

CREDIT OPINION

16 December 2024

Update



RATINGS

United Utilities Water Limited

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating
Outlook	Negative

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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United Utilities Water Limited / United Utilities PLC

Update following outlook change to negative

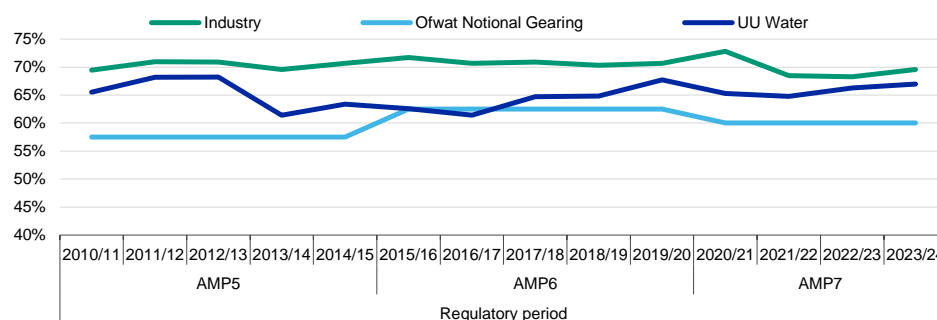
Summary

The credit quality of [United Utilities Water Limited](#) (UU Water, A3 negative) is supported by (1) its position as a monopoly provider of essential water and sewerage in the North West of England; (2) its solid operational performance, particularly on outcome delivery incentives (ODIs) with rewards earned boosting operating cash flow; and (3) its moderate leverage, reflected in net debt to regulatory capital value (RCV) only slightly above regulatory assumptions for both UU Water and its ultimate parent, United Utilities Group PLC (UU).

However, credit quality is constrained by a deterioration of the UK water sector's business risk amid a continuing trend of negative public perception resulting in more regulatory powers, an increased focus on enforcement action, demanding targets, greater penalties for operational underperformance and growing regulatory complexity that, in turn, result in higher cash flow volatility and leaner returns. UU Water's intermediate parent [United Utilities PLC](#) (UU Plc, Baa1 negative) has a weaker credit quality than the operating company as a result of its creditors' structural subordination (though the company has a net cash position).

On 13 November 2024, we [changed the outlook to negative on the group and affirmed the existing ratings](#). This reflects the risk that a final regulatory settlement for the upcoming regulatory period (AMP8, running from 1 April 2025 to 31 March 2030) that is not materially more favourable than Ofwat's draft determination will expose UU Water to the risk of material cost overruns (predominantly on enhancement expenditure) and overall net performance penalties. Without measures to protect credit quality, this would likely result in leverage above our tightened guidance for the current rating levels (not above 60%) given UU's large investment programme in AMP8.

Exhibit 1
UU Water's regulatory gearing has consistently been in the low- to mid-60s in percentage terms
Regulatory gearing ratios as reported by companies to Ofwat



Average gearing as reported, and not reflective of Moody's standard adjustments. Operating company gearing also does not consider any benefit from intercompany receivables as part of cash pooling within the wider group.
Source: Companies' performance reports, Ofwat, Moody's Ratings

Credit strengths

- » Monopoly position for the provision of water and wastewater services, in North West England, operating under a well-established and transparent regulatory regime
- » Track record of maintaining moderate leverage, as measured by net debt to RCV
- » Solid operational performance resulting in net rewards over the current regulatory period which will boost operating cash flow at the start of AMP8
- » Low interest costs, compared to both peers and regulatory assumptions

Credit challenges

- » Challenging draft determination, if adopted, for AMP8 and sizeable investment programme will weigh on financial profile, absent mitigation action
- » UU Water is not currently in focus but ongoing investigation by Ofwat and the Environment Agency into the sector's performance with respect to wastewater assets may result in penalties

Rating outlook

The negative outlook reflects the risk that a final regulatory settlement, expected on 19 December 2024, that is not materially more favourable than Ofwat's draft determination will expose UU Water to the risk of material cost overruns (predominantly on enhancement expenditure) and overall net performance penalties.

