

SOUTHERN WATER SUSTAINABILITY BOND 2021 ASSESSMENT

DNV ELIGIBILITY ASSESSMENT

Scope and Objectives

Southern Water Services Ltd. (henceforth referred to as Southern Water) is the eighth largest water and sewerage company in England and Wales, operating throughout Kent, East and West Sussex, Hampshire and the Isle of Wight, and small parts of Wiltshire, Berkshire and Surrey.

Southern Water supplies water and wastewater services to more than 7.3 million customers and 3.1 million properties; it looks after over 13,959 km of water mains and 39,872 km of sewers, and maintains and manages 84 water treatment works and 367 sewage treatment sites.

Southern Water intends to issue its second Sustainability Bond of an approximate value of £250 million sterling (henceforth referred to as "the Bond") for the purpose of financing its business activities including financing capital expenditure to meet its obligations under Ofwat's seventh Asset Management Period (AMP7). This is Southern Water's second bond issuance under the Southern Water Sustainable Financing Framework 2020 (henceforth referred to as "the Framework").

DNV GL Business Assurance Services UK Limited (henceforth referred to as "DNV") has been commissioned by Southern Water to provide an eligibility assessment on the Bond against the International Capital Market Association (ICMA) Green Bond Principles 2018 (GBP), Social Bond Principles 2020 (SBP) and the Sustainability Bond Guidelines 2018 (SBG). 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 the Bond, the value of any investments in the Bond, the alignment of the Bond with Regulatory requirements, or the long-term environmental and social benefits of the transaction. Our objective has been to provide an assessment that the Bond has met the criteria established on the basis set out below.

Responsibilities of the Management of Southern Water and DNV

The management of Southern Water has provided the information and data used by DNV during the delivery of this review. Our statement represents an independent opinion and is intended to inform Southern Water management and other interested stakeholders in the Bond as to whether the established criteria have been met, based on the information provided to us. In our work we have relied on the information and the facts presented to us by Southern Water. DNV is not responsible for any aspect of the projects or assets referred to in this opinion and cannot be held liable if estimates, findings, opinions, or conclusions are incorrect. Thus, DNV 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's opinion

We have adapted our Sustainability Bond Eligibility Assessment methodology to create a Southern Water-specific Sustainability Bond Eligibility Assessment Protocol (henceforth referred to as "Protocol") - see Schedule 2. Our Protocol includes a set of suitable criteria that can be used to underpin DNV's opinion.

As per our Protocol, the criteria against which the Bond 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 sustainability bond must use the funds raised to finance eligible activities. The eligible activities should produce clear social and environmental 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 sustainability bond should outline the process it follows when determining eligibility of an investment using Sustainability Bond 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 sustainability bond 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 investors should be made of the use of bond 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 Bond, as described above and in Schedule 2 to this Assessment;
- Assessment of documentary evidence provided by Southern Water on the Bond and supplemented by a high-level desktop research. These checks refer to current assessment, best practices and standards methodology;
- Discussions with Southern Water management on, and review of, relevant documentation and evidence related to the criteria of the Protocol;
- Documentation of findings against each element of the criteria. Our opinion as detailed below is a summary of these findings.

Findings and DNV's opinion

DNV's findings are listed below:

1. Principle One: Use of Proceeds.

Southern Water intends to use the proceeds from this sustainability bond to finance new capital and operational expenditure in the following eligible categories:

Eligible Green Categories

- Renewable Energy
- Energy Efficiency
- Pollution Prevention and Control
- Sustainable Water and Wastewater Management
- Environmentally Sustainable Management of living natural resources and land use
- Eco-efficient and/or circular economy, adapted productions, production technologies and processes

Eligible Social Categories

- Affordable Basic Infrastructure
- Socioeconomic advancement and empowerment

These investments form part of the Eligible Green Investments and, Eligible Social Investments which when aggregated are called Eligible Sustainable Investments.

Southern Water has provided evidence showing for each project whether the benefits of the use of proceeds will be green, social or both, and whether the impact of these will be low, medium or high. For this second issuance, Southern Water plans to exclusively finance new projects which fall into the AMP7 period.

DNV has reviewed the portfolio of eligible projects and concludes that the projects outlined in the Bond documentation fall within the eligible categories described in Southern Water's Sustainable Financing Framework 2020, these eligible project are also consistent with the categories outlined in the GBP, SBP and SBG and will provide clear environmental benefits.

In addition, the proceeds from this Bond issuance will also contribute to Southern Water's five transformational programmes detailed in the appendix of the Framework and reflected in Southern Water's 2020–25 Business Plan, which also gets reviewed by the economic regulator Ofwat.

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

DNV can confirm that activities to be financed by the Bond have been evaluated by the Sustainable Finance Committee, which has selected the activities according to their environmental and societal contribution, and assessed that they fit the requirements of the Eligible Sustainable Investments, in line with Southern Water's Eligible Sustainable Categories (described under Principle One).

