Heathrow Funding Limited

Annual report and financial statements for the year ended 31 December 2017

Company registration number: 99529 (Jersey)

Heathrow Funding Limited

Contents

Heathrow Funding Limited

Officers and professional advisers

Directors
Javier Echave
Nicholas Golding
Beejadhursingh Surnam

Company secretary
Sanne Secretaries Limited

Registered office
13 Castle Street
St Helier
Jersey
JE4 5UT
Channel Islands

Independent auditor
Deloitte LLP
Statutory Auditor
2 New Street Square
London, United Kingdom
EC4A 3BZ

Bankers
Lloyds Bank plc
10 Gresham Street
London
EC2V 7AE

Directors' report

The Directors present their annual report and the audited financial statements for Heathrow Funding Limited (the 'Company') for the year ended 31 December 2017.

Principal activities

The Company's primary purpose is to raise funding from external sources and provide funding to Heathrow (SP) Limited and its subsidiaries (together the 'SP Group'). This is done through the issuance of external bonds and use of external derivatives. The proceeds raised are distributed to Heathrow Airport Limited ('Heathrow'), a fellow subsidiary of Heathrow (SP) Limited, under the terms of Borrower Loan Agreements ('BLAs'). The advances under BLAs are secured and are issued on substantially the same terms as the bonds issued by the Company, taking into consideration any related hedging instruments.

The Company is a direct subsidiary of Heathrow (SP) Limited and forms part of the Heathrow Airport Holdings Limited group (the 'Group'). The Company is incorporated in Jersey but is resident in the United Kingdom for taxation purposes.

Cross-currency swaps, interest rate swaps and index-linked swaps are entered into by the Company to hedge the SP Group's and the wider Heathrow Airport Holdings Group's exposures. Interest rate and index-linked derivatives are mainly passed through to Heathrow as back-to-back derivatives, or otherwise incorporated into related BLAs. The Company's cross-currency swaps are packaged with their associated non-Sterling debt and passed through to Heathrow under the BLAs.

For the year ended 31 December 2017 net finance cost decreased to £48 million (2016: £72 million).

For the year ended 31 December 2017 interest receivable from group undertakings was £733 million (2016: £642 million) and interest payable on external borrowings was £610 million (2016: £625 million).

Net interest on derivative financial instruments increased from £37 million payable in 2016 to £152 million payable in 2017. This was in part due to accretion on index-linked swaps, which was affected by increase in the inflation rate during 2017.

The fair value loss on financial instruments was £19 million (2016: £52 million loss). This was due to the fair value movement on index-linked swaps, cross-currency swaps and retranslation of foreign currency debt. The mark-to-market value of index-linked swaps was negatively impacted during the period by the increase in inflation expectations. The loss was partially offset by the fair value gains in the period on cross-currency swaps mainly due to lower EUR and USD Libor rates.

The settlement of £10 million of accretion on index-linked swaps and the depreciation of Sterling against the hedged currencies, impacted the carrying value of derivatives which changed from a net asset of £421 million at 31 December 2016 to a net asset of £243 million at 31 December 2017 as shown in Note 6.

Heathrow Funding Limited 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 with the cost of carrying substantial cash on the statement of financial position. This has been achieved partly by securing term debt with delays between commitment and drawing. During 2017, the Company successfully closed one term debt financing transactions, raising €500 million (£443m). Taking into account financing raised elsewhere in the Heathrow Airport Holdings Group, circa £0.9 billion was raised for Heathrow. Early 2018, a Canadian Bond (CAD400m bond due 2028) was issued and is due to be drawn down in March 2018.

Further, £20 million of its £620 million liquidity facilities have been cancelled as Heathrow continues to focus on the efficiency of its financing arrangements for itself and counterparties.

During 2017, the Company also repaid €700 million (£584 million) and CHF400 million (£272 million) bonds in January and February 2017 respectively. Since the start of 2018, the Company has also repaid €750 million (£510 million) bonds in February 2018.

The Company currently expects to raise no more than £1.0 billion in senior (Class A) term debt in 2018.