Without measures to protect credit quality, this would likely result in credit metrics below our tightened guidance for the current ratings - net debt / RCV not above 60% and an average adjusted interest coverage ratio (AICR) of at least 1.8x over AMP8.

Factors that could lead to an upgrade

Given the deterioration in the sector's business risk profile and the current negative outlook, a rating upgrade is considered unlikely. Nevertheless, we could consider an upgrade, if both UU Water and UU appeared likely to achieve net debt to RCV sustainably below 50% and an AICR consistently above 2.1x. The outlook could be stabilised if UU were to exhibit net debt / RCV no higher than 60% and an AICR of at least 1.8x on average over AMP8.

Factors that could lead to a downgrade

The ratings could be downgraded if UU appeared likely to demonstrate net debt / RCV consistently above 60% or an AICR below 1.8x on average over AMP8.

In addition, downward rating pressure could result from a change in corporate strategy towards higher-risk unregulated activities or a significant increase in business risk for the sector as a result of legal or regulatory changes leading to a further reduction in the stability and predictability of regulated earnings, in each case if not offset by credit enhancing measures. The rating could also be downgraded as a result of unforeseen funding difficulties.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the issuer/deal page on <https://ratings.moody's.com> for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

United Utilities Group PLC

Consolidated group metrics drives rating positioning of UU Water and UU PLC

	2020	2021	2022	2023	2024	2025F
Adjusted Interest Coverage Ratio	2.7x	2.2x	3.0x	1.4x	1.4x	1.4x-1.6x
Net Debt / Regulated Asset Base	61.2%	62.5%	62.7%	60.3%	61.6%	65%-68%
FFO / Net Debt	14.6%	11.2%	11.7%	9.3%	8.9%	9%-11%
RCF / Net Debt	10.6%	7.2%	7.8%	5.5%	5.2%	6%-8%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Periods are financial year-end unless indicated. UU Water's financial year ends on 31 March. Moody's forecasts are Moody's opinion and do not represent the views of the issuer. Ratios for United Utilities Water Limited and United Utilities PLC can be found under the relevant issuer landing page on moodys.com

Source: Moody's Financial Metrics TM

Profile

UU Water is the main operating subsidiary of UU PLC, an intermediate holding company under UU. UU Water is the second largest of 10 water and sewerage companies in England and Wales, with an RCV of almost £14 billion as of 31 March 2024. UU is one of the three publicly listed water and sewerage groups and had a market capitalisation of around £7.5 billion as of 20 November 2024.

Exhibit 3

Operating area of UU Water



Source: Moody's Ratings

Exhibit 4

Price control overview

GB Water	
Regulator/Price Control	Ofwat / AMP7
Term of price control	April 2020 - March 2025
Allowed return (appointee, vanilla CPIH-real)	2.96%
Regulatory Capital Value	£14 billion (March 2024)

Source: Ofwat, Moody's Ratings

Detailed credit considerations

Deterioration in the sector's business risk profile amid growing public, political and regulatory scrutiny

There has been a material and sustained weakening of credit quality for nearly all UK water companies amid continued public scrutiny and heightened political and regulatory focus. Across the sector, previous decisions, such as prioritising affordability and shareholder distributions, have contributed to underinvestment and exacerbated the sector's exposure to changing weather patterns, population growth and shifting expectations. Regulatory targets have become more demanding and penalties for those that fall short have continued to rise. With widespread investigations ongoing, fines for UK water companies breaching environmental legislation are likely to increase further.

In addition, the perception that the water sector is “broken” has prompted a [government-initiated strategic review](#), which aims to improve the regulatory environment and create a stable backdrop to attract investment. However, the review results in greater short-term uncertainty for the sector until it is completed and any potentially credit positive recommendations are successfully implemented.

