

Heathrow Funding Limited
Annual report and financial statements
for the year ended 31 December 2020

Heathrow Funding Limited

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Heathrow Funding Limited

Officers and professional advisers

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Javier Echave
Nicholas Golding
Lisa Aune

Company secretary

Sanne Secretaries Limited

Registered office

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Heathrow Funding Limited

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 2020.

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 'HAHL 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 HAHL 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 2020, the net finance income has decreased to £19 million (2019: Net finance income of £139 million). This decrease was predominantly driven by the fair value gain on financial instruments which decreased to £53 million (2019: £163 million) as a result of the fair value movement on cross-currency swaps. In addition, interest receivable from group undertakings reduced to £600 million (2019: £609 million), interest payable on external borrowings reduced to £554 million (2019: £558 million) and net interest on derivative financial instruments increased to £80 million (2019: £75 million). The increase in net interest on derivative financial instruments was in part due to accretion on index-linked swaps, which was affected by the increase in the inflation growth during 2020 as the company pays RPI.

The mark-to-market value of cross-currency swaps was positively impacted during the period mainly due to lower EUR and CHF Libor rates.

The settlement of £285 million of accretion on index-linked swaps and the appreciation of Sterling against the hedged currencies, impacted the carrying value of all derivatives which changed from a net asset of £372 million at 31 December 2019 to a net asset of £580 million at 31 December 2020 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 the year the Company raised £1.6 billion of debt financing, with just over £1.4 billion raised in Class A debt, excluding extensions to existing facilities and £182 million in Class B debt. A further £381 million of Class B debt signed prior to 2020 was drawn down during the first half of the year.

Class A financing activities included:

- a. A new €750m public bond maturing in 2025
- b. A new £450m public bond maturing in 2029
- c. A new C\$500m public bond maturing in 2031

Class B financing activities included:

- a. The drawdown of £381m in private placements
- b. A new £182m index-linked private placement maturing in 2032
- c. The scheduled repayment of a £400m public bond in March

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

Heathrow Funding Limited

Directors' report *continued*

Results and dividends

The profit after taxation for the financial year amounted to £19 million (2019: £139 million). The Company's net assets as at 31 December 2020 were £187 million (2019: £168 million). No ordinary dividends were proposed or paid during the year (2019: £nil). The statutory results for the year are set out on page 17.

Directors

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

Yuanyuan Ding	
Javier Echave	
Nicholas Golding	
Beejadhursingh Surnam	resigned 04/06/2020
Lisa Aune	appointed 05/06/2020

Employment policies

The Company has no direct employees (2019: 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 information presented within these financial statements has been prepared on a going concern basis. The Company, as part of the H AHL Group, has a strong liquidity position and adequate resources to continue in operational existence for the foreseeable future. Nevertheless, the impact of Covid-19 continues to create considerable uncertainty for the aviation industry, which may result in the Group needing to take further action, including seeking a further covenant waiver or amendment from Heathrow Finance Plc creditors. This indicates the existence of a material uncertainty which could cast significant doubt upon the Company's ability to continue as a going concern. More detail can be found in the going concern statement on page 20.

Internal controls and risk management

Internal controls and risk management are key elements of the Company's corporate operations.

Internal controls

The directors are responsible for the system of internal controls designed to mitigate the risks faced by the Company and for reviewing the effectiveness of the system. This is implemented by applying the H AHL 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 Company's internal control and risk management systems in relation to the financial reporting process include:

- a company-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 Audit Committee; and
- a confidential whistleblowing process.

Heathrow Funding Limited

Directors' report *continued*

Risk management

The Heathrow Risk and Assurance Management framework is an enterprise risk management system that is embedded Group-wide with the principal aim of providing oversight and governance of the key risks that HAML Group faces, and to monitor upcoming and emerging risks.

The framework provides guidance on how risks should be identified, mitigated, reviewed and reported within Heathrow. During 2020, we have continued to improve our risk processes, building on the current risk-management structure, to enhance the data quality, completeness of risk information and control measurement in addition to improving the overall reporting integrity.

The HAML Board has overall responsibility for the framework and for reviewing the effectiveness of the risk-response system. There are two HAML Board sub-committees which are responsible for risk: the Audit Committee, which reviews the effectiveness of systems for internal financial and operational control, and the Sustainability and Operational Risk Committee, which reviews the effectiveness of operational reporting and performs an oversight review of the performance against sustainability goals and operational targets.

The most significant risks are collated and reported to the Risk and Assurance Committee, a sub-committee of the Executive Committee, which meets on a monthly basis. The risks are then reviewed by the Executive Committee before being submitted to the Audit Committee and Sustainability and Operational Risk Committee for independent review and challenge. The final Heathrow Risk Outlook Report is then reviewed and approved by the HAML Board on a quarterly basis.

Principal risks have been identified at an Executive level ensuring a comprehensive top-down approach to risk identification. A Principal Risk is a risk that has been identified by the HAML Board, its formal committees, the Executive Committee, or the Risk and Assurance Committee, as an important risk that fundamentally affects the business's ability to deliver on its overarching objectives. A Principal Risk is assessed according to the likelihood, consequence and velocity by which the risk may impact Heathrow.

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

- **Mojo.** 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;
- **Transform customer service.** 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;
- **Beat the plan.** 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; and
- **Sustainable Growth.** To grow and operate our airport sustainably, now and in the future.

The risks outlined in the below are the principal strategic, corporate and operational risks identified during the year. This is a current point-in-time assessment of the risk profile that the HAML Group faces, as the risk environment evolves these risks are being constantly reviewed and updated.

Principal risks

A Safe and Secure Operating Environment

Keeping people safe is our top priority. We have a legal and moral responsibility to ensure that we safeguard the wellbeing of our people, and also our business partners and the public who may be affected by our activities, from the risks relating to fire, health, and safety. An airport as large and complex as Heathrow has a multitude of fire, safety, health and wellbeing risks. In 2020, COVID-19 has added to those risks and the complexity of their management. Failure to operate a safe and healthy environment risks damaging the health and wellbeing of stakeholders, impacting colleague engagement, operational disruption and costs, inconvenience to passengers and long-term damage to our reputation. The UK security threat level is severe. We are responsible for ensuring that our assets, infrastructure, human and electronic systems and processes meet requirements to protect aviation security, deliver high security standards and build confidence with regulators, airlines and passengers.

Risk mitigation

Our fire, health and safety ('FHS') management system includes risk assessment processes for all activities that have significant risk and ensures proportionate control measures are used. We set FHS standards for our own operations and companies that work at our airport. Our leaders, managers and colleagues receive the training they need to understand and manage risks associated with their roles.

Governance, led by our senior management teams, and assurance processes are used to ensure that controls around health-and safety risks remain effective and continuous improvement is encouraged. In the current year our safety improvement team has initiated a new '4 pillar' safety plan which is designed to improve the fundamental building blocks of a safe operating environment and safety culture. Colleagues' health and wellbeing is promoted and supported by a range of products and services including our Employee Assistance Programme, online GP service and information and tools for managers and colleagues.

Heathrow Funding Limited

Directors' report *continued*

Principal risks *continued*

A Safe and Secure Operating Environment *continued*

COVID-19 specific risks have been addressed within our Fly Safe programme. We have invested in UK aviation's most extensive array of COVID-19-secure technologies. New rapid testing technologies are already helping to open up overseas markets safely. We work with government agencies to ensure security procedures are appropriate and mitigate evolving threats. Procedures are subject to review through the internal controls mechanism and via independent scrutiny from the CAA.

