

Cayman Island Substitution Proposals

15 November 2018

The Proposals

Background to the Proposals and the Comfort Package Being Offered

Introduction

Affinity Water is seeking the removal of its Cayman Island incorporated financing company

Affinity Water ("**AW**") established a whole business securitisation ("**WBS**") structure in 2013 to raise long-term finance for its investment programme and operations. At the time of implementing the whole business structure AW believed, and continues to believe, that the WBS structure offers many advantages to AW through ensuring access to long term capital, best matched to the financing needs of AW. A Cayman Island subsidiary ("**Cayco**") was established to facilitate access to the international bond markets under the WBS structure

This was needed to comply with two competing pieces of legislation under English law:

- Public bonds could only be issued by a PLC
- A prohibition on PLCs providing "financial assistance" in respect of the purchase of their own shares

Although the financial assistance rules were recast under the 2006 Companies Act, there was little precedent at the time AW's WBS structure was established that would give comfort a UK PLC could be used without infringing such rules. A Cayco was therefore considered a more efficient and expedient route to the establishment of the Financing Group

The Cayco is exclusively UK managed and a UK tax resident and has always been since its incorporation. The Cayco does not confer any tax advantage to AW

Notwithstanding this, operating to the highest standards of governance and transparency is of the utmost importance to AW. As part of this we have a continuing commitment to ensure that all aspects of our business support this, alongside all our wider objectives – including delivering a financing approach that best ensures the ongoing financial resilience of AW

Recently, HM Government and Ofwat have both questioned whether the presence of off-shore finance companies within the financing structure of water companies is consistent with a transparency objective – indeed three water companies (Anglian, Yorkshire and Thames) have already instigated these changes

Introduction

Affinity Water is seeking the removal of its Cayman Island incorporated financing company

We now believe that the time is opportune to remove Cayco and replace it with a UK incorporated company: this will support our transparency objective, be in the interests of customers and wider stakeholders and, we believe, be viewed as a positive step by Ofwat and HM Government

It is for these reasons that we are seeking removal of the Cayco via a consent process

On the 23rd August 2018, AW released an RNS indicating it was considering the substitution of Cayco with a special purpose vehicle incorporated in the UK

We have subsequently engaged with a number of stakeholders including Ofwat, bank lenders and certain creditors of private debt to discuss these intentions and have received positive feedback on our proposals

We have engaged with the Rating Agencies and as a precondition to the proposals they will be providing (or AW will provide certification of such affirmations having consulted with the relevant Rating Agency) the Security Trustee affirmations that the proposals will not affect current ratings

Our proposals are therefore expected to be credit neutral and potentially credit positive given the benefits the proposal will generate with respect to our relationship with Ofwat and our reputation with customers

Additionally, the Proposals described in the Solicitation Memorandum have been considered by a special committee (the "**Special Committee**") of The Investment Association at our request. The members of the Special Committee, who hold in aggregate approximately 58.1 per cent. of the aggregate principal amount outstanding of the Class A Bonds issued by the Current Programme Issuer (at their originally issued nominal amount) and approximately 36.8 per cent. of the aggregate principal amount outstanding of the Bonds issued by the Existing Issuer (at their originally issued nominal amount) have examined the Proposals. They have informed us they find the proposals acceptable and that, subject to client and other approvals, they intend to vote in favour of the Proposals in respect of their holdings of Bonds

The Special Committee has advised the Affinity Water group that this recommendation relates only to the Proposals set out in the Solicitation Memorandum and not to any future offers or proposals which we may make

The Proposals

The Proposals are set out in the 'STID Proposal' for consideration by Qualifying Class A Creditors

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Incorporation of NewCo

- A new financing company will be established (“**NewCo**”) – NewCo will initially be incorporated outside the Financing Group and then shares transferred to AWL to bring it into the Financing Group
- NewCo will be a special purpose vehicle incorporated in England & Wales

NewCo will be the issuance vehicle for the Financing Group going forward

Substitution of Cayco

- Creditors will be invited to substitute Cayco as issuer or borrower of debt with NewCo¹ via a vote of Class A Creditors^{2,3}
- Associated assets (intragroup loans) will be transferred to NewCo with substitution of debt
- Creditors will benefit from equivalent guarantees and security package in relation to NewCo as they did in relation to the existing Cayco

Once all debt and assets are substituted / transferred to NewCo, Cayco will be transferred out of the Financing Group

Disposal of Cayco

- Cayco will be transferred to a group company outside the Financing Group
- Cayco will then be liquidated on a solvent basis

The Financing Group will no longer have offshore incorporated entities

(1) Issuer substitution of Cayco for NewCo will satisfy all of the conditions precedent set out in the Bond Trust Deed to effect issuer substitution

(2) Note that no Class B Creditor vote is required to effect the Proposals.

