

Heathrow Airport Holdings Limited

Annual report and financial statements for the year ended 31 December 2016

Company registration number: 05757208



Heathrow Airport Holdings Limited

Contents

Officers and professional advisers	1
Strategic report	
Business overview	2
Management review	6
Financial review	11
Leadership and governance	20
Internal controls and risk management	22
Directors' report	27
Directors' responsibilities statement	30
Independent auditor's report on the Group financial statements	31
Group financial statements	
Consolidated income statement	32
Consolidated statement of comprehensive income	33
Consolidated statement of financial position	34
Consolidated statement of changes in equity	35
Consolidated statement of cash flows	36
Accounting policies	37
Significant accounting judgements and estimates	48
Notes to the Group financial statements	49
Independent auditor's report on the Company financial statements	88
Company financial statements	
Statement of financial position	90
Accounting policies	91
Significant accounting judgements and estimates	93
Notes to the Company financial statements	94

Heathrow Airport Holdings Limited

Officers and professional advisers

Directors

Lord Deighton (Chair)	
Stuart Baldwin (Non-Executive Director)	
Benjamin Bao (Non-Executive Director)	
Christopher Beale (Non-Executive Director)	
David Begg (Non-Executive Director)	
Ali Bouzarif (Non-Executive Director)	
Akbar Abbas Al Baker (Non-Executive Director)	
Javier Echave (Executive Director)	
Olivier Fortin (Non-Executive Director)	
Jorge Gil (Non-Executive Director)	
John Holland-Kaye (Executive Director)	
Rachel Lomax (Non-Executive Director)	
Ernesto Lopez (Non-Executive Director)	
Fidel Lopez (Non-Executive Director)	
Mike Powell (Non-Executive Director)	
Juan Carlos Bullon Aleman	(Alternate to Fidel Lopez)
Richard Agutter	(Alternate to Akbar Abbas Al Baker)
Paul Barr	(Alternate to Stuart Baldwin)
Ignacio Aitor Garcia Bilbao	(Alternate to Ernesto Lopez)
Samuel Coxe	(Alternate to Chris Beale)
Robert Horsnall	(Alternate to Mike Powell)
Deven Karnik	(Alternate to Ali Bouzarif)
Inigo Meiras	(Alternate to Jorge Gil)
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Carol Hui

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Heathrow Airport Holdings Limited

Strategic report

Heathrow Airport Holdings Limited ('Heathrow Airport Holdings' or the 'Company') is the holding company of a group of companies that owns Heathrow airport ('Heathrow') and operates the Heathrow Express rail service. Heathrow Airport Holdings Limited group (the 'Group') is an indirect subsidiary of the FGP Topco Limited group.

The consolidated financial statements of the Group are prepared in accordance with International Financial Reporting Standards ('IFRSs') as adopted by the European Union ('EU'). The accounting policies have been applied consistently in dealing with items which are considered material in relation to the financial statements.

This strategic report is presented in five sections:

Business overview – an overview of the business model and strategy of the Group;

Management review – overview of the year ended 31 December 2016, along with the key factors likely to impact the Group in 2017;

Financial review – presentation and explanation of the key drivers behind the financial performance reported for the year ended 31 December 2016 and analysis of the financial position of the Group as at that date. The Group's accounting and reporting policies and procedures are also considered;

Leadership and governance – description of the Board of Directors (the 'Board') and Committees of the Board which provide overall leadership to the Group; and

Internal controls and risk management – outline of the Group's internal controls, approach to risk management, sources of assurance and highlights of the key business risks identified by the Group Executive Committee and Board.

Business overview

Heathrow's business model

Heathrow airport ('Heathrow') is one of the best connected hub airports in the world, with 81 global airlines operating regular scheduled flights to almost 200 destinations. Heathrow is the primary airport in the world's largest aviation market – demand to fly to and from London is 15% higher than the next largest city. With 75.7 million passengers in 2016, Heathrow is Europe's busiest and the world's seventh busiest airport.

Heathrow has maintained a strong focus over recent years on operational performance, improving the passenger experience and investing in new and upgraded facilities. Heathrow has invested approximately £11 billion transforming the airport over the last decade. The focus and investment has resulted in Heathrow Airport being named "Best Airport in Western Europe" by Skytrax for the second consecutive year in 2016 and becoming the top performing major European hub airport in terms of overall passenger satisfaction.

Heathrow provides service to a range of market segments, including business and leisure travellers, direct and transfer passengers on long- and short-haul routes, operated by a diversified range of major airlines. Heathrow is subject to economic regulation by the Civil Aviation Authority, which sets caps on the amount that Heathrow can charge airlines for using its facilities. This price setting mechanism provides significant cash flow predictability within each regulatory period, with the current regulatory period now ending December 2019 following its recent one year extension. As well as earning income from services to airlines, Heathrow also generates revenue from a variety of sources, including concession fees from retail operators, income from car parks, advertising revenue, the rental of airport premises, the provision of facilities and services and the Heathrow Express rail service.

Heathrow's strategy

Heathrow's strategy is focused on developing the airport's position from one of the best airports in Europe to one of the best in the world. Heathrow's vision is to give passengers the best airport service in the world.

To support and develop Heathrow airport's role as a hub, the Group will continue enabling the success of the major network airlines operating at Heathrow by investing in further capacity, operational flexibility and resilience at sustainable charges for airline customers.

For both local and transfer passengers, Heathrow is working continuously to make every journey better through improved service standards to ensure it remains passengers' preferred airport. Improving the passenger experience is supported by on-going investment in modern airport facilities and operating processes.

Heathrow Airport Holdings Limited

Strategic report continued

Business overview continued

Heathrow's priorities

Heathrow aims to deliver the best airport service in the world and has four strategic priorities going forward to help achieve this aim.

Mojo

To be a great place to work, Heathrow will help its people fulfil their potential and work together to lead change across Heathrow with energy and pride.

Transform customer service

To deliver the world's best passenger experience, Heathrow will work with the Heathrow community to transform the service it gives to passengers and airlines, improving punctuality and resilience.

Beat the plan

Aiming to beat the business plan for the current regulatory period and deliver a competitive return to shareholders by growing revenue, reducing costs and delivering investments efficiently.

Sustainable growth

To operate and grow Heathrow airport sustainably, now and in the future.

Heathrow's regulatory environment

Heathrow is subject to economic regulation by the Civil Aviation Authority ('CAA'), which is the independent aviation regulator in the UK, responsible for economic regulation, airspace policy, safety and consumer protection.

The CAA sets the maximum level of airport charges for Heathrow, generally for five-year regulatory periods using a per passenger price cap mechanism known as RPI +/- X, which incorporates an allowed return on the Regulatory Asset Base ('RAB'). Heathrow's current regulatory period ('Q6') initially ran from 1 April 2014 to 31 December 2018. On 21 December 2016, the CAA issued a formal notice under section 22(6) of the Civil Aviation Act 2012 to modify the licence issued to Heathrow, by extending Heathrow's current regulatory period by one year so that it will end on 31 December 2019 and rolling over the current price control of RPI-1.5% for the additional year.

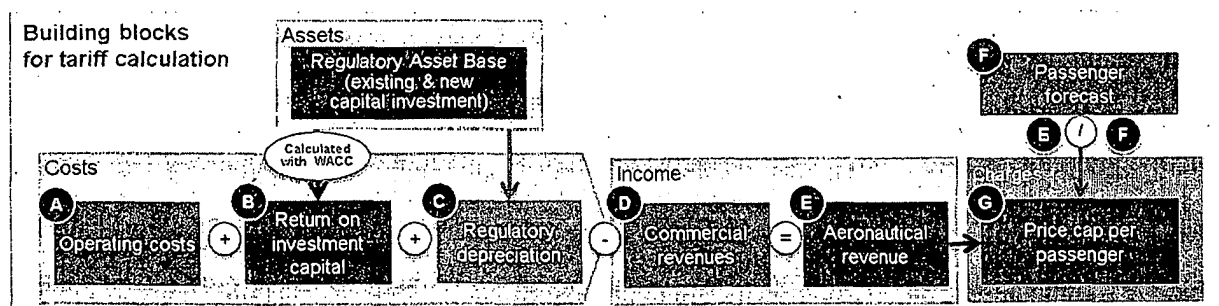
Heathrow's regulation is consistent with the economic regulation of other UK regulated industries (such as telecoms and the energy sector). This form of economic regulation is also sometimes referred to as incentive regulation, in that Heathrow has an incentive to outperform the price control by means of attracting more passengers, reducing operating costs or delivering higher commercial revenues than forecast. If the opposite is the case, then Heathrow has to absorb the cost or lower revenue. There is no adjustment for shortfalls in passenger numbers or additional costs (except where Heathrow incurs additional security costs, above an established threshold, when implementing new security directives imposed by the EU or the UK Government).

The Price Cap

The price cap for Heathrow is based on a RAB methodology using a "single till" building block approach. The single till takes into account revenue and costs from both aeronautical and non-aeronautical activities when setting the price caps for a regulatory period.

In setting the price cap, the CAA determines the regulated revenue requirement. This is calculated as the sum of forecast operating expenditure less other revenue plus the required return (using the cost of capital determined by the CAA) on the forecast RAB taking into account forecast capital expenditure, plus regulatory depreciation and plus or minus any profiling adjustment. The profiling adjustment is a mechanism used to smooth changes in charges that might otherwise occur as a result of major investments. The resulting aeronautical revenue requirement effectively amounts to the total income from airport charges.

This methodology for deriving the aeronautical revenue requirement can be represented by the following simplified diagram:



Heathrow Airport Holdings Limited

Strategic report *continued*

Business overview *continued*

Heathrow's regulatory environment *continued*

The Price Cap continued

Since the start of the current regulatory period, the maximum allowable yield (the amount of income generated from regulated airport charges on a per passenger basis) changes from 1 January each year by RPI minus 1.5%, based on RPI from the previous April.

In setting the price cap the CAA takes its own view of the scope for future efficiency savings, the appropriate level of capital expenditure and the rate of growth in demand for airport services.

While the price cap places a limit on the increase in the airport charges yield, Heathrow has the discretion on whether to price to the maximum permitted level. Therefore, Heathrow can choose to price charges below the cap. For example, if there is unused capacity, Heathrow could choose to set prices below the cap in order to stimulate demand.

The price cap takes certain elements into account in the maximum allowable yield. These include an adjustment for additional or reduced security costs as a result of new UK or European security directives; reductions where capital expenditure project milestones are not delivered; a 2017 business rates revaluation factor and a service quality rebate scheme. In addition there is a mechanism known as the "K factor" which is designed to correct for any under recovery (dilution) or over recovery (concentration) in airport charges compared to the annual maximum allowable yield per passenger. Under or over recoveries generally arise due to changes in passenger mix or average load factors compared to those forecast at the time prices were prospectively set for the relevant year.

Heathrow Income

Heathrow generates two primary types of income: aeronautical income, which is generated from fees charged to airlines for use of the airport's facilities, including passenger fees, landing charges and aircraft parking charges, and non-aeronautical income from a variety of sources, including concession fees from retail operators, direct income from car parks and advertising and income from other services supplied by Heathrow.

Aeronautical Income

Aeronautical income reflects the charges levied by Heathrow on the airport's airline customers. These charges (tariffs) cannot exceed the regulated maximum allowable yield per passenger.

The tariff structure through which the aeronautical income is recovered from airlines includes three key elements:

Passenger fees

- Fees per passenger are based on the number of passengers on board an aircraft, and are levied in respect of all departing passengers. There is no charge in respect of crew members working on flights.
- Three levels of charge based on route area: European, domestic and rest of world. Transfer and transit passengers benefit from a discount.

Landing charges

- Landing charges are levied for substantially all aircrafts (with certain diplomatic and other flights being exempted). These are calculated in accordance with the certified maximum take-off weight of the aircraft and are banded into categories for aircraft weighing less than and those weighing more than sixteen tonnes, which includes nearly all commercial aircraft. These charges are adjusted, where applicable, in accordance with each aircraft's noise-rating, its emissions and the time of day, with landing charges at Heathrow Airport being higher during peak traffic times than off-peak traffic times).

Parking charges

- Aircraft parking charges are levied for each 15 minute slot after 30 minutes (for narrow-bodied aircraft) and 90 minutes (for wide-bodied aircraft).

Non-aeronautical income

Heathrow generates non-aeronautical income from a variety of sources. These include concession fees from retail operators; direct income from car parks, advertising revenue and VIP products; the rental of airport premises such as aircraft hangars, warehouses, cargo storage facilities, maintenance facilities, offices and airline lounges; the provision of facilities such as baggage handling and passenger check-in; and fare revenue from the operation of the Heathrow Express rail service.

Heathrow Airport Holdings Limited

Strategic report continued

Business overview continued

Infrastructure

The Group has invested £11 billion transforming Heathrow's infrastructure over the last decade, with £674 million invested in 2016 (2015: £627 million).

Runways

Heathrow airport has two parallel runways. These generally operate in 'segregated mode', with arriving aircraft allocated to one runway and departing aircraft to the other. The airport is permitted to schedule up to 480,000 air transport movements per year and in 2016 its runways operated at 98.6% (2015: 98.3%) of this limit.

Terminals

Each of Heathrow's four operational terminals is either new or recently refurbished. Terminal 2, which opened in June 2014, handled 16.5 million passengers in 2016 (2015: 16.7 million) and complements the award winning Terminal 5, which celebrated its eighth birthday in 2016, and handled 31.9 million passengers in 2016 (2015: 33.1 million). Terminal 1 operations were discontinued in June 2015.

Heathrow airport's terminal capacity is currently estimated to be 85 million passengers per year.

Baggage systems

In parallel with the work on Heathrow's terminals, significant investment continues in Heathrow's baggage infrastructure. The underground automated baggage system between Terminal 3 and Terminal 5 is now fully operational, and the Terminal 3 integrated baggage system started operating in March 2015 and was fully operational in April 2016.

Cargo and mail carriers

Cargo and mail carriers are responsible for handling merchandise and packages at Heathrow airport, including delivery to cargo warehouses, customs procedures and clearance, aircraft loading and unloading, sorting and transport to the final destination. The bulk of cargo and mail at the airport is carried in the cargo holds of passenger flights rather than by dedicated cargo flights.

Certain cargo sheds at the airport are owned by third parties who lease space to cargo service providers. Heathrow also provides cargo sheds and other accommodation and facilities which are leased, or separately billed on a use basis, to cargo-service providers.

Heathrow Airport Holdings Limited

Strategic report continued

Management review

Review of the year

Heathrow saw excellent progress in 2016 towards its vision to give passengers the best airport service in the world. There was significant momentum in all four of its priorities: making Heathrow a great place to work, transforming the service to passengers and airlines, beating the business plan over the current regulatory period and winning support for expansion. These priorities are underpinned by a simple business logic that engaged people deliver great service which in turn delivers financial returns and Heathrow's licence to grow.

Heathrow's people are measurably more engaged. In the latest internal survey 78% of colleagues rated themselves engaged – up 10 points in 4 years. And Heathrow has been recognised as one of the top 30 UK companies in an annual national survey by The Sunday Times. Engagement efforts took many forms. All managers have participated in leadership and values training. Heathrow raised over £250,000 for the Duke of Edinburgh scheme with people participating in a range of community or personal challenges such as running the runway and a mass cycle race against a plane to New York. Heathrow signed a long-term partnership with Hong Kong airport, one of the world's leading hub airports, which includes long-term exchange of talented managers and in-depth peer reviews of core processes.

Heathrow is serving passengers better. Heathrow's people delivered the best ever result in the global Airport Service Quality survey of 4.19 in Q4 2016. This was supported by record baggage performance with 986 bags for every thousand passengers travelling as intended. Punctuality of flights also improved supported by airfield improvements, close work with airlines and innovative air traffic control. Skytrax's survey of over 16 million passengers yet again rated Heathrow the best airport in Western Europe and Terminal 5 the best airport terminal in the world.

In 2016, a record 75.7 million passengers flew through Heathrow, this was up 1.0% on 2015 and the sixth successive annual record. Major airlines added more seats per aircraft while also introducing cleaner, quieter and more efficient new generation aircraft such as the Boeing 787 Dreamliner and Airbus A350 to grow capacity at the airport. Airlines are also adding new destinations from Heathrow, with recent or imminent new long haul routes including Ahmedabad, Jakarta, New Orleans, Portland, Salt Lake City, San José (California), Santiago and Tehran.

Cost efficiency is as important to beating the plan as volume growth. Total cost efficiencies of over £500 million out of a target of £600 million to the end of 2018 have been secured. Savings were achieved in energy bills, key contracts and people costs. The latter included further reducing senior manager roles and increasing the proportion of people on new contracts. Over £200 million of incremental commercial revenue streams out of a target of £300 million have also been developed over the same period. Across the year revenue grew 1.5% to £2.8 billion and Adjusted EBITDA was up 4.7% to nearly £1.7 billion. In addition, £1.6 billion in debt financing was raised in the year as Heathrow continues to capitalise on opportunities in the global debt capital markets.

The government supported expansion of Heathrow in October 2016. Expansion will connect all of Britain to the world, bringing up to 180,000 new jobs and £211 billion of economic growth across the UK. The decision was supported by a wide coalition built up over years. A new runway will be built to the north-west of the existing airport which will allow 260,000 more flights at Heathrow by 2030. Heathrow will also consult on adding 25,000 extra flights from 2021 on the existing runways, while reducing noise for local people, to give Britain a 'Brexite Boost' of jobs and growth as soon as possible. Heathrow is now working toward planning approval by 2020. Heathrow intends to deliver a world leading and ambitious airport that is affordable and financeable. It must also balance national and local economic gain with environmental impacts. Heathrow is seeking to deliver sustainable growth that ensures the careers of even more people, the growth of local communities and continued business success.

Heathrow Airport Holdings Limited

Strategic report continued Management review continued

Passenger traffic

Heathrow's passenger traffic by geographic segment for the year ended 31 December 2016:

Passengers by geographic segment (millions)	Year ended	Year ended	Change ¹
	31 December 2016	31 December 2015	%
UK	4.6	5.1	(9.6)
Europe	31.7	31.2	1.8
North America	17.2	17.3	(0.5)
Asia Pacific	10.8	10.5	2.8
Middle East	7.0	6.4	8.8
Africa	3.2	3.3	(4.1)
Latin America	1.2	1.2	1.4
Total passengers¹	75.7	75.0	1.0

¹ These figures have been calculated using un-rounded passenger numbers.

For the year ended 31 December 2016, traffic grew 1.0% to a record 75.7 million passengers (2015: 75.0 million) on a total of 470,764 passenger flights (2015: 469,671). The 2016 leap year contributed over 0.2% to the growth. The average number of seats per passenger aircraft increased 1.3% to 211.5 (2015: 208.7) and the average load factor was slightly lower at 76.0% (2015: 76.5%). On eight separate days (2015: 5 days) over a quarter of a million passengers used Heathrow. 2016 was the sixth successive year of record traffic at Heathrow. Traffic increased early in the year, softened either side of the EU referendum and then ended the year strongly.

Passengers had even greater choice in 2016, with new airlines, new destinations and more seats available per flight. In March 2016, Garuda followed in the steps of Vietnam Airlines and Air China and became the latest airline to move services from Gatwick to Heathrow, bringing Jakarta as a new destination at Heathrow. Other new long haul routes introduced in 2016 were Ahmedabad, Salt Lake City, San José (California) and Tehran.

Intercontinental traffic was the key driver of traffic growth in 2016, increasing 1.7%, with more flights operated and more seats per flight. A380 long haul aircraft now account for up to 26 departures per day by up to nine airlines.

Intercontinental traffic growth was particularly robust on routes serving the Middle East where passenger numbers increased 8.8% reflecting more flights and larger aircraft, including additional A380 services from Emirates, Etihad and Qatar Airways and British Airways' relaunched Tehran service. Momentum in this region increased in the second half of the year. The rise in Asia Pacific traffic of 2.8% included substantial growth on existing routes serving Thailand, China, Vietnam and the Philippines and new services to Indonesia. In the first quarter of the year, increased services to North America supported continued traffic growth with this region although geopolitical and macro-economic factors saw traffic soften as the year progressed. Latin American traffic grew 1.4% mainly reflecting modest remaining year on year benefits from Avianca's route to Colombia launched in 2014. There should be a further boost to traffic with this region in 2017 given British Airways' launch in January of a regular flight between Heathrow and Santiago in Chile. African traffic was lower partly reflecting Virgin Atlantic's schedule changes in 2015.

European passengers increased by 1.8% although short haul traffic overall was only marginally higher year on year with growth in continental European traffic, driven by British Airways increasing seat capacity, largely offset by reduced UK traffic principally due to Virgin Little Red ending operations in 2015.

Over a quarter of the UK's non-EU exports by value pass through Heathrow today. Cargo volumes passing through Heathrow increased 3.0% in 2016 to 1.54 million metric tonnes (2015: 1.50 million tonnes). There were particularly notable increases in cargo volumes on Hong Kong, China and Vietnam.

Transforming customer service

Heathrow delivered its best ever passenger service in 2016 with a record 84% of passengers surveyed rating their overall experience as 'Excellent' or 'Very Good' (2015: 81%); Heathrow has now achieved a score above 4.00 in the Airport Service Quality ('ASQ') survey directed by Airports Council International ('ACI') for twelve successive quarters culminating in its highest ever quarterly score of 4.19 in the fourth quarter of 2016. Heathrow has been ranked first among major European hub airports for service quality in this survey for ten successive quarters.

The high service standards have resulted in Heathrow being named 'Best Airport in Western Europe' for the second consecutive year at the Skytrax World Airport Awards. The award, voted for globally by passengers, came in addition to Terminal 5 being named the world's 'Best Airport Terminal' and Heathrow 'Best Airport for Shopping' for the fifth and seventh consecutive years respectively. In addition, the new Plaza Premium Lounge in Terminal 2 was voted the world's best independent airport lounge in the same awards. For the first time, Heathrow received the prestigious accolade of 'Europe's Best Airport' (with over 40 million passengers) in the 2016 ASQ awards. Heathrow also received ACI Europe's Best Airport Award (with over 25 million passengers) for the third time. Heathrow's success was also recognised at the latest Frontier Awards where the airport won the categories of 'Operator of the Year' and 'Marketing Campaign of the Year by an Airport'.

Heathrow Airport Holdings Limited

Strategic report continued

Management review continued

Transforming customer service continued

Improvements to passengers' journeys through the airport continue. An additional escalator was opened in Terminal 5, improving operational flexibility and resilience. Passengers continue to enjoy efficient queuing to pass through security, passing through central security within the five minute period prescribed under the Service Quality Rebate scheme 97.0% of the time (2015: 97.4%) compared with a 95% service standard. The service quality regime penalty threshold was not triggered in 2016 in respect of any performance standard.

As part of the focus on increasing the resilience of operations, the final two of four new enhanced Instrument Landing Systems (eILS) were implemented at Heathrow. The eILS is based on new navigation technology and provides Heathrow with the capability to increase the number of aircraft that can land in low visibility giving improved safety, resilience and punctuality to airfield operations.

Heathrow had its busiest days ever in 2016 and achieved strong levels of service, with departure punctuality (the proportion of aircraft departing within 15 minutes of schedule) improving to 78.8% (2015: 78.1%). This reflects investments to improve operational resilience, including introducing time-based separation of aircraft on windy days in 2015. Further work on widening taxiways during 2016 to support increasing A380 operations also enabled more efficient use of the airfield. Baggage performance also improved significantly with the misconnect rate down to 14 bags per 1,000 passengers (2015: 17). The best ever monthly misconnect performance of 9 bags per 1,000 passengers was achieved in October 2016.

Beating the plan

Heathrow's business plan for the current regulatory period is intended to improve customer service, strengthen operational resilience and deliver an ambitious programme of cost efficiencies and revenue growth. Work continues to secure cost efficiencies and over £500 million of efficiencies have now been secured, out of the target £600 million for the period to the end of 2018. A three year pay offer was agreed in 2016 and further contract improvements have been secured with suppliers.

The benefits of investment in Terminal 5 retail outlets and new car parking capacity continue to flow through strongly with over £200 million secured out of the £300 million incremental commercial revenue target set for the regulatory period.

In March 2016, the CAA published its "Strategic Themes for the Review of Heathrow Airport's Charges (H7)" document. The document sets out the CAA's key milestones and details four key priorities for the next regulatory period (H7). The four priorities are 'empowering consumers and furthering their interests', 'incentivising the right consumer outcomes', 'increasing airport operational resilience' and 'promoting cost efficiency and financeability'. Heathrow responded to the CAA's consultation in April.

In addition, in July 2016, the CAA launched a consultation on the potential extension of Heathrow's current Q6 regulatory period in order, particularly, to reduce the risk that the process for agreeing the terms for the next regulatory period is sub-optimal due to uncertainty regarding potential new runway capacity. Following this process, on 21 December 2016, the CAA issued a formal notice to modify Heathrow's economic licence by extending Heathrow's current regulatory period by one year to 31 December 2019, rolling over the current price control of RPI-1.5% for the additional year.

Investing in Heathrow

In 2016, Heathrow invested over £650 million across the airport campus, improving the passenger experience and airport resilience, enhancing baggage resilience and working through a broad asset replacement programme. Passengers should benefit from improved baggage connection reliability following the opening of the Terminal 3 integrated baggage facility and see reduced baggage disruption as facilities are made more resilient. Security processes have been strengthened and made more efficient with more body scanners installed across terminals and additional automated immigration gates introduced. Also, passengers connecting through Terminal 5 should now experience an improved connection experience with the installation of an additional escalator.

The retail proposition at Terminal 4 is currently in the final stages of being significantly refreshed. The restaurant and bar group, Drake & Morgan, opened their first airport unit, 'The Commission'. Terminal 4's luxury stores, such as Harrods, Burberry and Cartier, are also being re-developed with five new luxury brands introduced, two of which are new to Heathrow. The luxury retail redevelopment in Terminal 5 has now been matched by the introduction of an enhanced food and beverage offer.

Airfield improvements continue to meet increased A380 operations with taxiway widening projects and stand modifications substantially completed. Winter operations will benefit from improved de-icing facilities and enhanced runway landing systems should assist arrivals punctuality. The refurbishment and enhancing of the main road access tunnels into the central terminal area will be completed in the coming months.

Heathrow Airport Holdings Limited

Strategic report *continued*

Management review *continued*

Responsible Heathrow

Giving passengers the best airport service in the world relies on managing the airport responsibly. Responsible Heathrow 2020 is Heathrow's commitment to supporting the UK and local economies whilst managing its impacts on communities and the environment. Building on progress achieved through Responsible Heathrow, during 2016 Heathrow consulted with leading sustainability experts and NGOs, the airport business community and local stakeholders to develop a new sustainability strategy. The plan sets long term, ambitious goals which demonstrate Heathrow's commitment to being a leader in sustainability.

In 2016, Heathrow delivered a number of initiatives and commitments that lay the foundation for the launch of the new plan and for strong performance in sustainable growth at Heathrow.

Heathrow's Noise Action Plan adopted by Government sets out over 40 actions to manage noise impacts. As part of this, in August 2016, Heathrow launched its second Blueprint for Noise Reduction. Key elements include introducing lower charges for the quietest types of aircraft (Chapter 14), such as the A350. This will make Heathrow the first airport in the world to differentiate charges for such aircraft. Another world first, Heathrow launched xPlane; enabling local residents to access flight data specific to their location and carry out their own comparative analysis.

Reducing the impact of night flights is also a key aspect of the noise blueprint. As part of this, Heathrow strives to minimise the number of aircraft departures after 11.30pm. In 2016, there were 330 such departures. Finally, as part of planning for future expansion of Heathrow, it is proposed that the new runway is sited 1 mile further west than Heathrow's two existing runways to reduce the noise impact of aircraft on their final descent into the airport over central London. Heathrow aims to delay the start of early arrivals from 4.30am to 5.30am once planning approval for expansion is obtained.