Information Security

Information security, which refers primarily to our systems and information and the data contained in them, continues to be a risk for us. Malicious cyber-attack is a continued risk given the size and breadth of our network and operating environment. Attacks continue to be more sophisticated and prevalent. In addition, new ways of working following the COVID-19 crisis have also resulted in an increased risk profile.

Risk mitigation

Under the direction of a newly formed Cyber Security Directorate, we are implementing an improved cybersecurity programme which will ensure strong technical and operational measures are in place to enable us to comply with our regulatory and legal requirements. Mandatory training has been successfully rolled out along with regular awareness campaigns with emphasis on phishing emails and the use of social media. The cyber-security programme will continue to make improvements across all parts of Heathrow into 2021.

Regulation Requirements

We are currently subject to economic regulatory review. Changes to economic regulation could materially impact the performance of the business. Failure to comply with laws and regulations could result in loss of licence, penalties, claims and litigation, reputational damage and loss of stakeholder confidence.

Risk mitigation

The risk of an adverse outcome from economic regulatory reviews is mitigated as far as possible by a dedicated regulatory team. This team ensures full compliance with regulatory requirements, establishes a sound relationship with the regulator and advises the Executive Committee and HAHL Board on regulatory matters. The regulatory framework requires formal engagement with airline customers. All airlines are invited to be represented on engagement forums – for example joint steering groups.

In addition, key stakeholders are engaged on a joint planning basis which provides the opportunity to air views and share plans, thereby ensuring their ongoing requirements are articulated and understood. We worked closely with airlines, the CAA and other stakeholders as we developed Heathrow's Revised Business Plan for the H7 regulatory period which was published in December 2020. In parallel we continue to engage on our application for an adjustment to the RAB to recover an appropriate amount of the unexpected losses which occurred due to the impact of COVID-19. The CAA announced in April 2021 that it has agreed to a limited, early adjustment to the Regulatory Asset Base of £300m and that the issue will be considered further as part of the H7 price control. Both the H7 settlement and the enactment of any further RAB adjustment are highly uncertain at this stage. There is a material risk for both that, based on regulatory publications to date, the regulator could fail in practice to enact established regulatory principles such as a fair balance of risk and return or the return of regulatory depreciation. Beyond engagement with the regulator, these risks are somewhat further mitigated by our right of appeal to the Competition and Markets Authority.

Following the Court of Appeal ruling setting aside the ANPS, the CAA began a review of its policy on the recovery of expansion costs. The CAA has proposed that all costs efficiently incurred until the end of February 2020 related to the delivery of expansion can be recovered from 2022. It is also proposing to implement a similar policy for the recovery of wind down and Supreme Court Appeal costs. A final policy is due to be established in Q1 2021.

In addition, we engage closely with internal and external legal advisors to ensure that relevant and appropriate advice is received and that our response to reviews and our actions to ensure compliance with regulatory requirements reflect such advice.

Legal status of Airports National Policy Statement ('ANPS')

In June 2018 the Secretary of State for Transport designated the ANPS providing policy support for Heathrow expansion. In February 2020, the Court of Appeal held that the ANPS was not lawfully made because the Secretary of State was required but failed to take into account the Paris Agreement and other climate change matters. The Court of Appeal declared that the ANPS has no legal effect unless and until it is reviewed by the Government under statutory procedures. We appealed this decision. Our appeal was heard by the Supreme Court in October 2020 and judgment issued on 16 December 2020. The Supreme Court unanimously allowed our appeal meaning the ANPS has been reinstated. Following the judgment, it is still possible that the Government may decide to review the ANPS.

Risk mitigation

We appealed the Court of Appeal's judgment on legal grounds with a view to reinstating the ANPS. Having won the appeal and restored the ANPS, we have positively reiterated the case for expanding Heathrow in line with Government policy and we are consulting with the Government, the CAA and other stakeholders on the next steps to progress our plans.

Heathrow Funding Limited

Directors' report *continued*

Principal risks *continued*

Reduced revenue

COVID-19 has led to an unprecedented decline in passenger volumes and revenues. These circumstances have been exacerbated by the regulatory and policy environment - Government has imposed quarantines, delayed the introduction of testing solutions, removed VAT Free shopping and excluded Heathrow from full business rates alleviation. Retail has been the largest non-aeronautical income stream impacted.

Risk mitigation

Aviation - Our strategic response to protect revenues and drive passenger volumes has been:

1. Where possible, getting our incumbents to fly the slots which they have – informed by our intense lobbying on slot waiver and desire to offer growth incentives where sustained return to flight looks plausible.
2. Encouraging consolidation of airlines' London operations at Heathrow; as successfully done with BA and VS.
3. Where slots are not flown, gaining access to those slots to maximise ad-hoc slot utilisation and particularly new entrant operations (9 secured in 2020).

The above approach is underpinned by a cargo operation which has allowed airlines to switch their operations to cargo-only and / or 'freighters' (passenger planes temporarily converted to freighters) and by an approach to aeronautical pricing which supports airlines building back their schedules in 2021 whilst recognising the increasing importance of cargo and the reality of lower load factors.

In order to protect our right to recover the costs which we have incurred in good faith in order to allow all our airlines to fly any passenger, any route, all cargo throughout the pandemic, we have taken swift action to reduce costs in 2020. We will either apply the 'Other Regulated Charges' ('ORC') protocol through increased unit costs throughout 2021 or progress an alternate airline proposal to secure the under-recovered cost base.

Retail - Key measures implemented to contain the impact on retail income include:

1. Close monitoring and balance of assessed debt and contractual fixed income guarantees in order to maximise overall retail revenue.
2. Targeted scouting of the market to identify potential new entrants with the ability to enter into a commercial deed with minimal level of disruption and delays (e.g. lending locations to businesses that could make immediate use of the structure 'as is').

Liquidity and ability to Access Finance

We need to continue to be able to access finance to fund our current operations.

Risk mitigation

We produce long-term forecasts which include consideration of significant downside risk to enable our management to conclude that covenant terms are likely to be met, and that we have the ability to access additional future finance as required.

We have invested in a suitably skilled Treasury and Investment team who have robust procedures in place to ensure that the best quality investment decisions are made, and that investments can be appropriately financed. Realisation of Principal and other risks could deteriorate the quality of our credit rating and increase this risk.

Resilience of Team Heathrow

The COVID-19 pandemic has had a significant impact on the aviation industry, as well as more widely on the other key customers and stakeholders that support the supply of services and facilities to passengers and airlines. There is a risk that a sustained lack of resilience across the wider Team Heathrow has an impact on our ability to provide the service levels and passenger experience our passengers and airlines expect.

Risk mitigation

We continue to work closely with our airline customers, retailers and wider stakeholders during the pandemic. We monitor the financial health of our key Team Heathrow partners to ensure we have early warning of any concerns so that where possible we can work together to find a solution or provide alternative facilities where this proves to be the more viable option. Regular engagement takes place at both management and operative level across key members of Team Heathrow to discuss future plans and strategies.

Across our supply chain, our Supplier Management function monitors the real-time financial risks associated with our critical suppliers (e.g. financial strength, likelihood of insolvency, liquidity, credit worthiness, compliance with payment terms, etc.). This monitoring enables early sight of potential insolvency risks, which are initially investigated by Supplier Management and highlighted immediately to relevant Commercial Managers, allowing risks to be managed by all relevant stakeholders and mitigated.

Heathrow Funding Limited

Directors' report *continued*

Principal risks *continued*

Ineffective Organisation – Systems and People

Systems - We are constantly adapting to our internal and external requirements. Existing systems and processes become unsuitable, outdated and need to evolve to meet the needs of our business.