Southern Water has also committed to excluding certain categories of spend such as personnel costs, potential fines and legal costs associated with pollution incidents, as well as financing costs, which include costs associated with raising finance.

The assets and expenditures linked to the Bond also follow Southern Water's strict internal process for investments, summarised in the Framework, whereby investments are proposed through business cases, assets and expenditures are reviewed and approved by the Board and by multiple

functions such as the Asset Steering Group and the Investment Committee, with additional oversight by the water and waste strategy groups.

DNV GL concludes that the process of project evaluation and selection is in line with the Framework and the requirements of the GBP, SBP and SBG.

3. Principle Three: Management of Proceeds.

DNV has reviewed the total value of the updated portfolio of eligible projects, taking into account the amounts allocated from the previous Bond issuance, and can therefore confirm that, with this new Bond issuance, the amounts represented by Southern Water's Eligible Sustainable Portfolio will still exceed the amount of finance raised, and will continue to provide a healthy buffer of over-collateralisation above the previously committed to 20% minimum.

Southern Water has sufficiently described and evidenced that they have suitable processes in place for the management of proceeds and will be handled appropriately by Southern Water's treasury team in line with internal treasury policies.

Southern Water has confirmed that provisions have been made for managing any unallocated net proceeds and ensuring that in the future those funds be allocated to investments compatible with Southern Water's Sustainable Financing Framework and Treasury policy.

Special attention has been paid to avoiding double-counting, in line with the Framework, through various means: the use of unique identifiers for Eligible Sustainable Investments as part of Southern Water's internal reporting systems, reconciliation at each issuance, and additional support from the Capital Reporting team.

DNV GL concludes that the net proceeds arising from this issuance will be appropriately managed by the Treasury team at Southern Water, in line with the Framework and the requirements of the GBP, SBP and SBG.

4. Principle Four: Reporting.

DNV can confirm that Southern Water has committed to providing information annually to investors on the allocation and impact of the Bond.

In terms of allocation reporting, Southern Water has committed to issuing a report within one year of the Bond issuance. Reporting will detail how much of the financing raised has been allocated and to which sub-portfolio, a description of the assets financed, and the allocation of new financing.

In terms of impact reporting, Southern Water plans to report on an annual basis and until the maturity of the issue, where feasible. Examples of metrics are outlined in the Framework and summarised below:

- Carbon (greenhouse gases) Emissions (ktCO₂e)
- 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

Southern Water has also started to publish annually the details of their carbon emissions performance on its company website in the Environmental Performance section.

DNV concludes that Southern Water has committed to producing appropriate reporting on the environmental and social impacts of the Bond and is in line with the Framework and the requirements of the GBP, SBP and SBG.

On the basis of the information provided by Southern Water and the work undertaken, it is DNV's opinion that the Bond meets the criteria established in the Protocol, it is eligible under Southern Water's Sustainable Financing Framework 2020 and that it is aligned with the stated definition of sustainability bonds within the Green Bond Principles 2018, Social Bond Principles 2020, Sustainability Bond Guidelines 2018.

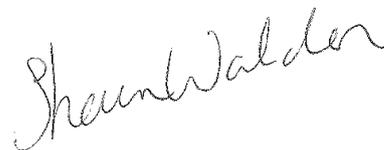
for DNV GL Business Assurance Services UK Limited

London, 11th March 2020

A handwritten signature in black ink, appearing to read "R Strutt".

Richard Strutt

Senior Consultant and Project Manager
DNV – Business Assurance

A handwritten signature in black ink, appearing to read "Shaun Walden".

Shaun Walden

Principal Consultant and Reviewer
DNV – Business Assurance

About DNV

Driven by our purpose of safeguarding life, property and the environment, DNV 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 12,000 professionals are dedicated to helping customers make the world safer, smarter and greener.

1 SCHEDULE 1: DESCRIPTION OF ACTIVITIES TO BE FINANCED THROUGH THE BOND

Southern Water's Sustainable Eligible Categories relevant to this Bond

Eligible Green Categories

- Renewable Energy
- Energy Efficiency
- Pollution Prevention and Control
- Sustainable Water and Wastewater Management
- Environmentally Sustainable Management of living natural resources and land use
- Eco-efficient and/or circular economy, adapted productions, production technologies and processes

