volume risk, but HAL remains exposed to such risk. As a result, HAL may face fixed or broadly fixed payment obligations while passenger revenues are lower than expected, increasing cash flow risk and reducing financial headroom. This could be detrimental to HAL's credit rating and would weaken the equity proposition for HAL's shareholders, particularly where the model is applied to a core operational asset.

19.14 *Risk allocation:* The model is intended to transfer design, construction and operational performance risks to the third party. In theory, this creates alignment because the same party that designs and builds the asset must also operate it and meet agreed performance standards. However, we disagree with the CAA's conclusion that a DPC model could transfer "construction and lifecycle performance risks" to the third party in the context of core operational assets like a new terminal, as any risk transfer would be severely constrained in practice for three key reasons:

(a) *Integrated risks:* a terminal is deeply integrated with the wider airport system, including security, baggage, airfield operations, utilities, passenger flows and airline operations. HAL would therefore remain responsible for overall airport resilience, operational continuity and system coordination, preventing any meaningful transfer of construction and operational risk to a third party;

(b) *Ultimate delivery risk:* HAL would need step-in rights if the third party failed to deliver or operate the asset effectively. The scenarios in which HAL would need to exercise step-in rights or provide last-resort support are likely to be downside scenarios involving cost overruns, delay, operational underperformance or financial distress of the third party. In those circumstances, HAL may need to absorb additional costs, provide operational support or fund remedial measures at a time when project performance and cashflows are already under pressure, which risks destabilising HAL's existing business; and

(c) *Contractual risk-sharing:* expected contractual risk-sharing of cost overruns for a core, operational asset between HAL and the third party makes it unlikely that debt providers, equity investors or rating agencies will view this as a meaningful transfer of construction and operational risk.

19.15 *Compatibility and deliverability:*

Compatibility:

19.16 As flagged above, HAL would need to recover contractual payments through allowed revenues to protect covenant ratios.

19.17 Further, the development of a core asset such as a terminal within Heathrow's existing operational perimeter by a third party SPV would require a carve-out of the relevant land through a long lease disposal, as well as leases or the grant of other contractual rights of use in respect of other assets to the third party. A robust separation is necessary to provide the SPV with assets capable of being secured in favour of debt providers to raise its own limited recourse financing, and to give its debt providers an adequate security package to provide operational control over the assets if enforced.

19.18 Each asset disposal to the third party would need to comply with HAL's ongoing business-as-usual financing covenants and, where relevant, be permitted to be released from the existing security granted in favour of HAL's creditors.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



19.19 In the example of a DPC concession contract for a new terminal, a long lease or other disposal of HAL's land in favour of the third party would likely be required. Bondholder and other creditor consents could be required unless:

- (a) the disposal is made pursuant to mandatory requirements imposed by, or undertakings given to, the CAA. Such requirements are not defined, creating uncertainty as to when and how this condition would be satisfied;
- (b) the disposal would not result in HAL's financial ratios measuring its senior net debt to RAB reaching or exceeding 0.725x (as adjusted on a pro forma basis to take into account the proposed disposal and any prepayment of debt required using the disposal proceeds). This would seem to require a carve-out of the existing HAL RAB to be formally agreed to reflect the disposal;
- (c) the terms of the lease are evidenced as arm's length (for example, using independent external valuations to underpin this assessment) and for the benefit of Heathrow's existing business; or
- (d) the value of the disposal represents less than 2% of Total RAB. Otherwise the net disposal proceeds would need to be applied within six months of receipt to prepay HAL's outstanding debt. This threshold would roughly equate to £420 million based on HAL's RAB value of £21bn as of 2025.