People - We rely on our people to ensure that we operate effectively. External and internal requirements put pressure on colleagues, particularly during the COVID-19 pandemic, with the additional risk of a threat of industrial action.

Risk mitigation

Systems - We continuously review systems and processes to ensure they meet the needs of our business. Where benefits exceed the cost, we invest in new systems. In 2020 we launched a project to upgrade our financial and people ERP system to support working in a simpler, more agile and cost-effective way.

People - We continue to invest in our people and have a strategy to ensure the development of talent. Policies are in place to engage and motivate our colleagues; as well as maintain accountability and compliance with internal governance, policies and procedures. We provide career opportunities, development and training. This supports the retention of talent, skills and business knowledge thus preventing single points of failure.

Political environment

Our ability to meet passenger and cargo demand is reliant on political support. Changes to the Government, and therefore to government priorities, can impact material decisions that are taken by us. The implementation of Brexit and COVID-19 related restrictions has the potential to impact airline operations which may cause disruption to our passengers, impact immigration, cargo operations, our supply chain, and our people.

Risk mitigation

We continue to make a strong case for our place in aviation and the wider economy and the part we play in Global Britain, and we explain the benefits that our ability to meet the UK's demand for long-haul travel brings. Whilst a change in the Government's focus cannot be controlled, risk is monitored and proposed mitigating actions agreed in advance where necessary. We have a cross functional Policy Coordination Group, reporting to the Executive Committee and HAHL Board, which has implemented a structured approach to the identification and management of all risks related to Brexit and Government COVID-19 policy. With regard to Brexit, we have made preparations to ensure the continued safe and secure operation for passengers and cargo with a plan jointly created with stakeholders to deliver predictable and appropriate processes which minimise the pre and post Brexit impacts.

Competition

We compete against other airports both within the UK and across the world for passengers; some make marginal choices, particularly connecting passengers, about which route to fly. The impact of COVID-19 has closed many global aviation markets as governments seek to control the spread of the virus and led many airlines to materially reduce their flying schedules or even cease flying to some airports altogether. As a result, there is currently spare capacity across all of the airports in the 'London system' including Heathrow, and also across our European Hub competitors.

Risk mitigation

Our primary focus is to ensure the continuity of safe, secure and efficient airport operations in the interests of all air transport users, with no degradation to the experience of our passengers and colleagues despite the impact of COVID-19. Maintaining commercial strategies that enable us not only to remain affordable but will actually make us more competitive is also important to retain key passenger groups.

Net Zero Carbon

Climate change remains the most significant mid to long-term risk facing the aviation sector and Heathrow, working with the wider industry, must set firmly on a path to net zero and demonstrate real progress in this decade. Heathrow follows the TCFD recommendations and climate related risk is therefore considered under the following categories:

- **Transitional risks** – Transitional risks relate to the decarbonisation of Heathrow and the aviation sector to achieve Net Zero carbon emissions. Political, consumer and investor attitudes to aviation's climate impacts will become more negative without tangible progress to cut emissions and confidence in the sectors Net Zero plan, threatening our ability to recover, operate and grow.
- **Physical risks** – Physical risks relate to the resilience of our assets, operations and network to the negative impacts of climate change including more extreme weather events

Risk mitigation

The UK aviation sector, including Heathrow, has committed to Net Zero carbon and published a joint roadmap to get there. The aviation sector roadmap sets a clear industry goal for tackling climate change and focuses attention on the actions that will be needed to meet it. We published our 'Target Net Zero' strategy to guide our approach to decarbonisation and aligned to the broader aviation sector roadmap. 'Target Net Zero' frames the priorities and progress we plan to deliver in the short to medium term as well as what will be required to achieve net zero.

Heathrow Funding Limited

Directors' report *continued*

Principal risks *continued*

Net Zero Carbon *continued*

The significant priority is accelerating net zero flying in the 2020s by securing the right policies for Sustainable Aviation Fuel ('SAF') production at scale in the UK and building a high ambition coalition globally for net zero aviation and SAF. To ensure and support the delivery of our strategy, climate change has been embedded into our governance structures, business planning development and operational processes and is supported by employee training and targets. We operate ISO 140001 and 50001 management systems which commit us to continuous improvement.

Financial stability

The HAML 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 HAML Group 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 HAML 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 HAML Group are:

- a. Interest rates
The Group maintains a mix of fixed and floating rate 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 and sub-investment grade financing platforms for Heathrow. The platforms support 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 or junior format. Covenants are standardised wherever possible and are monitored on an ongoing basis with formal testing reported to the HAML Group 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.
Risk mitigation
HAML Group 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 2021. As at 31 December 2020, the HAML Group had cash and cash equivalents and term deposits of £3,930 million
- 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.

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

After a comprehensive tender process, and recommendation made by the Audit Committee, the Board has appointed PricewaterhouseCoopers LLP (PwC) as auditor of the Group for the financial year ending 31 December 2020.

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 PwC will be deemed to be appointed.

Heathrow Funding Limited

Directors' report *continued*

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.

Subsequent events

Subsequent events are disclosed in note 11.

On behalf of the Board



Javier Echave
Director

29 June 2021

Heathrow Funding Limited

Directors' responsibilities statement

The directors are responsible for preparing financial statements for each financial year which give a true and fair view, in accordance with applicable Jersey law and United Kingdom Accounting Standards, of the state of affairs of the Company and of the profit or loss of the Company for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable 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.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

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.

So far as the directors are aware, there is no relevant audit information of which the Company's auditors are unaware, and each director has taken all the steps that he or she ought to have taken as a director in order to make himself or herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

On behalf of the Board



Javier Echave
Director

29 June 2021

Independent auditors' report to the members of Heathrow Funding Limited

Report on the audit of the financial statements

Opinion

In our opinion, Heathrow Funding Limited's financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2020 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards, comprising FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland", and applicable law); and
- have been prepared in accordance with the requirements of the Companies (Jersey) Law 1991.

We have audited the financial statements, included within the Annual report and financial statements (the "Annual Report"), which comprise: the statement of financial position as at 31 December 2020; the statement of comprehensive income and the statement of changes in equity for the year then ended; the accounting policies; the significant estimates and judgements; and the notes to the financial statements.

Our opinion is consistent with our reporting to the Audit Committee.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities under ISAs (UK) are further described in the Auditors' responsibilities for the audit of the financial statements section of our report. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

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

To the best of our knowledge and belief, we declare that non-audit services prohibited by the FRC's Ethical Standard were not provided.

We have provided no non-audit services to the company in the period under audit.

Material uncertainty related to going concern

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in the going concern section of the accounting policies to the financial statements concerning the company's ability to continue as a going concern. Heathrow has been significantly impacted by the COVID-19 pandemic which has resulted in a rapid deterioration in passenger traffic and cash flows. The ability of the company to continue as a going concern is underpinned by the performance of the wider Heathrow group of companies (the "group"). The group's forecast and projections assume a continued phased increase in passenger forecast which represents a significant reduction to historical revenue levels, along with cost saving measures and reductions in capital expenditure. In the event there are further waves of the pandemic, or the implementation or continuation of local lockdown periods, leading to further travel restrictions being imposed worldwide, the group, whilst having sufficient liquidity, may require further covenant waivers in respect to the group interest cover ratio and group regulated asset ratio measured as at 31 December 2021. These conditions, along with the other matters explained in the going concern section of the accounting policies to the financial statements,

indicate the existence of a material uncertainty which may cast significant doubt about the company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the company were unable to continue as a going concern.

