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Re: Response to CAA H8 Consultation on RAB Indexation and Allowed Return on Debt

The Airline Community welcomes the opportunity to comment on the CAA's consultation regarding the CAA's emerging policy position with regards to the treatment of RAB indexation and allowed return on debt for H8.

This response should be read alongside the Airline Community's response to the H8 Initial Proposals (CAP3232) and the supporting report undertaken by CEPA[1] ("CEPA Report"), which are hereby incorporated. This submission should also be read alongside the submissions made by individual airlines to both the Initial Proposals, as well as this follow up consultation. Nothing in this response should be taken as prejudicing, qualifying or departing from the positions set out in our response to CAP3232. Rather, this submission should be read as supplementary to, and consistent with, those earlier views.

The Airline Community welcomes the CAA's minded-to position to adopt the fixed indexation approach for H8 and consider this to represent a material improvement on the existing framework.

The Airline Community has consistently argued throughout the H8 review that the current framework creates the potential for inflation-driven windfall gains and losses because the RAB is fully indexed to outturn inflation while a substantial proportion of HAL's financing is assumed to be fixed-rate nominal debt whose financing costs do not vary with inflation once issued. This concern was reflected in Recommendation #7 of the CEPA Report submitted alongside the Airline Community's response to H8 Initial Proposals, which recommended removing outturn inflation indexation for nominal fixed-rate debt

The issue is not merely technical. Inflation-driven growth in the RAB ultimately feeds through into airport charges paid by airlines and consumers. Recent experience has demonstrated that inflation indexation can materially increase the RAB despite no corresponding increase in the cost of servicing nominal fixed-rate debt. Indeed, in 2022 alone indexation added to the RAB £2.3 billion due to the inflationary shock ensuing the Russia-Ukraine war. Regulatory approaches that permit such outcomes risk imposing costs on consumers that are not justified by efficient risk allocation. The proposed fixed indexation approach therefore represents an important step towards improving affordability and protecting consumers from inflation-driven windfall gains.

[1] "H8 Initial Proposals – Response on Financial Issues", dated 29th May 2026

The Airline Community therefore supports the CAA's proposed direction of travel. We consider that the proposed approach:

- better aligns regulatory treatment with the characteristics of the financing it is intended to remunerate;
- reduces the potential for inflation-driven windfall gains and losses;
- improves internal consistency within the regulatory framework;
- improves affordability for consumers relative to the status quo;
- and better aligns risk and reward within the H8 settlement

The Airline Community nevertheless considers that several implementation issues require further consideration ahead of Final Proposals, including transparency around financing assumptions, the treatment of future debt, the inflation forecast used within the framework, and the implications of reduced risk for the wider financial package.

1. Case for Change

1.1 The CAA is right in proposing a move away from the status quo

The Airline Community welcomes the fact that the CAA's emerging policy position reflects concerns raised consistently by airlines throughout the H8 process and the H7 lessons learned exercise. As set out in the Airline Community's response to H8 Initial Proposals and the accompanying CEPA Report, airlines recommended removing outturn inflation indexation for nominal fixed-rate debt and replacing it with an approach that aligns regulatory inflation treatment with the underlying financing characteristics. The CAA's fixed indexation proposal represents a significant step towards achieving that objective and is materially closer to the Airline Community's position than the framework applied during H7.

The existing framework relies upon medium-term inflation forecasts when deriving a real debt allowance while simultaneously indexing the whole RAB to outturn inflation. This creates a clear mismatch where fixed-rate debt costs remain unchanged, but RAB values continue to rise when inflation exceeds expectations. In those circumstances, HAL may recover inflation-linked returns despite not being exposed to equivalent inflation-related financing costs. Equally, the reverse may occur when inflation falls below expectations.

The experience since the start of H7 demonstrates that these issues are not theoretical. The significant inflation shock in 2022 and onwards has highlighted the extent to which outturn inflation can diverge from expectations and materially increase the RAB despite no corresponding increase in the cost of servicing fixed-rate debt. Airlines highlighted this concern in their H8 Initial Proposals response, the H7 lessons learned review, and continue to consider it a fundamental weakness in the existing framework.

The Airline Community therefore agrees with the CAA's conclusion that retaining the H7 approach would no longer represent the most appropriate regulatory outcome.

1.2 Fixed Indexation is a materially better approach

The Airline Community supports the CAA's minded-to position to adopt the fixed indexation approach for H8.

The principal advantage of the proposal is that it removes unnecessary inflation exposure for the fixed-rate debt funded portion of the RAB. Fixed-rate debt does not experience changes in financing costs as inflation rises or falls after issuance. It follows that indexing that portion of the RAB to outturn inflation introduces a risk exposure that does not reflect the underlying financing characteristics. The fixed indexation approach more appropriately aligns the regulatory framework with the financing assumptions used elsewhere in the price control.

