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15th January 2015

The Airports Commission
Freepost RTKX-USUC-CXA
GU22 2QR

Dear sirs,

Consultation on Gatwick Airport Second Runway, etc November 2014

This is my response to the consultation concerning the expansion of the South-east's runway capacity, with particular reference to Gatwick (LGW) as sponsored by GAL.

To declare an interest: I am a resident in the high weald area, currently – and lately, in particular - badly affected by recent unconsulted changes to flight paths leading to unrespited over-flying by inbound traffic into Gatwick (LGW). In addition to this response, I have also contributed to the submissions by Leigh (Kent) Parish Council and the High Weald Councils Aviation Action Group. It almost goes without saying that I, along with thousands of others in this area, object strongly to the proposal to build a second runway at LGW on the basis that it is unnecessary and will be bad for the local and global environment.

Having spend much time going through the Commission's Report, I would make the following comments concerning the Report and the conclusions therein.

First and foremost, LGW 2R almost certainly cannot be financed as suggested – I say this as a former practitioner of 30 years in the UK corporate credit, bond and credit ratings market. The Commission's report makes an assumption of continued unfettered access to the bond market as at present, using the BBB+ rating and borrowing at Gilts + 200bps. However, not only will the massive debt requirement be hugely detrimental to GAL's financial ratios, but I believe that any decision to create a second hub at LGW would be hugely flawed strategically, to the point where it makes so little sense that I cannot see the bond market or the ratings agencies supporting the scheme regardless of the impact on financial ratios. The airlines (customers) don't want it, the inherent risks in the business model are vast and it makes absolutely no strategic sense to have two "hubs" so close such that any benefits of the expansion would be severely diluted.

In this context, I believe the Commission has not fully researched the likely response of the ratings agencies and the bond market and, were it to do so, would likely conclude that there would be an unacceptably high probability of the business suffering a non-investment grade ("junk") rating, if not upfront then at some point. In such circumstances, Gatwick would struggle to obtain the necessary finance without a government guarantee, as for example was required for HS1. Unfortunately such a need is only likely to manifest itself sometime after Gatwick has been chosen, leaving any government of the day with little choice but to accede to such a request by Gatwick or see a flagship project flounder with all that implies in terms of cost cutting and cash preservation, a pretty horrific thought.

Secondly, I do not believe that the Commission has made suitable allowance for the management and ownership regime and motivation at GAL. GAL (in conjunction with NATS and the CAA) has recently visited considerable blight on an otherwise tranquil part of Kent by their recent trialling of ever-narrow and lower-flying approach routes into LGW from the east, with no respite, partly to maximise traffic throughput (and therefore profits) and partly to free up a second, similar, approach channel for the potential second runway. This has been done cynically and without any proper consultation process. It has resulted in an avalanche of public protest and in the emergence of a number of new local representative groups, of which the Commission is no doubt aware. However, I saw nothing in the Report regarding the suitability of LGW's managers and owners. They have proven themselves to be totally unsuitable.

Thirdly, I do not believe that the GAL proposal (nor the Commission) has properly costed the impact of the expansion upon already-insufficient local infrastructure capacity (housing, workforce, roads/rail transport) in order to cope with the expanded workforce and traveller traffic. The likely costs of bring ALL infrastructure up to scratch were ignored by GAL but, falling at the government's door, would likely destroy the already slender (additional national GDP benefit of between 0.2-1% by 2060!) economics. In addition, the Report said nothing about a major flaw in road access (the A23 into London north of the M25).

Fourthly, the GAL case would be even weaker without its ability to operate night flights. Other airports either are not, or are allowed far fewer, e.g. LHR, and I believe that, if anything, the direction of travel here has to be against night flights rather than for more of the same. *The Times* (10-1-15) recently ran a report on the effects of sleep deprivation. You have already had this issue brought to your attention by Councillor Richard Streatfeild (Chiddingstone, Kent). Sleep deprivation is officially a "torture". Furthermore, *The Times* article refers to research which has indicated that long-term sleep deprivation can lead to the acceleration, by several years, of conditions such Alzheimer's or Parkinson's. I would, therefore, request the Commission to further research and properly factor into its calculation of the wider economic "benefits" of the LGW option, the potential additional cost of treating accelerated conditions like Alzheimer's and Parkinson's resulting from the potential doubling of LGW's (night) traffic. Ideally, I would like the Commission, as well as discounting the LGW 2R option entirely, to go further and recommend the abolition of night flights altogether.

