

# SOUTHERN WATER SUSTAINABLE FINANCING FRAMEWORK

## DNV GL ELIGIBILITY ASSESSMENT

### Scope and Objectives

Southern Water Services Ltd (henceforth referred to as "Southern Water") is a water and wastewater services company in England and Wales. Southern Water collects, treats and distributes potable water, recycles wastewater and provides engineering design, laboratory analysis and environmental assessment, systems technology, waste management, property and specialist services. Southern Water serves domestic, commercial and industrial customers in the United Kingdom.

Operating in an area of approximately 10,550 km<sup>2</sup> in the counties of Kent, East and West Sussex, Hampshire and the Isle of Wight, and small parts of Wiltshire, Berkshire and Surrey.

Southern Water directly employ over 2,300 people but have a total direct and indirect workforce of circa 4,000 supporting a customer base of 2.5 million water customers and also wastewater services to more than 4.7 million customers across the South East of England.

Southern Water manages and maintain 13,929km of water mains and 84 water treatment works as well as managing and maintaining 39,808 km of sewer and 365 sewage treatment sites.

DNV GL Business Assurance Services Limited ("DNV GL") has been commissioned by Southern Water to provide a review of the Southern Water Sustainable Financing Framework (henceforth referred to as the "Framework"). Our methodology to achieve this is described under 'Work Undertaken' below. We were not commissioned to provide independent assurance or other audit activities.

No assurance is provided regarding the financial performance of instruments issued via the Southern Water Financing Framework, the value of any investments, or the long term environmental & social benefits of the transaction. Our objective has been to provide an assessment that the Framework has met the criteria established on the basis set out below.

### Responsibilities of the Management of Southern Water and DNV GL

The management of Southern Water has provided the information used by DNV GL during the delivery of this review. Our statement represents an independent opinion and is intended to inform Southern Water's management and other interested stakeholders in the Framework as to whether the Framework is aligned with the ICMA Green Bond Principles (GBP), Social Bond Principles (SBP), the LMA Green Loan Principles (GLP) and the Sustainability Bond Guidelines (SBG). In our work, we have relied on the information and the facts presented to us by Southern Water. DNV GL is not responsible for any aspect of the projects, expenditures or assets referred to in this opinion and cannot be held liable if estimates, findings, opinions, or conclusions are incorrect. Thus, DNV GL shall not be held liable if any of the information or data provided by Southern Water management and used as a basis for this assessment were not correct or complete.

## Basis of DNV GL's opinion

We have adapted our eligibility assessment methodology to create a Southern Water specific Sustainability Financing Framework Eligibility Assessment Protocol (henceforth referred to as "Protocol"). Our Protocol includes a set of suitable criteria that can be used to underpin DNV GL's opinion.

As per our Protocol, the criteria against which the Framework has been reviewed are grouped under the four Principles:

- **Principle One: Use of Proceeds.** The Use of Proceeds criteria are guided by the requirement that an issuer of a bond/loan must use the funds raised to finance eligible activities. The eligible activities should produce clear environmental & social benefits.
- **Principle Two: Process for Project Evaluation and Selection.** The Project Evaluation and Selection criteria are guided by the requirements that an issuer of a bond/loan should outline the process it follows when determining eligibility of an investment using Green, Social & Sustainability Bond/Loan proceeds, and outline any impact objectives it will consider.
- **Principle Three: Management of Proceeds.** The Management of Proceeds criteria are guided by the requirements that a bond/loan should be tracked within the issuing organisation, that separate portfolios should be created when necessary and that a declaration of how unallocated funds will be handled should be made.
- **Principle Four: Reporting.** The Reporting criteria are guided by the recommendation that at least annual reporting to the bond/loan investors should be made of the use of proceeds and that quantitative and/or qualitative performance indicators should be used, where feasible.

## Work undertaken

Our work constituted a high-level review of the available information, based on the understanding that this information was provided to us by Southern Water in good faith. We have not performed an audit or other tests to check the veracity of the information provided to us. The work undertaken to form our opinion included:

- Creation of a Southern Water-specific Protocol, adapted to the purpose of the Framework;
  - Assessment of documentary evidence provided by Southern Water on the Framework and supplemented by a high-level desktop research. These checks refer to current assessment best practices and standards methodology;
  - Discussions with Southern Water management, and review of relevant documentation and evidence related to the criteria of the Protocol; and
  - Documentation of findings against each element of the criteria. Our opinion as detailed below is a summary of these findings.
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## Findings and DNV GL's opinion

DNV GL's findings are listed below:

### 1. Principle One: Use of Proceeds.

Southern Water intends to use the proceeds issued under the Framework to finance and/or re-finance both social and environmental projects.

Southern Water has confirmed that eligible investments will fall within one or several of the following eligible categories:

#### Social Eligible Categories

- Affordable basic infrastructure
- Access to essential services
- Food security
- Socioeconomic advancement and empowerment

#### Green Eligible Categories

- Renewable Energy
- Energy Efficiency
- Pollution prevention and control
- Sustainable water and wastewater management
- Environmentally sustainable management of living natural resources and land use.
- Climate change adaptation
- Eco- efficient and/or circular economy, adapted productions, production technologies and processes

Assets and expenditures falling within the defined Social Eligible Categories ("Eligible Social Investments") and Green Eligible Categories ("Eligible Green Investments") will be aggregated to form the Eligible Social Portfolio and Eligible Green Portfolio. Eligible Social Investments and Eligible Green Investments are together referred to as Eligible Sustainable Investments.