Given the above considerations, [we have changed our assessment of the stability and predictability of the regulatory environment for the UK water sector under our rating methodology to A from Aa](#).

We believe that the predictability and supportiveness of the regime has reduced regardless of whether the final determination for the next regulatory period (1 April 2025 to 31 March 2030, known as AMP8), expected on 19 December 2024, ultimately results in a more positive outcome for the sector than the draft determination. This assessment reflects a continuing trend of negative public perception resulting in more regulatory powers, an increased focus on enforcement action, demanding targets, greater penalties for operational underperformance and growing regulatory complexity that, in turn, result in higher cash flow volatility and leaner returns. All of these factors are leading to an environment that is less supportive of the water utilities' operations and, therefore, credit negative.

Challenging draft determination

On 11 July 2024, Ofwat published its draft determination for AMP8 which provided a significant downside skew for UU Water, and the sector more widely, on both total expenditure (totex) and outcome delivery incentives (ODIs) - see [Ofwat's draft determination increases sector risk](#), August 2024, for more information. The large proposed cuts to planned expenditure on wastewater expenditure, coupled with challenging performance targets, expose UU Water to the risk of material cost overruns and overall net performance penalties. This would weigh on interest coverage metrics in AMP8 and place upward pressure on leverage at a time the company is undertaking a large investment programme.

The draft determination includes an allowed return of 3.66% (CPIH-deflated) for the wholesale activities, which is above Ofwat's early view (3.23%) that UU applied in its business plan submission¹ and the company's current allowed returns (2.92% on the same basis). However, in its representations to Ofwat's draft determination, UU proposed an allowed return of 4.19% to reflect the downside risk to earning the allowed return and updated market rates (the company had stated in its original submission, in common with other companies, that they believed the allowed equity return was too low). We believe updating Ofwat's methodology for latest data would lead to an allowed return in the range of 3.7% - 4.1%.

Exhibit 5

Allowed returns in AMP8 will be higher than in the current period but UU, in keeping with sector peers, is seeking a material increase from Ofwat's proposals

Components of allowed return (real, CPIH-stripped)

	PR19 (AMP7)		PR24 (AMP8)		
	UU Final Determination	CMA Appeal ¹	Ofwat Final Methodology (Dec 22) + UU business plan	UU Draft Determination (DD) July 24	UU DD Representation ² (Aug-24)
Notional gearing	60%	60%	55%	55%	55%
Existing debt	2.42%	2.47%	2.34%	2.46%	2.41%
New debt	0.53%	0.19%	3.28%	3.36%	3.64%
Existing: new debt ratio	80%	83%	83%	74%	70%
Explicit debt issuance cost	0.10%	0.10%	0.10%	0.15%	0.22%
Company specific adjustment ³					
Cost of debt (pre-tax)	2.14%	2.18%	2.60%	2.84%	2.99%
Risk-free rate	-1.39%	-1.34%	0.47%	1.43%	2.48%
Equity risk premium	7.89%	8.15%	5.99%	5.15%	4.62%
Total market return	6.50%	6.81%	6.46%	6.58%	7.10%
Equity beta	0.71	0.71	0.61	0.60	0.69
Point estimate above mid-point		0.25%			
Cost of equity (post-tax)	4.19%	4.73%	4.14%	4.80%	5.65%
Appointee WACC (vanilla)	2.96%	3.20%	3.29%	3.72%	4.19%
Retail Margin	0.04%	0.08%	0.06%	0.06%	0.09%
Wholesale WACC (vanilla)	2.92%	3.12%	3.23%	3.66%	4.10%
Cash return (appointee)	2.46%	2.75%	3.29%	3.72%	4.19%

Note: The "cash" return in PR19 was lower than the CPIH-stripped allowed return because 50% of the opening RCV was linked to the RPI measure of inflation. [1] Four companies, including Bristol Water, received a higher return following an appeal to the Competition and Markets Authority. [2] UU's Representation reflects the conclusion of a Frontier Economics consultancy report, commissioned by UU, adjusted for Ofwat's regulatory gearing assumption for AMP8 of 55%. [3] Company specific adjustments applied to several small water-only companies in both AMP7 and AMP8.