Fifthly, I believe that the Commission erred by excluding altogether the option of *not* building any new capacity in the south-east. My review of the documentation suggests that the business case for additional capacity is flimsy and far from proven, whilst it is irresponsible for the UK to be promoting additional aviation capacity at a time when it is imperative to be seen to be leading the way in measures to reduce the world's CO_2 emissions. A real option would be to say "enough is enough" and to let the market(s) within the existing airports reallocate that precious capacity to where it is wanted or needed. Perhaps this whole option (and it IS an option) has been weakened by the lack of a sponsor for "no runway" (although undoubtedly the Green Party and Friends of the Earth, PlaneStupid et al will raise this).

Sixthly, on process, (and referring to the footnote to the Appendix regarding the impact on the financial modelling of different inflation scenarios) I should very much like to see the various financial sensitivity cases modelled and, whilst clearly understanding the commercial sensitivity behind such numbers, believe the Commission should have made this information available to enable proper assessment of the financial case(s).

To conclude: I regard the LGW 2R proposal as not financeable on the basis proposed and likely to require government financial support down the road, if not from the outset. The business and strategic case is flawed. The environmental impact would be horrific and for what? A really miniscule national benefit (to GDP, not to Quality of Life or wellbeing) given the appalling upheaval to our environment that would result. Not only should the Commission should rule out a second runway at Gatwick completely and utterly, and – importantly - find a way to shut the door for ever on such a ludicrous proposal, but it should also recommend the cessation of night flights at Gatwick.

Finally, I am also a member of GACC which has already responded separately and I would commend to you their more detailed and researched response.

Thank you for reading this.

Yours faithfully

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Appendix
Economic Viability and Financing

GAL's estimate of the debt needed to finance the 2R construction is ~£8bn; however, the Commission estimates this between £10-14bn[1]. This is excluding any additional cost of GAL's stated change to the new terminal programme (bringing that forward to coincide with runway opening in 2025) which will, presumably, increase the funding need further.

Additionally, access to public debt markets is more complex than one might suppose: For the financing case to work as proposed, the markets and the ratings agencies will have to buy in to the non-financial case as well as the actual (and prospective) financial ratios. Even if the ratings agencies are brought onside, the markets also have to agree with the agencies' conclusion and rating (not always the case).

However, this seems unlikely given that (1) the strategic business case for the doubling of Gatwick's size is tenuous at best and that filling it as projected might be something of a best-case scenario, and (2) that the amount of debt to be taken on increases the risk profile of the business. Financially, the LGW 2R option is weak and vulnerable on 4 main fronts: the plausibility of maintaining the BBB rating, the market's buy-in to all of this and consequent willingness to provide the funds, the predictability of applicable credit spreads, and the impact of future levels of inflation and interest rates give how marginal it looks. Consequently, there is a high risk that the funding will not be there, or that it will be too expensive or that the operator's rating might at some point fall to "junk" status, implying uncertainty and pressure on costs and cashflow.

- Without getting bogged down in specific numbers, the extra debt to be raised appears to dwarf existing debt levels by a factor of between 5-10 times depending on the assumptions used. Whilst it is proposed that airport charges will rise, in essence the airport is to become only twice as big, throughput- if not revenue- and cashflow-wise.
- This will in itself concern the bond market, if not the ratings agencies, and cause considerable scrutiny of the assumptions behind the proposal and the risks. Already leveraged into triple-BBB territory, the company does not – in our view - have the debt capacity to significantly increase its leverage ratios.
- The overall project risk, from a financial perspective, is clearly high, partly because of the scale of the engineering and budgeting risks, but also due to the lack of any guaranteed additional income resulting from the new expenditure until the new runway is operational (unless airport charges can be increased ahead of this as proposed, which is clearly being resisted by easyJet and in any event may be insufficient).

