

Board assurance and viability statements



Document Reference: C0011

The U UW Board Assurance Statement that supports the U UW business plan and supporting documentation and the U UW Viability Statement.

Both documents were approved at a meeting of the Board of directors of United Utilities Water Limited on 23 August 2018 and are signed by all members of the Board.

United Utilities Water Limited



UW Board Assurance Statement

The Board of directors (the Board) of United Utilities Water Limited (UW or the company) confirms that it has taken ownership of the strategy and long-term direction of this business plan and has progressively reviewed and challenged the company Executive and management to ensure that evidence and assurance has been provided to demonstrate that all the elements add up to a plan that is high quality and deliverable.

The Board has been actively involved in defining the nature of the assurance undertaken on the plan and in reviewing the findings from the assurance that has been undertaken to validate and support the plan. As a consequence of the rigour that we have applied to the governance and assurance of our plan we are confident that:

- **The strategy for data assurance and governance processes has taken all reasonable steps to deliver high quality data**— The assurance framework that has been applied throughout the development of the business plan has built upon the framework that we have developed and applied to our annual regulatory reporting. This framework utilises a targeted risk assessment process to determine the nature of the governance and the level of the assurance that has been applied to each component of the plan
- **The business plan demonstrates that we are actively engaging with customers, listening to feedback and proposing to deliver services they want and can afford**— We believe that we have been innovative in the way that we have sought to understand customers' views and reflect these in our plan
- **The business plan will enable the company to meet its statutory and licence obligations, both now and in the future**— We have actively worked with our quality regulators to understand and - where appropriate - challenge their expectations for the AMP7 period and the longer term. The delivery of key obligations has been incorporated into our suite of performance commitments and outcome delivery incentives
- **The plan will deliver operational, financial and corporate resilience over the next control period and in the longer-term**— We have undertaken a scenario analysis process, supported by independent experts, to provide assurance that the plan is financeable on both an actual and notional basis and have published a long-term viability statement to confirm this
- **We have developed and published a business plan and supporting publications which have been designed to be transparent**— We are pleased to have retained a self-assurance rating in Ofwat's 2017 company monitoring framework and have learnt lessons from this in developing our business plan documentation

The remainder of this Board Assurance Statement sets out the governance, risk assessment, assurance and review and challenge processes that the Board has put in place to demonstrate that the business plan is both high quality and deliverable.

The statement also summarises the key conclusions that have been drawn from the evidence and assurance that has been provided to the Board, which demonstrate that the plan has addressed the key tests that Ofwat will use to assess the plan.

1 Governance and corporate responsibility

United Utilities maintains high ethical standards of business conduct and corporate governance — through systems and processes by which our organisation is managed, controlled and held accountable.

We comply fully with the principles and the spirit of the UK Corporate Governance Code and Ofwat's principles on Board Leadership, Transparency and Governance. This is set out in the United Utilities' Code on Board leadership, transparency and governance, published on 26 June 2018. The code can be found on our website¹. We also have procedures and policies in place to ensure that we act in accordance with the Universal Declaration of Human Rights.

¹ Our code on Board Leadership, Transparency and Governance can be found on our website:

https://www.unitedutilities.com/globalassets/z_corporate-site/corporate-governance/code-on-board-leadership-transparency-and-governance-26-june-2018.pdf

As a Board, we must take long-term decisions to ensure the company continues to be able to operate efficiently for customers and to build our assets and enhance our capabilities to meet future demand and circumstances.

Our aim is to behave as a responsible business, and our business principles can be found on our website². Core values of acting with integrity and focusing on our customers provide the framework for our business culture and the way in which our employees go about their daily work. Behaving responsibly has been part of the United Utilities' ethos for many years.

2 Risk assessment and strategic direction

Our approach to risk is very much aligned with our culture. We are an organisation that provides a vital service to its customers and we recognise the privilege and responsibilities that this entails. Our intention is to act responsibly towards stakeholders, in particular customers, in the provision of our services to them.

As a Board we must take long-term decisions to ensure our successors are able to operate the business efficiently for customers and provide resilience to meet future circumstances and demand. We are a commercial organisation operating within a regulated framework and accepting some level of risk is a normal consequence of doing business.

We use a sophisticated approach to assess, manage and report risks, with this process being aligned to ISO 9001. More details on how we manage risk is published within the UU Group Annual Report and Financial Statement³.