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- Reviewing management's models supporting the going concern assessment, ensuring appropriate stress test scenarios were considered. We challenged management's key cash flow assumptions by performing our own sensitivity analysis;
- Evaluating management's assumptions in light of both historical and post year end performance and assessing consistency with other evidence obtained during the course of our audit work. Understanding the covenants and assessing the forecast covenant calculations; and .
- Assessing the adequacy of management's disclosures in relation to going concern basis of preparation.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

Our audit approach

Context

This is our first year as auditors of the company. During our first year we have performed extensive audit transition activities and met with members of the Board and management to understand the business, its challenges, opportunities and associated risks .

Overview

Audit scope

- We performed full scope audit procedures over the company.

Key audit matters

- Material uncertainty related to going concern
- Valuation of derivative financial instruments - inflation linked swaps including day 1 fair valuation and credit risk adjustment
- Impact of COVID-19

Materiality

- Overall materiality: £71m which reflects approximately 0.5% of external borrowings.
- Performance materiality: £53m.

The scope of our audit

As part of designing our audit, we determined materiality and assessed the risks of material misstatement in the financial statements.

Key audit matters

Key audit matters are those matters that, in the auditors' professional judgement, were of most significance in the 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) identified by the auditors, including 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, and any comments we make on the results of our procedures thereon, 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.

In addition to going concern, described in the Material uncertainty related to going concern section above, we determined the matters described below to be the key audit matters to be communicated in our report. This is not a complete list of all risks identified by our audit.

Key audit matter	How our audit addressed the key audit matter
<p>Valuation of derivative financial instruments - inflation linked swaps including day 1 fair valuation and credit risk adjustment</p> <p>Refer to the Accounting Policies, the significant estimates and judgements and to note 6 in the financial statements. As at 31 December 2020, the company held derivative assets of £1,819m and derivative liabilities of £1,239m on the balance sheet. Included in these derivative balances were inflation linked swaps totalling £660m assets and £728m liabilities. These swaps are held to mitigate interest rate and foreign exchange risk arising on material levels of debt.</p> <p>IAS 39 “Financial Instruments” requires derivatives to be accounted for at fair value with movements recognised in profit or loss, unless designated in a hedge relationship.</p> <p>Due to the nature and complexity in the valuation involved, we identified a significant risk that the fair value of inflation linked swaps may be misstated. The risk is mainly driven by:</p> <ul style="list-style-type: none"> the treatment (being manual in nature) of valuation differences between the consideration paid or received and the system derived fair value on inception or restructuring; and the application of credit risk (in particular the assumed loss given default percentage) to the valuation due to these derivatives ranking as super senior in the priority of payments. 	<p>We, with the support of our Treasury experts, performed the following audit procedures:</p> <ul style="list-style-type: none"> On a sample basis, performed independent valuation testing on the derivatives, including the credit risk adjustment and the new day-1 fair value at 31 December 2020; Recalculated and assessed the accounting treatment for the day-1 fair value of derivatives in line with IAS 39 - Financial Instruments; Inspected the documentation supporting the super senior nature of interest rate swaps and inflation linked swaps where a higher recovery rate is used in the valuation and evaluated whether the rate used is in line with the expected market rate; Tested the application and quantum of the recovery rate applied to the super senior derivatives; and Assessed management’s derivative fair value disclosures in the financial statements. <p>The results of our procedures above did not identify any exceptions.</p>
<p>Impact of COVID-19</p> <p>Refer to the COVID-19 section within the Accounting Policies. The COVID-19 outbreak developed rapidly during 2020. Measures taken to contain the virus have affected the wider economy and directly impacted the company’s results.</p> <p>In addition, the lockdown in the first half of 2021 has also resulted in the year end financial close process, as well as the external audit, having to take place remotely. Management has considered the impact of COVID-19 on the financial statements. Primarily, these considerations related to the going concern basis of preparation.</p>	<p>There was a risk that the financial impact due to COVID-19 which had been recorded by management is inaccurate or that we may have been unable to obtain sufficient appropriate audit evidence in order to support our conclusions in respect of this assessment.</p> <p>Our audit focused on those areas where management identified potential financial impacts arising as a result of the pandemic, which, based on our independent risk assessment, could have given rise to a risk of material misstatement.</p> <p>Despite undertaking most of our year end work remotely, we did not encounter any significant difficulties in performing our audit testing or in obtaining the required evidence to support our audit conclusions.</p> <p>Other than as already described in the relevant sections within this report (including the material uncertainty related to going concern section and the matter disclosed in the key audit matters above, we noted the following key material impacts on the financial statements, arising from COVID-19:</p> <ul style="list-style-type: none"> We tested management’s cash flow models used to support the going concern basis of preparation. We evaluated management’s

	<p>assumptions in those models in light of both historical and post year end performance. Where relevant, downside scenarios were modelled by management which we assessed using our independent sensitivities.</p> <ul style="list-style-type: none"> • We also evaluated the consistency of the various forecast models. In relation to going concern, we have understood the debt covenants, assessed the forecast covenant calculations and the adequacy of management's disclosure in relation to going concern basis of preparation. • We reviewed the disclosures in the financial statements in respect of the impact of COVID-19 and concluded that these are appropriate. <p>Based on the above work performed, we found that management's conclusions in respect of the impact of COVID-19 on the company are appropriate</p>
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How we tailored the audit scope

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates.

We tailored the scope of our audit to ensure that we performed enough work to be able to give an opinion on the financial statements as a whole, taking into account the structure of the company, the accounting processes and controls, and the industry in which it operates. Our audit effort included substantive testing of material financial statement line items .

Materiality

The scope of our audit was influenced by our application of materiality. We set certain quantitative thresholds for materiality. These, together with qualitative considerations, helped us to determine the scope of our audit and the nature, timing and extent of our audit procedures on the individual financial statement line items and disclosures and in evaluating the effect of misstatements, both individually and in aggregate on the financial statements as a whole.

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

<i>Overall company materiality</i>	£71m.
<i>How we determined it</i>	Materiality reflects approximately 0.5% of external borrowings
<i>Rationale for benchmark applied</i>	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 external borrowings as the benchmark.

We use performance materiality to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds overall materiality. Specifically, we use performance materiality in determining the scope of our audit and the nature and extent of our testing of account balances, classes of transactions and disclosures, for example in determining sample sizes. Our performance materiality was 75% of overall materiality, amounting to £53m for the company financial statements.

In determining the performance materiality, we considered a number of factors - the history of misstatements, risk assessment and aggregation risk and the effectiveness of controls - and concluded that an amount at the upper end of our normal range was appropriate.

We agreed with the Audit Committee that we would report to them misstatements identified during our audit above £1.4m as well as misstatements below that amount that, in our view, warranted reporting for qualitative reasons.

Reporting on other information

The other information comprises all of the information in the Annual Report other than the financial statements and our auditors' report thereon. The directors are responsible for the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or any form of assurance 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 an apparent material inconsistency or material misstatement, we are required to perform procedures to conclude whether there is a material misstatement of 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. We have nothing to report based on these responsibilities.

Responsibilities for the financial statements and the audit

Responsibilities of the directors for the financial statements

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements in accordance with the applicable framework and for being satisfied that they give a true and fair view. The directors are also responsible for such internal control as they 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.

Auditors' 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 auditors' 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.

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud, is detailed below.

