

# Economic regulation of Heathrow Airport: H8 Initial Proposals Section 2: building blocks and incentives

CAP 3232B

Published by the Civil Aviation Authority 2026

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First published March 2026

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# Contents

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<b>Contents</b>	<b>3</b>
<b>Chapter 4</b>	<b>6</b>
<b>Operating expenditure</b>	<b>6</b>
<b>Introduction to opex</b>	<b>6</b>
<b>What we said in the H8 Method Statement</b>	<b>7</b>
<b>Stakeholders' views on opex</b>	<b>7</b>
HAL	7
Airlines	10
<b>Our views on opex</b>	<b>11</b>
Our method for opex	12
Developing our initial proposals for opex	13
<b>Initial proposals for opex</b>	<b>25</b>
<b>Next steps and implementation</b>	<b>29</b>
<b>Chapter 5</b>	<b>30</b>
<b>Commercial revenues</b>	<b>30</b>
<b>Introduction to commercial revenues</b>	<b>30</b>
<b>What we said in the H8 Method Statement</b>	<b>31</b>
<b>Stakeholders' views on commercial revenues</b>	<b>31</b>
HAL	31
Airlines	34
<b>Our views on commercial revenues</b>	<b>35</b>
Our method for commercial revenues	35
Developing our initial proposals for commercial revenues	36
<b>Initial proposals for commercial revenues</b>	<b>50</b>
<b>Next steps and implementation</b>	<b>54</b>
<b>Chapter 6</b>	<b>55</b>
<b>Capex assessment</b>	<b>55</b>
<b>Introduction to capex</b>	<b>55</b>

<b>What we said in the H8 Method Statement</b>	<b>56</b>
<b>Stakeholders' views on capex</b>	<b>56</b>
HAL	56
Airlines	59
<b>Our views on capex</b>	<b>60</b>
Our method for capex	60
Developing our initial proposals for capex	61
<b>Initial proposals for capex</b>	<b>77</b>
<b>Next steps and implementation</b>	<b>80</b>
<b>Chapter 7</b>	<b>81</b>
<b>Other regulated charges</b>	<b>81</b>
<b>Introduction to ORCs</b>	<b>81</b>
<b>What we said in the H8 Method Statement</b>	<b>82</b>
<b>Stakeholder views on ORCs</b>	<b>82</b>
HAL	82
Airlines	84
Other stakeholders	84
<b>Our assessment of ORCs</b>	<b>85</b>
Scope of ORCs for H8	85
Treatment of H8 ORC fixed costs	86
<b>Initial proposals for ORCs</b>	<b>88</b>
Our proposed ORC profile in 2024 CPIH	90
<b>Other ORC issues</b>	<b>91</b>
Reconciliation of the fixed costs of providing ORCs during the H7 period	91
Review of licence condition C2	92
<b>Conclusions and next steps</b>	<b>92</b>
<b>Chapter 8</b>	<b>93</b>
<b>Regulatory incentives</b>	<b>93</b>
<b>Introduction to regulatory incentives</b>	<b>93</b>
<b>Capital expenditure incentives</b>	<b>93</b>
Capex incentives	94
Capex governance	96

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Capex uncertainty mechanism	99
<b>Commercial revenue incentives</b>	<b>100</b>
Commercial property investment incentives	101
Terminal Drop-Off Charges	104
Lessons from the increase to fast track security charges in H7	105
<b>Key issues for consultation and next steps</b>	<b>106</b>

## Chapter 4

# Operating expenditure

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## Introduction to opex

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- 4.1 HAL incurs operating expenditure (“opex”) related to staff, maintenance, facilities management, utilities, business rates, and other costs needed for the day-to-day operation of the airport. The efficient opex allowance we set for HAL’s H8 price control is a key building block and driver of the level of airport charges and Other Regulated Charges (“ORCs”).
- 4.2 The quality of consumer services at Heathrow is materially influenced by how effectively HAL manages and deploys its opex to deliver a safe, efficient, and high-quality airport service. We protect consumers against the risk that opex savings could be achieved through lower service quality by setting an efficient opex allowance alongside appropriate quality of service incentives, which are set out in Chapter 3 (Service quality and resilience).
- 4.3 Setting an efficient opex allowance furthers the interest of consumers by ensuring that users pay charges that are based on an efficient level of opex and so are not higher than necessary, having regard to the need to:
- secure that HAL is able to finance its activities;
  - secure that users’ reasonable demands for airport operation services at Heathrow are met;
  - promote economy and efficiency on the part of HAL in its provision of airport operation services; and
  - provide an appropriate level and quality of service.
- 4.4 The broad approach to setting the H8 price control and determining the efficient opex allowance also provides HAL with incentives to operate efficiently. Other things being equal, if HAL underspends our opex allowance, it earns extra profits until the next price control is set. If it incurs extra costs, then typically it must fund the shortfall. As noted above applying incentives for appropriate levels of service quality helps to protect against the risk that opex savings could be achieved at the expense of service quality.
- 4.5 This chapter describes our approach to determining the efficient opex allowance for the H8 price control period. It sets out:
- a summary of what we said in the H8 Method Statement and Business Plan Guidance;

- a summary of stakeholders' views of the level of opex required for H8;
- our method for setting the efficient opex allowance for H8;
- our initial proposals for the efficient level of opex in H8; and
- next steps and implementation.

## What we said in the H8 Method Statement

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4.6 The H8 Method Statement said that we would work with consultants to strengthen our independent assessment of the efficient level of opex by:

- broadening the evidence base beyond HAL's Business Plan;
- increasing the granularity of opex categories assessed;
- using targeted bottom-up analysis;
- using external benchmarking where practical; and
- exploring the use of top-down econometric benchmarking.

4.7 We also said that HAL's H8 Business Plan would remain a key component of our assessment and the starting point of our analysis for some opex categories. The H8 Business Plan Guidance and accompanying data template, set clear and detailed guidance about the form, contents and granularity of opex information we expected HAL to submit in its H8 Business Plan.

## Stakeholders' views on opex

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### HAL

4.8 HAL's Business Plan, submitted in July 2025, included a base case traffic scenario of £8,102 million (2024 CPI prices) for opex over the H8 price control period.<sup>1</sup>

4.9 In December 2025, HAL submitted an update to its July 2025 Business Plan, setting out the following changes in respect of opex:

- the removal of £21 million (2024 CPI) of overlay costs associated with Security Enhanced Outcomes;
- a reduction in pension deficit repair costs to nil, following a finalised valuation of pension scheme liabilities; and

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<sup>1</sup> HAL forecasts two alternative opex scenarios in its Business Plan July 2025 submission, a low traffic scenario at £8,082 million (2024 CPI) and a high traffic scenario at £8,122 million (2024 CPI).

- an increase in its forecast of business rates to £1,071 million (2024 CPI) over H8, up from £722 million (2024 CPI), to reflect HAL's interpretation of the Government's position on business rates, announced in the November 2025 Autumn Budget.

4.10 The December 2025 update brought HAL's opex proposals for H8 to £8,431 million (2024 CPI), in its base traffic scenario, up from £8,102 million (2024 CPI) in the July 2025 submission. We have set our view of an efficient opex allowance for H8 by reference to HAL's updated forecast of £8,431 million (2024 CPI). But we retain the July 2025 numbers in the remainder of this section to allow comparability with airlines' views, which refer to the Business Plan submitted in July 2025.

4.11 HAL has also made the following two scope adjustments to its H8 opex proposals:

- the removal of T5 POD parking<sup>2</sup> costs, which aligns with the appropriate regulatory treatment of POD parking costs as they are treated as a non-regulated activity, consistent with the H7 price control. However, historically, HAL has reported its outturn regulatory opex inclusive of T5 POD costs; and
- the removal of noise and vortex mitigation costs, which HAL proposes to be treated as capex in the regulatory accounts, starting in H8. Noise and vortex mitigation costs have historically been treated and reported in the regulatory accounts as opex.

4.12 Figure 4.1 shows a comparison of historical opex, as reported in the regulatory accounts, against HAL's H8 forecasts submitted in July 2025. For comparability with outturns, the chart also shows HAL's forecast inclusive of POD parking (£2.7 million, 2024 CPI) and noise and vortex mitigation costs (£10.6 million, 2024 CPI). We note that the 2024 baseline that HAL rolls forward into H8 is exclusive of both noise and vortex, and POD parking costs. We detail the baseline implications of these adjustments in a dedicated section later in this chapter.

4.13 HAL has explained that opex costs rebounded strongly in the post-covid years of 2023 and 2024, reaching £1.6 billion (2024 CPI) per year and surpassing the pre-covid 2019 opex of £1.5 billion (2024 CPI). It says that this upwards trajectory reflects:

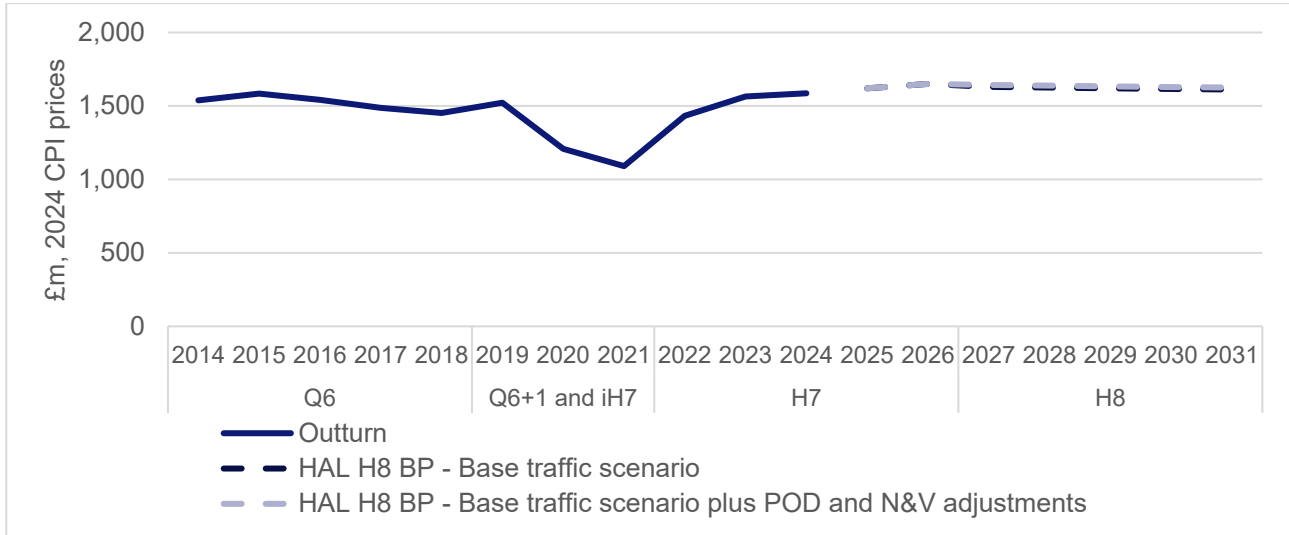
- the need to ramp up capacity to meet increased post-covid demand;

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<sup>2</sup> T5 POD refers to the small, driverless electric personal rapid transit pods that transport passengers between car parks and Heathrow Terminal 5.

- higher labour costs following HAL’s transition from the National Living Wage to the London Living Wage in 2022;
- higher per-passenger security and maintenance costs owing to increased congestion as the airport approaches capacity; and
- a higher proportion of passengers requiring additional support.

**Figure 4.1: Historical and forecast opex in HAL’s July 2025 Business Plan**



Source: HAL data tables submitted as part of its H8 Business Plan in July 2025, and Figure 120 of HAL H8 Business Plan, July 2025. Note: both historical and forecasts are exclusive of pension deficit repair costs.

4.14 As Figure 4.1 also shows, HAL forecasts annual opex in H8 to plateau at a level similar to that in 2024 and above pre-covid-19 levels, saying that structural cost increases that occurred during and after the pandemic are likely to persist over the longer term.

4.15 HAL has explained that its approach to forecast opex for H8 is consistent with that adopted in H7 and that it includes the following features:

- a) HAL’s baseline is 2024 outturn without any efficiency adjustments. HAL has said that 2024 is the latest representative full year of operations at or above capacity. It has also argued that opex in 2024 was at the average level expected for an airport of Heathrow’s size, complexity and throughput, consistent with the econometric benchmarking of opex costs conducted by its consultants, KPMG. HAL has removed the following costs from its 2024 baseline to ensure consistency with the opex scope it proposes for H8:
  - i. £2.7 million (2024 CPI) of Terminal 5 POD opex incurred in 2024, as this is a non-regulated activity; and
  - ii. £10.6 million (2024 CPI) of noise and vortex mitigation opex incurred in 2024, as HAL proposes that these costs are treated as capex starting in H8.

- b) HAL has rolled forward the 2024 baseline for each opex category, based on elasticities. The elasticities reflect HAL's view of the expected percentage change in opex for each one-percentage point change in the relevant cost driver, primarily passenger numbers and terminal area. HAL has used econometric analysis of historical relationship between opex categories and its view of the relevant drivers to estimate its H8 elasticities, which are broadly consistent with the elasticities used in its H7 opex forecasts.<sup>3</sup>
- c) It has applied an ongoing efficiency of 1.2% per year to all opex categories excluding business rates, utilities, and its electricity distribution contract. HAL explained through Questions and Answers (Q&A) that, of the 1.2% efficiency, 0.5 percentage points reflect ongoing efficiencies, as recommended by their consultants, Economic Insight. The remaining 0.7 percentage points account for expected efficiencies from past capital investment, operational optimisation, passenger automation, IT systems, and improved procurement.
- d) HAL has applied real price effect adjustments to some opex categories, namely labour, utilities, and insurance, which HAL has said are likely to see cost inflation in H8 above CPI inflation.
- e) It has proposed several overlays to account for one-off cost increases in H8 which, in HAL's view, are not accounted for by the elasticities nor by the real price effect adjustments. In its December 2025 update, HAL reduced its cost overlays to £235 million (2024 CPI),<sup>4</sup> down from £255 million (2024 CPI) in its July 2025 submission, by removing the £21 million (2024 CPI) overlay costs associated with Security Enhanced Outcomes.

4.16 HAL has also forecasted business rates for H8, which it says are consistent with the approach set by the Government in the November 2025 Autumn Budget, and has proposed that, starting in H8, business rates should be recovered through ORCs, rather than through airport charges.

## Airlines

4.17 Airlines submitted their H8 Alternative Business Plan to us on 17 October 2025, by reference to the H8 Business Plan that HAL submitted in July 2025. This included a report on HAL's opex by the airlines' consultants, CEPA. Airlines also expressed wider views on HAL's H8 Business Plan in a letter sent to us on 13 October 2025, namely concerns about the absence of a bottom-up approach to

<sup>3</sup> The main exceptions are the elasticity for facilities and maintenance, which HAL estimates at 0.35 in H8 (0.66 in H7); utilities, estimated at 0.25 (0.39 in H7); and general expenses, estimated at 0.30 (0.39 in H7).

<sup>4</sup> HAL's proposed overlays for H8 are: technology maintenance (£90 million); resilience costs (£63 million); support for passengers requiring assistance (£15 million); digital investment (£40 million); and multi-storey car park arrangements (£27 million).

opex and commercial revenues forecasting in HAL's plan, a lack of transparency in the underlying calculations, and delays in responding to information requests.

- 4.18 In their Alternative Business Plan, airlines have proposed a level of opex for H8 at £7,046 million (2024 CPI), representing a 13%, or -£1,056 million (2024 CPI), reduction from HAL's July 2025 proposal of £8,102 million (2024 CPI).
- 4.19 Airlines/CEPA have based their assessment on the following arguments:
- a) Inefficiency of 9% versus the top quartile performing airport, which reduces HAL's July 2025 opex proposal by £641 million (2024 CPI). Airlines have applied a 9% reduction to all H8 opex categories, except business rates and the electricity distribution contract, and have said that this is consistent with the findings from the opex econometric benchmarking report that HAL commissioned from KPMG. They have said that KPMG's report shows Heathrow having a level of opex inefficiency ranging from 5% to 11% as compared to the top quartile performer. Airlines have also said that their consultants, CEPA, performed a targeted bottom-up review of material opex categories, which confirmed the 9% reduction they have proposed across most opex categories for H8 is appropriate.
  - b) Unconvincing evidence of both need and additionality in many of the six cost overlays that HAL proposes for H8. Airlines have proposed reducing HAL's July 2025 proposed opex by a further £184 million (2024 CPI) owing to fewer overlays. They have said that only two cost overlays, passenger requiring assistance and part of the multi-storey car park arrangements, have a strong need case.
  - c) Lower business rates, which reduces HAL's July 2025 H8 opex proposal by a further £140 million (2024 CPI). Airlines have rolled forward the 2024 outturn business rates and have said that further investigation is needed before setting the business rates allowance for H8.
  - d) Less generous adjustments for real price effects for electricity and insurance, which further reduces HAL's proposed July 2025 H8 opex by £120 million (2024 CPI).
  - e) An opex uplift of £27 million (2024 CPI) over HAL's July 2025 submission, reflecting airlines' less stretching ongoing efficiency assumption of 1% per year (compared to HAL's proposed 1.2%), and higher passenger forecasts. Airlines have used the same elasticities that HAL uses for H8.

## Our views on opex

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- 4.20 We value the engagement with HAL and airlines ahead of the Business Plan submitted in July 2025 where we discussed our proposed method for assessing

opex in H8. The feedback and challenge we received is fully reflected in our final method, which we set out below.

4.21 We have developed our assessment of HAL’s H8 opex (and commercial revenue) proposals with support from, and in close collaboration with, our technical consultants Europe Economics and York Aviation (EE/YA), whose report we publish alongside our initial proposals.<sup>5</sup>

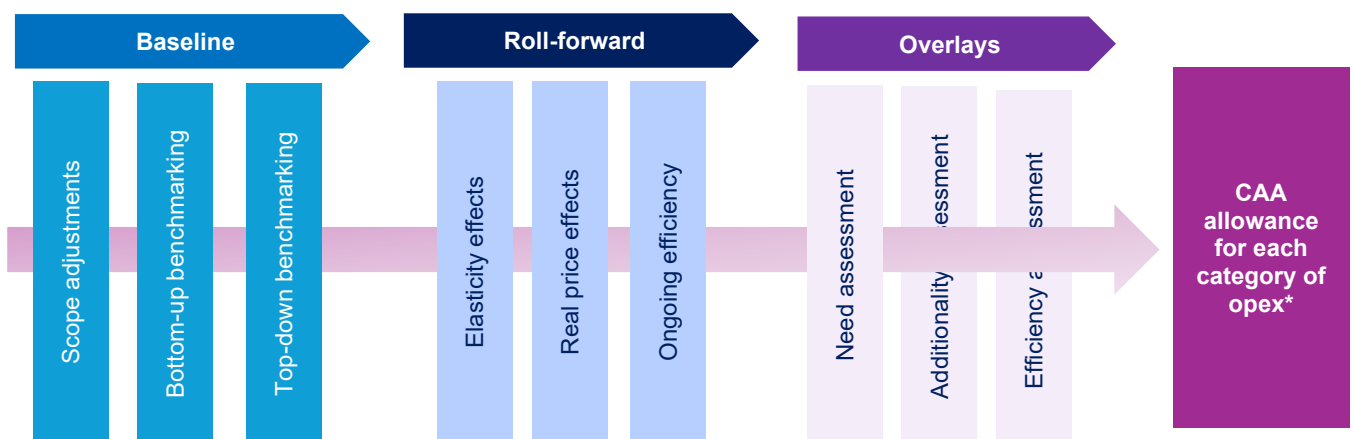
### Our method for opex

4.22 As illustrated in Figure 4.2, we have designed a method for setting the efficient level of opex for H8 that builds on the “base-trend-step” approach we used in H7. Our method has three components:

- baseline – where we set the efficient baseline level for each opex category, taking account of both bottom-up assessments and top-down benchmarking;
- roll-forward – where we roll each opex category baseline forward to and through the H8 period taking account of changes in volumes, input price inflation, and productivity adjustments, and
- overlays – where we determine whether any one-off adjustments are supported by evidence of need, additionality, and cost efficiency.

4.23 Our assessment of the efficient level of opex required by HAL to operate the airport during H8 is the result of these components (as indicated in Figure 4.2 with two exceptions, business rates and pension deficit recovery costs. For these two exceptional opex categories, we have used bespoke assessment methods, which we explain later in this chapter.

**Figure 4.2: Our opex assessment method for H8**



Source: CAA \*Note: For business rates and pension deficit repair costs, we have used bespoke assessment methods outside this framework.

<sup>5</sup> EE-YA H8 opex and commercial revenues report for IPs - REDACTED

## Developing our initial proposals for opex

### Baseline

- 4.24 Setting the efficient baseline for each opex category is the first component of our opex assessment method. We agree with HAL and the airlines that 2024 should be our base year, as this year was representative of business-as-usual operations at Heathrow Airport and is the latest full year for which outturn information is available.
- 4.25 As shown in Figure 4.2, setting our efficient 2024 baseline involves three steps:
- making certain scope adjustments to the 2024 outturn regulatory accounts;
  - establishing the efficient baseline level of each opex category through targeted bottom-up benchmarking; and
  - using top-down econometric benchmarking as a cross-check to assess whether the efficient baseline resulting from our bottom-up assessment should be subject to further adjustment.

### Scope adjustments

- 4.26 Consistent with our previous decision to exclude capex on T5 POD parking from HAL's RAB, we agree with HAL that we should remove the £2.7 million (2024 CPI) of opex costs related to T5 POD parking that HAL reported in its 2024 regulatory accounts. T5 POD parking is outside the single till as it is effectively a non-regulated activity and, therefore, we exclude the costs and revenues of this activity from our price control calculations. HAL explained through Q&A that it reported POD costs across five opex categories in its 2024 regulatory accounts. Table 4.1 shows the POD cost amounts removed from each of these opex categories.
- 4.27 HAL has proposed to treat costs to mitigate noise and vortex as capex, starting in H8, in contrast with the historical regulatory precedent of treating these costs as opex. As we explain in Chapter 6 (Capex assessment), we have decided to retain the treatment of noise and vortex mitigation costs as opex. HAL explained through Q&A that its noise and vortex opex in 2024 was £10.6 million (2024 CPI), which it reported in its 2024 regulatory accounts against two opex categories indicated in Table 4.1. We retain the £10.6 million (2024 CPI) of noise and vortex opex in our 2024 baseline but, for transparency, we treat it as a separate opex category. We note, though, that HAL removed noise and vortex from the 2024 baseline used as the basis to generate its H8 opex proposals, meaning that our 2024 starting position diverges from HAL's in this regard.

**Table 4.1: Scope-adjusted 2024 outturn opex**

(£ million, 2024 CPI)					
Opex category	HAL 2024 outturns	Adjustment for POD parking	N&V adjustment	CAA scope-adjusted 2024 outturns	HAL 2024 baseline
Security staff	197.1			197.1	197.1
Other staff	287.7	-0.8	-0.4	286.5	286.5
Maintenance, facilities management & equipment	239.7	-1.6		238.1	238.1
Rent and rates	116.4	-0.02		116.4	116.4
Utilities	126.1	-0.1		126.0	126.0
Electricity distribution contract	33.1			33.1	33.1
Insurance	19.7			19.7	19.7
Other opex	566.3	-0.1	-10.2	556.0	556.0
Noise and vortex	-	-	-	10.6	-
<b>Total opex</b>	<b>1,586.2</b>	<b>-2.7</b>	<b>-10.6</b>	<b>1,583.5</b>	<b>1,572.9</b>

Source: CAA analysis. Notes: HAL's 2024 baseline excludes £10.6 million (2024 CPI) of noise and vortex costs. CAA's 2024 scope-adjusted outturns are inclusive of £10.6 million (2024 CPI) noise and vortex costs. N&V = noise and vortex.

### Bottom-up benchmarking

4.28 We commissioned our technical consultants EE/YA to carry out a bottom-up benchmarking of the priority opex categories marked as 'yes' in the last column of Table 4.2. Combined, they account for 89% of total opex in 2024. We selected these priority opex categories based on three criteria:

- materiality of above 5% of the total opex in 2024;
- whether stakeholder airlines indicated these as a priority through the extensive engagement we had with them ahead of Business Plan submission; and
- whether variations between H7 allowances and HAL's outturns from 2022 to 2024 (latest outturns) are not explained by passenger or price variations.

**Table 4.2: Opex categories selected for bottom-up benchmarking**

Opex category	Proportion of 2024 opex	Material category	Airline priority	Performance priority	Bottom-up analysis?
Security staff	12%	Yes	Yes	No	Yes
Other operational staff	8%	Yes	Yes	Yes	Yes
Non-operational staff	10%	Yes	Yes	Yes	Yes
Pensions costs	0% net	No	No	No	No
Other opex	36%	Yes	Yes	Yes	Yes
Insurance	1%	No	No	No	No
Facilities and maintenance	15%	Yes	Yes	Yes	Yes
Rent and rates	7%	Yes	No	Yes	n/a (bespoke assessment)
Utilities	8%	Yes	No	No	Yes
Distribution contract	2%	No	No	No	No

Source: EE/YA technical report.

- 4.29 For the priority opex categories (89% of total opex) our consultants EE/YA set the efficient 2024 opex baseline through independent technical assessments and external unit cost benchmarks, which are covered in detail in their technical report. For the remaining opex categories not selected for bottom-up assessment (11% of 2024 opex), we have accepted HAL’s 2024 outturns as the baseline level for our assessment.
- 4.30 As Table 4 shows, our efficient 2024 opex baseline is £1,520 million (2024 CPI), inclusive of £10.6 million (2024 CPI) of noise and vortex opex. Our efficient baseline is £64 million (2024 CPI), or 4.0% lower than HAL’s 2024 baseline inclusive of noise and vortex (for comparability).

**Table 4.3: CAA proposed efficient 2024 baseline versus HAL 2024 baseline**

(£ million, 2024 CPI) Opex category	HAL 2024 baseline	CAA 2024 baseline*	CAA minus HAL	
			Value	%
Security staff	197.1	173.6	-23.5	-11.9%
Other staff	286.5	271.9	-14.6	-5.1%
Maintenance, facilities management & equipment	238.1	235.4	-2.6	-1.1%
Rent and rates	116.4	116.4	0.0	0.0%
Utilities	126.0	109.4	-16.6	-13.2%
Electricity distribution contract	33.1	33.1	0.0	0.0%
Insurance	19.7	25.6	5.9	30.0%
Other opex	556.0	554.2	-1.7	-0.3%
<b>Total opex</b>	<b>1,572.9</b>	<b>1,519.7</b>	<b>-53.2</b>	<b>-</b>
Noise and vortex	10.6	-	-10.6	
<b>Total opex with noise and vortex</b>	<b>1,583.5</b>	<b>1,519.7</b>	<b>-63.8</b>	<b>-4.0%</b>

Source: CAA analysis. Note: \* CAA’s 2024 baseline is inclusive of £10.6 million (2024 CPI) of noise and vortex costs.

- 4.31 Our baseline for opex costs represents our estimate of the efficient level of opex that would have been achievable in 2024, had the airport not been constrained by short-term contractual or operational rigidities. This estimate is, therefore, not a direct measure of inefficiency in HAL’s 2024 outturn, but does indicate the broad cost savings likely to be available to HAL by or around the start of H8, as HAL is able to work through these contractual and operational rigidities.
- 4.32 The detailed rationale and evidence underpinning our efficient adjustments to the baseline is available in the technical report by EE/YA. In summary, the -£64 million (2024 CPI) difference between the CAA and HAL’s 2024 baselines is primarily driven by:
- lower ‘security staff’ costs (-11.9%), mostly reflecting the higher throughput expected with the efficient deployment of the next-generation security screening equipment;
  - savings associated with the outsourcing of trolley-handling activities to reduce ‘other operational and non-operational staff’ (-5.1%);

- in utilities, we understand HAL’s 2024 gas and electricity contracts reflect the Ukraine-war price spike. We expect the new energy contracts to reflect the lower energy prices of current markets (-13.2%);
- upward pressure on insurance premiums owing to mounting geopolitical risks and greater likelihood of natural disasters. HAL has proposed this to be accounted for through an insurance input price adjustment of 10% above CPI inflation. We consider it more transparent to make a baseline adjustment instead (+30%); and
- £10.6 million (2024 CPI) of noise and vortex costs, which HAL excludes from its baseline.

### Top-down benchmarking

- 4.33 We have commissioned our consultants EE/YA to conduct independent top-down econometric benchmarking to assess HAL’s relative opex efficiency compared with other airports. We have used this top-down benchmarking primarily as a cross-check on the efficiency challenge applied to HAL’s baseline when determining our efficient 2024 starting point. We have also taken the results from the top-down benchmarking into account when selecting appropriate point estimates for elasticities used to roll our 2024 baseline forward into H8.
- 4.34 Our top-down econometric benchmarking draws on a panel dataset primarily based on the publicly available Jacobs Airport Performance Indicators data,<sup>6</sup> which covers airport-level operational and financial data from 2010 to 2022 across 50 airports.<sup>7</sup> We supplemented this data with macroeconomic and structural indicators to enable meaningful comparisons across airports operating under different macroeconomic conditions, asset base, and passenger mix.
- 4.35 The EE/YA technical report details the modelling features of this top-down econometrics, which, in summary, include the following:
- Explained variable: total opex as standardised by Jacobs to allow consistent comparison across airports.
  - Explanatory variables: we have used workload units (“WLUs”), a combined measure of passengers and cargo, as the preferred measure of scale, which is the primary driver of opex in the models. The models also include variables to control for local economic conditions (proxied by GDP per capita), the size of the asset base, the share of international passengers, and the share of premium passengers. We have also included year dummies to control for sector-wide shocks, such as the effects of covid-19.

<sup>6</sup> [Airports Performance Indicators 2024 | Jacobs](#)

<sup>7</sup> We intend to update our analysis with 2023 and 2024 data as of when it is available.