Deliverability:

19.20 The model also introduces implementation complexity which has the potential to delay or obstruct the third party SPV raising financing for expansion from debt and equity sources. While DPC has precedent in the UK water sector, it is untested in the UK airport sector and HARP DPC took around five years from Ofwat's PR19 decision approving the HARP project for DPC delivery to STRABAG Equitix Consortium being awarded the contract in August 2025. Other DPC projects have not proceeded as planned.¹³

19.21 In the water sector, water companies are only required to consider DPC for particularly large projects and the projects must meet certain criteria including a clear discreteness test.¹⁴ With the agreement of the water company, large projects which meet such criteria can be designated for DPC.¹⁵ A further limitation that has been identified

by Ofwat in the context of the water sector with DPC is the lack of direct regulatory oversight between the third party delivery party and regulator.¹⁶

19.22 A terminal-style DPC at Heathrow would be more complex (and not "discrete") given operational interfaces, safety and security requirements, and the need to maintain airport continuity during construction and operation. Any commercial solutions which are mandated by the CAA would also result in a deviation to the approach adopted in the water sector and can be expected to introduce significant implementation delays for core non-discrete assets.¹⁷

19.23 *Conclusions:* Model 5b is likely to worsen financeability for expansion when applied to core, complex expansion assets such as terminals. Although it may attract additional third party capital, that capital would likely be more expensive than HAL's RAB-based funding because the third party SPV would price in greenfield construction risk, schedule risk and cost overrun risk. For a terminal, this premium would apply to a large upfront funding requirement over a multi-year construction period before revenue is generated, increasing charges by up to £3.17. For smaller, lower-risk non-core assets, the same premium or lower could apply to a smaller capital base and shorter delivery period, making the cost differential materially narrower.

19.24 Model 5b may also create rating pressure for HAL. In the context of a terminal asset, rating agencies may treat long-term availability payments, and potentially end-of-concession payments, as debt-like obligations where they are not an automatic regulatory pass-through or where HAL retains material residual risk. HAL would also remain exposed to passenger demand risk and act as the practical operational backstop for a core airport asset. As a result, Model 5b may increase financing costs without achieving meaningful risk transfer away from HAL.

¹³ [Funding an expanded Heathrow – Santander and Freshfields, 31 July 2025, page 12.](#)

¹⁴ [Guidance for Water Companies delivering DPC projects \(Ofwat\), May 2026.](#)

¹⁵ [Guidance for Water Companies delivering DPC projects \(Ofwat\), May 2026, section 2.4.](#)

¹⁶ [A Major Projects Guide for Investors, May 2025, page 12.](#)

¹⁷ For instance, see CAA, CAP1610: "the CAA does not have the power, directly or indirectly, to impose, or force HAL to enter into, particular commercial solutions to promote competition".

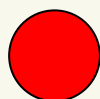
Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



19.25 The position is different for discrete, non-core assets. Where an asset is peripheral to the airport system, carries limited operational risk and does not engage demand risk, a third party structure is more capable of transferring construction and availability risk away from HAL.

19.26 The lack of precedent for this structure in the UK airport sector also introduces timeline uncertainty and implementation risk.

19.27 Score: Model worsens financeability for core operational assets and only has potential to be neutral or potentially improve financeability for discrete, non-core and less capital-intensive assets if implemented in line with the conditions stated.



For core operational assets – worsens



For discrete, non-core assets – neutral

Example – Terminal Joint Venture – potential application to Model 5b

Looking at industry precedents such as (1) the joint venture structure between Flughafen München GmbH and Deutsche Lufthansa AG which delivered Terminal 2 at Munich Airport, and (2) the joint venture between Changi Airport Group and CapitaLand which delivered Jewel Changi Airport, it is possible that a third party SPV acting as DPC delivery partner for a new terminal (or other assets) could be a joint venture between HAL, as majority owner in line with these precedents, and a third party (such as a construction company or airline stakeholders).

While a joint venture structure (“JV”) would not change our evaluation of Model 5b in the context of a core operational asset like a new terminal, legal and commercial details such as (i) the identity of the third party JV partner, (ii) the degree of HAL’s control over the JV itself and governance framework, and (iii) risk-sharing between HAL and the third party, would each have some bearing on the financeability of delivering that asset under Model 5b.