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[1] I note this incorporates the model's projected levels of inflation; clearly without inflation over the period the amount of debt would be lower, but also so would the amount of income GAL would have to service the debt. Given that inflation tends to be good for debtors by eroding the value of debt incurred in earlier periods, there is an additional risk to the financing model from the current low inflation (deflationary?) environment, should it persist. I would be intrigued to know the impact on key financial ratios and cashflow from a low inflation sensitivity; similarly, a high inflation scenario with resultant impact on borrowing costs would also be of interest.

- This project also potentially comes at a time when there might be a risk to GAL's future cashflow from any action by future UK governments to address the ability of leveraged or offshore-owned corporations to avoid tax or to reduce the tax deductibility of certain costs such as debt interest in a thinly-capitalised company.
- The stance of the ratings agencies is key, but not the only important factor since it is ultimately cautious financial institutions – insurance companies, pension funds, retail fund managers, etc – who will be looked to to provide the actual funding by buying the bonds. My understanding of S&P's methodology is that rather than being based on debt:RAB, it currently places significant weight on debt relative to a measure of Free Operating Cashflow, a metric that will stay largely flat as debt builds up through the build period. Even a reversion to an RAB-based methodology could still leave GAL vulnerable since it is by no means clear that ongoing capex in such a long-term project as this, yielding no actual income for several years, would be allowed to be added to RAB until completion and opening.
- Moody's (who does not rate GAL or its debt) has gone public stating that, in its view, GAL's own credit quality would be weakened by the project and its financing. Furthermore, one of the two ratings agencies which does currently rate GAL's debt has been quoted as stating privately that easyJet's credit rating could be impacted by the higher charges and squeezed margins. Clearly, the risk of loss of Gatwick's single largest airline customer by far (eg to Stansted) to protect its slender margins and own credit rating from increased charges – at whichever point in time - is a huge risk factor.
- To retain an investment grade rating, as well as permitting the increased debt levels, the agencies (and the debt market) would have to buy in to the strategic rationale for the airport expansion, effectively the top-line of the equation: revenue. Given the risk to easyJet's (and others?) long-term tenure, and the general preference of airlines for the better-connected Heathrow, this seems unlikely.
- Consequently it seems inconceivable that GAL would retain its BBB+ rating and (the risk of) a fall to "junk" levels – either initially or some time down the road - would presumably be a huge concern to the Commission given the likely amount of cost-cutting and cash squeezing that would result from same.
- I do not believe the agencies or the debt market will buy in to the business rationale for creating a second hub airport further out and less well-connected than LHR. And if they don't buy into it, they won't finance it (or at least will look for totally different – higher – junk-type returns from the higher risk venture).
- Where this would seem to lead next is the necessity of a government guarantee, if not initially then certainly down the road to bail out or rescue an otherwise failing project. This cannot be acceptable.
- Then there are additional and separate risks around the cost of funds: Even if BBB+ (or a lower, but still acceptable, investment grade rating) is retained and the market accepts and can absorb the debt, credit spreads today are at or near cyclical low levels and the cost of borrowing in 5, 10, 15 years' time could be a lot more expensive whether through higher gilt yields or the credit spread on top.
- To conclude: The Commission's stated assumption that the company could raise £10-15bn of debt in a rolling annual programme of £2bn issuance, at a cost of Gilts + 200bps seems highly optimistic at best. A lot of moving parts have to coincide

favourably for this to be the case, and there is no upside scenario here, only an ever-worsening range of downside cases. Furthermore, there is no evidence that the Commission has done any actual work of its own in this area or has simply accepted a claim by the sponsor, GAL.

Comments on process and public information:

1. It would be helpful if the specifics of the cash flow modelling of the financing period were to have been made public for assessment, including the assumptions use about interest rate levels, and so on;
2. The impact of inflation would seem to be important: Inflation benefits debtors by eroding the real amount of existing debt. A weaker ongoing rate of inflation (and therefore of GAL's subsequent cash flow growth relative to its debt pile) could cause problems.
3. Any evidence of any (favourable) discussions with the bond market or ratings agencies should be disclosed to support the proposal and provide some degree of comfort that the project can be financeable.