- **Functional form:** we have estimated a log-linear Cobb–Douglas econometric model using pooled Ordinary Least Squares (“OLS”), with cluster-robust standard errors at the airport level. Conceptually, pooled OLS is superior to other model specifications (namely panel models) in capturing time-invariant (or very slow moving) variation in efficiency across airports, which is the central focus of our benchmarking exercise. Our tests have confirmed that pooled OLS is also at least as statistically robust as the alternative functional forms that we have tested.
- **Frontier performer:** we have defined as “frontier performer” the airport occupying the upper quartile position, meaning that the frontier performer is more efficient than 75% of the airports in the sample. We have set HAL’s relative efficiency by reference to the upper quartile (frontier) performer.
- **Model fit:** as Table 4.4 shows, the pooled OLS model explains approximately 90% of the variation in opex costs in the sample, indicating a strong fit. The elasticity on WLUs implies plausible economies of scale. GDP per capita is a statistically significant control. The coefficients on fixed assets, international-passenger share and premium-passenger share are positive and significant, consistent with higher operational demands at airports with a greater asset base and a greater proportion of international or premium traffic.

**Table 4.4: Econometric model estimation for opex**

Model	WLUs	GDP per capita	Fixed assets	International pax	Premium pax	Year dummies	N	R <sup>2</sup>
Pooled OLS	0.80***	0.20***	0.11**	0.60***	1.82**	Insig.	416	90%

Source: EE/YA technical report. Notes: N=number of observations. \*, \*\*, \*\*\* denote statistical significance at 10%, 5% and 1% respectively. Year dummies are statistically insignificant.

4.36 The results of our preferred top-down econometric benchmarking model, shown in Table 45, indicate that HAL’s opex costs are 3 to 5% higher than the frontier airport. In 2019, it ranked 39<sup>th</sup> of 43 airports in the sample, with an inefficiency gap to the frontier of around 3%. In 2022, its position fell to 40<sup>th</sup>, with the efficiency gap widening to 5%. The frontier was anchored by Amsterdam Schiphol Airport.

**Table 4.5: HAL’s opex efficiency in CAA’s econometric benchmarking model**

	Ranking		Gap to frontier	
	2019	2022	2019	2022
HAL opex efficiency position	39 out of 43	40 out of 43	3.14%	4.92%

Source: EE/YA technical report. Notes: a positive gap to frontier indicates inefficiency as it indicates that HAL’s opex costs are higher than the frontier airport. Frontier airport is the airport occupying the upper quartile position, meaning the airport that is more efficient than 75% of the airports in the sample.

4.37 We do not consider it necessary to adjust our 2024 efficient baseline resulting from our bottom-up benchmarking and set out in Table 4.5. This is because our baseline implies an efficiency challenge on HAL’s 2024 baseline of 4%, which is

within the 3% to 5% range indicated by our top-down econometric benchmarking.

### Roll-forward

- 4.38 The second component of our opex method is rolling our 2024 opex efficient baseline forward into each year of H8. As Figure 4.2 shows, our roll forward involves applying the following three year-on-year effects to our opex baseline:
- elasticities – accounting for the impacts on opex of changes in volume drivers such as passenger numbers and terminal space expected in H8;
  - real price effects – accounting for material deviations from CPI inflation in input prices that are outside of HAL’s control; and
  - ongoing efficiency – also referred to as frontier shift, which accounts for expected underlying productivity improvements.

### Elasticities

- 4.39 Elasticities measure the percentage change in opex for a one percentage point change in passenger numbers, or other relevant cost drivers. These cost drivers will change over the H8 period and we have used elasticities and forecasts of the cost drivers to estimate the expected change in opex in H8, compared to the 2024 opex baseline.
- 4.40 Airlines have scrutinised and have accepted HAL’s elasticity estimates, although they also said that they have disagreed with the rationale HAL has used to justify its choice of elasticities.
- 4.41 We commissioned EE/YA to support us developing our independent view of elasticities for H8 and their technical report details this analysis. In summary, we agree with HAL and the airlines on:
- the choice of drivers of each opex category;
  - the suite of regression model specifications used for estimating elasticity ranges; and
  - the use of annual historical data, from 2014 to 2024, in the modelling.
- 4.42 We differ from HAL and the airlines in the choice of the specific elasticity point estimate. Our choice is based on our rounded view of the following factors:
- consistency with the findings of our bottom-up assessment and top-down benchmarking;
  - regulatory precedent; and

- expert judgement from our technical consultants EE/YA, drawing on first-principles reasoning to assess the plausibility of implied cost–driver relationships.

4.43 Table 4.6 summarises our assessment of opex elasticities for H8. These are broadly aligned with HAL’s proposed elasticities, with three exceptions:

- **Utilities:** we have used a higher elasticity of 0.30, compared with HAL’s 0.25, owing to our modelling producing somewhat higher estimates than those that HAL estimated.
- **Facilities and maintenance:** because no change is expected in terminal area in H8, then the elasticity estimate does not have an impact on the level of allowed costs, hence using an elasticity of 1.0, instead of HAL’s 0.35.
- **Other opex:** we adopted a single aggregate elasticity of 0.25, rather than HAL’s separate elasticities for operational costs (0.2) and general expenses (0.3). Bottom-up benchmarking by EE/YA indicates that items within these subcategories frequently shift between them over time, meaning that more disaggregated elasticities may be unstable or misleading.

**Table 4.6: CAA proposed opex elasticity assumptions for H8**

Opex category	Driver	HAL H8	CAA H7	IAA 2022	CAA H8 range	CAA H8 point estimate
Staff	Total pax	0.3	0.33	-	0.15-0.30	<b>0.3</b>
Security	Total pax	-	-	0.88 - 0.89	-	-
Non-security	Total pax	-	-	0.1 - 0.77	-	-
Operational	Total pax	-	0.39	0.1	-	-
Utilities	Total pax	0.25	0.39	-	0.22-0.49	<b>0.3</b>
Facilities and maintenance	Terminal area	0.35	-	0.4	No econometrics	<b>1.0</b>
Other opex	Total pax	-	-	-	-	<b>0.25</b>
Operational costs	Total pax	0.2	0.39	-	0.13-0.27	-
General expenses	Total pax	0.3	0.39	-	0.57-0.69	-
Noise and vortex	Total pax	0.2	-	-	No econometrics	<b>0.25</b> (same as other opex, the largest component)

Source: EE/YA technical report. Note: IAA= Irish Aviation Authority.

### Real price effects

4.44 Real price effects (“RPEs”) are cost adjustments (upwards or downwards) to account for any expected material changes in input prices (for example, labour or utilities) above or below the CPI inflation, which are generally outside of HAL’s control.

4.45 The assessment of RPEs requires technical analysis of which opex cost categories would justify a RPE adjustment and the magnitude of such adjustment. Our consultants EE/YA own a well-established RPE assessment

framework, which they have deployed in similar work they have conducted for other regulators, namely Ofwat and ORR, and is detailed in their technical report.

4.46 Building on the recommendations from our consultants, Table 4.7 summarises our proposed RPE adjustments for H8, alongside HAL’s proposals. Our views on RPEs differ from HAL’s for the following reasons.

- **Cleaning costs:** we understand that cleaning costs are outsourced and, therefore, expect the cleaning contract to trail general inflation. We note that the EE/YA bottom-up benchmarking has found that cleaning costs tend to follow the CPI. We, therefore, consider that a RPE adjustment is unnecessary for this component of the maintenance opex category.
- **Utilities:** where HAL assumes CPI+1%. Our decision to not apply a RPE adjustment to energy prices has been taken in the round considering: (i) that energy costs are already partially captured by CPI; (ii) the absence of a robust and up-to-date official energy retail price forecast; and (iii) the inconsistency between historical and forward-looking evidence on the wedge between energy prices and CPI. We recognise, however, that it may be appropriate to revisit this position, if more robust forecasts of energy prices become available. We note that the latest energy forecast by the Department for Energy, Security and Net Zero (DESNZ), which airlines have used to support their proposed negative energy RPE, dates from November 2023 and has been overtaken by outturn data and changing circumstances.
- **Insurance:** we acknowledge HAL’s evidence of insurance premiums price pressures, such as greater likelihood of natural disasters, and increased geopolitical and cyber risks. We have reflected these pressures through a baseline adjustment to insurance costs, rather than an RPE, recognising that the expected increases relate to HAL’s starting costs, rather than ongoing RPEs.

**Table 4.7: CAA proposed RPE adjustments to opex in H8**

Opex category	HAL H8	CAA H8
Staff	OBR average earnings forecast	OBR average earnings forecast
Maintenance, facilities management & equipment	16% Labour / 84% CPI	16% Staff / 84% CPI, except cleaning costs (CPI)
Utilities	CPI+1%	CPI
Electricity distribution contract	RPI	RPI
Insurance	10% year-on-year growth (assumed inclusive of inflation)	CPI
Other opex	28% staff / 72% CPI (Other operational costs) CPI (General expenses)	28% Staff / 72% CPI, except for subcategories where HAL informed us costs are linked to CPI or RPI

Source: EE/YA technical report.

## Ongoing efficiency

- 4.47 Ongoing efficiency, also referred to as frontier shift, accounts for cost savings stemming from improvements in HAL's productivity from adopting new technologies and new ways of working.
- 4.48 We have asked our consultants, EE/YA, to recommend a level of ongoing efficiency based on the most recent regulatory precedent. They have concluded that regulatory precedent over the past decade consistently supported applying a 1% per year ongoing efficiency challenge for opex. Recent determinations by Ofwat, Ofgem, and the Northern Ireland Utility Regulator have all applied a 1% ongoing efficiency challenge, based on established methodologies that rely on comparator-sector total factor productivity analysis using EU KLEMS<sup>8</sup> data.
- 4.49 Our consultants have noted that the CMA's PR24 redetermination set an ongoing efficiency of 0.7% per year for the water industry, albeit applied to both opex and capital expenditure.
- 4.50 We agree with our consultants' view that the CMA's approach appears to be specific to the water sector and not readily applicable to other regulated industries.
- 4.51 Therefore, we are of the view that the weight of regulatory precedent continues to support applying a 1% ongoing annual efficiency challenge to all opex categories except utilities and the electricity distribution contract. This is aligned with the airlines' proposal and lower than HAL's proposal of an annual 1.2% ongoing efficiency challenge (see Table 4.8). HAL has noted that its proposed ongoing efficiency partially accounts for efficiency gains from capital programmes such as next generation security equipment, which we account for in our adjustment to the 2024 baseline.

**Table 4.8: CAA proposed ongoing efficiency adjustments to opex in H8**

Cost category	HAL H8	CAA H8
Staff	1.2% per year	1.0% per year, except pension costs (no efficiency)
Maintenance, facilities management & equipment	1.2% per year	1.0% per year
Utilities	No ongoing efficiency	No ongoing efficiency
Electricity distribution contract	No ongoing efficiency	No ongoing efficiency
Insurance	1.2% per year	1.0% per year
Other opex	1.2% per year	1.0% per year

Source: EE/YA technical report.

<sup>8</sup> EU KLEMS is a European industry level data base of capital (K), labour (L), energy (E), materials (M), and service (S) inputs funded by the European Commission. It is recognised by researchers and practitioners as the most comprehensive data set of European-wide productivity data at industry level.

## Overlays

- 4.52 Overlays are the third and final component of our opex method. They refer to one-off exceptional costs or other adjustments, upwards or downwards, that are supported by persuasive evidence and not accounted for in the roll forward of base year costs.
- 4.53 In the Business Plan submitted in July 2025, HAL proposed six opex overlays which increased opex by £255 million (2024 CPI). In its December 2025 update, HAL withdrew the Security Enhanced Outcomes overlay of £21 million (2024 CPI), bringing the number of overlays down to five totalling an upwards opex adjustment of £235 million (2024 CPI). We have asked EE/YA to perform a technical assessment of the evidence supporting the five overlays against three criteria:
- need: whether there is an impact outside of HAL's control that affects its cost base and justifies the overlay;
  - additionality: whether the impact is clear and additional to what is already accounted for via volume adjustments, input price adjustments, other implemented overlays, or planned capex; and
  - efficiency: whether the size of the proposed overlay is efficient and reasonable.
- 4.54 Based on EE/YA analysis, we have proposed a further overlay to adjust security staff opex downwards reflecting the "learning-by-doing" effects associated with the transition to next-generation security standards, as well as ongoing improvements expected from advanced security detection algorithms. Evidence from comparator airports, collated as part of EE/YA's bottom-up benchmarking, indicates that operational efficiencies are expected to emerge over time as staff and passengers become more familiar with the security equipment and associated processes.
- 4.55 We have considered the recommendations from our consultants based on the evidence HAL provided in the plans and have made a total opex overlay adjustment for H8 of £30.1 million (2024 CPI). Table 4 summarises our assessment of each of the overlays proposed, by HAL and the CAA.

**Table 4.9: CAA assessment of proposed opex overlays for H8**

Proposed overlay	HAL H8 (million)	Need	Additionality	Efficiency	CAA H8	
Technology	£90	Uncertain. Hinges on renewal of existing asset base not catching up with delays due to covid.	Unclear. The rationale offered suggests that there should be some offsetting implications for capex.	Unclear. Limited information provided on how costs have been estimated. HAL's technology costs already seem high vis-à-vis peers.	0	
Resilience (operating at capacity)	£63	Uncertain. Hinges on renewal of existing asset base not catching up with delays due to covid.	The rationale for an uplift over 2024 baseline (as opposed to a 2020 baseline) is not convincing.	Unclear. Limited information on how costs have been estimated.	0	
PRM	£15	Established. Demographic trends suggest increasing demand for PRM.	Yes (the elasticity calculations do not address the extra propensity for passengers to seek PRM services).	Controlling for differences in baseline PRM costs, the proposed overlay is reasonable.	£13.4 million	
Digital investment	£40	The case for cyber security costs as an impact outside HAL's control seems persuasive, but need for remaining costs under this category not established.	Unclear. To the extent that the switch from outsourcing to insourcing is driving the estimate, it is not clear why the costs are additional.	HAL's current IT costs already appear high vis-à-vis peers, and our baseline adjustment was modest.	0	
Multi-story car park in Terminal 4 (MSCP4)	£27	Clear rationale provided. We accept that temporary arrangements will give rise to additional operating costs during the redevelopment period.	Clearly additional. HAL will need to operate a temporary substitute facility and provide bussing and related support services between the terminal and the interim car park.	Car parking component of the costs are broadly in line with costs forecast during capex consultation. We have adjusted the PRM share of the costs down in line with other PRM cost adjustments.	£25 million	
Security Enhanced Outcomes	£21	HAL removed this overlay, as per its representation made to the CAA in December 2025.				
<b>Total BP Jul-25</b>	<b>£255</b>					<b>£38.4 million</b>
CAA security staff adjustment		Evidence from comparator airports, indicates that operational efficiencies are expected to emerge over time as staff and passengers become more familiar with equipment and	Evidence from other airports shows efficiency gains in the first 5 years following roll-out and then plateau. We embed 2 years of savings in our baseline, meaning	EE/YA's bottom-up benchmarking shows a 1.6% efficiency gain per year, corresponding to - £2.78m opex reduction per year from 2027 to 2029.	<b>-£8.3 million</b>	

Proposed overlay	HAL H8 (million)	Need	Additionality	Efficiency	CAA H8
		associated processes.	overlay only includes three years of efficiencies (2027 to 2029)		
<b>Total Dec-25 update</b>	<b>£235m</b>	-	-	-	<b>£30.1 million</b>

Source: EE/YA technical report. Note: values are in 2024 CPI prices.

## Bespoke assessments

4.56 Business rates and pension deficit recovery costs are driven by unique factors and, therefore, do not lend themselves to an assessment using our ‘baseline, roll-forward, overlays’ method set out in Figure 4.2Figure . For these two exceptional opex categories we conduct bespoke assessments, which we explain below.

### Business rates

- 4.57 In its Business Plan submitted in July 2025, HAL proposed a business rate allowance of £721.9 million (2024 CPI) across H8. HAL noted that there was a material risk that business rates could increase significantly from 2026 onwards, once the Valuation Office Agency (“VoA”) confirmed the updated rateable values and the Government confirmed its position on policies such as business rate multipliers, inflation indexation, and any transitional relief scheme.
- 4.58 In its December 2025 update, HAL increased its forecast of business rates for H8 to £1,071 million (2024 CPI), up from £721.9 million (2024 CPI) proposed in July 2025. This increase reflects HAL’s assessment of business rates for the period 2026/27 to 2028/29 based on the VoA’s provisional rateable values and the Government policy decisions announced in November 2026. HAL has then rolled forward its 2028/29 estimate into the remaining years of H8.
- 4.59 In our H7 Final Issues,<sup>9</sup> we concluded that our H7 Final Decision on business rates was £85 million (2020 CPI prices) too high and “logged up” this amount against possible future increases from 2026 onwards. We said that we would true up this “logged up” amount as part of the H8 price control review. Based on our assessment of HAL’s business rates liabilities between 2022 and 2026, as submitted in its H8 Business Plan data tables, we have determined that HAL has not utilised any of the logged-up amount. We, have, therefore, deducted the full £85 million, in 2020 CPI, which is equivalent to £104 million in 2024 CPI, evenly from the business rates allowance across H8.

<sup>9</sup> CAA, Economic regulation of Heathrow Airport: H7 final issues (CAP 2980), March 2024, pages 10-11.

4.60 For initial proposals, we consider that HAL's December 2025 update, net of the logged-up amount, at £967 million (2024 CPI), is an appropriate allowance for business rates. Table 4.10 below summarises our allowance.

**Table 4.10: CAA proposed business rate allowance for H8**

(£ million, 2024 CPI)	2027	2028	2029	2030	2031	H8
H8 business rates forecast	180	223	223	223	223	1,071
Logged up amount from H7 Final Issues	21	21	21	21	21	104
<b>H8 business rates net of logged up amount</b>	<b>159</b>	<b>202</b>	<b>202</b>	<b>202</b>	<b>202</b>	<b>967</b>

Source: CAA analysis. Note: the logged up amount set out in our H7 Final Issues was £85 million, in 2020 CPI prices, which is equivalent to £104 million in 2024 CPI prices.

### Pension deficit recovery costs

4.61 In its Business Plan submitted in July 2025, HAL included an allowance for Pension Deficit Repair Costs ("PDRCs") in its charges calculation, presenting this as a separate line item and excluding it from opex. The total allowance proposed was £72 million (2024 CPI) across H8. In its December 2025 update HAL stated it estimated PDRCs at nil for H8, following its final valuation concluded in September 2025.

4.62 We remain of the view, consistent with our approach in Q6 and H7, that efficient PDRCs should be included in HAL's opex allowance, in line with the policy principle that consumers pay for deficits and benefit from surpluses. That said, given the result of HAL's most recent valuation, we have set our allowance for PDRCs at nil for H8.

## Initial proposals for opex

### Our proposed H8 opex forecast

4.63 Our efficient H8 opex allowance for these initial proposals is £7,862 million (2024 CPI) in our base traffic scenario, ranging between £7,828 million (2024 CPI) and £7,878 million (2024 CPI) in our low and high traffic scenarios, respectively. As Table 4.11 shows, compared with HAL and airlines' proposals, in a base traffic scenario, our proposed opex allowance for H8 is:

- 6.7%, or -£569 million (2024 CPI) lower than HAL's December 2025 updated proposal of £8,431 million (2024CPI); and
- 11.6% or £815 million (2024 CPI) higher than the airlines' proposals.

**Table 4.11: CAA proposed H8 opex allowances scenarios versus HAL and airlines**

(£ million, 2024 CPI)	HAL Dec-25	Airlines	CAA	CAA minus HAL Dec-25		CAA minus airlines	
				Value	%	Value	%

Low traffic scenario	8,411	-	7,828	-583	-6.9%	-	-
Base traffic scenario	8,431	7,046	7,862	-569	-6.7%	815	11.6%
High traffic scenario	8,451	-	7,878	-572	-6.8%	-	-

Source: CAA analysis of data extracted from EE/YA Opex and Comrev model for these initial proposals. Note: HAL's December 2025 proposals result from adjusting HAL's July 2025 Business Plan proposals of £8,102 million (2024 CPI) by adding £349.1 million (2024 CPI) of additional business rate liability and removing £21 million (2024 CPI) of the Security Enhanced Outcomes overlay.

4.64 Table 4.12 shows the drivers of the -£569 million (2024 CPI) difference between our initial proposals and HAL's proposals in a base traffic scenario across two dimensions, by component of our method (columns) and by opex category (rows). It shows that:

- the efficiency adjustment we propose to make to the 2024 baseline is the primary driver of the difference, accounting for around - £279 million (2024 CPI), or 49%, of the overall -£569 million gap between the proposals;
- the lower allowance we propose to make for overlays accounts for around - £205 million (2024 CPI), or 36%, of the -£569 million (2024 CPI) difference;
- the downward adjustment to the business rate liability of around £104 million, to true up the 'logged up' amount from H7, accounts for a further 18% of the - £569 million (2024 CPI) difference;
- volume, input price, and ongoing efficiency roll-forward effects result in an overall upward adjustment of £19 million (2024 CPI). This is owing to our proposed lower ongoing efficiency assumption of 1% per year, compared to HAL's 1.2% assumption, and our higher passenger forecasts; and
- by opex category, and in addition to business rates, our proposed allowances show material downward adjustments also in staff costs (-£135 million, 2024 CPI) and utilities (-£113 million, 2024 CPI), reflecting the efficiency opportunities identified through our bottom-up benchmarking and accounted for in our 2024 efficient baseline adjustment. The only upward adjustment relates to the inclusion of allowances for noise and vortex (£52 million, 2024 CPI), which are not included within HAL's H8 opex proposals.

4.65 The technical report from our consultants EE/YA and the accompanying Opex and Comrev model for initial proposals provide greater granularity of our proposed opex allowances for H8.

4.66 Nonetheless, it is also important to be clear that we are providing this granular information only for the purpose of bringing transparency to the projection of our allowance for the overall level of opex. It is for HAL to act in a way consistent with its safety, security and other obligations (irrespective of consistency with its allowance for opex) and decide on the level of spending on individual categories of costs.

**Table 4.12: CAA proposed deviation from HAL opex proposals (base traffic scenario)**

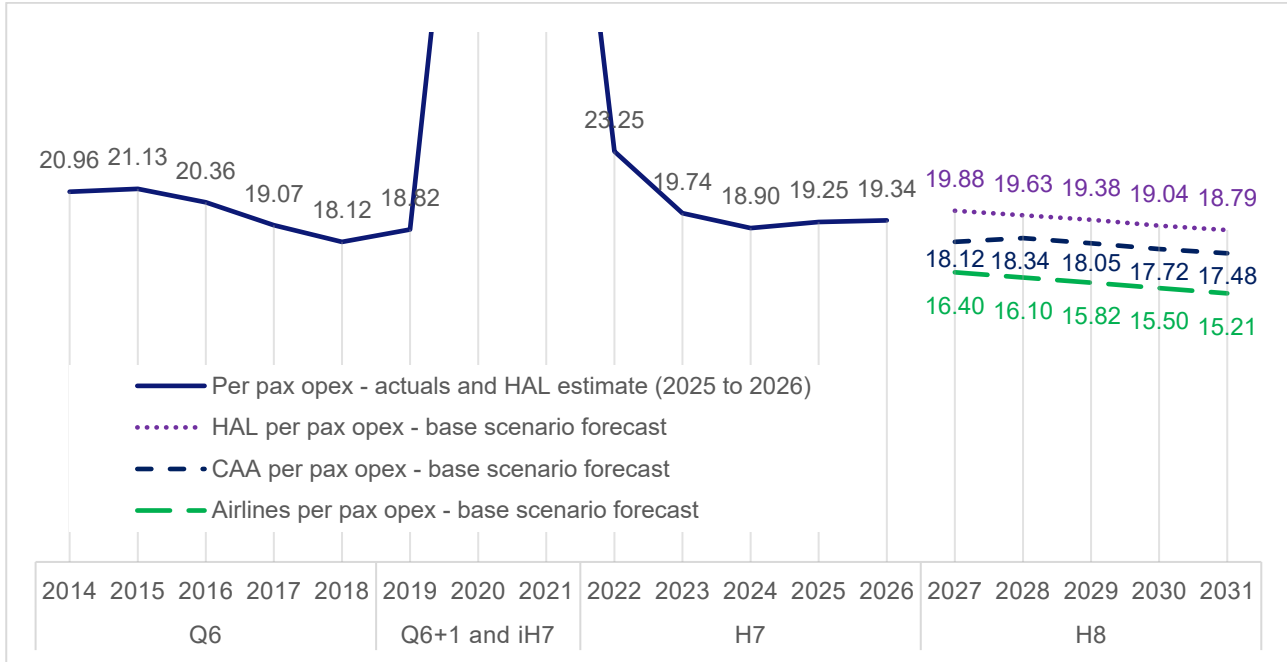
(£ million, 2024 CPI)	HAL Dec-25	CAA 2024 baseline adjustment	Disallowed overlays	BR logged up adjustment	Roll forward	CAA allowances	CAA minus HAL
Staff	2,346	-196			61	2,211	-135
Maintenance, facilities management & equipment	1,129	-21			16	1,124	-5
Business rates	1,071	0		-104	0	967	-104
Utilities	668	-84			-30	554	-113
Electricity distribution contract	181	0			-7	173	-7
Insurance	134	30			-41	122	-12
Other opex	2,668	-60			22	2,629	-39
Overlays	235		-205		0	30	-205
Noise and vortex	0	53			-2	52	52
<b>Total opex</b>	<b>8,431</b>	<b>-279</b>	<b>-205</b>	<b>-104</b>	<b>19</b>	<b>7,862</b>	<b>-569</b>

Source: CAA analysis of data extracted from EE/YA Opex and Comrev model for initial proposals. Note: HAL December 2025 proposals of £8,431 million (2024 CPI) result from adjusting HAL's July 2025 Business Plan proposals of £8,102 million (2024 CPI) by adding £349.1 million (2024 CPI) of additional business rate liability and removing £21 million (2024 CPI) of the Security Enhanced Outcomes overlay. Note: BR = business rates.

- 4.67 As Figure 4.3 shows, our proposed opex allowances imply a real per-passenger opex in 2027 and 2028 that is higher than HAL incurred in 2018, and slightly lower than HAL incurred in 2019, the last pre-covid year, and when we saw HAL reversing the downward trend in per passenger opex. By 2031, our proposed real per passenger opex allowance of £17.48 (2024 CPI), is 7% lower than HAL's spending of £18.82 (2024 CPI) in 2019. This is equivalent to cost savings of 0.6% per year.
- 4.68 Airlines proposed a lower, and declining, per-passenger opex in real terms, throughout H8 falling to £15.21 (2024 CPI) in 2031, -13% lower than our proposal of £17.48 (2024 CPI) by 2031.
- 4.69 The EE/YA technical report offers per passenger comparisons between HAL's proposals and our proposed allowances for each opex category. The results show that our lower proposed overall per passenger opex is driven by lower per passenger staff costs, utilities, and business rates, with the remaining categories showing similar per passenger opex to those in HAL's proposals. Our bottom-up

benchmarking indicates that it is appropriate to expect lower staff costs than those observed pre-covid owing to the transition to next generation security technology.

**Figure 4.3: Historic and proposed opex per passenger (£, 2024 CPI)**



Source: CAA analysis. Note: HAL forecasts are based on HAL December 2025 H8 opex proposals of £8,431 million (2024 CPI).

**Overall level of stretch**

4.70 Two one-offs, business rates true up and our views on overlays, account for over half of the -£569 million (2024 CPI) difference between the allowances we propose for H8 and HAL’s proposals.

4.71 As Table 4 shows, if we exclude these differences, and the fact that HAL’s opex proposals do not include noise and vortex mitigation costs, then our allowances imply scope for HAL realising opex about -4.4% lower than it has sought in its proposals for H8. This -4.4% level of stretch is consistent with the scope for improvements that we have concluded were possible when we performed our baseline adjustments based on bottom-up benchmarking and confirmed by the results from our top-down benchmarking.

**Table 4.13: Proposed overall level of stretch in opex across H8**

(£ million, 2024 CPI)	HAL Dec-25	CAA allowances	CAA minus HAL	Level of stretch
<b>Total opex</b>	<b>8,431</b>	<b>7,862</b>	<b>-569</b>	<b>-6.7%</b>
Business rates	1,071	967	-104	
Overlays	235	30	-205	

Noise and vortex	0	52	52	
<b>Total opex minus the items above</b>	<b>7,125</b>	<b>6,813</b>	<b>-312</b>	<b>-4.4%</b>

Source: CAA analysis of data from HAL submissions and EE/YA Opex and Comrev model for initial proposals.

### H8 proposed opex annual profile in 2024 CPIH

- 4.72 As we explain in Chapter 10 (Financial Framework), our view of the appropriate measure of inflation for H8 has evolved since we published our H8 Method Statement and we have developed these initial proposals using CPIH as our standard measure of inflation, rather than CPI.
- 4.73 Nonetheless, our detailed work on opex has used CPI to ensure consistency with, and traceability to, HAL's H8 Business Plan submission and airlines' Alternative Business Plan (which are both expressed in 2024 CPI, consistent with our Business Plan Guidance).
- 4.74 Table 4.14 shows the annual profile of our proposed opex allowance for H8 on the basis of each of 2024 CPI and converted into 2024 CPIH. We have used the Office for Budget Responsibility's forecasts of CPI and CPIH, published in November 2025 in the price conversion.

**Table 4.14: CAA proposed annual profile of opex for H8**

£ million, 2024 CPI	2027	2028	2029	2030	2031	H8 total
Low traffic scenario	1,552	1,585	1,576	1,562	1,553	<b>7,828</b>
Base traffic scenario	1,556	1,590	1,582	1,570	1,563	<b>7,862</b>
High traffic scenario	1,557	1,593	1,586	1,574	1,568	<b>7,878</b>
£ million, 2024 CPIH	2027	2028	2029	2030	2031	H8 total
Low traffic scenario	1,540	1,572	1,562	1,546	1,536	<b>7,756</b>
Base traffic scenario	1,544	1,577	1,568	1,554	1,545	<b>7,790</b>
High traffic scenario	1,545	1,580	1,572	1,559	1,551	<b>7,806</b>
CPIH forecast	2027	2028	2029	2030	2031	H8 total
Percentage	2.15%	2.08%	2.11%	2.13%	2.13%	-

Source: EE/YA Opex and Comrev model for initial proposals and OBR, 'Economic and fiscal outlook', November 2025 (CPIH forecast 2027 to 2029). Note: We roll forward OBR's CPIH 2029 forecast to 2030 and 2031.

### Next steps and implementation

- 4.75 We welcome stakeholders' views on our approach to making projections of opex and our initial proposals in relation to the allowances for opex and will consider these carefully as part of our work to develop our final proposals.
- 4.76 More broadly, we will continue to refine our projections of opex in developing our final proposals. This work will be informed by responses to this consultation and updated analysis by EE/YA.