Heathrow's 2016 blueprint for reducing emissions sets out a plan for working with partners to reduce emissions from aircraft, vehicles and buildings, as well as Heathrow's commitment to play its part in ensuring air quality limits in the local area are met. Progress has been made in several areas including increasing the range of electric vehicles in use on the airport and investing in infrastructure to help achieve Heathrow's aspiration to become an Ultra-Low Emission Zone (ULEZ). There are currently over 30 electric vehicles in the fleet or on order and approximately £400,000 was invested in 2016 to install electric vehicle chargers, with a further £1 million funding approved. During 2016, Heathrow also joined the Office for Low Emission Vehicles' Go Ultra Low Company initiative which requires large companies to convert at least 5% of their vehicles to electric by 2020.

Heathrow's energy footprint continues to shrink. The 2020 target of 6.5kWh per passenger was achieved in 2016, driven by the on-going reduction in electricity consumption due to Energy Demand Management works, such as installing nearly 100,000 LED lights across the airport, compared to 75,000 at the end of 2015. In 2016 Heathrow won the Onsite Energy Efficiency category at the Edie Environment and Energy Awards, in recognition of its energy efficiency programme which cut electricity use by 27GWh in 2015, as well as being shortlisted for the ACI Europe 2016 Eco-innovation Award.

Reflecting its commitment to be a responsible gateway to the world, in 2016 Heathrow became the first airport to sign the Buckingham Palace Declaration, a landmark agreement to shut down illegal wildlife trafficking routes. Heathrow also launched the Responsible Gateway Forum which works collaboratively with third parties including the Metropolitan Police, Border Force and specialist NGOs to tackle issues around the detection of and support for vulnerable travellers.

June saw the launch of Heathrow's Skills Task Force - an independent taskforce chaired by Lord Blunkett - to provide strategic advice and guidance in developing a comprehensive employment and skills strategy for the Heathrow area that will ensure the business, including its supply chain, has the skills needed to build and operate an expanded airport.

Finally, in 2016, "Sustainable Growth" became one of Heathrow's four strategic priorities, in recognition of its commitment to operate and grow the airport sustainably, now and in the future.

Expansion

On 25 October 2016, Heathrow welcomed the Government's decision to support its expansion and confirmed it will begin work to deliver the new runway that will connect all of Britain to the world, bringing new jobs and economic growth to every nation and region of the UK. A new third runway to the north west of Heathrow will deliver a world leading, ambitious and affordable plan which balances the huge national and local economic gain from expansion with the environmental impacts.

The Government's decision follows the unanimous and unambiguous recommendation of the Airports Commission in July 2015 after a two and a half year, £20 million study. A third runway will bring huge benefits to everyone in Britain, creating up to 180,000 jobs and £211 billion of growth across the country. As the UK charts a new course outside the EU, it will enable up to 40 new long-haul trading routes and support Britain's exporters to reach the fastest growing markets in the world. To give Britain a 'Brexit Boost' and unlock jobs and growth across the country sooner, Heathrow will consult on plans to bring in 25,000 extra flights per year from 2021.

Heathrow Airport Holdings Limited

Strategic report continued

Management review continued

Expansion continued

In July 2016, the Civil Aviation Authority ('CAA') commenced consultation on the regulatory treatment of costs incurred in obtaining the development consent order ('DCO') required to proceed with expansion (so called 'Category B' costs). Heathrow currently estimates £250-300 million of such costs will be incurred primarily between 2017 and 2020. Following responses to its initial consultation, in November 2016, the CAA issued its final proposals in relation to these costs.

Subsequently, Heathrow's licence has been modified to enable it to recover up to £10 million per annum of Category B costs through aeronautical income shortly after they are incurred. The CAA's proposals on other aspects of Category B costs, to be finalised in February 2017, include mechanisms that allow (i) costs in excess of £10 million per annum to be added to the regulatory asset base ('RAB'), (ii) the regulatory cost of capital to accrue on the costs once added to the RAB, (iii) recovery of the costs following receipt of the DCO and (iv) risk sharing under which either 105% or 85% of costs added to the RAB will be recovered if the DCO is granted or not granted, respectively.

In January 2017, the CAA initiated consultation on its key priorities and timetable for the development of the regulatory framework for Heathrow's expansion and in particular, the regulatory treatment of costs and financing of the construction programme (so called 'Category C' costs). Four key priorities are expected to be considered: (i) the expansion scheme must be designed to promote the interests of consumers by engaging with airlines in a transparent and effective manner, (ii) cost estimates must be robust and their regulatory treatment must incentivise timely and efficient delivery of the project, (iii) Heathrow must develop proposals for efficient financing while the regulatory framework needs to be consistent with efficient financing, affordability and financeability and (iv) affordability and financeability principles must apply to both existing operations and new runway and capacity expansion. Responses to this consultation are due by 14 March 2017 and a further consultation on the regulatory framework is expected in June 2017. In addition, the CAA intends to publish an update on the business plan expectations and outcomes for the next regulatory period in April 2017.

In February 2017, the Government published its draft Airports National Policy Statement ('NPS') outlining its policy for Heathrow's expansion. The publication started a 16-week public consultation on the draft NPS. A number of planning requirements are being consulted on, which are reflected in Heathrow's plans, including providing compensation to communities affected by the expansion, purchasing properties affected by the scheme at a 25% premium, implementing measures mitigating noise including a six and a half hour ban on scheduled night flights, setting specific mode share targets to curb impacts on air quality and demonstrating the scheme can be delivered in compliance with legal requirements on air quality. A final version of the NPS is expected to be submitted to a vote in Parliament during winter 2017/18.

In addition, Heathrow will run the first of two public consultations later this year as it develops its DCO for submission to the Planning Inspectorate.

Key management changes

On 22 June 2016, Paul Deighton succeeded Sir Nigel Rudd as Chairman of the board of Heathrow Airport Holdings Limited.

On 10 November 2016, Heathrow announced Javier Echave as Chief Financial Officer, who had acted as interim since the departure of Michael Uzielli in May 2016.

Heathrow Airport Holdings Limited

Strategic report *continued*

Financial review

Introduction

The following financial review, based on the consolidated financial statements of the Group, provides commentary on the performance of the Group's operations.

Basis of presentation of financial results

Heathrow Airport Holdings Limited consolidated financial statements are prepared under International Financial Reporting Standards ('IFRSs').

For the year ended 31 December 2016, there were no disposals of discontinued operations. Discontinued operations related to the disposal of Airport Holdings NDH1 Limited and its subsidiaries (the 'NDH1 Group') that principally owned and operated Aberdeen, Glasgow and Southampton airports, which was sold on 18 December 2014 generating a profit of £200 million. During the year ended 31 December 2015, the Group realised £5 million from the release of disposal provisions made in 2014 for costs associated with the disposal of the NDH1 Group. In addition to the remaining £1 million provision balance utilised in the year ended 31 December 2016, the Group incurred a further £1 million in costs relating to this disposal.

Summary performance

In the year ended 31 December 2016, the Group's operating profit before certain re-measurements was £1,005 million (2015: £919 million) and its loss after tax was £119 million (2015: £702 million profit).

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Continuing operations		
<i>Excluding exceptional items and certain re-measurements</i>		
Revenue	2,809	2,767
Operating costs before depreciation and amortisation	(1,126)	(1,159)
Adjusted EBITDA	1,683	1,608
Depreciation and amortisation	(678)	(689)
Adjusted Operating profit	1,005	919
Net finance costs	(714)	(668)
Adjusted Profit before tax	291	251
Tax charge on profit before exceptional items and certain re-measurements	(71)	(46)
<i>Including exceptional items and certain re-measurements</i>		
Exceptional items	-	236
Fair value gain on investment properties	44	95
Fair value (loss)/gain on financial instruments	(522)	150
Tax credit/(charge) on exceptional items and certain re-measurements	88	(89)
Tax credit relating to change in tax rate	52	100
(Loss)/profit from continuing operations	(118)	697
Discontinued operations		
(Loss)/profit from discontinued operations ¹	(1)	5
(Loss)/profit after tax	(119)	702

¹ Includes adjustments relating to the disposal of the NDH1 Group, which was sold in December 2014.

Adjusted EBITDA is earnings before interest, tax, depreciation and amortisation, certain re-measurements and exceptional items. For the year ended 31 December 2016, Adjusted EBITDA was £1,683 million (2015: £1,608) and EBITDA was £1,727 million (2015: £1,939 million).

Management uses Adjusted EBITDA to monitor performance of the segments as it believes it more appropriately reflects the underlying financial performance of the Group's operations. On a monthly basis management reviews results, paying particular attention to the airport operations over which it exercises control on a day-to-day basis.

Certain re-measurements comprise fair value movements on investment properties, which are mainly market-driven and over which management has little influence; fair value gains and losses on financial instruments which are subject to external financial market fluctuations; tax associated with these items and the effects of changes in tax rates, which are set by statute.

Exceptional items are presented separately as they are material items of income or expense that are not expected to be incurred on a recurring basis and because of their size or incidence, merit separate presentation to allow an understanding of the Group's financial performance.

Heathrow Airport Holdings Limited

Strategic report continued

Financial review continued

Summary performance continued

By isolating certain re-measurements and exceptional items, management believes the underlying results provide the reader with a clearer understanding of the performance of the Group, by concentrating on the matters over which it exerts influence, whilst recognising that information on these additional items is available within the financial statements, should the reader wish to refer to them.

Revenue

In the year ended 31 December 2016, revenue increased 1.5% to £2,809 million (2015: £2,767 million).

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m	Change %
Aeronautical	1,699	1,699	-
Retail	612	569	7.6
Other	498	499	(0.2)
Total revenue	2,809	2,767	1.5

Aeronautical

In the year ended 31 December 2016, aeronautical revenue was flat at £1,699 million (2015: £1,699 million) as Heathrow delivered better value for passengers and airlines with lower charges and average aeronautical revenue per passenger declined 1.0% to £22.45 (2015: £22.67).

Traffic growth of 1.0% generated £16 million incremental revenue and yield concentration, due primarily to more long haul and origin and destination passengers and a greater proportion of departing passengers than expected, also boosted year on year performance. These factors were offset by a lower maximum allowable yield due to the RPI-1.5% tariff formula, the non-recurrence of significant K factor recovery in 2015 and adjustments to reflect lower capital expenditure than forecast in the original regulatory settlement.

Retail

In the year ended 31 December 2016, retail revenue increased 7.6% to £612 million (2015: £569 million). Retail revenue per passenger rose 6.5% to £8.09 (2015: £7.59).

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m	Change %
Duty and tax-free	138	128	7.8
Airside specialist shops	115	100	15.0
Bureaux de change	50	53	(5.7)
Catering	49	45	8.9
Other retail income	86	75	14.7
Car parking	114	108	5.6
Other services	60	60	-
Total retail revenue	612	569	7.6

Retail performed strongly in 2016 following the major redevelopment of luxury stores in Terminal 5 including new brands which have strengthened Heathrow's unrivalled airport shopping experience. Performance in duty and tax-free stores has continued to improve following extensive store refurbishment in Terminals 4 and 5. Catering has grown in the year as a result of new and refurbished outlets and increases in passenger participation. Car parking also performed well, with continued take-up of Heathrow's expanded car parking product range and successful yield management. Growth in retail income accelerated in the second half of the year, particularly in areas such as duty and tax-free and airside specialist shops, driven by the depreciation of sterling following the EU referendum in late June 2016. Redevelopment of luxury stores in Terminal 4 was largely completed in late 2016 and started contributing to overall retail performance.

Heathrow Airport Holdings Limited

Strategic report continued Financial review continued

Other

In the year ended 31 December 2016, other revenue fell 0.2% to £498 million (2015: £499 million).

	Year ended 31 December 2016	Year ended 31 December 2015	Change
	£m	£m	%
Other regulated charges	232	239	(2.9)
Heathrow Express	134	132	1.5
Property and other	132	128	3.1
Total other revenue	498	499	(0.2)

Other regulated charges reflect a pass through to airlines of Heathrow's costs in areas such as baggage system operations and maintenance and utilities so the year on year reduction reflects not only lower costs but better value for airlines. Performance elsewhere in other revenue reflects growth from Heathrow Express, partly driven by the introduction of a more sophisticated pricing strategy, and additional property revenue supported by the opening of new independent lounges in Terminals 3 and 4.

Operating costs

In the year ended 31 December 2016, operating costs excluding depreciation, amortisation and exceptional items decreased by 2.8% to £1,126 million (2015: £1,159 million). Management excludes depreciation, amortisation and exceptional items from operating costs for the purpose of calculating Adjusted EBITDA.

	Year ended 31 December 2016	Year ended 31 December 2015 ¹	Change
	£m	£m	%
Employment	382	399	(4.3)
Operational	266	254	4.7
Maintenance	177	187	(5.3)
Business rates	128	123	4.1
Utilities	74	93	(20.4)
Other	99	103	(3.9)
Operating costs before depreciation and amortisation	1,126	1,159	(2.8)
Depreciation and amortisation	678	689	(1.6)
Exceptional items	-	(236)	n.m. ²
Total operating costs	1,804	1,612	11.9

¹ For the year ended 31 December 2015, £11 million of costs previously included under 'Other' have been re-classified into 'Operational' to be consistent with current year disclosure.

² n.m. means not meaningful.

Employment costs benefited from previously announced changes to the defined benefit pension scheme as well as take-up of voluntary severance programmes, lower new starter pay levels, lower headcount, automation and other workforce efficiencies, partially offset by higher costs for implementing organisational change. Higher operational costs reflect increased investment in operational resilience partially offset by improved service driving lower service quality rebates and savings from the re-negotiated NATS contract for providing aerodrome navigation services. The rise in business rates reflects general national trends with Heathrow remaining one of the UK's highest business rate payers. Other costs reflect savings across consultancy, marketing and general expenditure.

Significantly lower utilities costs particularly reflect a re-negotiated contract for the provision of electricity distribution infrastructure services due to a combination of recurrent cost savings and a one-off credit of £14 million related to prior periods. A focus on energy demand management continues to drive savings in electricity consumption. For example, Heathrow is the first European hub airport to install LED lighting on all aircraft stands. The number of LED light installations across the Heathrow campus is approaching 100,000, compared to 75,000 at the end of 2015. Additionally, since Terminal 2's opening, Heathrow has generated around 5GWh of electricity on-site, from solar panels and a biomass renewable energy facility.

Heathrow Airport Holdings Limited

Strategic report *continued* Financial review *continued*

Operating profit

For the year ended 31 December 2016, the Group recorded an operating profit after exceptional items but before certain re-measurements of £1,005 million (2015: £1,155 million).

	Year ended 31 December 2016	Year ended 31 December 2015	Change %
	£m	£m	
Adjusted EBITDA	1,683	1,608	4.7
Depreciation and amortisation	(678)	(689)	(1.6)
Exceptional items	-	236	n.m.
Operating profit before certain re-measurements	1,005	1,155	(12.9)
Fair value gain on investment properties	44	95	(53.7)
Operating profit	1,049	1,250	(16.1)

In the year ended 31 December 2016, Adjusted EBITDA (before certain re-measurements and exceptional items) increased 4.7% to £1,683 million (2015: £1,608 million), resulting in an Adjusted EBITDA margin of 59.9% (2015: 58.1%).

Depreciation and amortisation decreased to £678 million (2015: £689 million) mainly due to the decommissioning of Terminal 1 during 2015 and some Terminal 2 and Terminal 5 assets being re-assessed in the year as having longer useful economic lives. This decrease is partly offset by the accelerated depreciation of Terminal 3 to reflect the Airport Masterplan.

Exceptional items

In the year ended 31 December 2016, there were no exceptional items charged (2015: £236 million credited).

	Year ended 31 December 2016	Year ended 31 December 2015
	£m	£m
Pension: changes to terms	-	236
Exceptional pre-tax credit	-	236

In 2015, changes were agreed to the Group's defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members, which resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under IAS19, and was classified as an exceptional item in the income statement. There was no immediate cash flow impact as a result of these changes.

Taxation

All Heathrow group companies operate not only within the UK's tax laws, but also within the spirit of them and do not structure transactions in a way which gives a tax result contrary to the intentions of Parliament. All Heathrow group company profits are subject to UK corporation tax.

The total tax credit recognised for the year ended 31 December 2016 was £69 million (2015: £35 million charge). Based on a loss before tax for the year of £187 million (2015: £732 million profit), this results in an effective tax rate of 36.9% (2015: 4.8%).

Excluding the impact of the change in tax rate, the total tax charge, before certain re-measurements and exceptional items, for the year ended 31 December 2016 was £71 million (2015: £46 million charge). Based on profit before tax, certain re-measurements and exceptional items of £291 million (2015: £251 million), this results in an effective tax rate of 24.4% (2015: 18.3%). The tax charge for 2016 is more than implied by the statutory rate of 20% primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief. In 2015 the tax charge was less than implied by the statutory rate of 20.25%, primarily due to adjustments in respect of previous years. Excluding the adjustments in respect of previous years, the effective tax rate would have been higher than the statutory rate as a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

In addition there was an £88 million tax credit (2015: £89 million tax charge) reflecting the tax impact arising from fair value gains/losses on investment property revaluations and fair value gains/losses on financial instruments, along with any associated prior year adjustments.

Heathrow Airport Holdings Limited

Strategic report *continued* Financial review *continued*

Taxation *continued*

Further details supporting the above amounts are shown in Note 5 to the accounts.

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. Consequently, the Group's significant deferred tax balances, which were previously provided at 18%, were re-measured at the future tax rate at which the Group believes the timing differences will reverse. This has resulted in a net reduction in the deferred tax liability and a corresponding net deferred tax credit of £52 million being recognised in the income statement.

In December 2016 and January 2017 the UK Government published draft legislation on a new interest deductibility regime, in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). It has been announced that, effective from 1 April 2017, interest deductions will be limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public benefit infrastructure exemption (PBIE). Whilst the legislation could impact the future tax charge of the Group, Heathrow expects to be largely protected from the 30% of tax based EBITDA cap through the use of the PBIE and GRR. The position will be clarified when the legislation is enacted later in 2017.

As a business, Heathrow has high infrastructure costs and of these a significant proportion now attracts no tax deduction. For those that do attract a tax deduction there is a timing difference between the accounting depreciation of these assets (the asset cost is charged to the income statement over the useful life of the asset as depreciation on a straight line basis, which is not deductible for tax purposes) and the tax relief available for capital expenditure (capital allowances, being tax reliefs provided in law, spread over a number of years), that generates significant deferred tax liabilities within the Group, reflecting future tax payable once capital investment reduces.

(Loss)/profit for the year

	Year ended 31 December 2016	Year ended 31 December 2015	Change %
	£m	£m	
Operating profit before exceptional items	1,049	1,014	3.5
Exceptional items	-	236	n.m.
Operating profit	1,049	1,250	(16.1)
Net finance cost	(714)	(668)	(6.9)
Fair value (loss)/gain on financial instruments	(522)	150	n.m.
(Loss)/profit before tax	(187)	732	n.m.
Tax credit/(charge)	69	(35)	n.m.
(Loss)/profit from discontinued operations	(1)	5	n.m.
(Loss)/profit for the year	(119)	702	n.m.

In the year ended 31 December 2016, the Group recorded an operating profit of £1,049 million (2015: £1,250 million) with the year on year reduction attributable to an exceptional credit of £236 million arising in 2015 from changes in the defined benefit pension scheme discussed in note 3.

In the year ended 31 December 2016, the Group recorded a loss before tax of £187 million (2015: £732 million profit). In addition to the non-recurrence of 2015's pension related exceptional credit discussed above, the year on year move from a pre-tax profit to a pre-tax loss reflects in particular a £522 million non-cash fair value loss on financial instruments compared to a £150 million gain in 2015. 2016's fair value loss was driven by both lower long-term sterling interest rates and higher inflation expectations. Also contributing to 2016's pre-tax loss were increased net finance costs of £714 million (2015: £668 million) with the year on year change primarily reflecting higher index-linked accretion due to higher inflation during 2016 compared to 2015.

Heathrow Airport Holdings Limited

Strategic report continued

Financial review continued

Discontinued operations

For the year ended 31 December 2016, there were no disposals of discontinued operations. The £1 million loss from discontinued operations related to IT separation costs in relation to the disposal of the NDH1 Group in December 2014.

Summary cash flow

For the year ended 31 December 2016 there was an increase of £109 million in cash and cash equivalents, including restricted cash, compared with a decrease of £121 million in 2015.

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Cash generated from continuing operations	1,643	1,591
Taxation:		
Corporation tax paid	(45)	(24)
Group relief (paid)/received ¹	(10)	2
Net cash from operating activities	1,588	1,569
Purchase of property, plant and equipment and other assets	(674)	(627)
Decrease/(increase) in term deposits	170	(380)
Disposal proceeds, other cash movements and investing activities of discontinued operations ²	(1)	(56)
Interest received	6	8
Net cash used in investing activities	(499)	(1,055)
Dividends paid to ADI Finance 2 Limited	(540)	(331)
Proceeds from issuance of bonds, term notes and other financing	1,119	1,297
Repayment of bonds and facilities and other financing items	(807)	(783)
Swap restructuring	20	-
Settlement of accretion on index-linked swaps	(188)	(213)
Interest paid	(584)	(605)
Net cash used in financing activities	(980)	(635)
Net increase/(decrease) in cash and cash equivalents	109	(121)

¹ Group relief in 2015 was received from the NDH1 Group after its disposal in December 2014.

² Includes adjustments relating to the disposal of the NDH1 Group, which was sold in December 2014.

At 31 December 2016, the Group had £699 million (2015: £760 million) of cash and cash equivalents, restricted cash and term deposits of which cash and cash equivalents comprised £307 million (2015: £199 million).

Heathrow Airport Holdings Limited

Strategic report continued Financial review continued

Cash generated from operating activities of continuing operations

In the year ended 31 December 2016, cash generated from operating activities of continuing operations increased 3.3% to £1,643 million (2015: £1,591 million). The following table reconciles Adjusted EBITDA to cash generated from operating activities.

	Year ended 31 December 2016	Year ended 31 December 2015
	£m	£m
Adjusted EBITDA	1,683	1,608
(Increase)/decrease in receivables and inventories ¹	(15)	17
Increase/(decrease) in payables	2	(7)
Increase/(decrease) in provisions	3	(4)
Loss on disposal of property, plant and equipment	2	-
Difference between pension charge and cash contributions	(32)	(23)
Cash generated from operating activities of continuing operations	1,643	1,591

¹ Excludes movement in group deposits.

Dividends

In the year ended 31 December 2016, the Group's ultimate shareholders received £325 million in dividends (2015: £300 million) reflecting the continued strong performance achieved by the business including delivering better value for airlines and passengers and significantly improving service. This made up a substantial proportion of the total dividends of £540 million (2015: £331 million). Other payments related principally to meeting £195 million of principal and most of £20 million of interest payments on loan facilities at ADI Finance 2 Limited (2015: £31 million).

Pension scheme

Heathrow operates a defined benefit pension scheme, the BAA Pension Scheme, which closed to new members in June 2008. At 31 December 2016, the defined benefit pension scheme, as measured under IAS 19, had a deficit of £79 million (2015: £104 million surplus). The £183 million change in the year is primarily due to net actuarial losses of £219 million, partly offset by contributions in excess of current service cost of £34 million, including £25 million for agreed deficit repair contributions.

The deterioration in the scheme actuarial position was driven by a fall in the net discount rate, particularly corporate bond yields which fell significantly following the EU referendum. As a result, Heathrow's IAS19 pension liabilities have increased by £822 million, whilst assets have increased by £603 million, partly offsetting the increase in liabilities and reflecting the value of having a significant proportion of the scheme's assets that perform in a manner expected to be consistent with key drivers of change in the scheme's liabilities.

In July 2016, the trustee of the BAA Pension Scheme concluded a formal actuarial valuation of the scheme. The valuation was carried out as at 30 September 2015 and took into account changes implemented to reduce the scheme's liabilities. These changes were the introduction of an annual cap on future increases in pensionable pay for active members and a reduction in both the accrual rate for future service and inflationary increases for those future service pensions whilst in payment. The valuation indicated a scheme deficit of £228 million calculated using the agreed actuarial assumptions. As part of the process, LHR Airports Limited agreed a reduction to its annual deficit repair contribution from £27 million to £23 million that is intended to eliminate the deficit by 2022. The process also resulted in a reduction in ongoing cash contributions from 33% to 23% of pensionable salary, consistent with the efficiency targets under the current regulatory settlement. The reduction in cash contributions into the scheme applied from 1 July 2016 and is estimated at £12 million per annum.

Recent financing activity

Heathrow continues to focus on maintaining a strong liquidity position and optimising its long-term cost of debt as well as ensuring duration, diversification and resilience in its debt financing. Heathrow's recent financing strategy has looked to balance certainty of term funding, particularly to meet £1.2 billion in debt maturities in the first quarter of 2017, with the cost of carrying substantial cash on balance sheet. This has been achieved partly by securing term debt with delays between commitment and drawing.

In 2016, Heathrow raised approximately £1.6 billion of debt financing globally from a diverse range of sources. In January 2016, it consolidated its presence in the Swiss franc bond market, raising CHF400 million in an 8 year public bond with a fixed rate coupon of 0.5%. In June 2016, a £350 million 3.75 year term loan was signed with an initial group of 5 banks which is expected to be drawn by the end of the first quarter of 2017. Also in July 2016, a £400 million, 33 year public bond with a fixed rate coupon of 2.75% was issued, extending Heathrow's maturity profile. In August 2016, a £90 million private placement from non-sterling sources which was signed in April 2016 was drawn and matures in 2032. In December 2016, a NOK1 billion private placement which was signed in July 2016 was drawn and matures in 2029.

Heathrow Airport Holdings Limited

Strategic report continued

Financial review continued

Recent financing activity continued

At Heathrow Finance, a £150 million, 12 year term loan agreed earlier in the year was drawn in December 2016. In addition, Heathrow Finance entered into £200 million in 7-10 year term loans which are expected to be drawn in 2017.

Given the strength of its liquidity position, Heathrow has cancelled £250 million of its £1.4 billion core revolving credit facilities. The maturity of these facilities has also been extended by a year to October 2021. Further, £130 million of its £750 million liquidity facilities have been cancelled as Heathrow continues to focus on the efficiency of its financing arrangements for itself and counterparties.

Heathrow repaid £300 million and €500 million (£434 million) bonds in March 2016 and October 2016 respectively. Also during 2016, £195 million of term loan facilities at ADI Finance 2 Limited were repaid which are being replaced by debt raised at Heathrow Finance as Heathrow evolves to a simpler debt capital structure.

Since the start of 2017, Heathrow has also repaid €700 million (£584 million) and CHF400 million (£272 million) bonds in January 2017 and February 2017 respectively.

Heathrow currently expects to raise no more than £750 million in senior (Class A) term debt in 2017.

Net debt and liquidity

The Group's nominal net debt increased 2.7% to £12,984 million at 31 December 2016 (2015: £12,646 million) and comprised £12,729 million in bonds, £763 million in other term debt and £179 million in index-linked derivative accretion offset by £687 million cash at bank and term deposits. Nominal net debt comprised £10,168 million in senior net debt and £1,740 million in junior debt at the Heathrow (SP) group level, £1,097 million in net debt at Heathrow Finance and £21 million in cash in the rest of the Group.

