

Other income

Background

- Other than from airport charges, Stansted generates income from commercial revenues and non-regulated aeronautical charges. Commercial revenues and non-regulated aeronautical charges currently account for over half of Stansted's revenue. They also account for almost all of Stansted's profits. The main sources of Stansted's other income (with income from airport charges also shown for comparison) are shown in Table 1.

TABLE 1 Income, expenditure and profit, 2006/07

| | <i>£ million</i> | | |
|---------------------------|------------------|--------------------|---------------|
| | <i>Income</i> | <i>Expenditure</i> | <i>Profit</i> |
| Airport charges | 80.7 | 106.0 | -25.2 |
| Retail | 42.7 | 5.0 | 37.8 |
| Car rental | 2.2 | 0.3 | 1.9 |
| Car parks | 38.5 | 6.6 | 32.0 |
| Advertising | 1.9 | 0.2 | 1.6 |
| Terminal property | 2.4 | 0.4 | 2.0 |
| Cargo | 0.0 | 0.6 | -0.6 |
| Other property | 4.0 | 3.1 | 0.9 |
| Specified activities | 14.2 | 13.9 | 0.3 |
| Other services/facilities | <u>2.7</u> | <u>8.0</u> | <u>-5.3</u> |
| Total | 189.3 | 143.9 | 45.4 |

Source: BAA based on its Profit Centre Reporting system.

Notes:

- Table 1 shows the outputs from the Profit Centre Reporting system. Adjustments are made to Profit Centre Reporting to arrive at the adjusted profits in the trading statement. These are principally the inclusion of notional revenue for airports' own usage of facilities (mainly utilities), elimination of accounting depreciation and substitution of a capital charge to remunerate investment.
- Subject to rounding differences.
- Under the single-till approach, virtually all revenues are taken into account in setting airport charges.
- Following a recommendation in our 1991 report, the CAA requires Stansted to publish trading statements for certain 'specified activities'. These services are primarily to airlines and essential to their operations at the airport, but they are excluded from the scope of regulated airport charges. They are: check-in desks; other desk licences; staff car parking; staff identity cards; fixed electrical ground power (FEGP); aviation fuel supplied through hydrants; airside licences; heating and ventilation; electricity, gas and water; and bus and coach charges. In addition, it is BAA's policy is to publish guideline property rentals.
- However, neither the BAA accounts nor its financial model separately identify income or expenditure from specified activities, although BAA did provide us with reconciliations to its financial model.
- Table 2 shows BAA's latest projections of total revenue and revenue per passenger in Q4 compared with the CAA's regulatory projections when the current formula was set. The comparison is for the original five years of Q4, ending on 31 March 2008.

TABLE 2 Current and initial forecast of revenue and revenue per passenger in Q4

| <i>Total income, £ million</i> | | | |
|-------------------------------------|-------------------------|---------------------------------------|-------------------|
| <i>Out-turn prices</i> | | | |
| | <i>CAA forecast</i> | <i>BAA's current forecast</i> | <i>Difference</i> |
| Airport charges | 458.5 | 407.9 | -51 |
| Retail | 393.0 | 395.7 | +3 |
| Property | 76.1 | 43.6 | -32 |
| Utilities | 24.4 | 20.2 | -4 |
| Other incomes | <u>81.4</u> | <u>60.7</u> | <u>-20</u> |
| Total revenue | 1,033.4 | 928.1 | -105 |
| Total costs | <u>-501.3</u> | <u>-516.8</u> | <u>-16</u> |
| EBITDA | 532.1 | 411.3 | -121 |
| Regulatory depreciation | <u>-186.2</u> | <u>-186.2</u> | <u>0</u> |
| EBIT | 345.9 | 225.1 | -121 |
| | | | |
| % rate of return | 7.5 | 5.3 | -2.2 |
| Passengers (m) | 100.5 | 110.4 | +9 |
| <i>Income per passenger (£)</i> | | | |
| Airport charges | 4.54 | 3.70 | -0.84 |
| Retail | 3.89 | 3.59 | -0.30 |
| Property | 0.75 | 0.40 | -0.35 |
| Utilities | 0.24 | 0.18 | -0.06 |
| Other revenues | <u>0.80</u> | <u>0.55</u> | <u>-0.25</u> |
| Total revenue | 10.23 | 8.41 | -1.82 |
| Total costs | <u>-4.96</u> | <u>-4.68</u> | <u>+0.28</u> |
| EBITDA | 5.27 | 3.73 | -1.54 |

Source: BAA.

Notes:

1. Minus sign indicates negative effect on profit. Figures differ from those quoted elsewhere in the report due to different treatments of inter-company revenues/costs and changes to 2007/08 projections.
2. Subject to rounding differences.

6. Comparisons of revenue per passenger are relevant primarily to retail activities, the main driver for which is passenger numbers. Other revenues are likely to vary less with changes in passenger numbers. BAA relates bureau de change and duty- and tax-free and airside specialist shop revenues to international departing passengers (IDPs), but this does not significantly affect the trends shown.
7. As shown in Table 2, the overall revenues were lower than expected. The main reason for this performance was the shortfall in airport charges, which BAA explained as being due to a higher level of discounting than forecast.
8. BAA told us that its lower property revenues mainly resulted from the transfer of properties to the joint venture, APP, in March 2005. Lower revenue from utility charges reflected lower than expected utility consumption, slightly offset by recharges of higher utility costs. BAA said that other revenues had been below forecast mainly because of the way in which the CAA adjusted projected revenues to take account of its revised forecasts of passenger numbers.

Commercial revenues

9. Commercial revenues consist of income from retail and property. Retail revenues are those which BAA receives from concession agreements, which provide the airport with a percentage of sales from the retail outlets, backed by a minimum guarantee.

Performance over Q4

10. Annex 1 shows trends per passenger for the five main categories of retail revenues, and for property revenues since 1998/99.

Duty- and tax-free and airside specialist shops

11. Revenue per IDP from duty- and tax-free and airside specialist shops fell significantly in 1999/00 and 2000/01 due to the abolition of EU duty-free allowances in 1999/00, and because Stansted's traffic is heavily EU-weighted. Thereafter it remained fairly static, with a slight increase in the forecast for 2007/08 due to improved revenues from perfume and cosmetics.

Car parks

12. BAA's public car parks fall into three main subcategories:
 - (a) short-stay car parks—adjacent to the terminal and primarily used as an extension of the forecourt for passenger pick-ups and drop-offs;
 - (b) long-stay and mid-stay car parks—on the airport site and typically used by self-drive passengers; and
 - (c) valet parking—offering the convenience of the forecourt for self-drive passengers but which requires the car to be moved to a different location by the valet operator.
13. All three products operate in a competitive environment, which has intensified over recent years as broadband Internet growth has increased consumer knowledge and choice.
14. All the above car parks are operated by third parties, such as National Car Parks Limited (NCP), APCOA Parking (UK) Ltd (APCOA) and Meteor Parking Ltd (Meteor), which are responsible for managing the facilities, including payment machines and barrier systems. The management contracts are awarded typically for five to seven years and underpinned by SLAs. BAA sets prices for all three car park products.
15. The short-stay car parks compete against the forecourt and public transport alternatives, and more recently against valet parking. The average tariff increase over recent years has been 2 to 3 per cent above RPI. Pricing in the short-stay car parks is one of the key levers for influencing demand. BAA stated that price rises supported the effort to increase levels of public transport utilization, although this has to be balanced against the effect of pushing car drivers on to the airport roads and forecourts for extended periods.
16. BAA informed us that the market dynamics of the long-stay and business car park segment have changed considerably in recent years. A growing proportion of passengers are choosing to book their airport parking in advance, in much the same way as flights, hotels or rental cars. The advance-booking market has grown as a consequence of lower-cost, lower-price car park operators being able to access consumers at the point of booking. This is achieved either directly through their own websites, or via intermediaries such as airlines, affiliates (motoring organizations, etc) or consolidators. It has had a significant impact on sales and tariffs. Competition in this market is largely price-based and, in order to remain competitive at the time of

booking, the advance-booking tariff is discounted (historically this has been fixed by season).

17. BAA told us that, in order to maintain market share, it had also had to use intermediaries alongside its own sales channel. This had diluted margins as commissions ranged from 10 to 30 per cent. The roll-up tariffs are set according to the prevailing level of demand, capital investment plans and relevant competition. However, BAA told us that yield management techniques were introduced in 2007/08 to improve the competitiveness of these car parks in the advance-booking market. The purpose of yield management is to offer better prices to more users and increase the average length of stay by varying the level of discount to the roll-up tariff through pre-booking. BAA uses a web-based price monitoring service (provided by Electrobug Technologies Limited) to ensure that prices are responsive to changes by the off-airport car park and valet parking operators.
18. Car park revenue per passenger grew steadily in the early part of Q3; the opening of new mid-stay car parks in 2001/02 resulted in increased yields as passengers switched from long-stay car parks. Car park yields were expected to grow slightly in 2003/04 then remain constant over Q4 at the 2004/05 yield. Instead, car park yields fell steadily from the high in 2001/02 to 2006/07. BAA cited a number of reasons for the decline, including increased competition from local hotels and unofficial operators; margins being affected by agency fees from advance bookings; and the increase in the number of non-UK passengers using the airport: in 2000, 54 per cent of passengers were UK residents; by 2004 this had declined to 42 per cent.