Based on our understanding of the company and industry, we identified that the principal risks of non-compliance with laws and regulations related to Heathrow Airport's CAA operating license being revoked, breaches of environmental regulations, adherence to data protection requirements, UK tax legislation not being adhered to and non-compliance with employment regulations in the UK, and we considered the extent to which non-compliance might have a material effect on the financial statements. We also considered those laws and regulations that have a direct impact on the financial statements such as Companies (Jersey) Law 1991. We evaluated management's incentives and opportunities for fraudulent manipulation of the financial statements (including the risk of override of controls), and determined that the principal risks were related to posting inappropriate journal entries, either in the underlying books and records or as part of the consolidation process, and management bias in accounting estimates. Audit procedures performed by the engagement team included:

- Discussions with management, internal audit and the company's legal team, including consideration of known or suspected instances of non-compliance with laws and regulations and fraud.
- Challenging assumptions and judgements made by management in its significant accounting estimates in relation to the valuation of derivative financial instruments (see related key audit matter below).

- Identifying and testing journal entries, in particular any journal entries posted with unusual account combinations or those posted by unexpected users.

There are inherent limitations in the audit procedures described above. We are less likely to become aware of instances of non-compliance with laws and regulations that are not closely related to events and transactions reflected in the financial statements. Also, the risk of not detecting a material misstatement due to fraud is higher than the risk of not detecting one resulting from error, as fraud may involve deliberate concealment by, for example, forgery or intentional misrepresentations, or through collusion.

Our audit testing might include testing complete populations of certain transactions and balances, possibly using data auditing techniques. However, it typically involves selecting a limited number of items for testing, rather than testing complete populations. We will often seek to target particular items for testing based on their size or risk characteristics. In other cases, we will use audit sampling to enable us to draw a conclusion about the population from which the sample is selected.

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

Use of this report

This report, including the opinions, has been prepared for and only for the company's members as a body in accordance with Article 113A of the Companies (Jersey) Law 1991 and for no other purpose. We do not, in giving these opinions, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Other required reporting

Companies (Jersey) Law 1991 exception reporting

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

- we have not obtained all the information and explanations we require for our audit; or
- proper accounting records have not been kept by the company, 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 no exceptions to report arising from this responsibility.

Appointment

Following the recommendation of the Audit Committee, we were appointed by the members on 22 January 2019 to audit the financial statements for the year ended 31 December 2020 and subsequent financial periods. This is therefore our first year of uninterrupted engagement.



Sotiris Kroustis
for and on behalf of PricewaterhouseCoopers LLP
Chartered Accountants
Watford
29 June 2021

Heathrow Funding Limited

Statement of comprehensive income for the year ended 31 December 2020

	Note	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Financing			
Finance income	2	600	609
Finance cost	2	(634)	(633)
Fair value gain on financial instruments	2	53	163
Operating profit before taxation		19	139
Taxation	3	-	-
Profit after taxation for the financial year	9	19	139
Total comprehensive income for the year		19	139

The statement of comprehensive income has been prepared on the basis that all operations are continuing operations.

Heathrow Funding Limited

Statement of financial position as at 31 December 2020

	Note	31 December 2020 £m	31 December 2019 £m
Assets			
Non-current assets			
Trade and other receivables	4	12,582	11,741
Derivative financial instruments	6	1,653	1,623
		14,235	13,364
Current assets			
Trade and other receivables	4	1,279	567
Derivative financial instruments	6	166	55
		1,445	622
Total assets		15,680	13,986
Liabilities			
Non-current liabilities			
Borrowings	5	(12,812)	(11,903)
Derivative financial instruments	6	(1,216)	(1,251)
		(14,028)	(13,154)
Current liabilities			
Borrowings	5	(1,441)	(609)
Derivative financial instruments	6	(23)	(55)
Trade and other payables	7	(1)	-
		(1,465)	(664)
Total liabilities		(15,493)	(13,818)
Net assets¹		187	168
Capital and reserves			
Share capital	8	-	-
Retained earnings	9	187	168
Total shareholders' funds		187	168

¹ Net assets 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 (Company registration number: 99529 (Jersey)) from page 17 were approved by the Board of Directors and authorised for issue on 29 June 2021. 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 2020

	Share capital £m	Retained earnings £m	Total £m
At 1 January 2019	-	29	29
Total comprehensive profit for the financial year	-	139	139
At 31 December 2019	-	168	168
Total comprehensive profit for the financial year	-	19	19
At 31 December 2020	-	187	187

Heathrow Funding Limited

Accounting policies for the year ended 31 December 2020

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.

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

The Company is a limited liability company registered and incorporated in Jersey. The registered office is IFC 5, St Helier, Jersey, JE1 1ST.

Basis of accounting

The Company financial statements are prepared in accordance with FRS 102 and are presented on the basis of the historical cost convention, except for derivative financial instruments under fair value hedge accounting. These exceptions to the historic cost convention have been measured at fair value in accordance with FRS 102 and as permitted by the Fair Value Directive as implemented in the Companies Act 2006.

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

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

- IAS 39 'Financial Instruments: Recognition and Measurement', in compliance with FRS 102. As a result, the accounting requirements of IAS 39 have been applied to all financial instruments instead of those of FRS 102 (s.11 and s.12)

The individual financial statements of the Company have been prepared in compliance with United Kingdom Accounting Standards, including Financial Reporting Standard 102, 'The Financial Reporting Standard applicable in the United Kingdom and the Republic of Ireland' ('FRS 102') and the Companies Act 2006.

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 FGP Topco Limited. 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 individual accounts of Heathrow Funding Limited have adopted the following disclosure exemptions:

- the requirement to present a statement of cash flows and related notes
- financial instrument disclosures, including:
 - categories of financial instruments,
 - items of income, expenses, gains or losses relating to financial instruments, and
 - exposure to and management of financial risks.
- the requirement from disclosing related party transactions with entities that are wholly- owned subsidiaries of the FGP Topco Limited Group
- from providing certain other disclosures regarding key management personnel

Going concern

The Directors have prepared the financial information presented within these financial statements on a going concern basis as they have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future.

Cash flow and liquidity

The wider Heathrow Group can raise finance at both Heathrow SP Limited ('Heathrow SP') and Heathrow Finance Plc ('Heathrow Finance'). The Directors have considered the wider group when assessing going concern. In assessing the going concern position, the Directors have considered the potential impact of COVID-19 on cash flow and liquidity over the next 12 months. The Directors have also considered the period beyond 12 months to December 2022.

Heathrow Funding Limited

Accounting policies for the year ended 31 December 2020 *continued*

Going concern *continued*

Cash flow and liquidity *continued*

Despite a much more challenging market backdrop, given the COVID-19 pandemic, continued confidence and support for our credit enabled Heathrow to raise £1.4 billion of debt to the approval date of these financial statements across the capital structure in bond format. New €500 million, C\$650 million, C\$300 million and AUD125 million Class A transactions and a £350 million Class B transaction were successfully executed during the first half of 2021. Consequently, Heathrow SP held cash of circa. £4.7 billion as at 31 May 2021. Total debt maturity within Heathrow SP for the next 12 months from 30 June 2021 is £1.8 billion. The wider Heathrow Group (which includes Heathrow Finance and the cash held at Heathrow SP) has cash of circa. £5 billion available. No debt matures outside of Heathrow SP for the next 12 months from 30 June 2021. Taking this into account, the Group has sufficient liquidity to meet all forecast cash flow needs well into 2025 under the base case cash flow forecast or until at least October 2022 even under the most extreme scenario of no revenue. This includes forecast operational costs, capital investment, debt service costs, scheduled debt maturities and repayments.