This approach includes a well-established governance structure for the Group Board to review the nature and extent of the risks that the Group faces and the Audit Committee to review the effectiveness of the risk management processes. The process is supported by a central database, tools, templates and guidance to drive consistency.

Specific reviews of the risks that need to be managed within the business plan to 2025 have been undertaken and reviewed at the Board throughout the AMP6 period with increased focus leading up to the development and approval of the plan.

This process has been designed to ensure that all relevant risks associated with the PR19 submission have been highlighted to the Board which has been able to determine the nature and extent of the risks that were appropriate to address, mitigate or include within the plan.

3 Assurance

We have applied an overarching assurance framework to the development of this business plan. This framework was managed by a dedicated assurance work stream which defined and oversaw the implementation of the governance and assurance activity. Key elements of this framework are set out below:

Clear deliverables - At the start of the programme, we established a detailed programme of work based upon a defined list of external deliverables and supporting internal deliverables. These deliverables were cross referenced to the PR19 methodology to confirm that all elements of the methodology were being addressed by the programme;

Clear accountability - A programme wide RACI⁴ matrix has been developed. This sets out Executive accountabilities to the Board for each main component of the plan and for each individual deliverable within this component of the plan;

² Our business principles can be found on our website:

<https://www.unitedutilities.com/corporate/about-us/governance/business-principles/>

³ The risk management section of the United Utilities Group Annual Report and Financial Statement can be found on our website:

<http://unitedutilities.annualreport2018.com/strategic-report/how-we-manage-risks>

⁴ RACI is a matrix defining who within a programme of work is: **R**esponsible for delivering the activity; **A**ccountable for the activity; needs to be **C**onsulted on the activity or needs to be **I**nformed about the activity.

Comprehensive programme plan - The individual deliverables were managed through an integrated central plan, setting out key internal and external deliverables and dependencies, with this plan supported by more detailed plans managed by the individual work streams;

Risk assessment - Each deliverable in the programme was risk assessed to identify the likelihood and potential consequence of errors. The review ensured appropriate mitigation was in place and confirmed the minimum level of governance and assurance that needed to be applied to each deliverable;

Three lines of assurance - Each Executive sponsor was accountable for the assurance of their deliverables. The assurance framework was based upon the approach that supports our annual regulatory reporting. The effectiveness of the framework and completeness of the assurance has been reviewed by UU Corporate audit with independent technical assurance provided for higher risk elements of the plan;

Governance - Each Executive sponsor confirmed to the Board that they had successfully completed work which should adequately address all requirements of the published PR19 methodology. This confirmation, together with the findings from the three lines of assurance set out above - was used to support the Board's decision to sign the assurance statement supporting this plan; and

Review, challenge and scrutiny by YourVoice - In addition to the Executive led assurance process, our performance, customer engagement and reporting has been subject to independent challenge and review by YourVoice (the customer challenge group). YourVoice has reviewed our performance at each quarterly meeting, with these reviews being supported by UU director attendance and presentations on focus areas. YourVoice have also published their independent views and findings in a separate report and has presented and discussed these findings with the U UW Board.

4 Review and challenge

The Board has directly undertaken a comprehensive review and challenge process throughout the development of the business plan. In addition to regular programme updates provided at Board meetings, a series of strategic programme wide reviews supplemented by more detailed reviews of higher risk or higher priority areas, has been used to shape the strategy and direction of the business plan.

Reviews of the evolving methodology were held in October 2016 with a Board strategy day in October 2017 and further reviews following publication of the methodology in February 2018.

The Board reviewed the assurance plans as part of the review and sign off for the PR19 early submissions and annual performance reports, with detailed reviews in October 2017, April 2018 and June, July and August 2018.

The Board undertook its final review of the work that had been undertaken to provide confidence and assurance of the business plan at its Board Meeting of 23 August 2018, at which it unanimously gave its approval for the signature of the Board Assurance Statement and the publication and submission of the business plan.

The work that was undertaken to provide confidence and assurance in each area of the plan and which taken together demonstrates that all elements of the plan are of high quality, is summarised below.

5 All elements of the plan are of high quality

5.1 The customer engagement process has been effective, with customer views being reflected throughout the plan

Business as usual process: The Board is committed to placing customers at the heart of the business and to obtaining the best possible assurance that its business plan is responsive to their needs.