- 4.77 We do not intend to make any significant changes to the Licence to implement our approach to opex. Nonetheless, the allowance for opex is an important component in the calculation of the revised price cap.

## Chapter 5

# Commercial revenues

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## Introduction to commercial revenues

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- 5.1 HAL generates commercial revenues from a wide range of activities at Heathrow Airport. These activities include retail and catering outlets in its terminals, access to the airport (car parks, car rental, rail, and terminal drop-off charges), property rents, cargo, and other services such as fast track and VIP services for passengers.
- 5.2 The assumption that we make for the level of commercial revenues that HAL will generate during the H8 price control is a key building block in the calculation of charges, with higher levels of commercial revenue reducing the level of revenue HAL needs to recover from airport charges.
- 5.3 The broad approach to setting the H8 price control and determining the efficient commercial revenues allowance also provides HAL with incentives to operate its commercial activities efficiently. Other things being equal, if HAL generates higher revenues than the allowance over the H8 period, it earns extra profits until the next price control is set. If it generates less commercial revenue than the allowance, typically it must fund the shortfall.
- 5.4 This approach provides a strong incentive on HAL to increase commercial revenues and furthers the interests of consumers by ensuring that, in the longer term, airport charges are not higher than necessary. It also helps to promote efficiency and economy on the part of HAL's commercial activities.
- 5.5 This chapter describes our approach to determining the efficient commercial revenues allowance for the H8 price control period. It sets out:
- a summary of what we said in the H8 Method Statement and Business Plan Guidance;
  - a summary of stakeholders' views of the level of commercial revenues in H8;
  - our method for setting the efficient commercial revenues allowance for H8;
  - our initial proposals for the efficient level of commercial revenues in H8; and
  - next steps and implementation.

## What we said in the H8 Method Statement

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- 5.6 In the H8 Method Statement we said that we would strengthen the approach we used to assess the efficient level of the commercial revenues for the H7 price control by:
- broadening the evidence base beyond HAL's Business Plan;
  - making greater use of independent benchmarking;
  - conducting targeted bottom-up analysis of granular revenue categories; and
  - exploring the feasibility of top-down benchmarking.
- 5.7 We also said that HAL's H8 Business Plan would remain a key component of our assessment and the starting point of our analysis of commercial revenues. In our H8 Business Plan Guidance and accompanying data template, we set detailed guidance about the form, contents and granularity of the information we expected HAL to submit on commercial revenues in its H8 Business Plan.

## Stakeholders' views on commercial revenues

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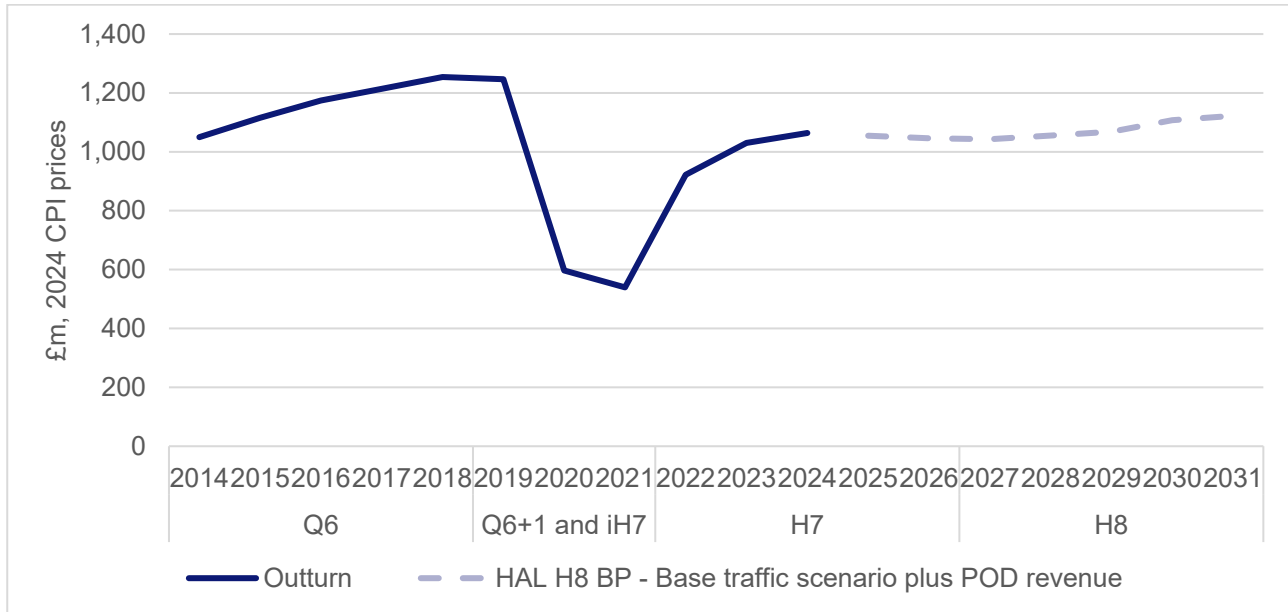
### HAL

- 5.8 HAL's H8 Business Plan has proposed commercial revenues for the H8 price control period of £5,347 million (2024 CPI prices), in its base traffic scenario.<sup>10</sup>
- 5.9 HAL has made one adjustment to the scope of its H8 commercial revenues proposals, compared to its reported outturn regulatory revenues, by removing T5 POD parking<sup>11</sup> revenues. This removal aligns with the appropriate regulatory treatment of POD parking revenues as our approach to setting the price control, consistently with the H7 price control, treats these as a non-regulated activity. HAL said through the Questions and Answers (Q&A) process that the 2024 outturn T5 POD revenue was £9.8 million (2024 CPI), reported in the regulatory accounts against the 'long-stay car parking' revenue category.
- 5.10 Figure reproduces HAL's comparison of historical commercial revenues, as reported in the regulatory accounts, against its H8 proposals. For comparability with outturn revenues, HAL increased its H8 proposals by £9.8 million (2024 CPI) per year to reflect the revenue it made in 2024 from POD parking.

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<sup>10</sup> HAL forecasts two alternative commercial revenue scenarios in its Business Plan submission, a low traffic scenario at £5,293 million (2024 CPI) and a high traffic scenario at £5,401 million (2024 CPI).

<sup>11</sup> T5 POD refers to the small, driverless electric personal rapid transit pods that transport passengers between car parks and Heathrow Terminal 5.

**Figure 5.1: Historical and forecast commercial revenues in HAL's Business Plan**

Source: HAL data tables submitted as part of its H8 Business Plan, and Table 142 of HAL H8 Business Plan, July 2025.

Notes: Both historical and forecast figures include cargo revenue. Forecasts are inclusive of T5 POD revenue of £9.8 million (2024 CPI) per year to ensure comparability with reported outturns.

5.11 HAL has stated that its commercial performance compares well with other airports and its revamped commercial proposition has supported a recovery in revenues post-covid. Nonetheless, HAL has also said that several factors have constrained revenue growth and kept revenue performance below pre-pandemic levels. HAL considered that these factors are likely to continue affecting its commercial revenue performance during H8. In HAL's view, these include:

- the loss of VAT-free shopping in 2021, which has reduced luxury retail spend and associated tax-refund revenues;
- the ongoing impact of the Elizabeth line on Heathrow Express revenues;
- changing passenger preferences and digitalisation, which has reduced bureaux de change revenues; and
- crowded terminals undermining passengers' likelihood to spend.

5.12 As Figure 5.1 also shows, HAL has forecasted annual commercial revenues in H8 starting broadly in line with the 2024 outturn, increasing modestly over the H8 period, and ending H8 somewhat still below the pre-pandemic 2019 revenue level in real terms.

5.13 HAL has explained that, consistent with its approach to opex, it has largely retained its H7 approach to forecast commercial revenues for H8, by:

- a) Using 2024 outturn revenues as the baseline without any efficiency adjustments. HAL has said that benchmarking exercises commissioned

from its consultants Pragma and ABG identify Heathrow as a 'global reference point', and that retaining 2024 as the starting point reflects its ambition to maintain this position.

- b) Removing £9.8 million (2024 CPI) T5 POD parking revenues from its 2024 baseline to ensure consistency with the commercial revenues scope it proposes for H8.
- c) Rolling forward the 2024 baseline for each commercial revenue category based on elasticities estimated through econometric analysis of the historical relationship between revenue and its view of revenue drivers. It has assumed an elasticity of 1.0 for most commercial revenue categories, meaning that for every one percentage point increase in the relevant driver, it has assumed that revenue will increase by 1%. The exceptions are: (i) retail (excluding bureaux de change), where it has assumed an elasticity of 0.8; (ii) other services (including fast track and VIP services), where it has assumed 0.6; and (iii) property where it has assumed an elasticity of 0.5.
- d) Applying a management stretch assumption of 1% per year throughout H8 to four commercial revenues categories: (i) retail revenue (excluding bureaux de change); (ii) short-stay car parking; (iii) car rental services; and (iv) other services. HAL has not assumed management stretch for any other commercial revenue category.
- e) Making real price effect adjustments to some commercial revenue categories where it considers that revenue price changes will deviate from CPI including: (i) bureaux de change, which it expects to decline 12.9% below CPI per year; and (ii) T5 Piccadilly line, cargo, and other revenue, which HAL expects to trail RPI.
- f) Proposing one overlay of around £49.8 million (2024 CPI) to reflect the reduction in car parking revenue and terminal drop off charges ("TDOC") revenue during the works to replace the short-stay multi-storey car park at Terminal 4 ("MSCP4"), which are planned to last up to 2029. The overlay includes the additional revenue expected in 2030 and 2031.

5.14 HAL has used a different approach from the above in the way it has forecasted TDOC and cargo revenues, for which it has followed the following bespoke methods:

- a) It has forecast TDOC revenues bottom-up based on:
  - i. the share of passengers using TDOC;
  - ii. the number of passengers per vehicle;
  - iii. on-time payment rate; and

- iv. assuming a TDOC nominal tariff across H8 of £5.8 per vehicle excluding VAT, equivalent to a nominal £7 per vehicle with VAT.
- b) HAL has also forecasted cargo revenues bottom-up assuming a flat 1,667 cargo air traffic movements (“ATMs”) per year during H8 and a charge per ATM that increases by 20% over H8 from the average 2024 level of £5,339 (2024 CPI). HAL has said that keeping cargo ATMs flat at the level of non-scheduled cargo ATMs in 2024 (1,667) and making zero allowances for both non-scheduled cargo ATMs and other non-passenger ATMs in H8 are reasonable assumptions given its 480,000 ATM cap.

## Airlines

- 5.15 Airlines submitted their H8 Alternative Plan to us in October 2025. This included a report on HAL’s commercial revenues by the airlines’ consultants, Skylark. Airlines also expressed wider views on HAL’s H8 Business Plan in a letter sent to us on the 13<sup>th</sup> of October 2025, namely concerns about the absence of a bottom-up approach to opex and commercial revenues forecasting in HAL’s plan, a lack of transparency in the underlying calculations, and delays in responding to information requests.
- 5.16 In their Alternative Plan, airlines have proposed a level of commercial revenues for H8 of £5,618 million (2024 CPI), representing a 5%, or £271 million (2024 CPI), increase on HAL’s proposals of £5,347 million (2024 CPI).
- 5.17 Airlines/Skylark have explained the £271 million (2024 CPI) increase on HAL’s proposals on the following basis:
- a) Higher elasticity assumptions for retail revenue (excluding bureaux de change) combined with higher passenger forecasts, which has resulted in an additional £70 million (2024 CPI) revenue. Skylark has assumed elasticities ranging from 0.90 to 1.0 applied to different retail categories, while HAL has assumed a lower elasticity of 0.8 across all retail revenue categories.
  - b) Differences in elasticity assumptions for car parking and car rental and applied to higher passenger forecasts account for an additional £69 million (2024 CPI) revenues. Skylark has applied elasticities of 0.25 for long-stay parking, 1.2 for short-stay parking, and 0.7 for car rental, compared with HAL’s assumption of 1.0 for the three revenue categories (and applied to lower passenger forecasts).
  - c) Consideration of non-scheduled cargo ATMs during H8, which HAL has assumed at zero, accounts for an additional £69 million (2024 CPI) of revenues.

- d) TDOC nominal tariff of £7 per vehicle, which increases revenues by £55 million (2024 CPI). Airlines have estimated TDOC revenues using the nominal tariff inclusive of VAT of £7 per vehicle, while HAL has used the corresponding pre-VAT nominal value of £5.8 per vehicle.
- e) Higher rail passenger numbers, resulting from higher passenger forecasts, and a higher elasticity assumption for VIP service revenue of 0.9 (compared to HAL's 0.6 assumption). Taken together, these add a further £8 million (2024 CPI) to HAL's revenue forecasts.

5.18 Airlines/ Skylark have retained HAL's assumptions for management stretch and adjustments for real price effects. They have also accepted HAL's proposed overlay related to the multi-storey car park at Terminal 4 of around £49.8 million (2024 CPI) in full.

## Our views on commercial revenues

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- 5.19 We discussed our method for H8 with HAL and airlines before the H8 Business Plan was submitted and reflected the feedback we received in developing these initial proposals.
- 5.20 We engaged Europe Economics and York Aviation ("EE/YA") to support us in our assessment of commercial revenues (alongside opex) for the H8 period. We have published EE/YA's independent technical report alongside these initial proposals.<sup>12</sup>

## Our method for commercial revenues

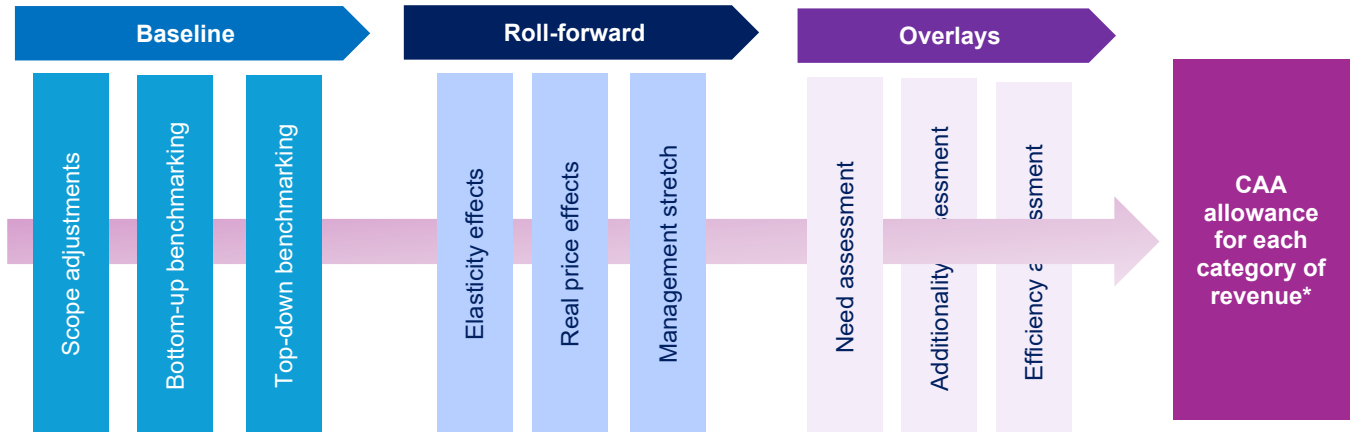
- 5.21 The method we have designed for determining our view of the efficient level of commercial revenues for the H8 period, illustrated in Figure 5.2, has the same components as the method we have used for setting our views for opex which, in summary, are:
  - baseline – where we determine the efficient baseline level for each commercial revenue category, taking account of bottom-up assessments and top-down benchmarking;
  - roll-forward – where we roll each commercial revenue category baseline forward to the H8 period using volume, input price inflation, and management stretch assumptions; and
  - overlays – where we determine whether any one-off adjustments are supported by evidence of need, additionality, and cost efficiency.
- 5.22 Our efficient commercial revenues forecast for the H8 period is the result of these components, with the exception of revenues from bureaux de change,

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<sup>12</sup> EE-YA H8 opex and commercial revenues report for IPs – REDACTED.

TDOC and cargo revenues. For these exceptional revenue categories, we have used bespoke assessment methods, which we explain later in this chapter.

**Figure 5.2: Our commercial revenues assessment method for H8**



Source: CAA \*Note: For bureaux de change, TDOC and cargo revenues we have used bespoke assessment methods outside this framework.

## Developing our initial proposals for commercial revenues

### Baseline

5.23 The first component of our method is setting the efficient baseline for each revenue category. As with opex, we agree with HAL and the airlines that 2024 should be our base year to set the commercial revenue allowance for the H8 period. We note that 2024 represents business-as-usual operations at Heathrow Airport and is also the latest full year of post-covid 19 operations for which outturn data are available.

5.24 As Figure 5.2 shows, setting our efficient 2024 baseline involves three steps:

- making certain scope adjustments to the 2024 regulatory accounts;
- establishing the efficient baseline level for each commercial revenue category through targeted bottom-up benchmarking; and
- using top-down econometric benchmarking as a cross-check to assess whether the efficient baseline resulting from our bottom-up assessment should be subject to further adjustment.

### Scope adjustments

5.25 Consistent with our previous decision to exclude capex on T5 POD parking from HAL’s RAB, we agree with HAL’s position of removing £9.8 million (2024 CPI) of revenues related to T5 POD parking from the car parking revenue reported in the 2024 regulatory accounts (Table 5.1). T5 POD parking revenues (and costs) relate to an asset excluded from HAL’s RAB, and it is effectively a non-regulated activity outside the single till. We therefore exclude the revenues and costs of this activity from our price control calculations.

**Table 5.1: Scope-adjusted 2024 outturn commercial revenues**

(£ million, 2024 CPI)	HAL 2024 outturns	Adjustment for POD parking	CAA scope-adjusted 2024 outturns	HAL 2024 baseline
Retail and catering	414.1		414.1	414.1
Bureaux de change	23.0		23.0	23.0
Surface access and car parking	212.7	-9.8	202.9	202.9
Terminal drop-off charge	53.1		53.1	53.1
Service revenue	69.6		69.6	69.6
Rail	117.7		117.7	117.7
Property	145.0		145.0	145.0
Other commercial revenue	7.3		7.3	7.3
Cargo	21.4		21.4	21.4
<b>Total revenue</b>	<b>1,063.9</b>	<b>-9.8</b>	<b>1,054.1</b>	<b>1,054.1</b>

Source: CAA analysis. Note: Service revenue includes fast track services, VIP charges and similar service revenues.

### Bottom-up benchmarking

5.26 We commissioned EE/YA to carry out a bottom-up benchmarking of the priority commercial revenue categories marked as 'yes' in the right-hand column of Table 5.2. Taken together, these account for 90% of HAL's total commercial revenues in 2024 and were selected based on the following three criteria:

- materiality above 5% of total commercial revenues in 2024;
- whether stakeholder airlines indicated these as a priority through the engagement we had with them before HAL's H8 Business Plan submission; or
- whether variations between H7 allowances and HAL's outturns from 2022 to 2024 (latest outturns) are not explained by passenger or price variations.

**Table 5.2: Revenue categories selected for bottom-up benchmarking**

Revenue category	Proportion of 2024 revenue	Material category	Airline priority	Performance priority	Bottom-up analysis?
Catering	9%	Yes	No	No	Yes
Retail	26%	Yes	No	Yes	Yes
Other retail	5%	Yes	No	Yes	Yes
Bureaux de change	0%	No	No	Yes	n/a (bespoke assessment)
Other services	0%	No	No	No	No
Car parking	18%	Yes	No	Yes	Yes
Other surface access	3%	No	No	No	No
Service revenue	7%	Yes	No	Yes	Yes
TDOC	5%	Yes	No	No	n/a (bespoke assessment)
Property	14%	Yes	Yes	No	Yes
Rail	11%	Yes	No	Yes	Yes
Other commercial revenue	1%	No	No	No	No

Revenue category	Proportion of 2024 revenue	Material category	Airline priority	Performance priority	Bottom-up analysis?
Cargo	-	No	No	Yes	n/a (bespoke assessment)

Source: EE/YA technical report. Note: Service revenue includes fast track services, VIP charges and similar service revenues.

5.27 With support from EE/YA, we have set our efficient 2024 baseline for each of the priority revenue categories through targeted bottom-up assessment using deep dives and external benchmarks. These are detailed and evidenced in the EE/YA technical report, Appendix 1. For the remaining revenue categories, we have accepted HAL's 2024 outturn as our baseline.

5.28 Our bottom-up assessment resulted in a proposed 2024 efficient baseline of £1,085 million (2024 CPI), which is 2.9%, or £31 million (2024 CPI), higher than HAL's 2024 baseline of £1,054 million (2024 CPI). Table 5.3 summarises the category-level adjustments we have made to derive our efficient baseline. The categories where we have proposed significant baseline adjustments are:

- Retail and catering, where our proposed baseline is 6.2% or £25.9 million (2024 CPI) higher than HAL's 2024 baseline. EE/YA's technical assessment indicates that, in 2024, HAL placed too strong an emphasis on its premium passenger offering and did not sufficiently adapt its products and services to reflect changes in passenger demand, including a higher share of outbound leisure passengers. We, therefore, apply efficiency adjustments based on unit cost benchmarking and evidence of HAL's underperformance relative to peers that have performed better at aligning retail and catering offerings with the post-covid passenger mix.
- Rail, where our proposed 2024 efficient baseline is 3.0% or £3.5 million (2024 CPI) higher than HAL's baseline. Our consultants' unit-cost benchmarking indicates that HAL's pricing for Heathrow Express appears to reflect a premium positioning that may deter usage, particularly given a passenger mix that is increasingly weighted towards more price-sensitive UK leisure travellers. EE/YA's assessment suggests there was scope in 2024 to generate some additional revenues through the targeted use of discounted advance fares to stimulate demand.
- Property, where our proposed baseline is 1% or £1.4 million (2024 CPI) higher than HAL's baseline. This adjustment reflects evidence from EE/YA's unit-cost benchmarking of non-terminal and non-guide-price rentals, which indicates that there is scope to achieve higher rental levels for non-terminal property not subject to guide prices.

**Table 5.3: CAA proposed efficient 2024 baseline versus HAL 2024 baseline**

Revenue category	HAL 2024 baseline	CAA 2024 baseline	CAA minus HAL	
			Value	%
Retail and catering	414.1	440.0	25.9	6.2%
Bureaux de change	23.0	23.0	0.0	0.0%
Surface access and car parking	202.9	202.9	0.0	0.0%
Terminal drop-off charge revenue	53.1	53.1	0.0	0.0%
Service revenue	69.6	69.7	0.2	0.2%
Rail	117.7	121.2	3.5	3.0%
Property	145.0	146.4	1.4	1.0%
Other commercial revenue	7.3	7.3	0.0	-0.1%
Cargo	21.4	21.4	0.0	0.0%
<b>Total revenue</b>	<b>1,054.1</b>	<b>1,085.1</b>	<b>30.9</b>	<b>2.9%</b>

Source: CAA analysis based on data from EE/YA opex and revenue model. Note: Service revenue includes fast track services, VIP charges and similar service revenues.

5.29 Our proposed efficient baseline represents our estimate of the efficient level of commercial revenue that could reasonably have been achieved in 2024, had the airport optimised its commercial offerings.

### Top-down benchmarking

5.30 We have asked EE/YA to conduct an independent top-down econometric benchmarking of HAL's revenue performance compared with other airports. We have used the results of the top-down benchmarking as a sense check on the efficiency challenge we have applied to HAL's 2024 baseline through bottom-up assessment. We have also taken HAL's relative efficiency position as determined by our top-down econometrics into consideration to calibrate the choice of elasticity point estimates used to roll our 2024 efficient baseline forward into the H8 period.

5.31 Our top-down econometric benchmarking for commercial revenues uses the same dataset we have used for opex, drawing primarily from the publicly available Jacobs Airport Performance Indicators data.<sup>13</sup> This covers airport-level operational and financial data from 2010 to 2022 across 50 airports.<sup>14</sup> We have supplemented Jacobs dataset with macroeconomic and structural indicators to enable meaningful comparisons across airports of different sizes, with different mixes of passengers, and operating under different macroeconomic conditions.

5.32 The EE/YA technical report details the statistical modelling features of this top-down econometrics, which in summary include the following.

<sup>13</sup> [Airports Performance Indicators 2024 | Jacobs](#)

<sup>14</sup> We intend on updating our analysis with 2023 and 2024 data as of when it is available.

- **Explained variable:** total commercial revenue, excluding cargo, as standardised by Jacobs to allow consistent comparison across airports.
- **Explanatory variables:** we have used workload units (“WLUs”), a combined measure of passengers and cargo, as the preferred measure of scale, which is the primary driver of commercial revenues in the models. We have also included variables to control for local economic conditions (proxied by GDP per capita), the size of the airport (proxied by fixed assets), and the share of premium passengers. The models also have year dummy variables to control for sector-wide shocks, such as the effects of the covid-19 pandemic.
- **Functional form:** we have estimated a log-linear Cobb–Douglas econometric model using pooled Ordinary Least Squares (“OLS”), with cluster-robust standard errors at the airport level. Conceptually, pooled OLS is superior to other model specifications (namely panel models) in capturing time-invariant (or very slow moving) variation in efficiency across airports, which is the central focus of our benchmarking exercise. Our tests have confirmed that pooled OLS is also at least as statistically robust as the alternative functional forms that we have tested.
- **Frontier performer:** we have defined as frontier performer the airport occupying the upper quartile position, which is the airport more efficient than 75% of the airports in the sample. We set HAL’s relative efficiency by reference to the upper quartile (frontier) performer.
- **Model fit:** Table 5.4 shows that our pooled OLS model explains 80% of the variation in commercial revenues among the airports in the sample, indicating a strong fit. The positive elasticity on WLUs implies the expected positive effects of scale on revenues. GDP per capita is a statistically significant control. The coefficients on fixed assets and premium-passenger share are positive and significant, consistent with greater revenues at larger airports and at airports with a greater proportion of high-spending premium traffic.

**Table 5.4: Econometric model estimation for commercial revenue**

Model	WLUs	GDP per capita	Fixed assets	Premium pax	Year dummies	N	R <sup>2</sup>
Pooled OLS	0.68***	0.14***	0.19**	2.70**	Sig.	416	80%

Source: EE/YA technical report Notes: N=number of observations. \*, \*\*, \*\*\* denote statistical significance at 10%, 5% and 1% respectively. Year dummies are statistically significant.

5.33 Table 5.5 shows HAL’s relative efficiency position according to our top-down econometric benchmarking. HAL ranks 15<sup>th</sup> (out of 43) in 2019 and 18<sup>th</sup> in 2022. This is below the upper-quartile frontier, which is anchored in Auckland Airport. Given Heathrow’s characteristics, the econometric results suggest that HAL’s revenues are slightly lower (-0.6% to -1.3%) than the benchmark performer.

**Table 5.5: HAL’s commercial revenues efficiency in CAA’s econometric benchmarking model**

	Ranking		Gap to frontier	
	2019	2022	2019	2022
HAL commercial revenues efficiency position	15 out of 43	18 out of 43	-0.46%	-1.28%

Source: EE/YA technical report Notes: a negative gap to frontier indicates inefficiency as it indicates that HAL’s commercial revenues are lower than the frontier airport. The frontier airport is the airport occupying the upper quartile position that is, the airport that is more efficient than 75% of the airports in the sample.

5.34 We do not consider it necessary to adjust our 2024 efficient baseline as a result of our bottom-up benchmarking, which increases HAL’s baseline by 2.9% (see Table 5.3). The econometric model indicates that HAL’s performance has weakened in recent years. Between 2019 and 2022, HAL’s performance moved from operating just below (-0.6%) the estimated efficiency frontier to being about 1.3% below it. Given the trend between 2019 and 2022, our proposed 2.9% increase to HAL’s 2024 baseline, which uses benchmark data up to 2024, is consistent with the direction and scale of the underperformance indicated by the top-down modelling while using more up-to-date data. We intend to update our top-down econometric model during the H8 review, when more recent data from Jacobs become available.

**Roll-forward**

5.35 Rolling our 2024 commercial revenues baseline into the H8 period is the second component of our method. As we show in Figure 5.2, our roll forward consists of applying three year-on-year adjustments to our efficient baseline:

- elasticities, accounting for the effect on commercial revenues of forecast changes in passenger numbers throughout the H8 period;
- real price effects, accounting for deviations from CPI indexation of revenues, for example, where above-CPI price adjustments are expected; and
- management stretch, which accounts for expected revenue improvements owing to factors not accounted for by volume or price adjustments, such as improved commercial strategy and innovative commercial practices.

**Elasticities**

5.36 Passenger numbers, and other relevant revenue drivers, are likely to change during the H8 period by comparison to their 2024 levels. This will have an impact on the level of commercial revenues. We have used elasticities to estimate the expected percentage change in H8 revenues, by comparison to the 2024 baseline, as a result of a one percentage point change in passenger numbers (and other drivers).

5.37 We commissioned EE/YA to support us developing our independent view of elasticities for H8 and the Appendix 3 of their technical report details this

analysis. In summary, our approach is consistent with that followed by HAL and the airlines on:

- the choice of drivers of each revenue category;
- the suite of regression model specifications used for estimating elasticity ranges; and
- the use of annual historical data, from 2014 to 2024 in the modelling.

5.38 Our choice of the specific elasticity point estimate within the estimated ranges is based on our view in the round of the following factors:

- consistency with the findings from our bottom-up assessment and top-down benchmarking;
- regulatory precedent; and
- expert judgement from EE/YA, drawing on first-principles reasoning to assess the plausibility of implied revenue–driver relationships.

5.39 Table 5.6 summarises the commercial revenue elasticities we propose for H8. These are aligned with HAL’s proposed elasticities, except for the ‘retail and catering’ category, where we use a higher elasticity of 1.0 and HAL uses 0.8. Our approach means that for each 1% increase in passenger numbers we assume that retail revenue will increase by the same 1%, a one-to-one effect. HAL assumes that for each 1% increase in passenger numbers, retail revenues would only increase by 0.8%, a lower than a one-to-one effect.