Nevertheless, continued low levels of traffic and cash flows have put covenants at Heathrow Finance under strain and the corresponding impact on the covenants associated with financing arrangements has been carefully considered when modelling the impacts of COVID-19.

Modelling the impact of COVID-19

The Directors have modelled future cash flows for the period beyond 12 months to December 2022 to include the impact of COVID-19 related disruption and have considered the following:

- forecast revenue and operating cash flows from the underlying operations,
- 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, projected covenant requirements, and its ability to access the debt markets.

In its assessment, management has included the impacts of several important actions implemented in 2020 to reduce operating expenditure including temporarily consolidating our operations in fewer terminals, multiple contract renegotiations, permanent changes in terms and conditions, freezing recruitment, removing all non-essential costs and adjusting our capital expenditure. Management have also included the impacts of actions implemented in 2021 to reprofile interest payments, which has created interest savings of £358 million, in its assessment.

In modelling the impact of COVID-19, there is a significant degree of uncertainty given the evolving current environment and the wide range of potential forecasts being formed by various stakeholders in the global aviation industry. This element of our forecasting is therefore inherently subjective. As reported in the June 2021 Investor Report, the Group has recently updated its financial modelling under the base case scenario to assume passenger traffic for 2021 will decline 2.7% compared to 2020 actual passenger numbers of 22.1 million, to 21.5 million passengers (a decrease of 73.4% compared to 2019). Despite the decline in passengers compared to 2020, Group EBITDA is expected to increase 23% to £332 million in 2021 driven by the annualised benefit of cost reduction initiatives implemented in 2020, management actions taken to optimise revenue and interest repricing in 2021.

To build the base case forecast of 21.5 million passengers in 2021 we assumed the implementation of a testing regime and a large-scale vaccine roll out during 2021 to drive the traffic increase compared to 2020. We then defined the stages of recovery, with key drivers being COVID-19 control, roll-out of a vaccine and reopening of key travel corridors. The level of demand at each stage of recovery is overlaid using data on actual passenger numbers. This is done at a granular level splitting into geographical markets and purpose of travel. Thereon, a timeline for moving between stages using latest information on testing and vaccine roll out and adjusting this for each of the geographical regions was taken into account. This approach is calibrated against information from airlines on planned schedules. The base case of passenger numbers for 2022 forecasts an improvement in passenger numbers with a graduated return to pre-pandemic levels, however the forecasted 2022 passengers remain significantly below 2019.

Under the base case scenario, the Group will meet all covenants associated with its financial arrangements.

Stress testing

As explained above, even under the most extreme scenario of no revenue, the Group has sufficient liquidity to meet all forecast cash flow needs until at least October 2022.

Nevertheless, Management has stress tested the base case, focusing in particular on the next annual covenant compliance date of 31 December 2021, by elongating the timing of the implementation of the testing regime, the rollout of vaccination programmes and the transition through the stages of recovery. This is reflected in further decreases in passenger numbers and a resulting drop in EBITDA and operating cashflow. Although no covenant breach is forecast under our base case scenario, the headroom to our ICR covenant is expected to be limited given ongoing pressures on our cashflow generation, with a reduction of £66m in EBITDA likely to lead to a breach of the Heathrow Finance ICR.

The stress test scenario representing a 'severe but plausible' downside models 13.0 million passengers in 2021 and a 71% fall in EBITDA in 2021 compared to the base case, arising from further COVID-19 related disruption due to uncertainty associated with reopening of travel corridors. This 'severe but plausible' scenario is expected to cause the Group to breach minimum levels required for ICR covenant compliance at Heathrow Finance.

Heathrow Funding Limited

Accounting policies for the year ended 31 December 2020 *continued*

Going concern *continued*

Stress testing *continued*

In this instance, management would need to undertake additional actions, including identifying additional cost savings and seeking a further covenant waiver or amendment from Heathrow Finance creditors.

In 2020, management agreed a waiver for the ICR covenant and an amendment to the RAR covenant from Heathrow Finance creditors which resulted in no breach occurring in relation to the financial year ended 31 December 2020. Whilst management is confident it would receive support from its creditors if required, there is no certainty a further covenant waiver would be agreed, and this indicates the existence of a material uncertainty which could cast significant doubt upon the Group and the Company's ability to continue as a going concern.

Conclusion

Having had regard to both liquidity and debt covenants, and considering severe but plausible downsides, the Directors have concluded that there will be funds available to meet the Group and Company's funding requirements for at least 12 months from the date of these financial statements, and that it is accordingly appropriate to adopt a going concern basis for the preparation of these financial statements.

The Directors consider that the underlying credit quality of the business means that it can secure, if necessary and in the event of a severe but plausible downside, the timely support of its debtholders as it successfully secured in 2020.

Nevertheless, the impact of Covid-19 continues to create considerable uncertainty for the aviation industry, which may result in the Group needing to take further action, including seeking a further covenant waiver or amendment from Heathrow Finance creditors. This indicates the existence of a material uncertainty which could cast significant doubt upon the Group and Company's ability to continue as a going concern.

These financial statements do not include the adjustments that would result if the Group and the Company were unable to continue as a going concern.

Foreign currency

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

Transactions denominated in foreign currencies are initially recorded in the entity's functional currency applying the spot exchange rate 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. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

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 and at the effective interest rate applicable.

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 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.

Borrowings from Company undertakings include the balance of the Borrower Loan Agreements ('BLAs') payable by the Company to Heathrow Funding Limited. Advances under the BLAs are secured and are issued on substantially the same terms as the bonds issued by Heathrow Funding Limited. The advances are carried at amortised cost with the interest expense recognised using the effective interest method. The nominal amount of the index-linked borrowings is accreted for the RPI component recognised within interest payable in the income statement.

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/ by group undertakings

Amounts owed to/ by 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 income statement over the period of the borrowings using the effective interest method.

Heathrow Funding Limited

Accounting policies for the year ended 31 December 2020 *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 reserve.

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

Derivative instruments not designated are accounted for at fair value and recognised immediately in the (income statement) profit and loss.

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 net amount in finance costs in the income statement.

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 at each reporting period. The Company does not designate derivatives held by the Company in a hedge relationship.

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

Certain derivatives, as indicated by their fair value at inception or immediately prior to the restructuring, could not be supported by observable inputs alone. These fair values are supported by unobservable factors including the counterparty's credit, capital, funding and trading charges. Therefore, such movement was deferred on the balance sheet in compliance with IAS 39 and will be recognised in the income statement on a straight-line basis over the life of the underlying derivative instrument.

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 monthly based on current market data. The back-to-back derivatives carry the same credit risk adjustment as the associated external derivatives, given that all credit risks are passed to Heathrow Airport Limited as a member of the Heathrow SP Obligor Group. When applying a credit risk adjustment to entities within the Heathrow SP sub-group, because of the ring fence around all the entities, we consider that the credit risk is the same for all entities within the sub-group. Consequently the credit adjustment on external derivatives with identical terms to intercompany derivatives will apply the same counterparty credit risks and hence not be subject to any sensitivity to credit or default risk.

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:

- they include contractual obligation to deliver cash or another financial asset; or
- 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.

The Company's financial liabilities include borrowings, trade and other payables and derivative financial 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 share 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 shareholders' funds are dealt with as appropriations in the reconciliation of movements in shareholders' funds.

Heathrow Funding Limited

Accounting policies for the year ended 31 December 2020 *continued*

Classification of financial instruments issued by the Company *continued*

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 a result, the accounting requirements of IAS 39 have been applied to all financial instruments instead of those of FRS 102.

