Southern Water

Investor Report and Compliance Certificate

For the SWS Financing Group

For the period ended 30 September 2019

Confidential

Important Notice

This report is being distributed in fulfilment of a finance document, the Common Terms Agreement. It is directed to, and intended for, existing investors in the company. No other persons should act or rely on it. The company makes no representation as to the accuracy of forecast information. This report should not be relied on as a guide to future performance and should not be relied on in deciding whether to undertake future investment in the company. It should be noted that the information in this report has not been reviewed by the company's auditors.

Investor Report

Contents **Page**

General overview and business update

This Investor Report is updated for the period ended 30 September 2019. The Investor Report is a requirement of the Common Terms Agreement (CTA), which governs the company's obligations to its lenders and investors.

Projected financial ratios are published for the current PR14 / AMP6 period from April 2015 to March 2020, and include additional interest cover ratios to maintain the effectiveness of financial ratios following regulatory building block changes for AMP6. Actual financial ratios for March 2015 continue to be based upon the AMP5 regulatory building blocks methodology.

General levels of service

Customer

The Service Incentive Mechanism (SIM), comprises two measures, a quantitative measure reflecting the number and type of "unwanted" contact from customers and a qualitative measure of customer satisfaction. These measures are combined into a score out of 100.

Our SIM score for the financial year 2018-19 was 80 (out of 100) which improved our relative industry position to 13th out of the 18 water companies. This is an improvement on the score for 2017-18 and a position of 15th.

	31 Mar 2016	31 Mar 2017	31-Mar 2018	31-Mar 2019
SIM score	73	78	79	80

Health & Safety

During 2018–19, we upheld our industry-leading health and safety record with some of the lowest accident statistics in the water industry. We recorded two periods of more than 100 days free of any reportable injuries among our own employees, and one 100 day period across our supply chain.

Operational performance

When we published our Annual Report for 2018–19, Ofwat was investigating breaches of licence conditions and statutory obligations regarding how we operated our wastewater treatment works between 2010 and 2017. Its Final Notice, published on 10 October 2019, set out the results of its investigations following a public consultation, and in undertakings given to Ofwat, Southern Water set out its commitment to make £123 million (at 2017–18 prices) in rebates to current customers and payments to some former customers, a promise of greater transparency on environmental performance and a number of other measures. These measures are being fully enacted and, along with our own initiatives, we hope that full trust and confidence in Southern Water from our customers, regulators and other stakeholders will be restored to us.

Starting before Ofwat's investigation began in 2017, we have made a number of fundamental improvements which were recognised in its report. As part of our turnaround, we have identified past performance failures and put in place plans to rectify them. We continue to co-operate with the Environment Agency as it continues its investigations.

We continue to meet our targets for discolouration and water pressure. In September 2019, our compliance with the DWI's quality measures was 99.96%, consistent with industry average.

Minimising the amount of water lost to leaks is important to us and to our customers. The pressure on Western Hampshire's water supply over the late summer made the issue even more pertinent. During 2019, our leakage rate exceeded our annual target and we anticipate that we will underperform against our five-year leakage target. We have, therefore, significantly increased activity and investment by deploying more field personnel and installing additional acoustic loggers, as well as an increased focus on reducing our backlog of leak repair work to decrease the impact of known leaks.

We have recorded five serious and 237 less serious pollution incidents so far this year, an increase from 123 this time last year. As discussed in our Annual Report 2018–19 (southernwater.co.uk/annual-report) as part of our Pollution Reduction Plan we are using root cause analysis to identify and report issues more quickly and are rolling out pollutions awareness training to 800 employees in our wastewater business. This activity is helping us find and fix issues sooner. Further, we are targeting spend of circa £2 million of specific investment on identified asset risks and power resilience activities.

We delivered 100% of the Environment Agency's 'Wastewater National Environment Programme' providing enhanced treatment at our Wastewater plants to improve our regions rivers and coastal waters to the benefit of the environment, our customers and the wider general public.

Please refer to our Annual Report and our Interim Report for further information on our operating performance

Financial performance for the period ended 30 September 2019

Accounts are prepared under IFRS (FRS101).

Six months to 30 September	**2019 £m**	**2018 £m**	***Change %***
Revenue	439.9	440.1	*0.0*
Operating costs	-188.0	-171.4	*-9.7*
EBITDA	**251.9**	**268.7**	***-6.3***
Depreciation & amortisation	-131.4	-128.6	
Profit on disposals	0.5	0.3	
Net finance costs	-70.8	-57.5	
Fair value on derivatives	-123.9	17.6	
Profit before tax	**-73.7**	**100.5**	
Tax	11.2	-18.4	
Profit after tax	**-62.5**	**82.1**	

Revenue reduced to £439.9 million (2018: £440.1 million) partly as a result a fall in income from our developer related activities and lower levels of consumption due to the extended heatwave last summer, mostly offset by changes to our inflation-linked water and wastewater tariffs.