**Table 5.6: CAA proposed commercial revenues elasticity assumptions for H8**

Commercial revenues category	Driver	HAL H8	CAA H7	IAA 2022	CAA H8 range	CAA H8 point estimate
Retail and catering	Total pax	0.8	0.97	1.3	0.61-0.83	1.0
Bureaux de change	Total pax	1.0	0.97	1.3	No econometrics	n/a (bespoke assessment)
Service revenue	Total pax	0.6	0.8	1.0	0.34-0.54	0.6
Rail	-	-	-	-	-	-
Heathrow Express	HEx pax	1.0	1.0	-	No econometrics	1.0
Surface access and car parking	Parking and rental pax	1.0	1.0	1.0	0.94-1.05	1.0
Property	Terminal area	0.5	0.52	1.0	No econometrics	0.5

Source: EE/YA technical report. Note: IAA= Irish Aviation Authority. Note: Service revenue includes fast track services, VIP charges and similar service revenues.

5.40 Our choice of an elasticity of 1.0 for the ‘retail and catering’ category is also higher than the top end of our 0.63-0.83 elasticity range estimated based on outturn retail performance (from 2014 to 2024). Two factors justify why estimated retail elasticities in the 2014 to 2024 period were below one:

- there were certain unfavourable developments, for example, the loss of VAT-free shopping in 2021, which had some impact on retail performance in the recent years; and
- the bottom-up assessment conducted by EE/YA has indicated that HAL's relative performance in retail has declined in recent years as compared to other UK airports, which faced similar unfavourable factors such as the loss of VAT-free shopping but better adapted their product mix to the changing passenger demographic.

5.41 We consider that an elasticity of 1.0 represents an appropriate assumption for two reasons. First, we are not persuaded that the factors explaining outturn retail elasticity below 1.0 historically (explained above) will persist throughout the H8 period. Second, we do not accept HAL's argument that the elasticity should be materially lower than 1.0 because additional passengers would generate overcrowding that may deter retail and catering spending by some users.

#### Real price effects

5.42 Price adjustments (upwards or downwards) of some revenue categories may not be adequately captured by CPI indexation when, for example, contractual arrangements between HAL and retailers, service providers, or rail operators set a price indexation different from CPI. In such circumstances, real price effects ("RPEs") adjustments are warranted.

5.43 Table 5.7 below summarises our proposed RPE indexation for revenues at H8, alongside HAL proposals. Our proposals are based on the independent assessment conducted by EE/YA, as set out in their technical report.

**Table 5.7: CAA proposed RPE indexation for commercial revenues categories in H8**

Commercial revenues category	HAL	CAA
Retail and catering	CPI	CPI
Bureaux de change	CPI-12.9%	n/a (see bespoke assessment)
Surface access and car parking	CPI (no indexation assumed for long-stay parking)	CPI
TDOC	CPI	CPI
Service revenue	CPI	CPI
Track access	RPI	RPI
Heathrow Express	CPI	CPI
T5 Piccadilly line	RPI	RPI
Property	CPI	CPI
Cargo	RPI	CPI (see bespoke assessment)
Other revenue	RPI	CPI

Source: EE/YA technical report. Note: Service revenue includes fast track services, VIP charges and similar service revenues.

- 5.44 We accept HAL's proposed RPI indexation of track access revenue, as this is in line with the regulated charging methodology, and for T5 Piccadilly line revenue, which is in line with contractual terms.
- 5.45 Our proposals for RPEs differ from HAL's in four revenue categories. These are:
- Bureaux de change: HAL has captured its forecast of a reduction in bureaux revenues over H8 through a negative RPE adjustment of CPI-12.9%. While we agree that lower usage of the bureaux de change services will result in lower revenue throughout H8, we do not consider a RPE to be the appropriate mechanism to reflect this reduction. Instead, we propose to set bureaux revenue allowances through a bespoke assessment, which we discuss later in this chapter.
  - Long-stay parking: we have applied CPI indexation across all surface access and car parking revenues, including long-stay parking, while HAL has assumed no price indexation for long-stay parking. EE/YA's bottom-up assessment has indicated that there is no compelling evidence to support a deviation from CPI indexation for long-stay parking.
  - Cargo: we have applied CPI indexation to cargo revenues as part of our bespoke method for estimating cargo revenues, which we explain later in this chapter. HAL has proposed indexing cargo revenues to RPI. EE/YA's assessment indicated that neither its RPEs framework nor the bottom-up analysis provides a compelling rationale for deviating from CPI.
  - Other revenue: we also applied CPI indexation to the 'other revenue' category, rather than the RPI indexation that HAL has proposed. EE/YA's RPE assessment framework does not find compelling evidence for deviating from CPI.

### Management stretch

- 5.46 Management stretch reflects HAL's potential to increase its commercial revenues over and above what would be expected from known volume drivers such as passenger volumes. It captures the long-run trend improvement in commercial revenue performance that arises from factors such as innovative commercial practices, improved commercial strategy, growth in passenger incomes, or other drivers of performance that are not directly included in the volume assumptions used in the commercial revenue forecast.
- 5.47 With support from EE/YA, we have estimated the level of management stretch through econometric analysis by isolating any residual time trend improvement in revenue growth that is not explained by the volume drivers used in our elasticity analysis. Table 5.8 contrasts our proposals with HAL's proposals.

**Table 5.8: CAA proposed management stretch to commercial revenues in H8**

Commercial revenues category	HAL	CAA
Retail & catering	1%	No stretch
Bureaux de change	No stretch	No stretch
Surface access and car parking	-	-
Car parking – long stay	No stretch	1%
Car parking – short stay	1%	1%
Car rental	1%	1%
Other surface access	No stretch	1%
TDOC	No stretch	No stretch
Service revenue	1%	1%
Track access	No stretch	No stretch
Heathrow Express	No stretch	No stretch
T5 Piccadilly line	No stretch	No stretch
Property	No stretch	No stretch
Cargo	No stretch	No stretch
Other revenue	No stretch	No stretch

Source: EE/YA technical report. Note: Service revenue includes fast track services, VIP charges and similar service revenues.

5.48 Our management stretch proposals differ from HAL's proposals in the following commercial revenue categories:

- Retail and catering: HAL has proposed 1% per year, while we propose not to apply any management stretch. Our econometric analysis indicates that the data is consistent with no long-run trend improvement in retail and catering revenue beyond the challenge already accounted for by our choice of elasticity to passenger volumes and our adjustment to the 2024 baseline; and
- Long-stay car parking and other surface access: our econometric analysis supports applying an annual 1% management stretch across the whole surface access and car parking revenue category, while HAL only applied a 1% management stretch to short-stay car parking and car rental.

## Overlays

5.49 Overlays are the third and final component of our commercial revenue method. They refer to one-off exceptional revenue adjustments, upwards or downwards, not accounted for in the roll forward and supported by evidence. As Figure 5.2 shows, we assess the evidence supporting overlays against three criteria:

- need: whether there is an impact outside of HAL's control that affects its revenue base and justifies the overlay;
- additionality: whether the impact is clear and additional to what is already accounted for by volume adjustments, price adjustments, other implemented overlays, or planned capex; and

- **efficiency:** whether the size of the proposed overlay is efficient and reasonable.

5.50 HAL proposes one commercial revenue overlay to reflect expected loss of income from short-stay car parking and TDOC at Terminal 4 during the redevelopment of the multi-story car park in Terminal 4 (MSCP4), with a corresponding revenue increase in 2030 and 2031 once the new car park becomes operational. Overall, HAL’s proposal would reduce total commercial revenues by around -£49.8 million (2024 CPI) during H8.

5.51 We recognise the rationale for such an overlay and have proposed an allowance in line with HAL’s proposal. We also note that airlines have accepted HAL’s MSCP4 overlay in full. Table 5.9 summarises our assessment of the MSCP4 short-stay car park overlay.

**Table 5.9: CAA assessment of proposed commercial revenues overlay for H8**

Proposed overlay	HAL H8	Need	Additionality	Efficiency	CAA H8
Multi-storage car park in Terminal 4 (MSCP4) revenue overlay	-£49.8 million	Clear rationale provided.	Clearly additional.	High-level description of the assumptions underpinning the estimated revenue loss provided. Airlines have also accepted this overlay in full.	<b>-£49.8 million</b>

Source: CAA and EE/YA technical report. Note: values are in 2024 CPI prices.

**Bespoke assessments**

5.52 In H8, we expect revenues from bureaux de change, TDOC, and cargo to be driven by unique factors, which call for bespoke assessment methods. We explain our bespoke methods in turn below. They are broadly consistent with HAL’s approach but based on different assumptions.

**Bureaux de change**

5.53 We agree with HAL that bureaux revenue will continue to fall in H8 reflecting an underlying trend of lower usage driven by the decline in cash transactions worldwide. We differ from HAL in the way we have accounted for this trend for the H8 period.

5.54 HAL’s approach is to reduce bureaux revenues by 12.9% per year through a negative RPE adjustment, by price-indexing bureaux revenues to CPI-12.9%. We do not consider this to be an appropriate use of an RPE, as the change reflects reduced passenger demand rather than changes in underlying prices.

5.55 Instead, our bespoke method captures this downward effect through lower passenger demand for bureaux services at Heathrow by:

- applying an annual passenger share adjustment: we have assumed a 10% annual reduction in the share of passengers using the service from the 2024 baseline. As the first row in Table 5.10 shows, this approach leads to an overall assumption that by 2031 the share of passengers using bureaux de change services at Heathrow will be 48% of the share seen in 2024;
- calculating the reduction in the number of passengers using bureaux services: we have translated the declining passenger share into a year-on-year reduction in the number of passengers using the service (see the second row of Table 5.10); and
- assuming that the reduction in bureaux revenue from 2024 outturns will be the same as the annual reduction in passengers using bureaux services. This has resulted in our proposed allowance shown in the third row of Table 5.10.

**Table 5.10: CAA proposed bureaux de change allowance for H8**

	Unit	2024	2025	2026	H8					H8 total
					2027	2028	2029	2030	2031	
Share of passengers using bureaux services	Index	1.00	0.90	0.81	0.73	0.66	0.59	0.53	0.48	-
Year-on-year change in passengers using bureaux services	%	-	-9.4%	-8.9%	-9.6%	-9.1%	-9.0%	-9.0%	-9.2%	-
<b>Bureaux allowance</b>	<b>£ million, 2024 CPI</b>	<b>23.0</b>	<b>20.8</b>	<b>19.0</b>	<b>17.1</b>	<b>15.6</b>	<b>14.2</b>	<b>12.9</b>	<b>11.7</b>	<b>71.5</b>

Source: CAA analysis based on data from EE/YA Opex and Commercial revenues model for initial proposals.

## TDOC revenue

5.56 We have estimated TDOC revenues using a bottom-up approach with the same components as HAL's approach, which we set out in Table 5.11. We have accepted the assumptions that HAL has proposed for the key components used in the calculation of TDOC revenues during H8, which are:

- proportion of passengers originating and departing from Heathrow Airport, ranging from 79% to 79.5%;
- nominal TDOC tariff of £7 per vehicle, including VAT, constant throughout H8, which is equivalent to £5.83 nominal, excluding VAT;
- proportion of passengers using TDOC (TDOC mode share) of 19.8%;
- vehicle per passenger ratio of 0.71; and
- on-time payment rate of 96.5%.

5.57 We differed from HAL in the passenger forecasts, as we have assumed our proposed base traffic scenario forecasts. We also note that, because the TDOC tariff is proposed to remain flat in nominal terms throughout H8, we have deflated to 2024 CPI prices the nominal revenue that results from multiplying the number

of passengers using TDOC in each year by the TDOC tariff of £5.83 (nominal, excluding VAT).<sup>15</sup> It is unclear from the information available in HAL's H8 Business Plan whether its proposed TDOC revenues in 2024 CPI prices account for the fact that HAL has proposed a TDOC tariff that remains flat, in nominal terms, at £5.83 (excluding VAT) during H8.

**Table 5.11: CAA proposed TDOC allowance for H8**

	Note	Units	H8					H8 total
			2027	2028	2029	2030	2031	
<b>Assumptions</b>								
CAA passenger forecast (base)	A	millions	85.86	86.73	87.68	88.61	89.40	-
Originating and departing pax share	B	%	79.0	79.2	79.3	79.4	79.5	-
TDOC tariff per vehicle, excluding VAT (nominal)	C	£	5.83	5.83	5.83	5.83	5.83	-
TDOC mode share	D	%	19.8	19.8	19.8	19.8	19.8	-
Vehicle per pax	E	ratio	0.71	0.71	0.71	0.71	0.71	-
On-time payment rate per vehicle	F	%	96.5	96.5	96.5	96.5	96.5	-
<b>Calculations</b>								
TDOC pax	$G = A \times B \times D$	millions	13.44	13.59	13.76	13.93	14.07	-
TDOC revenue (nominal)	$H = G \times E \times C \times F$	£ million, nominal	53.7	54.3	55.0	55.7	56.3	275.0
Inflation scalar (2024 CPI = 1)	I	Index	1.08	1.10	1.13	1.15	1.17	
<b>TDOC revenue allowance, 2024 CPI</b>	<b>J = H / I</b>	<b>£ million, 2024 CPI</b>	<b>49.6</b>	<b>49.2</b>	<b>48.9</b>	<b>48.5</b>	<b>48.0</b>	<b>244.2</b>

Source: CAA analysis based on data from EE/YA Opex and Commercial revenues model for initial proposals. Note: originating passengers are passengers starting their journey at Heathrow Airport.

## Cargo revenue

- 5.58 We have forecasted cargo revenues as the product of the number of cargo and other non-passenger movements, by the corresponding yield per movement. Table 5.12 shows our calculations. HAL has followed a similar bottom-up estimating approach. However, our proposed assumptions on cargo movements, other non-passenger movements and yields per movement differ from HAL's assumptions, as we explain below.
- 5.59 In 2024, there were 2,667 cargo ATMs at Heathrow Airport. These included both scheduled (1,675) and non-scheduled (992) cargo flights. Our H8 assumptions differ from HAL's on both scheduled and non-scheduled cargo ATMs, as follows:

<sup>15</sup> We have used the Office for Budget Responsibility ("OBR") forecasts for CPI inflation published in November 2025.

- HAL has assumed that, throughout H8, scheduled cargo flights will remain flat at the 2024 outturn of 1,675 and non-scheduled cargo flights will be zero, down from 992 in 2024. HAL argues these assumptions are necessary to comply with the overall annual 480,000 ATM cap for Heathrow Airport.
- We accept that non-scheduled cargo ATMs are likely to decline over time, bearing in mind the importance of HAL complying with the 480,000 ATM cap. However, we do not consider it appropriate to remove these movements entirely. We have estimated the number of scheduled and non-scheduled cargo flights expected during the H8 period using an econometric model based on the CAA's publicly available UK airport statistics on historical cargo movements from 1994 to 2024. We set out the detail of the assumptions and the data set we use in Appendix G (Cargo movement forecasts).<sup>16</sup> As **Error! Reference source not found.** shows, we have estimated scheduled and non-scheduled cargo flights will decline steadily throughout H8, reaching 2,274 flights in 2031, down from 2,667 in 2024.

**Table 5.12: CAA proposed cargo allowance for H8**

	Note	Units	H8					H8 total	
			2024	2027	2028	2029	2030		2031
<b>Assumptions</b>								-	
Cargo ATMs*	A	Number	2,667	2,440	2,390	2,347	2,309	2,274	11,760
Cargo ATM yield	B	£, 2024 CPI	5,339	5,339	5,339	5,339	5,339	5,339	-
Other non-pax ATMs	C	Number	1,785	1,633	1,494	1,367	1,251	1,144	6,889
Other non-pax ATM yield	D	£, 2024 CPI	4,006	4,006	4,006	4,006	4,006	4,006	-
<b>Calculations</b>								-	
Cargo ATM revenue	E = A x B	£ million, 2024 CPI	14.2	13.0	12.8	12.5	12.3	12.1	62.8
Non-pax ATM revenue	F = C x D	£ million, 2024 CPI	7.2	6.5	6.0	5.5	5.0	4.6	27.6
<b>Cargo revenue allowance</b>	<b>G = E + F</b>	<b>£ million, 2024 CPI</b>	<b>21.4</b>	<b>19.6</b>	<b>18.7</b>	<b>18.0</b>	<b>17.3</b>	<b>16.7</b>	<b>90.4</b>

Source: CAA analysis. Notes: ATM = airport transport movement. \* Cargo ATMs include both scheduled and non-scheduled cargo flights.

5.60 Other non-passenger ATMs include positioning flights, commercial training flights, and testing flights. In 2024, there were 1,785 such flights. Of these, 93% were positioning flights, which are typically required to support passenger operations, for example, following disruptions or technical issues. We are of the view that Heathrow Airport could not operate effectively without permitting such flights, particularly positioning flights, but also note the importance of the ATM cap. We therefore forecast other non-passenger ATMs across H8 by applying an annual reduction of 8.5% to HAL's 2024 outturn 1,785 flights. This reduction

<sup>16</sup> We intend to update the model to incorporate 2025 outturn data in preparing our final proposals.

reflects the implied change between 2024 and 2027 (the start of H8) from our total cargo ATM forecast and captures the expected declining trend over H8.

- 5.61 With respect to yields, for the purposes of these initial proposals we have assumed that ATM yields will remain constant across H8 in real terms, equal to the average revenue per movement observed in 2024. HAL has assumed that the cargo ATM yield will increase in real terms by 20% from £5,339 (2024 CPI) 2024 outturn to £6,407 (2024 CPI) across H8.

## Initial proposals for commercial revenues

### Our proposed H8 commercial revenues forecast

- 5.62 Our efficient H8 commercial revenues allowance for these initial proposals is £5,544 million (2024 CPI) in our base traffic scenario, ranging between £5,436 million (2024 CPI) and £5,597 million (2024 CPI) in our low and high traffic scenarios, respectively. As Table 5.13 shows, compared with HAL and airlines, in a base traffic scenario, our commercial revenues initial proposals for H8 are:
- 3.7%, or £197 million (2024 CPI) higher than HAL's proposal of £5,347 million (2024 CPI); and
  - -1.3% or -£75 million (2024 CPI) lower than the airlines' proposal of £5,618 million.

**Table 5.13: CAA proposed H8 commercial revenue allowance scenarios versus HAL and airlines**

(£ million, 2024 CPI)	HAL Dec-25	Airlines	CAA	CAA minus HAL Dec-25		CAA minus airlines	
				Value	%	Value	%
Low traffic scenario	5,293	-	5,436	143	2.7%	-	-
Base traffic scenario	5,347	5,618	5,544	197	3.7%	-75	-1.3%
High traffic scenario	5,401	-	5,597	196	3.6%	-	-

- 5.63 Table 5.14 shows the drivers of the £197 million (2024 CPI) difference between our initial proposals and HAL's proposals for H8 in a base traffic scenario across two dimensions, by component of our method (columns) and by commercial revenue category (lines). It shows that:
- the upward efficiency adjustment we propose to the 2024 baseline is the primary driver of this, accounting for £155 million (2024 CPI), or 79%, of the overall £197 million difference from HAL's proposals;
  - our passenger number, price indexation, and management stretch assumptions account for 18% or £36 million (2024 CPI) of that difference;
  - our bespoke methods used to estimate bureaux, TDOC and cargo revenues account for 3% or £6 million (2024 CPI) of the difference;

- by commercial revenues category, the main drivers of the proposed increase on HAL's proposals are surface access (£87 million, 2024 CPI); retail and catering (£58 million, 2024 CPI); other commercial revenues (£38 million, 2024 CPI), and cargo (£34 million, 2024 CPI). The reasons for these differences are explained by adjustments to the baseline, different assumptions in the roll-forward or bespoke assessment; and
- our proposed TDOC revenue is lower than HAL's by -£38 million (2024 CPI). This is explained by differences in passenger forecasts and the need to convert into 2024 CPI prices the nominal TDOC revenues calculated using a tariff that remains flat, in nominal terms, during H8.

**Table 5.14: CAA proposed deviation from HAL's commercial revenues proposals (base traffic scenario)**

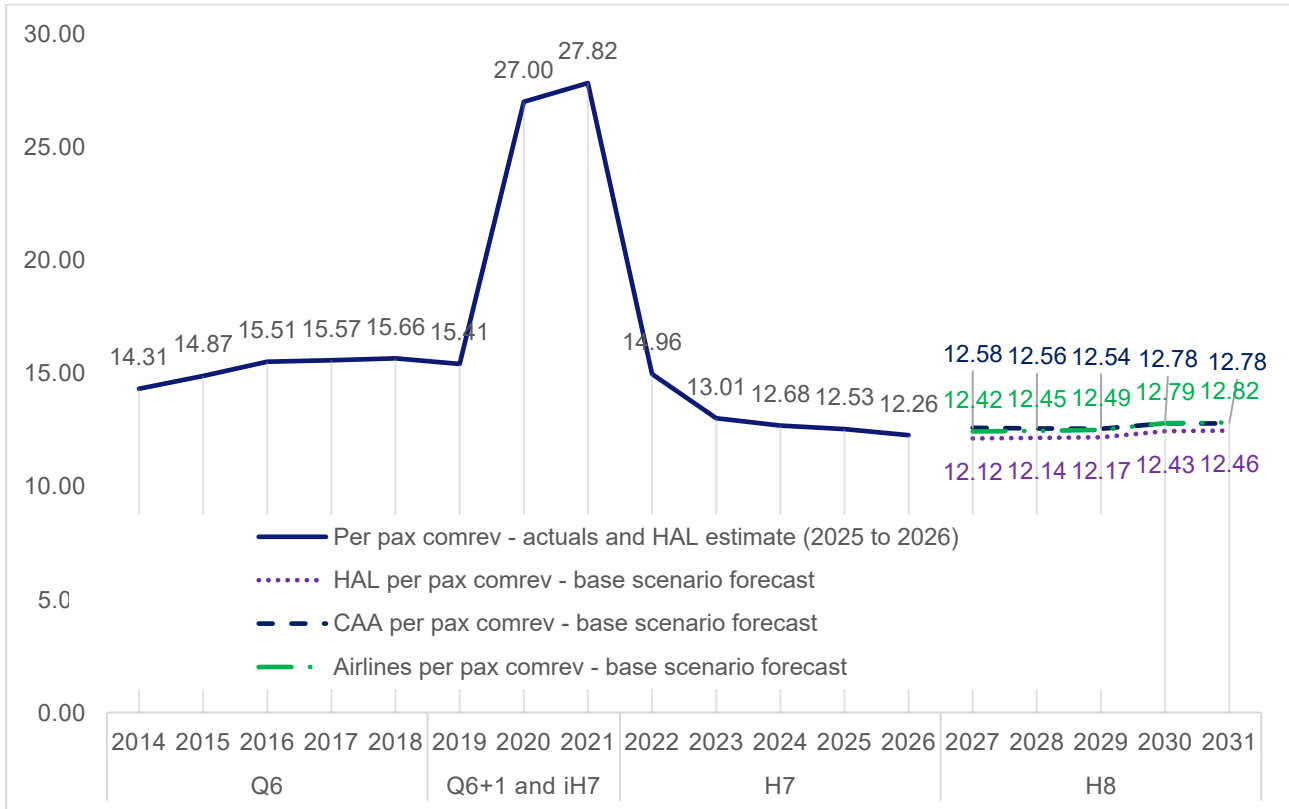
(£ million, 2024 CPI) Commercial revenues category	HAL	CAA 2024 baseline adjustment	Roll forward	Bespoke ass'ment	CAA allowances	CAA minus HAL
Retail and catering	2,241	129	-72		2,298	58
Bureaux de change	62	0		10	72	10
Surface access and car parking	1,029	0	87		1,116	87
TDOC	282	0		-38	244	-38
Service revenue	376	1	0		376	1
Rail	613	17	-20		611	-3
Property	738	7	3		748	10
Other commercial revenue	0	0	38		38	38
Cargo	56	0		34	90	34
Overlays	-49.8				-49.8	0
<b>Total revenue</b>	<b>5,347</b>	<b>155</b>	<b>36</b>	<b>6</b>	<b>5,544</b>	<b>197</b>

Source: CAA analysis of data extracted from EE/YA Opex and Commercial revenues model for initial proposals.

- 5.64 The technical report from EE/YA and the accompanying Opex and Commercial revenues model for initial proposals provide greater granularity of our proposed commercial revenues allowances for the H8 period.
- 5.65 Nonetheless, it is important to be clear that we are providing this granular information only for the purpose of bringing transparency to the projection of our allowance for the overall level of commercial revenues. It is for HAL to decide on its overall strategy and approach to raising individual categories of revenues.
- 5.66 Figure 5.3 shows historical and proposed commercial revenues for the H8 period on a per passenger basis. The CAA, HAL and airlines proposals imply that real per-passenger commercial revenues will remain below pre-covid 2019 outturns throughout the H8 period. Neither set of projections is more demanding than the

performance that HAL achieved historically and recognises the likely persistency of some unfavourable factors throughout H8. On a per-passenger basis, the gap between HAL’s proposed commercial revenue and our proposed per-passenger allowance narrows over the H8 period. The key difference between our and HAL’s per-passenger revenue proposals is the timing of when higher revenues materialise, rather than whether they can be achieved at all.

**Figure 5.3: Historic and proposed commercial revenue per passenger (£, 2024 CPI)**



Source: CAA analysis.

5.67 Our per-passenger commercial revenues profile is broadly flat over H8, moving from £12.58 per passenger (2024 CPI) in 2027 to £12.78 (2024 CPI) in 2031. HAL’s forecast increases more materially, from £12.12 per passenger (2024 CPI) in 2027 to £12.46 (2024 CPI) in 2031, narrowing the gap from £0.46 to £0.32 per passenger (2024 CPI). This pattern is consistent with HAL assuming a more gradual improvement in commercial revenue performance through H8, whereas our allowance embeds a higher efficient starting point from the beginning of the period.

**Overall level of stretch**

5.68 The combination of different assumptions in forecasting cargo revenue and bureaux de change account for about one-quarter of our £197 million (2024 CPI) stretch, or 3.7%, to HAL’s proposals.

5.69 As Table 5.15 shows, if we exclude these differences, then our revenue allowances imply scope for HAL realising commercial revenues about 2.9% higher than it has sought in its proposals for H8. This 2.9% level of stretch is of the same magnitude as the scope for improvements that we have concluded were possible when we performed our baseline adjustments (based on bottom-up benchmarking and validated by our top-down benchmarking).

**Table 5.15: Proposed overall level of stretch in commercial revenues across H8**

(£ million, 2024 CPI)	HAL	CAA allowances	CAA minus HAL	Level of stretch
<b>Total commercial revenues</b>	<b>5,347</b>	<b>5,544</b>	<b>197</b>	<b>3.7%</b>
Cargo	56	90	34	-
Bureaux de change	62	72	10	-
<b>Total commercial revenues minus the items above</b>	<b>5,229</b>	<b>5,382</b>	<b>152</b>	<b>2.9%</b>

Source: CAA analysis of data from HAL submissions and EE/YA Opex and Commercial revenues model for IPs.

**H8 proposed commercial revenues annual profile in 2024 CPIH**

5.70 As we explain in Chapter 10 (Financial framework), our view of the appropriate measure of inflation for the H8 period has evolved since we published the H8 Method Statement and we are setting our initial proposal for the price cap during the H8 period using CPIH, rather than CPI, as our standard measure of inflation.

5.71 Nonetheless, our detailed work on commercial revenues has used CPI to ensure consistency with, and traceability to, HAL’s H8 Business Plan submission and airlines’ Alternative Business Plan, which are both expressed in 2024 CPI, consistent with our Business Plan Guidance.

5.72 Table 5.16 shows the annual profile of our proposed commercial revenue allowance for the H8 period on the basis of both 2024 CPI and 2024 CPIH.

**Table 5.16: CAA H8 efficient commercial revenues allowance annual profile**

£ million, 2024 CPI	2027	2028	2029	2030	2031	H8 total
Low traffic scenario	1,068	1,072	1,078	1,106	1,112	<b>5,436</b>
Base traffic scenario	1,080	1,089	1,099	1,133	1,142	<b>5,544</b>
High traffic scenario	1,084	1,096	1,110	1,146	1,161	<b>5,597</b>
£ million, 2024 CPIH	2027	2028	2029	2030	2031	H8 total
Low traffic scenario	1,059	1,064	1,068	1,095	1,100	<b>5,386</b>
Base traffic scenario	1,072	1,080	1,090	1,121	1,129	<b>5,493</b>
High traffic scenario	1,075	1,087	1,100	1,135	1,148	<b>5,545</b>
CPIH forecast	2027	2028	2029	2030	2031	H8 total
Percentage	2.15%	2.08%	2.11%	2.13%	2.13%	-

Source: EE/YA Opex and Commercial revenues model for IPs and OBR, ‘Economic and fiscal outlook’, November 2025 (CPIH forecast 2027 to 2029). Note: We roll forward OBR’s CPIH 2029 forecast to 2030 and 2031.

## Next steps and implementation

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- 5.73 We welcome stakeholders' views on our approach to making projections of commercial revenues our initial proposals in relation to the allowances for commercial revenue and will consider these carefully as part of our work to develop our final proposals.
- 5.74 More broadly, we will continue to refine our projections of commercial revenues in developing our final proposals. This work will be informed by stakeholders' responses to this consultation and updated analysis by EE/YA.
- 5.75 In general we do not intend to make any significant changes to the Licence to implement our approach to commercial revenues. Nonetheless, the allowance that we determine is an important component in the calculation of the revised price cap. We discuss the licence implications of the TDOC mechanism in Appendix C (Draft licence modifications).

## Chapter 6

# Capex assessment

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## Introduction to capex

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- 6.1 Capital expenditure (“capex”) at Heathrow Airport is essential to maintaining safe, reliable and resilient operations. Through its capex programme, HAL renews key assets, meets statutory environmental, safety and security obligations, improves service for customers, and enhances capacity within the operation of the two-runway airport. The effective incentivisation of efficient capex is central to ensuring the airport functions efficiently and delivers appropriate outcomes for passengers and airlines.
- 6.2 The focus the H8 price control review is the operation of the business-as-usual, two-runway Heathrow Airport. We are reviewing capex related to significant capacity expansion of terminals and the third runway as part of a separate work programme.<sup>17</sup>
- 6.3 Efficient capex needed for the business-as-usual operation of a two-runway Heathrow Airport is added to HAL’s RAB. HAL recovers this capex from consumers over a long period of time, through the allowances we set for regulatory depreciation and return on capital, which are key building blocks of our projections of price-controlled revenues. Therefore, capex plays an important role in determining the overall level of airport charges in the long term.
- 6.4 We recognise there is uncertainty when forecasting and prioritising capex requirements more than five years ahead. Our approach accounts for this by:
- setting an efficient capex envelope that allows HAL and the airlines to progress, through the capex governance process, those projects with a strong “need case”; and
  - proposing to retain the flexibility of the capex uncertainty mechanism introduced in H7, including the five percent headroom, which allows for a higher level of efficient capex where this is appropriate and necessary. We detail the capex uncertainty mechanism in Chapter 8 (Regulatory incentives).
- 6.5 In setting HAL’s efficient capex envelope for H8 we take account of the benefits that we expect capex projects to deliver for consumers and assess the efficiency of the proposals. In doing so, our intention is to:

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<sup>17</sup> CAA, H8 Method Statement and Business Plan Guidance (CAP 3083), March 2025, paragraphs 1.10 and 1.30.