No significant changes to the activities of the Company are expected in the foreseeable future.

Directors' report *continued*

Results and dividends
The loss after taxation for the financial year amounted to £48 million (2016: £72 million loss). No ordinary dividends were proposed or paid during the year (2016: £nil). The statutory results for the year are set out on page 11.

Directors
The directors who served during the year and since the year end, except as noted, are as follows:

Javier Echave	
Andrew Efiong	Resigned 23 March 2018
Nicholas Golding	Appointed 17 January 2017
Beejadhursingh Surnam	
David Williamson	Resigned 9 January 2017

Employment policies
The Company has no direct employees (2016: none).

Key performance indicators
Given the straightforward nature of the business, the Company's directors are of the opinion that analysis using key performance indicators is not necessary for an understanding of the position of the Company's activity.

Going Concern
The financial statements have been prepared on the going concern basis, which requires the Directors to have a reasonable expectation that the Company, as part of the Heathrow Airport Holdings Group (the 'HAH Group'), has adequate resources to continue in operational existence for the foreseeable future. The going concern accounting policy on page 14 provides more detail.

Internal controls and risk management
Internal controls and risk management are key elements of the HAH Group's corporate operations. Risk is centrally managed within the HAH 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.

Internal controls
The directors are responsible for the system of internal controls designed to mitigate the risks faced by the HAH Group and for reviewing the effectiveness of the system. This is implemented by applying the HAH 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 HAH 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 and estimates;
  - key financial statement risk areas as reported further below in the report;
- 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.

Internal controls and risk management *continued*
Risk Management *continued*
We continue to roll out a risk improvement plan which is focussed on improving accountability for end-to-end risk management at all levels and drive improvements in our risk culture. The risk improvement plan covers all the key elements of an effective 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 assess and monitor our risk maturity across all key areas and drive improvements where required.

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 HAH Group's business operations and funding. To achieve this, the HAH 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 HAH Group are:

(a) Interest rates
The HAH Group maintains a mix of fixed and floating rate debt. As at 31 December 2017, fixed rate debt after hedging with derivatives represented 96.7% of the HAH Group's total external nominal debt.

(b) Inflation
The HAH 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 HAH Group uses cross-currency swaps to hedge all interest and principal payments on its foreign currency debt. The HAH 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 HAH 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 Finance 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. The Heathrow Finance platform is rated BB+/Ba3 and supports both loan and bond debt. 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 HAH 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 September 2019. As at 31 December 2017, the HAH Group had cash and cash equivalents and term deposits of £525 million, undrawn headroom under revolving credit facilities of £1,150 million, committed term debt financing to be drawn after 31 December 2017 of £100 million and undrawn liquidity facilities of £600 million.

(e) Counterparty credit
The HAH 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 HAH 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 HAH 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).

Directors' report *continued*

Directors' indemnity
The Company's Articles of Association provide that, subject to the provisions of the Companies (Jersey) Law 1991, 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 by reason of being or having been such an officer.

Auditor
Pursuant to the provisions of the Companies (Jersey) Law 1991 'Article 87 (4)', the Company has dispensed with the requirement to hold an annual general meeting and the auditor will be deemed to be re-appointed and Deloitte LLP will therefore continue in office.

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 Companies (Jersey) Law 1991.

Post balance sheet event
Early 2018, a Canadian Bond (CAD400m bond due 2028) was issued and is due to be drawn down in March 2018.

On behalf of the Board

Javier Echave
Director

28 March 2018

Directors' responsibilities statement

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

Companies (Jersey) Law 1991 requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". The financial statements are required by law to 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 these financial statements, the directors are required to:

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

The directors are responsible for keeping proper accounting records that 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 (Jersey) Law 1991. 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.

Independent auditor's report to the members of Heathrow Funding Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2017 and of its loss for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been properly prepared in accordance with requirements of the Companies (Jersey) Law, 1991.