Operating costs, net of other operating income, for the first half of the year of £188.0 million increased by 9.7% (2018: £171.4 million). This increase, was largely driven by inflation, costs associated with the ongoing transformation programme, the cost of operational incidents, and increased activity to tackle leakage.

Net finance costs, excluding fair value movements on financial derivatives, increased to £70.8 million (period to 30 September 2018: £57.5 million). This increase was largely due to a reduction in interest receivable (£23.9 million) following the partial repayment of the 'dividend loop' inter-group loan with SWS Group Ltd, offset by higher interest capitalised following the continued investment in our capital programme (£2.9 million) and a decrease in bond interest payable net of swap receipts following a restructure of our debt portfolio (£8.2 million).

Please refer to our Annual Report and our Interim Report for further information on our operating performance

Financing

We are in an adequate position of liquidity with closing unrestricted cash and undrawn revolving credit facility of £85m.

The £300 million A11 Class A bond was repaid on 01 April 2019.

Credit rating	
Standard & Poor’s	Class A debt: BBB+
Fitch	Class A debt: BBB+
Moody’s	Class A debt: Baa3

The Class B credit ratings were removed following the repayment of Class B debt in March 2019. A deed has been entered into by the Southern Water Services Financing group to not issue any Class B debt for so long as debt at Greensands Financing is outstanding.

The credit ratings for Fitch and Standard & Poor's have a negative outlook and the credit rating for Moody's has a stable outlook.

Our credit ratings were revised lower in the period as a result of the PR19 Draft Determination which included a further challenge on totex (total operating and capital investment expenditure), a further challenge on the weighted average cost of capital, and negatively skewed Outcome Delivery Incentive (ODI) rewards and penalties. We have made representations on these challenges and highlighted the risk to Ofwat of a further reduction to the weighted average cost of capital on the financeability of our plan. There is a risk that further credit rating downgrades could result in a restriction for SWS to pay dividends or a Trigger Event under our loan covenants.

The PR19 Final Determination is expected on 16 December. There is a risk of further rating pressure if Ofwat does not accept our representations and we have recourse to the Competition and Markets Authority to appeal the Final Determination.

Note:

- A Trigger Event occurs if any two of the credit ratings fall to BBB (Standard & Poor’s), BBB (Fitch) or Baa2 (Moody’s) or below.
- A cash lock-up under our Licence of Appointment occurs where the credit rating outlook assigned the lowest investment grade credit rating has been changed from stable or positive to negative.
- A Default occurs if any two of the credit ratings are less than the minimum rating required for the status of investment grade.

Dividend and Financing Policy

Our dividend policy is formulated to ensure a fair balance of reward between customers and investors. To deliver on our vision for the successful delivery of our Business Plan for 2020–25, all stakeholders must share in success: customers benefitting through enhanced service and lower bills, and shareholders earning a fair return on the near £2 billion of equity invested.

When proposing payment of a dividend the Directors of Southern Water Services Limited, acting independently in accordance with their directors' duties and in accordance with the Company's Licence, will apply the following principles:

1. Determination of a base level of dividend, based on an equity return consistent with our most recent Final Determination and our actual level of gearing. This recognises our management of economic risks and capital employed.
2. In assessing any adjustment to the base level of dividend, we will take into account our financial and non-financial performance. This would reflect our overall financial performance as compared to the final Business Plan for 2020–25 as agreed by Ofwat and would explicitly consider a qualitative assessment of customer service levels and how customers share in our successes.
3. We will consider our financial resilience ahead of any dividend decision, and whether any financial outperformance should be re-invested to benefit our customers. This consideration will also include taking into account the interests of our employees, other stakeholders, and our pension schemes.

Our dividend policy is intended to support the financial resilience and investment grade credit ratings of the business and ensure continued access to diversified sources of finance. As part of step three we carry out an assessment of:

   a) headroom under debt covenants
   b) the impact on the company's credit rating
   c) the liquidity position and ability to fulfil licence conditions
   d) key areas of business risk.

4. We will be transparent in the payment of dividends and will clearly justify the payment in relation to the factors outlined above.
5. We will publish our Dividend Policy annually (as part of the Annual Report), and highlight any changes.