As part of its day-to-day operations, U UW actively engages with customers and seeks to understand customer views in a variety of ways. These include using customer data and contacts collected through the normal course of business, customer focus groups and online community panels. The information gained through this feedback is used to provide an in-depth understanding of customers' priorities, to continue to improve our services and to ensure that communications are made in ways that are appropriate for the customer.

Specific work to support the AMP7 business plan: To complement this work and support the development of this business plan, a range of additional initiatives were developed and implemented alongside external specialists such as Frontier Economics, that involved customer engagement through bespoke research. These included sophisticated approaches incorporating behavioural economics.

The results from this research were triangulated to develop a coherent view of customer preferences and priorities. This information was used to support the investment programmes, performance commitments and incentive regimes set out within the plan.

Challenge and review: The YourVoice customer and stakeholder challenge group has provided challenge and scrutiny of the company throughout the development of the plan. YourVoice has particularly focussed on the way that the research to capture the views of customer has been designed and implemented and the way in which the outputs of this work have been reflected in the business plan.

The Board have been updated on customer engagement throughout the development of the plan. With YourVoice making direct representations to the Board on a number of occasions and non-executive Board members attending YourVoice meetings.

Assurance: The effectiveness of the process for obtaining and reflecting customer engagement throughout the plan, was reviewed by Deloitte.

5.2 The business plan is affordable with effective protection in place for vulnerable customers

Business as usual process: The Board recognises that a disproportionate number of customers in the North West suffer from financial hardship and deprivation and the Board acknowledges the importance of ensuring that our plan is affordable and that effective arrangements and support is in place for vulnerable customers.

Specific work to develop and challenge the AMP7 business plan: During AMP6 we have significantly enhanced the coverage and effectiveness of our support tariffs. We have worked with external specialist such as CACI and Populus to develop a suite of ongoing initiatives that we believe will continue to increase the reach and effectiveness of these approaches, both during the remainder of the AMP6 period and into AMP7.

We have also developed an AMP7 business plan that requires substantially less investment than we will incur during AMP6 and which can be financed at a lower cost of capital. This means that we will be able to reduce average household bills by 10.5% in real terms by the end of the period, that this contributes to an expected 250,000 households being lifted out of water poverty by 2025 and that during AMP7 we will directly help a further 66,500 out of water poverty.

Assurance: The effectiveness of the process for assessing whether the plan is affordable and our approach to supporting vulnerable customers, was reviewed by Deloitte.

5.3 The business plan includes stretching performance commitments which will help to demonstrate that U UW is meeting its regulatory, statutory and licence obligations

Business as usual process: As a regulated water and wastewater company U UW is subject to a number of obligations, which can be considered as falling in two categories:

- i. Fixed obligations either defined by legislation - such as the Water Industry Act 1991 - or defined through the Instrument of Appointment; or
- ii. Periodic delivery obligations defined through the price review, or related cyclical processes, such as the performance commitments and the quality enhancement programmes.

Each year the U UW Board signs a Risk and Compliance statement, published as part of the Annual Performance Report⁵. This statement describes the systems and processes that are used to demonstrate that U UW has complied with its relevant statutory, licence and regulatory obligations or, where relevant, highlight material areas where these obligations were not met.

⁵ United Utilities 2017/18 Annual Performance Report:

https://www.unitedutilities.com/globalassets/z_corporate-site/about-us-pdfs/apr/united-utilities-annual-performance-report-2017---2018.pdf

Specific work to develop and challenge the AMP7 business plan: For the AMP7 period we have worked with the quality regulators to understand and - where appropriate - influence the required quality enhancement programmes. These requirements have been embedded within our performance commitments and reflected within our expenditure proposals, with the Executive confirming to the Board that these requirements are deliverable.

We have worked with Frontier Economics to develop our performance commitments, which include all the common performance commitments proposed in Ofwat's PR19 final methodology, together with a suite of bespoke commitments that reflect customer priorities and take account of the UK Government's strategic policy statements.

The target performance levels for these measures have been designed to be stretching and where relevant reflect our view of future upper quartile performance. We have worked with ICF to triangulate customer views and develop incentive rates that reflect these views, with significantly more revenue exposed to risk depending upon future performance against our outcomes than was the case at the last review.

The Board review performance against our existing performance commitments as part of the operational review presented to each board meeting and have undertaken detailed reviews of the proposed AMP7 commitments as part of their programme wide reviews and through a specific review in April 2018.