The average cost of the Group's nominal gross debt at 31 December 2016 was 4.19% (2015: 4.46%). This includes interest rate, cross-currency and index-linked hedge impacts and excludes index-linked accretion. Including index-linked accretion, the Group's average cost of debt at 31 December 2016 was 5.24% (2015: 5.01%). The reduction in the average cost of debt excluding index-linked accretion since the end of 2015 is mainly due to the maturity on 31 March 2016 of a bond with a 12.45% coupon and the increased cost of debt including index-linked accretion reflects higher inflation at the end of 2016 compared to the end of 2015.

Nominal debt excludes any restricted cash and intra-group borrowings. It includes all the components used in calculating gearing ratios under the Group's financing agreements including index-linked swap accretion.

The accounting value of the Group's net debt was £13,489 million at 31 December 2016 (2015: £12,268 million). This includes £307 million of cash and cash equivalents and £380 million of term deposits, as reflected in the Statement of financial position, and excludes accrued interest and restricted cash. A reconciliation of total borrowings as per the Statement of financial Position to the Group's measure of net debt is shown in Note 28.

Heathrow expects to have sufficient liquidity to meet all its obligations in full up to December 2018. The obligations include, forecast capital investment (including expected investment over the coming years related to potential expansion), debt service costs, debt maturities and distributions. The liquidity forecast takes into account £2.4 billion in undrawn loan facilities and cash resources at 31 December 2016 as well as expected operating cash flow over the period.

Net finance costs and net interest paid

In the year ended 31 December 2016, the Group's net finance costs before certain re-measurements were £714 million (2015: £668 million) and net interest paid was £578 million (2015: £597 million). Reconciliation from net finance costs on the income statement to net interest paid (being the net of £584 million interest paid and £6 million interest received) on the cash flow statement is provided below.

	Year ended 31 December 2016	Year ended 31 December 2015
	£m	£m
Underlying net finance costs	746	700
Amortisation of financing fees and fair value adjustments	3	(10)
Borrowing costs capitalised	(35)	(22)
Net finance costs before certain re-measurements	714	668
Underlying net finance costs	746	700
Non-cash accretion on index-linked instruments	(139)	(74)
Other movements	(29)	(29)
Net interest paid on the cash flow statement	578	597

Heathrow Airport Holdings Limited

Strategic report *continued*

Financial review *continued*

Net finance costs and net interest paid *continued*

Underlying net finance costs were £746 million (2015: £700 million) after adjusting for capitalised borrowing costs of £35 million (2015: £22 million) and non-cash amortisation of financing fees, discounts and fair value adjustments of debt of £3 million (2015: £10 million gain). The year-on-year increase in underlying net finance costs primarily reflects higher index-linked accretion due to higher inflation during 2016 compared to 2015 partially offset by favourable pension-related charges and lower interest rates in the period.

Net interest paid is lower than underlying net finance costs primarily due to a £139 million (2015: £74 million) non-cash charge relating to accretion on index-linked instruments.

Financial ratios

The Group continues to operate comfortably within required financial ratios.

Gearing ratios under the Group's financing agreements are calculated by dividing consolidated nominal net debt by Heathrow's Regulatory Asset Base ('RAB') value. At 31 December 2016, Heathrow's RAB was £15,237 million (2015: £14,921 million).

At 31 December 2016, the Group's senior (Class A) and junior (Class B) gearing ratios were 66.7% and 78.2% respectively (2015: 67.5% and 78.7% respectively) compared with trigger levels of 70.0% and 85.0% under its financing agreements.

Heathrow Finance's gearing ratio was 85.4% (2015: 84.9%) compared to a covenant level of 90.0% under its financing agreements.

In the year ended 31 December 2016, the Group's senior and junior interest cover ratios (the ratio of cash flow from operations (excluding cash exceptional items) less tax paid less 2% of RAB to interest paid) were 3.12x and 2.50x respectively (2015: 2.90x and 2.36x respectively) compared to trigger levels of 1.40x and 1.20x under its financing agreements.

Heathrow Finance's interest cover ratio was 2.25x (2015: 2.12x) compared to a covenant level of 1.00x under its financing agreements.

Outlook

The early weeks of 2017 have been characterised by stronger than expected traffic volumes. Forecast Adjusted EBITDA for 2017 remains consistent with the guidance set out in the investor report published in December 2016 at £1,660 million.

Heathrow Airport Holdings Limited

Strategic report *continued*

Leadership and governance

Board of Directors

The Board consists of the Chief Executive Officer, the Chief Financial Officer and Non-Executive Directors. Board Meetings are attended also by the Company Secretary. More than half of the board are Non-Executive Directors. The majority of the Non-Executive Directors are shareholder representatives. The remaining minority are independent Non-Executive Directors.

The Board determines the Heathrow Airport Holdings Group's long-term strategy, to ensure that the Group acts ethically and has the necessary resources to meet its objectives, to monitor performance and to ensure the Group meets its responsibilities as a leading airport company.

Board Committees

Audit Committee

The Audit Committee members include a chairman appointed by the Board of Directors and three shareholder Non-Executive Directors, who also attend the Board.

The Audit Committee is a sub-committee of the Board and its responsibilities include:

- considering the appointment of the external auditor, taking into account relevant ethical guidance and assessing the independence of the external auditor ensuring that key audit personnel are rotated at appropriate intervals (including overseeing the process for selecting the external auditor and making recommendations to the Board);
- recommending the audit fee to the Board for approval and pre-approving any fees in respect of non-audit services provided by the external auditor and ensuring that the provision of non-audit services does not impair the external auditor's independence or objectivity;
- discussing with the external auditor the nature and the scope of the audit and reviewing the auditor's quality control procedures and steps taken by the auditor to respond to changes in regulatory and other requirements;
- reviewing reports on the effectiveness of systems for internal financial control, financial reporting and risk management;
- monitoring the integrity of the financial statements of the Group and reviewing, and challenging where necessary, the actions and judgements of management, in relation to the interim and annual financial statements and any press release related to those statements; and
- reviewing Internal Audit reports to the Audit Committee on the effectiveness of the Heathrow Airport Holdings Group's systems for internal control, financial reporting and risk management.

Nomination Committee

The Nomination Committee members include the Chairman of the Board, an independent Non-Executive Director and four shareholder Non-Executive Directors who attend the Board.

The Nomination Committee is a sub-committee of the Board and its responsibilities include:

- identifying and recommending for the consideration of the Board all new appointments of independent Non-Executive directors; and
- ensuring a formal, rigorous and transparent procedure is followed for the appointment of new independent Non-Executive directors to the Board.

Remuneration Committee

The Remuneration Committee members include a chairman appointed by the Board, three shareholder Non-Executive Directors who attend the Board and one independent Non-Executive Director.

The Remuneration Committee is a sub-committee of the Board and its responsibilities include approvals of:

- the remuneration policy of the members of the Executive Committee and Senior Managers;
- the compensation packages of the members of the Executive Committee (other than the Chief Executive Officer) including salary, bonus, pensions and other incentive compensation;
- the contractual terms for the members of the Executive Committee and independent Non-Executive Directors;
- the design and terms of bonus plans including approval of off-cycle bonus payments outside bonus guidelines including sign on, retention and guaranteed bonuses;
- the design and terms of long term incentive plans; and
- succession planning for the members of the Executive Committee.

Heathrow Airport Holdings Limited

Strategic report *continued*

Leadership and governance *continued*

Board Committees *continued*

Finance Committee

The Finance Committee members include a chairman appointed by the largest shareholder of FGP Topco Limited, the Chief Executive Officer, the Chief Financial Officer and a Non-Executive Director representing each shareholder entitled to appoint a director to the Board.

The Finance Committee is a sub-committee of the Board and also acts as a forum for obtaining consents required from the shareholders of FGP Topco Limited.

The Finance Committee is responsible for approving various matters relating to the Group's debt financing arrangements prior to their implementation including approval for:

- any prospectus or other listing document required in relation to the issuance of any capital markets instruments or any formal information memorandum in relation to borrowing by any member of the Group;
- the borrowing of any money or the assumption of any indebtedness by any member of the Group (including by way of the issue of securities) in excess of certain financial thresholds;
- the refinancing of any existing indebtedness in respect of any member of the Group in excess of certain financial thresholds;
- the making of any repayments of principal in addition to scheduled principal payments on any debt that may be owing by any member of the Group; and
- other than as required by the financing arrangements of any member of the Group, the making of any material loan or advance or giving of any guarantee, indemnity or provision of any credit, in each case in excess of certain financial thresholds.

Executive Committee

The Executive Committee consists of the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, the Chief Information Officer, the Chief of Staff and Group Company Secretary, the Chief People Officer, Expansion Director, Chief Commercial Officer and Chief Strategy Officer.

The Executive Committee is the management committee of the Chief Executive.

The Executive Committee is responsible for, among other things, developing, reviewing and refreshing medium and long term Group business strategies, policies and development plans for Board approval, agreeing short-term tactics and action plans to ensure their delivery and reviewing the principal risks and the risk management framework.

Executive Risk Committee

The Risk Committee was set up during the year and is chaired by the General Counsel and Group Company Secretary and consists of the Chief Financial Officer, the Chief Operating Officer and the Procurement Director. It is responsible for reviewing the effectiveness of the risk management strategy and framework and for reviewing the principal risks. The Risk Committee is a sub-committee of the Executive Committee.

Sustainability and Operational Risk Committee

The Sustainability and Operational Risk Committee (formerly the Responsible Heathrow and Operational Risk Committee) is chaired by an independent Non-Executive Director, and its members include the Chief Executive Officer and three shareholder Non-Executive Directors who attend the Board.

The Sustainability and Operational Risk Committee is a sub-committee of the Board and its responsibilities include:

- reviewing and challenging the performance and conduct of the Group relating to operational risks and delivery of Sustainability goals;
- monitoring and challenging management over the effectiveness of the relevant internal control systems and having access to any audit or assurance report it considers relevant;
- reviewing and assessing management's response to significant operational incidents and having access to any accident and investigation report it considers relevant; and
- monitoring and challenging the appropriateness of Sustainability and operational risk assurance strategies and plans, the execution and results of such plans, and relevant communications.

Heathrow Airport Holdings Limited

Strategic report *continued*

Internal controls and risk management

Internal controls and risk management are key elements of the Group's corporate operations. Risk is centrally managed within the Group as part of Corporate Services provided under the Shared Services Agreement ('SSA') by a fully dedicated senior team. The Corporate risk management function sets the strategy for risk management to provide the necessary framework to ensure that key risks are managed and embeds a sustainable risk management culture that views the execution of risk management processes and practices across Heathrow as a key enabler to Heathrow achieving its business objectives.

Of the four members of the Audit Committee all, including the Chair, are non-executive directors. Together they have appropriate competence in accounting and auditing.

Internal controls

The directors are responsible for the system of internal controls designed to mitigate the risks faced by the Group and for reviewing the effectiveness of the system. This is implemented by applying the Group internal control procedures, supported by a Code of Professional Conduct Policy, appropriate segregation of duties controls, organisational design and documented procedures. These internal controls and processes are designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable, and not absolute, assurance against material misstatements or loss.

The key features of the Group's internal control and risk management systems in relation to the financial reporting process include:

- a group-wide comprehensive system of financial reporting and financial planning and analysis;
- documented procedures and policies;
- defined and documented levels of delegated financial authority;
- an organisational structure with clearly defined and delegated authority thresholds and segregation of duties;
- a formal risk management process that includes the identification of financial risks;
- detailed reviews by the Executive Committee and the Board of monthly management accounts measuring actual performance against both budgets and forecasts on key metrics;
- Audit Committee review of press releases and key interim and annual financial statements, before submission to the Board, scrutinising amongst other items:
 - compliance with accounting, legal, regulatory and lending requirements
 - critical accounting policies and the going concern assumption
 - significant areas of judgement;
- independent review of controls by the Internal Audit function, reporting to the AC; and
- a confidential whistleblowing process.

Risk management

Our aim is to gain a deep understanding of the principal risks we face at all levels of the business and to focus management attention on effective mitigation of these risks as well as a review of over-the-horizon emerging risks which may impact the business and strategy of Heathrow.

We are rolling out a Risk Road Map for 2017/18 and beyond which will focus on improving accountability for enterprise risk management at all levels and drive improvements in our risk culture. The Risk Road Map will cover all the key elements of an effective enterprise risk management framework including risk leadership, informed risk decision making, competency and risk skills, governance including timeliness and transparency of risk information and clarity of accountability for managing risks. We plan to assess and monitor our risk maturity across all key areas and drive improvements where required.

Principal risks

Our principal risks are aligned to our 4 strategic priorities as follows:

- to be a great place to work, we will help our people fulfil their potential and work together to lead change across Heathrow with energy and pride.
- to give passengers the best airport service in the world we'll work with the Heathrow community to transform the service we give to passengers and airlines, improving punctuality and resilience.
- to secure future investment we will beat the Q6 business plan and deliver a competitive return to our shareholders by growing our revenue, reducing costs and delivering investments more efficiently.
- to grow and operate our airport sustainably, now and in the future.

Heathrow Airport Holdings Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

The principal risks identified by the Executive Committee are:

Business resilience

Business resilience risks can relate to Heathrow's assets, infrastructure, human or electronic processes or systems, the failure of which, by accident or deliberate act could result in prolonged periods of interruption to critical services/operations and passenger experience. There are a number of circumstances that can pose short-term risks to the normal operations at the airport such as shocks to the macroeconomic environment, terrorism, wars, airline bankruptcies, human health scares, weather conditions and natural disasters whose cause may be remote from Heathrow's location. These conditions can have a particularly significant impact where, due to operating close to full capacity, there is negligible spare capacity to utilise in recovering from some of the above conditions.

Where possible the Group seeks to anticipate the effects of these events on its operations and also maintains contingency plans to minimise disruption and passenger inconvenience working as necessary with those parties who have direct contractual responsibility. Through a series of programmes the Group seeks to keep a competent, flexible and motivated workforce that can respond to a changing business and operating environment. By driving engagement in its people the Group will achieve its goals and give excellent passenger service, avoid safety and security incidents, protect resilience and deliver successful change.

People

Heathrow employs around 6,500 colleagues and, in a complex business such as Heathrow's, there are risks associated with recruiting, screening, motivating, developing and training employees on a large scale, as well as rewarding appropriately and retaining critical talent and ensuring succession plans are in place.

Heathrow has strategies and policies in place to engage and motivate its colleagues so they are excited and challenged by their work environment, accountable and compliant with internal governance, policies and procedures. Heathrow provides great career opportunities, development and training, retaining talent and knowledge and preventing single points of failure.

Corporate social responsibility

Heathrow understands the importance to its business of the communities in which it operates, and through consultation and engagement seeks to ensure that their concerns are taken into account in the operation and planning of Heathrow. It may restrict opportunities to grow and threaten Heathrow's social license to operate if local communities do not believe the airport is managed responsibly or that its economic benefits are optimised without prioritising profits over the long term interests of local communities.

Environmental risk has the potential to impact negatively upon Heathrow's reputation and jeopardise its licence to operate and to grow.

The Group undertakes procurement responsibly and encourages trade and employment opportunities for local communities. Progressive influencing of third parties, stakeholder engagement and community relations programmes are also established.

Proactive environmental management systems and employee training programmes are embedded within operations through clear environmental strategies and resource conservation initiatives. The Group works closely with a range of stakeholders to ensure that it reacts effectively to the challenges posed by the environmental agenda.

Operational risks to the delivery of Responsible Heathrow goals are reviewed and monitored by a separate committee of the Board.

Stakeholders

Poor interactions and relationships with key stakeholders, including partners, suppliers and airlines could negatively impact passenger experience, airport operations, financial performance and Heathrow's reputation.

Heathrow aims to manage its contracts effectively and share with airport partners the information it may hold about their service providers. This is underpinned by robust and responsible procurement practices which consider the resilience and sustainability of suppliers before contracts are commenced with them, as well as frequent monitoring of their operational performance once they commence business with the airport.

Heathrow Airport Holdings Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

Legal, regulation and compliance

Operations at Heathrow airport are currently subject to economic regulatory review by the CAA normally every five years. Its principal risks relate to changes in economic regulations, non-compliance with these and other regulations, licence conditions, financing covenants, contractual requirements and penalties for failing to comply with competition and relevant EU law. Failure to comply with laws and regulations can have far reaching consequences, including loss of license, penalties, claims and litigation, reputational damage and loss of stakeholder confidence.

The risk of an adverse outcome from economic regulatory reviews is mitigated as far as possible by a dedicated project team which ensures full compliance with regulatory requirements, establishes a sound relationship with the regulator and advises the Executive Committee and Board on regulatory matters. Clear policy direction, which includes compulsory awareness training and close support from the internal legal department, reduces the risk of Heathrow breaching laws, regulations and contractual requirements.

Health and safety

Heathrow has a statutory and moral responsibility to ensure that it safeguards the welfare and safety of its people, business partners and the public who may be affected by its activities. Heathrow recognises that a failure to exercise this responsibility effectively also risks operational disruption, inconvenience to passengers and long-term damage to its reputation.

Heathrow's Safety Management System includes risk assessment processes for all activities entailing significant risk and proportionate control measures employed to safeguard everyone impacted by the airport's business. Heathrow also operates robust asset management processes to ensure property and equipment remains safe. Governance, led by the airport's senior management teams, and assurance processes are used to ensure that controls around health and safety risks remain effective and continuous improvement is encouraged.

Security

Heathrow is responsible for ensuring that its assets, infrastructure, human and electronic systems and processes meet the minimum statutory requirements to protect aviation security, deliver high security standards and build confidence with regulators, airlines and passengers. It also needs to ensure that its assets, infrastructure, human and electronic systems are protected from theft, damage or intrusion.

Security risks, including cyber security and terrorism risks, are mitigated by adopting and enforcing rigorous policies and procedures supported by professional training and by investment in leading edge security technology. Heathrow works closely with airlines and government agencies including the police building a framework to establish joint accountabilities for airport security and shared ownership of risk, thus ensuring security measures remain both flexible and proportionate to the prevailing threat environment.

Strategic direction and management of change

Heathrow airport is operating its runways at close to full capacity and failure to secure the necessary Development Consent Order, following a robust consultation process, for the third runway, for which Heathrow is the preferred choice of the UK Government, could lead to increased congestion, passenger delay and lack of opportunity for the UK.

Monitoring developments in the global aviation market and the levels of passenger satisfaction with different airports around the world provides input to the on-going relevance of the Group's strategy. The Group also needs to influence the pace and direction of changes to regulations, legislation, government policy, aviation and the wider economy and ensure that it does not lose airlines' support for expansion.

Heathrow recognises that failure to control key development costs and delivery could damage its financial standing and reputation. There are risks that projects fail to deliver to the agreed quality, specification, time and budget as well as risks that the benefits of change are not realised, return on investments not realised and transformation not delivered.

The planning process for all major national infrastructure projects in the UK sets out a number of steps that the Group needs to go through to obtain development consent to expand Heathrow: a National Policy Statement, a Development Consent Order and public consultation before a final decision is taken by the UK Government for the third runway. The Group's planning process has already begun and it is building an organisation and expertise to ensure this process runs smoothly. Heathrow will undertake extensive consultations with community groups and authorities at a local level and is an active participant in government consultations and other advisory groups.

The risk of unanticipated long-term changes in passenger demand for air travel could lead to a shortfall in revenue and misaligned operational capacity within Heathrow. Since it is not possible to identify the timing or period of such an effect, the Group carries out evaluations through a series of scenario planning exercises.

Heathrow Airport Holdings Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

Strategic direction and management of change *continued*

The regulatory framework requires formal engagement with airline customers. Helping manage the risk of adverse airline relations, all airlines are invited to be represented on engagement fora – e.g. joint steering groups. When feedback is sought or processes are measured, robust steps have been put in place to ensure confidentiality and neutrality of interpretation. In addition, key stakeholders are engaged on a joint planning basis which provides airlines with the opportunity to air views and share plans, thereby ensuring their ongoing requirements are articulated and understood.

Heathrow mitigates project risks through adherence to a robust project process and by a system of assurance, consisting of project and programme reviews before approval and during construction. The process is continually improved incorporating lessons learnt and “best practice” distilled from knowledge sharing with other client programmes, expertise within its supply chain and guidance from professional bodies.

Financial stability

The Board approves prudent treasury policies and delegates certain responsibilities including changes to treasury policies, the approval of funding and the implementation of funding and risk strategy to the Heathrow Finance Committee. Senior management directly control day-to-day treasury operations on a centralised basis.

The treasury function is not permitted to speculate in financial instruments. Its purpose is to identify, mitigate and hedge treasury-related financial risks inherent in the Group's business operations and funding. To achieve this, the Group enters into interest rate swaps, index-linked swaps, cross-currency swaps and foreign exchange contracts to protect against interest rate, inflation and currency risks.

The primary treasury-related financial risks faced by the Group are:

(a) Interest rates

The Group maintains a mix of fixed and floating rate debt. As at 31 December 2016, fixed rate debt after hedging with derivatives represented 97.9% of the Group's total external nominal debt.

(b) Inflation

The Group mitigates the risk of mismatch between Heathrow's aeronautical income and regulatory asset base, which are directly linked to changes in the retail prices index, and nominal debt and interest payments, by the issuance of index-linked instruments.

(c) Foreign currency

The Group uses cross-currency swaps to hedge all interest and principal payments on its foreign currency debt. The Group uses foreign exchange contracts to hedge material capital expenditure in foreign currencies once a project is certain to proceed.

(d) Funding and liquidity

The Group has established both investment grade (at the Heathrow (SP) level) and sub-investment grade (at the Heathrow Finance level) financing platforms for Heathrow. The Heathrow (SP) platform supports term loans, various revolving loan facilities including revolving credit facilities, working capital facilities and liquidity facilities, and Sterling and foreign currency capital markets issuance. All debt is secured and can be issued in either senior (A-/A-) or junior (BBB/BBB) format. Covenants are standardised wherever possible and are monitored on an ongoing basis with formal testing reported to the Audit Committee, the Board and Executive Committee.

Although there can be no certainty that financing markets will remain open for issuance at all times, debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year.

Heathrow Finance has positive cash flows after capital expenditure and interest and expects to have sufficient liquidity to meet all its obligations in full, including capital investment, debt service costs, debt maturities and distributions, up to December 2018. As at 31 December 2016, cash and cash equivalents and term deposits of £666 million, undrawn headroom under revolving credit facilities of £1,150 million, committed term debt financing to be drawn after 31 December 2016 of £550 million and undrawn headroom under liquidity facilities of £620 million.

Heathrow Airport Holdings Limited

Strategic report *continued*

Internal controls and risk management *continued*

Principal risks *continued*

Financial stability *continued*

(e) Counterparty credit

The Group's exposure to credit related losses, in the event of non-performance by counterparties to financial instruments, is mitigated by limiting exposure to any one party or instrument. The Group maintains a prudent split of cash and cash equivalents across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short- and long-term credit ratings. Investment activity is reviewed on a regular basis and generally no cash or cash equivalents are placed with counterparties with short-term credit ratings lower than A-2(S&P)/F1(Fitch). The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with a long-term credit rating below BBB+ (S&P)/BBB+ (Fitch).

On behalf of the Board



John Holland-Kaye
Director

23 February 2017

Heathrow Airport Holdings Limited

Directors' report

The Directors present their Annual report and the audited financial statements for the year ended 31 December 2016.

Principal activities

The principal activity of the Group is as the holding company of a group of companies that owns Heathrow airport and operates the Heathrow Express rail service.

A review of the progress of the Group's business during the year, the key performance indicators, internal controls, principal business risks and likely future developments are contained in the Strategic report on pages 2 to 266.

Results and dividends

The loss after taxation for the financial year amounted to £119 million (2015: £702 million profit).

Dividends of £540 million (2015: £331 million) were paid to ADI Finance 2 Limited during the year. The dividend payments were utilised primarily to fund dividends to the Groups' ultimate shareholders and to repay and service external debt of the Group holding companies.

The statutory results for the year are set out on page 1.

Directors

The directors who served during the year and since the year end were as follows:

Sir Nigel Rudd (Chair)	Resigned 22 June 2016
Lord Deighton (Chair)	Appointed 22 June 2016
Stuart Baldwin	
Benjamin Bao	Appointed 22 September 2016
Christopher Beale	
David Begg (Non-Executive Director)	
Ali Bouzarif	
Akbar Abbas Al Baker	
Javier Echave	Appointed 24 November 2016
Olivier Fortin	
Jorge Gil	
John Holland-Kaye	
Rachel Lomax (Non-Executive Director)	
Ernesto Lopez	
Fidel Lopez	
Mike Powell	
Michael Uzielli	Resigned 17 May 2016
Yan Wang	Resigned 22 September 2016
Juan Carlos Bullon Aleman	Alternate Director
Richard Agutter	Alternate Director
Paul Barr	Alternate Director
Ignacio Aitor Garcia Bilbao	Alternate Director
Samuel Coxe	Alternate Director
Robert Horsnall	Alternate Director
Deven Karnik	Alternate Director
Eric Lachance	Alternate Director
Inigo Meiras	Alternate Director
David Xie	Alternate Director

Resigned 21 December 2016

Heathrow Airport Holdings Limited

Directors' report *continued*

Company Secretary

The company secretary who served during the year and since the year end was Carol Hui.

Employment policies

The Group's employment policies are regularly reviewed and updated to ensure they remain effective. The Group's overall aim is to create and sustain a high performing organisation by building on the commitment of its people.

The Group has defined a set of guiding principles to ensure fair recruitment and selection. The Group continues to aim to recruit, retain and develop high calibre people and has talent and succession management programmes for managerial roles.

The Group is committed to giving full and fair consideration to applicants for employment. Every applicant or employee will be treated equally whatever their race, colour, nationality, ethnic or national origin, sex, marital status, sexual orientation, religious belief, disability, age or community background. The Group actively encourages a diverse range of applicants and commits to fair treatment of all applicants. The Group's investment in learning and development is guided by senior line managers who ensure that the Group provides the learning opportunities to support the competencies that are seen as key to the Group's success.

Disabled persons have equal opportunities when applying for vacancies, with due regard to their aptitudes and abilities. The Group has further procedures to ensure that disabled colleagues are fairly treated in line with the Equality Act (2010). Where employees have become disabled during the course of employment, the Group endeavours to ensure continuing employment through the arrangement of appropriate training.

Employee involvement and consultation is managed in a number of ways including employee surveys, team updates, briefings, road shows and an intranet. Collective bargaining takes place with the unions Unite, PCS and Prospect for those employee groups for which these unions are recognised. The Group is committed to managing people through change fairly.

Together these arrangements aim to provide a common awareness amongst employees of the financial and economic factors affecting the performance of their business. Bonuses paid to employees reflect the financial performance of the business. A Share In Success saver scheme in which eligible employees can save money which the company matches as a contribution in line with business performance has been in place since 2015. In addition, some senior management participate in a long-term incentive plan which also rewards based on group performance.

Donations

The Group's charitable donations for the year amounted to £2 million (2015: £2 million). The beneficiaries of charitable donations, the relevant amounts donated and the activities of these beneficiaries are as follows.

Hillingdon Community Trust (charity number: 1098235)	£1,000,000	Heathrow Airport Limited made a 15 year commitment ending 2017 to make an annual grant of £1 million to the Hillingdon Community Trust. The deed of gift to the Trust carries a requirement that grants must benefit the community in the southern part of the Borough of Hillingdon including Hayes (the wards of Botwell, Townfield and Pinkwell, West Drayton, Yiewsley and the Heathrow Villages).
LHR Airport Communities Trust (charity number: 1058617)	£700,000	Heathrow Airport Limited made donation to the charity LHR Airport Communities Trust, an independently run grant-making charity which operates the Heathrow Community Fund. The fund also received income from the proceeds of noise fines collected by Heathrow. Through the fund grant programme the charity supports significant and positive change for communities near the airport, with a priority on funding projects linked to education, the environment and economic regeneration. The charity also supports airport staff volunteering and fundraising to improve their community for a cause they believe in.
Green Corridor (charity number: 1092093)	£5,000	Green Corridor offers young people the opportunity to expand their skills, experience and qualifications through land-based activities with the primary aim of reducing social exclusion in some of west London's poorest areas.
Dreamflight (charity number: 1117303)	£5,000	Provides children with serious illness or disability with their holiday of a lifetime.