Board membership (of Southern Water Services Ltd)

Keith Lough (Chairman, appointed 01 August 2019)
Ian McAulay (Chief Executive Officer)
Sebastiaan Boelen (Chief Financial Offcer)
Paul Sheffield (Senior independent non-executive director)
Rosemary Boot (Independent non-executive director)
Gillian Guy (Independent non-executive director)
Sara Sulaiman (Non-executive director)
Wendy Barnes (Non-executive director)
Kevin McCullough (Independent non-executive director, appointed 18 July 2019)
Mike Putnam (Independent non-executive director)
Richard Manning (Company secretary)

Ultimate parent company

The ultimate parent company is Greensands Holdings Ltd.

Financial ratios

As required by the CTA, financial ratios are reported up to the end of the current five year regulatory period. The forecasts used to generate the financial ratios are derived from the SWS Business Financial Model and are in the format specified by the CTA.

New interest cover ratios have been included (page 17) as a result of regulatory and accounting changes for the PR14 / AMP6 period, for financial years 2016 to 2020. The change to the form of the new ratios is to replace CCD/IRC with RCV run down, and to define both measures as 'depreciation'. Analysis has also been included to further explain the changes.

Regulatory changes for the PR14 period include the removal of CCD (Current Cost Depreciation) and IRC (Infrastructure Renewals Charge) as regulatory building blocks used to determine prices for the next regulatory period. These measures of the depreciation of RCV are included within the original covenanted financial ratios. A total expenditure assessment has also been introduced ('Totex'), with a recovery of 'fast money' through revenues, and 'slow money' added to the RCV.

We have introduced additional interest cover ratios to ensure the effectiveness of the original intended purpose of the covenanted financial ratios:

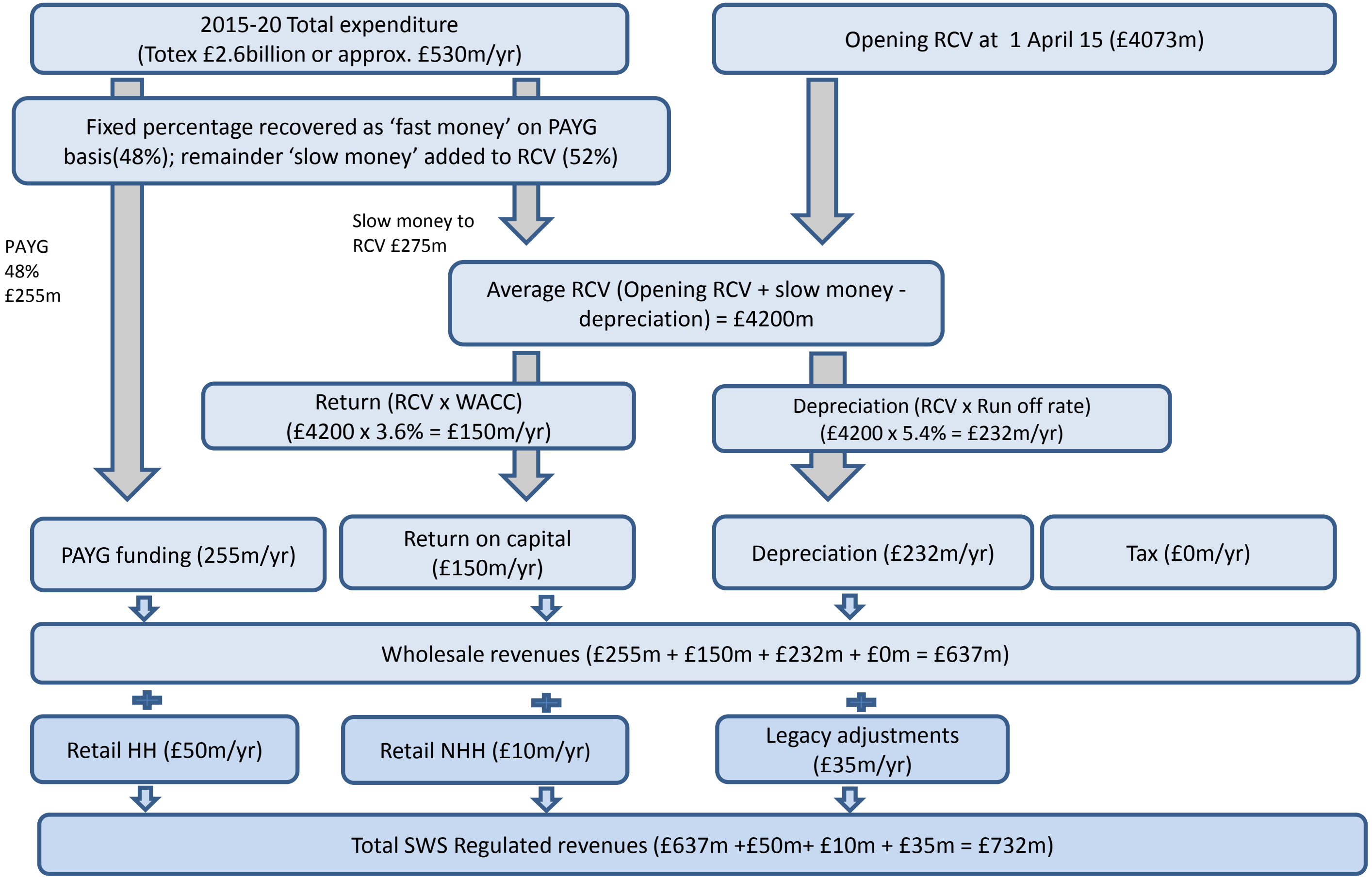
- CCD will be replaced with the RCV run-down rate. This is a directly comparable measure for the depreciation of the RCV.
- We adopted IFRS from 2015-16, and infrastructure renewals accounting is not permissible under IFRS. As a consequence, IRC will no longer exist for accounting purposes and has been removed as a regulatory building block for PR14 / AMP6. Infrastructure renewals expenditure will form an integral part of our operating and capital expenditure, and no longer 'smoothed' as IRC.
- For the AMP6 regulatory period, 'fast money' is recovered through customer charges, rather than operating costs. We have maintained a strong correlation between fast money and the previous ratio measure of operating costs. The balance of slow money is added to the RCV in line with the previous measure of capital expenditure being added to the RCV. A reconciliation between these measures has been included on page18 of this report, and will continue to form part the investor report and compliance certificate.