(3) The substitution of Cayco with Newco as principal debtor under the Cayco bonds will be implemented in accordance with the provisions of the Bond Trust Deed

The Comfort Package / Offering

In addition to a fee of 0.025% (as a percentage of principal amount outstanding of voted bonds – the fee is subject to conditions), investors will benefit from the following package of supporting materials

Ratings Affirmations

- It will be a precondition to the implementation of the Proposals that ratings affirmations are provided to the Security Trustee and Bond Trustee confirming Proposals will have no impact on ratings¹
- S&P will provide a RAC letter to the Security Trustee / AW
- Following discussions with Moody's, AW will certify to the Security Trustee that the current Moody's ratings will not be impacted
- The Rating Agencies were provided tax, accounting and legal opinions in addition to the transaction documents for their review and analysis. Ratings confirmations were only provided having considered this comprehensive comfort package

Transaction Documentation

- Investors will also get access to the Implementation Deed required to effect the Proposals showing the changes are limited to those required in relation to the incorporation of NewCo, the substitution of Cayco with NewCo and the subsequent disposal of Cayco

Opinions

- Provided to the Security Trustee
- Legal Opinion in respect of matters of capacity and enforceability
- Tax Opinion in respect of certain UK tax matters applicable to the Financing Group with respect to the Proposals

(1) Where no such written affirmation is provided, it is a precondition that the Company certifies to the Trustee, following discussions with the relevant Rating Agency, that the Proposals would not cause a downgrade