Heathrow Airport Holdings Limited

Directors' report *continued*

Donations *continued*

Heathrow continued fundraising for the benefit of Oxfam during the year, which represented the fourth year of the charity partnership with Oxfam. In January 2017, Heathrow passed the fantastic milestone of having raised £1 million for Oxfam since the beginning of the partnership and in 2016, a total of £447,634 was raised.

Internal controls and risk management

The Group actively manages all identified corporate risks and has in place a system of internal controls designed to mitigate these risks. Details of the Group's internal controls and risk management policies can be found on pages 22 to 26 in the Internal controls and risk management section of the Strategic report.

Financial risk management objectives and policies

The Group's financial risk management objectives and policies, including hedging policies along with the Group's exposure to risk can be found on pages 22 to 26 in the Internal controls and risk management section of the Strategic report.

Directors' indemnity

The Company's Articles of Association provide that, subject to the provisions of the Companies Act 2006, but without prejudice to any protection from liability which might otherwise apply, every director of the Company shall be indemnified out of the assets of the Company against any loss or liability incurred by him in defending any proceedings in which judgement is given in his favour, or in which he is acquitted or in connection with any application in which relief is granted to him by the court for any negligence, default, breach of duty or breach of trust by him in relation to the Company or otherwise in connection with his duties or powers or office.

Auditor

Pursuant to the provisions of section 485 of the Companies Act 2006, a resolution relating to the reappointment of the auditor Deloitte LLP will be proposed within the period set out in section 485 or, Deloitte LLP will be deemed re-appointed where no such resolution is proposed, following the period set out in section 485 in accordance with section 487.

Statement of disclosure of information to the Auditor

Each of the persons who is a director at the date of approval of this Annual report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

On behalf of the Board



Javier Echave
Director

23 February 2017

Company registration number: 05757208

Heathrow Airport Holdings Limited

Directors' responsibilities statement

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and the parent company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 101 "Reduced Disclosure Framework". Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period.

In preparing the parent company financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed, subject to any material departures, disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

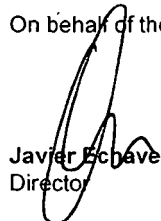
In preparing the group financial statements, International Accounting Standard 1 requires that directors:

- properly select and apply accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance; and
- make an assessment of the company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The directors are responsible for the maintenance and integrity of the corporate and financial information included on the company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

On behalf of the board,



Javier Echave
Director

23 February 2017

Heathrow Airport Holdings Limited

Independent auditor's report to the members of Heathrow Airport Holdings Limited

We have audited the group financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2016 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Statement of Financial Position, the Consolidated Statement of Changes in Equity and the Consolidated Statement of Cash Flows and the related notes 1 to 32. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the group financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the group financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the group financial statements:

- give a true and fair view of the state of the group's affairs as at 31 December 2016 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006 and Article 4 of the IAS Regulation.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Other matter

We have reported separately on the parent company financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2016.

Jacqueline Holden FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK

23 February 2017

Heathrow Airport Holdings Limited

Consolidated income statement for the year ended 31 December 2016

		Year ended 31 December 2016			Year ended 31 December 2015		
		Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items ¹ £m	Total £m	Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items ¹ £m	Total £m
	Note						
Continuing operations							
Revenue	1	2,809	-	2,809	2,767	-	2,767
Operating costs	2	(1,804)	-	(1,804)	(1,848)	236	(1,612)
Other operating items							
Fair value gain on investment properties	9		44	44		95	95
Operating profit	1	1,005	44	1,049	919	331	1,250
Financing							
Finance income	4a	220	-	220	251	-	251
Finance costs	4a	(934)	-	(934)	(919)	-	(919)
Fair value (loss)/gain on financial instruments	4b		(522)	(522)		150	150
		(714)	(522)	(1,236)	(668)	150	(518)
(Loss)/profit before tax		291	(478)	(187)	251	481	732
Tax credit/(charge) before change in tax rate		(71)	88	17	(46)	(89)	(135)
Change in tax rate		-	52	52	-	100	100
Taxation credit/(charge)	5	(71)	140	69	(46)	11	(35)
(Loss)/profit for the year from continuing operations		220	(338)	(118)	205	492	697
(Loss)/profit from discontinued operations ²	6	-	(1)	(1)	-	5	5
(Loss)/profit for the year³		220	(339)	(119)	205	497	702

¹ Certain re-measurements and exceptional items consist of: fair value gains and losses on investment property revaluations and disposals; gains and losses arising on the re-measurement and disposal of financial instruments, together with the associated fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship, the effects of the changes in tax rate, exceptional items; and the associated tax impact of these.

² Includes adjustments relating to the disposal of the NDH1 Group, which was sold in December 2014.

³ Attributable to owners of the parent.

Heathrow Airport Holdings Limited

Consolidated statement of comprehensive income for the year ended 31 December 2016

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
(Loss)/profit for the year		(119)	702
Other comprehensive income:			
<i>Items that will not be subsequently reclassified to the consolidated income statement</i>			
<i>Continuing operations</i>			
Tax relating to retirement benefits ¹	19,25	-	(10)
Actuarial loss on pensions	20,26		
Gain/(loss) on plan assets ²		501	(101)
(Increase)/decrease in scheme liabilities ²		(688)	98
Tax relating to indexation of operational land	19,25,26	1	-
Change in deferred tax due to tax rate change	19,25,26	5	7
<i>Items that may be subsequently reclassified to the consolidated income statement</i>			
<i>Continuing operations</i>			
Available-for-sale investments			
Gain taken to equity	24,25	-	4
Cash flow hedges			
Gains/(losses) taken to equity ²	24,25	263	(131)
Transferred to income statement ²	24,25	(240)	179
Change in deferred tax due to tax rate change	19,24,25	(6)	(9)
Other comprehensive (loss)/income for the year net of tax		(164)	37
Total comprehensive (loss)/income for the year		(283)	739
Attributable to owners of the parent		(283)	739

¹ For the year ended 31 December 2015, related to a £50 million commutation payment for which the Group receives no tax relief.

² Items in the statement above are disclosed net of tax. The tax relating to each component of other comprehensive income is disclosed in Note 25.

Heathrow Airport Holdings Limited

Consolidated statement of financial position as at 31 December 2016

	Note	31 December 2016 £m	31 December 2015 £m
Assets			
Non-current assets			
Property, plant and equipment	8	11,518	11,467
Investment properties	9	2,200	2,156
Intangible assets	10	2,893	2,909
Available-for-sale investments	11	31	31
Retirement benefit surplus	20	-	104
Derivative financial instruments	17	676	173
Trade and other receivables	13	120	116
		17,438	16,956
Current assets			
Inventories	12	11	11
Trade and other receivables	13	237	225
Derivative financial instruments	17	78	-
Term deposits	15	380	550
Restricted cash	14	12	11
Cash and cash equivalents	15	307	199
		1,025	996
Total assets		18,463	17,952
Liabilities			
Non-current liabilities			
Borrowings	16	(13,114)	(12,464)
Derivative financial instruments	17	(1,419)	(1,102)
Deferred income tax liabilities	19	(805)	(960)
Retirement benefit obligation	20	(114)	(28)
Provisions	21	(9)	(2)
Trade and other payables	22	(11)	(13)
		(15,472)	(14,569)
Current liabilities			
Borrowings	16	(1,501)	(986)
Derivative financial instruments	17	(3)	(90)
Provisions	21	(12)	(10)
Current income tax liabilities		(22)	(27)
Trade and other payables	22	(388)	(382)
		(1,926)	(1,495)
Total liabilities		(17,398)	(16,064)
Net assets		1,065	1,888
Equity			
Capital and reserves			
Share capital	23	2,666	2,666
Other reserves	24	(257)	(274)
Retained earnings	26	(1,344)	(504)
Total shareholder's equity		1,065	1,888

These financial statements of Heathrow Airport Holdings Limited (Company registration number: 05757208) were approved by the Board of Directors and authorised for issue on 23 February 2017. They were signed on its behalf by:


John Holland-Kaye
Director


Javier Echave
Director

Heathrow Airport Holdings Limited

Consolidated statement of changes in equity for the year ended 31 December 2016

	Note	Attributable to owners of the Company			
		Share capital £m	Other reserves £m	Retained earnings £m	Total £m
1 January 2015		2,666	(317)	(869)	1,480
Comprehensive income:					
Profit for the year				702	702
Other comprehensive income:					
Fair value gains on:					
Cash flow hedges net of tax	25		48		48
Available-for-sale investments	11,25		4		4
Tax relating to retirement benefits ¹	19,25,26			(10)	(10)
Actuarial loss on pension net of tax:					
Loss on plan assets	25			(101)	(101)
Decrease in scheme liabilities	25			98	98
Change in tax rate	19,25,26		(9)	7	(2)
Total comprehensive income			43	696	739
Transaction with owners:					
Dividends paid to ADI Finance 2 Limited	7,26			(331)	(331)
Total transaction with owners				(331)	(331)
1 January 2016		2,666	(274)	(504)	1,888
Comprehensive income:					
Loss for the year				(119)	(119)
Other comprehensive income:					
Fair value gains on:					
Cash flow hedges net of tax	25		23		23
Actuarial loss on pension net of tax:	20,25				
Gain on plan assets				501	501
Increase in scheme liabilities				(688)	(688)
Tax relating to indexation of operational land	19,25,26			1	1
Change in tax rate	19,25		(6)	5	(1)
Total comprehensive loss			17	(300)	(283)
Transaction with owners:					
Dividends paid to ADI Finance 2 Limited	7,26			(540)	(540)
Total transaction with owners				(540)	(540)
31 December 2016		2,666	(257)	(1,344)	1,065

¹ Relates to a £50 million commutation payment for which the group receives no tax relief.

Heathrow Airport Holdings Limited

Consolidated statement of cash flows for the year ended 31 December 2016

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Cash flows from operating activities			
Cash generated from operations	28	1,643	1,591
Taxation			
Corporation tax paid		(45)	(24)
Group relief (paid)/received ¹		(10)	2
Net cash from operating activities		1,588	1,569
Cash flows from investing activities			
Purchase of:			
Property, plant and equipment		(660)	(595)
Investment properties		-	(7)
Intangible assets		(14)	(25)
Decrease/(increase) in term deposits ²		170	(380)
Other cash movements of discontinued operations ³	6	-	(50)
Utilisation of disposal proceeds ⁴	6	(1)	(6)
Interest received		6	8
Net cash used in investing activities		(499)	(1,055)
Cash flows from financing activities			
Dividends paid to ADI Finance 2 Limited	7	(540)	(331)
Proceeds from issuance of bonds		829	1,022
Repayment of bonds		(761)	(660)
Repayment of subordinated facilities		-	(78)
Drawdown of subordinated facilities		200	125
Issuance of term note		90	150
Repayment of other facilities and other items		(46)	(45)
Swap restructuring		20	-
Settlement of accretion on index-linked swaps		(188)	(213)
Interest paid		(584)	(605)
Net cash used in financing activities		(980)	(635)
Net increase/(decrease) in cash and cash equivalents		109	(121)
Cash and cash equivalents at beginning of year		210	331
Cash and cash equivalents at end of year	15	319	210

¹ Group relief of £2 million was received during the year ended 31 December 2015 from the NDH1 Group, after its disposal in December 2014.

² Term deposits with an original maturity of over three months are invested at Heathrow Airport Limited and Heathrow (AH) Limited.

³ Other cash movements of discontinued operations in 2015 relates to a £50 million pensions commutation payment associated with the Group's disposal of the NDH1 Group which was sold in December 2014.

⁴ Utilisation of disposal proceeds in 2016 relates to £1 million separation costs (2015: £6 million) resulting from the disposal of the NDH1 Group.

Heathrow Airport Holdings Limited

Accounting policies

The principal accounting policies applied in the preparation of these consolidated financial statements of Heathrow Airport Holdings Limited (the 'Company') and its subsidiaries (together the 'Group') are set out below. These policies have been consistently applied to all the years presented, unless stated otherwise.

Statement of compliance

The financial statements have been prepared and approved by the directors in accordance with International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board ('IASB') and as adopted by the European Union ('EU').

The Group

The Company is the holding company of a group of companies that owns Heathrow airport ('Heathrow') and operates Heathrow Express ('HEX'), the express rail service between Heathrow and central London. Heathrow Airport Holdings Limited is a limited liability company incorporated in Great Britain and registered in England and Wales, and domiciled in the UK. Its registered office is The Compass Centre, Nelson Road, Hounslow, Middlesex TW6 2GW.

Basis of accounting

The Group financial statements are prepared in accordance with IFRSs as issued by the IASB and as adopted by the EU and prepared under the historic cost convention, except for investment properties, available-for-sale assets, derivative financial instruments and financial liabilities that qualify as hedged items under fair value hedge accounting. These exceptions to the historic cost convention have been measured at fair value in accordance with IFRS and as permitted by the Fair Value Directive as implemented in the Companies Act 2006.

The Group financial statements are presented in Sterling and are rounded to the nearest million pounds (£m), except when otherwise noted.

Primary financial statements format

The primary financial statements are prepared in accordance with IFRS as adopted by the EU as they apply to the financial statements of the Group for the year ended 31 December 2016.

A columnar approach has been adopted in the income statement and the impact of certain items is shown in a separate column. This column includes certain re-measurements as listed in (i) and (ii) below, which management now separates from the underlying operations of the Group. Also, this column includes exceptional items as listed in (iii) and the effect on taxation of changes in tax rates in (iv) and (v) below. By isolating certain re-measurements and exceptional items, management believes the underlying results provides the reader with a more meaningful understanding of the performance of the Group, by concentrating on the matters over which it exerts influence, whilst recognising that information on these additional items is available within the financial statements, should the reader wish to refer to them.

The column 'certain re-measurements and exceptional items' in the consolidated income statement contains the following items:

- i. fair value gains and losses on investment property revaluations and disposals;
- ii. derivative financial instruments and the fair value gains and losses on any underlying hedged items that are part of a fair value hedging relationship;
- iii. exceptional items (See Note 3 for definition of exceptional items);
- iv. the associated tax impacts of the items in (i), (ii) and (iii) above; and
- v. the impact on deferred tax balances of known future changes in tax rates.

Going concern

The directors have prepared the financial statements on a going concern basis which requires the directors to have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future.

Consequently the directors have reviewed the cash flow projections of the Group taking into account:

- the forecast revenue and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall Group liquidity position, including cash resources, the remaining committed and uncommitted facilities available to it, its scheduled debt maturities, its forecast financial ratios and its ability to access the debt markets (refer to Recent financing activities in the Financial review).

Whilst the Group is in a net current liability position, as a result of the review, and having made appropriate enquiries of management, the directors have a reasonable expectation that sufficient funds will be available to meet the Group's funding requirement for the twelve months following the date when the Statement of financial position was signed.

Changes in accounting policy and disclosures

(a) Amended standards adopted by the Group

During the year, the Group adopted a number of amendments to the IFRSs issued by the IASB that are mandatorily effective for accounting periods beginning on or after 1 January 2016. Their adoption has not had any material impact on the disclosures or on the amounts reported in these financial statements.

Heathrow Airport Holdings Limited

Accounting policies *continued*

Changes in accounting policy and disclosures *continued*

The following amendments, although relevant to the Group, have no impact on the Group's results for the reasons stated:

- Amendments to IAS 1: Disclosure initiative. No financial impact on the Group's results;
- Annual improvements to IFRSs 2012-2014 cycle. The only item of relevance was the discount rate methodology applied for IAS 19, for which the Group already complied with the requirement to apply a high quality corporate bond rate; and
- Amendments to IAS 16 and IAS 38: Clarification of Acceptable Methods of Depreciation and Amortisation. The Group was not affected by this amendment, prohibiting the use of revenue-based depreciation and amortisation methods since the Group uses the straight-line method for depreciation and amortisation for all tangible and intangible fixed assets.

The following amendments are not applicable to the Group:

- Amendments to IFRS 10, IFRS 12 and IAS 28: Investment Entities – The amendments are not applicable as the Group is applying the consolidation exception;
- Amendments to IAS 27: Equity Method in Separate Financial Statements – The amendments are not applicable to the Group as all investments related to subsidiaries are consolidated rather than accounted for under the equity method;
- Amendments to IFRS 11: Accounting for Acquisitions of Interests in Joint Operations – The amendments are not applicable to the Group as there are currently no joint operations owned by the Group; and
- Amendments to IAS 116 and IAS 41: Bearer Plants – The amendments are not applicable to the Group as they only apply to agricultural entities.

(b) Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Group

The following standards, amendments and interpretations, which have not been applied in these financial statements, were in issue but not yet effective (and in some cases had not yet been adopted by the EU):

- IFRS 9 Financial Instruments;
- IFRS 15 Revenue from Contracts with Customers;
- IFRS 16 Leases;
- IFRS 2 (amendments) Classification and Measurement of Share-based Payment Transactions;
- IAS 7 (amendments) Disclosure Initiative;
- IAS 12 (amendments) Recognition of Deferred Tax Assets for Unrealised Losses; and
- IFRS 10 and IAS 28 (amendments) Sale or Contribution of Assets between an Investor and its Associate or Joint Venture.

IFRS 9 *Financial Instruments* is effective for periods beginning on or after 1 January 2018, with early adoption permitted. The adoption of IFRS 9 may widen the ability to hedge account within the Group financial statements and reduce income statement fair value volatility. The Group is currently assessing the impact of the standard on its financial instruments portfolio and is considering whether to early adopt during 2017.

IFRS 15 *Revenue from Contracts with Customers* is effective for periods beginning on or after 1 January 2018. The standard outlines the steps that an entity will take to recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring goods or services to the customer. During 2016 the Group reviewed IFRS 15 to determine the impact (if any) on both revenue recognition and disclosure of contracts, concluding that additional disclosures would be likely and revenue would likely not be materially misstated. The Group continues to evaluate the impact of the standard on its contracts.

IFRS 16 *Leases* is effective for periods beginning on or after 1 January 2019. The standard requires a lessee to recognise an asset and corresponding liability for all leases (subject to certain exemptions). As a lessee, the Group will therefore recognise assets held under operating leases and the corresponding liabilities in its Statement of financial position. The Group has determined that the standard will have an impact on the financial statements, however, the financial effect continues to be evaluated.

Basis of consolidation

The Group financial statements consolidate the financial statements of Heathrow Airport Holdings Limited and all the entities it controls (its subsidiaries) drawn up to 31 December each year.

Subsidiaries

Subsidiaries are consolidated from the date of their acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date that such control ceases. Control is defined as the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

Intra-group balances and transactions are eliminated during the consolidation process.

Heathrow Airport Holdings Limited

Accounting policies *continued*

Segment reporting

Information reported to the Board for the purposes of resource allocation and assessment of segment performance relates to the operations of Heathrow, Heathrow Express and Other operations. The Other operations segment consists of corporate activities and other commercial operations.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts, VAT and other sales-related taxes and consists primarily of:

Aeronautical

- Passenger charges based on the number of departing passengers on departure.
- Aircraft landing charges levied according to noise, emissions and weight recognised on landing.
- Aircraft parking charges based on time parked and whether aircraft are wide or narrow bodied as provided.
- Other charges levied for passenger and baggage operations when these services are rendered.

Retail

- Concession fees from retail and commercial concessionaires at the airport are based upon reported revenue by concessionaires, taking into account contracted minimum guarantees where appropriate, and are recognised in the period to which they relate.
- Car parking income is recognised at the time of exiting the car park in accordance with operator management fee arrangements.

Other Regulated Charges ('ORCs')

- Usage charges made for operational systems (e.g. check-in desks), recognised as each service is provided.
- Charges related to passengers with restricted mobility and various other services recognised at the time of delivery.
- Other invoiced sales, recognised on the performance of the service.

Other

- Property letting rentals recognised on a straight-line basis over the term of the rental period.
- Proceeds from the sale of trading properties, recognised on the unconditional completion of the sale.
- Rail ticket sales, recognised at the time of travel.

Contributions

On occasion, the Group may receive grants to improve airport infrastructure considered to be in the best interest of the public. These are recorded as reductions in the cost of the property, plant and equipment to which they relate.

Exceptional items

The Group separately presents certain items on the face of the income statement as exceptional. Exceptional items are material items of income or expense that, because of their size or incidence, merit separate presentation to allow an understanding of the Group's financial performance. They are not expected to be incurred on a recurring basis.

Such events may include gains or losses on the disposal of businesses or assets that do not qualify as discontinued operations, major reorganisation of businesses, closure or mothballing of terminals and costs incurred in bringing new airport terminal complexes and airfields to operational readiness that are not able to be capitalised as part of the project.

In the year ended 31 December 2015, certain restructuring costs, previously categorised as exceptional, were reclassified as operating costs and re-categorised as such.

Finance income

Finance income is recognised when it is probable that the economic benefits will flow to the Group and the amount of revenue can be measured reliably. Finance income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to the asset's net carrying amount on initial recognition.

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that take a substantial period of time to get ready for their intended use or sale, are capitalised as part of the cost of those assets, until the asset is complete and available for use. Such borrowing costs are capitalised whilst projects are in progress.

Heathrow Airport Holdings Limited

Accounting policies *continued*

Borrowing costs *continued*

Where assets in the course of construction are financed by specific borrowing facilities the interest rate relating to those specific borrowing facilities is used to calculate the amount to capitalise, otherwise an interest rate based on the weighted average cost of debt is used. Capitalisation of interest ceases once the asset is complete and available for use. Interest is then charged to the income statement as a depreciation expense over the life of the relevant asset.

All other borrowing costs, including costs incurred in respect of the maintenance of the Group's credit ratings, are recognised in the income statement in the year in which they are incurred.

Discontinued operations

Discontinued operations consist of a component of the Group that has either been sold during the year or is classified as held-for-sale at year end and represents a separate major line of business or geographical area of operations, or is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operation.

Property, plant and equipment

Operational assets

Terminal complexes, airfield assets, plant and equipment, rail assets and other land and buildings are stated at cost less accumulated depreciation and accumulated impairment losses. An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected. Any gain or loss arising on the derecognition of the asset is included in the income statement in the period of derecognition.

Assets in the course of construction include qualifying costs in respect of the Heathrow Expansion following the Government decision and subsequent Board decision to apply for the Development Consent Order. Assets in the course of construction are stated at cost less any impairment. Assets in the course of construction are transferred to completed assets when substantially all the activities necessary to get the asset ready for use are complete and the asset is available for use. Where appropriate, cost includes borrowing costs capitalised (see "Borrowing Costs" policy), own labour costs of construction-related project management and directly attributable overheads. Costs associated with projects that are in the early stages of planning are capitalised where the directors are satisfied that it is probable the necessary consents will be received and the projects will be developed to achieve a successful delivery of an asset such that future commercial returns will flow to the Group. The Group reviews these projects on a regular basis to determine whether events or circumstances have arisen that may indicate that the carrying amount of the asset may not be recoverable, at which point the asset would be assessed for impairment.

The Government's decision and approval by the Board as a viable project in October 2016, in favour of expansion at Heathrow, was considered by management to be a trigger point for the expansion project to proceed. This was followed by management's announcement to apply for planning permission, in the belief that it is highly probable that expansion at Heathrow will be realised. As a result, the Group has started to capitalise eligible costs as 'assets in the course of construction'.

Heathrow Airport Holdings Limited

Accounting policies *continued*

Depreciation

Depreciation is provided on operational assets, other than land and assets in the course of construction, to write off the cost of the assets less estimated residual value, by equal instalments over their expected useful lives as set out below:

	<i>Fixed asset lives</i>
<i>Terminal complexes</i>	
Terminal building, pier and satellite structures	20–60 years
Terminal fixtures and fittings	5–20 years
<i>Airport plant and equipment</i>	
Baggage systems	15 years
Screening equipment	7 years
Lifts, escalators and travelators	20 years
Other plant and equipment, including runway lighting and building plant	5–20 years
Tunnels, bridges and subways	50–100 years
<i>Airport transit systems</i>	
Rolling stock	20 years
Track	50 years
<i>Airfields</i>	
Runway surfaces	10–15 years
Runway bases	100 years
Taxiways and aprons	50 years
<i>Rail</i>	
Rolling stock	8–40 years
Tunnels	100 years
Track metalwork	5–10 years
Track bases	50 years
Signals and electrification work	40 years
<i>Plant and equipment</i>	
Motor vehicles	4–8 years
Office equipment	5–10 years
Computer equipment	4–5 years
<i>Other land and buildings</i>	
Short leasehold properties	Over period of lease
Leasehold improvements	Lower of useful economic life or period of lease

In certain circumstances, the asset life may fall outside of the boundaries disclosed above.

Asset residual values and useful lives are reviewed and adjusted, if appropriate, at each reporting date.

Impairment of assets (excluding goodwill)

The Group assesses, at each reporting date, whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Group estimates the asset's recoverable amount. Where the asset does not generate cash flows independent of other assets, the recoverable amount of the cash-generating unit to which the asset belongs is estimated. The recoverable amount is the higher of an asset's fair value less costs of disposal and its value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where the carrying amount of a cash-generating unit exceeds its recoverable amount, the cash-generating unit is considered impaired and is written down to its recoverable amount.

Investment properties

Investment property, which is property held to earn rentals and/or for capital appreciation, is initially measured at cost and subsequently stated at fair value at the reporting date, as determined by the directors and supported by external valuers every year. Gains or losses arising from changes in the fair value of investment property are recognised in the income statement in the period in which they arise.

Gains or losses on disposal of an investment property are recognised in the income statement on the unconditional completion of the sale.

Goodwill

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the costs of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities if the fair value of the contingent liabilities can be measured reliably at the acquisition date. These identifiable assets, liabilities and any contingent liabilities are grouped together in cash generating units which are organised and managed separately. Goodwill arising on acquisition of subsidiaries is capitalised as an intangible asset and carried at cost less accumulated impairment losses. Goodwill is not amortised but is subject to an impairment review at least annually or more frequently if there is an indication that the carrying value of goodwill may be impaired and indicators of potential impairment are ordinarily market based. Any impairment is recognised immediately in the income statement.

Heathrow Airport Holdings Limited

Accounting policies *continued*

Goodwill *continued*

An impairment loss recognised in respect of goodwill is not reversed in a subsequent period. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Internally-generated intangible assets

Development expenditure incurred in respect of individual projects is capitalised when the future economic benefit of the project is probable and is recognised only if all of the following conditions are met:

- the Group can demonstrate the technical feasibility of completing the intangible asset so that it will be available for use or sale; and
- the Group can demonstrate how the intangible asset created will generate future economic benefits; and
- the Group has available the resources to complete the asset; and
- the Group intends to complete that asset and has the future ability to sell or use the asset; and
- the development cost of the intangible asset can be measured reliably.

Following initial recognition of the development expenditure as an asset, the cost model is applied requiring the asset to be held at cost less any accumulated amortisation and impairment. Amortisation begins when development is complete and the asset is ready for use.

This type of expenditure primarily relates to internally developed software and website projects and these are amortised on a straight-line basis over their useful lives of three to seven years. During the period of development, the asset is tested for impairment annually.

Where no internally-generated intangible asset can be recognised, development expenditure is recognised as an expense in the period in which it is incurred.

Expenditure on research activities is recognised as an expense in the period in which it is incurred.