Pages 10 and 11 of this report provide an overview of the regulatory building blocks for PR14, the foundation for the structure of debt covenant ratios. Pages 18 and 19 provide a comparison of the PR14 totex with the forecast level of operating and capital expenditure, and a reconciliation to the net operating cash flow input to the interest cover ratios.

Short term forecast RPI used for this Investor Report are calculated as the average of inflation forecasts published by a number of UK banks. RPI at March 2019 was 2.4%, the forecast RPI used for March 2020 is 2.8%.

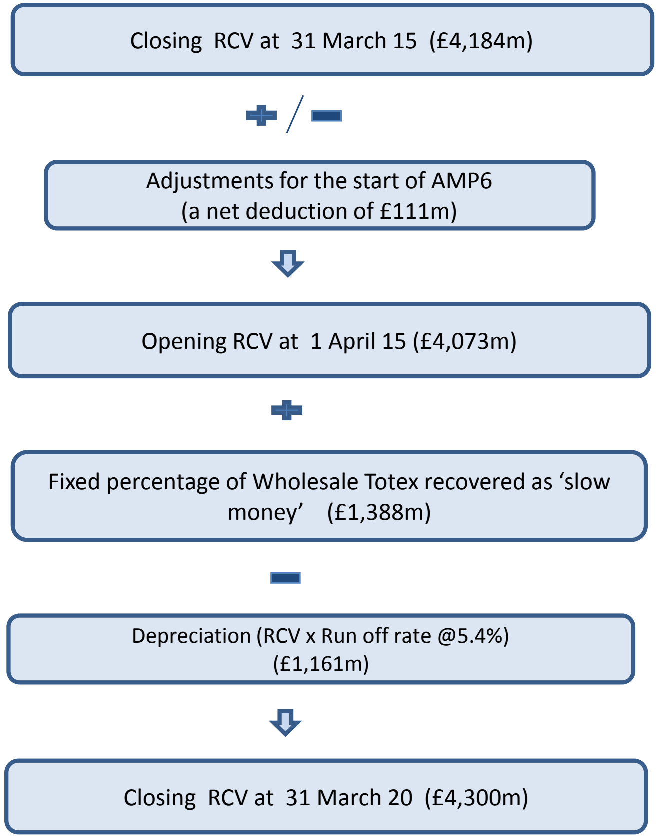
For investor reporting, interest paid is reported on an accruals basis in line with the requirements of the CTA.