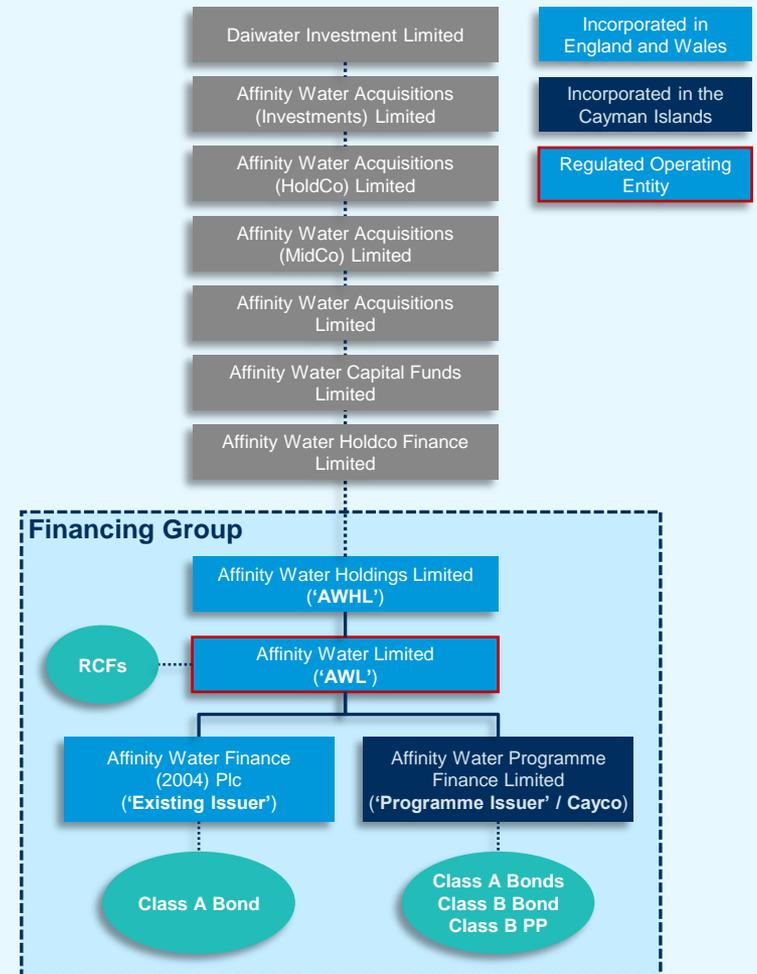
Impact of the Proposals

Financing Group Structure Change and Other Expected Impacts

The Existing Financing Group Structure

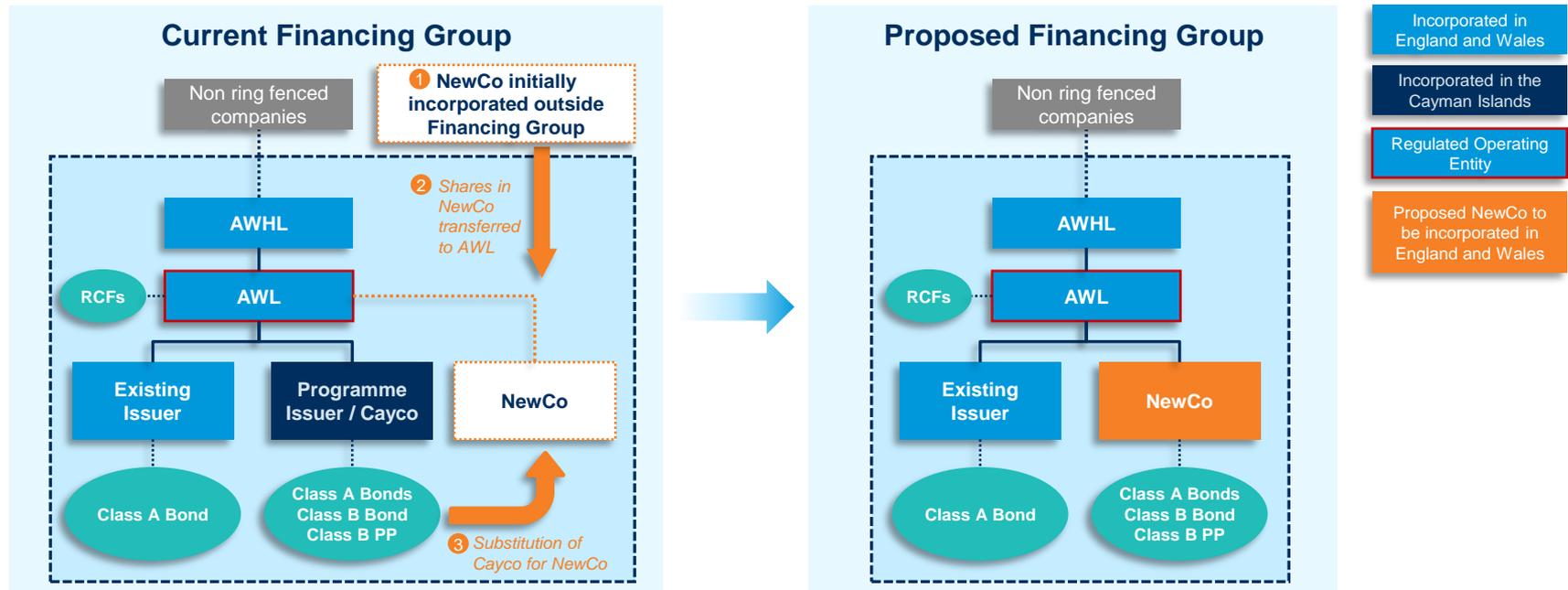
The existing Financing Group comprises two entities with outstanding bond issuance – Cayco and a legacy UK issuer

- Two companies are issuers of bonds / private placements to third party debt investors:
 - Affinity Water Finance (2004) Plc (“**Existing Issuer**”)
 - Affinity Water Programme Finance Limited (“**Programme Issuer**” or “**Cayco**”)
- Existing Issuer is incorporated in the UK while Programme Issuer is Cayman Islands incorporated
 - The Existing Issuer has one bond outstanding, issued in 2004 and subsequently tapped in 2014
- AWL also has two undrawn revolving credit facilities with a combined commitment of £100m as well as liquidity facilities
- Existing Issuer’s and Programme Issuer’s balance sheets consist of loan relationship assets and liabilities. In general, their payables are due to third parties and their receivables are due from other companies in the Financing Group



Overview of Proposed Structure Changes

Amendments to the underlying Finance Documents, required for the substitution and disposal of Cayco, will be effected by way of an Implementation Deed



AW have determined that a newly incorporated UK company should be used for all future public issuance out of the Financing Group and AW are seeking consent from Class A Bondholders to incorporate NewCo and substitute existing bonds from Cayco - the substitution itself will be implemented in accordance with the provisions of the Bond Trust Deed. Cayco can then be disposed from the Financing Group

Both revolving credit facilities and the Class A bond issued out of Existing Issuer will remain where they are currently situated within the Financing Group

Provided the consent is successful, the above changes will be implemented as soon as practicable but given the nature of the changes it may take several months for successful completion

The Impact of the Proposals

The Proposals are expected to have, at worst, a credit neutral impact

No Ratings Impact

- It is a precondition to implementing the Proposals that Rating Agencies confirm the Proposals will have no impact on current ratings
- The Rating Agencies have reviewed the Proposals
- We expect S&P will provide a RAC letter to the Trustee
- We will certify to the Trustee that the Proposals will have no impact on current Moody's ratings (based on feedback received from Moody's)
- Moody's and S&P both issued notes earlier in the year with respect to the Thames Water and Yorkshire Water consent processes which also sought to remove Caycos from their financing structures. Both Rating Agencies indicated these transactions were "credit neutral"