We have audited the financial statements of Heathrow Funding Limited (the 'company') which comprise:

- the statement of comprehensive income;
- the statement of financial position;
- the statement of changes in equity;
- the statement of 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, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Summary of our audit approach

Key audit matters	The key audit matter that we identified in the current year was Financial Instruments: derivative valuations.
Materiality	£59.5m determined on the basis of 0.05% total borrowings.
Scoping	A full scope audit of the company was performed, covering 100% of net liabilities and 100% of operating loss.

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

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where: • the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or • the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.	**We have nothing to report in respect of these matters.**

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Financial Instruments: derivative valuations	
Key audit matter description	As noted on page 2 of the Annual Report and page 17 in key sources of estimation uncertainty the Company holds a substantial derivative portfolio comprising interest rate swaps, cross currency swaps and retail price index ("RPI") swaps, which are recorded at fair value. These are held to mitigate interest rate and foreign exchange risk arising on material levels of debt due to the capital programme, as well as inflation risk which arises in inflation linked revenue. As disclosed in note 6 to the financial statements, at 31 December 2017, the Company has a net derivative asset of £243m (2016: £421m). IAS 39 "Financial Instruments: Recognition and Measurement" requires derivatives to be accounted for at fair value with movements recognised in profit or loss, unless designated in a hedge relationship. Where possible, management has elected to apply hedge accounting, however this is applied in the financial statements of the Company's immediate parent. We identified a key audit matter in particular on the following areas; • Judgements in the valuation of financial instruments, specifically in relation to new and restructured trades, and the associated accounting impact of swap restructures; and • The impact on valuations for changes in credit risk.
How the scope of our audit responded to the key audit matter	We, with the involvement of our financial instrument specialists, have: • Performed independent valuation testing on a sample of new and restructured trades, including the credit value adjustment and debit value adjustment in order to assess the appropriateness of the credit risk adjustments; • Considered the appropriateness of accounting treatment arising from the restructuring of index-linked swaps; and • Tested the accounting entries for fair value calculations.
Key observations	We are satisfied that the financial instrument valuations have been accounted for appropriately.

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

Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£59.5m
Basis for determining materiality	Approximately 0.5% of total borrowings.
Rationale for the benchmark applied	The primary purpose of the Company is to raise funding from external sources and provide funding to Heathrow (SP) Limited and its subsidiaries. We have therefore used total borrowings as the benchmark. The applied materiality is capped at the component materiality calculated as part of the FGP Topco Limited group audit.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £2.975m, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

Heathrow Funding Limited is a Jersey incorporated, wholly-owned subsidiary of Heathrow (SP) Limited. Deloitte LLP are the auditor of all non-dormant subsidiaries of the Heathrow (SP) Limited group. The primary purpose of the Company is to raise funding from external sources and provide funding to Heathrow (SP) Limited and its subsidiaries.

Our audit was scoped by obtaining an understanding of the entity and its environment, including internal control, and assessing the risks of material misstatement. Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.

Other information

We have nothing to report in respect of these matters.

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

This report is made solely to the company's members, as a body, in accordance with Article 113A of the Companies (Jersey) Law 1991. 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.

Report on other legal and regulatory requirements

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies (Jersey) Law 1991 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- proper accounting records have not been kept, or proper returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Jacqueline Holden FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
London, United Kingdom
March 2018

Heathrow Funding Limited

Statement of comprehensive income for the year ended 31 December 2017

	Note	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Financing			
Finance income	2	**1,064**	1,019
Finance cost	2	**(1,093)**	(1,039)
Fair value loss on financial instruments	2	**(19)**	(52)
Operating loss on ordinary activities before taxation		**(48)**	(72)
Taxation	3	**-**	-
Loss after taxation for the financial year	8	**(48)**	(72)
Total comprehensive loss for the year		**(48)**	(72)