Financial instruments

Financial instruments are recognised in the Company's balance sheet when the Company becomes party to the contractual provisions of the instrument.

Financial assets and liabilities are offset, with the net amounts presented in the financial statements, when there is a legally enforceable right to set off the recognised amounts and there is an intention to settle on a net basis or to realise the asset and settle the liability simultaneously.

Heathrow Funding Limited

Significant estimates and judgments for the year ended 31 December 2020

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

Going concern

The impact of COVID-19 on going concern was considered in some detail. Further information can be found within the 'accounting policies' section.

Key sources of estimation uncertainty

Loss given default and assumed recovery rates

Accounting standards require that the fair value of financial instruments reflects their credit quality, and also the assumed recovery rate which then implies a loss given default rate. The credit risk associated with the Company's derivatives is updated monthly based on current market data, and industry standard default rates. However certain derivatives are ranked higher in the waterfall priority payments schedule and apply a super senior recovery rate as described in Note 6.

On a semi-annual basis, the Group reviews any material changes to the valuation techniques and market data inputs used.

As all derivate and associated risks are passed to Heathrow Airport Limited there is no sensitivity applicable to the Company's super senior derivatives.

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2020

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 £108,000 (2019: £25,000) 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 (2019: nil).

Directors' remuneration

An amount was paid to Sanne Group (UK) Limited, for directors' services totalling £5,000 for the year ended 31 December 2020 (2019: £5,000). This payment is made annually for the services of Lisa Aune (previously 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 directorship corporate administration agreement between the companies. In addition to this £31,000 (2019: £17,000) was paid to Sanne Fiduciary Services Limited by various entities in the Heathrow Airport Holdings Group for registered office and company secretary services in line with the existing corporate HAH administration agreement between the companies.

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 2020 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. Yuanyuan Ding and Nicholas Golding were directors of a number of companies within the HAH 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 HAH Group based on services provided.

During the year, two of the directors (2019: two) had retirement benefits accruing to them under a defined benefit scheme and one of the directors (2019: two) had retirement benefits accruing to them under a defined contribution scheme.

2 Financing

Net finance income before certain re-measurements

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
Finance income		
Interest receivable from group undertakings	600	609
Total finance income	600	609
Finance costs		
Interest payable on external borrowings	(554)	(558)
Net interest payable on derivatives	(80)	(75)
Total finance costs	(634)	(633)
Net finance costs before certain re-measurements	(34)	(24)
Certain re-measurements		
Fair value gain on financial instruments		
Index-linked swaps with external counterparties	(75)	172
Index-linked swaps as internal derivatives with Heathrow Airport Limited	82	(112)
Cross-currency swaps with external counterparties and retranslation of foreign currency debt ¹	51	106
Interest rate swaps with external counterparties	(70)	(18)
Interest rate swaps as internal derivatives with Heathrow Airport Limited	65	15
Fair value gain on financial instruments	53	163
Net finance income including certain re-measurements	19	139

¹ Includes foreign exchange retranslation on the currency bonds of £122 million (2019: £133 million) which has moved systematically in the opposite direction to that of the cross currency swaps which economically hedge the related currency bonds.

Certain re-measurements relates to the derivative financial instruments, which are subject to external financial market fluctuations.

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2020 *continued*

3 Taxation

	Year ended 31 December 2020 £m	Year ended 31 December 2019 £m
UK corporation tax		
Current tax at 19% (2019: 19%)	-	-
Group relief payable	-	-
(Under)/Over provision in respect of prior years	-	-
Taxation charge for the year	-	-

Reconciliation of tax charge

The standard rate of current tax for the year, based on the UK standard rate of corporation tax, is 19% (2019: 19%). 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 2020 £m	Year ended 31 December 2019 £m
Profit on ordinary activities before tax	19	139
Tax charge on ordinary activities at 19% (2019: 19%)	(4)	(26)
Effect of:		
Non-taxable income	4	26
Taxation 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 profit shown in the statement of comprehensive income.

For the year ended 31 December 2020, the profits subject to corporation tax were £20,000 (2019: £20,000) which gave rise to a tax liability of £3,800 (2019: £3,800).

The previously announced reduction of the corporation tax rate to 17% from 1 April 2020 was revoked by the government in Finance Act 2020. The headline UK corporation tax rate of 19% was maintained and given Royal Assent on 22 July 2020.

In the Spring Budget 2021, the Government announced that from 1 April 2023 the corporation tax rate will increase to 25%. Since the proposal to increase the rate to 25% had not been substantively enacted at the balance sheet date, its effects are not included in these financial statements. Other than these changes, there are no items which would materially affect the future tax charge.

4 Trade and other receivables

	31 December 2020 £m	31 December 2019 £m
Current		
Interest receivable from group undertakings ¹	151	167
Amounts owed by group undertakings – interest bearing ²	1,128	400
	1,279	567
Non-current		
Amount owed by group undertakings – interest bearing ²	12,582	11,740
Prepaid Debt Fees	-	1
	12,582	11,741
Trade and other receivables	13,861	12,308

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.

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2020 *continued*

5 Borrowings

	31 December 2020 £m	31 December 2019 £m
Current		
Secured		
Bonds		
6.000% £400 million due 2020	-	400
8.500% £250 million due 2021	251	-
3.000% C\$450 million due 2021	258	-
4.875% US\$1,000 million due 2021	732	-
	1,241	400
Interest payable on borrowings	200	209
Total current	1,441	609
Non-current		
Secured		
Bonds		
9.200% £250 million due 2021	-	255
3.000% C\$450 million due 2021	-	261
4.875% US\$1,000 million due 2021	-	753
1.650%+RPI £180 million due 2022	222	218
1.875% €600 million due 2022	536	506
5.225% £750 million due 2023	717	704
7.125% £600 million due 2024	595	594
0.500% CHF400 million due 2024	331	312
3.250% C\$500 million due 2025	285	288
4.221% £155 million due 2026	155	155
6.750% £700 million due 2026	694	693
0.450% CHF210 million due 2026	175	164
2.650% NOK1,000 million due 2027	85	85
3.400% C\$400 million due 2028	228	231
7.075% £200 million due 2028	198	198
4.150% A\$175 million due 2028	98	92
2.500% NOK1,000 million due 2029	85	86
3.782% C\$400 million due 2030	228	231
1.500% €750 million due 2030	666	629
6.450% £900 million due 2031	857	855
Zero-coupon €50 million due January 2032	65	58
1.366%+RPI £75 million due 2032	88	86
Zero-coupon €50 million due April 2032	64	57
1.875% €500 million due 2032	446	421
4.171% £50 million due 2034	50	50
Zero-coupon €50 million due 2034	54	49
1.875% €650 million due 2034	572	540
1.061%+RPI £180 million due 2036	204	201
1.382%+RPI £50 million due 2039	58	58
3.334%+RPI £460 million due 2039	646	639
Zero coupon €86 million due 2039	81	75
0.800% JPY10bn due 2039	72	70
1.238%+RPI £100 million due 2040	115	113
5.875% £750 million due 2041	739	738
2.926% £55 million due 2043	54	54
4.625% £750 million due 2046	742	741
1.372%+RPI £75 million due 2049	87	86
2.750% £400 million due 2049	393	392
0.147%+RPI £160 million due 2058	166	165
0.347%+RPI £50 million due 2035	76	-
0.337%+RPI £75 million due 2036	76	-
0.419%+RPI £51 million due 2038	51	-
3.460% £105 million due 2038	105	-
0.362%+RPI £75 million due 2041	76	-
3.661% CAD500m due 2031	285	-
2.850% + RPI £181.75m due 2032	182	-
2.75% GBP450m due 2029	445	-
1.50% EUR 750m due 2025	665	-
Total non-current	12,812	11,903
Total borrowings	14,253	12,512
Total borrowings (excluding interest payable)	14,053	12,303

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2020 *continued*

5 Borrowings *continued*

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 7.125% £600 million due 2024, 4.221% £155 million due 2026, 0.101%+RPI £182 million due 2032, 0.347%+RPI £75 million due 2035, 0.337%+RPI £75 million due 2036, 1.061%+RPI £180 million due 2036, 0.419%+RPI £51 million due 2038, 3.460% £105 million due 2038, 0.362%+RPI £75 million due 2041 bonds wherein the redemption dates coincide with their legal maturity dates.