Purchased intangible assets (software costs)

Computer software costs principally relate to operating and financial software. These assets are amortised over a period of between four and fifteen years. Amortisation for the year is charged through operating costs. The assets are assessed for impairment whenever there is indication that the intangible asset may be impaired.

Leases

The determination of whether an arrangement is or contains a lease is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset.

Group as a lessee

Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease with a corresponding liability being recognised at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term if there is no reasonable certainty that the Group will obtain ownership by the end of the lease term.

Leases where the lessor retains a significant portion of the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

In the event that lease incentives are received to enter into operating leases, such incentives are recognised as a liability. The aggregate benefit of incentives is recognised as a reduction of rental expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed.

Group as a lessor

Leases where the Group retains substantially all the risks and benefits of ownership of the asset are classified as operating leases and with the exception of investment properties discussed above, the assets are included in property, plant and equipment and depreciated over their estimated useful lives. Rental income from operating leases is recognised on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same basis as the rental income.

Inventories

Inventories are stated at the lower of cost and net realisable value.

Heathrow Airport Holdings Limited

Accounting policies *continued*

Restricted cash

Cash that can only be used for a specific purpose or where access is restricted is classified as restricted cash.

Cash and cash equivalents

For the purposes of the Statement of financial position, cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less. For the Consolidated statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

Term deposits

Term deposits with an original maturity of over three months are shown separately on the Statement of financial position and Statement of cash flows.

Deferred income

Amounts received prior to the delivery of goods and services are recorded as deferred income and released to the income statement as they are provided.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Provisions are measured at the best estimate of the expenditure required to settle the obligation at the reporting date and are discounted, where material, to present value using a current, pre-tax rate that reflects, where appropriate, the risks specific to the liability.

Restructuring

A restructuring provision is recognised when the Group has developed a detailed formal plan for the restructuring and has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement the plan or announcing its main features to those affected by it. The measurement of a restructuring provision includes only the direct expenditures arising from the restructuring, which are those amounts that are both necessarily entailed by the restructuring and not associated with the on-going activities of the entity.

Home loss payments

A home loss payments provision is recognised where, an obligation arises during the year, as a result of a past event. The home loss payment provision is in respect of historic property purchases and related expenditures created in 2016 specifically in respect of Heathrow Expansion, following the Government's decision in October 2016.

Financial instruments

Trade and other receivables

Trade receivables, which generally have 30-90 day terms, are recognised and carried at the lower of their original invoiced value and recoverable amount. Where the time value of money is material, receivables are carried at amortised cost. Provision is made when there is objective evidence that the Group will not be able to recover balances in full. Balances are written off when the probability of recovery is remote.

Investments

Financial assets within the scope of IAS 39 are classified as financial assets at fair value through the income statement, loans and receivables, held-to-maturity investments, available-for-sale financial assets, or as derivatives designated as hedging instruments in an effective hedge, as appropriate. The Group determines the classification of its financial assets at initial recognition.

On initial recognition, financial assets are measured at fair value, plus, in the case of investments not at fair value through the income statement, directly attributable transaction costs. After initial recognition, investments that are classified as 'held-for-trading' and 'available-for-sale' are measured at fair value. Fair value gains or losses on investments held-for-trading are recognised in the income statement. Fair value gains or losses on available-for-sale investments are recognised in a separate component of equity until the investment is sold, collected or otherwise disposed of, or until the investment is determined to be impaired, at which time the cumulative fair value gain or loss previously reported in equity is included in the income statement. In the case of equity securities classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered an indication that the security is impaired. If impairment is indicated, the cumulative fair value gain or loss previously reported in equity is included in the income statement.

Assets classified as 'loans and receivables' or 'held-to-maturity' are recognised in the statement of financial position at their amortised cost, using the effective interest method, less any provision for impairment.

Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market are classified as 'loans and receivables' and are carried at amortised cost using the effective interest method. Non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intent and ability to hold-to-maturity are classified as 'held-to-maturity' and are carried at amortised cost using the effective interest method. For investments carried at amortised cost, gains and losses are recognised in the income statement when the investments are de-recognised or impaired, as well as through the amortisation process.

Heathrow Airport Holdings Limited

Accounting policies continued

Financial instruments continued

Investments continued

For investments that are traded in an active market, fair value is determined by reference to quoted market bid prices at the reporting date. For investments where there is no quoted market price, fair value is determined by using valuation techniques, such as estimated discounted cash flows, or by reference to the current market value of similar investments.

Purchases and sales of investments are recognised on trade-date being the date on which the Group commits to purchase or sell the asset.

Investments are classified as held-for-sale if their carrying amount will be recovered principally through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable, the asset is available for immediate sale in its present condition, management are committed to the sale and the sale is expected to be completed within one year of the date of classification. Assets classified as held-for-sale cease to be depreciated and are measured at the lower of carrying amount and fair value less selling costs.

A financial asset is derecognised when i) the rights to receive cash flows from the asset have expired or ii) the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party.

The Group assesses at each reporting date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Financial liabilities and equity

Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that provides a residual interest in the assets of a business after deducting all other liabilities.

Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost unless part of a fair value hedge relationship. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method. Borrowings being novated or cancelled and re-issued, with a substantial modification of the terms, are accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability, with any resulting gain or loss recognised in the income statement.

For index-linked borrowings, the nominal amount is adjusted for movements in the relevant price index. This accretion expense is recorded within finance costs in the income statement.

Debt issue costs

Prepaid fees in relation to the future issuance of debt are held on the statement of financial position on the basis that such issuance is considered probable. If issues do not occur, or are deemed not to be probable, such fees are recognised in the income statement.

Trade and other payables

Trade and other payables are non-interest bearing and are stated at their fair value and subsequently measured at amortised cost using the effective interest method.

Derivative financial instruments and hedging activities

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

The Group designates certain derivatives as either:

- fair value hedges, where they hedge exposure to changes in the fair value of the hedged asset or liability; or
- cash flow hedges, where they hedge exposure to variability in cash flows that are attributable to a particular risk associated with any changes in the fair value of the hedged asset, liability or forecasted transaction.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objectives and strategy for undertaking various hedging transactions. The Group also documents, both at hedge inception and on an on-going basis, its assessment of whether the derivatives used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

The fair value of a derivative is classified as a non-current asset or liability when the remaining maturity is more than 12 months and as a current asset or liability where it is less than 12 months.

Heathrow Airport Holdings Limited

Accounting policies continued

Financial instruments continued

Novations of financial instruments

Derivative financial instruments novated from other companies within the Heathrow Airport Holdings Group are transferred at fair value prevailing on that date.

Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised in the income statement over the period to maturity.

Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When or if a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

Derivatives at fair value through the income statement

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of these derivative instruments are recognised immediately in the income statement.

When derivatives are designated in a hedge relationship, the net interest payable or receivable on those derivatives is recorded net of the interest on the underlying hedged item in the income statement. When derivatives are not in a hedge relationship, the fair value changes on these derivatives are recognised within fair value gains/(losses) on financial instruments in the income statement. The interest payable and receivable on those derivatives are recorded at their gross amount in finance costs and finance income in the income statement.

Accounting for changes in credit risk

Accounting standards require that the fair value of financial instruments reflects their credit quality, and also changes in credit quality where there is evidence that this has occurred. The credit risk associated with the Group's derivatives is updated quarterly based on current market data.

Employment costs

The Group's airport incurs the cost of people which are contractually employed by LHR Airports Limited but provide services to the operation of the airport. Charges in relation to employment costs include wages and salaries, pension costs, medical costs and redundancy payments, as well as any other associated expenses properly incurred by the employees of LHR Airports Limited in providing the services.

Centralised services

LHR Airports Limited is considered to be acting as principal in relation to the services of the HAHL Group CEO, the HAHL Group CFO, the HAHL Chairman and HAHL non-executive board members and Ferrovial advisory services. These costs are recharged to Heathrow Airport Limited (the only remaining airport party to the SSA) with a mark-up of 7.5%. Other services are paid for and sourced directly by Heathrow Airport Limited, either without the Company's involvement or on a pass through fixed mark up only basis (agent). This judgement has been reached following consideration of whether the Company has been exposed to the majority of the significant benefits and risks associated with the exchange transaction.

Pension costs

Heathrow Airport Limited and Heathrow Express Operating Company Limited ('HEX') have an obligation to fund or benefit from their share of the LHR Airports Limited defined benefit pension scheme (or 'BAA Pension Scheme') deficit or surplus and Unfunded Unapproved Retirement Benefit Scheme and Post-Retirement Medical Benefits pension related liabilities under the SSA. Previously when part of a group with multiple operations, these provisions or assets were based on the relevant share of the scheme deficit or surplus and allocated on the basis of pensionable salaries. Movements in these provisions or assets arose due to current service costs, net finance costs or income, employer cash contributions and actuarial gains or losses. Heathrow Airport Limited and HEX recorded their share of the net actuarial gain or loss for the year as an exceptional item due to their size and nature.

Heathrow Airport Holdings Limited

Accounting policies continued

Pension costs continued

Following the disposal of Aberdeen, Glasgow and Southampton airports ('NDH1' group) in December 2014, the directors reassessed the Group's relationship with the legal sponsor of the retirement benefit schemes (LHR Airports Limited) given that the HAH Group's sole operating airport is now Heathrow. The directors determined, after taking into account the Shared Service Agreement, employment relationships and the funding risk associated with the schemes, that Heathrow Airport Limited, and consequently the Group, now acts as principal in relation to these schemes. As a result, the Group now recognises an external asset or liability, in relation to the schemes, on its statement of financial position, as non-current under the caption of Retirement benefit surplus/obligations. Additionally, it is now considered appropriate for the Group to record actuarial gains and losses on the external scheme within other comprehensive income rather than the income statement. There was no impact on cash or net asset in 2015 as a result of this change as it was not considered to be a change in the accounting policy as the change arose as a result of the disposal of the NDH1 group in December 2014. Consequently, there was no restatement of financial information in the prior year.

The cost of providing benefits under the defined benefit pension scheme is determined using the projected unit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of the defined benefit obligation) and is based on actuarial advice. Past service costs are recognised in the income statement on a straight-line basis over the vesting period or immediately if the benefits have vested. When a settlement or curtailment occurs, the obligation and related plan asset are remeasured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest element of the defined benefit cost represents the change in present value of scheme obligations resulting from the passage of time, and is determined by applying the discount rate to the opening present value of the benefit obligation, taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long-term market returns on scheme assets, adjusted for the effect on the fair value of plan assets of contributions received and benefits paid during the year. The difference between the expected return on plan assets and the interest cost is recognised in the income statement as other finance income or cost.

The Group recognises actuarial gains and losses in full in other comprehensive income in the period in which they occur.

The defined benefit pension asset or liability in the statement of financial position comprises the total for each plan of the present value of the defined benefit plan obligation (using a discount rate based on high-quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net defined benefit pension asset is restricted to the sum of any unrecognised past service costs and the present value of any amount the Group expects to recover by way of refunds from the plan or reductions in future contributions.

Contributions to defined contribution pension schemes are recognised in the income statement in the period in which they become payable.

Current and deferred income tax

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income. In this case, the tax is recognised in other comprehensive income.

Current tax liabilities are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

Deferred income taxation is provided in full using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Group's financial statements, at rates expected to apply when they crystallise, based on current tax rates and law. Deferred income taxation is not provided on the initial recognition of an asset or liability in a transaction, other than a business combination, if at the time of the transaction there is no effect on either accounting or taxable profit or loss. Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets and liabilities are not discounted.

Deferred income taxation is determined using the tax rates and laws that have been enacted, or substantively enacted, during the year and are expected to apply in the periods in which the related deferred tax asset or liability is realised or settled.

Heathrow Airport Holdings Limited

Accounting policies *continued*

Share capital

Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs, allowing for any reductions in the par value. Where shares are issued above par value, the proceeds in excess of par value are recorded in the share premium account.

Dividend distribution

A dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the shareholders' right to receive payment of the dividend is established. Interim dividends are recognised when paid.

Foreign currency

The consolidated financial statements are presented in Sterling, which is the parent company's functional currency.

Transactions denominated in foreign currencies are initially recorded in the entity's functional currency using the exchange rates prevailing at the dates of transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated into Sterling at the rates of exchange ruling at the reporting date. Differences arising on translation are charged or credited to the income statement.

Heathrow Airport Holdings Limited

Significant accounting judgements and estimates

In applying the Group's accounting policies, management have made judgements and estimates in a number of key areas. Actual results may, however, differ from the estimates calculated and management believes that the following areas present the greatest level of uncertainty.

Critical judgements in applying the Group's accounting policies

Capitalisation

Management are required to make judgements in relation to the capitalisation of costs. This relates to both when amounts may begin to be capitalised, where there may be doubt about planning consent or the ultimate completion of the asset, and in relation to the nature of costs incurred. Examples where judgement has been exercised in the year include capitalised interest, where judgement is exercised in relation to the applicable interest rate, the assessment of assets in the course of construction, including expansion costs, projects on hold and operational activities where judgement is exercised to determine costs that are directly attributable to the assets under construction.

Hedge accounting

Certain interest rate swaps are designated in a cash flow hedge relationship to hedge the exposure to variability in cash flows of forecast transactions or existing liabilities. Management compares on a regular basis existing and historic hedging arrangements against expectations for future Sterling re-financing. If there were significant changes in the expected quantum of future Sterling re-financing, then levels may be insufficient to support components of the cash flow hedge reserve, requiring the recycling of the cash flow hedge reserve through the income statement. As at 31 December 2016, £333 million of fair value losses (2015: £369 million) on these derivatives have been deferred into the cash flow hedge reserve.

Key sources of estimation uncertainty

Fair value of derivative financial instruments

The fair value of derivative financial instruments is calculated using a discounted cash flow approach and using inputs based on observable market data. Judgement is used to determine the recovery rate and associated reduction in credit risk of super senior ranking derivatives. Details of the carrying value and sensitivities are available in Note 17 and 18, respectively.

Investment properties

Investment properties are fair valued by CBRE Limited, Chartered Surveyors. The valuations are prepared in consideration of IFRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations are carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) is capitalised using yields derived from market evidence. This market evidence also takes into account planned transactions and use of the property (for example the future expansion of Heathrow). Approximately 80% (2015: 80%) of the investment properties comprise airport car parks and airside assets that are considered less vulnerable to market volatility than the overall market. Independent valuations are obtained for all investment properties. Further details are available in Note 9.

Pensions

Certain assumptions have been adopted for factors that determine the valuation of the Group's liability for pension obligations at period end and charges to the income statement. The factors have been determined in consultation with the Group's actuary taking into account market and economic conditions. Changes in assumptions can vary from period to period as a result of changing conditions and other determinants which may cause increases or decreases in the valuation of the Group's liability for pension obligations. The objective when setting pension scheme assumptions for future periods is to reflect the expected actual outcomes, other than the discount rate which must be set by reference to the yield on high quality corporate bonds with a term consistent with the obligations. The impact of the change in assumptions on the valuation of the net financial position of the Group pension scheme is recorded as a net actuarial gain or loss and is reflected in the statement of comprehensive income. Further details are available in Note 20.

Heathrow Airport Holdings Limited

Notes to the Group financial statements

1 Segment information

As described in the accounting policies on page 39, the Group is organised into business units according to the nature of the services and has the following reportable operating segments as follows:

- Heathrow (aeronautical, retail, other regulated charges ("ORCs"))
- Heathrow Express (rail income)
- Other operations (corporate activities and other commercial operations)

The performance of the above segments is measured on a revenue and Adjusted EBITDA basis, before certain re-measurements and exceptional items.

The reportable segments derive their revenues from a number of sources including aeronautical, retail, other regulated charges ('ORCs') and other products and services (including rail income), and this information is also provided to the Board on a monthly basis.

Table (a) details total revenue from external customers for the year ended 31 December 2016 and is broken down into aeronautical, retail, ORCs and other in respect of the reportable segments. No information in relation to inter-segmental revenue is disclosed as it is not considered material. Also detailed within table (a) is Adjusted EBITDA which is earnings before interest, tax, depreciation, amortisation, certain re-measurements and exceptional items.

Table (b) details comparative information to table (a) for the year ended 31 December 2015.

Table (c) details depreciation and amortisation, fair value adjustments, and profit and loss on disposals by reportable segment.

Table (d) details asset, liability and capital expenditure information by reportable segment. The assets and liabilities information by segment is not provided to the Board on a monthly basis, but is included in this note as additional information.

Section (e) details revenue and non-current asset information by geographical segment.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

1. Segment information *continued*

Table (a) Year ended 31 December 2016	Segment revenue					Adjusted EBITDA £m
	Aeronautical £m	Retail £m	ORCs £m	Other £m	Total external revenue £m	
Heathrow	1,699	612	232	130	2,673	1,616
Heathrow Express	-	-	-	134	134	66
	1,699	612	232	264	2,807	1,682
Other operations	-	-	-	2	2	1
Total continuing operations	1,699	612	232	266	2,809	1,683
Reconciliation to statutory information:						
Unallocated income and expense						
Depreciation and amortisation (table (c))						(678)
Operating profit (before certain re-measurements and exceptional items)						1,005
Fair value gain on investment properties (certain re-measurements) (table (c))						44
Operating profit						1,049
Finance income						220
Finance costs						(934)
Fair value loss on financial instruments (certain re-measurements)						(522)
Loss before tax						(187)
Taxation before certain re-measurements						(71)
Taxation (certain re-measurements)						140
Taxation						69
Loss for the year - continuing operations						(118)
Loss from discontinued operations ¹						(1)
Loss for the year						(119)

¹ For the year ended 31 December 2016, there were no disposals of discontinued operations but the Company incurred £1 million additional costs following the disposal of the NDH1 Group in December 2014.

Revenue of £909 million was derived from a single external customer and has been included within the Heathrow segment.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

1 Segment information *continued*

Table (b)
Year ended 31 December
2015

	Segment revenue				Total external revenue £m	Adjusted EBITDA £m
	Aeronautical £m	Retail £m	ORCs £m	Other £m		
Heathrow	1,699	569	239	124	2,631	1,528
Heathrow Express	-	-	-	132	132	80
	1,699	569	239	256	2,763	1,608
Other operations	-	-	-	4	4	-
Total continuing operations	1,699	569	239	260	2,767	1,608

Reconciliation to statutory information

Unallocated income and expense

Depreciation and amortisation (table (c)) (689)

Operating profit (before certain re-measurements and exceptional items) 919

Exceptional items 236

Fair value gain on investment properties (certain re-measurements) (table (c)) 95

Operating profit 1,250

Finance income 251

Finance costs (919)

Fair value gain on financial instruments (certain re-measurements) 150

Profit before tax 732

Taxation before certain re-measurements and exceptional items (46)

Taxation (certain re-measurements and exceptional items) 11

Taxation (35)

Profit for the year – continuing operations 697

Profit from discontinued operations¹ 5

Profit for the year 702

¹ For the year ended 31 December 2015, there were no disposals of discontinued operations but the Group realised £5m from the release of surplus disposal provisions made in the previous year.

Revenue of £903 million was derived from a single external customer and has been included within the Heathrow segment.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

1 Segment information *continued*

Table (c)

	Year ended 31 December 2016		Year ended 31 December 2015	
	Depreciation & amortisation ¹	Fair value gain ²	Depreciation & amortisation ¹	Fair value gain ²
	£m	£m	£m	£m
Heathrow	(636)	44	(642)	95
Heathrow Express	(42)	-	(47)	-
Total	(678)	44	(689)	95

¹ Includes intangible asset amortisation charges of £41 million (2015: £39 million).

² Reflects fair value gains on investment properties only.

Table (d)

	31 December 2016			31 December 2015		
	Assets ¹	Liabilities	Capital expenditure ²	Assets ¹	Liabilities	Capital expenditure
	£m	£m	£m	£m	£m	£m
Heathrow	15,970	(359)	669	15,797	(328)	578
Heathrow Express	916	(6)	11	994	(9)	8
	16,886	(365)	680	16,791	(337)	586
Other operations	93	(55)	-	93	(70)	-
Total operations	16,979	(420)	680	16,884	(407)	586
Unallocated assets and liabilities:						
Term deposits	380	-	-	550	-	-
Cash, borrowings and available-for-sale investments	350	(14,615)	-	241	(13,450)	-
Derivative financial instruments	754	(1,422)	-	173	(1,192)	-
Retirement benefit surplus/(obligations)	-	(114)	-	104	(28)	-
Taxation	-	(827)	-	-	(987)	-
Total	18,463	(17,398)	680	17,952	(16,064)	586

¹ Segment assets include primarily airport runways and facilities as well as goodwill allocated to the reportable segments.

² Capital expenditure excludes the impact of Capital auditors.

Section (e)

Heathrow Airport Holdings Limited is domiciled in the UK. All revenue from external customers for continuing operations comes from the UK which for the year ended 31 December 2016 was £2,809 million (2015: £2,767 million). The breakdown of the major components of total revenue from external customers is shown in tables (a) and (b) above.

Non-current assets excluding derivative financial instruments were £16,762 million (2015: £16,783 million). There were no non-current assets held outside the UK (2015: £nil).

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

2 Operating costs – continuing operations

Operating costs comprise:

	Year ended 31 December 2016 £m	Year ended 31 December 2015 ¹ £m
Employment		
Wages and salaries	330	326
Social security	33	29
Pension	37	55
Other staff related costs	21	27
Own staff costs capitalised	(39)	(38)
	382	399
Operational	266	254
Maintenance	177	187
Rates	128	123
Utilities	74	93
Other	99	103
Operating costs before depreciation, amortisation and exceptional items	1,126	1,159
Depreciation and amortisation		
Property, plant and equipment	637	650
Intangible assets	41	39
	678	689
Operating costs before exceptional items	1,804	1,848
Exceptional items (Note 3)	-	(236)
Total operating costs	1,804	1,612

¹ For the year ended 31 December 2015, £11 million of costs previously included under 'Other' have been re-classified into 'Operational' to be consistent with current year disclosures.

Rentals under operating leases

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Operating costs include:		
Land and buildings ^{1,2}	17	35
Others ³	15	16
Total rentals under operating leases	32	51
Property lease and sub-lease charges – minimum lease payments	14	12

¹ The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The amounts above are stated net of discounts.

² A significant portion of the operating rental costs relates to electricity supply equipment at the airport leased on agreement with UK Power Networks Services Limited ('UKPNS').

³ Others mainly comprises of wayleaves and easements.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

2 Operating costs – continuing operations *continued*

Auditor's remuneration

Audit fees and non-audit fees for the current and preceding financial years were borne by Heathrow Airport Limited.

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Fees payable to the Company's auditor for the audit of the Group's annual accounts		
Audit of the Company's ultimate parent and its subsidiaries, pursuant to legislation ¹	0.4	0.4
Total audit fees	0.4	0.4
Fees payable to the Company's auditor and their associates for other services specific to the Group		
Audit related assurance services	0.1	0.1
Other assurance services	0.1	0.2
Total non-audit fees	0.2	0.3
Total fees	0.6	0.7

¹ Fees payable to the Company's auditors for the audit of the Company's annual accounts was £62,000 (2015: £59,000).

Employee numbers

The average number of employees of the Group was 6,553 (2015: 6,714).

	Year ended 31 December 2016	Year ended 31 December 2015
<i>United Kingdom</i>		
Heathrow	5,938	6,104
Other operations	615	610
Total	6,553	6,714

Management and Directors' remuneration

	Year ended 31 December 2016 £'000	Year ended 31 December 2015 £'000
Key management compensation¹		
Salaries and short-term employee benefits ^{2,3}	7,513	8,351
Sum paid to related parties for directors' services	1,200	1,200
Termination benefits	-	579
	8,713	10,130

¹ Key management of the Company is the Board of Directors and members of the Executive Committee of Heathrow Airport Holdings Limited who control and direct the Group's operational activities and resources.

² For the year ended 31 December 2016 salaries and benefits includes salaries, allowances, director fees, company pension contributions, accrued bonuses and amounts payable under long term incentive plans ('LTIP').

³ £2,662,000, of bonus was paid in cash in 2016 (2015: £2,780,000).

Key management participates in various Long Term Incentive Performance Cash Plans. In respect of the Plans, a cash amount is granted which could vest in future periods contingent on achieving or surpassing EBITDA, Return on Equity and other operational targets over a three year period. The directors' remuneration in 2016 includes £1,406,000 which will be paid in 2019 if the targets are fully met. In 2016, £740,000 was paid.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

2 Operating costs – continuing operations *continued*

Directors' remuneration

	Year ended 31 December 2016	Year ended 31 December 2015
	£'000	£'000
Aggregate emoluments ^{1,2}	3,059	3,555
Sums paid to related parties for Directors' services	1,200	1,200
Termination benefits	-	575
	4,259	5,330

¹ For the year ended 31 December 2016 aggregate emoluments includes salaries, allowances, director fees, accrued bonuses and amounts payable under long term incentive plans ('LTIP').

² £1,012,000 of bonus was paid in cash in 2016 (2015: £1,252,000).

The directors participate in various Long Term Incentive Performance Cash Plans. In respect of the Plans, a cash amount is granted which could vest in future periods contingent on achieving or surpassing EBITDA, Return on Equity and other operational targets over a three year period. The directors' remuneration in 2016 includes £563,000 which will be paid in 2019 if the targets are fully met. In 2016, £143,000 was paid.

During the year, none of the directors (2015: none) had retirement benefits accruing to them under a defined benefits scheme and three of the directors (2015: two) had retirement benefits accruing to them under a defined contribution scheme.

None of the directors (2015: none) exercised share options during the year in respect of their services to the Group and no shares (2015: none) were received or became receivable under long term incentive plans.

Highest paid director

	Year ended 31 December 2016	Year ended 31 December 2015
	£'000	£'000
Salary and allowances	896	885
Bonus accrued	599	700
Amount accrued under LTIP	483	476
	1,978	2,061

During the year, the highest paid director had retirement benefits accruing to him under a defined contribution scheme and no retirement benefits accruing to him under a defined benefit scheme. £861,000 of bonus was paid in cash in 2016 (2015: £581,000).

The highest paid director participates in various Long Term Incentive Performance Cash Plans. In respect of the Plans, a cash amount is granted which could vest in future periods contingent on achieving or surpassing EBITDA, Return on Equity and other operational targets over a three year period. The highest paid director's remuneration in 2016 includes £483,000 which will be paid in 2019 if the targets are fully met. In 2016, £143,000 was paid.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

3 Exceptional items – continuing operations

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Pensions past service credit: change to terms	-	236
Exceptional items before income tax	-	236
Tax charge on exceptional items	-	(45)
Total exceptional items after tax	-	191

Pensions

In the year ended 31 December 2015, the Company agreed changes to the defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members which resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under IAS19, and is classified as an exceptional item in the income statement. There was no immediate cash flow impact as a result of these changes.

4 Financing – continuing operations

(a) Net finance costs before certain re-measurements

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Finance income		
Income from available-for-sale financial assets	1	3
Interest receivable on external derivatives not in hedge relationship	209	243
Interest on deposits	6	5
Net pension finance income	4	-
	220	251
Finance costs		
Interest on borrowings:		
Bonds and related hedging instruments ¹	(618)	(614)
Bank loans and overdrafts and related hedging instruments	(63)	(75)
Interest payable on external derivatives not in hedge relationship ²	(277)	(241)
Facility fees and other charges	(10)	(6)
Net pension finance costs	-	(4)
Unwinding of discount on provisions	(1)	(1)
Total borrowing costs	(969)	(941)
Less: capitalised borrowing costs ³ (Note.8)	35	22
	(934)	(919)
Net finance costs before certain re-measurements	(714)	(668)

¹ Includes accretion of £26 million (2015: £9 million) on index-linked bonds.

² Includes accretion of £113 million (2015: £65 million) on index-linked swaps.