An illustration of the Totex approach to cost recovery for AMP6 (the 'revenue building blocks'). 2012/13 prices



Note: Values stated are rounded average annual values used to illustrate the totex approach to cost recovery, rather than determined annual values

An illustration of the construction of the RCV for AMP6. 2012/13 prices



Consolidated cashflow

Ref.		31 Mar 2015 £m	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
	Revenue						
1	Appointed	806.1	800.5	801.8	797.9	846.2	866.4
2	Non Appointed	7.1	11.1	11.8	10.6	10.5	10.3
	Operating Costs						
3	Appointed	255.1	296.5	282.0	331.5	351.4	362.3
4	Non Appointed	2.1	6.9	7.3	7.5	7.6	8.5
	Exceptional item *	11.6	30.6	0.0	0.0	0.0	0.0
5	Net Capital Expenditure (inc Disposals of Assets)	336.0	232.7	274.7	368.6	406.4	473.8
	Annual Finance Charge	128.3	131.1	137.9	143.1	143.4	120.6
6	Taxation	0.1	0.1	0.1	0.1	0.1	0.1
	Payments on Subordinated Debt and Distributions	36.1	94.4	75.0	84.7	19.2	63.0
	Net cash flow before financing	43.9	19.4	36.6	-127.0	-71.4	-151.6
	Proceeds from new equity for SWS	0.0	59.4	288.0	0.0	0.0	495.0
	Proceeds from new finance	0.0	0.0	0.0	0.0	687.3	0.0
	Drawings from RCF	0.0	50.0	-50.0	0.0	170.0	-170.0
	Debt and swap accretion payments	-4.3	-298.4	-2.5	-4.7	-565.3	-316.2
	Net cash reserves movement after financing	39.6	-169.6	272.1	-131.7	220.6	-142.8

This table illustrates cash flows over the six year period to March 2020. The profile of Appointed revenue cash flows for 2016-17 and 2017-18 is affected by a short term timing variance from the disposal of the Retail Non-household business on 31 March 2017 (to Business Stream).

* The exceptional cash flow item in 2014-15 relates to the wet weather of winter 2013-14, the exceptional cash flow item in 2015-16 relates to a prepayment of pension deficit contributions.

The forecast value of payments on subordinated debt and distributions to March 2020 do not represent a forecast of distribution from Southern Water Services Ltd for the remainder of this regulatory period. These values have been calculated to illustrate the level available to mainitan debt/RCV in line with our stated gearing target for the current regulatory period of around 80% to March 2018 and around 70% from March 2019.

Annual Finance Charge

Ref.		31 Mar 2015 £m	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
	Class A debt interest	101.2	112.4	118.8	123.9	127.5	119.6
	Class B debt interest	20.2	19.1	18.3	18.0	17.9	0.0
	Interest income	1.3	2.4	1.2	0.8	1.7	0.2
	Class A Facilities commitment fees	8.2	2.0	2.0	2.0	2.1	1.2
7	Class A Debt Interest	108.1	112.0	119.6	125.1	127.9	120.6
8	Senior Debt Interest	128.3	131.1	137.9	143.1	145.8	120.6
	Annual Finance Charge	128.3	131.1	137.9	143.1	143.4	120.6
	Monthly Payment Amount *	11.0	11.1	11.6	12.0	12.3	10.1

* Monthly payment amount is stated gross and reduced by interest received in the Debt Service Payment Account

Cash accounts and reserves

Ref.		31 Mar 2015 £m	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
	SWS O&M Reserve account						
	Opening balance	46.3	46.3	0.0	0.0	0.0	0.0
	Cash transferred	0.0	-46.3	0.0	0.0	0.0	0.0
	Closing balance	46.3	0.0	0.0	0.0	0.0	0.0
	Capex Reserve account						
	Opening balance	52.4	52.7	0.00	272.1	141.2	47.4
	Cash transferred	0.3	-52.7	272.1	-130.9	-93.8	172.2
	Closing balance	52.7	0.0	272.1	141.2	47.4	219.6
	Debt Service Payment account						
	Opening balance	3.7	6.0	0.8	0.8	0.8	15.5
	Cash transferred	2.3	-5.2	0.0	0.0	14.7	-15.0
	Closing balance	6.0	0.8	0.8	0.8	15.5	0.5
	SWS Operating accounts						
	Opening balance	37.3	74.3	8.9	8.9	8.1	307.8
	Cash transferred	37.0	-65.4	0.0	-0.8	299.7	-300.0
	Closing balance	74.3	8.9	8.9	8.1	307.8	7.8
	Total Cash Balances						
	Opening balance	139.7	179.3	9.7	281.8	150.1	370.7
	Cash transferred	39.6	-169.6	272.1	-131.7	220.6	-142.8
9	Closing balance	179.3	9.7	281.8	150.1	370.7	227.9