At this stage, assuming HAL has majority control and ownership of the JV, we can observe:

Debt and equity proposition:

- HAL’s involvement could improve the cost of debt and equity of the JV compared to a third party by lowering greenfield risk perceived by investors; however, the need to raise significant upfront committed debt and equity financing to capitalise the JV would still lead to higher costs relative to HAL;
- Rating agencies may be more likely to treat the availability-based payments to the JV as debt-like obligations for HAL;
- The JV could attract new equity investment through a JV partner and reduce the drawbacks of Model 5b for HAL’s existing shareholders, given they can benefit from any potential upside achieved by the JV through HAL as a shareholder. HAL’s nominal equity targets will likely be similar to a third party SPV as HAL must invest on arm’s length terms;

Risk allocation:

- HAL’s involvement could undermine successful risk transfer further and increase the likelihood that HAL would ultimately guarantee delivery;

Compatibility and deliverability:

- Using a JV could exacerbate the challenges to deliverability of financing under Model 5b if negotiations between HAL and the JV partner of its governance framework and capital structure cause further delays; and
- HAL’s existing financing restricts investments in joint ventures depending on whether the CAA would include the JV assets within HAL’s existing RAB:
 - If included, the regulatory assets of the JV (when aggregated with any other “RAB Enhancing JVs”) must not represent more than 10% of HAL’s RAB at any time (roughly £2.1bn based on HAL’s RAB value of £21bn as of 2025); and
 - If excluded, the aggregate of all amounts invested/committed by HAL’s group to the JV (combined with all other “Non-RAB Enhancing JVs”) must not exceed 5% of HAL’s RAB at any time (roughly £1bn based on HAL’s RAB value of £21bn as of 2025).

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



20. Model 7b: Direct competition for airport operation services

Assumptions

20.1 Our evaluation is based on a set of working assumptions about the risk profile that a third party terminal developer would face relative to HAL's existing RAB-based financing model. We assume that:

- (a) an alternative developer would need to take on a combination of greenfield construction risk, operational interface risk, and demand risk; and
- (b) these risks would be more pronounced for a complex and highly integrated asset such as an airport terminal than for a more separable or standalone infrastructure asset.

20.2 On that basis, our analysis assumes that the required return for a third party developer would be materially higher than under HAL's current financing model. We have assumed nominal IRRs to lie in the range of mid- to high-teens.

20.3 We have also assumed that, given the operational importance of a terminal, HAL would require appropriate protections, including step-in rights or equivalent safeguards, in an extreme downside scenario.

Analysis

20.4 *Debt proposition:* We agree with Centrus that a third party developer may bring incremental debt capacity into the programme. However, additional debt capacity is not the same as improved whole-system financeability. A standalone greenfield terminal financing with construction, integration and demand risk is likely to carry a higher cost of debt than HAL's established financing platform and investor base. This is because HAL can apply its pre-established, cash-generative and gearing-optimised RAB platform to expansion, whereas a third party SPV with no operating cashflow could not replicate HAL's cost/gearing combination on a permanent basis (regardless of its structuring) and its debt would therefore be structurally less efficient and more expensive.

Focus on third party developer and consequent impact:

20.5 From the perspective of a third party developer investing into a greenfield project with demand risk, there are two key elements required for an investment grade structure that result in a less efficient financing:

- (a) *Timing:* The timing of raising debt is critical to financing efficiency. A third party developer would likely need to secure substantial committed debt upfront to support an investment grade rating, causing funding costs to accrue earlier than under HAL's RAB-based model, where capital can be raised progressively as programme needs arise. In a standalone greenfield financing, this effect may be compounded by the need for committed contingency funding from the outset of the project to cover potential cost overruns and construction delays. By contrast, a HAL-financed model can draw on the broader HAL platform, including operating cash flows and established funding capacity. Rating agencies have indicated that they are likely to focus on the project's resilience under independent technical downside scenarios, which could require additional standby debt and equity commitments and increase the overall cost of carry.
- (b) *Gearing:* Whereas HAL can support materially higher leverage within its capital structure and regulated financing framework, including gearing of up to 85% for Class B debt, a standalone greenfield terminal project would likely need to be financed with materially lower leverage, potentially with a significant proportion of the construction period funded by equity or gearing closer to c.50-60%, in order to support an investment grade structure on an asset with demand risk.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



Modelling of standalone third party developer:

20.6 For Model 7b, the modelling seeks to isolate the financing impact of a standalone third party airport operator structure relative to a HAL-led RAB-funded counterfactual. This includes an assumed debt/equity mix, greenfield construction-period debt premium, timing of debt drawdown or commitment, commitment fees on undrawn facilities, and the additional standby or contingency liquidity likely to be required to support an investment-grade financing.