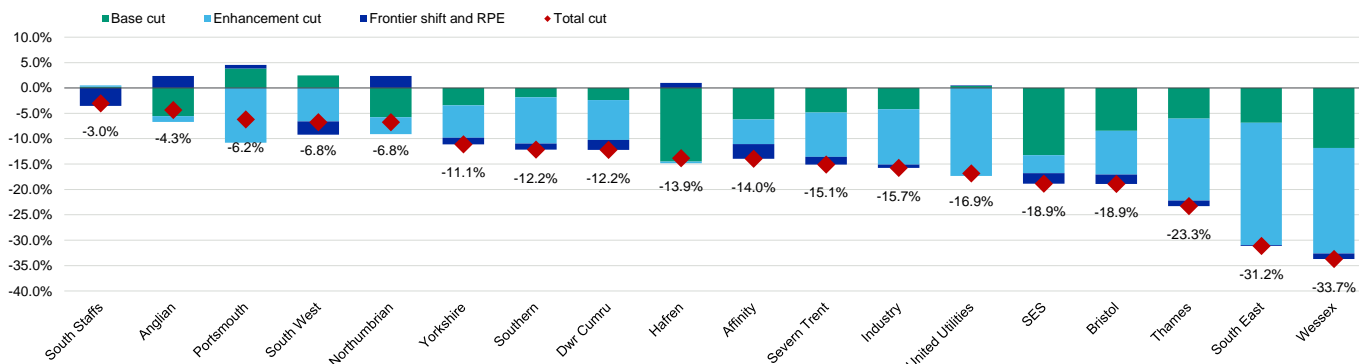
Source: Competition and Markets Authority (CMA), Ofwat, UU and Moody's Ratings

UU's business plan was assessed as standard with no intervention, which would provide a small reward of 5 basis point on the equity return or £16 million overall (in 2022/23 prices). The reward would be added to its opening RCV or AMP8 revenue allowance.

Cost efficiency challenge primarily on enhancement expenditure, which will be materially higher in AMP8 than AMP7

Ofwat's draft determination proposed regulatory cost (total expenditure, totex) allowances of £12.4 billion (pre-adjustments for assumed efficiency gains [frontier shift], 1% per annum compared to 1.1% in the current control, and costs subject to inflation protection [real price effect]), 16.5% below UU Water's request of £14.8 billion in its October 2023 business plan submission (both figures in 2022-23 prices), though this was lowered to £14.2 billion in a variant business plan published in January 2024. This large cut, slightly above the sector average, reflect that (1) the company received one of the largest percentage cuts to its enhancement expenditure request in the sector (32%, or £2.5 billion) but all of its base expenditure request (£7 billion); and (2) its totex request was broadly equally split between the two categories (with the majority of enhancement expenditure pertaining to UU Water's wastewater, rather than water, activities).

Exhibit 6
UU Water's received one of the largest cuts on enhancement expenditure in the sector under Ofwat's draft determination (DD)
 Proposed cost reduction as % of requested amount



Efficiency challenge calculated as cost difference between draft determination and company's plan divided by company's plan costs.
 Source: Ofwat's draft determinations

The uplift to UU Water's requested allowance for base costs would have been nearly 4% without a sizeable cut to the company's request on business rates, which accounted for almost all (£165 million) of the £171 million (15%) reduction in unmodelled costs. This reduces the scope for UU Water to deliver sizeable totex outperformance on base costs in-period (business rates are subject to a materially higher sharing rate, 90%, than all other items of base expenditure, 50%, with the exception energy costs which are subject to ex-post adjustments to reflect real price effects).