³ Capitalised interest included in the cost of qualifying assets arose on the general borrowing pool and is calculated by applying an average capitalisation rate of 4.89% (2015: 5.20%) to expenditure incurred on such assets.

(b) Fair value (loss)/gain on financial instruments

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Interest rate swaps: ineffective portion of cash flow hedges	-	(2)
Interest rate swaps: not in hedge relationship	(120)	37
Cross-currency swaps: ineffective portion of cash flow hedges	10	(10)
Cross-currency swaps: ineffective portion of fair value hedges	24	38
Index-linked swaps: not in hedge relationship	(436)	87
Fair value (loss)/gain on financial instruments	(522)	150
Net finance costs	(1,236)	(518)

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

5 Taxation – continuing operations

	Year ended 31 December 2016			Year ended 31 December 2015		
	Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items £m	Total £m	Before certain re-measurements and exceptional items £m	Certain re-measurements and exceptional items £m	Total £m
UK corporation tax						
Current tax charge at 20% (2015: 20.25%)	(48)	(2)	(50)	(44)	-	(44)
(Under)/over provision in respect of prior years	(1)	-	(1)	12	-	12
Deferred tax						
Current year credit/(charge)	(19)	89	70	(10)	(89)	(99)
Prior year charge	(3)	1	(2)	(4)	-	(4)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	-	52	52	-	100	100
Taxation credit/(charge) for the year	(71)	140	69	(46)	11	(35)

The tax credit/(charge) on the Group's (loss)/profit before tax differs from the theoretical amount that would arise by applying the UK statutory tax rate to the accounting profits of the Group for the reasons set out in the following reconciliation:

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Profit before tax (before certain re-measurements and exceptional items)	291	251
Reconciliation of the tax charge		
Tax calculated at the UK statutory rate of 20% (2015: 20.25%)	(58)	(51)
Adjustments in respect of current income tax of previous years	(1)	12
Net non-deductible expenses	(9)	(3)
Adjustments in respect of deferred income tax of previous years	(3)	(4)
Total tax charge before certain re-measurements and exceptional items excluding change in UK corporation tax rate	(71)	(46)
Change in UK corporation tax rate - impact on deferred tax assets and liabilities	52	100
Tax credit/(charge) on certain re-measurements and exceptional items¹	88	(89)
Taxation credit/(charge) for the year	69	(35)

¹ This consists of the tax impact arising from fair value gains/losses on investment property revaluations and fair value gains/losses on financial instruments, along with any associated prior year adjustments.

The total tax credit recognised for the year ended 31 December 2016 was £69 million (2015: £35 million charge). Based on a loss before tax for the year of £187 million (2015: £732 million profit), this results in an effective tax rate of 36.9% (2015: 4.8%).

Excluding the impact of the change in tax rate, the total tax charge, before certain re-measurements and exceptional items, for the year ended 31 December 2016 was £71 million (2015: £46 million charge). Based on a profit before tax, certain re-measurements and exceptional items of £291 million (2015: £251 million), this results in an effective tax rate of 24.4% (2015: 18.3%). The tax charge for 2016 is more than implied by the statutory rate of 20% primarily due to non-deductible expenses and because a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief. In 2015 the tax charge was less than implied by the statutory rate of 20.25%, primarily due to adjustments in respect of previous years. Excluding the adjustments in respect of previous years, the effective tax rate would be higher than the statutory rate as a substantial proportion of Heathrow's capital expenditure does not qualify for tax relief.

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. Consequently the Group's significant deferred tax balances, which were previously provided at 18%, were re-measured at the future tax rate at which the Group believes the timing differences will reverse. This has resulted in a net reduction in the deferred tax liability and a corresponding net deferred tax credit of £52 million being recognised in the income statement.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

5 Taxation – continuing operations *continued*

In December 2016 and January 2017 the UK government published draft legislation on a new interest deductibility regime, in response to the Organisation for Economic Co-operation and Development (OECD) reports on base erosion and profit shifting (BEPS). It has been announced that, effective from 1 April 2017, interest deductions will be limited to 30% of tax based EBITDA, with the ability to apply a group ratio rule (GRR) and a public benefit infrastructure exemption (PBIE). Whilst the legislation could impact the future tax charge of the group, Heathrow expects to be largely protected from the 30% of tax based EBITDA cap through the use of the PBIE and GRR. The position will be clarified when the legislation is enacted later in 2017.

Other than these changes there are no items which would materially affect the future tax charge.

6 Discontinued operations

For the year ended 31 December 2016, there were no disposals of discontinued operations.

On 18 December 2014, the Group completed the disposal of its 100% shareholding in Airport Holdings NDH1 Limited to AGS Airports Limited, which is owned by Macquarie European Investment Fund 4 and Ferrovial Aeropuertos S.A., in an arms-length transaction. Airport Holdings NDH1 Limited was the holding company of a group of companies (together, the 'NDH1 Group') that principally owned and operated three airports in the UK located in Glasgow, Aberdeen and Southampton. It was sold for a cash consideration of £1,045 million and generated a profit on disposal of £200 million.

During the year ended 31 December 2015, a £50 million commutation payment was made in relation to pensions.

During the year 2015 the Group realised £5 million from the release of a disposal provision made in 2014, but considered to be surplus at 31 December 2015. During the year ended 31 December 2016 the Group incurred a further £2 million separation costs, utilising the remaining £1 million disposal of operations provision (2015: £6 million) and incurring £1 million loss on discontinued operations.

7 Dividends

In the year ended 31 December 2016, dividends of £540 million were made by the Group which funded £325 million of quarterly dividends paid to shareholders, £195 million of loan repayments on behalf of ADI Finance 2 Limited and £20 million of interest payments (used to part fund £30 million of total interest paid) at ADI Finance 2 Limited (2015: £331 million were made by the Group which funded £300 million of quarterly dividends paid to shareholders and £31 million of interest payments at ADI Finance 2 Limited).

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

8 Property, plant and equipment

	Note	Terminal complexes £m	Airfields £m	Plant and equipment £m	Other land and buildings £m	Rail £m	Assets in the course of construction £m	Total £m
Cost								
1 January 2015		10,561	1,081	805	120	1,296	1,000	14,863
Additions		-	-	-	-	-	554	554
Transfers to completed assets		586	202	11	56	44	(899)	-
Borrowing costs capitalised	4	-	-	-	-	-	22	22
Disposals		(73)	(1)	(12)	(4)	(1)	-	(91)
Transfers to intangibles	10	-	-	-	-	-	(29)	(29)
Reclassifications ¹		27	-	-	-	-	-	27
1 January 2016		11,101	1,282	804	172	1,339	648	15,346
Additions		-	-	-	-	-	666	666
Transfers to completed assets		104	20	28	24	-	(176)	-
Borrowing costs capitalised	4	-	-	-	-	-	35	35
Disposals		(480)	(12)	(56)	(2)	-	(2)	(552)
Transfers to intangibles	10	-	-	-	-	-	(13)	(13)
Reclassifications ¹		217	1	-	-	(36)	-	182
31 December 2016		10,942	1,291	776	194	1,303	1,158	15,664
Depreciation and impairment								
1 January 2015		(2,458)	(240)	(247)	(33)	(314)	-	(3,292)
Charge for the year		(465)	(45)	(81)	(12)	(47)	-	(650)
Disposals		73	1	12	4	1	-	91
Reclassifications ¹		(27)	(1)	-	-	-	-	(28)
1 January 2016		(2,877)	(285)	(316)	(41)	(360)	-	(3,879)
Charge for the year		(471)	(44)	(70)	(10)	(42)	-	(637)
Disposals		480	12	56	2	-	-	550
Transfer to intangibles	10	-	-	2	-	-	-	2
Reclassifications ¹		(181)	(1)	-	-	-	-	(182)
31 December 2016		(3,049)	(318)	(328)	(49)	(402)	-	(4,146)
Net book value								
31 December 2016		7,893	973	448	145	901	1,158	11,518
31 December 2015		8,224	997	488	131	979	648	11,467

¹ Reclassifications comprises cost and amortisation with £nil impact on the net book value in relation to historic adjustments.

Other land and buildings

Other land and buildings are freehold except for certain short leasehold properties with a net book value at 31 December 2016 of £12 million (2015: £11 million).

Assets in the course of construction

The major balances in assets in the course of construction are the Asset Management programme to replace depreciated assets, the Baggage programme projects to enable the processing of check in and transfer baggage in a single facility, and the Airport resilience programme.

Borrowing costs capitalised

During the year ended 31 December 2016, borrowing costs of £35 million were capitalised (2015: £22 million). Capitalised borrowing costs were calculated by applying an average interest rate of 4.89% (2015: 5.20%) to expenditure incurred on qualifying assets.

A tax deduction of £35 million (2015: £22 million) for capitalised borrowing costs was taken in the year. Subsequent depreciation of the capitalised borrowing costs is disallowed for tax purposes. Consequently, the capitalised borrowing costs give rise to a deferred tax liability, which is released each year in line with the depreciation charged on the relevant assets.

Leased assets

The Group had assets rented to third parties under operating leases as follows:

	31 December 2016 £m	31 December 2015 £m
Cost or valuation	689	686
Accumulated depreciation	(259)	(239)
Net book value	430	447

Security granted by the Group over its assets, including property, plant and equipment, is disclosed in Note 16.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

9 Investment properties

	Airport investment properties £m	Assets in the course of construction £m	Total £m
Valuation			
1 January 2015	2,045	9	2,054
Additions	7	-	7
Transfers to completed assets	9	(9)	-
Revaluation	95	-	95
1 January 2016	2,156	-	2,156
Revaluation	44	-	44
31 December 2016	2,200	-	2,200

Investment properties were valued at fair value at 31 December 2016 by CBRE Limited, Chartered Surveyors (2015: CBRE Limited, Chartered Surveyors).

All valuations were prepared in consideration of IFRS and in accordance with the appraisal and valuation manual issued by the Royal Institution of Chartered Surveyors. Valuations were carried out having regard to comparable market evidence relevant to each specific property or class of properties. In assessing fair value, current and potential future income (after deduction of non-recoverable outgoings) has been capitalised using yields derived from market evidence. The fair value measurement hierarchy used in calculating fair value (refer to Note 18) has been classified as level 3. The higher the discount rate and expected vacancy rate, the lower the fair value. The higher the current and potential future income or rental growth rate, the higher the fair value.

The Group has historically had a low level of void properties.

Investment properties are let on either full repair and insuring leases, under which all outgoings are the responsibility of the lessee, or under tenancies, where costs are recovered through a service charge levied on tenants during their period of occupation. This service charge amounted to £1 million (2015: £1 million) for which a similar amount is included within operating costs.

Security granted by the Group over its assets, including investment properties, is disclosed in Note 16.

The property rental income earned by the Group from its investment property, all of which is leased out under operating leases, amounted to £66 million. Direct operating expenses arising on the investment property, all of which generated rental income in the period, amounted to £1 million. The Group has entered into contracts for the maintenance of its investment property, which will give rise to an annual charge of less than £1 million.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

10 Intangible assets

	Note	Goodwill £m	Software costs £m	Retail contracts £m	Total £m
Cost		2,756	155	79	2,990
1 January 2015					
Additions		-	25	-	25
Disposals		(3)	(3)	(14)	(20)
Transfers from property, plant and equipment		-	29	-	29
1 January 2016		2,753	206	65	3,024
Additions		-	14	-	14
Disposals		-	(2)	-	(2)
Transfers from property, plant and equipment	8	-	13	-	13
31 December 2016		2,753	231	65	3,049
Amortisation and impairment					
1 January 2015		(3)	(41)	(52)	(96)
Charge for the year		-	(35)	(4)	(39)
Disposals		3	3	14	20
1 January 2016		-	(73)	(42)	(115)
Charge for the year		-	(36)	(5)	(41)
Disposals		-	2	-	2
Transfers from property, plant and equipment	8	-	(2)	-	(2)
31 December 2016		-	(109)	(47)	(156)
Net book value					
31 December 2016		2,753	122	18	2,893
31 December 2015		2,753	133	23	2,909

Goodwill

Goodwill relates to the excess of the purchase consideration paid over the carrying values of the net assets of the Heathrow Airports Holdings Group, which was acquired in June 2006, and represents the potential for long-term growth in the infrastructure and passenger traffic and tariffs.

Goodwill is allocated to the Group's only cash-generating unit ('CGU'), identified as Heathrow.

The recoverable amount of Heathrow has been calculated using the fair value less cost to sell methodology. Fair value has been calculated using the Adjusted Present Value (APV) methodology based on the cash flow projections of the relevant plan over the period until year 2039. Management believes this is an appropriate period for a projection to provide the real value of a business that requires significant capital expenditure over a long period of time. The cash flows have been discounted at mid period and the residual value applied on the last year of the projection has been calculated applying a multiple of 1.15xRAB.

An impairment test is a comparison of the carrying value of the assets of a CGU, to their recoverable amount calculated as fair value less cost to sell. When the recoverable amount is less than the carrying value, impairment exists. The carrying value of goodwill at Heathrow was tested for impairment as at 31 December 2016. No impairment charges resulted.

The Group used as the starting base for Heathrow's long-term business plan the latest operational projections approved by the Board in December 2016. Projections beyond Q6 reflect Heathrow's plan presented to the Board of Directors in September 2016 (including passenger forecasts, investment plans, expected income and cost) and the result of future settlements has been simulated.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

10 Intangible assets *continued*

Goodwill continued

Key assumptions

In determining the fair value of Heathrow, management has made a number of assumptions based on recent experience and is consistent with relevant external sources of information. The key assumptions used in determining Heathrow's recoverable amount are:

- **Capital expenditure:**
From 2020 onwards, a series of major projects have been included covering the maintenance and replacement of existing assets, in order to add capacity to the existing infrastructure to meet forecast demand while maintaining the quality of the service. An updated forecast of the projections submitted to the Airports Commission have been used for this purpose.
- **Return allowed by the regulator and discount rates:**
The assumptions made for the return allowed by the regulator for future five yearly regulatory periods reflect a conservative view of the airport's cost of capital and expectations of the result of future price determinations. For Q6, the return assumed is slightly higher than the one allowed by the CAA in its decision due to an over performance expectation. For future quinquennia, Heathrow makes an assumption as to what the right cost of capital would be. The unlevered discount rate applied to the operational cash flows for the calculation of the recoverable amount in the base case was 7.0%.
- **Cost of debt:**
Long-term assumption for the cost of debt is consistent with the current cost of debt throughout the forecast period.

Sensitivity analysis

The sensitivity of Heathrow's fair value to changes in key assumptions has been tested. The most relevant impacts are those related to the increase of capacity for Heathrow, to the assumed allowed regulatory return and to the discount rates.

Software costs

The capitalised computer software costs principally relate to operating and financial software.

11 Available-for-sale investments

	2016 £m	2015 £m
Unlisted securities		
1 January	31	26
Gain recognised in equity	-	5
31 December	31	31

Available-for-sale investments relates to the Group's 4.19% equity interest in National Air Traffic Services Holdings Limited ('NATS'), the UK's national air traffic services provider. The Group does not exercise significant long-term influence over NATS and accordingly the investment has been classified as an available-for-sale investment.

The equity investment is valued by discounting the forecast dividend stream and an assigned terminal value to the equity in 2031. A rate of 6.7% (2015: 7.5%) has been used as the discount factor.

Disclosure of the Group's financial risk management framework that includes the governance of its available-for-sale investments is included in Note 18.

12 Inventories

	31 December 2016 £m	31 December 2015 £m
Consumables	11	11

The total amount of inventories consumed in the year was £6 million (2015: £6 million).

There is no material difference between the statement of financial position value of inventories and their replacement cost.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

13 Trade and other receivables

	31 December 2016 £m	31 December 2015 £m
Non-current		
Prepayments ¹	22	23
Other receivables	5	-
Amounts owed by parent entity	93	93
	120	116
Current		
Trade receivables	213	187
Less: provision for impairment	(1)	(1)
Trade receivables – net	212	186
Prepayments	25	30
Other receivables	-	9
	237	225

¹ Non-current prepayments include £6 million (2015: £6 million) financing fees on facilities not yet drawn. These are amortised over the term of the facility.

The fair value of trade and other receivables are not materially different from the carrying value.

Unless otherwise stated, trade and other receivables do not contain impaired assets.

Trade receivables are non-interest bearing and are generally on 14 day terms. No collateral is held as security.

As at 31 December 2016, trade receivables of £112 million (2015: £152 million) were fully performing. Trade receivables of £88 million (2015: £29 million) were past due but not impaired. These relate to a number of independent customers for whom there is no recent history of default. The ageing analysis of these trade receivables is as follows:

	31 December 2016 £m	31 December 2015 £m
Fully performing	112	152
Past due but not impaired		
Not impaired but overdue by less than 30 days	78	19
Not impaired but overdue by between 30 and 60 days	-	4
Not impaired but overdue by more than 60 days	10	6
	88	29
Overdue by more than 90 days	13	6

Movements in the provision for impairment of trade receivables are as follows:

	2016 £m	2015 £m
1 January	1	2
Provision for receivables impairment	-	(1)
31 December	1	1

As at 31 December 2016, trade receivables were considered for impairment of which £1 million (2015: £1 million) was provided for, with the remaining amount expected to be fully recovered. The individual impaired receivables mainly relate to customers who are in difficult economic situations. The creation and release of any provisions for impaired receivables have been included in 'general expenses' within 'operating costs' in the Consolidated income statement. Amounts charged to the provision account are generally written off when there is no expectation of recovery.

The Group is not exposed to significant foreign currency exchange risk as the majority of trade and other receivables are denominated in Sterling. Additional disclosure on credit risk management is included in Note 18.

14 Restricted cash

	31 December 2016 £m	31 December 2015 £m
Cash at bank and in hand	7	6
Short-term deposits	5	5
	12	11

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

15 Cash and cash equivalents and term deposits

	31 December 2016	31 December 2015
	£m	£m
Cash at bank and in hand	11	18
Short-term deposits	296	181
Cash and cash equivalents	307	199
Term deposits	380	550
Cash and cash equivalents, and term deposits	687	749

Cash at bank and in hand earns interest at floating rates based on daily bank deposit rates and is subject to interest rate risk. The fair value of cash and cash equivalents approximates to their book value.

Heathrow Airport Limited and Heathrow (AH) Limited hold investments in term deposits, which have an original maturity of more than three months.

For the purposes of the Consolidated statement of cash flows, cash and cash equivalents comprise cash at bank, cash in hand and short-term deposits with an original maturity of three months or less, held for the purpose of meeting short-term cash commitments and bank overdrafts, restricted cash and bank overdrafts. Cash and cash equivalents consist of:

	31 December 2016	31 December 2015
	£m	£m
Cash at bank and in hand	18	24
Short-term deposits	301	186
	319	210

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

16 Borrowings

	31 December 2016 £m	31 December 2015 £m
Current		
Secured		
Heathrow Funding Limited bonds		
12.450% £300 million due 2016	-	304
4.125% €500 million due 2016	-	365
4.375% €700 million due 2017	598	-
2.500% CHF400 million due 2017	318	-
Total Heathrow Funding Limited bonds	916	669
Heathrow Finance plc bonds		
7.125% £325 million due 2017	265	-
Total bonds	1,181	669
Heathrow Airport Limited loans	36	39
Total current (excluding interest payable)	1,217	708
Interest payable	284	278
Total current	1,501	986
Non-current		
Secured		
Heathrow Funding Limited bonds		
4.375% €700 million due 2017	-	516
2.500% CHF400 million due 2017	-	271
4.600% €750 million due 2018	638	548
6.250% £400 million due 2018	398	396
4.000% C\$400 million due 2019	240	195
6.000% £400 million due 2020	398	397
9.200% £250 million due 2021	288	290
3.000% C\$450 million due 2021	274	225
4.875% US\$1,000 million due 2021	828	698
1.650%+RPI £180 million due 2022	199	195
1.875% €600 million due 2022	534	453
5.225% £750 million due 2023	735	733
7.125% £600 million due 2024	591	590
0.500% CHF400 million due 2024	314	-
3.250% C\$500 million due 2025	303	248
4.221% £155 million due 2026	155	155
6.750% £700 million due 2026	685	684
2.650% NOK1,000 million due 2027	93	77
7.075% £200 million due 2028	225	227
1.500% €750 million due 2030	614	504
2.50% NOK1,000 million due 2029	85	-
6.450% £900 million due 2031	982	991
Zero-coupon €50 million due January 2032	52	43
1.366%+RPI £75 million due 2032	79	77
Zero-coupon €50 million due April 2032	52	43
4.171% £50 million due 2034	50	50
Zero-coupon €50 million due 2034	46	39
1.061%+RPI £180 million due 2036	183	115
1.382%+RPI £50 million due 2039	53	51
3.334%+RPI £460 million due 2039	583	572
1.238%+RPI £100 million due 2040	103	101
5.875% £750 million due 2041	732	734
4.625% £750 million due 2046	742	741
1.372%+RPI £75 million due 2049	79	77
2.750% £400 million due 2049	392	-
Total Heathrow Funding Limited bonds	11,725	11,036
Heathrow Finance plc bonds		
7.125% £325 million due 2017	-	291
5.375% £275 million due 2019	261	261
5.750% £250 million due 2025	248	248
Total Heathrow Finance plc bonds	509	800
Total bonds	12,234	11,836

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

16 Borrowings *continued*

	31 December 2016 £m	31 December 2015 £m
Heathrow Airport Limited debt:		
Term note: 3.770% £100 million due 2026	100	100
Term note: 2.630% £80 million due 2030	80	80
Term note: 3.160% £90 million due 2032	89	-
Term note: 2.970% £70 million due 2035	70	70
Loans	62	98
Heathrow Finance plc facilities	324	125
Total bank loans	725	473
Total external borrowings	12,959	12,309
Borrowings from parent	155	155
Total non-current	13,114	12,464
Total borrowings (excluding interest payable)	14,331	13,172

Heathrow Funding Limited Bonds

The maturity dates of the Heathrow Funding Limited bonds listed above reflect their scheduled redemption dates that correspond to the maturity dates of the loans between Heathrow Airport Limited and Heathrow Funding Limited. The bonds are not callable in nature and are expected to be repaid on their scheduled redemption date. However, to meet rating agency requirements the bonds have a legal maturity that is two years later, except for the 6.250% £400 million due 2018, 6.000% £400 million due 2020, 7.125% £600 million due 2024, 4.221% £155 million due 2026 bonds and 1.061%+RPI £180 million due 2036 bonds wherein the redemption dates coincide with their legal maturity dates.

Fair value of borrowings

	31 December 2016		31 December 2015	
	Book value £m	Fair value ¹ £m	Book value £m	Fair value ¹ £m
Current				
Short-term debt	1,217	1,223	708	727
Non-current				
Long-term debt	12,959	15,631	12,309	13,748
Borrowings from parent	155	155	155	155
	14,331	17,009	13,172	14,630

¹ Fair value of borrowings are for disclosure purposes only.

Accrued interest is included as a current borrowings balance and not in the carrying amount of non-current borrowings. The fair value of listed borrowings are based on quoted prices at balance sheet date. For unlisted borrowings, the Group establishes fair values by using discounted cash flow analysis utilising yield curves derived from observable market data (Level 2). The fair value of borrowings which have floating rate interest are assumed to equate to their nominal value. At 31 December 2016, the fair value of debt classified as Level 1 and Level 2 was £15,456 million and £1,553 million respectively (2015: £13,738 million and £892 million respectively).

The average cost of the Group's external gross debt at 31 December 2016 was 4.19% (2015: 4.46%), taking into account the impact of interest rate, cross-currency and index-linked hedges but excluding index-linked accretion. Including index-linked accretion, the Group's average cost of debt at 31 December 2016 was 5.24% (2015: 5.01%). The reduction in the average cost of debt excluding index-linked accretion since the end of 2015 is mainly due to the maturity on 31 March 2016 of a bond with a 12.45% coupon and the increased cost of debt including index-linked accretion reflects higher inflation at the end of 2016 compared to the end of 2015.

Securities and guarantees

Heathrow Airport Limited, Heathrow Express Operating Company Limited, Heathrow (SP) Limited and Heathrow (AH) Limited (together, the 'Obligors') have granted security to Deutsche Trustee Company Limited (in its capacity as the 'Borrower Security Trustee', for itself and as trustee for the Borrower Secured Creditors) over their property, assets and undertakings to secure their obligations under various financing agreements. Each Obligor has also guaranteed the obligations of each other Obligor under such financing agreements.

Heathrow (DSH) Limited and Heathrow Finance plc have also granted security over substantially all of their assets, which includes first priority security interests in the share capital of Heathrow Finance plc and its wholly-owned subsidiary, Heathrow (SP) Limited, to secure their obligations under their financing agreements.

BAA Pension Trust Company Limited, as a trustee from time to time of the BAA Pension Scheme, is a Borrower Secured Creditor and ranks equally in an amount up to £284 million with senior (Class A) debt.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

Securities and guarantees *continued*

LHR Airports Limited has provided a guarantee and indemnity to Deutsche Trustee Company Limited (in its capacity as the 'Bond Trustee') in exchange for the conversion of certain classes of legacy bonds originally issued by LHR Airports Limited (the 'LHR Guaranteed Bonds') into Bonds. Pursuant to this guarantee and indemnity, LHR Airports Limited unconditionally and irrevocably agrees to pay to the Bond Trustee all sums due and payable but unpaid by Heathrow Funding Limited in respect of scheduled interest and payment of principal on such LHR Guaranteed Bonds.

Heathrow Funding Limited has given the Bond Trustee a covenant to pay and discharge, when due, to each of the Issuer Secured Creditors (including Bondholders) all Issuer Secured Liabilities (including all amounts due under the Bonds). The Bond Trustee holds the benefit of that covenant on trust for itself and the Issuer Secured Creditors. Heathrow Funding Limited has also granted security to the Bond Trustee (for itself and as trustee for the Issuer Secured Creditors) over its property, assets, undertakings and rights to secure the covenant to pay and discharge the Issuer Secured Liabilities.

Heathrow Airport Limited and Heathrow Express Operating Company Limited have provided a guarantee and indemnity in favour of Lloyds Bank plc (in its capacity as the Borrower Account Bank) in respect of each other's obligations under the Borrower Account Bank Agreement and associated financing agreements.

Additional disclosures on risk management and hedging of borrowings are included in Notes 17 and 18.

17 Derivative financial instruments

	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2016				
Current				
Cross-currency swaps	856	78	-	78
Interest rate swaps	50	-	(3)	(3)
	906	78	(3)	75
Non-current				
Interest rate swaps	2,913	-	(531)	(531)
Cross-currency swaps	3,442	658	(9)	649
Index-linked swaps	5,116	18	(879)	(861)
	11,471	676	(1,419)	(743)
Total	12,377	754	(1,422)	(668)
31 December 2015				
Current				
Interest rate swaps	434	-	(60)	(60)
Cross-currency swaps	300	-	(30)	(30)
	734	-	(90)	(90)
Non-current				
Interest rate swaps	2,963	-	(408)	(408)
Cross-currency swaps	3,930	154	(188)	(34)
Index-linked swaps	5,116	19	(506)	(487)
	12,009	173	(1,102)	(929)
Total	12,743	173	(1,192)	(1,019)

Interest rate swaps

Interest rate swaps are maintained by the Group and designated as hedges, where they qualify against variability in interest cash flows on current and future floating or fixed rate borrowings. The gains and losses deferred in equity on the cash flow hedges will be continuously released to the income statement over the period of the hedged risk. The losses deferred of £42 million are expected to be released in less than one year, £34 million between one and two years, £81 million between two and five years and £176 million over five years.