The proposal also reduces reliance on inflation forecast accuracy. Although no forecast can be perfect, the proposed framework substantially limits the consequences of forecast error relative to the current approach by reducing the degree to which inflation surprises can create gains or losses unrelated to HAL's efficient financing costs.

Furthermore, the Airline Community agrees with the CAA's assessment that the additional granularity required by the proposal should be viewed as a strength rather than a weakness. The financing assumptions needed for implementation already exist within the CAA's cost of debt framework and financeability modelling. Using those assumptions consistently improves coherence and transparency across the overall regulatory settlement.

1.3 Consumer Outcomes and Affordability

The Airline Community's primary concern remains the impact of regulatory decisions on consumers.

Inflation-driven growth in the RAB ultimately feeds through into airport charges and therefore impacts affordability, connectivity and consumer choice. The Airline Community has consistently argued that consumers are already burdened by the highest airport charges among major international airports and that regulatory decisions should seek to ensure charges remain efficiently incurred and proportionate to underlying risks.

Between 2014 and 2025, inflation indexation contributed significantly to RAB growth despite depreciation, illustrating the scale of the issue in practice. Based on HAL' own regulatory accounts we estimate within this period a total of £8.4bn was added through indexation, contributing to the £6.5bn RAB growth despite depreciation. It is clear that periods of elevated inflation have the potential, and have been evidenced to, create material impacts on consumers through higher airport charges that are not necessarily linked to efficient financing costs.

The Airline Community therefore considers that the fixed indexation proposal represents an important improvement not simply because it refines the financial framework, but because it reduces the risk of consumers bearing costs associated with inflation outcomes that are disconnected from HAL's actual financing exposure.

2. Comments on the Approach

2.1 Comparison to a semi-notional approach

The Airline Community recognises that a semi-nominal approach could also address the mismatch between fixed-rate nominal debt and RAB indexation. However, we consider that the CAA's proposed fixed indexation approach has significant advantages.

First, the CAA has not consulted on a semi-nominal approach as its preferred solution, and it would therefore be inappropriate to introduce such a framework at Final Proposals.

Secondly, whilst a semi-nominal approach may be economically equivalent in net present value terms, it would bring forward revenues into near-term charges rather than through future RAB accretion. This would place a greater burden on current airport users, weaken intergenerational fairness and increase pressure on affordability for consumers and airlines.

A semi-nominal approach would also continue to rely on many of the same assumptions regarding debt composition as the proposed fixed indexation framework, whilst introducing additional complexity through hybrid WACC calculations and potential changes in financing shares over time.

Finally, whilst accelerated revenue recovery could improve some short-term financeability metrics, this would come at the expense of future financeability and would not necessarily improve underlying financial resilience.

The Airline Community therefore considers it reasonable for the CAA to prefer fixed indexation, which addresses the underlying mismatch whilst preserving the established real price control architecture, avoiding unnecessary front-loading of charges and providing a simpler and more transparent framework for stakeholders.

2.2 Consistency with notional company principle

The Airline Community notes that the proposed fixed indexation framework relies upon assumptions regarding the notional financing structure. We consider this entirely consistent with the wider notional company principle that has historically underpinned economic regulation.

Indeed, the proposal highlights a broader inconsistency within the H8 Initial Proposals. The Airline Community has previously expressed significant concerns regarding the proposal to move towards HAL's actual embedded debt costs when setting debt allowances. We noted that such an approach weakens financing incentives, reduces transparency and risks increasing costs for consumers. The proposed policy should start from the premise that companies' actual financing structures are, and have always been, a matter of their management choice.

If notional financing assumptions are considered sufficiently robust and appropriate to determine how RAB indexation should operate, there is a strong argument that the same notional principle should continue to apply in determining efficient debt allowances. A coherent regulatory framework should apply the same underlying financing principles consistently across both debt allowances and RAB indexation.

The Airline Community therefore considers that the consultation reinforces our previously stated view that a notional approach remains preferable to one which increasingly relies upon HAL's actual financing decisions. Such an approach better protects consumers, provides stronger incentives for efficient financing and is more consistent with established regulatory practice.

If the CAA nevertheless intends to inform these assumptions using HAL's actual debt portfolio, the underlying evidence should be disclosed, including information on derivatives and inflation swaps. To date, this information has not formed part of the H8 process and requests for its release have been refused by HAL, limiting stakeholders' ability to assess the basis for any such assumptions.

3. Implementation Considerations

3.1 Transparency of financing assumptions

The Airline Community agrees that assumptions regarding the shares of fixed-rate debt, index-linked debt and equity should be transparent and clearly explained.

Throughout the H8 process airlines have repeatedly experienced difficulties obtaining information regarding HAL's debt structure and financing arrangements[2]. Yet the proposed implementation relies upon assumptions about those financing characteristics.