Heathrow Funding Limited

Statement of financial position as at 31 December 2017

	Note	31 December 2017 £m	31 December 2016 £m
Assets			
Non-current assets			
Trade and other receivables	*4*	**10,736**	11,151
Derivative financial instruments	*6*	**1,536**	1,762
		12,272	12,913
Current assets			
Trade and other receivables	*4*	**1,131**	1,040
Derivative financial instruments	*6*	**173**	78
		1,304	1,118
Total assets		**13,576**	14,031
Liabilities			
Non-current liabilities			
Borrowings	*5*	**(10,883)**	(11,457)
Derivative financial instruments	*6*	**(1,459)**	(1,419)
		(12,342)	(12,876)
Current liabilities			
Borrowings	*5*	**(1,298)**	(1,178)
Derivative financial instruments	*6*	**(7)**	-
		(1,305)	(1,178)
Total liabilities		**(13,647)**	(14,054)
Net liabilities[1]		**(71)**	(23)
Capital and reserves			
Stated capital	*7*	**-**	-
Retained earnings	*8*	**(71)**	(23)
Total shareholder's deficit		**(71)**	(23)

[1] Net liabilities reflect the different measurement bases used for certain financial instruments: Borrower Loan Agreements and bonds are recorded at amortised cost but derivatives are re-measured to fair value at each reporting date.

The financial statements of Heathrow Funding Limited were approved by the Board of Directors and authorised for issue on 28 March 2018. They were signed on its behalf by:

Javier Echave
Director

Nicholas Golding
Director

Heathrow Funding Limited

Statement of changes in equity as at 31 December 2017

	Retained earnings £m	Total £m
At 1 January 2016	49	49
Total comprehensive loss for the financial year	(72)	(72)
At 31 December 2016	(23)	(23)
Total comprehensive loss for the financial year	**(48)**	**(48)**
At 31 December 2017	**(71)**	**(71)**

Accounting policies for the year ended 31 December 2017

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

The Company
The Company is a limited liability company registered and incorporated in Jersey.

Basis of accounting and statement of compliance
These financial statements have been prepared in accordance with Financial Reporting Standards 102 – 'The Financial Reporting Standard applicable in the United Kingdom and Republic of Ireland' (FRS 102) and with the Companies (Jersey) Law 1991. This provides for the Company to follow statements of accounting practice issued by the relevant accounting bodies in the United Kingdom. Consequently, the Company follows Financial Reporting Standard 100 ('FRS100') and in accordance with FRS 100 the Company has chosen to apply FRS 102.

The Company has adopted the following standard that is relevant to these financial statements:

IAS 39 'Financial Instruments: Recognition and Measurement', as endorsed by the European Union ('EU'). As a result, the accounting requirements of IAS 39 have been applied to all financial instruments instead of those of FRS 102.

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

The Company has taken advantage of certain disclosure exemptions in FRS 102 as its financial statements are included in the publicly available consolidated financial statements of Heathrow (SP) Limited, Heathrow Finance plc, Heathrow Airport Holdings Limited and FGP Topco Limited. These disclosure exemptions relate to the statement of cash flows and financial instruments. 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.

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. The Company forms part of the Heathrow (SP) Limited group (the 'SP Group'), which is the smallest group to consolidate these financial statements, and the level at which financial risks are managed for the Company.

Consequently the directors have reviewed the cash flow projections of the SP Group, of which the Company forms part, taking into account:

- the forecast turnover and operating cash flows from the underlying operations;
- the forecast level of capital expenditure; and
- the overall SP 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.

Whilst the Company 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 Company's funding requirement for the twelve months following the date when the Statement of financial position was signed.

Furthermore, Heathrow, 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. Consequently, as an Issuer under the common terms platform, the directors have a reasonable expectation that the Company will recover debts outstanding with Heathrow and be able to meet its liabilities due within one year.

Foreign currency
Items included in the financial statements of the Company are measured using the currency of the primary economic environment in which the entity operates (the 'functional currency'). The financial statements are presented in Pound Sterling, which is the 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 profit and loss account.

Finance income
Finance income is recognised when it is probable that the economic benefits will flow to the Company and the amount of revenue can be measured reliably. Finance income is accrued on a time basis, by reference to the principal outstanding

Accounting policies for the year ended 31 December 2017 *continued*

Finance income *continued*
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.