Cross-currency swaps

Cross-currency swaps have been entered into by the Group to hedge currency risk on interest and principal payments on its foreign currency-denominated bond issues. The gains and losses deferred in equity on certain swaps in cash flow hedge relationships will be continuously released to the income statement over the period to maturity of the hedged bonds. The gains deferred of £6 million are expected to be released in less than one year, £1 million between one and two years, £nil between two and five years and £nil over five years.

Index-linked swaps

Index-linked swaps have been entered into in order to economically hedge RPI linked revenue and the Regulatory Asset Base but are not designated in a hedge relationship.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

17 Derivative financial instruments *continued*

Foreign exchange contracts

Foreign exchange contracts are used to manage exposures relating to future capital expenditure. Hedge accounting is not sought for these derivatives.

18 Financial instruments

Financial risk management objectives and policies

The Group's principal financial instruments (other than derivatives) comprise loans, term notes, listed bonds, cash and short-term deposits. The main purpose of these instruments is to raise finance for the Group's operations.

The Group also enters into derivative transactions, principally interest rate swaps, index-linked swaps, cross-currency swaps and foreign exchange contracts. The purpose of these transactions is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance.

The Group mitigates the risk of mismatch between Heathrow's aeronautical income and its regulatory asset base, which are directly linked to changes in the retail prices index, and nominal debt and interest payments by the use of index-linked instruments.

The Group does not use financial instruments for speculative purposes. The treasury function operates on a centralised non-speculative risk basis. Its purpose is to identify, mitigate and hedge treasury-related financial risks inherent in the Group's business operations and funding.

The main risks arising from the Group's financial instruments are market risk (including fair value interest rate, foreign currency, cash flow interest rate and price risks), credit risk and liquidity risk. The Board approves prudent treasury policies for managing each of the risks which are summarised below.

Foreign exchange risk

For debt raised in foreign currencies, the Group uses cross-currency swaps to hedge the interest and principal payments. The Group uses foreign exchange contracts to hedge material capital expenditure in foreign currencies once a project is certain to proceed.

The Group is not exposed to foreign exchange risk on borrowings after hedging. The Group is not materially exposed to foreign exchange risk on an economic basis.

Price risk

The Group is exposed to RPI risk on its index-linked bonds and derivatives held to economically hedge cash flows on debt instruments and RPI linked revenue. As at 31 December 2016, with all other variables remaining constant, if the RPI had increased or decreased by a factor of 10%, annual pre-tax profit would have decreased or increased by £274 million and £264 million respectively (2015: £208 million and £203 million respectively).

Cash flow and fair value interest rate risk

The Group's interest rate risk arises primarily from its borrowings. Borrowings issued at variable interest rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. The Group's policy is to maintain a mix of fixed and floating rate debt within Board approved parameters such that a minimum of 75% of existing and forecast debt is at a fixed rate. To manage this mix, the Group enters into interest rate swaps. These swaps may be designated to hedge underlying debt obligations. The Group also uses floating rate interest bearing financial assets as a natural hedge of the exposure to fair value interest rate risk.

As at 31 December 2016, the Group's fixed floating interest rate profile, after hedging, on gross debt was 98:02 (2015: 96:04).

Each 0.50% change in interest rates would have resulted in the following gain/(loss) to pre-tax profit and equity, due to movements in the finance income, finance cost and mark-to-market valuation of derivatives:

	31 December 2016		31 December 2015	
	Income statement impact	Equity impact	Income statement impact	Equity impact
	£m	£m	£m	£m
0.50% increase	192	10	193	13
0.50% decrease	(203)	(11)	(204)	(14)

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

18 Financial instruments *continued*

Credit risk

Credit risk arises from cash and cash equivalents, term deposits, derivative financial instruments and accounts receivable. The Group has no significant concentrations of credit risk. The Group's exposure to credit related losses, in the event of non-performance by counterparties to financial instruments, is mitigated by limiting exposure to any one party or instrument and ensuring only counterparties within defined credit risk parameters are used.

The Group maintains a prudent split of cash and cash equivalents and term deposits across a range of market counterparties in order to mitigate counterparty credit risk. Board approved investment policies and relevant debt facility agreements provide counterparty investment limits, based on short and long-term credit ratings. Investment activity is reviewed on a regular basis and no cash or cash equivalents are placed with counterparties with short-term credit ratings lower than A-2 (S&P)/F1 (Fitch). The Group monitors the credit rating of derivative counterparties on a daily basis and ensures no positions are entered into with counterparties with long-term credit ratings below BBB+ (S&P)/BBB+ (Fitch).

As at 31 December 2016, the Group had credit risk on derivatives with asset mark to market of £754 million (2015: £173 million).

Financial assets past due but not impaired are disclosed in Note 13 'Trade and other receivables'. The maximum exposure to credit risk as at 31 December 2016 was £1,696 million (2015: £1,150 million) as disclosed in Note 18 'Financial instruments by category'.

Liquidity risk

Although there can be no certainty that financing markets will remain open for issuance at all times, debt maturities are spread over a range of dates, thereby ensuring that the Group is not exposed to excessive refinancing risk in any one year. Further details of the risk management objectives and policies are disclosed in the Internal controls and risk management section of the Strategic report in the statutory annual report and financial statements.

The Group has the following undrawn committed borrowing facilities available in respect of which all conditions precedent had been met at the relevant date:

	31 December 2016 £m	31 December 2015 £m
Floating rate facilities		
Expiring in more than two years and less than five years	1,500	1,475
Expiring in more than five years	200	-
	1,700	1,475

As at 31 December 2016, overdraft facilities of £10 million were available (2015: £10 million).

The tables below analyse the gross undiscounted contractual cash flows as at 31 December of the Group's financial liabilities and net settled derivative financial instruments to the contractual maturity date.

	31 December 2016			
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Borrowing principal payments	1,157	943	2,130	9,409
Borrowing interest payments	618	575	1,467	4,050
Derivative financial instruments	(25)	45	(22)	(296)
Trade payables	174	-	-	-
Capital payables	121	-	-	-

	31 December 2015			
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Borrowing principal payments	773	1,185	1,902	9,422
Borrowing interest payments	615	571	1,460	3,863
Derivative financial instruments	91	(15)	49	(178)
Trade payables	164	-	-	-
Capital payables	122	-	-	-

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

18 Financial instruments *continued*

Liquidity risk continued

The tables below analyse the expected gross undiscounted contractual cash flows as at 31 December of the Group's derivative financial instruments which will be settled on a gross basis based on the remaining period to the contractual maturity date. The table should be viewed in conjunction with the table presenting undiscounted cash flows on the Group's financial liabilities and net settled derivative financial instruments.

	31 December 2016			
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Cross-currency derivative payments	111	77	165	147
Cross-currency derivative receipts	(151)	(117)	(241)	(438)

	31 December 2015			
	Less than one year £m	One to two years £m	Two to five years £m	Greater than five years £m
Cross-currency derivative payments	121	90	123	83
Cross-currency derivative receipts	(140)	(125)	(227)	(450)

Capital risk management

The Group's objectives when managing capital are to safeguard the Group's ability to continue as a going concern in order to provide returns for shareholders and benefits for other stakeholders and to maintain an optimal capital structure. The Group regularly reviews and maintains or adjusts the capital structure as appropriate in order to achieve these objectives.

The Group monitors capital on the basis of its gearing ratio. Like other regulated utilities in the UK, gearing is measured by reference to the ratio of net debt to the Regulatory Asset Base ('RAB'). Net debt is the external consolidated nominal net debt at the entity within the Group that the relevant debt facility sits.

There are gearing covenants in financing agreements at various levels of the Group including Heathrow Finance plc. Gearing ratios of each of these are below:

	31 December 2016	31 December 2015
Net debt to RAB at Heathrow Finance plc	0.85	0.85
Total net debt to RAB at Heathrow (SP) Limited	0.78	0.79
Senior net debt to RAB at Heathrow (SP) Limited	0.67	0.68

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

18 Financial instruments *continued*

Financial instruments by category

The Group's financial instruments as classified in the financial statements as at 31 December can be analysed under the following categories:

31 December 2016					
	Loans and receivables £m	Assets at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Available- for-sale £m	Total £m
Available-for-sale investments	-	-	-	31	31
Derivative financial instruments	-	18	736	-	754
Cash and cash equivalents	319	-	-	-	319
Trade receivables	212	-	-	-	212
Term deposits	380	-	-	-	380
Total financial assets	911	18	736	31	1,696

31 December 2016					
		Liabilities at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Other financial liabilities at amortised cost £m	Total £m
Borrowings		-	-	(14,331)	(14,331)
Derivative financial instruments		(1,192)	(230)	-	(1,422)
Trade payables		-	-	(174)	(174)
Capital payables		-	-	(121)	(121)
Total financial liabilities		(1,192)	(230)	(14,626)	(16,048)

31 December 2015					
	Loans and receivables £m	Assets at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Available- for-sale £m	Total £m
Available-for-sale investments	-	-	-	31	31
Derivative financial instruments	-	19	154	-	173
Cash and cash equivalents	210	-	-	-	210
Trade receivables	186	-	-	-	186
Term deposits	550	-	-	-	550
Total financial assets	946	19	154	31	1,150

31 December 2015					
		Liabilities at fair value through income statement £m	Derivatives qualifying for hedge accounting £m	Other financial liabilities at amortised cost £m	Total £m
Borrowings		-	-	(13,172)	(13,172)
Derivative financial instruments		(772)	(420)	-	(1,192)
Trade payables		-	-	(164)	(164)
Capital payables		-	-	(122)	(122)
Total financial liabilities		(772)	(420)	(13,458)	(14,650)

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

18 Financial instruments *continued*

Financial instruments by category continued

At 31 December 2016, the only financial assets and financial liabilities at fair value through the income statement are derivatives that do not qualify for hedge accounting.

Fair value estimation

Financial instruments that are measured in the statement of financial position at fair value are classified by the following fair value measurement hierarchy:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2 - inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices); and
- Level 3 - inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs).

At 31 December 2016 and 2015, all the resulting fair value estimates on derivative financial instruments are included in level 2.

The fair value of financial instruments traded in active markets is based on quoted market prices at the reporting date. A market is regarded as active if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service, or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm's length basis. The quoted market price used for financial assets held by the Group is the current bid price. These instruments are included in level 1.

The fair value of financial instruments that are not traded in an active market (such as derivatives) is determined by using valuation techniques. These valuation techniques maximise the use of observable market data where it is available. If all significant inputs required to fair value an instrument are observable, the instrument is included in level 2.

If one or more of the significant inputs is not based on observable market data, the instrument is included in level 3.

Specific valuation techniques used to value financial instruments include:

- quoted market prices or dealer quotes for similar instruments;
- market prices for credit spreads based on counterparty's credit default swap prices and company's bond spread;
- the fair value of cross-currency and interest rate swaps is calculated as the present value of the estimated future cash flows based on observable yield curves; and
- other techniques, such as discounted cash flow analysis, are used to determine fair value for the remaining financial instruments.

The tables below present the Group's assets (other than investment properties) and liabilities that are measured at fair value as at 31 December:

	31 December 2016			
	Level 1 £m	Level 2 £m	Level 3 £m	Total £m
Assets				
Assets at fair value through income statement	-	18	-	18
Derivatives qualifying for hedge accounting	-	736	-	736
Available-for-sale investments	-	-	31	31
Total assets	-	754	31	785
Liabilities				
Liabilities at fair value through income statement	-	(1,192)	-	(1,192)
Derivatives qualifying for hedge accounting	-	(230)	-	(230)
Total liabilities	-	(1,422)	-	(1,422)

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

18 Financial instruments *continued*

Fair value estimation continued

	31 December 2015			Total £m
	Level 1 £m	Level 2 £m	Level 3 £m	
Assets				
Assets at fair value through income statement	-	19	-	19
Derivatives qualifying for hedge accounting	-	154	-	154
Available-for-sale investments	-	-	31	31
Total assets	-	173	31	204
Liabilities				
Liabilities at fair value through income statement	-	(772)	-	(772)
Derivatives qualifying for hedge accounting	-	(420)	-	(420)
Total liabilities	-	(1,192)	-	(1,192)

On a semi-annual basis, the Group reviews any material changes to the valuation techniques and market data inputs used. The potential impact to the fair value hierarchy is assessed if it is deemed a transfer. Significant transfers between levels are considered effective at the end of the reporting period. During the year there were no transfers between the levels in the fair value hierarchy.

Changes in Level 3 instruments have been disclosed in Note 11.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

19 Deferred income tax

The net movement on the deferred income tax account is as follows:

	Note	2016 £m	2015 £m
1 January		(960)	(935)
Credited/(charged) to income statement		68	(103)
Credited to income statement – change in tax rate		52	100
Credited/(charged) to equity	25	36	(20)
Charged to equity – change in tax rate	25	(1)	(2)
31 December		(805)	(960)

Deferred tax is analysed as follows:

	2016 £m	2015 £m
Deferred income tax liabilities	(1,110)	(1,173)
Deferred income tax assets	305	213
31 December	(805)	(960)

The movements in deferred income tax assets and liabilities during the financial year are shown below.

Deferred income tax liabilities

	Excess of capital allowances over depreciation £m	Revaluations of investment property to fair value £m	Revaluations of property, plant and equipment £m	Fair value of retail contracts £m	Post- employment benefits £m	Other £m	Total £m
1 January 2015	(958)	(194)	(68)	(5)	-	(23)	(1,248)
(Charged)/credited to income statement	(6)	(19)	-	1	-	(1)	(25)
Credited to income statement – change in tax rate	92	11	8	-	-	2	113
Charged to other comprehensive income	-	-	-	-	-	(1)	(1)
Credited/(charged) to other comprehensive income – change in tax rate	-	8	(1)	-	-	-	7
Re-allocation from deferred income tax assets note	-	-	-	-	(19)	-	(19)
1 January 2016	(872)	(194)	(61)	(4)	(19)	(23)	(1,173)
(Charged)/credited to income statement	(11)	(5)	-	1	(6)	(1)	(22)
Credited to income statement – change in tax rate	44	7	4	-	-	1	56
Credited to other comprehensive income	-	-	1	-	38	-	39
Credited/(charged) to other comprehensive income – change in tax rate	-	4	(1)	-	2	-	5
Re-allocation to deferred income tax assets note	-	-	-	-	(15)	-	(15)
31 December 2016	(839)	(188)	(57)	(3)	-	(23)	(1,110)

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

19 Deferred income tax *continued*

Deferred income tax assets

	Capital losses £m	Non trade deficit £m	Financial instruments £m	Fair value of long- term borrowings £m	Fair value uplift of bonds £m	Post employment benefits £m	Total £m
1 January 2015	12	96	99	37	23	46	313
Charged to income statement	-	(7)	(16)	(5)	-	(50)	(78)
(Charged)/credited to income statement – change in tax rate	(1)	(8)	1	(3)	(1)	(1)	(13)
Charged to other comprehensive income	-	-	(10)	-	-	(9)	(19)
Charged to other comprehensive income – change in tax rate	-	-	(9)	-	-	-	(9)
Re-allocation to deferred income tax liabilities note	-	-	-	-	-	19	19
1 January 2016	11	81	65	29	22	5	213
(Charged)/credited to income statement	-	(7)	103	(3)	(3)	-	90
(Charged)/credited to income statement - change in tax rate	(1)	(4)	2	(1)	-	-	(4)
(Charged)/credited to other comprehensive income	-	-	(4)	-	-	1	(3)
Charged to other comprehensive income - change in tax rate	-	-	(6)	-	-	-	(6)
Re-allocation from deferred income tax liabilities note	-	-	-	-	-	15	15
31 December 2016	10	70	160	25	19	21	305

Deferred income tax credited/(charged) to other comprehensive income during the year was as follows:

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Cash flow hedge reserve	(4)	(10)
Cash flow hedge reserve – change in tax rate	(6)	(9)
Tax relating to indexation of operational land	1	-
Tax credit on actuarial losses	39	1
Tax relating to retirement benefits	-	(10)
Retained earnings – change in tax rate	5	7
Available-for-sale investments	-	(1)
	35	(22)

The Finance (No 2) Act 2015 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. The Finance Act 2016 enacted a further 1% reduction in the main rate of corporation tax to 17% from 1 April 2020. Consequently, the Group's significant deferred tax balances, which were previously provided at 18%, were re-measured at the future tax rate at which the Group believes the timing differences will reverse. This has resulted in a reduction in the net deferred tax liability of £51 million, with £52 million recognised in the income statement and £1 million charged to other comprehensive income. There are not considered to be any other known items which would materially affect the future tax charge.

Deferred income tax assets have been recognised in respect of all temporary differences giving rise to deferred income tax assets where it is considered probable that there will be sufficient future taxable profit against which these assets will be recovered.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

20 Retirement benefit obligations

The Group has applied the requirements of the standard IAS 19 'Employee Benefits (Revised 2011)' ('IAS 19R') for the year ended 31 December 2016. The total cost of defined contribution pension arrangements are fully expensed as employment costs.

Characteristics of the Group's pension related liabilities

The Group operates a defined contribution pension scheme for all employees who joined the Group after 15 June 2008. The Group also has defined contribution pension schemes in respect of employees of Heathrow Express Operating Company Limited. The Group has no further payment obligations once the contributions have been paid.

The Group's primary UK defined benefit pension fund is a self-administered defined benefit scheme (the 'BAA Pension Scheme' or the 'Scheme') now closed to new employees. As required by UK pension law, there is a Pension Trustee's Board that, together with the Group, is responsible for governance of the Scheme. The employer's contributions are determined based on triennial valuations conducted on assumptions determined by the Trustee and agreed by the Group. The defined benefit obligation or surplus is calculated quarterly by independent actuaries.

The Group also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the rules of the Scheme. In addition, the Group provides post-retirement medical benefits to certain pensioners.

Amounts arising from pensions related liabilities in the Group's financial statements

The net deficit or surplus of the LHR Airports Limited retirement benefit schemes, being the BAA Pension Scheme, Unfunded Unapproved Retirement Benefit Scheme (or 'UURBS') and Post-Retirement Medical Benefit Scheme (or 'PRM'), is presented below for the current and previous four financial years.

The following tables identify the amounts in the Group's financial statements arising from its pension related liabilities. Further details of each scheme (except defined contribution schemes) are within sections a) and b).

Income statement - pension and other pension related liabilities costs

	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Employment costs:		
Defined contribution schemes	10	8
BAA Pension Scheme	27	46
	37	54
Finance (income)/charge - BAA Pension Scheme	(5)	3
Total pension costs – continuing operations	32	57
Total pension costs	32	57

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

20 Retirement benefit obligations *continued*

Characteristics of the Group's pension related liabilities continued

Other comprehensive income – (loss)/gain on pension and other pension related liabilities

	Year ended 31 December 2016	Year ended 31 December 2015
	£m	£m
BAA Pension Scheme	(219)	(5)
Unfunded schemes	(7)	1
Actuarial loss recognised before tax	(226)	(4)
Tax credit on actuarial loss	39	1
Actuarial loss recognised after tax	(187)	(3)

Statement of financial position – net defined benefit pension (deficit)/surplus and other pension related liabilities

The Group's liabilities in relation to pensions are recognised within non-current liabilities or assets if the pension schemes are in a deficit or surplus position, respectively. The net deficit or surplus is presented below for the current and previous four financial years.

	31 December				
	2016 £m	2015 £m	2014 £m	2013 £m	2012 £m
Fair value of plan assets	3,975	3,288	3,274	2,867	2,791
Benefit obligation	(4,054)	(3,184)	(3,473)	(2,960)	(2,894)
(Deficit)/surplus in BAA Pension Scheme	(79)	104	(199)	(93)	(103)
Unfunded pension obligations	(29)	(22)	(23)	(22)	(24)
Post-retirement medical benefits	(6)	(6)	(6)	(6)	(6)
Deficit in other pension related liabilities	(35)	(28)	(29)	(28)	(30)
Net (deficit)/surplus in pension schemes	(114)	76	(228)	(121)	(133)

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

20 Retirement benefit obligations *continued*

(a) BAA Pension Scheme

The Group operates one main defined benefit pension scheme for its UK employees, the BAA Pension Scheme, which is a funded defined benefit scheme with both open and closed sections. The Scheme closed to employees joining the Group after 15 June 2008. The Scheme's assets are held separately from the assets of the Group and are administered by the trustee.

The value placed on the Scheme's obligations as at 31 December 2016 is based on the full actuarial funding valuation carried out at 30 September 2015. This has been updated at 31 December 2016 by KPMG to take account of changes in economic and demographic assumptions, in accordance with IAS 19R. The Scheme assets are stated at their bid value at 31 December 2016. As required by IAS 19R, the Group recognises re-measurements as they occur in the statement of comprehensive income.

Analysis of movements in plan assets and defined benefit obligations.

	2016 £m	2015 £m
Fair value of plan assets at 1 January	3,288	3,274
<i>Income statement:</i>		
Interest income on plan assets	124	118
Administration costs	(2)	(2)
<i>Other comprehensive income:</i>		
Remeasurement gain/(loss) (return on assets in excess of interest income on plan assets)	603	(125)
<i>Cash flows:</i>		
Employer contributions (including benefits paid and reimbursed)	59	73
Members' contributions	5	6
NDH1 Group commutation payment ¹	-	50
Benefits paid (by fund and Group)	(102)	(106)
Fair value of plan assets at 31 December	3,975	3,288
Defined benefit obligation at 1 January	(3,184)	(3,473)
<i>Income statement:</i>		
Current service cost	(25)	(46)
Past service gain ²	-	236
Interest cost	(120)	(121)
<i>Other comprehensive income:</i>		
Experience gains	53	-
Remeasurements of defined benefit obligation:		
arising from changes in demographic assumptions	2	-
arising from changes in financial assumptions	(877)	120
<i>Cash flows:</i>		
Members' contributions	(5)	(6)
Benefits paid (by fund and Group)	102	106
Defined benefit obligation at 31 December	(4,054)	(3,184)

¹ In the year ended 31 December 2015, a commutation payment of £50 million was made as a result of Aberdeen, Glasgow and Southampton airports (the 'NDH1 Group') disposal on 18 December 2014.

² In the year ended 31 December 2015, the HAH Group agreed changes to the defined benefit pension scheme effective from 1 October 2015. The changes included the introduction of an annual cap of 2% on future increases to pensionable pay for active members. The changes resulted in a one-off reduction of £236 million in the scheme's liabilities, as measured under IAS19, and are classified as an exceptional item in the income statement. There is no immediate cash flow impact as a result of these changes.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

20 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

For the year ended 31 December 2016 there were experience gains of £53 million (2015: £nil).

The net actuarial loss of £219 million (2015: £5 million net loss) resulted from a loss on change in assumptions of £875 million (2015: £120 million gain), partially offset by the actual return on assets being £603 million in excess (2015: £125 million lower) of the income statement credit and experience gains of £53 million due to completion of the latest actuarial valuation of the BAA Pension Scheme.

The discount rate used has decreased from 3.80% in 2015 to 2.75% in 2016. IAS 19R requires that this discount rate should be derived from the yield on 'high quality corporate bonds' of a duration consistent with the liabilities of the Scheme.

The discount rate is based on a full yield curve approach, but at 31 December 2016 was refined to a "single agency approach" where the yield curve is constructed from the Merrill Lynch corporate bond universe, using the AA yield curve. The single agency approach typically increases the discount rate in current market conditions, but the extent of the increase can vary over time. At the point this approach was adopted, the effect on the discount rate was to reduce it by 0.2 pp.

Analysis of fair value of plan assets

	31 December 2016 £m	31 December 2015 £m
Fair value of plan assets		
Equity	476	644
Property	118	114
Bonds	1,095	1,032
Cash	153	112
LDI	1,583	1,048
Other	550	338
Total fair value of plan assets	3,975	3,288

At 31 December 2016, the largest single category of investment is a liability driven investment mandate, with a value of £1,583 million (40% of the asset holding at 31 December 2016). The purpose of the Scheme entering into this mandate is to reduce asset/liability mismatch risk. At 31 December 2015, the largest single category of investment is an interest rate and inflation hedging mandate, with value of £1,048 million (32% of the asset holding at 31 December 2015).

LDI holdings are portfolios of interest rate and inflation derivatives which are intended to protect the Scheme from movements in interest rates and inflation, so that the fair value of this element of the portfolio moves in the same way as the fair value of Scheme's obligations.

Analysis of financial assumptions

The financial assumptions used to calculate Scheme assets and liabilities under IAS 19R were:

	31 December 2016 %	31 December 2015 %
Rate of increase in pensionable salaries	1.90	2.00
Increase to deferred benefits during deferment	2.70	2.50
Increase to pensions in payment:		
Open section	3.35	3.15
Closed section	3.45	3.25
Discount rate	2.75	3.80
Inflation assumption	3.45	3.25

The assumptions relating to longevity underlying the pension liabilities at the reporting date are in line with those adopted for the 2015 actuarial funding valuation, and are based on standard actuarial mortality tables with an allowance for future improvements in longevity. The assumptions are equivalent to a life expectancy for a 60 year old male pensioner of 27.0 years (2015: 27.3 years) and 29.3 years (2015: 29.7 years) from age 60 for a 40 year old male non-pensioner.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

20 Retirement benefit obligations *continued*

(a) BAA Pension Scheme *continued*

The expected rate of inflation is an important assumption for the salary growth and pension increase assumptions. A rate of inflation is 'implied' by the difference between the yields on fixed and index-linked government bonds.

As required under IAS 19 Revised, interest income on the plan assets is calculated by multiplying the fair value of the plan assets by the discount rate discussed above.

Analysis of future cash flows

In July 2016, the trustee of the BAA Pension Scheme concluded a formal actuarial valuation of the Scheme. The valuation was carried out as at 30 September 2015 and took into account changes implemented to reduce the Scheme's liabilities. These were the introduction of an annual cap on future increases in pensionable pay for active members and a reduction in both the accrual rate for future service and inflationary increases for those service pensions whilst in payment. The valuation indicated a scheme deficit of £228 million calculated using the agreed actuarial assumptions. As part of the process, LHR Airports Limited agreed a reduction to its annual deficit repair contribution from £27 million to £23 million that is intended to eliminate the deficit by 2022. The process also resulted in a reduction in ongoing cash contributions from 33% to 23% of pensionable salary, consistent with the efficiency targets under the current regulatory settlement. The reduction in cash contributions into the Scheme applied from 1 July 2016 and is estimated at £12 million per annum.

Sensitivity analysis of significant assumptions

The following tables present a sensitivity analysis for each significant actuarial assumption showing how the defined benefit obligation would have been affected, before and after tax, by changes in the relevant actuarial assumptions that were reasonably possible at the reporting date.

	(Decrease)/increase in defined benefit obligation	
	Before tax £m	After tax £m
Discount rate		
+0.50% discount rate	(396)	(329)
-0.50% discount rate	459	381
Inflation rate		
+0.50% inflation rate	373	310
-0.50% inflation rate	(328)	(272)
Mortality		
Increase in life expectancy by one year	148	123

The sensitivity analysis is based on a change in one assumption while holding all other assumptions constant, therefore interdependencies between assumptions are excluded, with the exception of the inflation rate sensitivity which also impacts salary and pension increase assumptions. The analysis also makes no allowance for the impact of changes in gilt and corporate bond yields on asset values. The methodology applied is consistent to that used to determine the recognised pension liability.

The total contributions to the defined benefit pension scheme in 2017 are expected to be £50 million for the Group. The levels of contributions are based on the current service costs and the expected cash flows of the defined benefit pension Scheme. The Group estimates the present value of the duration of the Scheme liabilities on average fall due over 19 years (2015: 19 years).