If actual financing characteristics are to inform implementation, stakeholders should be provided with sufficient information to understand and assess the basis of those assumptions, including where relevant the treatment of inflation hedging arrangements, derivatives and inflation-linked instruments.

3.2 Choice of inflation forecast

The Airline Community continues to note the inherent challenges in forecasting inflation over regulatory timescales. Previous experience demonstrates that medium-term forecasts can diverge materially from outturn inflation and that such divergence can have significant consequences within price control frameworks.

The CAA should therefore carefully assess the most appropriate inflation estimate to use within the fixed indexation framework and consider the relative merits of market-based expectations and forecast-based approaches. The chosen methodology should aim to provide the closest possible alignment with market expectations at the point regulatory decisions are made.

3.3 Treatment of future debt

The Airline Community is not persuaded that all future debt should automatically be assumed to be fixed-rate debt.

Although this issue may have limited quantitative impact during H8, it establishes an important precedent for future controls. The rationale for such an assumption should therefore be clearly

[2] Further details set out in the Airline Community letter to Rob Toal, CAA on 8th May 2026 "*Airline Community concerns on CAA's H8 Information Sharing – Heathrow's Cost of Debt and Fixed Asset Register*"

explained, evidenced and tested before becoming embedded within the long-term regulatory framework.

3.4 Long-term application

The Airline Community would welcome further clarification regarding whether the CAA expects the fixed indexation approach to become an enduring feature of Heathrow's regulatory framework.

This issue is particularly relevant in the context of future expansion and any future regulatory treatment of expansion-related investment. Greater clarity would improve predictability for consumers, airlines and investors alike.

4. Wider implications for risk and the financial framework

The proposed fixed indexation approach reduces inflation mismatch risk.

The Airline Community therefore considers that the reduction in risk should be recognised within the broader assessment of HAL's risk profile. The CAA has already acknowledged that changes in risk allocation can have implications for beta estimates and the allowed return[3]. The same principle applies here.

More broadly, the Airline Community continues to believe that the H8 financial package should be assessed in the round. HAL benefits from multiple mechanisms that reduce traffic risk, financing risk and inflation risk. These include the Traffic Risk Sharing mechanism, inflation protections, pass-through arrangements and other elements of the framework that collectively reduce risk exposure.

Where risk is reduced, this should be reflected through an appropriately calibrated allowed return. Failure to do so risks consumers paying for risks that HAL no longer bears.

5. Requests for Final Proposals

As set out above, the Airline Community welcomes the CAA's emerging policy position and supports the proposed adoption of a fixed indexation approach for H8. The proposal addresses a longstanding concern raised by airlines throughout the H8 review regarding the mismatch between outturn inflation indexation and nominal fixed-rate debt and represents a material improvement on the current framework by aligning RAB indexation more closely with the inflation exposure of the financing it is intended to remunerate. In doing so, it reduces the potential for inflation-driven windfall gains and losses, improves consistency within the wider regulatory framework and supports a more efficient outcome for consumers. The Airline Community therefore encourages the CAA to adopt the fixed indexation approach at Final Proposals.

However, as covered in more detail throughout this response, several implementation issues remain important to securing the full benefits of the approach, including the transparency and robustness of the underlying financing assumptions, the choice of inflation forecast, the treatment of future debt

[3] Including comments and related adjustments made in the CAA H8 Initial Proposals, Chapter 9

issuances, and the appropriate recognition of the resulting reduction in investor risk within the wider H8 financial package.

As such, the Airline Community would encourage the CAA to give further consideration to the following implementation and policy issues in advance of Final Proposals:

I. ensure that the assumptions underpinning implementation, including the treatment of fixed-rate debt, index-linked debt and equity, are transparent, evidence-based and capable of independent scrutiny by stakeholders;

II. provide sufficient information on the basis of those assumptions, including relevant information on HAL's financing arrangements where those inform regulatory decisions;

III. carefully assess the most appropriate inflation measure to support implementation, including the relative merits of market-based expectations and forecast-based approaches;

IV. reconsider the assumption that future debt should automatically be treated as fixed-rate debt and ensure that implementation decisions remain consistent with efficient risk allocation principles;

V. confirm its reasons for preferring a fixed indexation approach over alternative solutions, including a semi-nominal framework, having regard to affordability, transparency, implementation complexity and intergenerational fairness;

VI. recognise that reducing inflation mismatch risk lowers the risk borne by investors and should therefore be considered as part of the wider assessment of risk and return within the H8 financial package;

VII. clarify whether the proposed approach is intended to apply beyond H8, including in any future expansion framework, to improve predictability and transparency for stakeholders;

VIII. illustrate more clearly the scale of consumer harm associated with retaining the status quo approach, including the potential impact of future inflation shocks on the RAB and airport charges; and

IX. consider whether the reliance on notional financing assumptions within the fixed indexation framework further supports the Airline Community's longstanding view that debt allowances should continue to be determined on a notional rather than actual basis.

Yours sincerely,

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