

CAA CAP 1819

Economic regulation of capacity expansion at Heathrow airport: consultation on early costs and regulatory timetable

Response; Stephen Clark, 12 August 2019

Introduction

This response to CAP 1819 is sent in an individual capacity although I am a member of Teddington Action Group (TAG) and gave evidence in 2018 to the Parliamentary Transport Select Committee on behalf of the no 3rd Runway Coalition. I have been a resident of Teddington for over 30 years.

I am now retired but am a past member of the Royal Institution of Chartered Surveyors and was a senior director of CBRE for 25 years, as well as holding non-executive roles at the Guinness Partnership, including chairman of Guinness Developments Ltd.

In a professional capacity I gave evidence as an expert witness at major planning inquiries, advised on very significant infrastructure projects (such as HS1) and specialised in provision of strategic advice in structuring private public partnerships, including to the Government of Luxembourg and the European Investment Bank.

Scope

This submission replies to the CAA's consultation document CAP1819 and in particular addresses;

- Policy proposals for Category B costs
- Early Category C costs
- Timetable and business plan guidance

Context – CAP 1819 reveals the following;

Planning Costs (Category B)

The budget for Planning Costs (Category B) has increased from £265 million in 2017 (in the Planning Cost Recovery Policy Statement) to over £500 million by December 2018. Heathrow (HAL) seeks to justify this increase of almost 100% in less than two years as necessary in order to produce 'a high quality' DCO application. It also argues it hadn't developed 'a sufficiently mature understanding' of the scope of work at the time of the original budget.

Given that HAL had entered a Statement of Principles Agreement with the Government (enabling Heathrow to reclaim costs under specified circumstances) after the DfT's policy announcement of the airport's selection as preferred location for expansion in October 2016, and that the Parliamentary vote on the ANPS took place on 25 June 2018, the increase

in planning budget gives no confidence in HAL's ability to plan and project manage a scheme of this size and complexity.

CAP 1891 also raises serious concerns regarding the transparency of arrangements between the scheme promoter and the Government, as well as the CAA's abilities as Regulator, given that the revised Category B budget came to light soon after the Parliamentary vote.

Early Enabling Costs (Category C)

The escalation in budget for Early Category C costs gives rise to even greater concern. In the April 2018 consultation HAL's estimate was £650 million. However by Autumn 2018 (very soon after the Parliamentary vote) the estimate increased to £1.6 billion (250% increase) and this was increased again in July 2019 to £2.4 billion, equivalent to 370% increase in less than two years!

This increase has been justified on the grounds the Early Category C Enabling Works are needed to meet the target opening date of 2026 (which had been advised to Parliament and formed a key assumption in the third runway's economic case). By way of response the CAA has asked HAL to model options including delaying opening of the runway for one year and the cessation of all work on expansion in September or October 2019 'until political or regulatory certainty is provided'.

Business Planning

Despite noting the overall projected cost of the project to opening of the runway, £14 billion, 'came under pressure' in 2018, the scheme total budget has not yet been reviewed, although the CAP notes HAL has developed a masterplan 'consistent with the original budget'. It is unclear how far the budget has been subject to independent review so far.

However the section on Business Planning notes the risks that the DCO (planning) application might not proceed, that there could be judicial challenges and that there are political risks associated with the DCO ratification in late 2021.

The Business Plan section (para 3.6) also contemplates further risks, including scenarios 'with the date for runway opening delayed until 2029 or 2030'.

Implications for Government

The great majority of the 'sunk costs' (Category B and early C) that would arise in the event of the ANPS not proceeding – now estimated at a total £2.9 billion – would be recoverable from airport users under the RAB model.

However, Heathrow already has practically the highest user fees in the world and this position will be exacerbated if HAL's proposals are accepted.

For this and other reasons this represents an unacceptable reverse transference of risk – ostensibly initially back on consumers - but on a wider basis potentially back on the UK taxpayer and the UK economy.

The information set out in CAP 1819 actually gives rise to wider and more serious concerns than just the requested increase in recoverable Category B and C costs.

What confidence can there be in the £14 billion overall budget being maintained given the vast increases in B and C budgets now being requested - to hit a timetables and milestones previously assured and reported to Parliament (also now open to question)?

The further the UK Government gets drawn into these arrangements, the more difficult it will become to extricate itself and in particular for the Secretary of State to decide the DCO application impartially, as he will have a very strong and increasing financial and political interest in enabling the project proceed.

