Appendix L: Single till income

Our single till income offsets our Determined Cost base. It reduces airline prices by around 10% than would otherwise be the case. The income comprises five categories:

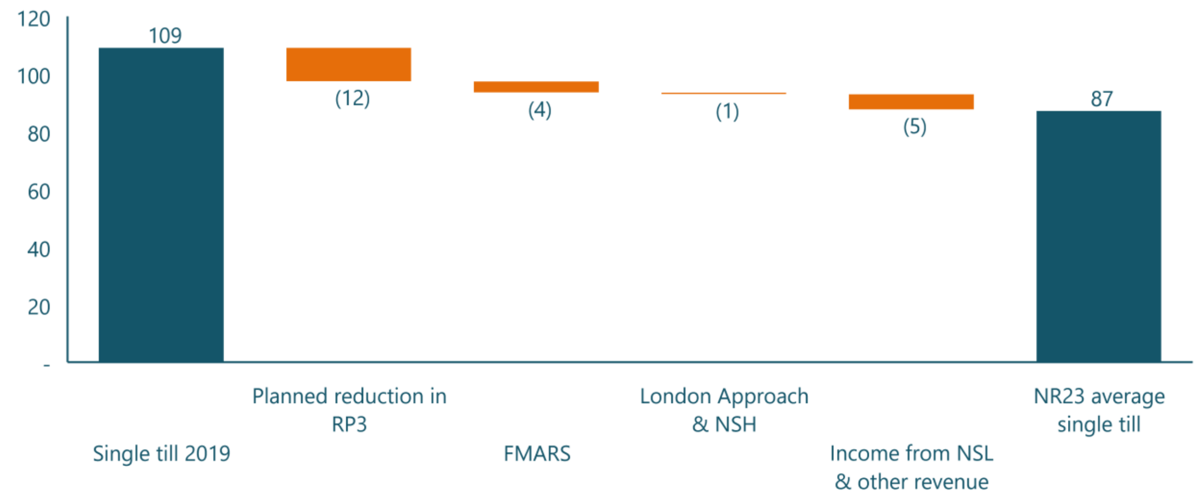
- **Ministry of Defence (MOD) revenue:** mainly through the Future Military Area Radar Services (FMARS) contract
- **London Approach:** the control and sequencing of flights between NERL's en route service and the tower service at London airports. This income is derived as a proportion of the total UK Air Traffic Services (UKATS) Determined Costs, and is regulated through NERL's licence
- **North Sea Helicopters:** the provision of services to helicopter operators servicing the offshore oil platforms in the North Sea, and is regulated through NERL's licence
- **Income from NATS Services Ltd (NSL):** revenues from (i) intercompany agreements (ICAs) providing NSL with resources / services to support projects or specific contracts that NSL has with its customers (eg provision of technical / engineering resources, analytics), and (ii) Managed Service Agreements (MSAs) to share the cost of NATS Group support functions such as Finance, HR, and Facilities Management between NERL and NSL
- **Other revenue:** trading directly with external customers including activities such as selling vacant space at NERL sites and the sale of NERL's radar data to third parties. Historically it also included income from Single European Sky ATM Research (SESAR) R&D activities, which no longer forms part of determined costs and is instead passed to customers via a price adjustment in line with Eurocontrol charging principles

Our projected single till income in NR23 for total NERL is shown below. We expect single till income to reduce by around £22m (20%) on average in NR23 vs 2019, with £12m of this already anticipated in our RP3 plan. The remaining £10m reduction is explained below.

CY, 2020 prices, £m	2019	2020	2021	2022	2023	2024	2025	2026	2027
	Actual	*Actual*	*Forecast*	*Forecast*	*NR23 plan*	*NR23 plan*	*NR23 plan*	*NR23 plan*	*NR23 plan*
MoD revenue	47	48	42	39	40	40	40	40	40
London Approach	13	12	9	13	13	14	15	15	15
North Sea Helicopters	*9*	*8*	*8*	*8*	*8*	*8*	*8*	*8*	*8*
Income from NSL	*27*	*27*	*21*	*21*	*20*	*20*	*20*	*20*	*20*
Other revenue	12	9	8	5	6	5	5	5	5
Total single till income	109	103	88	86	87	86	88	88	87

Single till income projections

Single till income projections



Average NR23 single till income vs 2019 actuals

Commentary on NR23 single till income

Our single till income in NR23 is on average around £10m lower than in the RP3 plan. The main driver for the reduction in single till income is because NERL's overall cost base is lower than the RP3 plan, reflecting cost savings which have been built in following the response taken to Covid-19. As described above, many of the elements of single till income are derived as a proportion of the overall cost base, therefore the lower cost base translates into lower single till income. However, the lower overall cost base net of lower single till income still provides lower charges to customers than would otherwise be the case. The reduction for each of the single till categories is explained in more detail below.

MOD revenue

The average income is £40m per annum in NR23 vs £47m in 2019. The main driver of the reduction is in the headline price as the contract was recently renegotiated commencing 1 April 2021, and was re-baselined to reflect NERL's lower costs since the previous contract; the RP3 plan assumed FMARS revenues would be around £41m in 2022.