Ofwat's proposed cuts, in percentage terms, to UU Water's request for enhancement totex was similar across both water and wastewater. However, the large cuts on storm overflows (by 44% to £1.9 billion from £3.4 billion, both in 2022-23 prices) accounted for nearly 70% of the total cut to requested enhancement expenditure, reflecting that UU has one of the largest programs in the sector. We believe that the majority of the proposed cuts to requested enhancement totex pertain to Ofwat seeking additional justification on either the need, scope or cost of the projects concerned - we estimate the overall cost efficiency challenge could be in the low-to-mid single digits in percentage terms, see Exhibit below.

Exhibit 7

Totex allowance per Ofwat's draft determination (DD) compared with company's business plan (BP) suggests efficiency challenge below 3%

Moody's assessment of driver(s) for difference between requested and proposed totex allowance (all figures in 2022-23 prices)

	Challenge	BP	PR24 DD	Difference	%
Base					
Modelled	Efficiency	5,825	6,050	225	4%
Unmodelled	Efficiency	1,167	996	(171)	-15%
Total base		6,992	7,047	55	1%
Water enhancement					
Supply-demand	Undefined	253	248	(5)	-2%
Metering	Undefined	245	213	(32)	-13%
Drinking water quality	Efficiency/Evidence	289	189	(100)	-35%
Resilience	Efficiency/Evidence	279	137	(142)	-51%
Water WINEP	Undefined	108	78	(30)	-28%
Other	Undefined	57	0	(57)	-100%
Total		1,230	865	(365)	-30%
Wastewater enhancement					
Nutrients	Undefined	972	963	(9)	-1%
Storm overflows	Evidence/Scope	3,372	1,875	(1,498)	-44%
Other WINEP	Undefined	1,409	1,220	(188)	-13%
Resilience	Undefined	39	35	(4)	-10%
Other	Efficiency/Evidence	815	371	(444)	-54%
Total		6,607	4,464	(2,144)	-32%
Total enhancement		7,837	5,329	(2,508)	-32%
Overall totex challenge		14,829	12,376	(2,453)	-17%
Estimated efficiency challenge				(343)	-2%
Additional challenge subject to evidence/scope/undefined				(2,166)	-15%
Frontier shift and RPE		(380)	(363)	17	0%
Overall totex challenge post frontier shift		14,449	12,013	(2,436)	-17%

Source: Ofwat draft determinations, Moody's Ratings

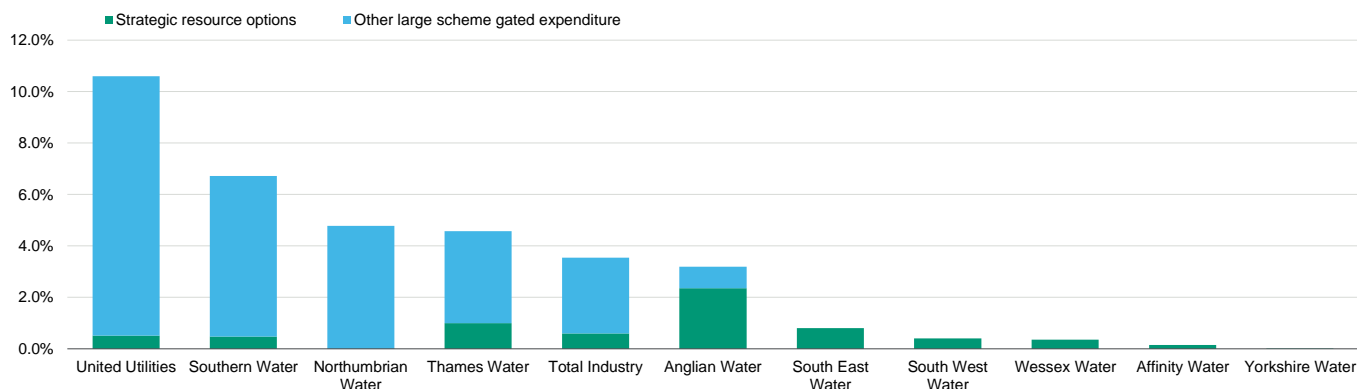
The introduction of a lower totex incentive rate on enhancement expenditure than base expenditure in AMP8 (either 25% or 40% as compared to a flat 50% in the current AMP) reduces UU Water's exposure at the end of the period (when the true-up to RCV takes place) to differences between out-turn and allowed enhancement expenditure. However, totex allowances for projects in the three areas of enhancement expenditure subject to the 25% incentive rate - those with the greatest uncertainty on cost (strategic resources, large complex projects and the industrial emissions directive) - will be subject to either "enhanced engagement" or a more structured assessment. Here, companies must submit detailed plans for proposed investments in stages or "gates".