In fact this could become the thin end of the wedge in terms of the Government being drawn in more directly to support the scheme. The initial budget will almost certainly be exceeded - possibly by a vast margin based on the experience of other major infrastructure projects such as the Channel Tunnel, HS1, HS2 and Crossrail – and this will result in escalating consumer costs to the point the project will become unworkable without major public subsidy or some other form of state aid.

Given that HAL has set a cap on its contribution towards surface access at £1 billion, the Airports Commission estimated £5 billion and TfL's advice that the expansion related costs should be £15 billion, the dangers are clear and obvious. Without Government capping and subsidising these costs or underwriting the scheme in some other way – something the Government has said it will not do - the project will become unworkable.

Implications for Consumers

The Category B and C costs will be recoverable through consumer user fees, essentially whether the project proceeds or not. As total costs rise (which they look certain to do) the airport's users' position becomes worse.

Much emphasis is placed in the CAP document on the 'consumer benefits' of the scheme proceeding. However this premise in itself is extremely questionable.

Reference has already been made to Heathrow's current very high user costs. In terms of consumer choice and competition between airports and airlines, substantially better outcomes can be achieved through alternative strategies which are not referred to in the CAP consultation document.

Especially given national carbon limits and climate change constraints a quicker, cheaper, less risky and less environmentally damaging outcome could be secured through a national strategy of making better use of additional runway capacity which is already available in the UK.

This is what most consumers really want in any event; real choice and competition between airports and airlines (not an entrenched private monopoly position for Heathrow), an ability to fly point to point direct to destinations, and from an airport as close as possible to where they live.

From a UK economic perspective this would also enable growth to be directed away from London and the South East, facilitating better balance across the national economy and giving a boost to the regions. It also presents a more sustainable solution in environmental terms as on an overall basis there would be less travelling to airports.

Views on Category B Costs

A 100% increase in budget over two years is truly extraordinary. As with Category C costs it is indicative of the danger that the overall project budget will rise very substantially and that this will fall back on consumers and/or the UK Government.

On this basis any increase in Category B Planning costs against the original £265 million budget should be at HAL's risk and not recoverable as a 'sunk cost'. This was the understanding on which the ANPS was approved by Parliament, and indeed the Transport Select Committee highlighted the dangers of costs rising costs and the affordability of user charges (which the DfT gave assurances about at the time).

Views on Early Category C Costs

A near 400% increase in these costs over two years is even more extraordinary, unsustainable and unsupportable. This cannot be explained away by referring to Heathrow's lack of maturity of understanding of the project. Robust risk analysis and sensitivity testing using Treasury Green Book guidance would have revealed the impact of what are now exposed as highly optimistic assumptions.

There is now a real danger that if the CAA and/or Government accepts the principle that risks should be passed on to consumers – to the point that Heathrow will be uncompetitive and unattractive to users – this will become the thin end of the wedge. This will lead to a situation where ultimately the project will have to be directly or indirectly supported by the UK taxpayer. In plain language there is now a considerable risk that Heathrow expansion will end up being state aided or supported.

This will be to the detriment of UK consumers, the UK economy, achieving regional balance and the environment.

On this basis any increase in Early Category C costs above the original £650 million budget should be wholly at Heathrow's risk and not recoverable from passengers and freight users through the RAB model should the project not go forwards.

Views on Business Plan Guidance

CAP 1819 makes clear there are distinct possibilities of reverse transference of risk, substantial cost overruns and significant delays to the project.

The CAA should now take a step back and commission an arms-length, fully independent audit of HAL's Business Plan in terms of the overall total cost estimate, the programme and the project risks. This should include a reappraisal of the net economic case in the light of WHO 2018 guidance on community noise, other recent research related to the health impacts of aviation and recent Government commitments in respect of climate change.

This review should include a full Treasury Green Book appraisal involving a comprehensive risk analysis (reflecting factors such as possible optimism bias) of potential total cost outcomes, impacts on user fees, timetable, climate change implications and environmental impacts.

Until this work has been undertaken and reported back to Parliament, as intimated in Para 2.16, there should be cessation of all work on expansion in September or October 2019 until political and regulatory certainty is provided.

Finally the Government should reach a final position on how surface access costs should be allocated (given the huge divergence of the parties' positions).

After this work has been done, if it is agreed the scheme should still proceed, the Government should make it absolutely clear that no further cost or programme overruns will be countenanced and reaffirm that the scheme will not be facilitated or bailed out in any shape or form by the UK taxpayer.