Assurance: Deloitte have undertaken separate reviews of our performance commitments definitions and subsequently the targets and incentive rates.

5.4 The business plan proposals provide long term operational, financial and corporate resilience

Business as usual process: One of the key accountabilities for the Board is to ensure that current and potential longer-term risks are identified and that adequate actions are implemented to ensure that the company will continue to remain resilient in the longer-term. This review process, combined with our robust capital position, allows UU to develop and publish a high quality annual long-term viability statement⁶.

The Board has reviewed and challenged the risks facing the business associated with the development of the AMP7 business plan. This has confirmed that robust and effective analysis has been undertaken to identify and quantify the potential risks to the resilience of the business. And has ensured that the business plan appropriately balances the pace of operational risk reduction against customer affordability, whilst maintaining our industry leading levels of financial resilience.

Specific work to develop and challenge the AMP7 business plan: Three main aspects of resilience have been reviewed:

- **Operational resilience** - A robust and systematic assessment of risks to the resilience of the company's systems and services has been undertaken. Key risks have been reported to the UUW board throughout the development of the plan, with specific reviews on the Manchester and Pennine resilience projects and the proposed resilience metrics. A comprehensive and objective assessment of the potential interventions to manage these risks has been undertaken. Options which are in customers' long term interests and which reflect customers' views have been incorporated into the business plan.
- **Financial resilience** - The Board has reviewed the financial resilience of the business plan as submitted, together with the impact of a range of potential outturn stress scenarios, to confirm that the plan will allow the company to maintain its high levels of financial resilience throughout the AMP7 period and into the longer term.
- **Corporate resilience** - UUW and its ultimate parent company United Utilities Group PLC have established, best practice governance, accountability and assurance processes that are effective in helping to avoid, cope with and recover from disruption; and to anticipate trends and variability in its business operations.

Assurance: We have used a number of specialist providers to review our approach to resilience, including Jacobs, ARUP and Deloitte.

⁶ Long-term viability statement (within United Utilities Group Annual Report and Financial Statements): <http://unitedutilities.annualreport2017.com/media/83269/united-utilities-ar2017-web-ready.pdf#page=75>

5.5 The plan has effectively harnessed the opportunities presented by innovation and via new markets

Business as usual process: The Board has recognised and embraced the fact that the water industry and its context is changing. During AMP6 U UW played a key role in the establishment of the non-household retail market, with U UW's non household retail customer base transferring to WaterPlus on the opening of the market in April 2017.

Specific work to develop and challenge the AMP7 business plan: Our Water Resource Management Plan includes options for a major transfer of water from the North West to the South East, although at this stage these proposals are not replicated within other companies' plans.

We have sought to embed a culture of innovation within the company, have expanded our innovation team to drive lower costs and improve services to customers in the current AMP and have worked with a series of external specialist to identify further opportunities in the AMP7 period. Having already implemented a series of major change programmes in the current period, our plan includes proposals which provide scope for further innovation and systems thinking development in the future. Further details can be found in chapter 6.

Our plan also proposes the use of direct procurement, developed alongside Deloitte, to offer best value to customers of a major multi AMP project to secure a reliable long term water supply to populations in Manchester and the Pennines.

The Board reviewed the effectiveness of the proposed use of innovation to improve customer service and drive down costs as part of the overall programme reviews and specific reviews in these areas and has undertaken specific reviews of the draft Water Resources Management Plan and the proposed water resources and bioresources RCV allocations.

Assurance: Specific reviews of elements of this test have been undertaken by Deloitte and Jacobs.

5.6 The business plan includes well evidenced, efficient and challenging cost forecasts

Business as usual process: The Board recognises that during the PR14 process, there were significant differences between the cost projections submitted by U UW and those of Ofwat. In recognition of this, the company developed and implemented major change programmes to make our processes more efficient.

Specific work to develop and challenge the AMP7 business plan: We have undertaken a comprehensive review of our cost base, alongside external specialist such as ARUP and Mott MacDonald, to identify efficient target costs.

We have also undertaken detailed bottom-up assessments of the scope and costs of the programmes of work which will be required to meet our obligations and deliver our performance commitments and have compared these costs against externally sourced efficiency benchmarks to provide a plan based on efficient costs. Further details can be found in chapter 7.