Positive ESG Impact

- Disposing of Cayco addresses the negative perception and scrutiny that is being directed at AW and other UK water companies for the use of offshore financing vehicles
- Disposing of Cayco will improve transparency for creditors, the regulators and customers as well as reducing administrative burden

No Tax Impact

- NewCo will be a securitisation company for the purposes of UK tax law so the current tax status of the Financing Group will not change following implementation of the Proposals
- Consequently there should be no adverse UK tax impact on the Financing Group from the Proposals

No Credit Impact

- Security and Guarantee arrangements will be replicated for NewCo
- No changes are being made other than those ancillary to the incorporation of NewCo and substitution of Cayco
- As such no impact is expected on the credit quality of bonds substituted
- Supporting materials demonstrate no adverse impact on bondholders (see package on page 6)
- All conditions precedent outlined in the Bond Trust Deed for issuer substitution will have been met and confirmed by the Trustee

Voting Mechanics

Voting Process for the Consent

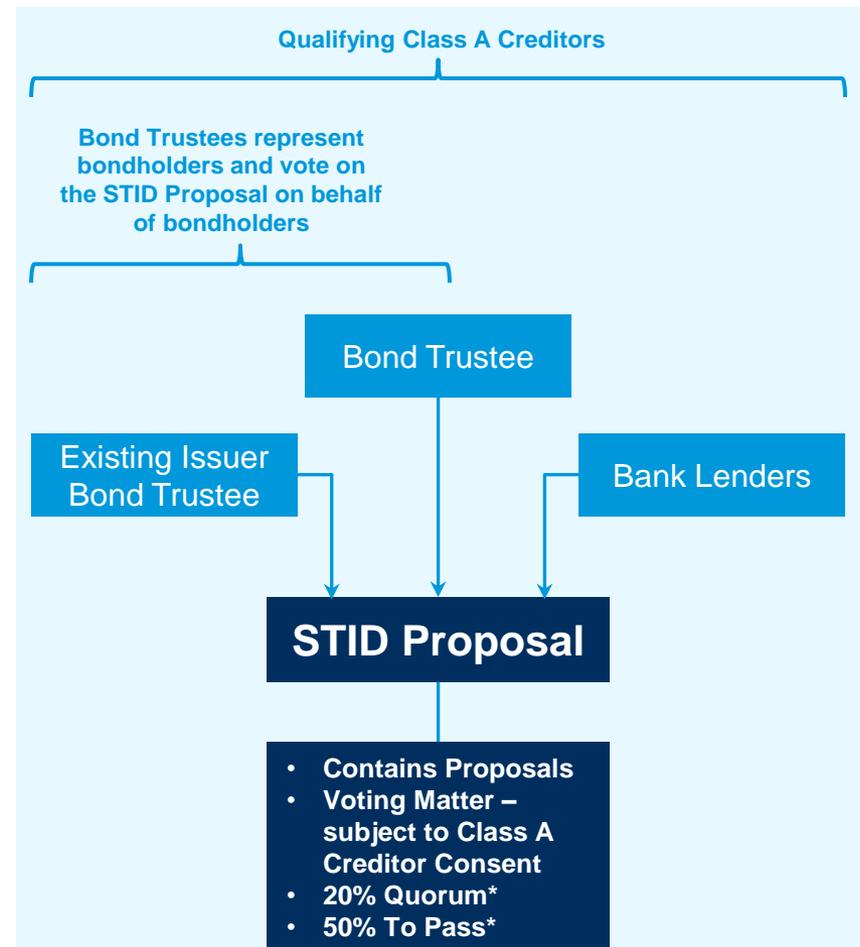
The Voting Process

Voting occurs by a single vote of all Qualifying Class A Creditors

The Proposals are set out in the STID Proposal which is sent via the Security Trustee to Secured Creditors or their Representatives along with a STID Voting Request asking for votes on the matters proposed in the STID Proposal

- The STID Proposal is voted on by the Class A Debt Instructing Group (Class A DIG) – Class B bonds do not form part of the Class A DIG
- Class A Bondholders are represented by the Bond Trustees which vote on behalf of bondholders as directed by electronic voting
 - Bonds issued out of Cayco are represented by the Bond Trustee
 - Bonds issued out of Existing Issuer are represented by the Existing Issuer Bond Trustee
- Certain Class A Creditors such as the bank lenders directly form part of the Class A DIG and so vote directly on the STID Proposal