Bureau de change

19. Bureau de change revenue per passenger at Stansted increased marginally between Q3 and Q4 despite the introduction of the euro in 2002 and subsequent expansion of the EU.
20. Bureau de change yields in Q4 were similar to those forecast until 2005/06 but, in that year, BAA forecast that the UK would join the euro, which did not happen, so bureau de change revenues were significantly above forecasts thereafter. Since Stansted's traffic is heavily EU-weighted, bureau de change revenue will be significantly reduced if the UK joins the euro as the majority of passengers will no longer need to purchase currency.
21. BAA attributed a step increase in 2005/06 revenues compared with 2004/05 to its successful negotiation of new bureau contracts.

Catering

22. Catering revenues increased between 2000/01 and 2002/03 due to the introduction of six new catering units and longer dwell times in the terminal after 11 September 2001. BAA stated that the increasing trend reflected the emphasis on 'grab and go' meals and improvements in catering facilities.
23. BAA forecast catering yields to remain constant through Q4. However, actual yields increased over the period through a combination of the introduction of new brands, diversifying the offer to passengers and the renegotiation of some contracts, which led to margin improvements. The step increase in 2004/05 was a result of new units introduced as part of the terminal extension programme. BAA noted that the predominance of LCCs at the airport had also stimulated growth in catering yields as such carriers normally offered limited on-board catering.

Other retail

24. Other retail revenue (mainly landside specialist shops, bookshops, car rental and advertising) was forecast to increase significantly in 2003/04 with the opening of satellite 3. Thereafter, yields were expected to decline slowly, reflecting the shift from landside to airside retailing.
25. The expected increase in 2003/04 did not occur and the expansion of the central search facility following increased security requirements in 2006 led to a sharp decline in yields, rather than the forecast slow decrease, as BAA relocated certain landside retailers.

Property

26. BAA forecast property revenues to increase gradually over Q4 as the number of passengers grew and the airport expanded. Actual property revenues were lower than expected in the first two years of Q4. BAA disposed of a significant part of its property portfolio to APP resulting in the large fall in revenues in 2005/06. Revenues increased slightly over the remainder of Q4 as BAA negotiated rent increases with tenants.
27. It said that property revenues were not essentially passenger-driven and therefore that the decline in property revenue per passenger was more indicative of the constant nature of the property portfolio than a reflection on its property management.

Q5 projections, including 2008/09

28. The analysis below is based on BAA's May 2008 forecasts for each of the categories of commercial revenue. These forecasts, which are set out in Annex 1, were based on the capex programme proposed by BAA at that time. (Subsequently, BAA reduced its capex programme, as explained in Section 8 of the main report.) As shown in Annex 1, and in Table 3, BAA projected marginally higher retail revenue per passenger in Q5, primarily driven by the proposed departures extension, and slightly lower property revenue per passenger in Q5 due to the disposal of property to APP by BAA in 2005. For completeness, Table 3 also shows BAA's proposed increase in revenue per passenger from airport charges over the period.

TABLE 3 BAA projected commercial revenue per passenger for Q5 compared with Q4

| | £ per pax, 2007/08 prices | |
|--|---------------------------|-------------|
| | Q4 | Q5 |
| Airport charges | 3.91 | 7.35 |
| Duty/tax-free and airside specialist shops | 0.61 | [X] |
| Car parking | 1.76 | 1.59 |
| Bureaux de change | 0.38 | [X] |
| Catering | 0.42 | 0.44 |
| Other | <u>0.66</u> | <u>0.70</u> |
| Total retail revenue | 3.83 | [X] |
| Property | 0.43 | 0.38 |
| Other | <u>0.80</u> | <u>0.61</u> |
| Total commercial revenue | 5.06 | [X] |

Source: BAA.

Notes:

1. Other includes inter-company revenue.
2. Subject to rounding differences.

29. In Ferrovial's June 2006 Business Plan, prepared prior to its acquisition of BAA, it assumed a greater increase in total retail revenue per passenger (in nominal prices) throughout Q5: from £3.60 in 2007 to £4.20 in 2012, equivalent to an annual increase of about 3.1 per cent a year. However, BAA said that Ferrovial's pre-acquisition Business Plan was based on externally-sourced data only. As such, the knowledge of the business at that stage was limited, and the plan could not have adequately taken into account the specific issues impacting on retail revenues detailed in various submissions to us during this review.

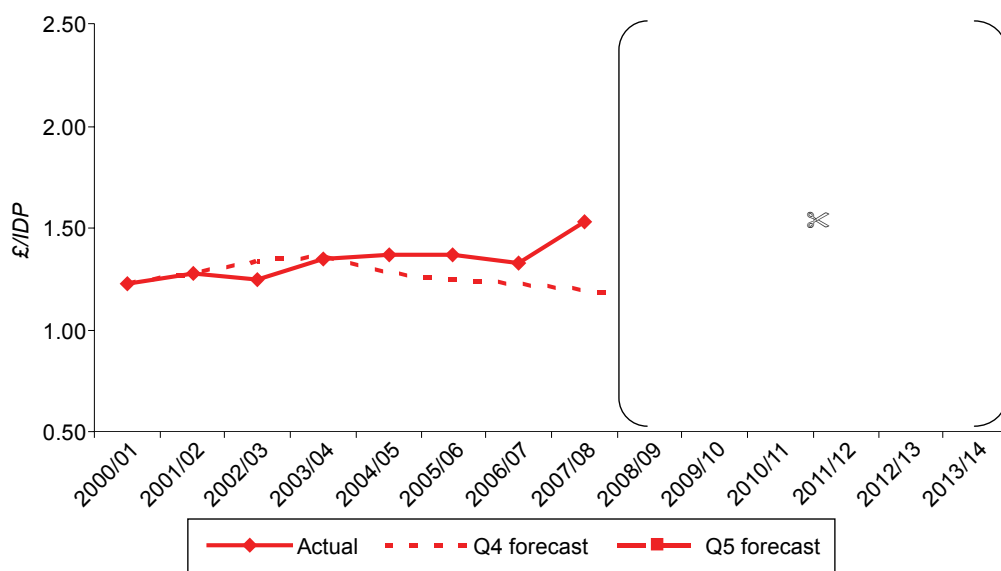
Duty- and tax-free and airside specialist shops

30. In making its projections for revenues from duty- and tax-free and airside specialist shops, BAA started with the 2008/09 forecast yield of £1.56 per IDP and then applied assumptions on consumer spending trends by category (such as declining tobacco spend) and other airport-specific impacts including those arising from capital projects. The resulting projected yields for Q5 were then multiplied by the IDP projections to determine the projected revenues from duty- and tax-free and airside specialist shops in each year.

31. Figure 1 shows the projected movement in concession yields from duty- and tax-free and airside specialist shops over Q5. BAA's expectation in its May 2008 submission to us was that revenues per passenger would remain at the 2007/08 level until 2011/12 and 2012/13, when there would be a step increase in revenues associated with the opening of the proposed departures extension.

FIGURE 1

Duty- and tax-free and airside specialist shops concession yields (2007/08 prices)



Source: CC, from information provided by BAA.

32. BAA made the following assumptions in its Q5 forecasts:

- (a) The number of passengers purchasing tobacco products would fall as a result of the ban on smoking in public places. BAA also assumed that there would be additional health warnings on tobacco packs by 2009 and that it might no longer be possible to sell cartons of 1,000 cigarettes.

- (b) Newly-designated EU passengers, arising from further EU enlargement, would reduce average spend in certain airside shop categories. BAA's forecast assumed that Croatia would enter the EU in 2010/11, followed by Turkey, Albania, Bosnia, Macedonia, Serbia and Montenegro in 2015/16. Accordingly, the impact on yields was anticipated mostly in Q6.
- (c) The anticipated introduction of duty-free *arrivals* shopping in Switzerland, Sweden and Canada, similar to that already in place in Norway and 20 other countries, would have a significant impact on the spend levels of passengers flying to those countries. BAA's forecast assumed that airports in these countries would have agreements in place by 2009/10.
- (d) The growing trade in non-food categories in the grocery sector, led by Tesco, would reduce spend in the travel accessory (suncreams and films), music and technology categories. BAA forecast a 0.2 per cent decrease in annual yields arising from this impact.
- (e) Complex and changing security restrictions on hand luggage, introduced in over 20 countries, had increased the uncertainty over the purchase of liquids in departure lounges. Increased check-in and security processing times also reduced passenger dwell times in the airside retail shops in the latter part of Q4. BAA forecast that the current regulations would remain unchanged, but it expected a lessening of the impact from these regulations due to an improved processing of passengers through security, following a significant increase in the number of security staff and investment in new security equipment and lanes.

33. Table 4 shows the outcome of these anticipated effects, resulting in BAA's May 2008 projections for duty- and tax-free and airside specialist shops revenue over Q5.