- secure that the reasonable demands of consumers for Airport Operation Services are met;
- promote efficiency and economy on the part of HAL; and
- where appropriate, capex also enables HAL to take reasonable steps to mitigate the environmental impact of the airport.

6.6 This chapter describes our approach to setting the efficient capex envelope for H8. It sets out:

- a summary of what we said in our H8 Method Statement and Business Plan Guidance;
- a summary of stakeholders' views on the capex envelope for H8;
- the method we have used to set the efficient capex envelope for H8;
- our initial proposals for the efficient capex envelope for H8; and
- key issues for consultation and next steps.

## What we said in the H8 Method Statement

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- 6.7 In the H8 Method Statement and accompanying data template, we set out detailed guidance about the type, granularity, completeness and robustness of information that we expected HAL to submit for each capital project/initiative included in its capital plan for H8.
- 6.8 We engaged with HAL ahead of the H8 Business Plan submission to improve its understanding of the level of information we expected to see in the capex plan in accordance with our Business Plan Guidance.
- 6.9 We also said in the Method Statement that HAL's H8 Business Plan should focus on the operation of the business-as-usual, two-runway airport, and that capex related to significant capacity expansion of terminals and the third runway will be dealt with in a separate work programme.

## Stakeholders' views on capex

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### HAL

- 6.10 For the H8 price control period (2027 to 2031), HAL has proposed a capex plan of £10 billion (2024 CPI prices), double the £4.9 billion (2024 CPI) capex that it expects to deliver during the ongoing H7 price control period (2022 to 2026).
- 6.11 HAL's H8 capex plan is split into 488 projects/initiatives, grouped in the 20 business cases listed in Table 6.1. The table shows that, before HAL's adjustments and capex efficiency target are accounted for, HAL's proposed capex plan for H8 is £10.3 billion (2024 CPI), coming down to £10 billion (2024

CPI) after prioritisation and phasing adjustments, and reducing further to £9.5 billion (2024 CPI), after applying the efficiency target of £0.5 billion that HAL set itself for H8.

**Table 6.1: HAL's H8 capex plan by business case**

<b>Business case / Adjustment</b>	<b>H8 capex (£ million, 2024 CPI prices)</b>
BC01.00 Security Programme	348
BC02.00 T2 Baggage Programme	493
BC03.01 Asset Management & Compliance Programme	2,036
BC03.02 Terminal 4 Front Door and Car Park	316
BC03.03 T3 Hold Baggage Screening replacement (T3IB)	92
BC03.04 T5 Pilz Obsolescence	113
BC04.00 H8 new asset renewal scope	1,185
BC05.00 Electrical network	568
BC06.00 Heat decarbonisation	319
BC07.00 Noise mitigation	241
BC08.00 Carbon and Sustainability Programme	369
BC09.00 People and Planet	207
BC10.00 Modernising Heathrow Programme	1,783
BC11.00 Occupancy infrastructure	394
BC12.00 Commercial Programme	229
BC13.00 H8 new - commercial scope	567
BC14.00 Digital	455
BC15.00 T5 Early Bag Store front door	50
BC16.00 Efficient Airport programme	212
BC17.00 H8 new - Passenger Experience	310
<b>HAL H8 capex plan prior phasing and efficiency</b>	<b>10,287</b>
People and Planet prioritisation adjustment	-112
Phasing adjustment	-176
<b>HAL H8 capex plan prior efficiency</b>	<b>9,999</b>
Efficiency	-496
<b>HAL H8 capex plan post adjustments and efficiency</b>	<b>9,502</b>

Source: HAL H8 Business Plan July 2025, Table 102, page 285.

- 6.12 HAL applied a "People and Planet prioritisation adjustment" which reduced its capex plan by around £112 million (2024 CPI). We understand this resulted from de-prioritising some of the scope of its £207 million (2024 CPI) "People and Planet" business case (BC09.00 in Table 6.1). It is unclear to us which of the projects included in this business case HAL decided to de-prioritise as part of this adjustment.

- 6.13 HAL has also clarified through the Questions and Answers (Q&A) process that the phasing adjustment of around £176 million (2024 CPI) is a broad adjustment across the whole capex plan to correct for misalignment between planned and actual spending.
- 6.14 HAL has set a capex efficiency target of 5% (-£496 million, 2024 CPI) across the whole of its £10 billion capex plan for H8. HAL expects efficiencies to increase year-on-year, with higher efficiencies expected in 2030 and 2031. The yearly profile of HAL's capex efficiency target is shown in Table 6.2.

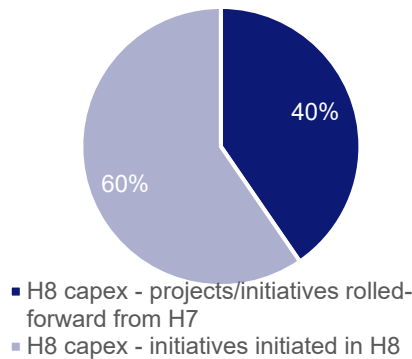
**Table 6.2: HAL's H8 capex efficiency target profile**

£ million (2024 CPI)	2027	2028	2029	2030	2031	H8
HAL H8 capex before efficiency	1,978	2,027	2,030	1,985	1,979	<b>9,999</b>
HAL capex efficiency target:						
Value	-68	-76	-95	-113	-144	<b>-496</b>
% of capex	-3.4%	-3.7%	-4.7%	-5.7%	-7.3%	<b>-5.0%</b>
<b>HAL H8 capex after efficiency</b>	<b>1,910</b>	<b>1,951</b>	<b>1,935</b>	<b>1,872</b>	<b>1,835</b>	<b>9,502</b>

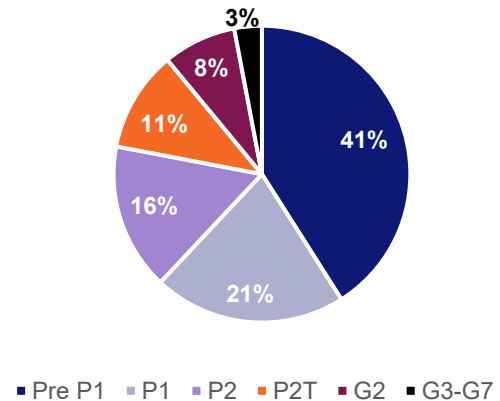
Source: HAL response to CAA Question and Answer process (Question 104)

- 6.15 In its Business Plan, HAL has presented commercial property investment as a choice outside of its capex plan. HAL has said that there is merit in exploring alternative regulatory arrangements for commercial property development at Heathrow. We discuss HAL's proposals for alternative regulatory arrangements for property development in Chapter 8 (Regulatory incentives).
- 6.16 HAL has proposed incurring 40% of the value of its H8 capex plan in projects/initiatives that roll forward from H7 (Figure 6.1), so that only about half of the proposed capex plan relates to projects that it intends to initiate in H8.
- 6.17 Airlines are yet to give their approval (through the capex governance process) for the delivery of nearly all of HAL's proposed capex plan for H8. At the time of the H8 Business Plan submission, only 3% of HAL's capex plan for H8 was at (or had progressed beyond) gateway stage 3 ("G3"), which is the stage at which airlines approve projects through the capex governance process (Figure 6.2).

**Figure 6.1: HAL’s H8 capex plan – roll forward vs new initi**



**Figure 6.2: HAL’s H8 capex plan by project maturity**



**atives**

Source: HAL, H8 BP, Table 114, page 305

Source: CAA analysis of HAL's H8 capex data tables

- 6.18 As shown in Figure 6.2, HAL’s capex plan includes projects/initiatives of different levels of maturity, according to their stage of design and approval.<sup>18</sup> HAL notes that 41% of the value of the capital programme it proposes for H8 is immature and at very early stages of development (pre-P1 level). This means that 41% of the proposed capex for H8 is yet to be scoped and incorporated within a defined programme.
- 6.19 HAL has said that the development of its capex plan for H8 has been informed by engagement with airlines through two rounds of Constructive Engagement carried out prior to its H8 Business Plan submission, and through the ongoing capital governance forums.

**Airlines**

- 6.20 Airlines submitted their H8 Alternative Plan to us in October 2025. Airlines also expressed wider views on HAL’s H8 Business Plan in a letter they submitted to us on 13 October 2025, where they raised concerns regarding the lack of a “golden thread”.
- 6.21 In their Alternative Plan, airlines have proposed a capex envelope for H8 of £5.5 billion (2024 CPI), evenly spread over the five years of H8. Airlines have said they reached this position by triangulating their views of capex priorities for H8, historical context, and considerations of deliverability and affordability.

<sup>18</sup> The level of maturity is consistent with HAL’s Programme Governance Framework and the Heathrow Gateway Lifecycle. It has the following stages: P1 gateway (identification at programme level); P2 gateway (breaks down the programme into tranches – “P2T”, and subsequently into projects); Gateway 2 (options decision at project level); Gateway 3 (investment decision and approval at project level); Gateway 4 (on-site project implementation); Gateway 5 (project readiness for use); Gateway 6 (project completeness); and Gateway 7 (project financial closure).

- 6.22 Airlines have explained, through Q&A, that their proposed £5.5 billion (2024 CPI) capex envelope for H8 is inclusive of consideration of HAL's proposed efficiencies and scope adjustments, which they have considered in the round.
- 6.23 They have also said that HAL provided them with limited information about its capex plan, which made their granular assessment of capex difficult and prevented them from completing a detailed prioritisation of capital projects for H8. Airlines also said that the discussion of HAL's H8 plan during the Round 3 of Constructive Engagement did not resolve their concerns over incomplete and insufficiently detailed capex information.
- 6.24 Airlines note that any capex prioritisation exercise on their part at this stage is "non-binding", as under the current governance framework "HAL is not required to deliver projects that airlines support at Business Plan stage".

## Our views on capex

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- 6.25 For the 488 projects/initiatives in its H8 capex plan, HAL submitted capex data tables, 20 business cases, and detailed project cost plans for each project with a clearly defined scope, that is, project at Portfolio Level 2 Tranche ("P2T") or later in the capex governance cycle. This information forms the evidence base for our assessment of each project's category, level, and likelihood of consumer benefits, which is central to the capex assessment method that we have developed for H8.
- 6.26 We value the engagement we had with HAL and airlines ahead of the July 2025 H8 Business Plan submission, which allowed us to discuss and refine our proposed capex assessment method. The feedback and challenge we received is reflected in our method, which we detail below.
- 6.27 We have assessed HAL's capex plan for H8 with support from, and in close collaboration with, our technical consultants Steer, whose report we are publishing alongside these initial proposals.<sup>19</sup>

## Our method for capex

- 6.28 We have designed a method for setting the efficient level of the capex envelope for the H8 period based on a robust and transparent assessment of each of the 488 individual projects/initiatives. Our method, as shown in Figure 6.3, has four components:
- need assessment – where we assess the strength of each project's "need case" in furthering the interest of consumers;

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<sup>19</sup> Steer H8 capex assessment for IPs.

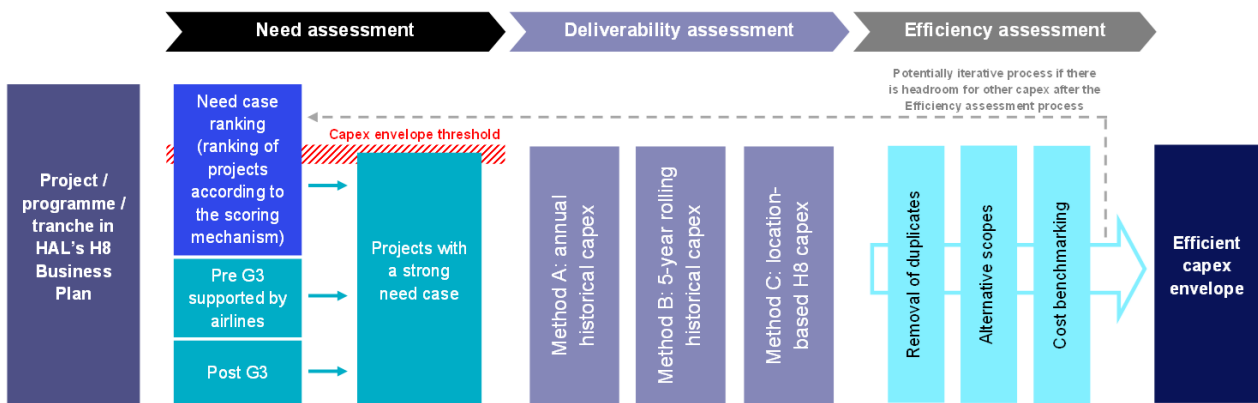
- level of the capex envelope threshold – which we set at a level sufficient to accommodate projects with a strong need case;
- deliverability assessment – where we assess whether HAL has the capacity to deliver the H8 capex envelope determined through the previous component; and
- efficiency assessment – where we assess the efficient cost of the projects with a strong need case through benchmarking, removal of duplications, and consideration of more cost-efficient scopes.

6.29 Our proposed efficient capex envelope is the result of these four components (as indicated by the last box in Figure 6.3) and we set this at a level that is sufficient to both:

- accommodate projects with a strong need case; and
- enable HAL to deliver these projects at an efficient cost.

6.30 In the next section, we detail each component of our H8 capex assessment method and explain how we have applied them to assess the 488 projects/initiatives in HAL’s capex plan for H8.

**Figure 6.3: Our capex assessment method for H8**



Source: CAA and Steer. Note: G3 stands for Gateway 3, which is the stage of the HAL-airline capex governance process at which the investment decision at project level is made and the investment is approved by the airlines.

## Developing our initial proposals for capex

### Scope adjustments

6.31 There are two aspects of the scope of its H8 capex plan that we consider require consideration. The first is the treatment of its “Modernising Heathrow” programme. The second relates to the treatment of noise and vortex mitigation costs. We address these in turn and then set out our view of the appropriate scope adjustments to HAL’s plan.

## Modernising Heathrow

- 6.32 HAL has said that its Modernising Heathrow programme addresses two critical needs: (i) increase passenger capacity and (ii) resolve infrastructure challenges in Terminal 3 (T3). The programme consists mainly of interventions to optimise capacity at Terminal 5 (T5), close and demolish T3, and significantly expand Terminal 2 (T2).
- 6.33 It has said that the full Modernising Heathrow programme totals £14.9 billion (2024 CPI, before efficiency) and would span multiple price control periods. Of this, HAL has proposed the inclusion of five projects totalling £1.8 billion (2024 CPI, before efficiency) as part of its H8 business-as-usual capital plan, under business case 'BC10.00 Modernising Heathrow' (projects 1, 2, 4a, 5, and 6 in Table 6.3 below).
- 6.34 HAL has also stated that a further £0.9 billion (2024 CPI) of expenditure is required during H8 in relation to projects 3, 4b, 7, 9, and 10 (Table 6.3), which HAL has considered to be outside the scope of the business-as-usual H8 price control. HAL has said that the regulatory treatment of these costs will depend on the outcome of the regulatory review process that the CAA is conducting as part of its separate work programme on capacity expansion.
- 6.35 We assess that, out of the five projects that HAL included in its H8 capex plan, only 'Project 5 – T5 capacity optimisation Phase 1', at £230 million (2024 CPI, before efficiency), meets the requirement we set in our H8 Method Statement in terms of separating business as usual, two runway capex from significant terminal expansion. This is because this project increases the passenger capacity of T5 by 2 million passengers per annum ("mppa") through optimisation of its layout but without changing its footprint.

**Table 6.3: HAL's Modernising Heathrow programme**

Project/Tranche	H7 total	H8 total	Beyond H8	Total
<b>In scope of HAL's H8 Business Plan – HAL proposal (£ million, 2024 CPI prices)</b>				
1 - Development Consent Order	101	185	8	<b>294</b>
2 - Enabling Modernising Heathrow	17	346	194	<b>557</b>
4a - Ancillary Projects	4	256	508	<b>768</b>
5 - T5 Capacity Optimisation Phase 1	65	230	-	<b>295</b>
6 - T5 Capacity Optimisation Phase 2	-	766	100	<b>866</b>
8 - T2A Main Building Stage 3 & T2 Satellite D	-	-	2,622	<b>2,622</b>
Contingency	-	-	1,082	<b>1,082</b>
<b>Total</b>	<b>187</b>	<b>1,783</b>	<b>4,514</b>	<b>6,484</b>
<b>Out of scope of HAL's H8 Business Plan – HAL proposal (£ million, 2024 CPI prices)</b>				
3 - Campus Wide Utilities Systems	-	12	167	<b>179</b>
4b - Ancillary Projects	-	91	0	<b>91</b>

7 - T2A Main Building Stage 2 & T2 Satellite C	6	702	6,097	<b>6,805</b>
9 - Southern Road Tunnel Access	3	70	784	<b>857</b>
10 - CTA/PTI Redevelopment	1	24	481	<b>506</b>
<b>Total</b>	<b>10</b>	<b>899</b>	<b>7,529</b>	<b>8,438</b>
<b>Overall Total</b>	<b>197</b>	<b>2,682</b>	<b>12,043</b>	<b>14,922</b>

Source: HAL, H8 Business Plan, July 2025, Business Case 'BC10.00 Modernising Heathrow', Appendix 3, Table 14.

Note: capex figures in this table are before consideration of HAL's proposed capex efficiency of 5% in H8.

6.36 We are of the view that the remaining four (out of five) Modernising Heathrow projects that HAL includes in its capex plan for H8, totalling £1,553 million (2024 CPI, before efficiency), relate to significant terminal expansion and, therefore, according to our Method Statement, are outside the scope of the H8 capex plan. Specifically:

- Project 1 – Development Consent order: we understand from the Q&A process and the deep dive we ran with HAL on Modernising Heathrow that this project is entirely about securing the consent for the expansion of T2. We therefore assess it as being an enabling project for 'significant capacity expansion of terminals'.
- Project 2 – Enabling Modernising Heathrow: This project consists of enabling works for the construction of T2 satellite C. We therefore consider it is an enabler for 'significant capacity expansion of terminals'.
- Project 4a – Ancillary Projects: During the Q&A and dedicated deep dive, HAL explained that the main scope of this project is the provision of spaces currently provided by the Est 2 ("E2") car park, which will be demolished as part of the T2 expansion project. We consider this to be an enabling project for the expansion of T2 and, therefore, is an enabler for 'significant capacity expansion of terminals'.
- Project 6 – T5 Capacity Optimisation Phase 2: This project is about delivering additional 4 mppa capacity by 2034 through the extensions of T5 Satellite B and T5 Satellite C. We assess this as being a 'significant capacity expansion of terminals', as it increases the footprint of a terminal.

6.37 We note that HAL excluded 'Project 3 – Campus Wide Utilities' from its H8 capex plan submission. However, the appendix to the business case sets out that this project will incur £12 million (2024 CPI, before efficiency) of capex during the H8 timeframe. Through Q&A and dedicated deep dive, HAL has explained that the scope of the H8 expenditure for this project relates to the design of a new fuel storage facility. HAL has also explained that this facility is required to maintain adequate fuel volumes to accommodate increased usage and improve resilience in the event of a supply line failure, within the two-runway airport configuration. We also understand from the Q&A, deep dive, and the business case that the

delivery of this facility is being brought forward in the programme to address airlines' concerns raised during Constructive Engagement.

- 6.38 Although HAL did not include this capex in its H8 plan, we consider that it satisfies our requirements for being part of the business-as-usual H8 capex in a two-runway airport. We will consider it in our capex assessment process, should HAL choose to include this project, and corresponding information, in its response to these initial proposals.

### Noise and vortex costs

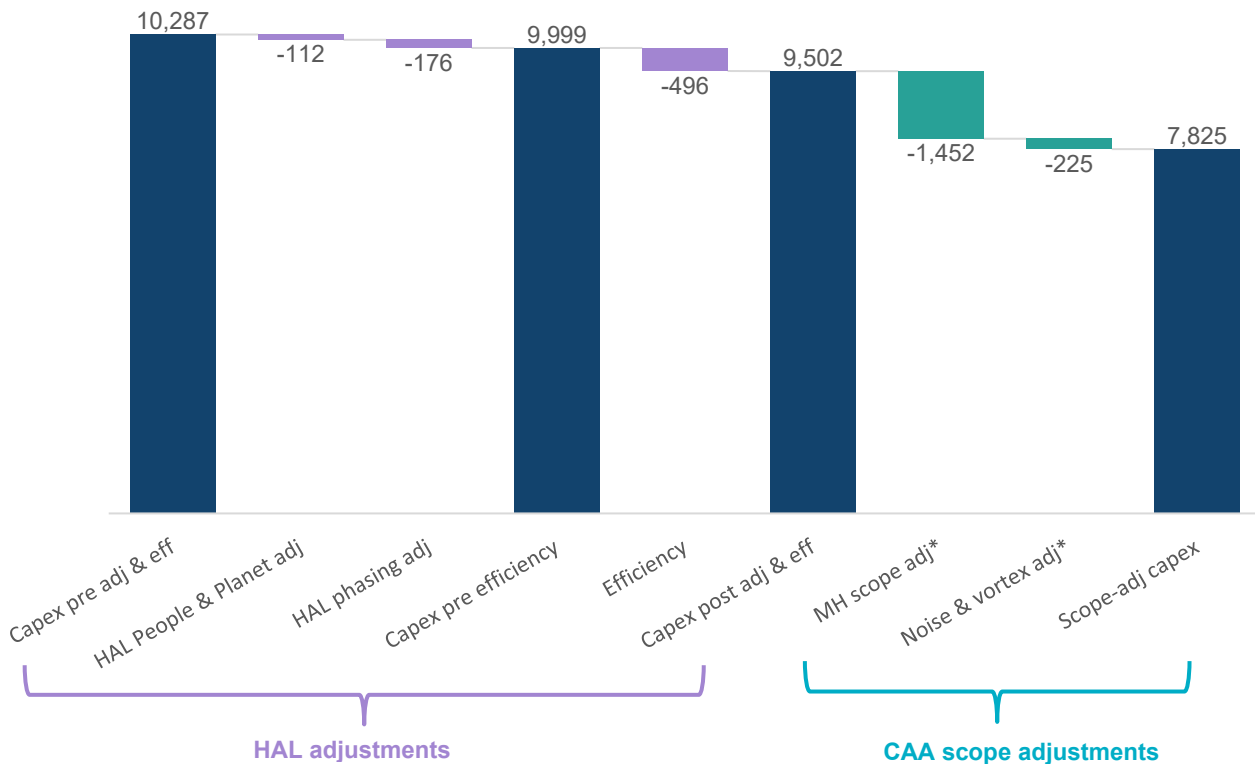
- 6.39 Expenditure to mitigate noise and vortex issues provides (i) acoustic insulation to buildings in the community located in the surroundings of the airport, (ii) vortex damage repairs, and (iii) economic assistance to residents to relocate from highest-noise areas. This type of expenditure has been treated as opex in HAL's statutory accounts and in HAL's regulatory accounts, in H7 and previous regulatory periods.
- 6.40 In its capex plan for H8, HAL has proposed to change the treatment of expenditure for noise and vortex mitigation and treat it as capex, rather than opex, for regulatory purposes, thus adding this type of expenditure to the RAB, starting in H8.
- 6.41 HAL has proposed to spend £241 million (2024 CPI prices, before efficiency) in H8, with an even spend of £48.2 million (2024 CPI, before efficiency) per year. This is, per year, more than four times the £10.6 million (2024 CPI) opex spent in noise and vortex mitigation in 2024. HAL's business case 'BC07.00 Noise mitigation' is relatively immature, with the full £241 million (2024 CPI, before efficiency) proposed capex allocated to one single initiative at pre P1 stage, meaning that HAL has yet to incorporate it into a defined programme and assess the viability of this initiative.
- 6.42 The reasons HAL has stated for proposing to treat noise and vortex mitigation costs as capex include:
- capex is recovered over the useful life of the investment, whereas opex is recovered fully in-period, which drives higher airport charges in the short term;
  - benefits of the investment are longer term, so treating this expenditure as capex would align timing of benefits with cost recovery;
  - actual capex spending is reflected in charges, rather than opex allowances;
  - providing greater certainty for its supply chain;
  - creating a ringfenced budget, once approved by airlines through the capex governance process; and
  - greater transparency for the airlines.

- 6.43 HAL has confirmed through Q&A that it plans to continue to treat noise and vortex costs as opex in its statutory accounts. The proposed change would, therefore, be a departure from both historical regulatory treatment and future statutory accounts.
- 6.44 With support from our technical consultants Steer, we conducted a high-level review of the treatment of noise mitigation costs at nine major and economically regulated European airports: Brussels, Dublin, Frankfurt, Madrid, Paris CDG, Rome FCO, Stockholm, Vienna, and Zurich. We concluded that, apart from Madrid airport, no other European airport treats these costs as capex in either their statutory accounts, or under their respective regulatory frameworks.
- 6.45 We recognise that HAL should play an active role in minimising the noise impact from aircraft landing and taking off on local communities and that noise and vortex mitigation initiatives are one of the tools at HAL's disposal to accomplish this. Other tools include alternation of runways, night quotas, climb gradient, continuous descent approach, higher aeronautical charges for noisier aircraft, and a cap on the annual air traffic movements set at 480,000 movements at Heathrow Airport.
- 6.46 We also recognise that the aircraft noise regulations under which HAL operates mandate it to protect local communities affected by aircraft noise, albeit the regulations are not prescriptive about the resources that should be deployed to fulfil these obligations.
- 6.47 In the context of the operation of a two-runway airport, we do not consider that HAL has made a compelling case for significantly increasing the resources deployed on noise and vortex mitigation, nor for changing the regulatory accounting treatment of these costs. We note that the accounting treatment of these costs does not determine the overall budget, whether the budget is ring fenced, provide certainty for the supply chain, or necessarily increase transparency.
- 6.48 Bearing the above in mind, we propose to retain the treatment of noise and vortex mitigation costs as opex, as we have not seen a compelling case, either from HAL or through our assessment of regulatory precedent in other European airports, for treating these costs as capex. We discuss the opex allowance we make for noise and vortex mitigation costs in the H8 period in Chapter 4 (Operating expenditure).

#### HAL H8 capex proposal after scope adjustments

- 6.49 Figure 6.4 shows the changes to the level of capex that HAL proposes for the H8 period after HAL's adjustments, and the two scope adjustments that we propose. Our proposed two scope adjustments reduce HAL's H8 capex plan from £9.5 billion (2024 CPI, after efficiency) to £7.8 billion (2024 CPI). This is the starting point for our cost assessment process.

**Figure 6.4: HAL’s H8 capex proposal post CAA scope adjustments (£ million, 2024 CPI)**



Source: CAA analysis. Notes: MH = Modernising Heathrow. (\*) denotes that these costs are net of HAL’s phasing and efficiency adjustments, which combined amount to around 6.5% of HAL’s £10,287 million (2024 CPI) capex plan pre-adjustments. These were calculated by applying a 6.5% adjustment to HAL’s £241 million (2024 CPI, before efficiency and phasing) proposal for noise and vortex mitigation and to HAL’s £1,553 million (2024 CPI, before efficiency and phasing) proposal for the four Modernising Heathrow projects in HAL’s H8 capex plan that we consider out of scope of the business-as-usual two-runway airport.

**Need assessment**

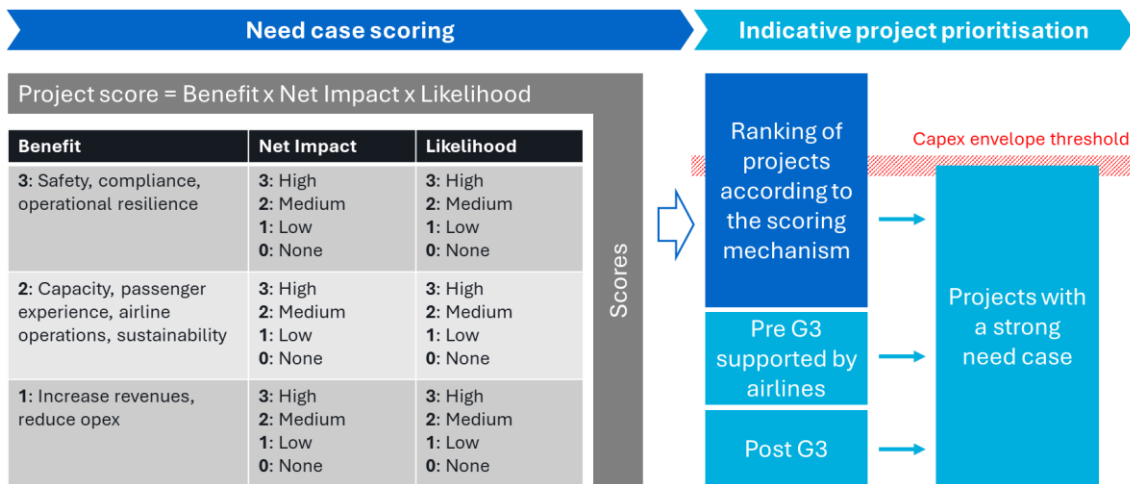
6.50 The need assessment is the first component of our capex assessment method shown in Figure 6.3, and consists of an assessment of the strength of each project’s need case.

6.51 We have developed the following three-step method for assessing the strength of the need case of each project in furthering the interests of consumers:

- consumer benefits;
- need case scoring; and
- indicative project prioritisation based on the strength of the need case.

6.52 Figure 6.5 illustrates how these three steps come together, which we also explain in the following paragraphs

**Figure 6.5: Our H8 need assessment method**



Source: Steer report on H8 capex assessment. Note: G3 stands for Gateway 3, which is the stage of the HAL-airline capex governance process at which the investment decision at project level is made and the investment is approved by the airlines.

