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21 Bloomsbury Street, London WC1B 3HF

By email and post

Susan Davy
South West Water Limited
Peninsula House
Rydon Lane
Exeter
EX2 7HR

20 December 2019

Dear Susan,

CONSENT TO FINANCING ARRANGEMENTS PURSUANT TO CONDITION P PARAGRAPH 6.3

1 Introduction

1.1 South West Water Limited ("**South West Water**") 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 On 1 April 2016 a new Condition P became effective in South West Water's Appointment. Condition P contains regulatory ring-fencing conditions which amongst other things, restrict South West Water's ability to enter into transactions with Associated Companies and to maintain agreements, which include guarantees and cross default obligations, without Ofwat's consent.

1.3 In a letter dated 17 December 2019 (the "**Consent Request Letter**", included as an Appendix to this letter), South West Water sought Ofwat's consent to the continuation of certain financing arrangements that were in existence at the time of the licence modifications.

- 1.4 We have not been provided with copies of the relevant 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. Ofwat's consent is provided on the basis that the material facts described in the Consent Request Letter are accurate and remain the same.
- 1.5 The purpose of this letter is to record Ofwat's agreement to the specific requests made by South West Water in their Consent Request Letter and to set out the conditions of that consent.

2 Background

- 2.1 South West Water accesses the debt capital markets through a separate financing subsidiary, South West Water Finance Plc, which has issued debt instruments into the debt capital markets.
- 2.2 The instruments issued by South West Water Finance Plc are:
- (a) SOUTH WEST WATER FINANCE PLC GBP150M BOND maturing 2040
 - (b) SOUTH WEST WATER FINANCE PLC GBP200M INDEX LINKED BOND maturing 2057
- (both (a) and (b) are the “**Relevant Instruments**”).
- 2.3 The Relevant Instruments are guaranteed by South West Water and cross-default obligations are included in South West Water's existing financing documentation. This is because lenders typically require that covenant packages in financing documentation apply to both South West Water Finance Plc as the borrower and to South West Water as the operating company. This is in order to provide continued protection to the lenders to South West Water Finance Plc in the event of a default in respect of its obligations under the Relevant Instruments.
- 2.4 South West Water have asked for Ofwat to consider the continuation of these financing arrangements as they support the effective long dated financing for South West Water.

3 Nature of Consents Sought

- 3.1 The Consent Request Letter asks for Ofwat to consent to:
- (a) guarantees given by South West Water in respect of South West Water Finance Plc's obligations under the Relevant Instruments (for the purposes of paragraph 6.3(a) of Condition P of South West Water's Appointment); and

(b) the existence of cross-default obligations in South West Water's financing arrangements (for the purposes of paragraph 6.3(c) of Condition P of South West Water's Appointment).

3.2 The guarantees and cross default obligations that are required for the Relevant Instruments are prohibited without the consent of Ofwat under paragraphs 6.3(a) and 6.3(c) of Condition P of South West Water's Appointment.

4 Ofwat's Consent

4.1 In accordance with, and for the purposes of Condition P, paragraph 6.3(a) and paragraph 6.3(c), and subject to the following paragraph of this letter (paragraph 4.2), Ofwat consents to the guarantees and cross default obligations set out in section 3 of this letter.

4.2 This Consent is subject to the following conditions:

a) South West Water Finance Plc continues to be wholly-owned and controlled by South West Water and has raising finance for South West Water as its sole purpose;

b) there shall be no material changes to the Relevant Instruments or to the arrangements described in paragraph 3.1 of this letter (including if such changes would constitute a renewal, extension or replacement) without South West Water first obtaining Ofwat's further consent.

5 Reasons for Consent

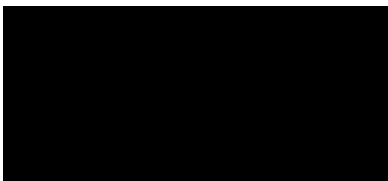
5.1 South West Water set out in the Consent Request Letter that the company's financing strategy has secured access to funding at efficient rates that are consistently amongst the lowest in the industry over the long term. It says that this financing strategy has supported the financial strength and resilience of the company, enabling continued investment in its infrastructure to support services to customers and protection and enhancement of the environment. It also states that the benefit of an efficient portfolio has been to protect customers from any unnecessary burden of high financing costs, and that efficient financing enables the company to share the financial benefits of relatively low costs of debt with customers.