TABLE 4 BAA projected duty- and tax-free and airside specialist shops revenue in Q5

£ million, 2007/08 prices

| | 2007/08 (Q4) | [X] | [X] | [X] | [X] | [X] | [X] |
|--------------------|-----------------|-----|-----|-----|-----|-----|-----|
| IDPs (m) | 10.6 | [X] | [X] | [X] | [X] | [X] | [X] |
| Yields £ per pax | <u>1.53</u> | [X] | [X] | [X] | [X] | [X] | [X] |
| Total revenue (£m) | 16.3 | [X] | [X] | [X] | [X] | [X] | [X] |

Source: BAA.

Note: Subject to rounding differences.

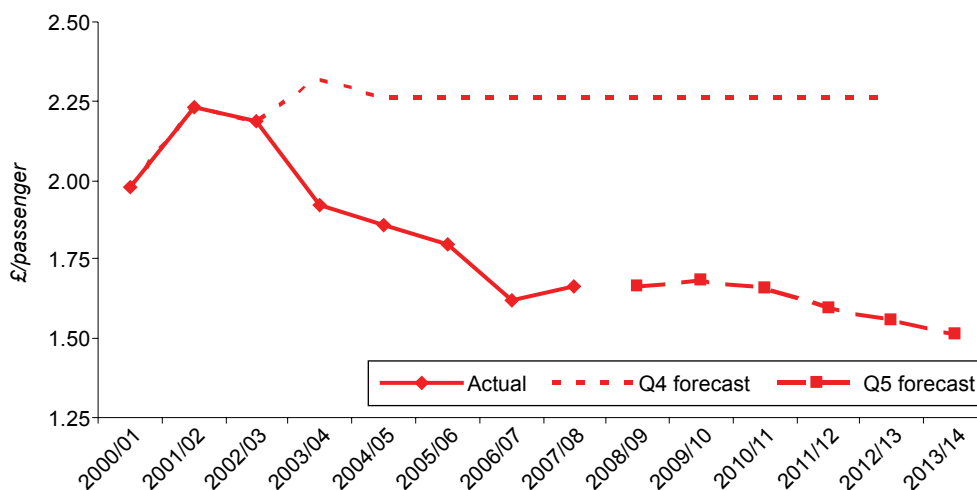
34. In constant value terms, the yields were expected to increase slightly following the opening of the arrivals extension in 2008/09. Yields were forecast to fall briefly in 2010/11 when the opening of the proposed departures extension was expected to result in the closure and relocation of several retail outlets as well as a certain amount of disruption. Thereafter yields were forecast to increase steeply with the additional revenue from the proposed departures extension. Although BAA anticipated that some of the additional revenue from the proposed departures extension would come in other areas, it modelled all of the retail revenue growth in duty- and tax-free and airside specialist shops revenue.

Car parking

35. Figure 2 shows BAA's projected movement in yields from car parks over Q5.

FIGURE 2

Car park yields (2007/08 prices)



Source: CC, from information provided by BAA.

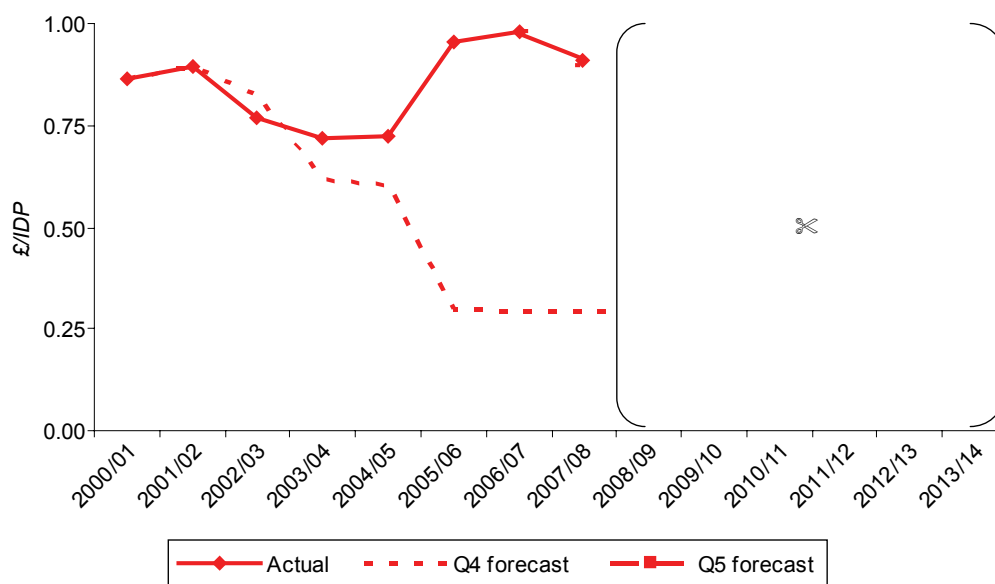
36. BAA forecast a slight increase in yields for 2007/08 from better revenue management which was expected to improve return per parking space. This higher yield was expected to be maintained through to 2010/11, before declining steadily over the remainder of Q5 as the real growth in tariff was offset by a reduction in penetration. Our consultants, DTZ, who reviewed BAA’s commercial revenue forecasts, commented that BAA’s assumption about the decline in car park revenues seemed overly pessimistic (see paragraph 62).

Bureau de change

37. Figure 3 shows the projected movement in yields from bureau de change over Q5.

FIGURE 3

Bureau de change yields (2007/08 prices)



Source: CC, from information provided by BAA.

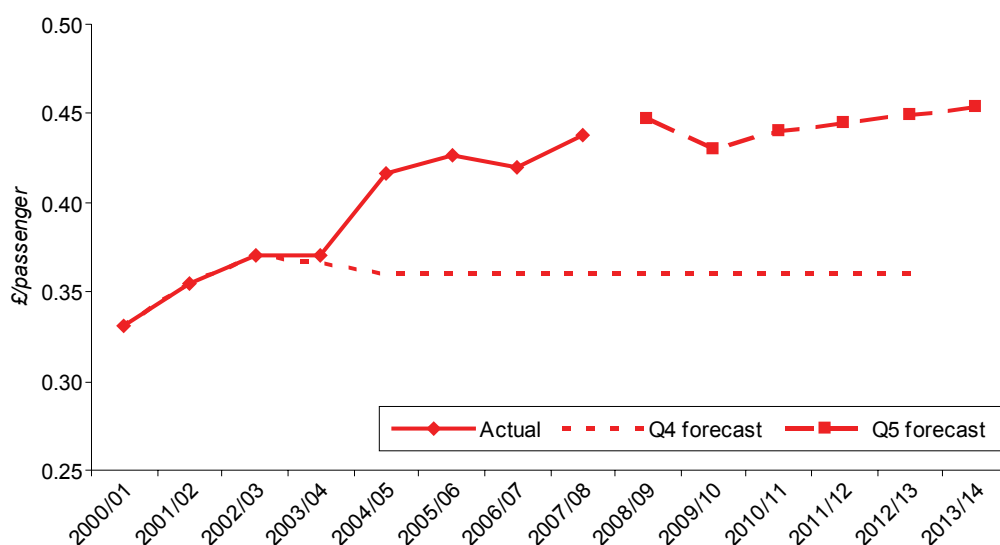
38. BAA forecast that bureau de change yields over Q5 would decline by 0.5 per cent a year in Q5 as a result of the increasing trend of using debit/credit cards and cash machines abroad rather than purchasing currency.
39. The forecast fall in bureau de change revenue per passenger in 2013/14 was primarily due to BAA's assumption that the UK would join the euro in that year, resulting in a forecast 90 per cent reduction in yield for 2013/14, and thereafter in Q6. DTZ considered that it was unlikely that the UK would join the euro in Q5 (see paragraph 62). BAA accepted that there was uncertainty over the date of adoption of the euro by the UK and noted our recommendation to rebase the forecasts if the UK did join the euro within Q5 (see paragraph 111).

Catering

40. Figure 4 shows BAA's projected movement in yields from catering over Q5.

FIGURE 4

Catering yields (2007/08 prices)



Source: CC, from information provided by BAA.