### Consumer benefits

6.53 The first step of our need assessment is to categorise the benefits to consumers from capital project into three categories and assign a consumer benefit score to each category. In categorising consumer benefits from capital projects, we have considered, in the round, the consumer research that informed HAL’s Business Plan submission; discussions with airlines and other stakeholders during the Constructive Engagement process, including the views from the Passenger Forum; and our engagement with HAL and airlines. This resulted in the following three consumer benefit categories, which we agreed with HAL and the airlines ahead of HAL’s Business Plan submission:

- Safety, compliance, and operational resilience benefits. This category is considered the most critical one to further the interest of consumers, and has been assigned the highest consumer benefit score, which is 3. It recognises (i) safety benefits; (ii) compliance with statutory requirements, including safety, security and environmental obligations; and (iii) benefits that result from maintaining the long-term capability of existing assets and enhancing the operational resilience of the airport.
- Capacity, passenger experience, airline operations, and sustainability benefits. This category is assigned a consumer benefit score of 2. It captures the benefits to consumers from capital projects that deliver (i) increased capacity; (ii) better passenger experience; (iii) improved and more resilient airline operations; and (iv) improved sustainability of the airport.

- Benefits to consumers from increases in revenues and/or reductions in opex. This category of consumer benefits has been assigned a benefit score of 1. It captures the potential benefits to consumers from lower airport charges if capex projects deliver higher commercial revenues or lower opex costs.

6.54 It could be argued that each subcategory of the consumer benefit categories above (for example, safety, resilience, capacity) could have its own scores. We discussed potential further breakdowns and relative importance with HAL and the airlines and concluded that different stakeholders assign a different score per subcategory. We consider that reducing the groupings to three benefit categories, as described above, is a pragmatic way to further the interests of consumers.

### Need case scoring

6.55 Capex governance G3 gateway is the stage of the HAL-airline capex governance process at which airlines approve the project investment. The approval validates the developed solution, ensuring it is buildable, costed, and aligned to project and programme objectives. Airlines' approval at this stage is necessary to allow HAL to add the capex incurred to the regulated asset base.

6.56 We have scored each of the 460 (out of 488 projects/initiatives) that have neither gone through G3, nor have support from the airlines outside the capex governance process, against:<sup>20</sup>

- each of the three categories of consumer benefits, scoring from 1 to 3, as described above;
- the level of the benefits, through a net impact score; and
- the likelihood of the benefits to materialise, using a likelihood score.

6.57 The net impact of each project against each consumer benefit category is defined as the positive impact that the project is expected to have minus the negative consequences. Some of the negative consequences could be the temporary decrease in service quality during construction works. The net impact on consumer benefits is scored on a 0-to-3-point scale, where 0 means no net benefit impact, and 3 is high net benefit impact, as shown in Figure 6.5.

6.58 We have also assessed the likelihood of the benefits to materialise, which reflects how likely it will be for the project to be executed as planned and to deliver what is expected from it. The likelihood of consumer benefit materialisation is scored on a 0-to-3-point scale, where 0 means no likelihood and 3 is high likelihood of benefit materialisation, as shown in Figure 6.5.

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<sup>20</sup> Only 28 of the 488 projects had gone through G3 and none had gained airline support ahead of us finalising these initial proposals.

- 6.59 The score attributed to each project/initiative is the sum of the multiplications of scores obtained from evaluating it against each of the three consumer benefit categories. For example, a project that it is assessed to have a 2 (medium) net impact and a 1 (low) likelihood for all three consumer benefit categories, has an overall score of:  $3 \times 2 \times 1 + 2 \times 2 \times 1 + 1 \times 2 \times 1 = 12$ . The maximum score that a project can achieve is 54 ( $= 3 \times 3 \times 3 + 2 \times 3 \times 3 + 1 \times 3 \times 3$ ).
- 6.60 The Steer report contains the technical explanation supporting the scores we have given to each project, grouped by business case. We worked with Steer to develop technical guidelines to support the scoring of both the level and the likelihood of consumer benefits expected from each project/initiative. We discussed these technical guidelines with HAL and the airlines ahead of the Business Plan submission. The version of the guidelines that we have used in our initial proposals, published in Appendix A of the Steer report, reflect the feedback of these discussions.

#### Strength of need case and indicative project prioritisation

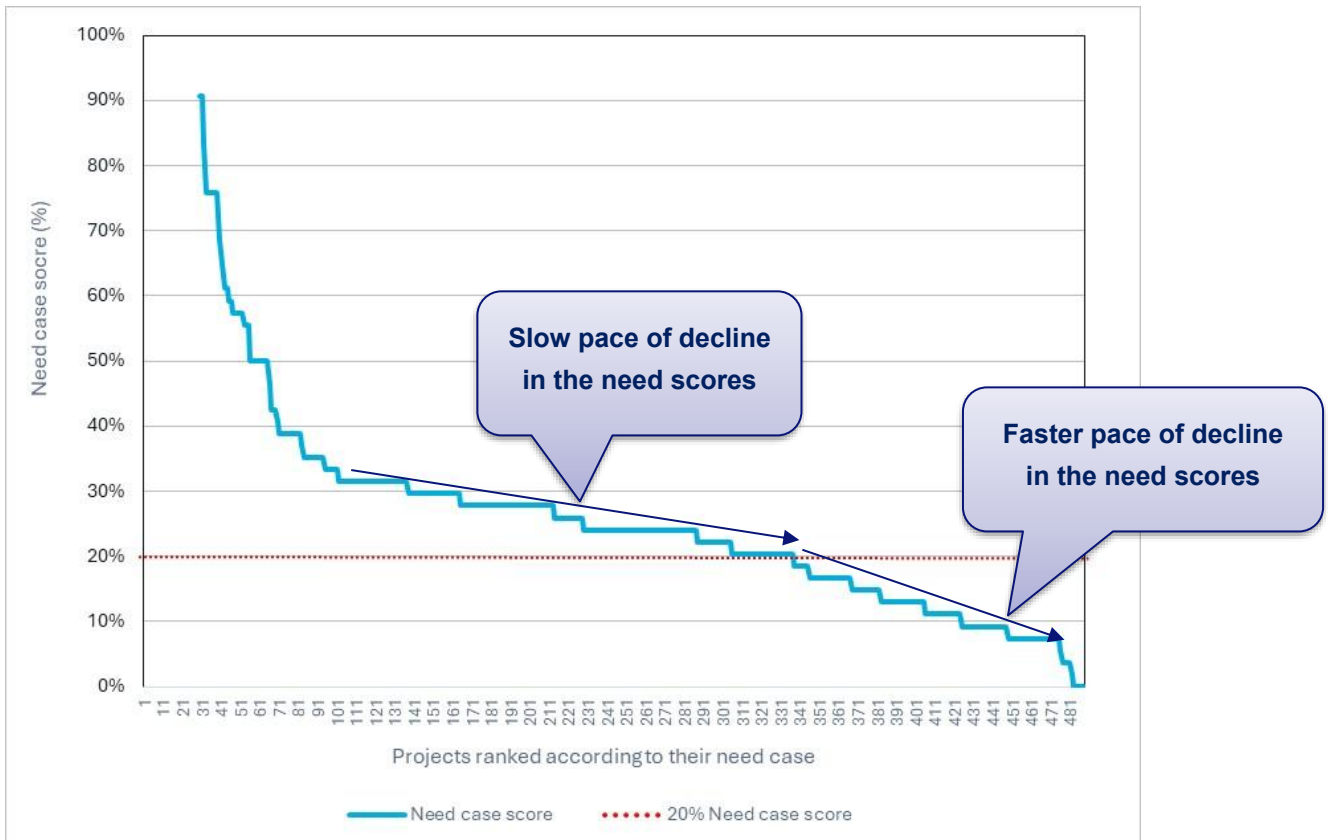
- 6.61 As Figure 6.5 shows, the projects in HAL's capex plan for the H8 period that have gone through the G3 gateway and projects at gateway stage earlier than G3 that have received support from the airlines, are automatically assessed as having a "strong" need case. We, therefore, have not performed a need assessment scoring of these projects.
- 6.62 Our need assessment scores, which are based on the information made available to us in the H8 Business Plan submission, subsequent Q&A, and dedicated deep dives, range from 0 to 49 points, or 0% to 91% of the maximum possible score of 54. The strength of the need case, at project level, is the key factor in determining the capex envelope threshold for H8, which we discuss in the next section.

#### Capex envelope threshold

- 6.63 Setting the capex envelope threshold is the second component of our capex assessment method, as shown in Figure 6.3.
- 6.64 Our broad aim is to determine the threshold, based on the minimum need score a project would need to achieve, to have a strong enough need case to be considered in the indicative set of prioritised projects for H8 (alongside the post-G3 projects and those supported by airlines).
- 6.65 We have established the threshold at the inflection point from a slow to a steep decline in the need score, as this reflects the point that indicates a sharp decrease in the strength of the need case. A threshold lower than this level would create room in the capex envelope for projects with an insufficient need case in furthering the interest of consumers.

6.66 As the dotted line in Figure 6.6 shows, using this approach, and based on the information made available to us for these initial proposals, the minimum need score is 20% of the maximum possible score (54), which is equivalent to a minimum need case score of 11. This means that 337 projects (69% of the total) have a strong enough need case to be considered in the indicative set of prioritised projects. These projects include the 28 projects at post G3 stage.

**Figure 6.6: H8 projects ranked according to their need case score**



Source: Steer analysis. Note: The chart includes the 488 projects that are included in HAL’s July 2025 Business Plan submission. The first 28 projects are the post-G3 projects (and projects supported by the airlines), which do not have a need score as we consider these as having a strong need case by default.

6.67 The capex envelope value corresponding to a 20% need case score is £5,931 million (2024 CPI prices). This capex envelope compares against the £7.8 billion (2024 CPI) envelope we determined after applying HAL’s adjustments and our scope adjustments, as set out in Figure 6.4.

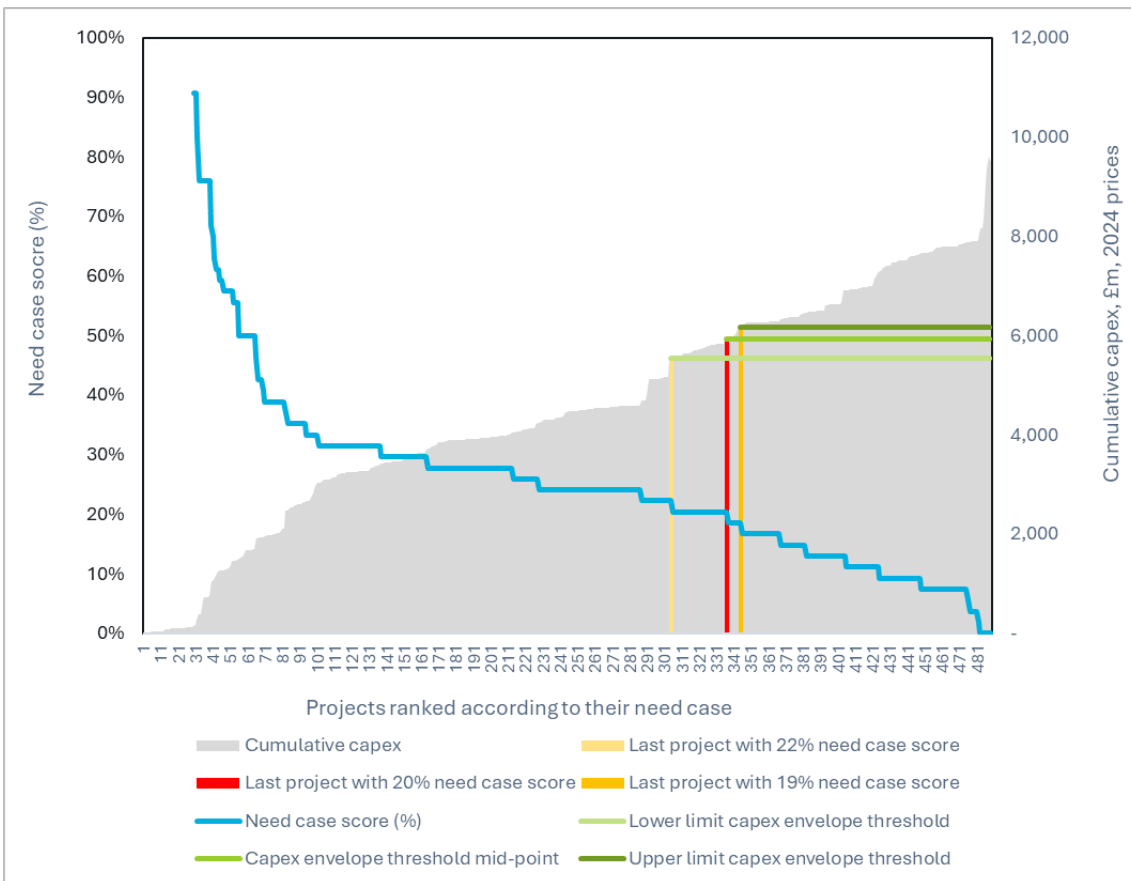
6.68 The capex envelope threshold is not intended precisely to specify the amount of capex to be spent, but rather sets a broad envelop for HAL’s capex. At this stage, we are also considering a range so as to:

- include projects with broadly comparable need cases, albeit having slightly different need case scores; and
- accommodate any borderline issues in the need case scoring, recognising that the process involves a degree of expert judgement.

6.69 We have accounted for these factors by setting the capex envelope threshold range as follows, and as illustrated in Figure 6.7:

- we have set the mid-point of the capex envelope threshold at the capex level corresponding to a need score of 11 (or 20% of the maximum score), for the reasons explained above;
- the upper limit of the capex envelope threshold is at the capex level corresponding to a need score of 10 which is one point lower than the mid-point (and 19% of the maximum possible score of 54), resulting in an upper limit of £6.2 billion (2024 CPI prices); and
- the lower limit of the capex envelope threshold is at the capex level corresponding to a need score of 12, which is one point higher than the mid-point (and 22% of the maximum possible score of 54), resulting in a lower limit of £5.5 billion (2024 CPI prices).

**Figure 6.7: Illustration of our capex envelope threshold range for H8**



Source: Steer analysis. Note: the capex presented in the chart is post HAL’s phasing and capex efficiency adjustments, to ensure comparability with the scope-adjusted HAL’s H8 capex plan of £7.8 billion (2024 CPI) in Figure 6.4.

6.70 Table 6.4 summarises our capex threshold range for the H8 price control period, which ranges from £5.5 billion to £6.2 billion with a mid-point of £5.9 billion (2024 CPI prices).

**Table 6.4: Our proposed capex envelope threshold range for H8**

	Score (points)	% Score (% of maximum possible score of 54)	Number of projects	H8 capex (£ million, 2024 CPI prices)
<b>Lower limit of capex envelope threshold</b>	12	22%	305	5,535
<b>Capex envelope threshold (midpoint)</b>	11	20%	337	5,931
<b>Upper limit of capex envelope threshold</b>	10	19%	345	6,174

Source: Steer analysis. Note: the capex envelope threshold range is post HAL's phasing and capex efficiency adjustments, to ensure comparability with the scope-adjusted HAL's H8 capex plan of £7.8 billion (2024 CPI) in Figure 6.4.

6.71 For consistency with HAL's scope-adjusted capex plan for H8 of £7.8 billion (2024 CPI) set out in Figure 6.4, our proposed capex envelope threshold range is also expressed post phasing adjustment and capex efficiency, both of which HAL applies as blanket adjustments across the whole capex plan.

### Deliverability assessment

6.72 The third component of our capex assessment method, as shown in Figure 6.3, is to assess whether HAL has the capacity to deliver the level of capex represented by the envelope threshold range we propose for the H8 period.

6.73 We have made this deliverability assessment in two steps:

- we have assessed the amount of capex that HAL has the capacity to deliver in H8; and
- we have tested whether the capex envelope threshold sits within reasonable deliverability ranges, or whether it needs calibrating to address deliverability risks.

6.74 We explain these two steps in turn below.

### HAL's capacity to deliver capex in H8

6.75 We have assessed the amount of capex HAL has the capacity to deliver in H8 through three quantitative methods. These methods combine information from capex delivered by HAL during the last 25 years with information on the capex projects that HAL proposes for H8, as follows:

- Method A: annual historical capex, which represents the amount of capex that HAL has the capacity to deliver in H8 based on annual historical capex trends, both with and without one-off projects such as T2 and T5;
- Method B: 5-year rolling historical capex, which is similar to method A but uses 5-year rolling historical capex to simulate price control period cycles; and

- Method C: location-based H8 capex, which takes account of constraints to capex delivery based on the location of works.

6.76 We have created a lower range by focusing on business-as-usual projects and an upper range by also including the major investment programmes in T2 and T5. The detailed analysis supporting this assessment is set out in Chapter 3 of Steer report. Table 6.5 summarises the results of our analysis. It shows that, based on past performance, the range of levels of capex that we consider that HAL is likely to be able to deliver in H8 is between £4.2 billion and £7.5 billion (2024 CPI).

**Table 6.5: Estimate of HAL's capacity to deliver capex in H8**

£ billion, 2024 CPI prices	Lower limit of the capex envelope likely to be deliverable during H8	Upper limit of the capex envelope likely to be deliverable during H8 (challenging)
Method A	Historical average excluding T5, T2, other one-off projects, and COVID years	4.0
Method B	Historical average including T5, T2 and other one-off projects but excluding COVID years	7.1
Method C	Maximum of £0.2bn per location	4.5
Threshold level (average of the three methods)	4.2	7.3
		7.5

Source: Steer analysis. Note: we consider as one-off projects the following: building T5 and T2; Category B and C costs; next generation security; and acquisition of the Compass Centre office building.

6.77 We note that the £ 7.5 billion (2024 CPI) capex level is not an absolute maximum and, indeed, HAL has historically delivered a maximum capex over a 5-year period ranging from £10.6 billion to £12.7 billion (2024 CPI). However, these maximums occurred when about 50% of capex was for one-off projects confined to a specific location within the airport, such as the construction of T5 and T2.

6.78 Based on historical precedent of HAL's capex delivery, and with technical support from Steer, we are of the view that:

- the lower limit of the historical average capex at £4.2 billion (2024 CPI) is a capex level that HAL can deliver in a five-year period without significant constraints to delivery;
- the delivery of a capex envelope above this level comes with delivery constraints and, therefore, becomes increasingly challenging. Delivering the challenging upper limit of the historical average of £7.5 billion (2024 CPI) would require having the right resources and planning in place, and favourable external market conditions, including a relatively unconstrained supply chain; and

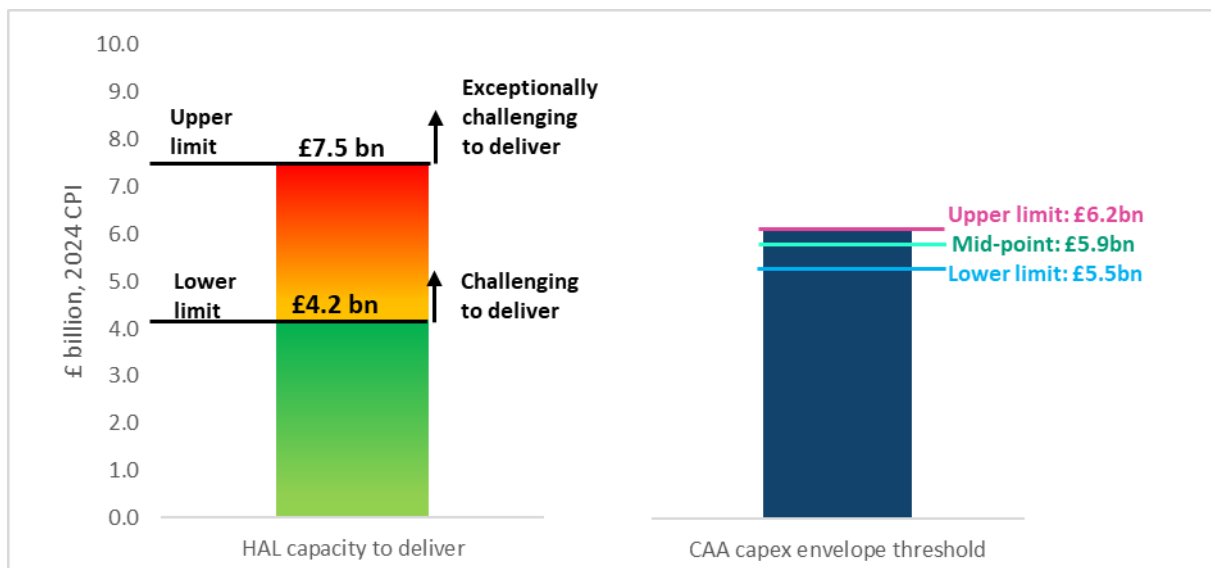
- delivering a capex envelope above £7.5 billion (2024 CPI) would likely be very challenging. In the past, HAL has delivered capex above this level only during the construction of T5 and T2. There was a degree of physical ringfencing from the rest of the airport operations during the construction of these terminals which we consider would have facilitated the delivery of this level of capex. This is not the case with the capex projects that HAL proposes for H8.

6.79 We note two main potential constraints on HAL’s ability to deliver capex in H8: constraints in the supply chain and coincidence with planning for the expansion of Heathrow Airport. We consider these factors will likely put extra pressure on HAL’s ability to deliver a H8 capex envelope close to or above the £7.5 billion (2024 CPI) upper limit of its historical average.

**Testing the capex envelope threshold**

6.80 As noted above, the capex envelope we propose ranges from £5.5 to £6.2 billion (2024 CPI), with a mid-point at £5.9 billion (2024 CPI). These values are well within the lower and upper limits of capex that we consider that HAL can deliver in H8, albeit may not be without challenges, as Figure 6.8 shows.

**Figure 6.8: HAL’s capacity to deliver range vs our proposed capex envelope range**



Source: Steer and CAA analysis

6.81 Bearing the above in mind, we do not consider it necessary to calibrate our capex envelope range to address deliverability considerations. While this level of capex may be challenging to deliver, we are of the view that HAL has sufficient time to mobilise the necessary resources to support delivery.

**Efficiency assessment**

6.82 The efficiency assessment is the fourth component of our capex assessment method, as we illustrate in Figure 6.3. Only if a project has a strong need case have we considered it appropriate to subject that project to our efficiency assessment.

- 6.83 We have assessed the efficiency of the projects with a strong need case in three steps:
- removal of duplications, where we have removed scopes which have been included in more than one project or several times in the same project;
  - alternative scopes, where we consider alternative scopes if we have found that projects could be scoped more efficiently; and
  - cost benchmarking, using independent benchmarks to ensure projects are costed at a reasonable level.

#### Removal of duplications

- 6.84 With technical support from Steer, we have scrutinised HAL's capex plans to remove potential duplicated scopes. Where the technical information made available to us through the H8 Business Plan submission was insufficient for this assessment, we requested further information from HAL through Q&A. We did not identify any instances where scopes were duplicated in HAL's H8 capex plan.

#### Alternative scopes

- 6.85 A thorough identification of possible alternative scopes is only possible for projects at a level of maturity of capex governance gateway G2 or beyond, which is when the optioneering process and selection of the preferred option has been conducted at project level. With 90% of HAL's capex plan at the pre-G2 maturity stage (see Figure 6.2), we, with support from Steer, were only able to conduct an assessment of whether there are any obvious scope oversights from HAL.
- 6.86 We have found scope issues in only one project, 'PRJ-001606 - B7239 - Airspace Modernisation – Easterly Alternation Infrastructure', where part of the scope relates to noise mitigation. As discussed above, we propose to retain the treatment of noise and vortex mitigation as opex in H8. Therefore, we have removed the noise mitigation scope from this project, which amounts to £35 million (2024 CPI) post HAL's phasing and efficiency target adjustment (or £37.7 million in 2024 CPI prices pre HAL's phasing and efficiency adjustment).

#### Cost benchmarking

- 6.87 As shown in Table 6.4 above, the number of projects with a strong need case ranges from 305 to 345 with a mid-point of 337. It would not be practical to benchmark each of these projects. As a pragmatic approach, we used a sampling method based on materiality and selected for benchmarking only those projects with a forecast H8 capex of £50 million (2024 CPI) or above.
- 6.88 As Table 6.6 shows, this meant benchmarking 28 projects with a strong need case and with capex at or above £50 million (2024 CPI), pre-phasing and efficiency adjustments. This is equivalent to benchmarking £3.8 billion (2024

CPI) of capex, or 57% of the upper limit of our capex envelope threshold for H8 (pre-phasing and efficiency adjustments).

**Table 6.6: Selection of H8 projects for efficiency benchmarking**

Minimum H8 capex per project with a strong need case (£ million, 2024 CPI)	No. of projects included	H8 capex of the projects included (£ million, 2024 CPI)	Share of the upper limit of the capex envelope threshold
<b>All projects</b>	345	6,612	100%
<b>10</b>	124	5,937	90%
<b>20</b>	74	5,216	79%
<b>30</b>	48	4,587	69%
<b>40</b>	38	4,226	64%
<b>50</b>	28	3,771	57%
<b>60</b>	20	3,319	50%
<b>70</b>	18	3,191	48%
<b>80</b>	17	3,111	47%
<b>90</b>	14	2,857	43%
<b>100</b>	12	2,670	40%

Source: Steer. Note: The £6,612 million (2024 CPI) capex for all projects with a strong need case is the pre HAL's phasing and efficiency adjustment equivalent to the upper limit of our capex envelope threshold at £6,174 million (2024 CPI), shown in Table 6.4.

- 6.89 The granularity of the independent benchmarking that Steer has performed on each of these 28 projects varied depending on the maturity of the project and, more specifically, on the type of project information HAL provided in its H8 Business Plan submission, as follows:
- 11 (out of the 28) projects selected for benchmarking had a detailed cost plan showing a clearly defined scope, typically at P2T level of maturity or beyond.
  - 17 (out of 28) projects selected for benchmarking have only a broad explanation of cost estimation, owing to their early level of maturity (pre P2T) and with even less detail for projects at very early maturity stages (at or pre-P1).
- 6.90 The Steer report details, for each of the 28 projects benchmarked, the granularity of the benchmarking conducted, external benchmarking data used, and data comparability adjustments to ensure like-for-like comparisons. Steer's independent benchmark costs are a marginal 1% higher than HAL's costs across the 28 benchmarked projects.
- 6.91 Given the marginal difference between HAL's costs and the independent cost benchmarks from our technical consultants, we conclude that HAL's cost forecasts are reasonably efficient. Therefore, we propose not to make any

adjustments to the capex envelope threshold as a result of our cost benchmarking exercise.

## Initial proposals for capex

### Summary of our proposed efficient H8 capex envelope

- 6.92 Our broad approach to capex assessment is designed to identify a capex envelope for H8 that is sufficient to both accommodate projects with a strong need case and to allow the delivery of these projects at an efficient cost.
- 6.93 As illustrated in Figure 6.3, this approach has involved (i) setting a capex envelope threshold range based on our assessment of the strength of the need case and (ii) considering whether there is a need to calibrate this envelope threshold to account for deliverability considerations. We have then assessed scope duplications, alternative scopes, and independent cost benchmarking. As we have explained in the previous section, the only calibration necessary was the removal of the £35 million (2024 CPI, post HAL's phasing and efficiency adjustments) noise mitigation scope from project 'PRJ-001606 - B7239 - Airspace Modernisation'.
- 6.94 Having conducted this analysis, the efficient capex envelope for H8 that we propose to use, as shown in Table 6.7, is £5,895 million (2024 CPI), which is the mid-point of the range that goes from a lower limit of £5,500 million (2024 CPI) to an upper limit of £6,139 million (2024 CPI).

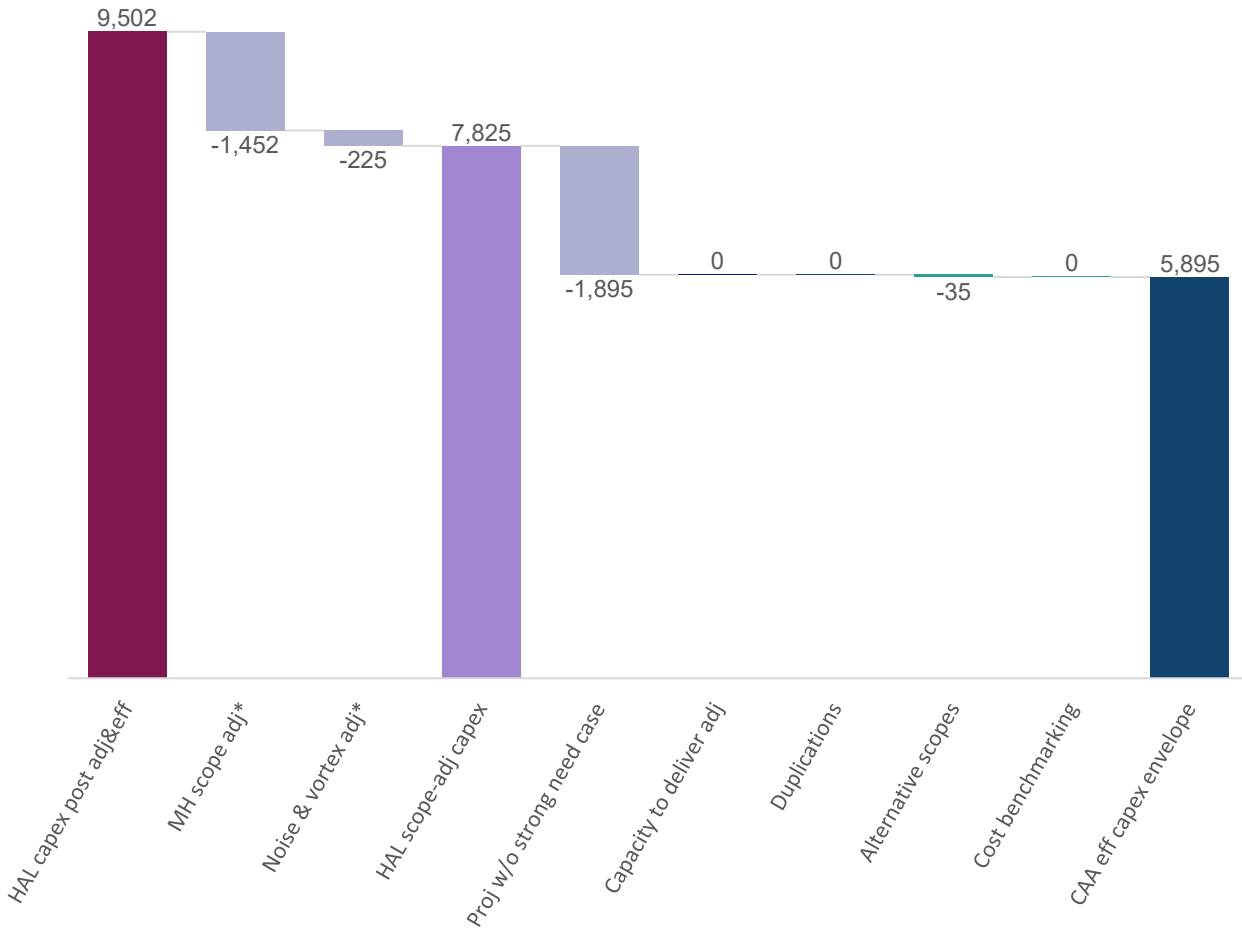
**Table 6.7: Our proposed efficient H8 capex envelope range**

£ million (2024 CPI)	Capex envelope threshold	Efficiency adjustment	H8 efficient capex envelope
Lower limit	5,535	-35	5,500
Mid-point	5,931		5,895
Upper limit	6,174		6,139

Source: Steer

- 6.95 Figure 6.9 below summarises the contribution of each of the components of our method leading to this proposed capex envelope. It shows that HAL's proposed H8 capex plan of £9.5 billion (2024 CPI, post HAL's phasing, prioritisation and efficiency adjustments) comes down to a scope-adjusted H8 plan of £7,825 million (2024 CPI), once we remove:
- HAL's proposed capex for noise and vortex mitigation (which we retain as opex); and
  - the Modernising Heathrow scope relating to substantial terminal expansion (which we said in our H8 Method Statement is out of the scope of the H8 business-as-usual, two-runway airport).