Gated investments account for over 10% of UU Water's overall totex allowance, the highest percentage in the sector (see Exhibit 8 below) and may not be included in upfront allowances but reflected via an end-of-period true-up adjustment. The company will have to pre-fund such capital spending over the AMP8 period, increasing leverage and depressing cash-flow based credit metrics, before being remunerated for this investment from the start of the next regulatory period (AMP9, which will commence on 1 April 2030).

Exhibit 8

UU Water has the largest proportional exposure to gated investments in the sector

Proportion of gated allowances in relation to overall DD allowed totex, post-frontier shift and RPE adjustments (includes strategic resources)



Source: Ofwat's draft determinations

In its draft determination representation², UU Water provided additional evidence on its original costs submission and increased its totex request by £0.65 billion (4.4%, sector average 7.7%), reflecting both higher base costs (including on business rates) and enhancement expenditure (on storm overflows) to meet additional requirements. UU also sought a material reduction in gated investments citing that most of its allowances pertain to four large projects (WINEP schemes) which have already been approved by the Environmental Agency (EA).

While UU Water's final totex allowances will be materially higher than in the current regulatory period (£5 billion of base and £0.8 billion of enhancement, in 2017-18 prices, was approved at the final determination), we believe UU Water will be able to deliver the required step-up in investment levels. This reflects that since its final determination for AMP7 UU Water has brought forward over £1 billion (in 2017-18 prices) of AMP8 investments into the current AMP, around 20% of its original wholesale totex allowance for the period, and taken steps to ensure it has the requisite supply chain capabilities.

The cost of the additional investments will be recovered through regulatory mechanisms, i.e. through a sizeable upwards adjustments to UU's RCV at the end of the current AMP, but has led to the company reporting material overspend against regulatory allowances during the current period.

The Haweswater Aqueduct Resilience Programme (HARP) project, which plays a key role in UU Water's resilience strategy given the aqueduct provides around one third of the company's total distribution input, will be provided by a third party under the new direct procurement for customers (DPC) framework (see highlight box below) with UU receiving £57 million (in 2017-18 prices) for preparatory works in the current AMP.

Large projects considered for DPC framework

During the 2019 regulatory price review, Ofwat introduced a new framework for the provision of major discrete water and wastewater infrastructure projects through third party providers, the so-called Direct Procurement for Customers (DPC).

UU Water's Haweswater Aqueduct Resilience Programme (HARP) project is one of the first investment projects to be considered under the DPC framework (Ofwat issued the DPC designation in December 2021).

The existing aqueduct is the largest potable water aqueduct by capacity and length in England and Wales. It is a key strategic asset to ensure water supply within UU Water's region, supplying 570ML per day to Manchester, Cumbria, the Pennines and Lancashire across 19 offtakes, providing roughly one third of the company's total distribution input. The asset consists of ca. 52 kilometres of single line tunnel sections and 47 kilometres of pressured single- and multi-line siphons. The existing aqueduct was completed post-World War 2, built between 70-90 years ago during a period of material and skill shortages, and – given the age and condition of the asset – UU Water has identified material resilience risks, in particular with the six tunnel sections.