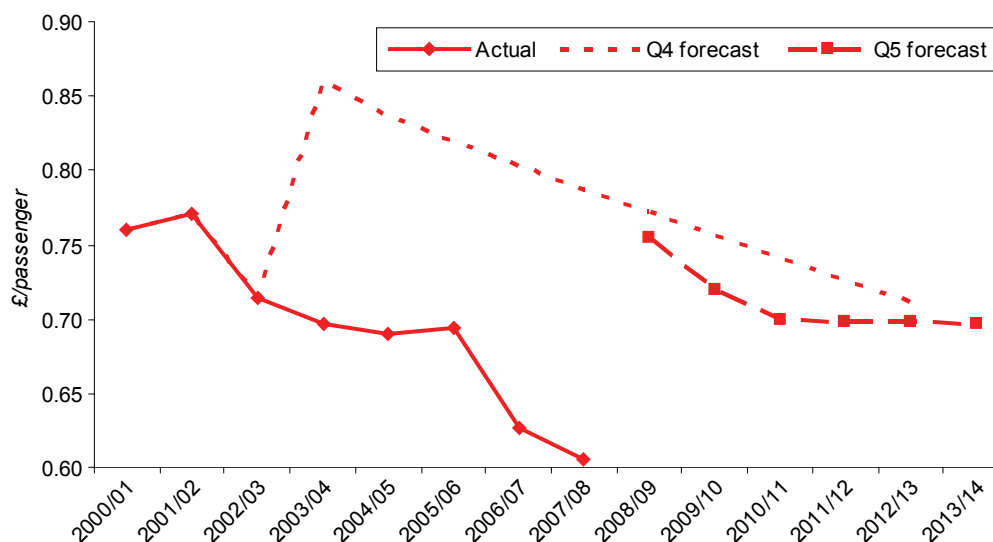
41. BAA forecast that catering yields would increase by about 1 per cent a year over Q5 through the introduction of new brands, new outlets and growth stimulated by the LCCs' limited catering offers.
42. BAA said that the current under-provision of catering outlets was a prime reason for the proposed departures extension. It noted that many of the current catering outlets at Stansted such as Prêt a Manger, Starbucks and Costa Coffee, were among the best performing such outlets nationally. As many outlets were over-trading (ie unable to satisfy demand at peak times due to queuing and congestion in-store), opportunities to increase catering revenues were limited without the provision of additional space.
43. Although much of the proposed departures extension retail area was forecast to be devoted to catering, for simplicity BAA modelled all additional retail revenue from the proposed extension in duty- and tax-free and airside specialist shops revenue.

Other retail

44. Figure 5 shows BAA's projected movement in yields from other retail over Q5.

FIGURE 5

Other retail yields (2007/08 prices)



Source: CC, from information provided by BAA.

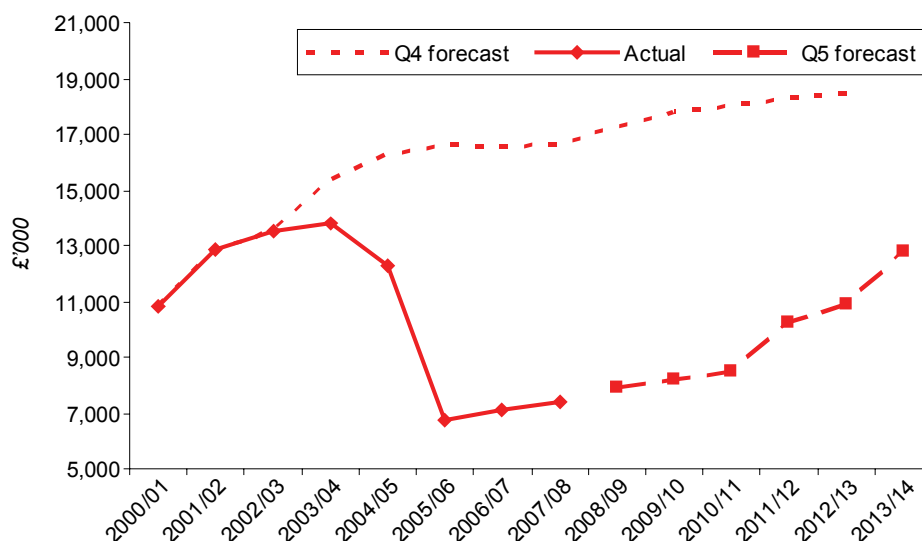
45. BAA forecast that the consolidation of a number of global brands and the rapid growth of low-cost Internet-based providers would have an impact on forecast margins and passenger spend on car rentals over the period. BAA predicted that Internet pre-booking of car hire and off-airport competition would reduce revenue per passenger by 0.5 per cent a year over Q5.
46. BAA also forecast that media and advertising revenues per passenger would remain constant throughout Q5. Although revenue was not directly linked to passenger numbers, BAA expected that the new seven-year advertising management contract with JC Decaux would stimulate new media opportunities.

Property

47. Figure 6 shows BAA's projected property revenues over Q5.

FIGURE 6

Property revenues (2007/08 prices)



Source: CC, from information provided by BAA.

48. Property revenues were forecast to increase over Q5 through the letting of existing voids and rent increases. The significant forecast increase in 2011/12 was a result of the provision of property in the proposed departures extension. The further significant increase in the final year of Q5 related to revenues from the proposed new cargo shed.

The 2006 Donaldsons report

49. In 2006 the CAA commissioned Donaldsons (now part of DTZ) to examine BAA's projections of commercial revenues in Q5. It concluded that BAA's forecasts for Q5 commercial revenues were unduly conservative.
50. Donaldsons believed that BAA had applied growth rates in its 2006 forecasts that were considerably more modest than would be applied by commercial managers of other retail assets and were also more modest than might be inferred from a comparison of relevant GDP forecasts.
51. In relation to property, Donaldsons identified that applying Investment Property Databank (IPD) market predictions of south-east office rental growth would increase BAA's forecast revenues at each of its London area airports. Donaldsons also suggested that a 5 per cent increase in base levels might be achieved.
52. Accordingly, Donaldsons believed that there was a realistic upside range for total Q5 revenue projections at Stansted of between £1.4 million and £28.6 million, as shown in Table 5.

TABLE 5 Donaldsons' range for additional Q5 revenue

| | £m | £/passenger |
|--|------------|-------------|
| <i>Effect of alternative growth rate</i> | | |
| On retail | 0.0 | 0.00 |
| On property | <u>1.4</u> | <u>0.01</u> |
| Total | 1.4 | 0.01 |
| <i>Effect of 5% uplift and alternative growth rate</i> | | |
| On retail | 25.3 | 0.19 |
| On property | <u>3.3</u> | <u>0.02</u> |
| Total | 28.6 | 0.21 |

Source: Donaldsons.

Note: Subject to rounding differences.

CAA indicative projections

53. The CAA in its April 2008 reference to us said that BAA had substantially increased its retail and property revenue forecasts following the 2006 Donaldsons report. The CAA noted that BAA's March 2008 forecasts were more optimistic than those of September 2006, although the forecast revenue per passenger remained significantly below the levels expected at Heathrow and Gatwick. It also noted that BAA's March 2008 forecasts suggested that Stansted's revenue yield would be within 5 per cent of that at Gatwick by 2012/13.
54. Table 6 shows BAA's original September 2006 forecasts of commercial revenues per passenger at Stansted (in 2006/07 prices) together with the subsequent revisions as set out in its March 2008 submission to the CAA and its May 2008 submission to us.

TABLE 6 BAA projections of commercial (retail plus property) revenue per passenger

| | Q4 (from Table 3) | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | Q5 |
|-------------------------------|-------------------|---------|---------|---------|---------|---------|---------|------|
| | 4.26 | | | | | | | |
| BAA Sep 06 (2006/07 prices) | | 3.89 | 3.86 | 3.82 | 3.78 | 3.74 | 3.41 | 3.71 |
| BAA March 08 (2007/08 prices) | | 4.17 | 4.21 | 4.17 | 4.37 | 4.41 | 4.05 | 4.24 |
| BAA May 08 (2007/08 prices) | | 4.32 | 4.26 | 4.18 | 4.38 | 4.41 | 4.05 | 4.25 |

Source: CAA and BAA.

55. Between its September 2006 submission (prepared in 2006/07 prices) and its May 2008 projections (prepared in 2007/08 prices), BAA increased its forecast revenue per passenger, increasing total forecast revenue over Q5 as a whole by £15 million. This increase masked a reduction between BAA's March 2008 and May 2008 forecasts, caused by a reduction in its forecasts for passenger numbers: BAA's May 2008 submission forecast £21 million less in total revenue over the course of Q5 than its March 2008 submission to the CAA.
56. The combined retail and property revenue per passenger in Table 6 proposed by BAA remains below that achieved in Q4, and even further below the high of £4.59 per passenger achieved in 2003/04. However, Q4 revenues included approximately £14 million in relation to properties that were disposed of to APP in 2005/06. Taking the reduced property revenue into account, BAA's May 2008 submission forecast a significant improvement in per passenger yields when compared with Q4.

DTZ report

57. We commissioned DTZ to update the Stansted sections of the 2006 Donaldsons' report and to consider BAA's revised Q5 commercial revenue projections.