At a high level, FMARS revenues are based on the capital and operating costs incurred by NERL in the provision of the services to the MOD, as previously reviewed by the CAA. The NR23 plan is around £1m lower pa from 2023 than assumed in the RP3 plan. This is driven by further cost reductions in the NR23 plan relative to the RP3 assumptions. The FMARS income is most closely linked to NERL's regulatory depreciation and non-staff costs, albeit calculated from total costs. These are around 14% lower pa on average in NR23 compared to the RP3 plan, and would therefore lead to around £6m reduction in the headline contract price. However the contract's gainshare mechanism means that only around £1m of the savings are passed to the MOD via a reduction in the FMARS revenue.

London Approach

London Approach income is driven by the costs of providing the service, and is derived from the UKATS cost base using service line drivers (see below). The costs allocated to London Approach in NR23 are similar to those in the RP3 plan; the savings from the lower overall UKATS cost base are offset by additional costs to deliver airspace change in the London airspace in 2025 - 2026. As a result, there is no material change in the overall London Approach cost base, and therefore no change in the level of single till income.

North Sea Helicopters

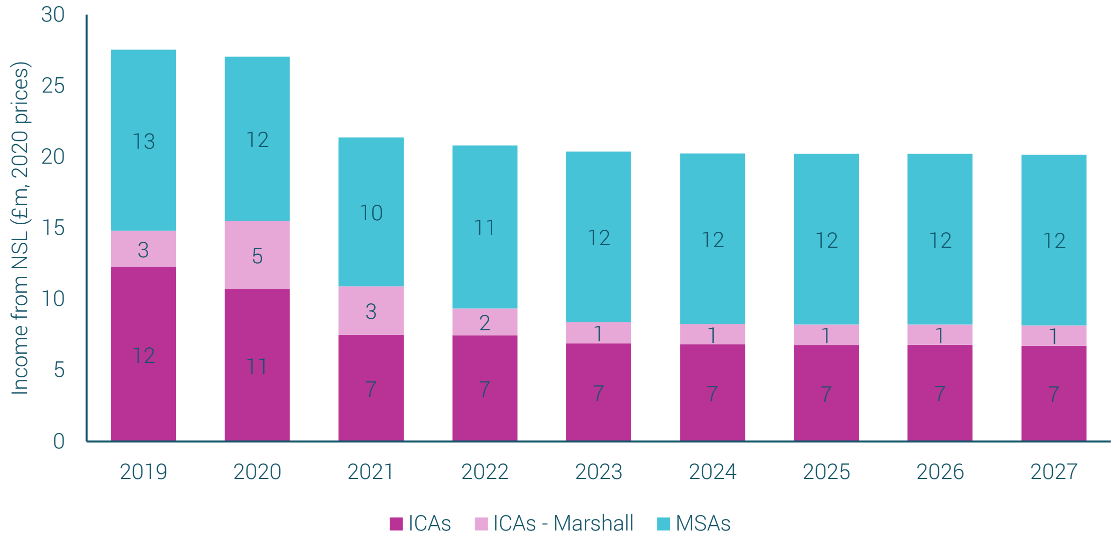
North Sea Helicopters income is derived from the UKATS cost base. The reduction in the NR23 plan relative to the RP3 plan reflects the lower cost of providing the operational service following actions taken in response to Covid-19, as well as a reduction in the dedicated North Sea Helicopter costs due to an asset becoming fully depreciated.

Income from NSL

The average income from NSL is £20m per annum in NR23 vs £27m in 2019. There are a number of contracts within this category:

- Managed Service Agreements (MSAs) to share the cost of central support functions such as Finance, HR, and Facilities Management between NERL and NSL
- Intercompany agreements (ICAs) are the contractual arrangements for traded services provided directly by one group entity to another, in this case from NERL to NSL. NERL are providing NSL with resources / services to support projects or specific contracts that NSL has with its customers (eg provision of technical / engineering resources, analytics). In the analysis below, we have differentiated between ICAs, and ICAs supporting Marshall (a contract under which NSL provides services and support to the MOD) as there are a number of long term significant ICAs

The chart below shows the evolution of the income from NSL over time.



Income from NSLcomponents

Managed Service Agreements (MSAs)

As the MSAs reflect a share of central support costs, there have been a wide range of decreases following the voluntary redundancy programme, NERL have lower costs, and subsequently lower income from sharing these costs with NSL. However, NSL demand for for trainee controllers for its airports business, has reduced with a peak of around £2m in 2019, but just £0.5m in 2021.

Intercompany Agreements (ICAs)

Income from ICAs will reduce in NR23 to an average of £8m pa from £15m in 2019. This is largely due to the economic impacts of Covid-19 on the aviation sector, which have led to a constrained UK market for commercial services as airports seek to reduce costs and defer investment. In addition, the NSL strategy has an increasing focus on International opportunities, delivered by its own in-country resource. There is thus a reduction in the level of NERL effort required to support delivery of NSL's commercial strategy.