This review demonstrated that the efficiencies delivered during the current period and the challenging assumptions for future efficiencies that have been built into the plan compare favourably against other water companies and other industries.

Where we consider that Ofwat's modelled cost assessment may not adequately reflect our costs, and where this impact may be material, we have developed well evidenced cost adjustment claims which quantify the impact on U UW costs and, where relevant, the basis on which these factors could be applied more broadly.

The Board have undertaken specific reviews on wastewater cost modelling, deprivation impacts and the AMP7 environmental programmes, with the proposals for the final totex plan being reviewed in May 2018.

Assurance: Specific reviews of our proposed costs have been undertaken by a number of specialist consultants, with Deloitte undertaking an overall assessment of the end to end totex plan.

5.7 The business plan is financeable on both the notional and actual capital structures

Specific work to develop and challenge the AMP7 business plan: The Board has targeted credit ratings of Baa1 with Moody's and BBB+ with Standard and Poor's, for the notional company which corresponds to credit ratings of A3 with Moody's and BBB+ with Standard and Poor's for the actual company. These provide a degree of headroom above the threshold for investment grade and enables us to maintain efficient access to the debt capital markets throughout the economic cycle.

The Board has assessed the financeability of the business plan under both the notional and actual capital structures and has reviewed the supporting independent assurance undertaken.

Assurance: Specific reviews have been undertaken of a number of aspects of the financeability of the plan including by Goldman Sachs and Deloitte.

5.8 The Board is committed to high levels of transparency and engagement and building trust and confidence with customers

Business as usual process: The Board is committed to high levels of transparency. Amongst other things this is reflected in the way that we report our performance, the way the company's corporate and financial structures are constructed and explained and the way that we demonstrate how our performance and financial structures relate to our long term resilience within the United Utilities Group PLC Annual Report and Financial Statements⁷.

We are also pleased that we retained "self-assurance" status in Ofwat's 2017 company monitoring framework, and that we are one of only two companies to have achieved this status for both years of monitoring during the AMP6 period.

We have worked extensively with YourVoice and have actively engaged with customers and other stakeholders to allow us to develop and continually improve our reporting. More detail on the five year view of performance and further information on financial flows has been added to this year's Annual Performance Report, with our AMP7 business plan, supplementary documentation and additional documentation targeted at specific stakeholder groups being published on our web site.

Specific work to develop and challenge the AMP7 business plan: We have committed to a balanced approach to dividends, gearing and benefit sharing which builds on our responsible track record. Before dividends are considered, we will provide company funding for £71m towards financial support schemes for financially vulnerable customers. Base dividends will be set at a reasonable level, guided by the expected allowed regulatory return. Dividends above this level will be subject to consideration of safeguards on levels of gearing, delivery for customers, financial resilience and the impact on customers and other stakeholders including employees. We will explain our decisions on dividend policy every year.

We have committed that where dividend payments or gearing are much higher than expected in the plan there will be a benefit sharing arrangement which will see customers benefit from either lower bills, further targeted financial support and/or grants for community schemes. Customers will be consulted about the application of these funds, under the scrutiny of YourVoice. These approaches are incremental to voluntary approaches to benefit sharing, such as the reinvestment in services undertaken in AMP5 and AMP6.

This package should build confidence among stakeholders that the company remains committed to a significant and meaningful sharing of benefits with customers in the event that the business significantly outperforms the regulatory contract and that the company will maintain its track record of delivering fairly and responsibly in this area.

We have also committed to bringing forward our triennial review of directors' remuneration so consultation with shareholders and stakeholders commences before the end of 2018. Our business plan contains details of the scope of this review which, in summary, will reflect a comprehensive assessment of performance-related pay arrangements, and will seek opportunities to advance the weighting given to customer-focussed measures and priorities.

⁷ United Utilities Group PLC Annual Report and Financial Statements:
https://www.unitedutilities.com/globalassets/z_corporate-site/investor-pdfs/annual-reports/united-utilities-ar2018-web-ready.pdf

Signed

The Board of United Utilities Water Limited:



Dr John McAdam
Chairman



Steve Mogford
Chief Executive Officer



Mark Clare
Senior Independent non-executive director



Russ Houlden
Chief Financial Officer



Paulette Rowe
Independent non-executive director



Steve Fraser
Chief Operating Officer



Brian May
Independent non-executive director



Sara Weller
Independent non-executive director



Alison Goligher
Independent non-executive director



Stephen Carter
Independent non-executive director

This Board Assurance Statement was approved at a meeting of the Board of directors of United Utilities Water Limited on 23 August 2018.

