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Ferrovial initial views on CAA Final Proposal

Ferrovial is a world leader in infrastructure investments, with over 70 years of infrastructure investment experience and more than 20 years' experience investing in the aviation industry.

Since 2006 Heathrow has invested more than £12 billion in projects that have transformed the passenger experience such as Terminal 5, Terminal 2 and the construction of the world's largest integrated baggage system.

As a long-term industrial investor our goals are to improve airport results, attend customer needs and make efficient investments that help improve service and allow us to earn a fair return.

Since 2006, the investment at Heathrow has generated negative profitability in real terms. As a long-term investor, Ferrovial looks at returns over the life of the asset and despite such negative returns, Ferrovial had confidence in the regulatory system in the long run. Ferrovial had always seen the CAA's approach as generally fostering a reliable environment even though profitability was elusive.

Although Ferrovial accepted that potential equity returns were capped, in return we expected to have the comfort that downside risk was more protected than in unregulated businesses. In particular, Ferrovial had always expected that Heathrow would be able to recover investments executed through the capex programme that was approved by both CAA and airlines. Regulated businesses are expected to deliver material investments in the benefit of consumers but with certainty of achieving a fair return that includes full recovery of amounts invested.

Nevertheless, the outlook of the Final Proposal from the CAA is totally misaligned with Ferrovial's understanding of the regulatory framework.

It is extremely difficult to accept that the CAA has characterised Heathrow as a low-risk asset in the past, imposing a low allowed return, and for H7 it acknowledges that this historic assessment was erroneous but it does not take the necessary action to adjust the RAB accordingly, as Heathrow requested. On the contrary, it proposes to implement a Traffic Risk Sharing mechanism to try to actually deliver the low-risk profile that it had relied upon in making its decisions at Q6, and then inconsistently proposes to reduce the allowed return even further.

We are supportive of the TRS mechanism. Nevertheless, in our views, the regulatory model has not recognised the risk from previous years, and that is why Ferrovial deeply believes that this historic error should have been corrected when the issue of the Covid was first raised by Heathrow with the CAA, and that such risk should be recognised through the whole life of the asset. Further we believe that the CAA has overestimated the extent to which TRS reduces risk when calculating the asset beta.

In our views, with this context of the new regulatory environment, Heathrow is becoming a business with an unattractively skewed asymmetry. This is really an issue for us as investors, as in this kind of business, we do not see appropriate risk adjusted returns considering, on one hand, the limited upsides that the asset can offer and, on the other, the large downside risks which we would be taking on. This is why investing in Heathrow would be considered poor capital allocation.

Moreover, Ferrovial disagrees with the CAA approach in its Final Proposal regarding the assessment of Heathrow's cost of equity. In Ferrovial's view the CAA has made a deficient approach to assess the asset beta, underestimating its value compared to other airports and infrastructure benchmarks where higher returns expectations are likely across the different market comparators. We also believe that, contrary to the CAA's approach, airports are perceived as higher risk asset, post Covid.

Given the long-term nature of the investments and the large amounts of capital involved, infrastructure investors need a framework that is predictable and fair. We are deeply concerned that, with the final proposal from the CAA, the regulatory framework is not encouraging lenders and investors to make future investments. Investment is needed to cater for consumers' needs, but that capital allocation is based offered risk adjusted returns by risk that are among the worst in the infrastructure landscape.

Furthermore, Ferrovial is also concerned that with the proposed scheme and the level of charges set by the CAA on their Final Proposal, there is a significant risk that Heathrow will not be able to raise debt in the coming years under the conditions assumed by the CAA, limiting investment capacity.

Consumers need investments to flow in to improve airports operations. Investments can be recovered in the long-term, but the framework must allow this to happen. This is not the case with the current proposals from the CAA. The CAA has moved away from acting as an arbitrator between airlines and airports, taking a position which seems to be in favour of airlines to the detriment of Heathrow and the regulatory model. A RAB adjustment would allow recovery of losses over a long time. A sudden large increase in consumer prices could be unnecessary, and the losses could be recovered over multiple regulatory periods.

We, Ferrovial, hope that the CAA will reconsider its position in the Final Proposal by reviewing the level of WACC that has been set and allowing Heathrow to recover their investment with a clear mechanism.

We remain fully supportive to keep collaborating with all the regulatory bodies, as we have done during the last 16 years, to ensure the appropriate framework is set for the upcoming years.