(b) Other pension and post-retirement liabilities

The Group operates a defined contribution scheme for all employees who joined the Group after 15 June 2008. The Group also has defined contribution schemes in respect of employees of Heathrow Express Operating Company Limited. The total cost of defined contribution arrangements fully expensed against operating profit in the year is £9 million (2015: £8 million).

The Group also provides unfunded pensions in respect of a limited number of former directors and senior employees whose benefits are restricted by the Scheme rules. The provision for unfunded pension obligations of £29 million (2015: £22 million) is included in the statement of financial position. In addition, the Group provides post-retirement medical benefits to certain pensioners. The present value of the future liabilities under this arrangement of £6 million (2015: £6 million) is also included in the statement of financial position. The value of these unfunded pensions has been assessed by the actuary using the same assumptions as those used to calculate the Scheme's liabilities.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

21 Provisions

	Disposal of operations £m	Reorganisation costs £m	Home loss payments £m	Other £m	Total £m
Non-current	-	-	-	2	2
Current	1	5	-	4	10
1 January 2016	1	5	-	6	12
Utilised	(1)	(5)	-	(2)	(8)
Charged to income statement	-	11	-	1	12
Released to income statement	-	-	-	(2)	(2)
Arising during the year	-	-	7	-	7
31 December 2016	-	11	7	3	21
Non-current	-	-	7	2	9
Current	-	11	-	1	12
31 December 2016	-	11	7	3	21

Disposal of operations

Provisions are held mainly for costs associated with the Group's disposal of the NDH1 Group, which was sold in December 2014. During the year ended 31 December 2016, the Group utilised this provision.

Reorganisation costs

These are costs associated with the Group's reorganisation programmes primarily relating to restructuring processes designed to reduce the size and costs of overhead functions. The charge relates to severance and pension payments associated with the reorganisation programme carried out during 2016 and continuing into 2017.

Home loss payments

Between 2005 and 2011, Heathrow Airport Limited entered into a number of agreements to buy residential properties in the original third runway blight area. The purchase price for these properties included a deferred 10% payment ("deferred payment") which would be settled in cash when planning consent is obtained. In October 2016, the Government announced its support for expansion at Heathrow and, following Board approval, a public statement was issued by Heathrow Airport Limited stating its intention to apply for planning consent, making it probable that the Group will be required to pay the deferred payment in the future. As a result, during the year ended 31 December 2016, the Group recorded a provision for the deferred payment equal to the amount it expects to pay of £7 million.

The provision has been created in 2016 specifically in respect of Heathrow expansion, following the Government's decision in October 2016.

Other

During 2016, there was £2 million utilised and £2 million released in relation to some employment costs that were initially provided in 2015.

Also, there was a £1 million charge relating to insurance claims and potential liabilities from incidents which occurred at Heathrow airport.

22 Trade and other payables

	31 December 2016 £m	31 December 2015 £m
Non-current		
Other payables	11	13
	11	13
Current		
Deferred income	30	29
Trade payables ¹	174	164
Other tax and social security	7	9
Other payables	15	20
Capital payables	121	122
Amounts owed to parent entity	41	38
	388	382

¹ Trade payables are non-interest bearing and are generally on 30-day terms.

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

23 Share capital

	Number of shares	Nominal value £m
Authorised		
Ordinary shares of 6.2p each		
At 1 January 2015, 1 January 2016 and 31 December 2016	43,000,000,100	2,666
Called up, allotted and fully paid		
Ordinary shares of 6.2p each		
At 1 January 2015, 1 January 2016 and 31 December 2016	42,998,461,934	2,666

24 Other reserves

	Cash flow hedge reserve £m	Available-for-sale reserve £m	Total £m
1 January 2015	(327)	10	(317)
Fair value (losses)/gains	(159)	5	(154)
Transferred to income statement	217	-	217
Deferred tax on fair value gains	(10)	(1)	(11)
Change in tax rate	(9)	-	(9)
1 January 2016	(288)	14	(274)
Fair value gains taken to equity	317	-	317
Transferred to income statement	(290)	-	(290)
Deferred tax on fair value gains	(4)	-	(4)
Change in tax rate	(6)	-	(6)
31 December 2016	(271)	14	(257)

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

25 Tax relating to components of other comprehensive income

The tax credit/(charge) relating to components of other comprehensive income was as follows:

	Year ended 31 December 2016			Year ended 31 December 2015		
	Before tax £m	Tax credit/ (charge) £m	After tax £m	Before tax £m	Tax (charge)/ credit £m	After tax £m
Continuing operations						
Available-for-sale investments						
Gain taken to equity	-	-	-	5	(1)	4
Cash flow hedges						
Gains/(losses) taken to equity	317	(54)	263	(159)	28	(131)
Transferred to income statement	(290)	50	(240)	217	(38)	179
Change in tax rate	-	(6)	(6)	-	(9)	(9)
Actuarial loss (Note 20)						
Actuarial loss on pensions	(226)	39	(187)	(4)	1	(3)
Tax relating to retirement benefits	-	-	-	-	(10)	(10)
Tax relating to indexation of operational land	-	1	1	-	-	-
Change in tax rate	-	5	5	-	7	7
Other comprehensive (loss)/income	(199)	35	(164)	59	(22)	37
Deferred tax (Note 19)	-	35	-	-	(22)	-

26 Retained earnings

	2016 £m	2015 £m
1 January	(504)	(869)
Consolidated (loss)/profit for the year	(119)	702
Tax relating to retirement benefits	-	(10)
Tax relating to indexation of operational land	1	-
Change in tax rate	5	7
Actuarial loss on pensions (Note 20)	(226)	(4)
Tax credit on actuarial loss	39	1
Dividends paid ¹ (Note 7)	(540)	(331)
31 December	(1,344)	(504)

¹ During the year ended 31 December 2016, the company paid dividends of £540 million to ADI Finance 2 Limited comprising £75 million on 22 February 2016, £8 million on 11 March 2016, £83 million on 23 June 2016, £151 million on 22 July 2016, £1 million on 16 September 2016, £121 million on 6 October 2016 and £101 million on 21 December 2016 (2015: £331 million to ADI Finance 2 Limited being £75 million on 27 February 2015, £91 million on 30 June 2015, £75 million on 24 July 2015 and £90 million on 16 December 2015).

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

27 Commitments and contingent liabilities

Non-cancellable operating lease commitments – Group as a lessee

Total future minimum rentals payable as at the year end are as follows:

	31 December 2016		31 December 2015	
	Land and buildings £m	Other £m	Land and buildings £m	Other £m
Within one year	14	35	12	42
Within two to five years	26	134	30	156
After five years	8	450	10	592
	48	619	52	790

The Group leases various offices and warehouses under non-cancellable operating lease agreements. The leases have various terms, escalation clauses and renewal rights. The Group also leases plant and machinery under non-cancellable operating leases.

A significant portion of the commitments classified as 'other' relates to electricity supply equipment at Heathrow leased on agreement with UK Power Networks Services Limited ('UKPNS'). The lease expires in 2083. The amounts disclosed are the total estimated charges under the agreement including both the actual lease commitment and the significant maintenance element of the fee payable to UKPNS as neither the Group nor UKPNS are able to split the base fee between a 'capital' and 'maintenance' charge. The commitment has been discounted at the Group's incremental borrowing rate. Other commitments have decreased from £790 million in 2015 to £619 million in 2016 due to the change in assumptions used to calculate the net present value of the commitments under the UKPNS contract.

Non-cancellable operating lease commitments – Group as a lessor

Total future minimum rentals receivable as at the year end are as follows:

	31 December 2016	31 December 2015
	Land and buildings £m	Land and buildings £m
Within one year	92	95
Within two to five years	205	291
After five years	1,709	1,745
	2,006	2,131

The Group uses a number of different leasing and contractual structures depending on the type and location of the investment property. Typically in multi-let offices and industrial premises a standard indefinite tenancy is used, which is terminable by the tenant on three months' notice at any time. However, it is common for the accommodation to remain let or be quickly re-let should it be vacated. For larger, stand-alone premises, e.g. cargo sheds, longer leases of multiples of three years are used.

Car rental facilities are operated under concession agreements subject to minimum guaranteed payments and the amounts are included above. Public car parks are covered by a single management contract.

Group commitments for property, plant and equipment

	31 December 2016 £m	31 December 2015 £m
Contracted for, but not accrued:		
Baggage systems	157	67
Terminal restoration and modernisation	173	53
Tunnel refurbishment	8	21
IT projects	28	17
Capacity optimisation	33	14
	399	172
Other projects	16	29
	415	201

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

27 Commitments and contingent liabilities *continued*

The figures in the above table are contractual commitments to purchase goods and services at the reporting date. Capital expenditure for the Q6 regulatory period from 1 April 2014 to 31 December 2018 is currently forecast to be £3.0 billion (excluding expansion related costs). The Q6 capital programme may increase to up to £3.3 billion, in line with the regulatory settlement. This is subject to further scoping of the remaining individual projects and approval of the corresponding business cases. The capital programme is primarily focussed on maintenance and compliance related projects, together with sustaining and improving the passenger experience. The capital plan for the period includes a £1 billion programme of asset management projects and a project to implement the latest generation of hold baggage screening equipment to comply with EU directives. Capital spend in 2017 is forecast to be in the region of £666 million (excluding expansion related costs)

Other commitments

Heathrow Airport Limited has a commitment to pay £87 million in 2018 to the Department for Transport in relation to the Crossrail project in return for a service commitment for Crossrail to operate services to Heathrow for 15 years. It is expected that the amount will be included in the Regulatory Asset Base.

Following the Government decision in October 2016 for Heathrow as preferred option for expansion, the Company recognises that up to 64 residential property owners could exercise their right under the previous scheme for which bonds were issued, to redeem those bonds at some point in the future. The Company's best estimate of the total payment is £21 million based on a valuation in accordance with the terms set out in the bond contract, and assumes all 64 bondholders will exercise their option to sell.

Contingent liabilities

The Group has external contingent liabilities, comprising letters of credit, performance/surety bonds, performance guarantees and other items arising in the normal course of business amounting to £9 million at 31 December 2016 (2015: £10 million).

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

28 Note to the consolidated statement of cash flows

Reconciliation of profit before tax to cash generated from continuing operations

	Note	Year ended 31 December 2016 £m	Year ended 31 December 2015 £m
Operating activities			
(Loss)/profit before tax		(187)	732
<i>Adjustments for:</i>			
Fair value loss/(gain) on financial instruments	4b	522	(150)
Finance costs	4a	934	919
Finance income	4a	(220)	(251)
Fair value gain on investment properties		(44)	(95)
Depreciation	2	637	650
Amortisation	2	41	39
Loss on disposal of property, plant and equipment		2	-
(Increase)/decrease in trade and other receivables		(15)	18
Increase in inventories		-	(1)
Increase/(decrease) in trade and other payables		2	(7)
Increase/(decrease) in provisions		3	(4)
Difference between pension charge and cash contributions		(32)	(23)
Exceptional pension credit: change to terms		-	(236)
Cash generated from continuing operations		1,643	1,591

Reconciliation in net debt

Net debt comprised the Group's external consolidated borrowings excluding interest accruals, net of cash and cash equivalents and term deposits, and excludes restricted cash.

	1 January 2016 £m	Cash flow £m	Transfers from non- current to current £m	Other non-cash changes ¹ £m	31 December 2016 £m
Cash and cash equivalents	199	108	-	-	307
Term deposits	550	(170)	-	-	380
Current borrowings	(708)	800	(1,162)	(147)	(1,217)
Non-current borrowings	(12,309)	(1,114)	1,162	(698)	(12,959)
Net debt	(12,268)	(376)	-	(845)	(13,489)

¹ Relates to amortisation of issue costs, premiums and discounts, foreign exchange translations of foreign currency debt, fair value adjustments on hedged bonds and accretion accruals.

29 Related party transactions

During the year the Group entered into the following transactions with related parties.

	Sales to related party		Purchases from related party		Amounts owed by related party		Amounts owed to related party	
Related party	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m	2016 £m	2015 £m
AGS Airports	-	3	-	-	-	-	-	-
Amey OWR Ltd	-	-	1	-	-	-	-	-
Ferrovial	-	-	2	5	-	-	-	-
Ferrovial Agroman	-	-	62	35	-	-	-	-
Harrods International Limited	23	22	-	-	-	-	-	-
HETCo	-	-	7	48	-	-	-	-
Qatar Airways	32	31	-	-	1	1	-	-
ADI Finance 2 Limited	-	-	-	-	93	93	155	194
	55	56	72	88	94	94	155	194

The related parties above are related through ownership by the same parties. Related party transactions relate primarily to construction projects, loans and interest payable, and are conducted on an arms-length basis. In addition, in 2014 the Group completed the disposal of its 100% shareholding in the NDH1 Group to AGS Airports Limited, which is owned by Macquarie European Investment Fund 4 and Ferrovial Aeropuertos S.A., in an arms-length transaction (Note 6).

Heathrow Airport Holdings Limited

Notes to the Group financial statements *continued*

30 Parent undertaking and controlling party

The immediate parent undertaking of the Group is ADI Finance 2 Limited, a company registered in England and Wales.

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (25.00%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly-owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. and Alinda Airports L.P. (11.18%) (investment vehicles managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (10.00%) (wholly-owned by the Universities Superannuation Scheme).

The Company is the parent undertaking of the smallest group to consolidate these financial statements.

Copies of the financial statements of Heathrow Airport Holdings Limited and FGP Topco Limited may be obtained by writing to the Company Secretarial Department at The Compass Centre, Nelson Road, Hounslow, Middlesex TW6 2GW.

31 Subsidiaries

The subsidiaries whose financial position affects the Group are as follows:

Direct Subsidiaries:

Heathrow Holdco Limited

Indirect subsidiaries:

9G Rail Limited	BMG (Swindon Phases II & III) General Partner Limited	LHR Insurance Services Limited ³
Airport Hotels General Partner Limited	BMG (Swindon) Limited	London Airports 1992 Limited
Airport Property GP (No.1) Limited	BMG Europe Limited ¹	London Airports 1993 Limited
BAA (NDH2) Limited	Devon Nominees Limited	London Airports Limited
BAA General Partner Limited	Heathrow (AH) Limited	Non Des Topco Limited
BAA International Limited	Heathrow (DSH) Limited	Scottish Airports Limited
BAA Lynton Developments Limited	Heathrow (SP) Limited	The BMG (Ashford) LP
BAA Lynton Management Limited	Heathrow Airport Holdings Limited	The BMG (Bridgend Phases II and III) LP
BAA Partnership Limited	Heathrow Airport Limited	The BMG (CO Phase IV) LP
BAA Pension Trust Company Limited	Heathrow Enterprises Limited	The BMG (Swindon Phases II and III) LP
BAA Properties Limited	Heathrow Express Operating Company Limited	Ultra Global Limited
BMG (Ashford) General Partner Limited	Heathrow Finance plc	World Duty Free Limited
BMG (Ashford) General Partner Limited	Heathrow Funding Limited ²	
BMG (Ashford) Limited	LHR (Hong Kong) Limited	
BMG (Ashford) Partnership Trustco Limited	LHR (IP Holdco) Limited	
BMG (Bridgend) Limited	LHR Airports Limited	
BMG (Cheshire Oaks) Limited	LHR Building Central Services Limited	
BMG (CO2) Limited	LHR Business Support Centre Limited	

¹ Incorporated in Jersey, but all profit taxed in the UK as a Controlled Foreign Company.

² Incorporated in Jersey, but UK tax resident.

³ Incorporated in the Isle of Man, but all profit taxed in the UK as a Controlled Foreign Company.

Unless otherwise indicated, all subsidiaries are wholly-owned, incorporated in Great Britain and registered in England and Wales. A complete list of subsidiaries will be annexed to the next annual return delivered to the Registrar of Companies.

The registered office of the Company's subsidiaries is the same as FGP Topco Limited as set out below, with the exception of Heathrow Funding Limited whose registered office is 13 Castle Street, St Helier, Jersey, JE5 5UT, Channel Islands.

32 Subsequent events

On the 23 February 2017, the Board approved the payment of a £93.75 million dividend to the Shareholders.

Heathrow Airport Holdings Limited

Independent auditor's report to the members of Heathrow Airport Holdings Limited

We have audited the parent company financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2016 which comprise the Company Statement of Financial Position, the Accounting policies and the related notes 1 to 10. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice), including FRS 101 "Reduced Disclosure Framework".

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement, the directors are responsible for the preparation of the parent company financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the parent company financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the parent company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the parent company financial statements:

- give a true and fair view of the state of the parent company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with Financial Reporting Standard 101 Reduced Disclosure Framework; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic Report and the Directors' Report.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

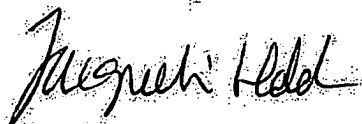
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Heathrow Airport Holdings Limited

Independent auditor's report to the members of Heathrow Airport Holdings Limited *continued*

Other matter

We have reported separately on the Group consolidated financial statements of Heathrow Airport Holdings Limited for the year ended 31 December 2016.



Jacqueline Holden FCA (Senior Statutory Auditor)
for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, UK

23 February 2017

Heathrow Airport Holdings Limited
Statement of financial position as at 31 December 2016

	Notes	31 December 2016 £m	31 December 2015 £m
Assets			
Non-current assets			
Investments in subsidiaries	2	4,609	4,609
Trade and other receivables	3	934	946
		5,543	5,555
Current assets			
Trade and other receivables	3	149	98
		149	98
Total assets		5,692	5,653
Liabilities			
Non-current liabilities			
Trade and other payables	4	(155)	(155)
Total liabilities		(155)	(155)
Net assets		5,537	5,498
Capital and reserves			
Called up share capital	5	2,666	2,666
Profit and loss reserve	6	2,871	2,832
Total shareholder's funds		5,537	5,498

The profit of the Company for the year attributable to shareholders was £579 million (2015: £369 million).

These financial statements of Heathrow Airport Holdings Limited (Company registration number: 05757208) were approved by the Board of Directors and authorised for issue on 23 February 2017. They were signed on its behalf by:


John Holland-Kaye
 Director


Javier Echave
 Director

Heathrow Airport Holdings Limited

Accounting policies for the year ended 31 December 2016

The principal accounting policies applied in the preparation of the financial statements of Heathrow Airport Holdings Limited (the 'Company') are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated.

Basis of preparation

These financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment in subsidiary in accordance with the Companies Act 2006 and applicable accounting standards. They have been prepared by the directors in accordance with FRS 101.

Under FRS 101, the Company has chosen to apply the recognition and measurement provisions of International Accounting Standard ('IAS') 27 'Separate Financial Statements', as endorsed by the European Union ('EU').

The Company has taken advantage of certain disclosure exemptions in FRS 101 as its financial statements are included in the publicly available consolidated financial statements of FGP Topco Limited, a company registered in England and Wales. As such, the Company is exempt from presenting a Statement of cash flows and from the disclosure requirement to show related party transactions with entities that are wholly owned subsidiaries of FGP Topco Limited group. In addition, the Company has also taken advantage of disclosure exemption of the income statement as allowed by the Companies Act. Copies of those consolidated financial statements may be obtained by writing to the Company Secretarial Department at the Compass Centre, Nelson Road, Hounslow, Middlesex TW6 2GW.

The Company is not a financial institution and is therefore able to take advantage of exemption from all requirements of IFRS 7 'Financial Instruments: Disclosure' and from the disclosure requirements of IFRS 13 'Fair Value Measurement'.

Going concern

The directors have prepared the financial statements on a going concern basis which requires the directors to have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future.

Investment in subsidiaries

Investments in subsidiaries are stated at cost and reviewed for impairment if there are any indications that the carrying value may not be recoverable. Reversals are recognised where there is a favourable change in the economic assumptions in the period since the provision was made.

Trade receivables

Trade receivables are recognised initially at cost less any provision for impairment.

Cash

Cash comprises cash in hand and deposits repayable on demand, less overdrafts payable on demand when a right to offset exists.

Amounts owed to group undertakings

Amounts owed to group undertakings are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost. Any difference between the amount initially recognised (net of transaction costs) and the redemption value is recognised in the profit and loss account over the period of the borrowings using the effective interest method.

Current and deferred taxation

The tax expense for the year comprises current and deferred tax. Tax is recognised in the income statement, except to the extent that it relates to items recognised directly in other comprehensive income. In this case, the tax is recognised in other comprehensive income.

Current tax liabilities are measured at the amount expected to be paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the reporting date. Management periodically evaluates positions taken in tax returns with respect to situations in which applicable tax regulation is subject to interpretation.

Deferred income taxation is provided in full using the liability method on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Group's financial statements. Deferred income taxation is not provided on the initial recognition of an asset or liability in a transaction, other than a business combination, if at the time of the transaction there is no effect on either accounting or taxable profit or loss.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred tax assets and liabilities are not discounted.

Heathrow Airport Holdings Limited

Accounting policies for the year ended 31 December 2016 *continued*

Current and deferred taxation *continued*

Deferred income taxation is determined using the tax rates and laws that have been enacted, or substantively enacted, during the year and are expected to apply in the periods in which the related deferred tax asset or liability is realised or settled.

Share capital

Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs, allowing for any reductions in the par value. Where shares are issued above par value, the proceeds in excess of par value are recorded in the share premium reserve.

Dividend distribution

A dividend distribution to the Company's shareholders is recognised as a liability in the Company's financial statements in the period in which the shareholder's right to receive payment of the dividend is established. Interim dividends are recognised when paid.

Heathrow Airport Holdings Limited

Significant accounting judgements and estimates for the year ended 31 December 2016

In applying the Company's accounting policies, management have made judgements and estimates in a number of key areas. Actual results may, however, differ from the estimates calculated and management believes that the following areas present the greatest level of uncertainty.

Investment valuation

The Company reviews investment in subsidiary for impairment if there are any indications that the carrying value may not be recoverable. The carrying value of the investment is compared to the recoverable amount of the subsidiary and where a deficiency exists, an impairment charge is considered by management. The recoverable amount has been calculated using the fair value less cost to sell methodology. Fair value less cost to sell has been calculated based on discounted cash flow projections of the business.

Heathrow Airport Holdings Limited

Notes to the Company financial statements for the year ended 31 December 2016

1 Company result for the year

As permitted by Section 408 of the Companies Act 2006, the income statement of the Company is not presented as part of these financial statements. The profit of the Company for the year attributable to shareholders was £579 million (2015: £369 million).

2 Investments in subsidiaries

	£m
Cost	
1 January 2016 and 31 December 2016	4,609

Details of the subsidiary undertakings of the Group have been provided in Note 31 of the Heathrow Airport Holdings Limited consolidated financial statements.

3 Trade and other receivables

	31 December 2016 £m	31 December 2015 £m
Current		
Amounts owed by group undertakings – interest free	29	29
Amounts owed by group undertakings – interest bearing ¹	8	8
Interest owed by group undertakings	112	61
	149	98
Non-current		
Amounts owed by parent undertaking – interest free ²	93	93
Amounts owed by group undertakings – interest bearing ³	771	771
Deferred tax asset	70	82
	934	946
Total receivables	1,083	1,044

¹ Represents a loan advanced to LHR Airports Limited and attracts a rate of interest of 0.80%.

² Amounts owed by parent undertaking represent a loan to ADI Finance 2 Limited and is on an interest free basis.

³ Amounts owed by group undertakings represent a loan advanced to Heathrow Holdco Limited and attracts a fixed rate of interest of 6.65% at 31 December 2016.

Deferred tax asset

The Finance (No 2) Act 2016 enacted reductions in the main rate of UK corporation tax from 20% to 19% from 1 April 2017 and from 19% to 18% from 1 April 2020. As a result, the Group's deferred tax balances, which were previously provided at 20%, were re-measured at the rate at which the Group believes the temporary differences will reverse. This resulted in a reduction in the Company's deferred tax asset of £5 million. The additional £7 million movement in the deferred tax asset relates to utilisation of the non-trade deficit in 2016. There are no other items which would materially affect the future tax charge.

Deferred income tax assets have been recognised in respect of all temporary differences giving rise to deferred income tax assets where it is probable that these assets will be recovered

	31 December 2016 £m	31 December 2015 £m
Surplus non trade deficit	70	81

4 Trade and other payables: amounts falling due after more than one year

	31 December 2016 £m	31 December 2015 £m
Loan from parent undertaking – interest free	155	155

The loan from parent undertaking represents an amount lent by ADI Finance 2 Limited to the Company.

Heathrow Airport Holdings Limited

Notes to the Company financial statements for the year ended 31 December *continued*

5 Share capital

	Number of shares	Nominal value £m
Authorised		
Ordinary shares of 6.2p each		
At 1 January 2016 and 31 December 2016	43,000,000,100	2,666
Called up, allotted and fully paid		
Ordinary shares of 6.2p each		
At 1 January 2016 and 31 December 2016	42,998,461,934	2,666

6 Profit and loss reserve

	£m
1 January 2016	2,832
Profit for the financial year	579
Dividends paid ¹	(540)
31 December 2016	2,871

¹ Refer to Note 7

7 Dividends

In the year ended 31 December 2016, dividends of £540 million were made by the Group which funded £325 million of quarterly dividends paid to shareholders, £195 million of loan repayments on behalf of ADI Finance 2 Limited and £20 million of interest payments (used to part fund £30 million of total interest paid) at ADI Finance 2 Limited (2015: £331 million were made by the Group which funded £300 million of quarterly dividends paid to shareholders and £31 million of interest payments at ADI Finance 2 Limited).

8 Auditor's remuneration

The Company's auditor received £22,000 (2015: £21,000) as remuneration for the audit of the Company's financial statements, the cost of which was borne by Heathrow Airport Limited.

9 Employee information and directors' remuneration

Employee numbers

The Company had no employees (2015: none).

Directors' remuneration

None of the directors (2015: none) who served during the year ended 31 December 2016 received any emoluments from the Company.

During the year, none of the directors (2015: none) had retirement benefits accruing to them under a defined benefit or defined contribution pension scheme.

None of the directors (2015: none) exercised any share options during the year in respect of their services to the Company and no shares (2015: none) were received or became receivable under long term incentive plans.

Details of directors' remuneration for the year are provided in Note 2 of the Group financial statements.

Heathrow Airport Holdings Limited

Notes to the Company financial statements for the year ended 31 December *continued*

10 Ultimate parent undertaking and controlling party

The immediate parent undertaking of the Company is ADI Finance 2 Limited, a company registered in England and Wales.

The ultimate parent entity is FGP Topco Limited, which is the parent undertaking of the largest group to consolidate these financial statements. The shareholders of FGP Topco Limited are Hubco Netherlands B.V. (25.00%) (an indirect subsidiary of Ferrovial, S.A., Spain), Qatar Holding Aviation (20.00%) (a wholly-owned subsidiary of Qatar Holding LLC), Caisse de dépôt et placement du Québec (12.62%), Baker Street Investment Pte Ltd (11.20%) (an investment vehicle of the Government of Singapore Investment Corporation), Alinda Airports UK L.P. and Alinda Airports L.P. (11.18%) (investment vehicles managed by Alinda Capital Partners), Stable Investment Corporation (10.00%) (an investment vehicle of the China Investment Corporation) and USS Buzzard Limited (10.00%) (wholly-owned by the Universities Superannuation Scheme).

The Company is the parent undertaking of the smallest group to consolidate these financial statements.

Copies of the financial statements of Heathrow Airport Holdings Limited and FGP Topco Limited may be obtained by writing to the Company Secretarial Department at The Compass Centre, Nelson Road, Hounslow, Middlesex TW6 2GW.

11 Subsequent events

On 23 February 2017, the Board approved the payment of a £93.75 million dividend to the Shareholders.

Registered office

Heathrow Airport Holdings Limited, The Compass Centre, Nelson Road, Hounslow, Middlesex TW6 2GW
Registered in England Number: 05757208