Borrowings
Borrowings 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. For index-linked borrowings, the nominal amount is adjusted for movements in the relevant price index. The accretion expense is recorded within net interest payable on derivative financial instruments in the profit and loss account.

All borrowings issued by the Company are on-lent to Heathrow under Borrower Loan Agreements ('BLAs'). The advances under the BLAs are issued on substantially the same terms as the new bonds issued by the Company, taking into consideration the related hedging instruments. The advances are carried at amortised cost with interest income recognised using the effective interest method. The nominal amount of the index-linked advances is accreted for the RPI component recognised within finance income in the profit and loss account.

Taxation
Whilst the Company is incorporated outside the UK, it is treated as a UK resident company for tax purposes. The Company qualifies as a 'securitisation company' within the scope of the Taxation of Securitisation Companies Regulations 2006 under UK tax law.

Amounts owed to group undertakings
Amounts owed to group undertakings are repayable on demand and are recognised initially at fair value, net of transaction costs incurred and are subsequently stated at amortised cost.

Share capital
Ordinary shares are classified as equity and are recorded at the par value of proceeds received, net of direct issue costs. Where the shares are issued above par value, the proceeds in excess of par value are recorded in the share premium reserve. Where a share capital reduction has taken place, shares are classified at their re nominalisation value.

Issue costs and arrangement fees
Immediately after issue, debt is stated at the fair value of the consideration received on the issue of the capital instrument after deduction of issue costs. The finance cost of the debt is allocated to periods over the term of the debt at an effective interest rate on the carrying amount.

Issue costs are those that are incurred directly in connection with the issue of a capital instrument, that would not have been incurred had the instrument not been issued. These are accounted for as a deduction from the fair value of consideration received and amortised using the effective interest method.

Facility and arrangement fees resulting from the negotiation of finance that do not qualify as issue costs are written off to the profit and loss account as incurred.

Derivative financial instruments
Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured 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 Company does not currently designate the derivatives held by the Company in a hedge relationship, but rather they are hedge accounted for at the SP Group level. Derivatives are classified based on their maturity.

Changes in the fair value of derivatives not in a hedge relationship are recorded in the profit and loss account.

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

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 Company's derivatives is updated quarterly based on current market data. The back-to-back derivatives carry the same credit risk adjustment as the associated external derivatives.

Accounting policies for the year ended 31 December 2017 *continued*

Classification of financial instruments issued by the Company
In accordance with FRS 102, Section 22: *Liabilities and Equity,* financial instruments issued by the Company are treated as a liability only to the extent that they meet the following two conditions:

(a) they include contractual obligation to deliver cash or another financial asset; or

(b) they include a contract that will or may be settled in the entity's own equity instruments and:

- under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

- will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments.

To the extent that this definition is met, the proceeds of issue are classified as a financial liability. Where the instrument so classified takes the legal form of the Company's own shares, the amounts presented in these financial statements for stated capital and share premium reserve exclude amounts in relation to those shares. Finance payments associated with financial liabilities are dealt with as part of interest payable and similar charges.

Finance payments associated with financial instruments that are classified as part of shareholder's funds are dealt with as appropriations in the reconciliation of movements in shareholder's funds.

As permitted by FRS 102, the Company has chosen to apply the classification provisions of International Accounting Standard ('IAS') 39 'Financial Instruments: Classification of financial assets and Classification of financial liabilities', as endorsed by the European Union ('EU'). As a result, the accounting requirements of IAS 39 have been applied to all financial instruments instead of those of FRS 102.

Cash flow statement and related party transactions
The ultimate parent entity is FGP Topco Limited, a company registered in England and Wales. The results of the Company are included in the audited consolidated financial statements of FGP Topco Limited for the year ended 31 December 2017. The results are also included in the audited consolidated financial statements of Heathrow (SP) Limited for the year ended 31 December 2017 (immediate parent entity and the smallest group to consolidate these financial statements). They are also included in the audited consolidated financial statements of Heathrow Finance plc and Heathrow Airport Holdings Limited for the year ended 31 December 2017. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement and from disclosing related party transactions with entities that are wholly owned subsidiaries of the FGP Topco Limited group under the terms of accounting standard FRS 102 (1.12 (b) and (e)).