Retail revenues

58. DTZ reported that BAA appeared to have taken on board many of the comments made in the 2006 Donaldsons' report, and that the retail offering at Stansted had been improved with the introduction of new fascias and a change in merchandising allocation to reflect changing markets.
59. DTZ felt that the current departures lounge became overcrowded at peak times and that BAA might be losing retail revenue as a result. DTZ said that passengers would choose not to spend money rather than join long queues, or would be able to spend less in the time available in the departures lounge due to overcrowding. Whilst improving passenger processing would allow passengers to spend more time in the departures lounge and maximize retail revenue opportunities, the resultant impact on revenues would be limited because of overcrowding, indeed improved processing might increase overcrowding at peak periods. Consequently, DTZ considered that Stansted did not have significant capacity to increase retail revenues in the short term.
60. DTZ considered BAA's forecasts for the proposed departures extension and concluded that the extension would unlock retail growth opportunities at the end of the quinquennium, although revenues would only reach maturity in Q6. DTZ considered that, based on current yields in the existing international departure lounge (IDL), the proposed departures extension could generate additional retail revenues in the region of £16 million a year from the existing passenger numbers, somewhat higher than BAA's forecast of £9 million. However, DTZ noted that many of the retailers in the existing IDL were over-trading and this would not be expected to continue when the proposed extension opened. Furthermore, DTZ commented that it was possible that the existing IDL already contained the best-performing retailers and thus retailers in the proposed departures extension might not be able to achieve similar yields. Overall, DTZ considered BAA's forecast additional revenue of £9 million from the departures extension, and the resulting IRR, to be achievable on the basis of present passenger numbers and therefore to warrant proceeding with the investment.
61. DTZ identified that BAA did not appear to have considered alternatives to the departures extension. In particular, DTZ considered that additional catering retail space could be created through the introduction of a mezzanine level above the existing IDL. This could potentially free space in the IDL for new retail facilities or the expansion of existing offerings and would give passengers a discrete area to eat and drink away from the main retail area. DTZ considered that creating a mezzanine space of 1,500 sq metres could deliver additional catering revenue of £4 million a year. BAA commented that it understood that developing the mezzanine space was not technically feasible and said that DTZ had not provided any technical advice to the contrary. In any event, BAA subsequently removed the departures extension from the Q5 capex programme (see Section 8 of the main report).
62. DTZ considered that there was an opportunity to increase forecast retail revenues over Q5 by around 5 to 6 per cent (approximately £29 million) from three areas:
- (a) BAA's May 2008 forecasts projected car park yields to fall throughout Q5 as a result of a reduction in market share, an increase in the proportion of non-UK passengers using the airport and competition from off-site parking ventures. DTZ

considered that, through increasing its market share in a declining market, refocusing the valet parking offering to align better with prices offered by competitors and offering other value-added services such as servicing, MOT tests, tyre checks etc whilst the customer was abroad, BAA could halt the projected decline in car park yields. DTZ estimated that maintaining car park yields at 2010/11 levels would result in an additional £9 million of retail revenue over Q5. BAA acknowledged the arithmetic accuracy of DTZ's calculation but considered that it ignored the fact that measures to stop the decline in yields had already been taken into account when setting its May 2008 forecasts. BAA considered that arresting the decline in car park yields looked increasingly unlikely given that it was currently achieving a yield of £1.58 per passenger whereas the forecast yield for 2009/10 in the GSM was £1.68 per passenger. BAA also noted that the actual and forecast decline in yields was caused by an increasing proportion of overseas passengers in the traffic forecasts, coupled with an increase in the use of public transport by UK residents.

- (b) BAA assumed that the UK would join the euro in 2013/14 resulting in a 90 per cent reduction in bureau de change revenue in the final year of Q5. DTZ considered that the UK was unlikely to join the euro within the next six years as politically it did not appear to be regarded as a priority. DTZ considered that an additional £10 million of bureau de change revenue should therefore be included for 2013/14, resulting in an additional £10 million of retail revenue in Q5.
- (c) BAA had commissioned a report from Creative Commercial Solutions Ltd to look at the revenue implications of increasing passenger dwell time in the IDL. The report identified that the most significant factor behind lost commercial dwell time at Stansted was the operation of the Ryanair check-in, which had resulted in Ryanair passengers spending considerably less time airside than passengers of other airlines at the airport. The report suggested that increasing dwell time airside, in addition to improving communications, standards and service, could result in an additional £15 million in commercial revenues a year. Although BAA's May 2008 submission showed a considerable uplift of approximately £3 million a year in retail revenues compared with its September 2006 submission, DTZ felt that the significant investment in improving security processing, the recent improvements in tenant mix and merchandise allocation, and Ryanair changing to automated check-in should result in additional growth in retail revenue over and above that forecast by BAA. DTZ suggested that an average annual increase of £5 million in retail revenues could be achieved as a result of these recent improvements, which would equate to an increase of £2 million a year on BAA's May 2008 forecasts. This would result in an additional £10 million of retail revenue over Q5. BAA did not accept DTZ's conclusions. BAA considered that the majority of the benefits from increased dwell time were already factored into its GSM forecasts. BAA also noted that, elsewhere in its report, DTZ stated that the IDL was currently overcrowded at peak times which might be exacerbated by increased dwell time airside, and that at peak times catering and some other retail units in the IDL were trading at full capacity. Consequently BAA felt that imposing such increases would amount to an unfounded regulatory penalty.

63. DTZ also felt that there was potential scope for advertising revenue growth at Stansted through greater alignment between brands and the socio-economic profile of the Stansted customers and the potential for exploiting naming rights opportunities. DTZ recommended that an advertising specialist be consulted to forecast accurately what additional revenues could be achieved from these sources.

Property revenues

64. During Q4 BAA disposed of some developable land and revenue-producing property at Stansted, reducing property revenue and limiting the airport's ability to increase property revenues through further development and enhancement.
65. DTZ noted that, in the past, BAA had not demonstrated a commercial approach to property management, particularly in relation to the Northside Business Park. However, since 2006, BAA had become more proactive in marketing space and reassessing its own operational needs in order to provide opportunities to maximize revenue potential.
66. There were still a significant number of vacancies at the airport. However, many of the vacant properties were expected to be redeveloped under the SG2 proposals and therefore BAA took the decision to manage the properties through short-term lets in order to maintain flexibility. If the proposed SG2 development did not take place, or was expected to be significantly delayed, DTZ suggested that these properties could be refurbished in order to attract tenants and improve yields.
67. In its May 2008 forecast, BAA projected that it would significantly increase property revenues in Q5 through filling existing voids, improving returns from existing tenants, and the provision of additional lettable space in the proposed departures extension and cargo shed.
68. DTZ considered that BAA had set itself challenging property forecasts, particularly in the light of the current property market conditions. DTZ noted that BAA had forecast property revenue growth in excess of that forecast for the 'South East office and industrial' rental market and had assumed that it would be able to fill existing voids in the airport, despite its previous inability to do so.
69. BAA's proposed departures extension included space for two commercially-important passenger lounges, Regus Group plc (Regus) office space, offices, a budget hotel and an area for 'new business opportunities'. DTZ considered the forecast property returns from the proposed departures extension to be reasonable, based on market yields, although it questioned whether two commercially-important passenger lounges would be required and identified that there could be some duplication of target passengers between the commercially-important passenger lounges and the Regus office space. Therefore, DTZ felt there was a risk that the forecast £2 million of property revenue from the proposed departures extension, although reasonably calculated, might not be achieved.
70. DTZ also questioned BAA's forecast return of £1.6 million in the last year of Q5 from the proposed new cargo shed. DTZ considered that the forecast revenues did not account for adequate initial, or future, void risk, which called into question the achievability of the forecast rents and the viability of the project as a whole. In any event, BAA subsequently removed the new cargo shed from the Q5 capex programme (see Section 8 of the main report).
71. DTZ welcomed BAA's intention to enhance property revenues through better management of its existing portfolio, improving the offering to airport customers and passengers, and anticipating increases in demand as the airport was forecast to expand. DTZ broadly concurred with BAA's property forecasts although it highlighted the risk that certain forecast revenues might not be achievable, based on past performance.

BAA revised capital investment programme

72. Following the resumption of discussions between BAA and the SACC concerning the Q5 capex programme, BAA proposed a significantly reduced capital development programme. In particular, BAA's capex programme no longer included the proposed departures extension or cargo shed and further car park expenditure was deferred until Q6 or removed from its plans completely.
73. As a result of these significant changes to the capex programme and our traffic forecasts, which showed significantly lower passenger numbers than BAA's May 2008 forecasts, we asked DTZ to reconsider its recommendations:
- (a) DTZ concluded that there was still the potential to increase retail revenues by £10 million over Q5 through improved dwell time in the IDL, as its recommendation was influenced by a report to BAA from Creative Commercial Solutions, which was itself based on 2006 passenger numbers. Since our forecast average annual passenger numbers over Q5 were of a similar magnitude to actual passenger numbers in 2006, DTZ remained of the opinion that a £10 million increase in retail revenues over Q5 was achievable.
 - (b) DTZ considered that its assumption that the UK would not join the euro in 2013/14, which would mean that 2012/13 bureau de change revenues could be maintained in 2013/14, would also remain unchanged, although the revenue would be reduced as a result of the reduction in traffic forecasts for 2012/13.
 - (c) DTZ noted BAA's recent experience in failing to achieve its forecast car park yields for 2008/09 and recognized that this challenged DTZ's own prediction that BAA could maintain 2010/11 car park yields for the remainder of Q5. DTZ accepted that there might be some yield decline in the short term, as a result of a change in the passenger profile, and accepted BAA's reduced forecast yields for the first three years of the quinquennium. However, DTZ remained of the opinion that BAA could maintain yields at the (revised) 2010/11 forecast through more competitive pricing and a more creative offering.