20.7 We have modelled a scenario whereby the third party developer raises an additional committed standby debt facility representing a financing source available for a 25% downside cost overrun scenario to simulate the additional contingency requirement for a standalone terminal operator. This incurs higher financing charges from commitment fees due to the committed but undrawn nature of this facility. This increases the weighted passenger charge by £2.73.

Modelling Evidence

Model 7b – Modelling Assumptions

- Third party SPV develops and raises funding for terminal T5X, and associated baggage and connectivity infrastructure.
- Funding sourced and committed on day one.
- Third party gearing assumed to be 50%.
- Assuming cost of debt premium of up to 150bps, and cost of equity of 15% (nominal).

Sensitivities

- Capex savings of up to 30% applied due to third party efficiency.

Key Conclusions

- Weighted average passenger charge increases by £2.73.
- 10% capex savings increases the charge by £2.14.
- 30% capex savings increases charge by £0.95.

Focus on HAL and consequent impact:

20.8 From HAL's perspective, and following discussions with rating agencies that highlighted this as the most credit-negative model, Model 7b will weaken HAL's business risk profile. The rating agencies highlighted HAL's current strengths including its London catchment area, diversified traffic base and strong competitive position, all of which would be weakened under this model. Model 7b would introduce direct competition into HAL's core regulated business, weakening the cashflow stability that supports HAL's investment-grade credit profile. This could increase HAL's perceived business risk, weaken credit metrics and increase the cost of debt for HAL and, potentially, the alternative developer.

20.9 This risk has been tested through modelling two scenarios, which have been selected as reasonable impacts of a weaker HAL business risk profile:

Modelling Evidence

Model 7b Sensitivities

- Higher rating thresholds applied to simulate a weakening of HAL's business risk profile. Modelled as a 2%-6% increase in FFO/Net debt requirement to maintain HAL's current rating.
- 50bps additional financing costs.

Key Conclusions

- A weakening of HAL's business risk profile leads to airport charges increasing by £5-18.
- Holding charges flat, nominal equity returns are reduced by c.90bps for HAL due to increased cost of debt.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



20.10 This indicates that, even before taking account of the alternative developer's own higher greenfield cost of capital, direct competition could place material upward pressure on airport charges by weakening HAL's existing business risk profile. Rating agencies have indicated that the direct competition risks identified above could impact HAL's business risk profile and consequent rating before operations commence if there is sufficient certainty that direct competition will be introduced.

20.11 *Equity proposition:* We agree with Centrus that this model may increase the cost of equity for HAL. Direct competition would increase uncertainty over future revenues, margins and market position given greater demand risk exposure. Further, although the model creates an investable opportunity for the alternative developer, it only does so at a required return-on-equity that reflects the greenfield construction risk, operational integration risk, demand risk and the absence of financial government support to backstop extreme downside risk. This risk profile is materially different from HAL's established funding structure.

20.12 As noted in the debt proposition above, to achieve an investment grade structure the SPV would require lower permanent gearing than HAL's existing structure and potentially equity-first funding during construction. This would increase both the equity contribution required and the proportion of higher-cost equity in the financing mix.

20.13 As a result, any incremental sources of equity are likely to require higher rates of return. Therefore, although the model appears to diversify equity sources, it does so by introducing a more expensive and riskier equity proposition. We have modelled scenarios targeting mid- and high-teen nominal equity returns for the third party developer (based on market precedents across sectors), and the resulting real WACCs are 9% and 12%, respectively.¹⁸

20.14 Higher return requirements and lower gearing would lead to average airport charges increasing by £2.73-4.92 compared to HAL developing the terminal under its existing funding structure.

Modelling Evidence

Model 7b Sensitivities

- Third party investors targeting nominal equity returns in the mid- to high-teens.

