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Liz Barber
Director of Finance, Regulation and Markets
Yorkshire Water
Western House
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8 June 2018

OFFICIAL

Dear Liz,

Proposed changes to the financing structure and subsidiaries of Yorkshire Water Services Limited (“YWS”)

- 1.1 YWS is the holder of an instrument of appointment granted under sections 11 and 14 of the Water Act 1989 (the “**Appointment**”). Words and expressions defined in the Appointment shall have the same meaning in this letter unless the context otherwise requires.
- 1.2 In a letter dated 3 May 2018 (the “**Consent Request Letter**”, included as Appendix 1 to this letter), supplemented by information received before 29 May 2018 (the “**Supplementary Request**”, included as Appendix 2), YWS sought Ofwat's consent in relation to proposed changes to its financing structure which YWS consider require Ofwat's consent pursuant to certain provisions of Condition F of its Appointment.
- 1.3 We have not been provided with copies of the relevant revised financing arrangements and in our consideration of the requests for consent, we have relied on the information and assurances contained in the Consent Request Letter and the Supplementary Request.
- 1.4 The purpose of this letter is to record Ofwat's Consent to the specific requests made by YWS and to set out any conditions of that Consent.

- 1.5 Words and expressions defined in the Appointment shall have the same meaning in this letter unless the context otherwise requires.

2 Background

- 2.1 We note that YWS¹ requests are made in the context of proposed changes to its financing structure¹. The existing financing structure was implemented in 2009 as part of the refinancing of YWS. It comprises YWS, its holding company, Yorkshire Water Services Holdings Limited (“YWH”) and its subsidiaries Yorkshire Water Services Bradford Finance Limited (the “Programme Issuer”), Yorkshire Water Services Finance Limited (“YWSF”), Yorkshire Water Services Odsal Finance Holdings Limited (“YWSOFH”) and Yorkshire Water Services Odsal Finance Limited (the “Exchange Issuer”) and together with YWS, YWH, YWSF, the Programme Issuer and YWSOFH, the “YW Financing Group”).
- 2.2 The Programme Issuer, the Exchange Issuer and YWSF (together, the “Existing Issuers”) have each issued bonds under the existing structure (together, the “Bonds”).
- 2.3 The Consent Request Letter states that the changes reflect YWS’ public commitment to remove Cayman Islands incorporated subsidiaries from the YW Financing Group. YWS is also proposing to simplify the YW Financing Group by removing YWSF and intends to create a newly incorporated UK company, as a subsidiary of YWS, to take the place of the Existing Issuers as the issuer for the Bonds.
- 2.4 In 2009, Ofwat provided consent to certain guarantees and cross default obligations being entered into by YWS when the current financing structure was established. YWS is now seeking consent in respect of certain proposed specific guarantees and cross default obligations as set out in the Consent Request Letter and Supplementary Request, arising out of the proposed restructuring, which it believes do not substantively change the nature of the cross-default and guarantee arrangements that were previously granted consent by Ofwat (letter from Keith Mason to Allison Bainbridge dated 12 June 2009).

¹ A key to entities involved in the financing structure is included as Appendix 3.

3 Nature of consents sought

3.1 The guarantees and cross default provisions that are required pursuant to the proposed restructuring are prohibited without the consent of Ofwat under paragraphs 6.11(1) and 6.11(1A) of Condition F of the Appointment.

3.2 The specific arrangements that require YWS to enter into agreements for which consent is required are as follows:-

3.2.1 Guarantees

- (a) YWS will guarantee the obligations of the UK Issuer (supported by an indemnity in respect of losses incurred in relation to the relevant guaranteed obligations).

We note that YWS will continue to make certain standard representations and warranties and be bound by certain standard covenants (e.g. as to permitted financial indebtedness, maintenance of interest cover, restrictions on disposals, conduct of business etc).

3.2.2 Cross-default obligations

- (a) There will be a new cross-default obligation applicable to YWS on certain specified events in relation to the UK Issuer.

We note there will continue to be cross-default obligations applicable to YWS on certain specified events in relation to the obligations of YWH, and for the period they remain in the financing structure, the obligations of the Cayman Companies and YWSF.

4 Ofwat's Consent

4.1 Guarantees and Cross-default obligations

4.1.1 In accordance with, and for the purposes of Condition F, paragraphs 6.11(1) and 6.11(1A) of the Appointment and subject to the condition set out in paragraph 4.1.3 below, Ofwat consents to the guarantees and cross-default obligations set out in section 3 of this letter. As noted above, we have relied on the information provided by YWS in its Consent Request Letter and Supplementary Request.

4.1.2 For the avoidance of doubt, we note that it is for YWS to satisfy itself that, in implementing this restructuring and the particular matters for which we are providing Consent, it will remain compliant with its obligations under the Appointment, and in particular with respect to the ring-fencing and related

requirements in the Appointment. We do not, in providing the above Consent, provide any assurance in that respect.