From 2015, a £45.0m O&MF (Operating & Maintenance Facility) replaces cash previously held in the SWS O&M reserve account

Bonds, Authorised Loan Facilities and Leases

Ref.			31 Mar 2015 £m	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
	*	Senior £350m A1 6.192% Fixed Rate Bonds due 2029	350.0	350.0	350.0	350.0	350.0	350.0
	*	£150m A2a 3.706% Index-linked Bonds due 2034	215.5	217.7	221.7	229.7	237.1	243.7
	*	£35m A2b 3.706% Limited Index Bonds due 2034	49.6	50.1	51.7	53.6	55.3	56.9
		£350m A4 6.64% Fixed Rate Bonds due 2026	350.0	350.0	350.0	350.0	350.0	350.0
		£150m A5 3.816% Index-linked Bonds due 2023	215.5	217.7	221.7	229.7	237.1	243.7
	*	£350m A7 5.0% Fixed Rate Bonds due 2021	350.0	350.0	350.0	350.0	350.0	350.0
	*	£150m A8 5.0% Fixed Rate Bonds due 2041	150.0	150.0	150.0	150.0	150.0	150.0
	*	£200m A9 4.5% Fixed Rate Bonds due 2052	200.0	200.0	200.0	200.0	200.0	200.0
	*	£300m A10 5.125% Fixed Rate Bonds due 2056	300.0	300.0	300.0	300.0	300.0	300.0
	***	£300m A11 6.125% Fixed Rate Bonds due 2019	300.0	300.0	300.0	300.0	300.0	0.0
		RPI accretion on Index-linked swaps	283.4	4.4	42.1	108.9	160.8	208.2
		£250m B2 4.5% Fixed/Floating rate Bonds due 2038	250.0	250.0	250.0	250.0	0.0	0.0
		£150m Class B loan facility due 2021	150.0	150.0	150.0	150.0	0.0	0.0
	*	£165m Artesian 4.076% Index-linked Bonds due 2033	237.1	239.5	244.0	252.7	261.0	268.1
	*	£156m Artesian 3.635% Index-linked Bonds due 2032	219.4	221.7	225.8	233.9	241.5	248.1
		£100m EIB Index Linked loan due 2025	0.0	60.5	103.1	107.1	105.2	92.0
		£250m USPP Fixed Rate Loan due 2031 / 2036	0.0	0.0	250.0	250.0	250.0	250.0
	**	New cash required	0.0	0.0	0.0	0.0	0.0	500.0
		Drawings under the Revolving Credit Facility	0.0	50.0	0.0	0.0	170.0	0.0
		Drawings under the DSR Liquidity Facility	0.0	0.0	0.0	0.0	0.0	0.0
		Finance Leases	0.0	0.0	0.0	0.0	0.0	0.0
		Class A Indebtedness	3,220.5	3,061.6	3,360.1	3,465.6	3,718.0	3,810.7
		Senior Indebtedness	3,620.5	3,461.6	3,760.1	3,865.6	3,718.0	3,810.7
10		Class A Net Indebtedness	3,041.2	3,051.9	3,078.3	3,315.5	3,347.3	3,582.8
11		Senior Net Indebtedness	3,441.2	3,451.9	3,478.3	3,715.5	3,347.3	3,582.8
		Nominal value of fixed rate debt swapped to Index-linked	1,318.0	1,318.0	1,318.0	1,318.0	1,318.0	1,318.0

* Wrapped by AG

** 'New cash required' is a notional class of debt included to forecast compliance ratios correctly. This is not an attempt to forecast the actual quantum, mix, cost and timing of future financing.

*** £300m A11 bond due 2019 was repaid 01 April 2019

Interest Cover Ratios - Original format

		Trigger	Default	31 Mar 2015 £m	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
A	Net Appointed Income (1+3+6)			550.9	504.0	519.7	466.3	494.7	504.0
B	Net Total Income (1+2+3+4+6)			555.9	508.2	524.2	469.4	497.6	505.8
C	Depreciation (CCD & IRC)			346.5	0.0	0.0	0.0	0.0	0.0
D	Class A Debt interest (7)			108.1	112.0	119.6	125.1	127.9	120.6
E	Senior Debt interest (8)			128.3	131.1	137.9	143.1	145.8	120.6
F	Period end VAT debtor			5.4	6.0	8.5	9.3	10.7	8.5
G	Capital Maintenance (MNI & IRE)			218.3	164.0	186.7	226.2	245.7	N/A
Class A Adjusted ICR									
	Historic: (B-C+F)/D Projected: (A-C+F)/D	1.3	N/A	2.0	4.6	4.5	3.8	4.0	4.3
Class A Average ICR		1.4	N/A	3.7	4.2	4.1	4.0	4.1	4.3
Senior Adjusted ICR									
	Historic: (B-C+F)/E Projected: (A-C+F)/E	1.1	N/A	1.7	3.9	3.9	3.4	3.5	4.3
Senior Average Adjusted ICR		1.2	N/A	3.2	3.7	3.7	3.7	3.9	4.3
Class A ICR									
	Historic: B/D Projected: A/D	N/A	1.6	5.2	4.6	4.5	3.8	4.0	4.3
Class A Post Maintenance ICR									
	Historic: (B-G+F)/D	N/A	1.0	3.2	3.1	2.9	2.0	2.1	N/A