Assessment

Retail revenues

74. Following the abolition of EU duty-free allowances in 1999/2000, retail revenues peaked at £4.28 per passenger in 2001/02, then declined until 2005/06, when BAA renegotiated bureau de change contracts. Revenues fell again in 2006/07 before increasing in 2007/08 as a result of changing the duty- and tax-free and airside specialist shops offerings. The increased retail offering from the opening of the arrivals extension in 2008/09 and the proposed departures extension in 2011/12 were forecast to improve yields such that the Q5 average of £3.88 per passenger would be higher than the actual Q4 average. As is apparent from Annex 1, following the opening of the proposed departures extension, retail revenues were forecast to rise in 2011/12 and 2013/14, before falling significantly in 2013/14 as a result of BAA's assumption that the UK would join the euro. We noted:
- (a) Actual retail revenue was higher than forecast at the last review, although this was due to actual passenger numbers being higher than forecast, rather than a lower yield per passenger.
 - (b) BAA forecast a general decline in retail revenues per passenger. However, it has shown in the past that it is able to reduce, or even reverse, such declines in

certain years through, for example: new car park offerings (2001/02); renegotiation of contracts (2005/06); changing the duty- and tax-free and airside specialist shops offering (2007/08); and expanding retail floor space (2008/09).

(c) BAA projected declining retail revenue per passenger due to overcrowding in the IDL and a reduction in car park penetration until the opening of the proposed departures extension in 2011/12.

75. However, we believed that, as suggested by DTZ, it was reasonable to expect that commercial revenues will benefit from the increased dwell time in the IDL created by the significant investment in central security facilities, the conversion of Ryanair's paper-based check-in to automated check-in, the growing use of Internet check-in, the introduction of check-in kiosks by Ryanair which will allow passengers to check-in up to eight hours before departure, and the stabilization of security measures. As noted in paragraph 62, BAA did not accept DTZ's conclusions. BAA argued that most of the benefits were allowed for in its forecasts and pointed to DTZ's acceptance that the IDL was currently overcrowded at peak times.
76. We agreed with DTZ that was not likely, in the current climate, that the UK will adopt the euro in 2013/14 as forecast by BAA. Therefore, we concluded that bureau de change revenues in that year should be increased, as recommended by DTZ.
77. Finally, we believed it was reasonable to expect BAA to be able to maintain car park yields towards the end of Q5, through increasing its market share, offering premium and other value added services and offering more competitive prices, as suggested by DTZ.
78. Overall, we assumed an increase in retail revenues to £3.93 per passenger by the end of the quinquennium (on our most likely traffic forecasts), compared with BAA's May 2008 forecast of £3.64. If BAA were to build a mezzanine floor in the terminal for catering outlets, as suggested by DTZ, we believed this could increase retail revenues to £4.11 per passenger by 2013/14. It should be noted that BAA's original forecasts included revenue from a number of capex projects, such as the departures extension, which have subsequently been removed from the capital programme and hence have also been removed from our assumptions of retail revenues in Q5.

Property

79. We accepted that there did not appear to be material scope for increasing BAA's forecasts for Stansted's property revenues. Indeed, DTZ felt that BAA's forecast property revenue would be challenging based on current market views on property revenue growth and BAA's historic performance. We excluded property revenues from capex projects which had now been excluded from the capex programme, such as the cargo shed but, as property revenues are not affected significantly by our assumption of lower traffic forecasts, they remained otherwise unchanged. Overall, we assumed property revenue per passenger of £0.38 in 2009/10 reducing to £0.33 in 2013/14, compared with BAA's May 2008 forecast of £0.35 per passenger in 2009/10 rising to £0.41 in 2013/14, although the increase in BAA's projected property revenues was primarily due to revenues from additional capex projects which have subsequently been removed from its capex plans.

Overall assessment

80. The above assumptions resulted in forecasts for total commercial revenues of £4.36 per passenger in 2009/10 reducing to £4.26 by 2013/14, as shown in Table 7.

TABLE 7 CC assumptions of retail revenue per passenger

| | 2009/10 | 2013/14 | Paragraph reference |
|----------|-------------|-------------|---------------------|
| Retail | 3.98 | 3.93 | 78 |
| Property | <u>0.38</u> | <u>0.33</u> | 79 |
| Total | 4.36 | 4.26 | |

Source: CC analysis.

81. However, the figures in Table 7 are based on BAA's forecast passenger numbers. Table 8 shows the effect on commercial revenues of using our most likely traffic forecasts and our assumptions of retail revenue per passenger.

TABLE 8 Effect of CC assumptions on commercial revenue

| | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | Total Q5 |
|---------------------------------------|-------------|-------------|-------------|-------------|-------------|--------------|
| BAA (p per pax) | 4.26 | 4.18 | 4.38 | 4.41 | 4.05 | 4.25 |
| CC (p per pax) | <u>4.36</u> | <u>4.31</u> | <u>4.31</u> | <u>4.29</u> | <u>4.26</u> | <u>4.30</u> |
| Difference (p per pax) | 0.10 | 0.13 | -0.07 | -0.12 | 0.21 | 0.05 |
| CC most likely passenger forecast (m) | <u>21.5</u> | <u>22.7</u> | <u>23.9</u> | <u>25.6</u> | <u>27.0</u> | <u>120.7</u> |
| Effect on revenue (£m) | +2.2 | +3.0 | -1.7 | -3.1 | +5.7 | +6.0 |

Source: CC study.

Note: Subject to rounding differences.

Non-regulated aeronautical charges, including specified activities

82. Non-regulated aeronautical charges consist of all revenues generated from aeronautical activities, other than airport charges.¹ These revenues encompass charges made by Stansted to airlines, and other companies operating at the airport, for services such as servicing aircraft, the handling of passengers, baggage and cargo and the occupation and use of airport property, such as commercially-important passenger lounges.
83. In its submission to us, the CAA said that the principles for non-regulated aeronautical charges, which emerged from the constructive engagement discussions at Heathrow and Gatwick, could, in principle, provide adequate protection to airport users at Stansted within Q5. Those principles were as follows:
- full cost recovery for each of the specified charges to airlines during Q5;
 - no offsetting or subsidizing of such charges from one source with revenue from non-regulated aeronautical charges from another source;
 - under-recovery of non-regulated aeronautical charges against prior projections would be limited to recovery during the respective year or first subsequent year;
 - in recognition of the fact that the charge for a number of the services provided are based upon the costs of services provided by outside suppliers to BAA, which may inevitably change during the course of Q5, BAA would reflect such changes in its charges to airlines; and

¹Most non-regulated aeronautical charges relate to 'specified activities'. However, within non-regulated aeronautical charges are charges for some activities which are not 'specified activities' (see paragraph 105).

- (e) BAA would provide an annual update of estimates for the costs associated with non-regulated aeronautical charges to the airlines for the Q5 period, at least three months prior to the commencement of any revised charges.
84. BAA informed the CAA that Stansted continued to consult annually with users on changes to charges, and the basis for BAA's current forecasts was as follows:
- (a) not all specified charges were being fully recovered;
 - (b) there was no offsetting or subsidizing of charges from one source of revenue with those from another;
 - (c) BAA was gradually recovering losses from the under-recovery of costs from prior periods for some specified charges;
 - (d) Stansted would reflect any changes in costs of services by outside suppliers; and
 - (e) BAA undertook to provide users with an update of cost estimates for non-regulated aeronautical charges, in line with the consultation period, for any increases to charges.
85. In the absence of any substantive discussions between BAA and the airlines at Stansted on BAA's forecasts for non-regulated aeronautical charges in Q5, the CAA adopted BAA's own projections for non-regulated aeronautical charges at Stansted in its reference to us. It invited us to consider further BAA's approach to non-regulated aeronautical charges as part of our review.

Performance during Q4

86. Table 9 compares BAA's forecasts for non-regulated aeronautical charges in Q4 with its actual revenues in the period.

TABLE 9 **BAA non-regulated aeronautical charges in Q4**

£ million, 2007/08 prices

| | <i>Forecast</i> | <i>Actual</i> |
|--------------------------|-----------------|---------------|
| Utilities | 26.0 | 21.5 |
| Other operational income | 3.3 | 2.9 |
| Other operating revenue | 83.5 | 63.2 |
| Total | 112.9 | 87.6 |

Source: BAA and CC study.

Note: Subject to rounding differences.

87. BAA did not achieve the amount it forecast for non-regulated aeronautical charges in Q4. In particular:
- (a) Utility revenues were below forecast because BAA did not succeed in letting all the property envisaged at the time of the Q4 determination.
 - (b) Other operating revenue was significantly less than forecast primarily because of the reduced tariff for aviation fuel from 2005/06, the increasing impact of Internet check-in on check-in desk revenue, and the outsourcing of the supply of vehicle fuel to third parties in 2006/07.

(c) BAA also noted that the CAA forecast other operating revenues to increase with passenger numbers, whereas the relationship was not linear.

Q5 projections

88. BAA's projections of non-regulated aeronautical charges in Q5, adopted by the CAA in its reference to us, are set out in Table 10.