Eligible Social Categories

- Affordable Basic Infrastructure
- Socioeconomic advancement and empowerment

SCHEDULE 2: SOUTHERN WATER-SPECIFIC SUSTAINABILITY BOND ELIGIBILITY ASSESSMENT PROTOCOL

1. Use of proceeds

Ref.	Criteria	Requirements	Work Undertaken	DNV Findings
1a	Type of bond	<p>The bond must fall in one of the following categories:</p> <ul style="list-style-type: none"> • Use of Proceeds Bond • Revenue Bond • Project Bond • Securitized or covered Bond 	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> • 2020 OpCo Update_Prospectus dated 6 May 2020 • Draft term sheet 	<p>The type of bond is appropriately described in the Prospectus and Draft Term Sheet, and that it will fall within the category of a Use of Proceeds Bond.</p>
1b	Sustainability Project Categories	<p>The cornerstone of a Sustainability Bond is the utilization of the proceeds of the bond which should be appropriately described in the legal documentation for the security.</p>	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> • 5051_SustainableFinancing_Framework_2020_v9 • 2020 OpCo Update_Prospectus dated 6 May 2020 • Draft term sheet • EP Master Template V27 for green bond AMP7 PH • Southern Water bank presentation v5 	<p>Southern Water will use the proceeds to finance the following activities:</p> <ul style="list-style-type: none"> • Renewable Energy • Energy Efficiency • Pollution Prevention and Control • Sustainable Water and Wastewater Management • Environmentally Sustainable Management of living natural resources and land use • Eco- efficient and/or circular economy, adapted productions, production technologies and processes • Affordable Basic Infrastructure • Socioeconomic advancement and empowerment <p>Those activities form part of Southern Water’s Eligible Sustainable Investments. These projects fall within the eligible categories outlined in the Framework and are consistent with the categories outlined in the GBP, SBP, SBG.</p> <p>DNV concludes that the use of proceeds is appropriately described in the Bond documentation.</p>

Ref.	Criteria	Requirements	Work Undertaken	DNV Findings
1c	Social and Environmental benefits	All designated Green and Social Project categories should provide clear socially and environmentally sustainable benefits, which, where feasible, will be quantified or assessed by the issuer.	Discussions with Southern Water and review of the following documents: <ul style="list-style-type: none"> 5051_SustainableFinancing_Framework_2020_v9 Southern water 5025_wrmp_-v11 (Water Resource Management Plan) Draft term sheet EP Master Template V27 for green bond AMP7 PH 	<p>Southern Water has selected projects for the Bond which fall under both social and environmental categories.</p> <p>Southern Water has determined for each activity whether the benefits of the use of proceeds will be green, social or both.</p> <p>Southern Water has prioritised those activities which they feel best support progress towards Southern Water’s five transformational programmes as part of its 2020-2025 Business Plan.</p> <p>In order to make the benefits quantifiable, Southern Water has provided examples of potential KPIs.</p> <p>The evidence reviewed gives us the opinion that the Bond will deliver clear social and environmental benefits.</p>
1d	Refinancing share	In the event that a proportion of the proceeds may be used for refinancing, it is recommended that issuers provide an estimate of the share of financing vs. re-financing, and where appropriate, also clarify which investments or project portfolios may be refinanced.	Discussions with Southern Water and review of the following documents: <ul style="list-style-type: none"> 5051_SustainableFinancing_Framework_2020_v9 EP Master Template V27 for green bond AMP7 PH 	For this second issuance, Southern Water plans to exclusively finance new projects.

2. Process for Project Selection and Evaluation

Ref.	Criteria	Requirements	Work Undertaken	DNV Findings
2a	Investment-decision process	<p>The issuer of a Sustainability Bond should outline the decision-making process it follows to determine the eligibility of projects using Sustainability Bond proceeds. This includes, without limitation:</p> <ul style="list-style-type: none"> • A process to determine how the projects fit within the eligible Sustainability Project categories identified in the Sustainability Bond Guidelines; • The criteria making the projects eligible for using the Sustainability Bond proceeds. 	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> • 5051_SustainableFinancing_Framework_2020_v9 • EP Master Template V27 for green bond AMP7 PH 	<p>The evidence reviewed clearly outlines the decision-making process. Southern Water has established a Committee to review and approve the activities included in the Sustainability Bond. The Committee is composed of representatives from the Treasury, Corporate Finance and Sustainability teams.</p> <p>The assets and expenditures linked to the Bond also follow Southern Water’s strict internal process for investments.</p> <p>Southern Water has also committed, in alignment with the Framework, to excluding certain categories.</p> <p>DNV concludes that the activities financed by the Bond were appropriately evaluated and selected, in line with the Framework.</p>
2b	Issuer’s environmental and social and governance framework	<p>In addition to information disclosed by an issuer on its Sustainability Bond process, criteria and assurances, Sustainability Bond investors may also take into consideration the quality of the issuer’s overall framework and performance regarding environmental sustainability.</p>	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> • 5051_SustainableFinancing_Framework_2020_v9 • EP Master Template V27 for green bond AMP7 PH • Southern Water bank presentation v5 <p>Environmental and social governance documentation:</p> <ul style="list-style-type: none"> • Southern Water 5025_wrmp_-v11 (Water Resource Management Plan) 	<p>Southern Water produces a series of reports detailing their mechanism for monitoring the effectiveness of its social and environmental framework, results and plans for the future.</p> <p>We conclude that from the information provided, the objective of the Bond is in line with Southern Water’s wider approach to managing environmental and social impacts.</p>