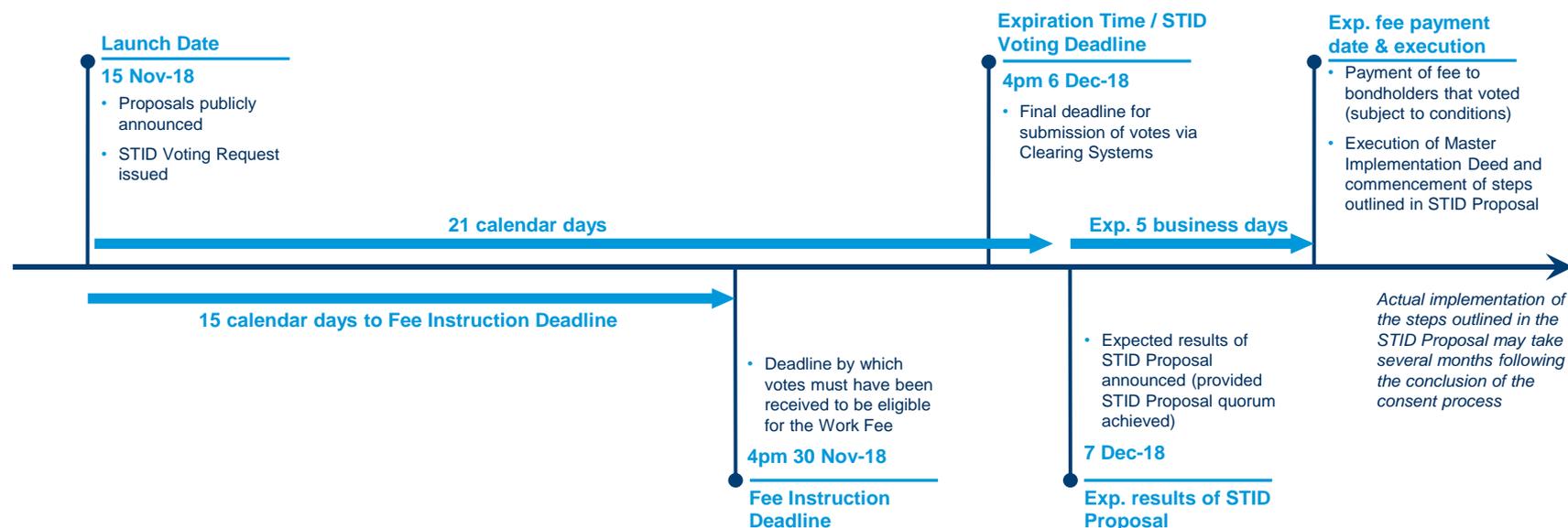
The Bond Trustees will vote on the STID Proposal as directed by the bondholders – bondholders direct the Bond Trustees by submitting Electronic Voting Instructions through the Clearing Systems



**Percentages relate to the aggregate Outstanding Principal Amount of Qualifying Class A Debt*

The Proposal Timeline

The timeline for voting is 21 calendar days



Voting on the STID Proposal will conclude at the earlier of:

- The STID Voting Deadline
- When 50% or more of the principal outstanding of Qualifying Class A Creditors have voted in favour

As Class B Creditors (including Class B Bondholders and Class B Private Placements) do not form part of the Class A DIG these creditors will not be able to vote in the above process

On submitting an Electronic Voting Instruction, bonds will be blocked in the relevant account in the Clearing System until the conclusion of the consent process and subsequent announcement of results (unless the offer is terminated)

Appendix

Steps for Implementation

The steps outlined in the STID Proposal for implementing the Proposals are summarised below

Please note: subject to the outcome of the consent process, the following steps may be partially implemented, may not be implemented or may be implemented in a different order from that outlined below

- 1 • Incorporation of NewCo outside the Financing Group as a direct wholly owned subsidiary of one of AW's non ring fenced companies
- 2 • Transfer of shares in NewCo to AWL to bring NewCo into the Financing Group
- 3 • Transfer of assets and liabilities from Cayco to NewCo
- 4 • NewCo assumes all rights and obligations of Cayco under the Transaction Documents
- 5 • NewCo grants replacement security equivalent to the Security granted by Cayco
- 6 • All Guarantors of Cayco confirm Guarantees remain in effect and apply to the secured obligations / liabilities of NewCo – NewCo also replaces Cayco as Guarantor for obligations / liabilities guaranteed by Cayco
- 7 • Following transfer of assets / liabilities, the entire share capital of Cayco is transferred to another AW group company, outside the Financing Group, where Cayco will be liquidated

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