The DPC project will include design, construction, testing, commissioning, planned and corrective maintenance of the tunnel assets as well as financing of these activities under a 25-year project agreement. The estimated DPC project value could exceed £2.0 billion of construction costs. In November 2022, UU shortlisted three bidding consortia to participate in the tender process

In November 2022, UU shortlisted three bidding consortia to participate in the tender process.³ We understand that, following preferred bidder appointment, the contract for the HARP project will be awarded in the first half of calendar 2025 with construction works commencing shortly thereafter.

Construction risk will be largely passed on to the construction counterparties of the DPC provider. However, UU Water may carry responsibility for certain risks for activities within its control. Under Ofwat's guidance for DPC arrangements, we expect risks, which UU Water will have to bear under the DPC contractual agreements but are outside of its control, would be passed on to customers. While any material unmitigated risk that was retained by the company could adversely affect credit quality, we currently assume that any such retained construction risk would be adequately compensated under the regulatory regime.

Likely accounting treatment and considerations around calculation of key ratios

We expect that if the HARP project is delivered under the DPC framework and built, financed and maintained by a special purpose vehicle (SPV) for a certain period of time, it will likely fall under the definition of a lease under IFRS16 accounting standards.

Once a new tunnel section becomes available for use, a lease liability and corresponding right of use asset would be recognised on UU Water's balance sheet, and the lease liability would be included in UU Water's and the consolidated group's net debt position. However, the asset would not become part of UU Water's RCV as long as it is owned and maintained by a project SPV under the DPC framework.

Based on the current project timetable, it is expected that all the tunnel sections will be put into operational use over the course of AMP9 (which will run from 1 April 2030 to 31 March 2035). As such, the associated lease liability and right of use asset will increase with each additional tunnel put into operational use, peak when all tunnels are operational, and then decline in subsequent regulatory periods.

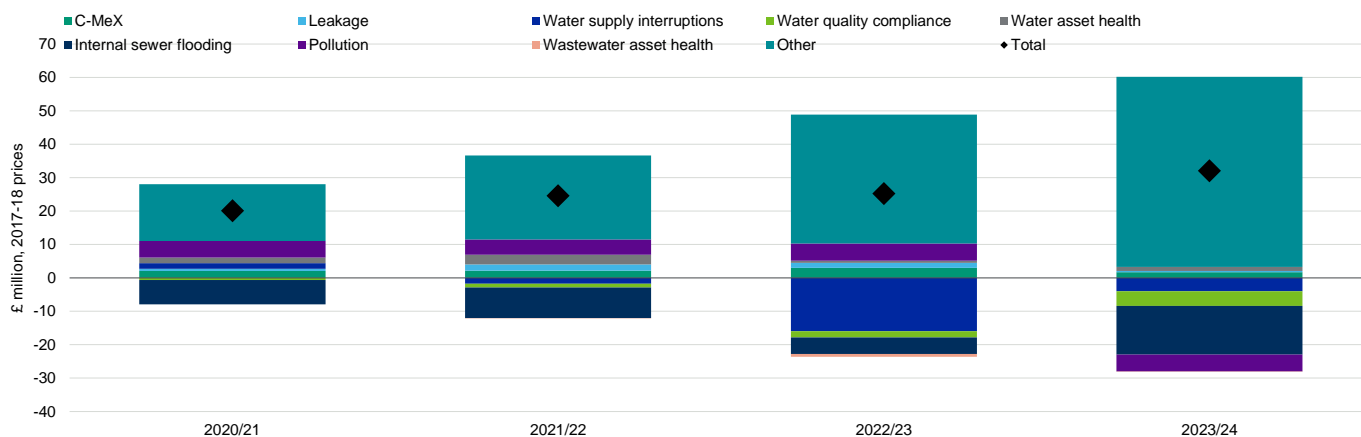
In assessing UU Water's and the wider UU Group's financial risk profile, we envisage to add the reported IFRS16 lease asset or liability⁴ to UU Water's RCV. This would allow us to look at the financial metrics of the group in a way that is broadly comparable to a self-funding approach. It also reflects the importance of the asset to UU Water's operations as well as the likelihood that it would ultimately become part of the company's RCV at the end of any DPC project agreement (through the applicable regulatory price review process at that time). We note, however, that, depending on the gearing profile of the project SPV and the size of the project relative to the company's RCV at the time of lease recognition, this approach may result in a modest loss of financial flexibility for UU Water and the UU Group with respect to Moody's ratio guidance.