Ref.	Criteria	Requirements	Work Undertaken	DNV Findings
			<ul style="list-style-type: none"> • Annual Report and Financial Statements for the year ended 31 March 2020 • Public reporting of Southern Water’s on-going sustainability work per region • Our Environmental Policy, May 2019 • “Help paying your bill” section of website • “Environmental performance” section of website (pollution reporting, river levels, carbon emissions, effluent compliance, flows and spills, bathing water quality) 	

3. Management of proceeds

Ref.	Criteria	Requirements	Work Undertaken	DNV Findings
3a	Tracking procedure	<p>The net proceeds of Sustainability Bonds should be credited to a sub-account, moved to a sub-portfolio or otherwise tracked by the issuer in an appropriate manner and attested to by a formal internal process that will be linked to the issuer's lending and investment operations for Sustainability Projects.</p> <p>So long as the Sustainability Bonds are outstanding, the balance of the tracked proceeds should be periodically reduced by amounts matching eligible sustainability investments or loan disbursements made during that period.</p>	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> 5051_SustainableFinancing_Framework_2020_v9 EP Master Template V27 for green bond AMP7 PH FNI 225 – Management and Control of Capital Expenditure (extract) Capital Reporting System (extract) 	<p>All expenditure items will be tracked, and Southern Water's Treasury team will make sure that the amounts represented by the Eligible Sustainable Portfolio will exceed, or at least be equal to, the amount of finance raised under the Bond.</p> <p>Internal tracking relies on Southern Water's capital reporting management system and unique identifiers, ensuring that no double-counting occurs.</p> <p>We conclude that there is a clear process in place for the tracking of the balance of the proceeds.</p>
3b	Temporary holdings	<p>Pending such investments or disbursements to eligible Sustainability Projects, the issuer should make known to investors the intended types of temporary investment instruments for the balance of unallocated proceeds.</p>	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> 5051_SustainableFinancing_Framework_2020_v9 	<p>We conclude that Southern Water has appropriately disclosed how it will manage any unallocated proceeds in line with its Treasury Policy</p>
3c	Over-collateralisation	<p>If a list of planned investments has been identified at the time of issuance, the company shall demonstrate that the value of the bond is smaller than or equal to the financing needs of the eligible nominated projects.</p> <p>A comparison of the outstanding principal of the bond to the value of the</p>	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> 5051_SustainableFinancing_Framework_2020_v9 	<p>DNV has reviewed the total value of the updated portfolio of eligible projects, taking into account the amounts allocated from the previous Bond issuance, and can therefore confirm that, with this new Bond issuance, the amounts represented by Southern Water's Eligible Sustainable Portfolio will still exceed the amount of finance raised, and will continue to provide a healthy buffer of over-collateralisation above the recommended 20% minimum.</p>

Ref.	Criteria	Requirements	Work Undertaken	DNV Findings
		financing needs of the nominated projects should be made. The bond should be "over-collateralised" and/or a replacement project list should be drawn up.	<ul style="list-style-type: none"> • EP Master Template V27 for green bond AMP7 PH • Draft term sheet TBC 	

4. Reporting

Ref.	Criteria	Requirements	Work Undertaken	DNV Findings
4a	Periodical reporting	In addition to reporting on the use of proceeds and the temporary investment of unallocated proceeds, issuers should provide at least annually a list of projects to which Sustainability Bond proceeds have been allocated including - when possible with regards to confidentiality and/or competitive considerations - a brief description of the projects and the amounts disbursed, as well as the expected environmentally sustainable impact.	<p>Discussions with Southern Water and review of the following documents:</p> <ul style="list-style-type: none"> • 5051_SustainableFinancing_Framework_k_2020_v9 • Southern water 5025_wrmp_-v11 (Water Resource Management Plan) 	<p>Southern Water will provide information annually to investors on the allocation and impact of social and environmental assets and expenditures financed through the Bond.</p> <p>Allocation reporting will detail how much of the financing raised has been allocated and to which sub-portfolio, a description of the assets financed, and the allocation of new financing, impact reporting will measure the benefits of social and environmental assets and expenditures through a number of KPIs which may include:</p> <ul style="list-style-type: none"> • Carbon emissions • Total level of leakage • Number of pollution incidents • Renewable energy generation • Bathing water quality <p>DNV can confirm Southern Water has committed to producing appropriate reporting on the environmental and social impacts of the Bond.</p>