UUW Viability Statement

The directors have assessed the viability of the company, taking account of the company's current position, the potential impact of the principal risks facing the business in severe but reasonable scenarios, and the effectiveness of any mitigating actions. This assessment has been performed in the context of the company's prospects as considered over the longer term. Based on this financial resilience assessment, the directors have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period to March 2025.

This viability statement is based on the fundamental assumption that the current regulatory and statutory framework does not substantively change, for example a change which facilitated the compulsory purchase of the shares or assets of either UUW or its ultimate parent undertaking for the Renationalisation of the water sector, throughout the financial resilience assessment period. In addition, it assumes that the PR19 final determination reflects the business plan submitted to Ofwat in September 2018.

The long-term planning detailed on page 37 of the UUW statutory accounts assesses the company's prospects and establishes its strategy over a 25-year time horizon consistent with its rolling 25-year licence and its published long-term strategy. This provides a framework for the company's strategic planning process, and is key to achieving the company's aim of providing the best service to customers at the lowest sustainable cost and in a responsible manner over the longer term, underpinning our business model set out on pages 20 to 21 of the UUW statutory accounts.

In order to achieve this aim and promote the long-term sustainability and resilience of the business, due consideration is given to the identification and management of risks over the long-term that could impact on the business model, future performance, solvency and liquidity of the company. This includes consideration of, amongst other things: the potential impacts of Brexit; increasing penalties under the Environmental Sentencing guidelines; compliance risks associated with non-household retail following the opening of the market to competition in April 2017; performance penalties against the regulatory contract; and continuing to adapt to climate change both in terms of its significant and permanent impacts on the water cycle and the potential for extreme weather events. An overview of our risk management approach that supports the company's long-term planning and prospects can be found on pages 51 to 54 of the UUW statutory accounts.

The viability statement for the period to March 2025 has been assessed based upon the company's medium-term business planning process, which sits within the overarching strategic planning process and considers:

- The company's current liquidity position – which provides headroom to cover projected financing needs through until 2020;
- The company's robust capital solvency position – with a debt to regulatory capital value (RCV) ratio of around 60 per cent, providing considerable headroom supporting access to medium-term liquidity as required; and
- The current regulatory framework within which the company operates – which provides a high degree of certainty over cash flows in the short to medium term and broader regulatory protections in the longer term.

The analysis underpinning this assessment has been through a robust review process, which has included scrutiny and challenge by the board and assurance by Deloitte.

The company has a proven track-record of being able to raise new forms of finance in most market conditions, and expects to continue to do so into the future. In addition, the board has considered the protections that exist from the regulatory and economic environment within which it operates.

From an economic perspective, given the market structure of water and wastewater services, threats to the company's viability from risks such as reduced market share, substitution of services and reduced demand are low in contrast to those faced by many other industries.

From a regulatory perspective, the company currently benefits from a rolling 25-year licence and a regulatory regime in which regulators – including the economic regulator, Ofwat – are required to have regard to the principles of best regulatory practice. These include that regulation should be carried out in a way which is transparent, accountable, proportionate, consistent and targeted. Ofwat’s primary duties provide that it should protect consumers’ interests, by promoting effective competition wherever appropriate; secure that the company properly carries out its statutory functions; secure that the company can finance the proper carrying out of these functions – in particular through securing reasonable returns on capital; and secure that water and wastewater supply systems have long-term resilience and that the company takes steps to meet long-term demands for water supplies and wastewater services.

The business planning process is closely aligned with these principles, and, coupled with the company’s robust management of risks, gives confidence that current and future regulatory price controls will provide certainty around cash flows that will support the continuing viability and prospects of the company. For these reasons, the board considers it appropriate to provide a viability statement for the period to March 2025.