CCD (Current Cost Depreciation) and IRC (Infrastructure Renewals Charge) have been removed as regulatory building blocks for the regulatory period 2016 to 2020. As a consequence, the values for this input into interest cover ratios is zero for these years.

Additional interest cover ratios have been introduced (following page) that maintain consistency of ratio performance with previous periods.

Further explanation of this change can be found on page 9 of this report.

Interest Cover Ratios - New (Post PR14) format

		Trigger	Default	31 Mar 2015 £m	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
A	Net Appointed Income (1+3+6)			550.9	504.0	519.7	466.3	494.7	504.0
B	Net Total Income (1+2+3+4+6)			555.9	508.2	524.2	469.4	497.6	505.8
C	Depreciation of the RCV:								
	Depreciation (CCD & IRC)			346.5	0.0	0.0	0.0	0.0	0.0
	RCV run down			0.0	242.4	245.7	260.0	273.3	285.1
D	Class A Debt interest (7)			108.1	112.0	119.6	125.1	127.9	120.6
E	Senior Debt interest (8)			128.3	131.1	137.9	143.1	145.8	120.6
F	Period end VAT debtor			5.4	6.0	8.5	9.3	10.7	8.5
G	Capital Maintenance (MNI & IRE)			218.3	164.0	186.7	226.2	245.7	N/A
Class A Adjusted ICR									
	Historic: (B-C+F)/D Projected: (A-C+F)/D	1.3	N/A	2.0	2.4	2.4	1.8	1.8	1.9
Class A Average ICR		1.4	N/A	2.1	2.1	2.0	1.8	1.9	1.9
Senior Adjusted ICR									
	Historic: (B-C+F)/E Projected: (A-C+F)/E	1.1	N/A	1.7	2.1	2.1	1.5	1.6	1.9
Senior Average Adjusted ICR		1.2	N/A	1.8	1.8	1.8	1.7	1.7	1.9
Class A ICR									
	Historic: B/D Projected: A/D	N/A	1.6	5.2	4.6	4.5	3.8	4.0	4.3
Class A Post Maintenance ICR									
	Historic: (B-G+F)/D	N/A	1.0	3.2	3.1	2.9	2.0	2.0	N/A

These new interest cover ratios include both, CCD & IRC (2015), and RCV run down rate (2016 to 2020), as depreciation of the RCV .

The effect of the reclassification of Infrastructure Renewals expenditure is illustrated by, amongst other changes from 2015 to 2016, a reduction in net income from expenditure included in operating costs and a reduction in RCV depreciation from the expenditure no longer added to the RCV.

Comparison of FD PAYG funding ('fast money') to actual operating costs

PR14 Final Determination:		**Period from 2016 to 2020 £m**	
Totex funding	2012/13 prices	2,639.4	Wholesale operating costs and capital expenditure for the regulatory period (excluding pension deficit contributions outside of the Totex assessment)
Totex funding	Outturn	2,958.7	
PAYG fast money	Outturn	1,404.2	The value of Wholesale Totex recovered via revenues
Slow money	Outturn	1,554.4	The value of Wholesale Totex added to the RCV
Retail operating costs	FD	294.9	Operating costs for the Retail price control per Final Determination
Total		3,253.6	
Total Appointed expenditure (treating Retail Opex as Fast money)			
Fast money		52.2%	
Slow money		47.8%	

Comparison to actual operating costs		**Period from 2016 to 2020 £m**
Operating costs per accounts	Outturn	1,634.8
Capital expenditure per accounts	Outturn	1,692.4
Total Appointed expenditure	Outturn	3,327.1

Comparison of FD with actual costs		**Actual**	**FD**	
Total Appointed expenditure	Outturn	3,327.1	3,253.6	
		Actual (%)	**FD (%)**	
Operating costs / Fast money		49.1%	52.2%	There is a 3.1% (£51m) variance over the regulatory period between FD and actual forecast apportionment of costs between operating costs / capital expenditure and fast / slow money
Capital expenditure / Slow money		50.9%	47.8%	

PAYG funding and actual costs

The PR14 Final Determination has determined the proportion of AMP6 Totex Wholesale expenditure recovered via revenues and the proportion of AMP6 Totex Wholesale expenditure added to the RCV.