Key Conclusions

- If equity investors are targeting nominal IRRs in the mid-teens, the resulting real WACC would be 9-10%. The weighted passenger charge would increase by £2.73-3.76.
- If equity investors are targeting nominal IRRs in the high teens, the resulting real WACC would be 12%. The weighted passenger charge would increase by up to £4.92.

20.15 *Risk allocation:* We consider that this model creates an unclear and inefficient allocation of risk. In principle, construction and operational risk for the relevant asset would be transferred to the alternative developer (which Centrus highlights). In practice, however, the asset would remain deeply integrated with Heathrow's wider airport system. HAL would continue to be responsible for common airport services, airport-wide resilience, operational coordination, safety and security interfaces, passenger flows, baggage interfaces, airfield coordination and the overall functioning of Heathrow as a hub airport.

20.16 As a result, if the SPV experienced material cost overruns, delays or financing pressure, HAL may in practice need to step in or provide support, flexibility or other accommodations to preserve airport resilience and avoid disruption or default. This is not support that a privately owned airport would ordinarily be expected to provide on an unfunded basis. In the JFK precedent, the terminal owner benefits from certain downside protections as detailed at paragraph 20.20, including flexibility and grants from the government-owned airport counterparty to help the SPV complete construction without defaulting. Absent an explicit and funded support mechanism, downside risk under Model 7b could therefore fall back on the wider Heathrow system (which is not designed to be a supplier of last resort), undermining the transfer of risk.

¹⁸ WACC adjusted to achieve mid- to high-teens nominal equity returns.

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



20.17 *Compatibility and deliverability:* We agree with Centrus that this model introduces additional complexity and higher delivery risk.

Compatibility:

20.18 We consider that this model is incompatible with the efficient financing of HAL's existing business and the timely financeability of expansion. The introduction of a directly competing terminal operator could trigger issues under HAL's existing financing arrangements, including potential covenant, consent and security questions under the financing terms depending on the scope of the project. If a core asset such as a terminal within Heathrow's existing operational perimeter is to be developed by a third party, the same issues described at paragraphs 19.17 to 19.19 would be relevant to this model. Issues could also arise from a change in HAL's business risk profile, reducing market appetite to provide debt to HAL on current terms.

Deliverability:

20.19 We agree with Centrus that Model 7b is untested in the UK airport sector and would introduce significant delivery, legal, regulatory and financing complexity. The need to create a wholesale product, regulate common cost allocation, impose non-discrimination obligations, introduce required legislative changes, carry out a market power determination (and consider whether any changes are required to HAL's own market power determination), determine operator licensing requirements and manage interactions with the Development Consent Order planning process would create uncertainty and potential delay.

20.20 Rating agencies raised concerns about how a RAB framework would operate in a competitive environment and whether competing operators would be subject to equivalent regulatory arrangements.

Example - John F. Kennedy International Airport

- As JFK benefits from a public airport landlord framework, including features such as lease subordination and deferral that can provide resilience in downside scenarios, it should be treated with caution when considered by the CAA. Comparable support should not be assumed to be available at Heathrow.
- Further, Moody's revision of the JFK terminal outlook on 15 May 2026 from stable to negative illustrates that standalone terminal structures can carry additional credit risk, particularly where there is material construction, ramp-up and refinancing exposure (and in spite of its public financial support).

Models 4b, 5b and 7b: Models that mandate arrangements for introducing competition



20.21 *Conclusions:* Model 7b is unlikely to be financeable on an efficient whole-system basis relative to HAL delivery. The model would be expected to increase airport charges given it would likely lead to a higher cost of capital for both HAL and the alternative developer. HAL's financing costs could rise by direct terminal competition weakening revenue predictability, single-till stability and its perceived business risk profile as confirmed by rating agencies. The alternative developer's financing costs are also likely to exceed HAL's RAB-based cost of capital, given the greenfield construction risk, operational integration risk, demand risk and absence of government support.

20.22 Additional third party capital therefore does not, in itself, improve financeability where that capital is more expensive and simultaneously weakens HAL's existing financing platform. Indicative modelling shows that Model 7b would only benefit consumers if the alternative developer could deliver unrealistic capex savings (for a "like-for-like" scheme) of more than 30% relative to HAL's RAB-funded delivery case, such that airport charges are no higher than under HAL delivery and HAL's investment-grade position is preserved.