**Figure 6.9: Bridge from HAL’s H8 capex to our proposed H8 efficient capex envelope (2024 CPI)**



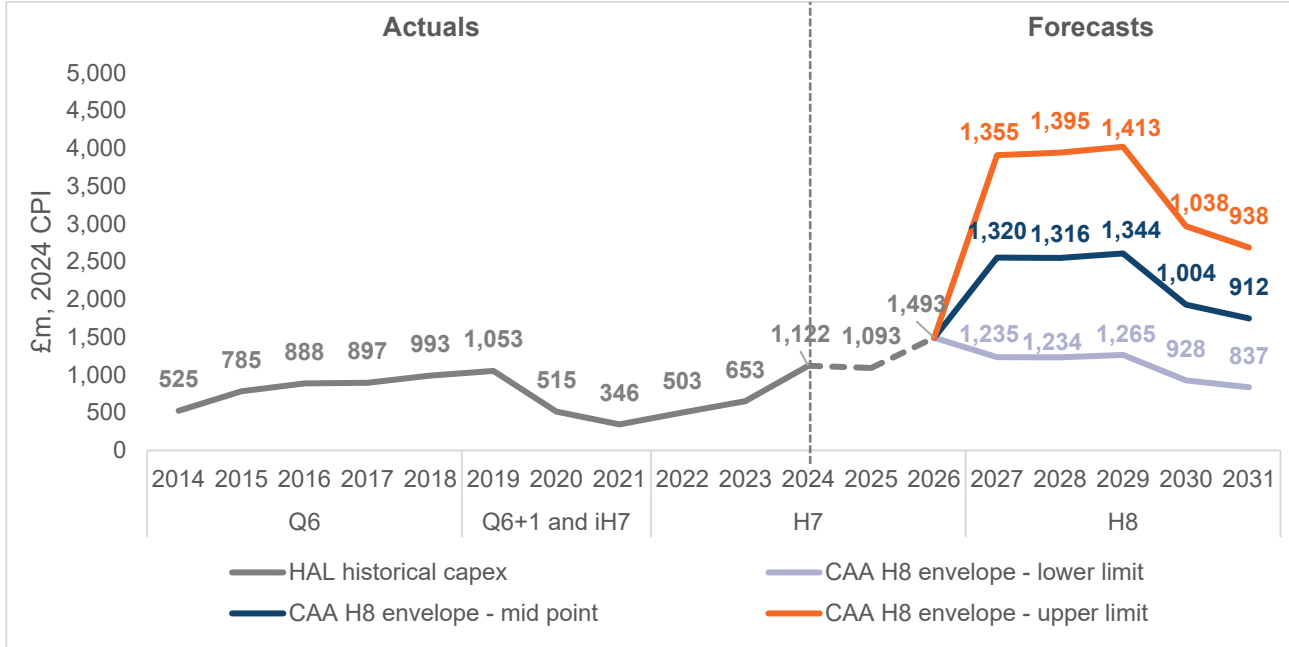
Source: CAA analysis. MH = Modernising Heathrow. Note: (\*) denotes that these costs are net of HAL’s phasing adjustment and capex efficiency, both of which HAL applies as blanket adjustments across the whole capex plan and combined amount to around 6.5% of HAL’s £10,287 million (2024 CPI) capex plan pre-adjustments. They were calculated by applying a 6.5% adjustment to HAL’s £241 million (2024 CPI, before efficiency and phasing) proposal for noise and vortex mitigation and to HAL’s £1,553 million (2024 CPI, before efficiency and phasing) proposal for the four Modernising Heathrow projects in H8 we consider out of scope of the business-as-usual two-runway airport.

6.96 Our need assessment reduces this capex by a further £1,895 million (2024 CPI), or 24%, as we assessed that, based on the information available for these initial proposals, £1,895 million (2024 CPI) of HAL’s capex does not have a strong enough need case. Our efficiency assessment removes £35 million (2024 CPI) of noise mitigation capex that HAL included in its Airspace Modernisation project (PRJ-001606 - B7239), resulting in a mid-point H8 capex envelope of £5,895 million (2024 CPI).

6.97 The proposed £5,895 million (2024 CPI) efficient capex envelope for H8 is 21% higher than the forecast of HAL’s capex spending for H7 of £4,864 million (2024 CPI) and 44% higher than the £4,088 (2024 CPI) HAL spent on capex in Q6. Figure 6.10 shows HAL’s historical capex since 2014 and CAA’s H8 efficient capex envelope year on year. Our annual profiling replicates HAL’s annual

profile of the projects with a strong enough need case to be considered in the upper limit, mid-point and lower limit of our efficient capex envelope.

**Figure 6.10: CAA capex envelope for Initial Proposals vs HAL historical capex**



Source: CAA analysis of HAL, H8 BP, Capex data tables and Steer

6.98 Appendix H (Indicative set of projects in the capex envelope) shows the indicative list of projects that our H8 capex envelope of £5,895 million (2024 CPI) accommodates. We note this is an indicative list of projects as it is based on the maturity of the information available for these initial proposals. It is for HAL and the airlines to agree during H8, through the capex governance process, the actual projects to be delivered within the capex envelope we ultimately determine.

6.99 As we stated in the introduction to this chapter and detail in Chapter 8 (Regulatory incentives), we intend to retain the capex uncertainty mechanism, including the 5 per cent headroom, introduced in H7 to allow for additional capex spending in H8, if evolving needs and more mature project information on optioneering, need cases, and benefits to consumers make a compelling case for additional spending.

6.100 The capex envelope in these initial proposals should allow HAL and airlines to work together to deliver:

- an appropriate level of service for consumers;
- maintain the long-term capability of existing assets;
- enhance the resilience of airport operation;
- allow for the safe and secure operation of the airport in accordance with statutory obligations;

- take reasonable steps to mitigate the environmental impact of the airport; and
- provide additional capacity within the operation of the two-runway airport.

### H8 efficient capex envelope annual profile in 2024 CPIH

- 6.101 As we explain in Chapter 10 (Financial framework), our view of the appropriate measure of inflation for H8 has evolved since we published the H8 Method Statement and we are making these initial proposals using 2024 CPIH, rather than 2024 CPI.
- 6.102 We have conducted our capex assessment in 2024 CPI. This ensures consistency with, and traceability to, HAL's H8 Business Plan submission and airlines' Alternative Plan. Each is expressed in 2024 CPI, in accordance with the H8 Method Statement and Business Plan Guidance.
- 6.103 Table 6.8 shows the annual profile of our H8 efficient capex envelope in 2024 CPI and 2024 CPIH. The table also sets out our CPIH inflation assumptions for the duration of H8.

**Table 6.8: CAA H8 efficient capex envelope annual profile**

£ million, 2024 CPI	2027	2028	2029	2030	2031	H8 total
Lower limit	1,235	1,234	1,265	928	837	5,500
Mid-point	1,320	1,316	1,344	1,004	912	5,896
Upper limit	1,355	1,395	1,413	1,038	938	6,139
£ million, 2024 CPIH	2027	2028	2029	2030	2031	H8 total
Lower limit	1,223	1,221	1,251	917	826	5,439
Mid-point	1,307	1,303	1,329	992	900	5,831
Upper limit	1,343	1,381	1,397	1,025	925	6,072
CPIH forecast	2027	2028	2029	2030	2031	H8 total
Percentage	2.15%	2.08%	2.11%	2.13%	2.13%	-

Source: Steer (capex envelope); and OBR, 'Economic and fiscal outlook', November 2025 (CPIH forecast 2027 to 2029).

Note: We roll forward OBR's CPIH 2029 forecast to 2030 and 2031.

## Next steps and implementation

- 6.104 We welcome stakeholder views on any of the issues relating to our estimate of the capex envelope for HAL and in particular our initial proposals for a capex envelope of £5.5 billion to £6.1 billion for HAL over the H8 period.
- 6.105 The estimates of the H8 efficient capex envelope we propose in this chapter are used in the calculation of the price cap and our assessment of the financeability of the price control.

## Chapter 7

# Other regulated charges

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## Introduction to ORCs

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- 7.1 Other regulated charges (“ORCs”) are charges levied by HAL on airline and non-airline users for the provision of certain services and facilities designated as Specified Facilities. ORCs that apply to all users (airline and non-airline) include electricity, water and staff identity cards (referred to as “all-airport ORCs”). ORCs that apply only to airlines (“airline-only ORCs”) include services such as baggage handling systems and facilities for Passengers with Reduced Mobility (“PRMs”). These services are not part of the airport’s main price control but are still subject to separate obligations on HAL with respect to governance, transparency, cost allocation and pricing.
- 7.2 ORCs comprise both direct costs and an allocation of fixed costs. At each price control review we include projections of ORC costs and revenues in our single till calculations for HAL’s price control to avoid any double counting of costs or revenues. This helps ensure that airport charges are set in a way that is no higher than is necessary and reflect efficient costs, consistent with furthering the interests of consumers.
- 7.3 The economic regulation of ORCs is important not only because of the interactions with the calculation of airport charges, but also because ORCs can have an impact on services that are important to consumers. Having appropriate and effective arrangements in place for the regulation of ORCs also supports the credibility and effectiveness of the overall regulatory regime, which provides additional indirect benefits to consumers.
- 7.4 In this chapter, we discuss:
- our position on ORCs as set out in the H8 Method Statement and Business Plan Guidance;
  - stakeholder views on the key issues;
  - our assessment of these views, which covers the scope, treatment of fixed costs and our projections for H8;
  - other issues relating to ORCs, including incentives for efficiency, an update on the reconciliation of ORC fixed costs for the H7 period and a review of Licence condition C2 which governs ORCs;
  - our projections of ORC revenues for the H8 period; and

- our conclusions and next steps including key issues for consultation.

## What we said in the H8 Method Statement

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- 7.5 The H8 Method Statement stated that we would review our approach to ORCs. In particular, we committed to considering the appropriate approach to the estimation and recovery of ORCs for the H8 period, including whether the fixed cost recovery approach adopted in the H7 period remains appropriate. We encouraged HAL to consider how it can better engage with airline and non-airline users of ORCs and improve the transparency of these charging arrangements.
- 7.6 The Business Plan Guidance required HAL to present forecasts for ORCs at a more granular level, split by each Specified Facility and split between direct costs, allocated costs and “annuities”<sup>21</sup>. We also said that the relationship of the forecasts of ORCs to traffic and passenger forecasts should be explained and separate ORC forecasts provided for each of the traffic forecast scenarios.

## Stakeholder views on ORCs

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### HAL

- 7.7 HAL’s H8 Business Plan set out five proposals that underpin its approach to estimating ORC revenues for the H8 period:
1. ORC scope-decision principles: HAL proposed to retain the ORC scope-decision principles established for the H7 period. These are a list of seven guiding principles that HAL agreed with airlines and which are used to define which activities are treated as ORCs. HAL stated that these principles will inform the plans for the H8 period, ensuring transparent cost recovery and incentivising operational efficiency and improved service levels. HAL sought to introduce an additional sustainability principle through the Constructive Engagement process: however, airlines did not support this proposal.
  2. Fixed cost recovery: HAL proposed to recover all fixed costs (for both airline and non-airline ORCs) through aeronautical charges, with the exception of fixed costs associated with staff car parking. HAL said that retaining staff car parking fixed costs within the ORC framework would move charges closer to market rates, result in a “less distortionary” outcome, simplify cost allocation and would be aligned with its net zero objectives.
  3. Evolving cost recovery for specific services: HAL proposed to evolve the scope of certain ORC items including:

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<sup>21</sup> Annuities are fixed, annualised payment amounts used to recover the cost of long-term airport investments over their economic life

- a) **Baggage systems and screening:** HAL stated that adjusting this ORC mechanism would better support on-time bag delivery and reduce misconnections, aligning it with the Measures, Targets and Incentives (“MTI”) framework. HAL would seek a joined-up approach with the airline community to develop this mechanism.
  - b) **Passengers with Reduced Mobility (“PRM”):** HAL would like to engage with the airline community to develop the future PRM proposition for H8 focused on transparent costs, improved pre-notification, and streamlined governance.
  - c) **Preconditioned air (“PCA”):** These are external units powered by electricity from the grid that provide conditioned air to aircraft. HAL said that optimising the pricing structure for PCA would incentivise greater consumption of PCA in the H8 period, supporting carbon and cost reduction.
  - d) **Staff car parking:** HAL proposed to change the cost recovery mechanism from a unit-based to a usage-based charge, saying that will allow more efficient capacity management and potentially reduce costs for ORC users.
4. **Taxi feeder park costs:** HAL proposed to remove taxi feeder park costs from the ORC framework. It said that a commercial charging approach, similar to that used for private-hire vehicles, would better manage cost and revenue variability and support more effective investment and operational efficiency for taxi feeder park users.
5. **Proposed additions to the ORC framework:** HAL proposed to widen the scope of the ORC framework by including the recovery of the following costs:
- a) **Business rates:** HAL said this would improve transparency and reduce the risk that differences between forecasts and outturns lead to windfall gains or losses.
  - b) **Check-in desks/Common Use Self Service (“CUSS”) kiosks:** HAL said that, in order to address emerging capacity constraints driven by increasing passenger volumes and expected growth, this infrastructure should be included within the ORC framework. HAL stated that this would support efficient passenger behaviour through price signals, improve operational efficiency, and optimise terminal capacity.
  - c) **CAA licence fee:** HAL said this would improve transparency and governance and reduce the risk of windfall gains or losses.
  - d) **One Stop Security (“OSS”):** This is currently subject to a trial allowing certain transfer passengers from the US to bypass security screening at

Heathrow. HAL said that including OSS within the ORC framework would improve cost management and transparency.

## Airlines

- 7.8 Airlines provided representations in their Airline Alternative Plan on ORCs, responding to HAL's proposals.
- 7.9 These representations included the following objections to HAL's proposals to recover more costs through the ORC framework.
- a) Business rates: Airlines did not support the inclusion of business rates within ORCs. Given the materiality of this cost, airlines considered that HAL should retain accountability for its efficient management rather than passing the cost directly through to users.
  - b) CAA licence fees: Airlines said they see no clear rationale for treating the CAA licence fee as an ORC and argued that doing so would transfer additional risk to airlines and consumers.
  - c) Airlines Check-in/CUSS kiosks: Airlines stated that they were not consulted on the proposal to return Check-in/CUSS kiosks as ORCs and, therefore, do not support moving these costs into the ORC framework.
- 7.10 Airlines did not support the removal of taxi feeder park costs from the ORC framework arguing that consumers should not be funding this service without any quantified or measurable benefits.
- 7.11 Further, airlines have said that the existing arrangements for the treatment of baggage systems/hold baggage as ORCs should change with these costs being treated as aeronautical charges in the future. Airlines have suggested that retaining these costs within ORCs limits their ability to influence the level of the charge and that classifying as aeronautical charges would align with the principle of MTIs focusing on activities within the aeronautical charges framework rather than ORCs.
- 7.12 Airlines expressed that, in the light of the conclusions of the Grant Thornton Independent Review published in June 2024 on HAL's ORC cost allocation approach, it is not appropriate for electricity fixed costs to be fully recovered through aeronautical charges given they apply to both airline and non-airline users.
- 7.13 Airlines said that where costs are "airline-only costs", they wanted to be more involved in cost determination rather than only being consulted on changes.

## Other stakeholders

- 7.14 The Arora Group ("Arora") raised concerns with the way in which ORCs are calculated and charged by HAL. Arora suggested that the costs levied by HAL

are not reasonable as the charges for essential services such as water and electricity are respectively ten and two times higher than market-based benchmarks.

- 7.15 During the H7 period, ORC users raised concerns about significant increases in ORC direct costs, particularly for PRM services, and questioned whether HAL faced sufficient incentives to control these costs given their pass-through treatment. While licence condition B3.1 places a general obligation on HAL to, among other things, conduct its business and activities that relate to the provision of airport operation services so as to secure the economical and efficient operation and maintenance of the Airport, there is no specific efficiency incentive linked to ORCs.

## Our assessment of ORCs

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### Scope of ORCs for H8

- 7.16 As noted above, both HAL and airlines have proposed changes to the Specified Facilities included within the scope of ORCs. Our views on the proposed inclusions and exclusions are as follows:
- Business rates and CAA licence fees: We do not consider that these costs should be included within ORCs. In particular, we do not agree that moving these items into ORCs would necessarily improve transparency as HAL has argued. We also note that it is important to retain some incentives on HAL to try and manage these costs efficiently, recategorizing these as ORCs will not necessarily achieve this objective. The discussion Chapter 4 (Operating expenditure) includes more information on our proposed treatment of business rates.
  - Check-in/CUSS kiosks: Check-in services were removed from ORCs at the start of the H7 period on the basis that they are provided for the benefit of the generality of consumers and, therefore, it was more appropriate to include the relevant charges as part of airport charges. We note that airlines did not support HAL's proposed change to reverse the position from the H7 price control. It is also not currently clear to us that HAL has provided sufficient evidence in support of this change, or that reinstating them as an ORC would be necessary to deliver the greater charging flexibility that HAL suggests is required.

- **One Stop Security:** The one-stop security (“OSS”) trial was launched relatively recently in February 2025. HAL has told us that it plans to engage and consult on this matter as part of regular ORC governance to gather further views from the airline community as this approach to security increases in scale during the H8 period. Given that the future policy position on OSS currently remains uncertain, the case for recovering OSS costs through ORCs requires further consideration.
- **Taxi Feeder Park:** Further information and assurance from HAL in respect of the process to support this changes and prospective benefits to consumers is required before we could support this change.
- **Baggage systems/Hold Baggage Screening (“HBS”):** It is not clear at this stage how reclassifying these costs as aeronautical charges would deliver the benefits proposed by airlines and we would require additional evidence of consumer benefits before we could support this type of change.

7.17 In each of the above cases, we have not been persuaded that there is a compelling case for the proposed change, nor have we seen evidence of sufficient engagement between HAL and ORC users to reach agreement or identify areas of common ground. For the purposes of our H8 initial proposals, we therefore assume no change to the scope of ORCs in terms of the Specified Facilities included or excluded.

### **Treatment of H8 ORC fixed costs**

7.18 In the H7 period, fixed costs relating to non-airline users are recovered through ORC charges while fixed costs for airlines users are recovered through airport charges. For the H8 period, HAL proposed to exclude all fixed costs from ORCs, including those relating to non-airline users, and instead recover them through airport charges, with the exception of staff car parking (discussed further below).

7.19 We remain of the view that recovering all the fixed costs from airport charges would not be in the interests of consumers as non-airline users would not make any contribution to the fixed costs of these services while benefitting from their use. We therefore consider it appropriate for non-airline ORC charges to continue to include a reasonable allocation of fixed costs.

7.20 For the H7 period, we assumed non-airline fixed costs at approximately £17.5 million per annum in 2020 CPI real prices, based on HAL estimates. Following an independent review of its cost allocation methods by Grant Thornton in 2024, HAL revised this estimate to £8.05 million per annum in 2020 CPI real prices, based on an assessment of the 2023 fixed asset register. HAL shared this revised estimate with ORC users in January 2025. The updated figures provided by HAL are set out in Table 7.1, where we have also expressed these in 2024 CPI real prices.

**Table 7.1: HAL revised estimates of H7 non-airline ORC fixed costs per annum (£ million)**

Shared Specified Facilities	H7 Final Decision (2020 CPI)	HAL Revised Estimates (2020 CPI)	HAL Revised Estimates (2024 CPI)
Electricity	11.05	3.35	4.12
Staff car parking	3.14	0.50	0.62
Staff ID	0.21	0.38	0.47
Waste – Area	0.18	0.24	0.30
Water & Sewerage	2.82	3.57	4.39
Airside Licences	0.14	0.01	0.01
<b>Total</b>	<b>17.54</b>	<b>8.05</b>	<b>9.91</b>

Source: HAL presentation to ORC users, January 2025

- 7.21 While we continue to engage with HAL on several aspects of its fixed cost re-estimation we consider that HAL's updated allocation represents a more reasonable estimate of non-airline ORC fixed costs and have incorporated these estimates in our projections for non-airline ORC fixed costs for H8 in these initial proposals.
- 7.22 We also intend to introduce new guidance that will address some of the uncertainties and asymmetries that can be created by HAL's approach to cost allocation. Under this approach, there will be a cap on recovery of fixed costs from services where there is clear evidence that the charges that HAL would otherwise make for these services would be significantly out of line with external benchmarks. This will provide additional reassurance that the ORC arrangements are reasonable and credible.
- 7.23 Bearing the above in mind, we intend to retain the approach adopted in the H7 period, keeping non-airline fixed costs within the ORC framework. Nonetheless, the evidence that we have available suggests that it would be appropriate to cap the recovery of fixed costs in relation to HAL's water and wastewater charges, otherwise the level of the charges would be very significantly out of line with those at other major airports in the UK. Bearing this in mind, we will introduce a cap for recovery of associated fixed costs through these charges at 100% of direct costs. This will provide a safeguard for consumers against a disproportionate cost recovery in an area where HAL's current charges are clearly out of line with benchmarks.
- 7.24 Taking account of the revised allocations of the fixed costs noted above, which arise from the cap on the recovery of fixed costs from water and wastewater charges, gives the allocations shown in Table 7.2 below. We will ensure that the calculations of the price cap are updated for these changes to fixed cost allocations in our final proposals. As the increase in fixed costs allocated towards

the price cap is likely to be a few millions of pounds, we do not expect there to be any significant impact on the level of the price cap.

- 7.25 At this stage, we do not consider a cap necessary for the recovery of other non-airline ORCs. For instance, HAL's electricity charges appear to be broadly in line with other UK airports.

### Staff car parking fixed costs

- 7.26 HAL has estimated the fixed costs of staff car parking by benchmarking against the cost of a new car park, rather than applying the asset allocation method used for other ORC fixed costs. We will consider this further in discussion with HAL and other stakeholders whether departing from the standard approach is appropriate in these circumstances. We will update on this issue in our final proposals.

### Incentives for ORC efficiency

- 7.27 Noting the comments from stakeholders on the low powered incentives on cost control for ORCs, we propose to introduce a licence requirement for HAL to provide an annual written explanation to the CAA and ORC users where the outturn real unit charge of any ORC, or any of its components, increases compared to the previous year. This measure will enhance transparency and provide a stronger basis for scrutinising and, where necessary, investigating, the drivers of increases in ORC direct costs. Our proposed approach is discussed further in Appendix C (Draft licence modifications) which sets out details of the proposed licence modifications.

**Table 7.2: Illustrative revised estimate of H7 non-airline ORC fixed costs per annum after cap (2024 CPI real prices, £ million)**

Shared Specified Facilities	HAL Revised Estimates after W&S Cap (2024 CPI)
Electricity	4.12
Staff car parking	0.62
Staff ID	0.47
Waste – Area	0.30
Water & Sewerage ( <i>cap imposed</i> )	0.98
Airside Licences	0.01
<b>Total</b>	<b>6.5</b>

## Initial proposals for ORCs

- 7.28 Our forecast of ORCs revenues for the H8 period is summarised below in Table 7.3. This has been calculated as follows:

- ORC direct costs for 2024 have been identified based on information provided by HAL. This includes activities within the defined scope of ORCs, as well as additional maintenance and input costs. The total ORC direct costs for 2024 are estimated at £263.3 million;
- to determine an efficient forecast of ORC direct costs for the H8 period, we have:
  - applied the 2024 proportion of ORC direct costs to the 2024 outturn opex, and
  - then applied this ratio to our efficient opex forecast for the H8 period.

7.29 This approach assumes that the direct costs attributable to ORCs will continue to represent a similar proportion of total opex during the H8 period. It also ensures that an efficiency challenge is captured within these ORC costs, as this has been reflected in the setting of opex allowances;

- non-airline ORC fixed costs have been included in line with HAL's most recent revised estimates converted into 2024 CPI real prices (see Table 7.1 above);
- an allocation of business rates to ORCs has been included consistent with the assumption adopted for the H7 period and shared by HAL; and
- separately, HAL provided a forecast of growth in the demand for passenger assistance services. We have reviewed HAL's calculation and incorporated an adjustment to reflect anticipated ongoing growth of the number of passengers in this category.

**Table 7.3: CAA H8 ORCs revenue Initial Proposals, £ million, 2024 CPI (unless stated otherwise)**

Year	Outturn		H8 period			
	2024	2027	2028	2029	2030	2031
ORC revenues	285.7	-	-	-	-	-
less H7 fixed costs and business rates	39.9	-	-	-	-	-
plus 2024 under-recovery	3.2	-	-	-	-	-
plus 2023 over-recovery reflected in lower 2024 charges	14.4	-	-	-	-	-
2024 outturn ORC direct costs	263.3	-	-	-	-	-
Baseline efficiency adjustments (excluding Business rates)	95.7%	-	-	-	-	-
Efficient ORC direct cost baseline	251.9	-	-	-	-	-
Total efficient opex (excluding Business rates)	1,403.3	1,396.7	1,388.5	1,380.6	1,368.4	1,360.7
Share of 2024 direct ORC costs as a proportion of total opex (excluding Business rates)	17.9%	17.9%	17.9%	17.9%	17.9%	17.9%
Forecast H8 direct costs	-	250.7	249.2	247.8	245.6	244.2

Year	Outturn			H8 period		
	2024	2027	2028	2029	2030	2031
H8 non-airline fixed costs	-	9.91	9.91	9.91	9.91	9.91
Allocation of rates to ORCs	-	1.35	1.35	1.35	1.35	1.35
PRM adjustment	-	1.99	2.56	2.56	3.16	3.16
ORC revenue	<b>285</b>	-	-	-	-	-
H8 ORC revenues	-	<b>263.9</b>	<b>263.0</b>	<b>261.6</b>	<b>260.0</b>	<b>258.6</b>

Source: EE/YA technical report and CAA analysis.

### Our proposed ORC profile in 2024 CPIH

- 7.30 As we explain in Chapter 10 (Financial framework), our view on the appropriate inflation measure for calculating the H8 price control has evolved since we published the H8 Method Statement. We have calculated these initial proposals using 2024 CPIH prices rather than 2024 CPI, as the H8 Method Statement previously proposed.
- 7.31 As set out in earlier sections of this chapter, we have conducted our ORCs assessment in 2024 CPI. This ensures consistency with, and traceability to, the H8 Business Plan submission and airlines’ representations, which are expressed in 2024 CPI in accordance with the H8 Method Statement and Business Plan Guidance.
- 7.32 Calculating the price cap for the H8 period in 2024 CPIH requires all inputs to our Price Control Model (“PCM”) to be expressed in 2024 CPIH. Table 7.4 presents the annual profile of ORCs during the H8 period in 2024 CPI and CPIH. The table also sets out our inflation assumptions for CPIH over the duration of H8.

**Table 7.4: CAA ORCs allowance base, low and high scenarios for the H8 period**

£m, 2024 CPI	2027	2028	2029	2030	2031	H8 total
Low	263.2	262.0	260.4	258.5	257.0	1,301
Base	263.9	263.0	261.6	260.0	258.6	1,307
High	264.1	263.4	262.2	260.8	259.6	1,310
£m, 2024 CPIH	2027	2028	2029	2030	2031	H8 total
Low	261.2	259.9	258.1	255.9	254.1	1,289
Base	261.9	260.9	259.3	257.4	255.7	1,295
High	262.1	261.3	259.9	258.1	256.7	1,298
CPIH forecast	2027	2028	2029	2030	2031	H8 total
Percentage	2.15%	2.08%	2.11%	2.13%	2.13%	-

Source: CAA analysis and OBR, ‘Economic and fiscal outlook’, November 2025 (CPIH forecast 2027 to 2029). Note: We roll forward OBR’s CPIH 2029 forecast to 2030 and 2031.

## Other ORC issues

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- 7.33 As part of the H8 review, we are also considering a number of other issues relating to ORCs. These include:
- the reconciliation of the fixed costs of providing ORCs during the H7 period; and
  - a review of licence condition C2.