4.1.3 Further, this Consent is subject to the following condition:

- (a) there shall be no material changes to the terms of the arrangements between YWS and the entities described in the Consent Request Letter and the Supplementary Request unless Ofwat's further consent has been obtained for the same.

4.2 General Provisions relating to Ofwat's Consent

4.2.1 The Consent described in paragraph 4.1 shall take effect from the date of this letter.

5 Reasons for Consent

Ofwat considers that the Consent provided in paragraph 4.1 above should be granted because from the information provided, Ofwat is satisfied that the granting of consent is consistent with its statutory duties.

This is on the basis that, as set out in the Consent Request Letter and Supplementary Request:

- the proposed changes to the financing structure of the YW Financing Group do not substantively change the nature of the cross-default and guarantee arrangements to which Ofwat previously granted consent;
- the purposes of these particular cross-default and guarantee arrangements is to facilitate the financing of the Appointed Business with such arrangements being confined within the YW Financing Group (which excludes Kelda Group Limited);
- no changes in covenants and credit ratings are expected and the relevant transaction will be substantially neutral from a tax, credit rating and gearing perspective;
- the transaction enables YWS to simplify its financing structure and remove the Cayman companies from the YW Financing Group. The costs of the transaction will not be borne by customers and on their own the quantum of these costs does not result in a significant threat to the financial resilience of YWS.

We trust that you will keep us advised of any material changes to the matters or proposals set out in your letter including, without limitation, those which relate specifically to the consents requested.

Yours sincerely



Aileen Armstrong
Senior Director Finance and Governance

Encs:

1. Appendix 1 – Consent Request Letter
2. Appendix 2 - Additional information provided, prior to 29 May 2018, in response to Ofwat enquiries
3. Appendix 3 - Key to entities involved in the financing structure

Appendix 2

Additional information provided, prior to 29 May 2018, in response to Ofwat enquiries

Consent is being requested since YWS will guarantee the obligations of the UK Issuer (supported by an indemnity in respect of losses incurred in relation to the relevant guaranteed obligations) and there will be a new cross-default obligation applicable to YWS on certain specified events in relation to the UK Issuer.

The proposed changes are solely to add a new UK company to the current structure so to be able to remove the Cayman Companies and YWSF. There is no intention to change the financial obligations of YWS nor to amend cross default and guarantee provisions, other than to add or remove companies as appropriate. This will also be confirmed to bondholders when their consent is requested for the proposed changes.

We note that there will be a continuation of the existing guarantees and cross-defaults (including YWSF or any Cayman Companies if they remain in the securitisation structure) with amendments to include the UK Issuer, which does not increase the liability of YWS any more than the status quo today.

We are no longer proposing to create new intercompany loans for the removal of the Cayman Companies and not seeking consent to do so. Specifically:

- The YWS/KGL Loan referred to on p5 and p6 of the letter will not be required since KGL will cash settle any amount owing to YWS when the Cayman Companies and YWSF are disposed by YWS to KGL. This will be incorporated into the steps that we will implement once we receive creditors' consent to the proposed changes.
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- YWS will subscribe for shares in the UK Issuer in cash and will not leave a balance outstanding on an intercompany account.

For YWS, the only changes to existing intercompany loans will be changing the names of loan counterparties to reflect the novation of agreements for the introduction of the UK Issuer and the removal of the Cayman Companies and YWSF. These intercompany loans result from the lending of external debt, raised by the Cayman Companies and YWSF, to YWS on the same terms. Following the proposed changes these balances will be held by a UK registered company instead of the Cayman Companies.

In respect of 2(f) in the letter, the transfer of certain bank facilities and associated amounts owing to banks will not change the financial position of YWS. This is because any amounts currently borrowed by the Exchange Issuer against these facilities have been lent to YWS via an inter-company loan, which will be offset fully when the bank facilities and outstanding balances are transferred to YWS. The end position is that YWS will have a borrowing of the same amount owed to the syndicate of bank lenders that previously it owed to the Exchange Issuer.

Appendix 3 – Key to entities involved in the financing structure

1. Yorkshire Water Services Limited (02366682) – YWS
2. Holding company of YWS, Yorkshire Water Services Holdings Limited (06815156) – YWH
3. Subsidiary of YWS, Yorkshire Water Services Bradford Finance Limited (MC-219838)– the Programme Issuer
4. Subsidiary of YWS, Yorkshire Water Services Finance Limited (04636719) – YWSF
5. Subsidiary of YWS, Yorkshire Water Services Odsal Finance Holdings Limited (MC-219850) – YWSOFH
6. Subsidiary of YWS, Yorkshire Water Services Odsal Finance Limited (MC-222763) – the Exchange Issuer
7. YWS, YWH, YWSF, the Programme Issuer, YWSOFH and the Exchange Issuer – the YW Financing Group
8. The Programme Issuer, the Exchange Issuer and YWSF – the Existing Issuers
9. The Programme Issuer, the Exchange Issuer and YWSOFH – the Cayman Companies
10. New UK incorporated public limited liability company, to be a wholly owned subsidiary of YWS – the UK Issuer