20.23 There is no precedent for this structure in the UK airport sector and it would introduce significant delivery, legal, regulatory and financing complexity which would create uncertainty and delay.

Modelling Evidence

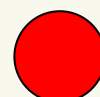
Model 7b Sensitivities

- Third party investors targeting nominal equity returns in the mid-teens.
- Capex savings of up to 30% applied due to third party efficiency.

Key Conclusions

- 10% capex savings increases the weighted passenger charge by £2.14.
- 30% capex savings increases the weighted passenger charge by £0.95.

20.24 *Score:* Model materially worsens financeability because it increases HAL's business risk profile, undermines revenue predictability, introduces higher-cost third party capital for a core integrated asset and is likely to undermine HAL's existing financing.



Worsens

7.

Disclaimer

1. Freshfields LLP (**Freshfields**) and Banco Santander, S.A., London Branch (**Santander**) (**we** or **us**) have prepared this report (being the **Report**) for and on the instructions of, and in each case in accordance with our terms of engagement with, Heathrow Airport Limited, which is our client (the **Client**). Any analysis contained in the Report is subject to the scope, terms of reference, assumptions and qualifications which we have each agreed with the Client and does not reflect or include any work undertaken or opinions held by any other professional advisers of the Client or any other work product that we may have separately provided to the Client.
2. Nothing in this Report shall be interpreted as creating any joint liability between Freshfields and Santander. In the Report, Freshfields will only be responsible for contents in relation to English law matters and Santander will only be responsible for contents in relation to debt advisory matters and advice based on the scope of work as set out in Santander's engagement letter dated on or around the date of this report. Each of Freshfields and Santander only accepts responsibility for those parts of this Report that fall within their respective scope of, and concern, the appointment and remit(s) listed above and accepts no responsibility for any other parts of the Report or any omission from the Report within the other's remit. Freshfields does not assume any liability or responsibility for accurately transcribing the advice of Santander in this Report. In addition, Freshfields has assumed that the information or advice provided by Santander is true and complete in all respects and Freshfields has undertaken no steps whatsoever to verify such information or advice by Santander.
3. The Report is for discussion with the Client, Heathrow Airport Holdings Limited and its directors only and not for any other individual, firm, company, partnership, joint venture, government, state or agency of a state, association, works council or employee representative body (each a **person**).
4. Only the Client is entitled to rely on the Report and we (and our personnel and associated firms) accept no responsibility, duty or liability to Heathrow Airport Holdings Limited or its directors or any other person in respect of the contents of the Report (or any discussions relating to it) unless: (i) the Client, Freshfields and Santander have consented to their reliance in such form and on terms that each of Freshfields, Santander and the Client agree to in their sole discretion and in writing in each case; and (ii) there has been valid acceptance of the terms on which they may rely on the Report by the counter-signature of a reliance letter in such form as each of Freshfields and Santander agree.
5. This report is strictly confidential and is addressed only to the Client. It is not to be provided or reproduced in any way by the Client or any other recipient to any other person without the prior written consent of Freshfields and Santander.
6. The Report relates only to the position as at 15 June 2026 based on the information of which we were aware at that time. We will not update this Report unless we specifically agree with the Client to do so.
7. If you have received the Report with the prior written consent of Freshfields and Santander and you are not the Client (and you have not executed a reliance letter with each of Freshfields and Santander), you acknowledge that the Report is provided to you for information purposes only and on a non-reliance basis. It should not be taken out of context or in any way serve as a substitute for other enquiries that you would (or should) otherwise undertake. You further acknowledge that:
 - (a) The Report has been prepared for the Client and consequently the analysis contained in it may not address or reflect those matters that may be important to you or a person in your position;
 - (b) We make no representation as to the accuracy, reliability or completeness of the Report; and
 - (c) Your receipt of the Report does not create a lawyer-client relationship between you and Freshfields nor any kind of legal, fiduciary or other relationship with Freshfields or Santander.