Significant estimates and judgments for the year ended 31 December 2017

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 believe that the following areas present the greatest level of uncertainty.

Critical judgements in applying the Company's accounting policies

There are no critical judgments for the Company.

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.

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2017

1 Operating costs

Auditor's fee

Audit fees are recharged in accordance with the Shared Service Agreement ('SSA') into the operating entities. The Company is not an operating entity and is therefore not party to the SSA and receives no recharge of the audit cost. However, the Company's auditor received £27,000 (2016: £21,000) as remuneration for the audit of the Company's financial statements the cost of which is borne by Heathrow.

Employee information

The Company has no employees (2016: nil).

Directors' remuneration

An amount was paid to Sanne Group (UK) Limited (a related party due to their ability to appoint a director), for directors' services totalling £5,000 for the year ended 31 December 2017 (2016: £5,000). This payment is made annually for the services of Beejadhursingh Surnam, an independent UK-resident director provided by Sanne Group (UK) Limited as a director of Heathrow Funding Limited, in line with the existing Issuer Corporate Agreements between the companies. In addition to this £14,000 (2016: £6,450) was paid to Sanne Fiduciary Services Limited by various entities in the Heathrow Airport Holdings Group for registered office and company secretary services.

Javier Echave is a director of a number of companies within the Heathrow Airport Holdings Group during the year. His remuneration for the year ended 31 December 2017 was disclosed in the financial statements of Heathrow Airport Holdings Limited. The directors do not believe it is possible to accurately apportion their remuneration to individual companies based on services provided. Andrew Efiong and Nicholas Golding were directors of a number of companies within the Heathrow Airport Holdings Group during the year. They were paid by, but are not directors of, Heathrow Airport Limited. The directors do not believe it is possible to accurately apportion their remuneration to individual companies within the Heathrow Airport Holdings Group based on services provided.

During the year, one of the directors (2016: none) had retirement benefits accruing to them under a defined benefit scheme and three of the directors (2016: four) had retirement benefits accruing to them under a defined contribution scheme.

2 Financing

(a) Net finance costs before certain re-measurements

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Finance income		
Interest receivable from group undertakings	**733**	642
Interest receivable on derivatives	**331**	377
	1,064	1,019
Finance costs		
Interest payable on external borrowings	**(610)**	(625)
Interest payable on derivatives	**(483)**	(414)
	(1,093)	(1,039)
Net finance costs before certain re-measurements	**(29)**	(20)

(b) Fair value loss on financial instruments

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Index-linked swaps with external counterparties	**134**	(436)
Index-linked swaps as back-to-back derivatives with Heathrow Airport Limited	**(81)**	350
Cross-currency swaps with external counterparties and retranslation of foreign currency debt	**(67)**	36
Interest rate swaps with external counterparties	**62**	(126)
Interest rate swaps as back-to-back derivatives with Heathrow Airport Limited	**(67)**	124
Fair value loss on financial instruments	**(19)**	(52)
Net finance cost	**(48)**	(72)

Notes to the financial statements for the year ended 31 December 2017 *continued*

3 Taxation

Reconciliation of tax charge

The standard rate of current tax for the year, based on the UK standard rate of corporation tax, is 19.25% (2016: 20%). The actual tax charge for the current and prior year differs from the standard rate for the reasons set out in the following reconciliation:

	Year ended 31 December 2017 £m	Year ended 31 December 2016 £m
Loss on ordinary activities before tax	**(48)**	(72)
Tax credit on loss on ordinary activities at 19.25% (2016: 20%)	**9**	14
Effect of:		
Expenses not deductible for tax purposes	**(9)**	(14)
Tax charge for the year	**-**	-

Whilst the Company is incorporated outside the UK, it is treated as a UK resident company for tax purposes. As the Company qualifies as a 'securitisation company' within the scope of the Taxation of Securitisation Companies Regulations 2006, it is subject to UK corporation tax on a small margin rather than the loss shown in the statement of comprehensive income.