### Reconciliation of the fixed costs of providing ORCs during the H7 period

- 7.34 As noted above, for the H7 price control, we assumed non-airline ORC fixed costs of £18 million per annum, based on HAL's estimates, and reflected this assumption in our projections of ORC revenues in the H7 Final Decision. HAL will have recovered this amount through all-airport ORCs over the course of the H7 period, amounting to £90 million in 2020 CPI real prices over the period 2022 to 2026. Of this total, HAL expects approximately 48.6% (£43.7 million in 2020 CPI real prices) to have been recovered from non-airline ORC users by the end of H7, with the remainder recovered from airlines. This outcome reflects HAL's matched-pricing approach for all-airport ORCs, under which the same charges apply to both airline and non-airline users.
- 7.35 Given concerns about the robustness of HAL's ORC fixed cost estimates at the time we set the H7 price control, we included an obligation in the Licence for HAL to commission an independent review of its cost allocation methodology. The purpose of this review was to assess whether the costs of Specified Facilities were allocated between airline and non-airline users on a fair and reasonable basis. We also stated in the H7 Final Decision that, where the review identified material issues, we would ensure that its outcome did not result in windfall gains or losses for HAL.
- 7.36 The independent review carried out by Grant Thornton in 2024 was unable to validate that ORC fixed costs had been allocated on a fair and reasonable basis. Following that review, HAL re-estimated non-airline ORC fixed costs at £8.1 million per annum in 2020 CPI real prices, equivalent to approximately £40.5 million over the H7 period. HAL shared this revised estimate with airline and non-airline ORC users in January 2025 (see Table 7.1). Comparing this estimate with the amounts to be recovered from non-airline ORC users over H7 (the £43.7 million noted above) suggests a small over-recovery of about £3 million when compared to HAL's revised fixed cost estimate. We will consider further this over-recovery and how it should be treated in our final proposals including whether an adjustment is appropriate.

## Review of licence condition C2

- 7.37 Condition C2 of the Licence sets out the governance and reporting arrangements for ORCs and defines the Specified Facilities. For the H8 period, we propose the following modifications to this condition designed to improve transparency and accountability:
- f) Condition C2.4. We propose to replace the specific requirement for HAL to commission an independent review of its ORC cost allocation methods with a more general requirement to do so where requested by the CAA. The review required by the Licence has now been carried out so the change is designed to retain the possibility of undertaking a future review should the need arise.
  - g) Condition C2.5. We propose to bring forward the publication date for HAL's ORC trading and transparency statements from 30 September to 30 June each year.
  - h) Condition C2.6. We propose to align the timing of publication of the ORC pricing principles with the cost allocation methodology by moving the deadline from 31 December to 30 September. This change will ensure that both can be considered as part of the annual consultation on the following year's ORC charges.
- 7.38 New Condition C2.8. We propose to introduce an additional reporting requirement, as described above, requiring HAL to explain any increase in the outturn real unit charge of any ORC, or any of its components, compared to the previous year.
- 7.39 Further details of these proposals are set out in Appendix C (Draft licence modifications).

## Conclusions and next steps

- 7.40 We welcome stakeholders' views on the matters relating to the regulation of ORCs as set out in this chapter and we will consider these carefully as part of our work to develop our final proposals.
- 7.41 As noted above, we intend to propose certain licence changes to improve alignment in the publications and materials shared by HAL, and to strengthen transparency requirements in relation to real unit charge increases.
- 7.42 As also set out earlier in this chapter, we continue to engage with HAL on the reconciliation of the fixed costs incurred in the H7 in respect of ORCs. We intend to conclude this work and address any potential over- or under-recovery as part of our final proposals.

## Chapter 8

# Regulatory incentives

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## Introduction to regulatory incentives

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- 8.1 This chapter sets out our initial proposals in relation to cost and revenue incentives which apply to HAL. Cost and revenue incentives are a key element of the CAA's price control framework for HAL because they aim to align the airport's financial interests with the interests of consumers by promoting economy and efficiency. By encouraging HAL to deliver efficient capital and operating expenditure, and maximise commercial revenues, the framework helps ensure that users pay charges that reflect efficient costs. At the same time, appropriately designed incentives and risk sharing arrangements support HAL's ability to finance its licensed activities, by providing clarity and predictability around cost recovery.
- 8.2 For instance, HAL retains, during the price control period, any benefits from outperforming the opex assumptions used to set the price control. At the subsequent price control review, these efficiencies inform the setting of the next price control and, from that point, the benefit of those efficiencies is passed on to consumers in the form of lower baseline costs. Conversely, the regulated business is exposed to the cost of overspends against the opex assumptions for the duration of the price control period.
- 8.3 The H8 Method Statement indicated our intention to retain the current broad approach to opex incentives, under which, as described above, HAL retains the risk for overspend and underspend during the price control period. We have retained this approach for these initial proposals. Chapter 4 (Operating expenditure) provides more information in relation to our projections of opex for the H8 period.
- 8.4 The remainder of this chapter focuses on capital expenditure ("capex") and revenue incentives, and covers:
- capex incentives (including governance and uncertainty mechanisms);
  - commercial revenue incentives, including Terminal Drop Off Charges ("TDOC") and commercial property; and
  - our conclusions and next steps including key issues for consultation.

## Capital expenditure incentives

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- 8.5 In considering how best to further consumers' interests in relation to capital expenditure undertaken at Heathrow Airport, we have regard to the need to

promote economy and efficiency on the part of HAL and the need to secure that HAL can finance its activities.

- 8.6 A framework of incentives and governance arrangements that promotes efficient capex delivery, taken together with our proposed “capex envelope” and a capex uncertainty mechanism, supports our approach to encouraging economy and efficiency on the part of HAL. These arrangements also help ensure that HAL can meet the reasonable demands of consumers by enabling timely and cost-effective investment that meets consumers’ needs, including the delivery of a safe, secure and appropriately resilient airport. These arrangements also support HAL’s ability to finance efficient capex.
- 8.7 We discuss our approach to capex incentives, capex governance and the capex uncertainty mechanism below. Chapter 6 (Capex assessment) describes our approach to establishing the capex envelope.

## Capex incentives

### Introduction and the H8 Method Statement

- 8.8 Our approach to incentives for capital efficiency changed for the H7 price control when we introduced forward looking (or *ex ante*) capex efficiency arrangements. In previous price controls, we performed a backward looking, or *ex post*, assessment of capex, to determine whether it had been efficiently incurred.
- 8.9 *Ex post* efficiency assessments proved challenging in practice, for several reasons. For example, it was difficult to quantify inefficiency, while being confident that projects were not being assessed with the benefit of hindsight. These challenges, as well as broader considerations about capital efficiency, led us to introduce new forward-looking capex incentives at the H7 price control. This came into effect in March 2024, following the conclusion of the CMA appeals, and a period of work with HAL and airlines to implement the new forward looking arrangements.
- 8.10 Under the forward looking approach, as part of the price review, we set an overall capex envelope for the regulatory period, as set out in Chapter 6 (Capex assessment). Budgets for individual projects are agreed in-period, through a capital governance process involving HAL and airlines, at a project gateway stage known as “G3” (this is the investment decision gateway, where an option has been developed with sufficient detail for a decision to be made on the business case as to whether to proceed). HAL then bears 25% of the risk of any underspend or overspend against these project budgets, provided specified outputs known as delivery obligations (“DOs”) are met. DOs are set for each project at G3, alongside the capex baseline. They reflect the scope, quality and timing of the project to be delivered by the capex. In the event of partial or non-delivery against each of the individual obligations the capex baseline is adjusted downwards to reflect the partial or non-delivery.

- 8.11 Taken together these arrangements are designed to provide incentives for capex efficiency. The impact of any overspend or underspend on airport charges will be accounted for at subsequent price reviews, through adjustments to HAL's opening RAB.<sup>22</sup>
- 8.12 In practice, since March 2024, the *ex post* and *ex ante* approaches have been running concurrently, with the *ex post* regime applying to all projects which had obtained G3 approval before 1 March 2024. Any projects that obtained G3 approval after 1 March 2024 will be subject to *ex ante*<sup>23</sup> incentives.
- 8.13 The H8 Method Statement noted that the forward looking capex incentive framework was relatively new at the time, but we were open to considering how it might be improved. We also noted that changes could potentially be implemented through the existing capital governance processes and that we could address more fundamental policy questions as part of our initial proposals.

### Stakeholders' views

- 8.14 In its H8 Business Plan, HAL noted that the capex framework for the H7 price control, including the forward looking capex incentive approach and 25% incentive rate, was relatively new and it did not propose any major changes to it (see further below for its proposed changes, which relate to capex governance). Earlier in the process, HAL noted the importance of setting the framework in advance so that risk allocation and incentives are understood. While some airlines have supported the continuation of the forward looking incentives framework airlines have also expressed wider concerns about the incentives on HAL to increase its RAB over time and raised concerns over the efficacy of the existing capex governance arrangements, as discussed further below.

### CAA views and initial proposals

- 8.15 We remain of the view that the introduction of a forward looking approach, where HAL:
- shares a proportion of the benefits of delivering capex projects below a set budget; but
  - bears a proportion of the costs of any over-spend against that budget,
- has strengthened the incentives for capex efficiency. Therefore, we propose to continue with this approach in H8 price control, including retaining the 25% incentive rate.

<sup>22</sup> As set out in Appendix F to our H7 Final Proposals (CAP 2635).

<sup>23</sup> We note that the *ex ante* approach does not apply to pass through costs (para 7.88, pg 96, *Economic regulation of Heathrow Airport: H7 Final Proposals Section 2: Building Blocks*, CAP 2635, June 2022).

- 8.16 Nonetheless, we will also be considering the wider points made by airlines in our work on regulatory models for capacity expansion, together with suggestions made by HAL. We are also considering reforms to the capex governance arrangements as discussed further below.

## Capex governance

### Introduction and the H8 Method Statement

- 8.17 As well as introducing forward looking capex incentives, as part of the implementation of the H7 price control, we set out a strengthened capex governance framework intended to improve the transparency, quality and effectiveness of engagement between HAL and airlines on capex planning and delivery.
- 8.18 Following our H7 Final Decision, we published guidance proposing enhancements to existing governance arrangements, particularly improvements in the standardisation of information provision, clearer processes for project assessment, and better accessibility of project and performance information to airline stakeholders.

### HAL's views

- 8.19 In its H8 Business Plan, HAL noted that the capex framework for the H7 price control was relatively new and that major changes at this stage could create unnecessary burdens. However, it noted three key drawbacks with the existing framework:
- it creates a disproportionate level of complexity to achieve project certainty;
  - is a “one-size-fits-all” approach which lacks flexibility to deliver dynamically in a live operational environment; and
  - is not scalable for HAL's proposed capex plan for the H8 period.
- 8.20 To address these issues HAL proposed two broad evolutionary changes. Firstly, the simplification of delivery obligations.
- Targeted removal of the schedule element in Delivery Obligations (“DOs”): DOs for a project are generally specified in terms of outputs, quality and schedule. At present, the schedule element is sometimes removed with the agreement of airlines. HAL has proposed that the schedule element is only included where it is explicitly agreed with airlines, on key projects or where it is an airline-requested project critical to their daily operations. HAL says this will enable more operational flexibility and reduced “time to investment decision”, delivering savings, while maintaining a focus on outputs and quality.

- Higher DO thresholds for low complexity asset renewals: HAL proposed to increase the DO threshold for asset renewals from £1 million to £10 million with a 'lighter' governance approach for these projects. HAL said that this would result in more proportionate governance and reduce the volume of DOs by 20 to 30 percent while 95 to 98 percent of its capex portfolio by value would remain subject to the DO mechanism.
- Sequential DOs for large complex projects: HAL expressed concern that large, complex projects have a much higher level of risk and uncertainty at the investment decision stage, and has suggested introducing multiple sequential DOs within one investment decision for multi-disciplinary projects in excess of £100 million.

8.21 Secondly, tailored project governance structures, including a 'light' governance approach for asset renewal projects of less than £10 million and a tranche-level, rather than project-level, approach for assets with a similar replacement profile over time (i.e. rolling life-cycle investments, such as in IT asset maintenance).

#### **Other stakeholders' views**

8.22 Throughout the H7 review, the H8 review process to date and discussions of future regulatory models for expansion, the airline community has expressed significant concerns over the effectiveness of existing capital governance processes. They argue that fundamental reform is needed in this area.

8.23 Airlines have highlighted that information asymmetry and HAL's control over both the content and timing of information shared about capital projects limits their ability to challenge and influence decisions. We have heard concerns regarding the (poor) quality and (excessive, in some cases) quantity of information provided by HAL at key points in the process, and the investment option at the G3 decision gateway has been described as, at times, a "take it or leave it" offer from HAL, with little scope to reflect airline input.

8.24 In broad terms, airline suggestions for improvement have included:

- extending the scope of capital governance, to start earlier in the process to support more strategic oversight and control of the pipeline of capex projects, and to go through to monitoring of delivery;
- strengthening the scrutiny of HAL's capital plans and decisions, with a variety of suggestions for greater involvement of the CAA, independent oversight, improved transparency, and greater accountability (including through enhanced arrangements for dispute escalation and resolution); and
- focusing the regime on outcomes, not outputs, with funding conditional on delivering the benefits promised.

- 8.25 In its submission, following round 3 of Constructive Engagement, the Heathrow Passenger Forum (“HPF”) expressed concern that the existing capital governance processes may not serve passengers’ interests, as decisions in the capital process are made by HAL and the airline community. HPF encouraged us to explore approaches in other regulated sectors to give consumers a more direct and active role in the governance process.

### **CAA views and initial proposals**

- 8.26 Where stakeholders are making suggestions for incremental refinements to the capex governance process, we will consider these as part of our work on the H8 price control. More fundamental reform will be dealt with as part of our work on regulatory models and capacity expansion.
- 8.27 Some of HAL’s suggestions for simplifying DOs and more tailored governance structures, and some of the suggestions from the airline community, for example in relation to improving the quality of information and providing an appropriate level of information for a given project, can reasonably be considered as incremental refinements to the existing arrangements.
- 8.28 As for HAL’s first two suggested changes to DOs, while we do not see a strong case for changing the default position of including schedules within DOs, there may be a case for a modest increase in the DO threshold for asset renewals. However, HAL’s suggestion for a very substantial increase in the threshold may be premature given the new capex incentive framework has only been in operation for a relatively short period (approximately two years). Furthermore, if more projects were to be exempted from DOs (through the use of a higher threshold) we would not necessarily expect them to be exempt from the 25 percent capex incentive rate.
- 8.29 These incremental refinements should be discussed between HAL and airlines under the existing capital governance framework, to see if common ground can be reached. To the extent common ground is not reached, we will put forward our position in the final proposals, informed by any additional stakeholder responses to these initial proposals.
- 8.30 Some of the stakeholder suggestions represent more significant developments to the capital governance framework. These include HAL’s third suggestion for DO simplification (in relation to large, complex projects) and some of the suggestions from other stakeholders, such as extending the scope of capital governance across the lifecycle, application of a more outcome focused regime, and an expanded role for consumers. We will consider these matters further in our work on the regulatory models for capacity expansion, factoring in any relevant findings for H8 in our final proposals, where possible.
- 8.31 Separately, we are consulting on the drafting of Condition F in HAL’s licence, which incorporates consultation requirements in relation to capex governance, to

ensure it provides a clear framework for facilitating ongoing compliance by HAL in the interests of consumers. The revised drafting we propose, together with an explanation of the approach we have taken in preparing it, is set out at Appendix C (Draft licence modifications).

- 8.32 Finally, we would emphasise that, in order for capex governance processes to be effective, it is necessary for both HAL and airlines to allocate the appropriate level of resources and expertise. We consider that better quality engagement within the current capex governance process could materially improve its effectiveness.

### Capex uncertainty mechanism

- 8.33 In the H7 price control, we introduced a new mechanism that allows us to increase the capex envelope during the price control period, reflecting the uncertainty in setting the capex envelope which existed at that time. This “capex uncertainty mechanism” was intended to provide additional funding for capital expenditure on new scope/projects/programmes that had not been anticipated in the H7 capex plan, but which were considered necessary, and could not be delivered within the capex envelope set. To help protect incentives for efficiency it was not intended as a mechanism through which HAL could seek additional funding to cover overspending against budgets
- 8.34 Applications for an increase could be made by HAL to the CAA during two defined ‘windows’ within the H7 period, with the onus being on HAL to justify the proposed investment(s). An application would trigger a CAA consultation on whether to adjust the price cap and, if so, by how much. We also confirmed that, in exceptional cases, HAL might seek our consent to make an application outside of the windows. In practice, this uncertainty mechanism has not been used to date in the H7 period.<sup>24</sup>
- 8.35 We also specified a five percent ‘margin’ to the capex allowance, so that HAL and airlines could agree increases of up to a five percent in the size of the original H7 capex envelope without making an application or requiring us to make a direction.
- 8.36 The H8 Method Statement stated that existing mechanisms, of which the capex uncertainty mechanism is one, offer an appropriate level of protection against cost increases in capex delivery beyond HAL’s control.

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<sup>24</sup> HAL had proposed the use of this uncertainty mechanism for the recovery of early costs of capacity expansion at Heathrow airport but we proposed to deal with this through modification to the Licence, for the reasons set out in: CAA, [CAP3201 Proposals on the regulatory treatment of early costs of capacity expansion at Heathrow airport](#), December 2025.

- 8.37 During the H8 price control process to date, stakeholders have not raised any objections to the continuation of the uncertainty mechanism.
- 8.38 Although not triggered in during the H7 period, we consider that the capex uncertainty mechanism helps mitigates the risk that HAL is required to incur significant, necessary capital expenditure, beyond its allowance, for activities not anticipated in the capex plan for the H8 period. In addition, the five percent “capex margin” affords flexibility for HAL, in agreement with airlines, to pursue smaller additional activity, without any additional regulatory burden.
- 8.39 For the H8 price control, we are proposing to retain, in substantially the same form, the capex uncertainty mechanism in HAL’s licence, including the five percent capex margin. We propose that the two ‘windows’ for the capex uncertainty mechanism would, as for H7, be the months of February and March in the third and fourth years of the price control period, that is between:
- (a) 1 February 2029 and 31 March 2029, and
  - (b) 1 February 2030 and 31 March 2030.
- 8.40 As in the H7 price control, in exceptional cases, we might also permit HAL to seek our consent to make an application outside of these windows.

## Commercial revenue incentives

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- 8.41 Commercial revenues comprise the income HAL earns from a wide range of its activities at Heathrow Airport that are not funded through the airport charge. These activities include retail, property rents, airport access (rail, car parks and the terminal drop-off charge) and other services. These commercial revenues that HAL earns from these activities are included in the “single till”, and, hence, are deducted from HAL’s revenue requirement when we calculate the price control that applies to HAL’s airport charges.
- 8.42 Under the single till approach, we estimate an efficient allowance for HAL’s commercial revenues for the duration of the price control period and deduct this from our calculation of its overall revenue requirement before determining airport charges. This approach provides HAL with an incentive to grow its commercial revenue, as it retains any amounts above our allowance that it realises (and, conversely, bears the cost of underperforming the allowance). The outturn commercial revenue from one period informs our assessment of the efficient commercial revenue allowance in the subsequent period. This ensures the airport charge is no higher than it needs to be. These arrangements help to promote efficiency and economy on the part of HAL’s commercial activities.
- 8.43 In general, we consider the above approach provides an appropriate incentive for HAL to grow its commercial revenue streams for the benefit of consumers. The H8 Method Statement stated our intention to retain the current broad

approach to commercial revenue incentives but noted some specific areas we wanted to consider further, including:

- possible changes to the single till boundary for commercial property investment;
- the regulatory treatment of TDOCs; and
- ensuring that estimates of single till revenue appropriately reflect recent developments (such as the recent changes to the fast-track departure security).

### Commercial property investment incentives

- 8.44 During the H8 process to date, HAL has highlighted a concern that the single till framework has resulted in stakeholders not prioritising investment in commercial property on land that it owns in the vicinity of the airport.
- 8.45 Currently, any HAL investment in commercial property enters its RAB (subject to any adjustments arising from the capex incentives). This provides HAL with a return on its efficient commercial investment, and, under the single till, the incentive to earn a greater return by beating our forecast of commercial revenue. In turn, under these arrangements, consumers substantially bear the associated construction risk and most of the revenue risk (although HAL has some exposure in the short term to revenue risk).
- 8.46 The H8 Method Statement said that we were open to considering proposals in this area further, where these can be demonstrated to be in the interests of consumers. We also said that the appropriate regulatory treatment may vary on a case-to-case basis or by different categories of investment, but that it may be possible, as part of the H8 process, to establish some baseline rules and/or agree a suitable procedure to govern these arrangements. We invited HAL to submit practical case studies relating to specific proposed investments.

#### HAL's views

- 8.47 HAL has said that the current arrangements have created an environment in which commercial property investments at Heathrow Airport are not prioritised or brought forward. HAL noted in its H8 Business Plan that there has been no commercial property development within the airport perimeter since 2005, but that over the past ten years, there has been significant investment by third parties, not driven by HAL, just outside the airport perimeter. It also noted that around half of the Central Terminal Area ("CTA") has been moth-balled as assets are at their end-of-life.
- 8.48 In its H8 Business Plan, HAL identified some wider regulatory and economic factors contributing to the relative lack of development of commercial property, including that:

- the issue has been de-prioritised by stakeholders, evidenced by there being just one project progressing during the past 20 years (the Eastern Business Park);
- CAA's capex allowances for commercial projects and for property development were fractions of those requested by HAL for the H7 period; and
- the short term nature of price control cycles does not encourage prioritisation of commercial activity, which, HAL states, have longer pay back periods and an implicit higher cost of capital.

8.49 HAL proposed that CAA should further consider the limitations of the current arrangements and the opportunities available. HAL commissioned Frontier Economics<sup>25</sup> to outline how potential future models could operate, based on the principles that: (1) property investment should not increase airport charges during the development phase; (2) revenue risk should sit with HAL; and (3) property should be recognised as a higher risk investment (than, we assume, HAL's other capital expenditure under the price control).

8.50 It did not recommend a single approach, to avoid pre-judging discussions and further evaluation it considered were needed. However, it did highlight a 'sharing mechanism' approach, which Frontier Economics identified as performing best in its initial evaluation of options. Under this broad model, HAL would face the full cost and revenue risk from commercial property investments, and consumers would (potentially) benefit from some form of profit sharing agreement between HAL and the single till. Different versions of this model would be possible, under Frontier's analysis, including the option of HAL 'buying' the land to be developed out of the RAB, thereby reducing the RAB and, consequently, charges.

### **Airlines' views**

8.51 Airlines have expressed concerns regarding both the case for change that HAL has put forward as well as any proposal for change that compromises the single till to the detriment of consumers. BA commissioned its own consultancy report that elaborated further on these concerns and critiqued the arguments advanced by HAL and Frontier Economics.

8.52 Regarding the case for change, airlines reject what they see as HAL's characterisation that they have, or would, reject suitable commercial projects, stating they have approved such investments, including the Eastern Business Park (approved at G3 in June 2025). They also rejected the notion that HAL requires a higher return on its commercial property investments, as the single till significantly de-risks these investments.

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<sup>25</sup> HAL H8 Business Plan, Appendix A3 – 36, *'Incentivising Commercial Property Investment at Heathrow: An independent report for Heathrow'*, Frontier Economics, June 2025.

- 8.53 On the relative merits of a sharing model, or other hybrid/dual till models, concern was expressed that they distort incentives, acting against the interests of consumers, and that further regulatory action would be required to prevent this. These interventions would introduce greater regulatory complexity (for example, in the form of cost allocation rules and monitoring) and a higher risk of disputes.

### CAA's views

- 8.54 HAL, and Frontier Economics suggested potential reasons for HAL's perceived underinvestment, which we discuss below:
- Returns are too low: HAL and Frontier Economics observe that commercial property has a higher implicit cost of capital than the overall airport environment, with the implication being the return under the single-till is too low compared to the risks, which deters them from investing. We note that while commercial property investment in the wider economy may have higher risk, there appears to be some force in airline arguments that the impact of the single till de-risks these investments for HAL by providing a return on the investment added to the RAB.
  - Capex allowances for commercial property investment are too low and their treatment uncertain: HAL noted that in the H7 price control review it requested £200 million for property development, but the CAA allowed only £17 million in the H7 capex envelope. We set HAL's capex allowance as an envelope, within which it is for HAL and the airlines to prioritise projects to take forward, including property development.

HAL referred to the statement in our H7 Final Proposals saying we had included capex for commercial projects that "*have a positive business case which is forecast to payback within 5 years (that is, within the timespan of a single control period)*."<sup>26</sup> HAL stated that this, coupled with the capex allowance for commercial property, has created uncertainty for it as to how to bring forward commercial property business cases. We note that the context for the quoted text was to clarify that in setting our commercial revenue forecast for the H7 price control, we had taken account of the potential link between capex and commercial revenue.

Nonetheless, we do accept that, in setting the capex envelope, we prioritise projects that have direct consumer benefits, including in relation to asset resilience, safety and security and projects delivering enhanced consumer outcomes.

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<sup>26</sup> Para 5.42, pg 29, *Economic regulation of Heathrow Airport: H7 Final Proposals Section 2: Building Blocks*, CAP2524C, CAA, March 2023.

- The regulatory period is too short: HAL considers that five year price control periods do not encourage commercial property investment which has longer payback periods. We consider that, in general, our price controls (and those applied by other regulators) reasonably accommodate investment in long-lived assets by the use of the RAB, which is a prominent feature of most sectors subject to price controls.

8.55 In the event that a clearer case for change is made, we are mindful of the practical implementation and monitoring issues that have been raised by airlines. For instance, new arrangements could require revenue associated with different commercial projects to be separately tracked and potentially be subject to differential regulatory treatments.

### CAA initial proposals

8.56 For the above reasons, we are not proposing to change the treatment of commercial property investment in these initial proposals.

8.57 Nonetheless, we remain open to the possibility that there could be circumstances in which an alternative revenue-sharing approach for specific investments may provide HAL with an incentive (that may not presently exist) for it to invest in a project that delivers net financial benefits to consumers. Therefore, while we consider HAL has not yet made a strong case for change or a sufficiently developed proposal relating to a specific investment, we remain open to giving this matter further consideration.

### Terminal Drop-Off Charges

8.58 In January 2022, at the start of the H7 period, HAL introduced TDOCs. These are a fixed levy for vehicles that drop-off passengers at the terminal forecourts. There was considerable uncertainty at the time when we set the H7 price control as to the level of future TDOC charges and revenues arising from them:

- because it was a new charge; and
- due to the potential impact of a code of practice issued by the Government, in accordance with the Parking Code of Practice Act 2019, in February 2022 but subsequently withdrawn in June 2022.<sup>27</sup>

8.59 As a result of those uncertainties, we introduced a risk sharing mechanism and a requirement for HAL to consult the CAA and airlines if it was seeking to increase TDOC by more than 10% (licence condition F1.1(b)(iv)).

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<sup>27</sup> The Act requires private car parks to implement a free five-minute consideration period to view the car park's terms and conditions. The concern at the time was this could prevent TDOCs being levied.

- 8.60 The H8 Method Statement said that, given TDOCs have been in place for a number of years, we intended to review whether the risk sharing arrangements used in the H7 period remain appropriate.
- 8.61 HAL proposed in its H8 Business Plan that, with TDOC now being a “more mature product”, the risk-sharing mechanism in its licence should be removed.
- 8.62 We understand that some of the earlier uncertainties in relation to TDOCs have now been resolved. But we are also mindful of the impact on consumers of these charges and the potential for undesirable consequences of giving HAL an incentive to maximise revenue from TDOCs. Therefore, we are only minded to remove the risk sharing mechanism if HAL makes a clear commitment to the level of TDOCs over the H8 period. As the Parking Code of Practice Act 2019 was enacted, we consider the reference in the licence to protection from a change to legislation is no longer relevant and we are proposing to delete this.
- 8.63 Separately, we are consulting on the drafting of Condition F in HAL’s licence, which incorporates consultation requirements in relation to the Terminal Drop Off Charge to ensure it provides a clear framework facilitating ongoing compliance by HAL in interests of consumers. The revised drafting we propose, together with an explanation of the approach we have taken in preparing it, is set out at Appendix C (Draft licence modifications).

### **Lessons from the increase to fast track security charges in H7**

- 8.64 Shortly after the end of the H7 regulatory process, HAL increased charges levied on airlines for fast-track departures security products (with charges more than doubling in some cases). Airlines wrote to us concerning these changes.
- 8.65 Given these changes, the H8 Method Statement said we would consider further our approach to ensuring that estimates of single till revenue appropriately reflect developments, such as recent changes in charges.
- 8.66 Our approach to the economic regulation of HAL is designed to provide it with a reasonable amount of commercial freedom, and to allow charging and other arrangements to evolve sensibly between price control reviews. Under the single till, as described further above, HAL’s incentive to grow commercial review in a price control period can be of benefit to consumers in the subsequent periods. Nonetheless, we would be concerned if price changes led to a substantial increase in income for an existing (or new) commercial service that had not been identified at the price control review or which appeared likely to result in an excessive level of profits for the service provided.
- 8.67 As for fast-track departures security, following evidence gathering and review, we wrote to HAL. We advised that any further examples of significant increases in charges in the H7 period for services provided to airlines within the single till would, absent a significant increase in underlying costs, prompt us to consider

the introduction of a true-up mechanism in the H8 price control. We have not seen evidence, at this stage, that we consider justifies the need for such a true-up mechanism, but propose to keep this option open.

- 8.68 While a true-up mechanism can help capture previously realised windfall gains in such situations, *ex ante* measures have the potential to prevent windfall gains arising in the first place. Such a requirement could be most beneficial where charges or tariffs are directly, or closely indirectly, levied on consumers, such as TDOC, fast-track security, and some transportation services, for which a significant increase is more likely to be contrary to consumers' interests.
- 8.69 One approach would be to introduce greater obligations on HAL to consult, as is the existing position with TDOC charges, although we note that this in itself would not prevent price increases. We have not reached a final view on these matters, and would welcome further stakeholder representations in response to these initial proposals.

## Key issues for consultation and next steps

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- 8.70 For the reasons set out above, we propose to retain the same broad opex, capex and commercial revenue incentive frameworks that we used for the H7 price control for the H8 period. On capex governance processes, we strongly encourage further discussion between stakeholders on these matters; particularly in relation to incremental or evolutionary improvements that might be introduced during the H8 period. We also welcome further representations on capex governance from stakeholders, either in response to these initial proposals, or our wider work on regulatory models for capacity expansion.
- 8.71 We welcome stakeholders' views on the approach to incentive arrangements set out in these initial proposals, in particular in relation to capex governance, the treatment of commercial property development in the single till, and the regulation of consumer facing charges such as terminal drop-off charges.