5.2 The Consent Request Letter states that the instruments raised through South West Water Finance plc specifically contribute to the overall financing position for South West Water and are part of its diversified portfolio. The Consent Request Letter explains that using a separate subsidiary which is established as a public limited company is necessary to access the debt capital market. Therefore, South West

Water Finance was established to issue instruments into debt capital markets for the sole purpose of financing South West Water's regulated activities. The consent letter also explains that the cross default and guarantee arrangements described in paragraph 3.1 are typically required by lenders, and that these arrangements support the effective long-dated financing for South West Water. We also understand that South West Water is not exposed to risks beyond those that it would face if the company had raised this finance directly.

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

Yours sincerely



Aileen Armstrong

Senior Director Finance and Governance

Appendix 1 - Consent Request Letter

Date: 17 December 2019

Elinor Mathieson
Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Dear Elinor

SOUTH WEST WATER LIMITED LICENCE

Thank you for the recent correspondence and discussions regarding the migration by South West Water Limited (**SWW**) to its revised Licence in 2016.

In that correspondence and those discussions, Ofwat indicated, based on the information disclosed by SWW, that it would be prepared to agree to the continuation of certain arrangements at SWW in existence at the time that the Licence was revised. This letter constitutes SWW's formal request for Ofwat to consider its agreement to the continuation of those arrangements.

The arrangements in question relate to Licence Condition P, paragraph 6.3.

SWW's financing strategy is to have a diversified portfolio of financing in place that enables access to cost-effective financing. This financing strategy has secured access to funding at efficient rates, consistently amongst the lowest in the industry over the long term. This efficient financing supports the financial strength of the business and enables continued investment in its infrastructure to support services to customers and protection and enhancement of the environment. The instruments raised through South West Water Finance plc (**SWW Finance**) specifically contribute to the overall financing position for SWW and are part of the diversified portfolio that has served customers well.

The benefit of an efficient portfolio has been to protect customers from any unnecessary burden of high financing costs, keeping their bills as low as possible. SWW's efficient financing allows us to share the financial benefits of relatively low cost financing with our customers - through our unique WaterShare mechanism (note that customers can only gain from this mechanism).

Research undertaken with our customers during PR19 indicated strong support for sharing the benefits of relatively low costs of debt through our WaterShare mechanism. They support any actions that ensure that bills are kept as low as possible and provide value for money but not at the detriment of their services, therefore it is implicit that customers are supportive of our financing strategy. Our customers not only support the sharing of benefits but see it as being an important factor in ensuring trust between the company and customers.

In parallel this strategy has supported the financial strength and resilience of the company, enabling the continued investment in infrastructure required to deliver critical services to customers and protection and enhancement of the environment.

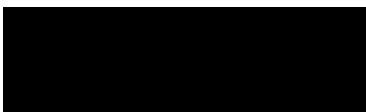
An element of the strategy is to ensure there is long term funding in place which better matches the underlying asset base of the business. This provides the necessary flexibility needed to meet the demands for funding aligned to when improvements in services for customers and the environment are required.

Whilst SWW is a subsidiary of Pennon Group plc, financing for SWW is usually raised at the SWW level to ensure efficient financing. However, to access the debt capital market it is necessary to use a separate subsidiary SWW which is established as a public limited company. SWW Finance was therefore established to issue instruments into the debt capital markets for the sole purpose of financing SWW's regulated activities. The instruments issued by SWW Finance are included in Appendix A (the **Relevant Instruments**).

The Relevant Instruments are guaranteed by SWW and Cross-Default Obligations are included in SWW's existing financing documentation because lenders typically require that covenant packages in financing documentation apply to the subsidiaries of borrowers as well as to the borrower itself. The rationale is that lenders to SWW would have a legitimate concern in the event that there was to be a default by SWW Finance in respect of its obligations under the Relevant Instruments (Appendix A). We believe it is appropriate for Ofwat to consider its agreement to the continuation of the arrangements as it supports the effective long dated financing for SWW.

Formal confirmation from Ofwat is therefore requested of its approval of the guarantees given by SWW in respect of SWW Finance's obligations under the Relevant Instruments (for the purposes of paragraph 6.3(a) of Condition P of the Licence) and (b) the existence of Cross-Default Obligations in SWW's financing documentation as at the date of this letter (for the purposes of paragraph 6.3(c) of Condition P of the Licence).

Yours sincerely



Susan Davy
Chief Financial Officer

D: 

E: 

APPENDIX A

FINANCIAL INSTRUMENTS RAISED BY SOUTH WEST WATER FINANCE PLC

SOUTH WEST WATER FINANCE PLC GBP150M BOND maturing 2040

SOUTH WEST WATER FINANCE PLC GBP200M INDEX LINKED BOND maturing
2057