For the year ended 31 December 2017, the profits subject to corporation tax were £20,000 (2016: £20,000) which gave rise to a tax liability of £3,850 (2016: £4,000). A prior year adjustment of £4,000 (2016: £nil) arose in the year.

4 Trade and other receivables

	31 December 2017 £m	31 December 2016 £m
Non-current		
Amount owed by group undertakings – interest bearing[2]	**10,736**	11,151
	10,736	11,151
Current		
Interest receivable from group undertakings[1]	**174**	184
Amounts owed by group undertakings – interest bearing[2]	**957**	856
	1,131	1,040
	11,867	12,191

[1] "Interest receivable from group undertakings" relates to interest accrued on the BLAs receivable from Heathrow Airport Limited ('Heathrow').

[2] "Amounts owed by group undertakings - interest bearing" largely represent the balance of the BLAs receivable from Heathrow. The advances under the BLAs are secured and are issued on substantially the same terms as the bonds issued by the Company, taking into consideration the related hedging instruments. Heathrow (SP) Limited, Heathrow (AH) Limited, Heathrow Airport Limited and Heathrow Express Operating Company Limited are joint guarantors in respect of principal, indexation, interest, fees and hedging arrangements in relation to the borrowings of Heathrow under the BLAs.

Notes to the financial statements for the year ended 31 December 2017 *continued*

5 Borrowings

	31 December 2017 £m	31 December 2016 £m
Current		
Secured		
Bonds		
4.375% €700 million due 2017	-	598
2.500% CHF400 million due 2017	-	318
4.600% €750 million due 2018	665	-
6.250% £400 million due 2018	399	-
	1,064	916
Interest payable on borrowings	234	262
Total current	1,298	1,178
Non-current		
Secured		
Bonds		
4.600% €750 million due 2018	-	627
6.250% £400 million due 2018	-	399
4.000% C$400 million due 2019	235	240
6.000% £400 million due 2020	398	398
9.200% £250 million due 2021	263	266
3.000% C$450 million due 2021	263	269
4.875% US$1,000 million due 2021	738	807
1.650%+RPI £180 million due 2022	206	199
1.875% €600 million due 2022	529	508
5.225% £750 million due 2023	679	669
7.125% £600 million due 2024	592	591
0.500% CHF400 million due 2024	303	318
3.250% C$500 million due 2025	290	297
4.221% £155 million due 2026	155	155
6.750% £700 million due 2026	693	692
2.650% NOK1,000 million due 2027	90	93
7.075% £200 million due 2028	198	198
2.500% NOK1,000 million due 2029	90	93
1.500% €750 million due 2030	659	633
6.450% £900 million due 2031	851	849
Zero-coupon €50 million due January 2032	57	52
1.366%+RPI £75 million due 2032	82	79
Zero-coupon €50 million due April 2032	56	52
1.875% €500 million due 2032	442	-
4.171% £50 million due 2034	50	50
Zero-coupon €50 million due 2034	49	46
1.061%+RPI £180 million due 2036	191	183
1.382%+RPI £50 million due 2039	55	53
3.334%+RPI £460 million due 2039	608	587
1.238%+RPI £100 million due 2040	107	103
5.875% £750 million due 2041	738	738
4.625% £750 million due 2046	742	742
1.372%+RPI £75 million due 2049	82	79
2.750% £400 million due 2049	392	392
Total non-current	10,883	11,457
Total borrowings	12,181	12,635
Total borrowings (excluding interest payable)	11,947	12,373

The maturity dates of the 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 and 1.061%+RPI £180 million due 2036 bonds, wherein the redemption dates coincide with their legal maturity dates.

Notes to the financial statements for the year ended 31 December 2017 *continued*

5 Borrowings *continued*

Fair value of borrowings

	31 December 2017		31 December 2016	
	Book value £m	**Fair value[1] £m**	Book value £m	Fair value[1] £m
Current				
Bonds	**1,064**	**1,084**	916	919
Non-current				
Bonds	**10,883**	**13,410**	11,457	14,260
	11,947	**14,494**	12,373	15,179

[1] Fair values of borrowings are for disclosure purposes only

The fair values of listed borrowings are based on quoted prices at reporting date. For unlisted borrowings, the Company establishes fair values by using discounted cash flow analysis utilising yield curves derived from observable market data.