TABLE 10 BAA projections of non-regulated aeronautical charges

| | <i>£ million, 2007/08 prices</i> | | | | | | | |
|--------------------------|----------------------------------|---------|------------|---------|------------|------------|------------|-------------|
| | Q4 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | Q5 |
| Utilities | 21.5 | 5.0 | 4.9 | 5.1 | 5.5 | 5.8 | 6.3 | 27.7 |
| Other operational income | 2.9 | 4.2 | 2.2 | 2.4 | 2.5 | 2.7 | 2.9 | 12.7 |
| Other operating revenue | <u>63.2</u> | 8.1 | <u>8.3</u> | 8.3 | <u>8.3</u> | <u>8.3</u> | <u>8.3</u> | <u>41.6</u> |
| Total | 87.6 | 17.3 | 15.4 | 15.8 | 16.3 | 16.9 | 17.6 | 82.0 |

Source: BAA.

Note: Subject to rounding differences.

89. Utility revenues are partly determined by the underlying cost of the utilities and partly by the amount of property let. BAA forecast that it would fill the existing voids over Q5 and this was reflected in the growth in utility revenues over the period. The significant increases in the latter part of Q5 related to the opening of the proposed departures extension in 2010/11, which was projected to include offices, commercially-important passenger lounges, a Regus lounge and a budget hotel, and the proposed cargo shed in 2013/14.
90. Other operational income consists primarily of recharges for PRM services and FEGP charges. PRM came under the full control of the airport with effect from July 2008, whereas previously the airlines bore the majority of the costs directly. FEGP charges are driven by the number of aircraft movements and the forecast increase over Q5 reflected the forecast growing passenger numbers and improvements to the way in which BAA captured usage. In 2008/09, BAA also forecast to recover its additional security costs for 2006/07 and 2007/08 through the S factor.
91. Other operational revenue covers revenue from check-in desks (42 per cent), aviation fuel (23 per cent) and staff car park passes (14 per cent) as well as revenue from buses and coaches, non-airport rents, security IDs and revenue from the former World Duty Free (WDF) concession. Revenues were forecast to increase gradually as passenger numbers were expected to rise.
92. BAA's May 2008 forecasts were based on utility prices consistent with those that had been supplied to the rating agencies as part of its refinancing proposals. However, since that time, prices have increased significantly. In addition, BAA has significantly reduced its capex forecasts for Q5, and we prepared our own traffic forecasts which projected significantly lower passenger numbers over Q5 than the numbers projected by BAA. We engaged IPA to review BAA's utility cost forecasts and to provide alternative projections for Q5 costs based on current market expectations. Table 11 shows our forecast of non-regulated aeronautical charges based on IPA's projections of utility costs over Q5, the reduced capex programme and our most likely traffic forecast.

TABLE 11 CC projections of non-regulated aeronautical charges

| | £ million, 2007/08 prices | | | | | |
|--------------------------|---------------------------|------------|------------|------------|------------|-------------|
| | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | Q5 |
| Utilities | 7.3 | 6.9 | 6.6 | 6.4 | 5.9 | 33.0 |
| Other operational income | 2.0 | 2.2 | 2.3 | 2.4 | 2.5 | 11.5 |
| Other operating revenue | <u>7.9</u> | <u>8.1</u> | <u>8.3</u> | <u>8.7</u> | <u>9.0</u> | <u>42.0</u> |
| Total | 17.2 | 17.2 | 17.2 | 17.5 | 17.4 | 86.5 |

Source: CC workings.

Note: Subject to rounding differences.

Specified activities

93. Table 12 summarizes BAA's 2007/08 actual data for specified charges based on draft reports that exclude capital annuity. The data suggested that these activities generate widely differing profit margins, some causing substantial losses to BAA, while others earn a significant profit.

TABLE 12 Summary of specified activities 2007/08

| | £'000 | | | |
|-------------------------|------------|-------------|-------------|---------------|
| | Income | Costs | Profit | % |
| Check-in desks | 3,639 | -5,744 | -2,105 | -57.8 |
| Staff car parking | 1,057 | +93 | 1,150 | 108.8 |
| Security documentation | 203 | -538 | -335 | -165.0 |
| FEGP | 509 | -2,479 | -1,970 | -387.0 |
| Aviation fuel | 4,955 | -1,226 | 3,729 | 75.3 |
| Heating and ventilation | 13 | -2,519 | -2,506 | -19,276.9 |
| Gas | 36 | -78 | -42 | -116.7 |
| Electricity | 4,805 | -6,319 | -1,514 | -31.5 |
| Water and sewerage | <u>393</u> | <u>-990</u> | <u>-597</u> | <u>-151.9</u> |
| Total | 15,611 | -19,801 | -4,190 | -26.8 |

Source: BAA.

Notes:

1. Subject to rounding differences.
2. These numbers exclude any trading statement adjustments, eg capital annuity.

94. BAA's auditors report to BAA and the CAA on whether the information presented in its transparency statements has been properly extracted from the books and records of the airports and is arithmetically accurate. We have not been advised of any adverse finding by the auditors.

95. From the above table it appears that BAA only makes profits on staff car parking and aviation fuel. Key elements in the costs for the specified activities are: the capital annuity, which is an annual charge based on the underlying value of the assets used and a cost of capital of 8 per cent; and allocated costs, which represent an apportionment of the airport's opex. Costs also include staff, property, maintenance and general expenses.

Check-in desks

96. Charges for check-in desks include remuneration of the outbound baggage systems (but not inbound baggage systems, which are remunerated through airport charges), for which a rental per desk is charged. Some desks are subject to common user arrangements and are charged on an hourly basis. Over Q4, revenues have

increased from £2.9 million to £3.4 million, reflecting the increased traffic volumes, routes and airlines served by the airport.

97. For 2008/09, BAA proposed a 4.1 per cent price increase for check-in desks.

Staff car parking

98. The airport provides staff car parking facilities for airlines and other airport users. Revenue has increased over the period, due principally to the increased investment in car park facilities, reflected in the capital charge included in the pricing calculations, and due to increased property costs, in particular rates. BAA stated that the increase in revenue reflected the increased costs incurred by Stansted to accommodate the demand for staff car park spaces.
99. For 2008/09, BAA proposed no price increase. The current price is £200 per space a year.

Security documentation

100. BAA provides staff identity cards and vehicle apron passes. The current cost of a five-year staff identity pass is £53. BAA proposed no price increase for 2008/09.

Aviation fuel

101. The substantial increase in ATMs at Stansted has increased revenues from charges for the use of hydrant fuel facilities at the airport. This has been driven mainly by the increase in routes from LCCs. Although the fuel cost is paid by the airlines to third parties, the airport received 0.68p per litre during Q4, covering a throughput charge and a capital annuity element. Following a legal challenge by Ryanair, the charge was reduced to 0.412p per litre from 1 April 2005. BAA anticipates further pressure to reduce charges in Q5, which will decrease the profits from this activity.

Electricity, gas and water

102. Electricity, gas and water charges are cost-based, with the principal components being the supply cost to BAA and a return on the cost of investment in infrastructure. Charges are set per unit of consumption. Revenues increased over Q4 from £3.0 million to £5.2 million. New facilities in Q4, such as a hotel and the terminal arrivals extension, resulted in increased usage. The revenue to BAA from these utilities also increased in Q4 due to large increases in the costs of these services to BAA.
103. For 2008/09, BAA proposed a 7 per cent increase in electricity prices, a 4 per cent increase in water and sewerage prices and a 7 per cent reduction in gas prices. BAA said that the increases reflected increased energy and water charges.

Comparison of specified charges with non-regulated aeronautical charges

104. Table 13 compares BAA's projected revenues for Q5 for the main categories of specified charges with BAA's figures for non-regulated aeronautical charges quoted in Table 10.

TABLE 13 Projected specified activity charges

£ million

| | BAA May 2008 projections | | | | 2007/08 prices | |
|-----------------------------|--------------------------|------------|------------|------------|----------------|------------|
| | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
| Electricity | 4.5 | 4.3 | 4.5 | 4.8 | 5.2 | 5.6 |
| Water | 0.3 | 0.3 | 0.3 | 0.4 | 0.4 | 0.4 |
| Gas | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| FEGP | 0.5 | 0.6 | 0.6 | 0.6 | 0.7 | 0.7 |
| Check-in and baggage | 3.4 | 3.5 | 3.5 | 3.6 | 3.6 | 3.6 |
| Aviation fuel rents | 1.9 | 1.9 | 1.9 | 1.9 | 2.0 | 2.0 |
| Staff car parking | 1.1 | 1.1 | 1.1 | 1.1 | 1.2 | 1.2 |
| Bus and coach charges | 0.3 | 0.4 | 0.4 | 0.4 | 0.4 | 0.4 |
| Security ID | <u>0.2</u> | <u>0.2</u> | <u>0.2</u> | <u>0.2</u> | <u>0.2</u> | <u>0.3</u> |
| Total | 12.2 | 12.3 | 12.5 | 13.0 | 13.7 | 14.2 |
| BAA projections in Table 10 | 17.3 | 15.4 | 15.8 | 16.3 | 16.9 | 17.6 |

Source: BAA.

Note: Subject to rounding differences.

105. The difference arises because there are a number of activities not currently covered by the specified activity statements, with projected revenue throughout Q5 of approximately £17 million. These activities are PRM services, non-airport rents, bus and coach income, revenue received from WDF for staff car park passes, utilities and ID passes, apron passes, and the 'S factor' claim in 2008/09. Charges for bus and coach services are a specified activity, for which Stansted does not currently make any charge, although it intends to charge during Q5. BAA told us that it would consult on specified activities where changes to charges were proposed, but it pointed out to us that there was £17 million in its projections that related to costs which were not specified activities and for which transparency statements were not currently required.
106. BAA said that it did not anticipate extending the conditions relating to specified activities to other chargeable activities. However, we noted that we had received no complaints about any inadequacy in the information provided in relation to these extra activities.