Southern Water has stated that for its inaugural financing it aims to refinance Eligible Green, Social and/or Sustainable Investments that have been completed or charged no earlier than April 2015. For future financing Southern water has confirmed that they will use the net proceeds for new financing, refinancing or a combination of both against Eligible Green, Social and/or Sustainable Investments that have been completed in the 3 years prior to the date of finance raised.

### 2. Principle Two: Process for Project Evaluation and Selection.

DNV GL reviewed the Framework which describes the process through which projects are evaluated and selected. DNV GL can confirm all investments and expenditures at Southern Water go through a strict internal process for evaluation and selection. All capital expenditure is reviewed by a number of boards internally to assess their business case and evaluate projects based on the costs and benefits of each investment. The risk management and procurement policy is summarised within the Framework.

DNV GL can confirm subsequent to capital expenditure approval, projects and programmes of work will be assessed by a Committee made up of Treasury, Corporate Finance and Sustainability teams who formally assess investments for eligibility against the defined eligible criteria. Southern Water have confirmed the Committee will meet at least once a year where they will review the asset and expenditure categories submitted for inclusion and to confirm their alignment with the Eligible Social and Green Categories. Following selection and evaluation against the criteria, the investments may be included in the Eligible Sustainable Portfolio.

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DNV GL can also confirm Southern Water has committed to excluding certain categories such as personnel costs, potential fines and legal costs associated with any pollution incidents and also financing costs (which includes the costs associated with raising finance).

DNV GL concludes that Southern Water's Sustainable Financing Framework appropriately describes the process of project evaluation, selection and exclusions. DNV GL can also confirm it is anticipated that the majority of Southern Water's assets and expenditure will be included in the Eligible Sustainable Portfolio under the Framework.

### **3. Principle Three: Management of Proceeds.**

DNV GL has reviewed Southern Water's evidence and can confirm the proceeds from sustainable financing will be managed by the Southern Water's treasury team. Southern Water will follow the company's internal treasury policy who will hold or invest, at its discretion, any unallocated net proceeds. Where possible and practicable, unallocated net proceeds will be placed as deposits with Money Market Funds or bank counterparties in accordance with Southern Water's treasury policy.

Southern Water intends to maintain as 20% overcollateralization to create a buffer to account for possible changes to project and programme financing costs. Southern intends that the amounts represented by the Eligible Sustainable Portfolio will exceed, or at least be equal to, the amount raised by sustainable financing under this Framework.

Southern Water will identify all programmes and projects identified by the Committee as eligible with unique identifiers and allocated amounts against the relevant project in our capital reporting management system. This will be reconciled at the time of each issuance to prevent any double counting of allocation of proceeds.

DNV GL has reviewed the evidence presented and can confirm that the proceeds arising from future issuances will be appropriately managed.

### **4. Principle Four: Reporting.**

Southern Water has confirmed it plans to report on the use of proceeds and impacts within one year from the date of a sustainable financing issuance under the Framework and at least annually thereafter. Investors will receive information on the allocation and impact of social and environmental projects financed through the Framework. These reports will include how much financing raised has been allocated and to which sub-portfolio (Social or Green or both Social and Green) projects or programmes of work, a description of the assets refinanced or financed with the proceeds, the allocation of new financing and refinancing.

Southern Water has also committed to measuring - where feasible - the impact of social and environmental projects through a wide range of KPIs, which are listed in the Framework. Examples of KPIs include:

- Carbon (greenhouse gases) Emissions (ktCO<sub>2</sub>e)
- Total level of Leakage (million litres of water per day)
- The number of Pollution incidents (Cats 1-3)
- Renewable Energy Generation (% Energy use)
- Bathing Water Quality

DNV GL can confirm Southern Water has committed to producing appropriate reporting on the allocation of proceeds, and environmental and social impacts of its investments made under the Framework.

**Conclusion**

On the basis of the information provided by Southern Water and the work undertaken, it is DNV GL's opinion that the Framework meets the criteria established in the Protocol and that it is aligned with the stated definition of green bonds within the Green Bond Principles, green loans within the Green Loan Principles, social bonds within the Social Bond Principles and Sustainability Bonds with the Sustainability Bond Guidelines.

**for DNV GL Business Assurance Services UK Limited**

London, 14<sup>th</sup> January 2020

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**About DNV GL**

Driven by our purpose of safeguarding life, property and the environment, DNV GL enables organisations to advance the safety and sustainability of their business. Combining leading technical and operational expertise, risk methodology and in-depth industry knowledge, we empower our customers' decisions and actions with trust and confidence. We continuously invest in research and collaborative innovation to provide customers and society with operational and technological foresight.

With our origins stretching back to 1864, our reach today is global. Operating in more than 100 countries, our 16,000 professionals are dedicated to helping customers make the world safer, smarter and greener.

## 1 SCHEDULE 1: DESCRIPTION OF CATEGORIES TO BE FINANCED THROUGH BOND

<b>Social categories</b>	<b>Green categories</b>
<ul style="list-style-type: none"><li>• Affordable basic infrastructure</li><li>• Access to essential services</li><li>• Food security</li><li>• Socioeconomic advancement and empowerment</li></ul>	<ul style="list-style-type: none"><li>• Renewable Energy</li><li>• Energy Efficiency</li><li>• Pollution prevention and control</li><li>• Sustainable water and wastewater management</li><li>• Environmentally sustainable management of living natural resources and land use.</li><li>• Climate change adaptation</li><li>• Eco- efficient and/or circular economy, adapted productions, production technologies and processes</li></ul>