Fair value of borrowings

	31 December 2020		31 December 2019	
	Book value £m	Fair value ¹ £m	Book value £m	Fair value ¹ £m
Current				
Bonds	1,241	1,263	400	404
Non-current				
Bonds	12,812	15,334	11,903	15,862
	14,053	16,597	12,303	16,266

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.

At 31 December 2020, the fair value of debt classified as Level 1 and Level 2 was £15,467 million and £1,130 million respectively.

Securities and guarantees

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 2020				
Current				
Cross-currency swaps	868	144	-	144
<i>Interest rate swaps:</i>				
with counterparties external to the SP Group	-	-	-	-
with fellow subsidiary Heathrow Airport Limited	93	4	-	4
<i>Index-linked swaps:</i>				
with counterparties external to the SP Group	326	1	(21)	(20)
with fellow subsidiary Heathrow Airport Limited	306	17	(2)	15
Total current	1,593	166	(23)	143
Non-current				
Cross currency swaps	4,656	547	(47)	500
<i>Interest rate swaps:</i>				
with counterparties external to the SP Group	6,844	33	(431)	(398)
with fellow subsidiary Heathrow Airport Limited	6,844	431	(33)	398
<i>Index-linked swaps:</i>				
with counterparties external to the SP Group	5,756	76	(653)	(577)
with fellow subsidiary Heathrow Airport Limited	5,613	566	(52)	514
Total non-current	29,713	1,653	(1,216)	437
Total	31,306	1,819	(1,239)	580

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2020 *continued*

6 Derivative financial instruments *continued*

	Notional £m	Assets £m	Liabilities £m	Total £m
31 December 2019				
Current				
Cross-currency swaps	-	-	-	-
<i>Interest rate swaps:</i>				
with counterparties external to the SP Group	738	-	(10)	(10)
with fellow subsidiary Heathrow Airport Limited	738	10	-	10
<i>Index-linked swaps:</i>				
with counterparties external to the SP Group	313	-	(45)	(45)
with fellow subsidiary Heathrow Airport Limited	313	45	-	45
Total current	2,102	55	(55)	-
Non-current				
Cross currency swaps	4,551	482	(25)	457
<i>Interest rate swaps:</i>				
with counterparties external to the SP Group	1,572	-	(388)	(388)
with fellow subsidiary Heathrow Airport Limited	1,665	396	-	396
<i>Index-linked swaps:</i>				
with counterparties external to the SP Group	6,082	57	(814)	(757)
with fellow subsidiary Heathrow Airport Limited	5,919	688	(24)	664
Total non-current	19,789	1,623	(1,251)	372
Total	21,891	1,678	(1,306)	372

A full disclosure of derivative financial instruments can be found in the consolidated financial statements of Heathrow (SP) Limited (external derivative financial instruments) and in the financial statements of Heathrow Airport Limited (internal derivative financial instruments).

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.

During the year, interest rate swaps, with a total notional of £1 billion had their maturity dates extended and interest rate swaps, with notional of £0.7 billion were restructured.

This had resulted in a fair value difference of £13 million (loss) at the restructuring date and deferred on the balance sheet. Additionally, new interest rate swaps with a notional of £4.8 billion were entered into during the year which had resulted in a fair value difference of £27 million (loss) at initial recognition and deferred on the balance sheet.

As at 31 December 2020, £300 million (31 December 2019: £289 million) remained deferred on the balance sheet and £29 million had been recognised in the income statement for the period (2019: £29 million).

In relation to the internal swaps with Heathrow Airport Limited, £283 million remained deferred on the balance sheet as at 31 December 2020 (31 December 2019: £271 million) and £28 million had been recognised in the income statement for the period (2019: £28 million).

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2020 *continued*

6 Derivative financial instruments *continued*

Interest rate benchmark reform

As listed below, the Company is exposed to interest rate benchmarks within its derivative financial instrument portfolio, which is subject to interest rate benchmark reform.

The Company will continue to apply these amendments until the uncertainty arising from interest rate benchmark reform is no longer present with respect to the timing and amount of the interest rate benchmark cash flows. None of the Company's current GBP LIBOR- or EURIBOR-linked contracts include adequate and robust fallback provisions for a cessation of the referenced benchmark interest rate.

At 31 December 2020, the Company was directly exposed to interest rate benchmark reform as it holds interest rate derivatives that reference GBP LIBOR and fixed rate bonds with various maturities up to 2039.

The Company is monitoring the market and the output from various industry working groups managing the transition to new benchmark interest rates and will look to implement fallback language for different instruments and IBORs when appropriate. For the Company's derivatives, the International Swaps and Derivatives Association's ('ISDA') fallback clauses were made available at the end of 2019 and the Company began discussion with its banks with the aim to implement this language into its ISDA agreements in 2020.

The Company is also aware that transition to potential development of RFR-based term rates is at different stages depending on the jurisdiction. The Group also expects that the timing of any transition away from relevant interbank offered rates to take into account liquidity of the development of robust RFR-based term rates, changes in relevant industry conventions and the speed with which market participants transition away from LIBOR. As a part of our treasury risk management strategy, the Company intends to follow milestones set out by the ICE Benchmark Administration ('IBA') with respect to providing LIBOR-linked products maturing after the end of 2021 and will also explore solutions to reduce our footprint in relation to LIBOR-linked products, under Phase 2 of the 'Interest rate benchmark reform'.

7 Trade and other payables

	31 December 2020	31 December 2019
	£m	£m
Current		
Amounts owed to group undertakings – non interest bearing	1	-
Trade and other payables	1	-

8 Share capital

	£
Authorised	
At 1 January and 31 December 2020	
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 2020	
2 no par value ordinary shares of £1 each	2

9 Retained earnings

	£m
1 January 2019	29
Total comprehensive income for the year	139
31 December 2019	168
Total comprehensive income for the year	19
31 December 2020	187

Heathrow Funding Limited

Notes to the financial statements for the year ended 31 December 2020 *continued*

10 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 all hold ordinary shares in the following proportion; 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), QS 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 2020, 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 2020.

Copies of the financial statements of FGP Topco Limited, Heathrow Airport Holdings Limited, Heathrow Finance plc and Heathrow (SP) Limited may be obtained by writing to the Company Secretarial Department at The Compass Centre, Nelson Road, Hounslow, Middlesex, TW6 2GW. This is the registered office for the smallest and the largest undertaking to consolidate these financial statements.

11 Subsequent events

Heathrow Funding Limited issued a £350m class B bond in March 2021, a €500m class A bond, CAD650m class A bond and CAD300m class A bond in April 2021 and an AUD125m class A bond in June 2021. Standard and Poor ('S&P') took Heathrow Funding Limited off the negative outlook in March 2021.