The PR14 Final Determination has also determined how any variance between actual Totex Wholesale expenditure and PR14 Totex Wholesale expenditure is 'trued' for the next AMP7 regulatory period, with around 50% of any variance shared with customers plus an adjustment for any timing difference regarding the profile of expenditure.

Variance to Retail expenditure is not shared for AMP7.

Reconciliation to Net Appointed Income

	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
Operating costs per Accounts	286.3	307.8	336.0	349.3	354.9
Non-appointed expenditure	-6.9	-7.3	-7.5	-7.6	-8.5
Movement in operating cash flows	47.7	-18.5	3.0	9.7	15.9
Prepayment of future pension deficit payments	-30.6	0.0	0.0	0.0	0.0
Appointed operating cost cash flow (ref 3. page 10)	296.5	282.0	331.5	351.4	362.3

Regulatory Asset Ratios

		Lock-up	Trigger	Default	31 Mar 2015 £m	31 Mar 2016 £m	31 Mar 2017 £m	31 Mar 2018 £m	31 Mar 2019 £m	31 Mar 2020 £m
G	Class A Net Indebtedness (10)				3,041.2	3,051.9	3,078.3	3,315.5	3,347.3	3,582.8
H	Senior Net Indebtedness (11)				3,441.2	3,451.9	3,478.3	3,715.5	3,347.3	3,582.8
I	RCV				4,397.1	4,385.2	4,619.7	4,864.8	5,034.6	5,150.7
Class A RAR										
	Historic / Projected: G/I	0.850	0.750	N/A	0.692	0.696	0.666	0.682	0.665	0.696
Senior RAR										
	Historic / Projected: H/I	0.850	0.900	0.950	0.783	0.787	0.753	0.764	0.665	0.696
Control of Repayments (maturity buckets)										
Percentage of refinancing - consecutive two years: no more than:				20%		6.9%	6.7%	0.2%	0.2%	6.3%
Percentage of refinancing - within a regulatory period: no more than:				40%		<<<<<<<<<<<<<<<<<		13.0%	>>>>>>>>>>>>>>>	

Note: swap accretion payments have been included in this test

During 2018–19 we completed our financing plan to improve financial resilience of Southern Water ahead of the PR19 price review period starting April 2020. This plan included the formation of new ‘Midco’ financing companies and raising additional finance for the benefit of Southern Water:

- £451.5 million new borrowings raised by newly incorporated Greensands Financing companies, outside of Southern Water
- £250 million new borrowing raised by Southern Water (Greensands) Financing, outside of Southern Water
- £701.5 million of new finance raised was invested into Southern Water, net of £14.2 million costs, by a repayment of inter-company liabilities totalling £687.3 million
- These proceeds were used by Southern Water to repay £400 million of outstanding Class B debt, provide £150 million towards repayment of a £300 million Class A bond due 01 April 2019, £113.6 million was used toward reducing the interest cost of inflation linked derivatives for the period 2021 to 2031, and the remaining £37.0 million was used to pay costs associated with repaying the Class B debt and terminating a derivative associated with the Class B debt.

Declaration

We confirm that each of the above Ratios has been calculated in respect of each of the relevant periods for which it is required under the Common Terms Agreement and has not breached the Trigger Event Ratio Levels and has not caused Paragraph 20 (Ratios) of Part 2 (Event of Default (SWS and the Issuer)) of Schedule 7 of the Common Terms Agreement to be breached.

We confirm that the Annual Finance Charge is £120.6 million for 2019/20 equating to a Monthly Payment Amount for this period of £10.1 million.

We also confirm that no Default or Potential Trigger Event is outstanding and that SWS's insurances are being maintained in accordance with the Common Terms Agreement.

Sebastiaan Boelen
Chief Financial Officer
For and on behalf of
Southern Water Services Ltd

Sebastiaan Boelen
For and on behalf of
Southern Water Services (Finance) Ltd

Richard Manning
For and on behalf of
Southern Water Services Ltd

S. Collins

Steven Collins
For and on behalf of
Southern Water Services (Finance) Ltd

Contact:

Steve Collins
Group Treasurer
Telephone: 01903 272056
Email: SteveM.Collins@southernwater.co.uk