The Company has given Deutsche Trustee Company Limited (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. The Company 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.

All borrowings issued by the Company are on-lent to Heathrow Airport Limited under the BLAs. The advances under the BLAs are issued on substantially the same terms as the new bonds issued by the Company, taking into consideration the related hedging instruments. Foreign currency bonds and the related cross-currency swaps are packaged together and on-lent to Heathrow Airport Limited.

6 Derivative financial instruments

	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2017				
Current				
Interest rate swaps:				
with counterparties external to the SP Group	400	-	(3)	(3)
with fellow subsidiary Heathrow Airport Limited	400	3	-	3
Cross-currency swaps:	510	170	-	170
with counterparties external to the SP Group	97	-	(4)	(4)
Total current	1,407	173	(7)	166
Non-current				
Cross- currency swaps	3,374	408	(29)	379
Interest rate swaps:				
with counterparties external to the SP Group	2,513	-	(466)	(466)
with fellow subsidiary Heathrow Airport Limited	2,606	482	-	482
Index-linked swaps:				
with counterparties external to the SP Group	5,119	36	(964)	(928)
with fellow subsidiary Heathrow Airport Limited	4,081	610	-	610
Total non-current	17,693	1,536	(1,459)	77
Total	19,100	1,709	(1,466)	243

Notes to the financial statements for the year ended 31 December 2017 *continued*

6 Derivative financial instruments *continued*

	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2016				
Current				
Cross-currency swaps:				
with counterparties external to the SP Group	856	78	-	78
Total current	856	78	-	78
Non-current				
Cross- currency swaps:				
With counterparties external to the SP Group	3,442	658	(9)	649
Interest rate swaps:				
with fellow subsidiary Heathrow Airport Limited	3,006	552	-	552
with counterparties external to the SP Group	2,913	-	(531)	(531)
Index-linked swaps:				
with fellow subsidiary Heathrow Airport Limited	3,981	534	-	534
With counterparties external to the SP Group	5,116	18	(879)	(861)
Total non-current	18,458	1,762	(1,419)	343
Total	19,314	1,840	(1,419)	421

The Company does not apply hedge accounting in relation to any of its derivative financial instruments.

Cross-currency swaps
Cross-currency swaps have been entered into by the Company to hedge currency risk on interest and principal payments on its foreign currency-denominated bond issues.

Index-linked swaps
Index-linked swaps have been entered into to economically hedge RPI linked revenue and regulatory asset base of Heathrow Airport Limited.

Interest rate swaps
Interest rate swaps have been entered into to hedge against variability in interest cash flows on current and future debt issuances.

7 Stated capital

	£
Authorised	
At 1 January and 31 December 2017	
Unlimited number of shares with no par value of one class, designated as ordinary shares	-
Called up, allotted and fully paid	
At 1 January and 31 December 2017	
2 no par value ordinary shares of £1 each	2

8 Retained earnings

	£m
1 January 2017	(23)
Loss for the year	(48)
31 December 2017	(71)

Notes to the financial statements for the year ended 31 December 2017 *continued*

9 Ultimate parent undertaking

The immediate parent undertaking of the Company is Heathrow (SP) 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 GIC), Alinda Airports UK L.P. (11.18%) (an investment vehicle 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's results are also included in the audited consolidated financial statements of Heathrow (SP) Limited for the year ended 31 December 2017, which is the parent undertaking of the smallest group to consolidate these financial statements. They are also included in the audited consolidated financial statements of Heathrow Finance plc, Heathrow Airport Holdings Limited and FGP Topco Limited for the year ended 31 December 2017.

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

10 Subsequent events

Early 2018, a Canadian Bond (CAD400m bond due 2028) was issued and is due to be drawn down in March 2018.