In further detail, there are three main drivers for the reduction:

› One-off (non-repeatable) sales: there has been a £3m reduction (NR23 compared to 2019) from one-offs that we do not expect to replace given the current commercial environment noted above. These activities include support to Heathrow Runway 3 work (currently suspended), support to London City Digital Tower project (completed), and contracts for Intelligent Approach (significant drop in demand following Covid-19)

› Resourcing change: compared to 2019, there has been a £2m reduction in income from ICAs due to a change in the structure of our Analytics and Customer Solutions teams. To best reflect the nature of the work they were supporting, several staff transferred from NERL to NSL. The cost of these employees was moved from NERL to NSL, and therefore the income to NERL has also reduced. There is no net impact overall

› Marshall ICAs: several ICAs are all in support of NSL's contract with the MOD (Marshall). This is a 22 year contract to replace assets and then maintain new assets at MOD sites. The asset replacement phase began in 2015 and will largely complete in 2022. The £2m reduction in NR23 relative to 2019 reflects the change in the level of support required for Marshall as the contract moves into ongoing maintenance and support phase of the contract. This lower activity was included within our RP3 projections

Other revenue

The average income is £5m per annum in NR23 vs £12m in 2019 due to:

- SESAR income: 2019 included almost £4m of SESAR income which formed part of single till income in the RP2 regulations. In RP3, the European performance and charging regulations required that SESAR income is no longer classified in single till income. The income is therefore not netted off against total Determined Costs. Instead, the regulations required us to pass SESAR income back to airlines as an adjustment to prices (in the 'other revenue' category of the cost reporting tables). We have assumed this treatment continues in NR23

  In our RP3 plan, we assumed that this funding will cease as a result of Brexit. We have maintained this assumption in NR23. However, if we are able to secure R&D funding in the future, either from the EU or the UK Government, we will pass this back to airline customers through 'other revenues'

- SESAR Deployment Manager: Our RP3 plan also included £1m per annum (and £1m of costs, therefore nil contribution) related to SESAR Deployment Manager. Previously NERL provided assistance to the management function of the European wide SESAR deployment and were compensated for the costs incurred. This activity is now undertaken centrally, without ANSP involvement, as such both the income and costs do not exist

- One-offs: the peak in 2019 included one-off income from various contracts such as accelerated time based separation feasibility studies which are not expected to repeat due to the lack of opportunities, driven by business uncertainty around traffic levels and recovery

Risks and challenges to single till income

Around 85% of the single till income is derived as an allocation of NERL's overall cost base. As a result, our projections for FMARS, London Approach, North Sea Helicopters and inter-company MSAs are aligned with the rest of our plan.

For the remaining 15% of our single till income (£13m pa) which relates to inter-company ICAs and other revenue, we estimate around up to £12.5m risk across the whole NR23 period. The main assumptions underpinning these projections are:

- A flow of new commercial contracts with NSL and third party customers being secured (£3m). This will be challenging to meet, given industry pressures to reduce costs and defer investment

- The continuation of the vast majority of our existing contracts at existing prices (£2.5m), which will be stretching as many of our customers seek cost reductions in light of Covid-19

- The extension of lease arrangements beyond current terms (£6m). However given the change in working patterns with increased working from home following Covid-19, there is a risk leases may not be required, or may be required at lower level

Ongoing provision of services to airports via ICAs with NSL (£1m). Some of these are due to expire during the NR23 period, but we have assumed that the provision of radar data to these airports is still required even if other elements of these contracts are no longer required. For example, smaller airports in particular will be seeking to save costs following the pandemic, and those in the London area may seek to reduce their surveillance data feeds that they purchase from NERL because these feeds provide them with situational awareness only, ie the control of aircraft is handled by London Terminal Control, and therefore the radar data feeds may be seen as a cost that is not wholly necessary.

Cost allocation and inter-company pricing

The policies and procedures that we use to allocate costs to each of the service lines are materially the same as that in our RP3 plan. This approach was reviewed in depth by the CAA and its consultants at the RP3 review, and found to be satisfactory. One update that has been made since is for NERL to build in a specific check on the treatment of NERL intellectual property within any contract with NSL for supply to an NSL customer. This is to ensure that the NERL-NSL contract adequately rewards NERL for the commercial exploitation of intellectual property rights which are embodied in the services that NERL provides to NSL.

A table of the costs associated with each of the single till income lines is provided below.

FMARS has very limited direct costs, the income received from the MOD is a contribution to the infrastructure NERL has and the ongoing support costs thereof. London Approach and North Sea Helicopters incomes are based on an allocation of the costs. The table shows the income and costs for the remaining categories of single till income (income from NSL and other income). For MSAs, the revenue and costs are equivalent as these revenues are based an allocation of cost.

In 2019 and 2020, other income includes SESAR income. As this was either cost recovery or only part funded, the contribution in those years is reduced.

[✂ redacted]

Single till income and costs