The directors have assessed the company’s viability in the context of its expected performance and past ability to deliver for customers, considering the principal risks as set out on in S4006 - appendix 6 of the financial resilience assessment supplementary and its ability to absorb a number of severe but reasonable scenarios including those arising from operational and environmental risks, political and regulatory risks, the risk of critical asset failure, and the potential for a restriction to the availability of financing resulting from a global capital markets crisis. The financial resilience assessment has considered the potential impacts of these risks on the company’s business model, future performance, solvency and liquidity based on a number of stress-tested and sensitised scenarios in which the company is assumed to face a series of the top risks in terms of the most severe impact and likelihood of occurrence over the course of the financial resilience assessment period. As well as the protections that exist from the regulatory environment within which the company operates, a number of mitigating actions are available in the kind of severe scenarios considered, including the restriction of dividend payments, access to additional equity, the raising of new finance, the closeout of derivative asset positions, and capital programme deferral. These actions provide the company with significant scope to improve its liquidity and capital position to further absorb such threats.

In addition, the assessment has also considered the impact of the common scenarios prescribed by Ofwat⁸ on the company’s ability to maintain its credit ratings, financial metrics and its ability to service debt.

- The individual scenarios modelled assumed a totex underperformance of 10%, inflation of 4% RPI/3% CPIH, an increase in bad debt of 5% and a cost of new debt at 2% above forward interest rate projections - for each year of AMP7- and an ODI penalty at 3% of RoRE and a financial penalty at 3% of turnover in relation to one year of the viability period.
- The combined scenario modelled assumed totex and retail cost underperformance of 10% and an ODI penalty at 1.5% of RoRE - in each year of AMP7- and a financial penalty of 1% of revenue in relation to one year of the viability period.

The principal financial risk not captured within these scenarios relates to the funding deficit of defined benefit pension schemes. As the company’s schemes are well funded and operate an asset liability investment mandate hedging the liability exposure (and in the unlikely event of a substantial deterioration of the funding position, a period of time would be allowed for deficit repair payments), pension risk is not considered to have a material impact on the company’s financial resilience assessment.

The company’s existing credit ratings are A3 with Moody’s and A- with Standard and Poor’s. In all but the most extreme scenarios the company would reasonably expect, on a standalone basis, to be able to maintain credit ratings of A3, BBB+. In the most extreme scenario the credit rating is likely to reduce further to Baa2, BBB, without taking mitigating actions, which we consider inappropriate given the lack of headroom this provides and, as such, mitigating actions would be considered to restore the ratings to a more comfortable level. The most extreme scenario results in a c6% increase in debt to RCV gearing⁹ to c66%, a c1.1x reduction in adjusted interest cover¹⁰ to

⁸ Putting the sector in balance – position statement on PR19 business plans (July 2018)

⁹ Debt to RCV gearing is calculated based on the company’s shadow RCV

¹⁰ Adjusted interest cover calculated based on the methodology published by Moody’s

c1.0x and a c3.2% reduction in FFO to debt¹¹ to c6% by the end of the viability period. Following any stress period, FFO would then be reasonably expected to revert to more normalised levels, improving adjusted interest cover to c1.4x and FFO to debt to c8% which supports the Baa2, BBB credit rating associated with the extreme scenario. Given the strong capital base and prudent levels of liquidity, none of the scenarios are reasonably expected to impact the company’s ability to service debt.

Mitigating actions to support the overall financeability of the company could include: a temporary reduction in dividends; a revised dividend policy; or the raising of new equity capital. As a consequence of the significant equity base, dividends across the viability period equivalent to c16% of the RCV at the end of the viability period, providing substantial headroom to improve the capital strength of the company and its credit ratings and/or allow the company to absorb more extreme downside scenarios.

Additionally, we have assessed the potential impact of financing the Manchester & Pennines Resilience programme through the traditional in house funding approach in the event that a direct procurement for customers cannot be secured. Adding the expected impact to Ofwat’s most extreme scenario still indicates that the company would be able to sustain a Baa2, BBB credit rating assuming that there was a firm commitment to reflect this expenditure in the RCV from AMP8 on a NPV neutral basis.

Signed, the Board of United Utilities Water Limited:



Dr John McAdam
Chairman



Alison Goligher
Independent non-executive director



Mark Clare
Senior Independent non-executive director



Stephen Carter
Independent non-executive director



Paulette Rowe
Independent non-executive director



Steve Mogford
Chief Executive Officer



Brian May
Independent non-executive director



Russ Houlden
Chief Financial Officer



Sara Weller
Independent non-executive director



Steve Fraser
Chief Operating Officer

This UUW Viability Statement was approved at a meeting of the Board of directors of United Utilities Water Limited on 23 August 2018.

¹¹ FFO to debt calculated based on the methodology published by Standard & Poor’s