Assessment

107. Since BAA makes losses on the majority of specified charges, it did not appear likely to us that it could achieve full cost recovery within Q5 as suggested by the CAA. Indeed, we believed that BAA would find it difficult to obtain the airlines' agreement to the required cost increase, even if increasing costs in this area would result in a reduction in airport charges.
108. Non-regulated aeronautical charges are a contentious issue between airport operators and their customers, as demonstrated in the need to provide transparency statements to airlines for the specified charges. Consequently, we believed that any attempt by BAA to increase its non-regulated aeronautical charges in order to achieve full cost recovery was likely to be strongly opposed by the airlines.
109. Given the level of losses suffered on specified charges, we concluded that limiting the timeframe in which BAA could recover previous under-recoveries to the respective year or the first subsequent year, as suggested by the CAA, might be too restrictive.

Overall assessment

Commercial revenues

Retail revenues

110. We concluded that it was reasonable to expect that commercial revenues will benefit on the scale suggested by DTZ from increased dwell times in the IDL.
111. We did not consider that it was likely that the UK will adopt the euro in 2013/14. If the UK were to adopt the euro within Q5, we recommend that the forecasts should be rebased.
112. We believed that it was reasonable to expect BAA to be able to maintain car park yields towards the end of Q5.
113. We have assumed an increase in retail revenues to £3.93 per passenger by the end of the quinquennium, based on our most likely passenger forecasts, compared with BAA's May 2008 forecast of £3.64 (an average of £3.94 over Q5 compared with BAA's forecast of £3.88). If BAA were to build a mezzanine space for catering, as suggested by DTZ, we believed that this could increase retail revenues to £4.11 per passenger by 2013/14 (£4.03 over Q5). Table 14 sets out our projections for Stansted's retail revenues in Q5, assuming our low, most likely and high passenger forecasts.

TABLE 14 CC projections of retail revenues

| | £ million, 2007/08 prices | | | | | |
|---------------------------------|---------------------------|---------|---------|---------|---------|-------|
| | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | Q5 |
| Low passenger forecasts | 82.8 | 85.0 | 89.1 | 93.9 | 97.9 | 448.8 |
| Most likely passenger forecasts | 85.5 | 89.3 | 94.1 | 100.9 | 106.0 | 475.8 |
| High passenger forecasts | 88.6 | 93.1 | 99.5 | 107.9 | 114.4 | 503.4 |

Source: CC workings.

Note: Subject to rounding differences.

Property

114. In our view, there did not appear to be material scope for assuming higher property revenues at Stansted over Q5, and we noted that, in DTZ's view, BAA had set itself challenging forecasts. We have assumed property revenue per passenger of £0.38 in 2009/10 reducing to £0.33 by 2013/14, based on our most likely passenger forecasts. Table 15 sets out our projections for Stansted's property revenues in Q5, which stay the same in each scenario of our passenger forecasts.

TABLE 15 CC projections of property revenues

| | £ million, 2007/08 prices | | | | | |
|-------------------------|---------------------------|---------|---------|---------|---------|------|
| | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | Q5 |
| All passenger forecasts | 8.2 | 8.5 | 9.0 | 9.0 | 9.0 | 43.6 |

Source: CC workings.

Note: Subject to rounding differences.

Non-regulated aeronautical charges

115. We have amended BAA's forecast for non-regulated aeronautical charges at Stansted over Q5 to reflect our latest traffic forecasts, the significant increase in utility prices since BAA's forecasts were prepared, and the reduced capex programme.
116. Table 16 sets out our projections for Stansted's non-regulated aeronautical charges in Q5, assuming our low, most likely and high passenger forecasts.

TABLE 16 **CC projections of non-regulated aeronautical charges**

£ million, 2007/08 prices

| | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 | Q5 |
|--|-------------|-------------|-------------|-------------|-------------|-------------|
| <i>Low passenger forecasts</i> | | | | | | |
| Utilities | 7.3 | 6.9 | 6.6 | 6.4 | 5.9 | 33.0 |
| Other operational income | 2.0 | 2.1 | 2.2 | 2.3 | 2.3 | 10.8 |
| Other operating revenue | <u>7.7</u> | <u>7.8</u> | <u>8.0</u> | <u>8.3</u> | <u>8.5</u> | <u>40.4</u> |
| Total | <u>17.0</u> | <u>16.8</u> | <u>16.8</u> | <u>16.9</u> | <u>16.8</u> | <u>84.2</u> |
| <i>Most likely passenger forecasts</i> | | | | | | |
| Utilities | 7.3 | 6.9 | 6.6 | 6.4 | 5.9 | 33.0 |
| Other operational income | 2.0 | 2.2 | 2.3 | 2.4 | 2.5 | 11.5 |
| Other operating revenue | <u>7.9</u> | <u>8.1</u> | <u>8.3</u> | <u>8.7</u> | <u>9.0</u> | <u>42.0</u> |
| Total | <u>17.2</u> | <u>17.2</u> | <u>17.2</u> | <u>17.5</u> | <u>17.4</u> | <u>86.5</u> |
| <i>High passenger forecasts</i> | | | | | | |
| Utilities | 7.3 | 6.9 | 6.6 | 6.4 | 5.9 | 33.0 |
| Other operational income | 2.1 | 2.3 | 2.4 | 2.6 | 2.8 | 12.1 |
| Other operating revenue | <u>8.0</u> | <u>8.3</u> | <u>8.7</u> | <u>9.1</u> | <u>9.5</u> | <u>43.7</u> |
| Total | <u>17.4</u> | <u>17.5</u> | <u>17.7</u> | <u>18.1</u> | <u>18.1</u> | <u>88.8</u> |

Source: CC workings.

Note: Subject to rounding differences.

Past and projected trend of commercial revenues at Stansted

£/passenger

| | <i>Duty/tax-free and airside specialist</i> | <i>Car parks</i> | <i>Bureau de change</i> | <i>Catering</i> | <i>Other retail</i> | <i>Total retail</i> | <i>Property</i> | <i>Retail plus property</i> |
|--------------------------------|---|------------------|-------------------------|-----------------|---------------------|---------------------|-----------------|-----------------------------|
| BAA(07/8p) actual | | | | | | | | |
| 1998/99 | 3.10 | 1.78 | 0.34 | 0.30 | 0.66 | 6.18 | 1.12 | 7.31 |
| 1999/00 | 1.17 | 1.88 | 0.38 | 0.30 | 0.73 | 4.45 | 1.01 | 5.46 |
| 2000/01 | 0.54 | 1.98 | 0.38 | 0.33 | 0.76 | 3.98 | 0.88 | 4.87 |
| 2001/02 | 0.54 | 2.23 | 0.38 | 0.35 | 0.77 | 4.28 | 0.91 | 5.20 |
| 2002/03 | 0.53 | 2.18 | 0.33 | 0.37 | 0.71 | 4.13 | 0.81 | 4.93 |
| Q3 average | 1.18 | 2.01 | 0.36 | 0.33 | 0.73 | 4.61 | 0.95 | 5.55 |
| 2003/04 | 0.58 | 1.92 | 0.31 | 0.37 | 0.70 | 3.88 | 0.71 | 4.59 |
| 2004/05 | 0.60 | 1.86 | 0.32 | 0.42 | 0.69 | 3.88 | 0.58 | 4.46 |
| 2005/06 | 0.60 | 1.79 | 0.42 | 0.43 | 0.69 | 3.94 | 0.30 | 4.24 |
| 2006/07 | 0.59 | 1.62 | 0.44 | 0.42 | 0.63 | 3.69 | 0.30 | 3.98 |
| 2007/08 | 0.66 | 1.61 | 0.43 | 0.43 | 0.64 | 3.78 | 0.31 | 4.09 |
| Q4 average (excluding 2008/09) | 0.61 | 1.76 | 0.38 | 0.41 | 0.67 | 3.83 | 0.44 | 4.27 |
| 2008/09 | [X] | 1.67 | [X] | 0.45 | 0.75 | [X] | 0.35 | [X] |
| 2009/10 | [X] | 1.68 | [X] | 0.43 | 0.72 | [X] | 0.35 | [X] |
| 2010/11 | [X] | 1.66 | [X] | 0.44 | 0.70 | [X] | 0.34 | [X] |
| 2011/12 | [X] | 1.59 | [X] | 0.44 | 0.70 | [X] | 0.39 | [X] |
| 2012/13 | [X] | 1.56 | [X] | 0.45 | 0.70 | [X] | 0.38 | [X] |
| 2013/14 | [X] | 1.51 | [X] | 0.45 | 0.70 | [X] | 0.41 | [X] |
| Q5 average | [X] | 1.60 | [X] | 0.44 | 0.70 | [X] | 0.37 | [X] |

Source: CC study.

Note: Subject to rounding differences.