Our prevailing ratio guidance will continue to reflect the key drivers of UU's credit quality. These include, but are not limited to, the sector's business risk profile, UUW's operational performance and developments with the HARP project (both pre- and post it being recognised on UU's balance sheet).

Net rewards for strong operational performance in AMP7 to-date but reduced scope for material rewards in AMP8

Despite challenging targets on outcome delivery incentives (ODIs) in AMP7, where only the top quartile performers can achieve a reward, UU Water has earned sizeable net rewards, which are paid with a two year lag. This reflects that rewards earned for company-specific ODIs (£138 million, in 2017-18 prices, over the first four years of AMP7) have far exceeded those on sector-wide measures, including customer service metrics, where UU has accrued net penalties (£36 million, all attributable to internal sewer flooding, where sewerage enters a customer's property, with the company net neutral on other ODIs). The net rewards earned (£102 million in 2017-18 prices) have boosted operating cash flow in the current AMP and will support interest coverage metrics at the start of AMP8. We expect net rewards received in the first two years of AMP8 will total around £65-70 million (in 2017-18 prices) and add over 0.1x to AICR in these years.

Exhibit 9
UU Water has accrued sizeable net rewards over AMP7
 Breakdown of annual ODI rewards/penalties by area



ODIs here include customer service. Ofwat's final decision on amended PCC targets for AMP7 will be made as part of its AMP8 final determination. Data represents Ofwat determination of ODI performance.
 Source: Ofwat

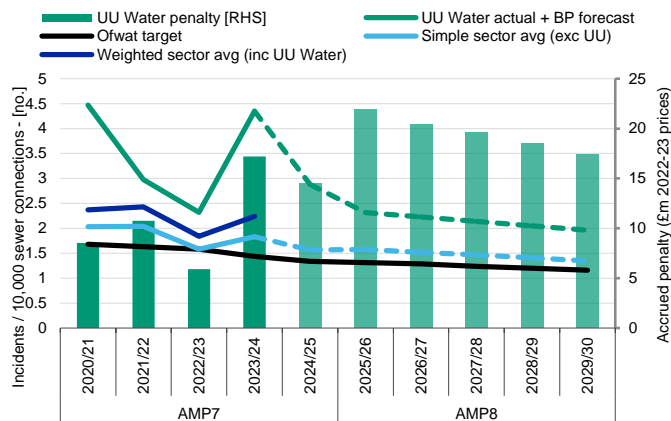
This strong operational performance reflects UU Water's investments in measures to improve performance levels, e.g. the company reinvested £100 million of outperformance in the prior regulatory period (AMP6) in FY2019/20 to help it meet some of its most stretching targets in AMP7. We expect the acceleration of its original AMP8 investment programme (i.e. bringing over £1 billion of investments into AMP7), coupled with the timely delivery of its AMP7 programme (many peers backloaded enhancement expenditure during the control), will support operational performance in AMP8.

Although Ofwat has slightly relaxed the demanding regulatory benchmark on ODIs for AMP8 (to above the industry median, based on companies' plans) the regulator has proposed materially stronger reward and penalty rates for commitments linked to environmental, asset health and customer service performance and tightened some performance commitment levels compared to regulatory submissions.

If targets remain unchanged and the company performs in line with its regulatory submissions, this would likely lead to substantial net penalties over AMP8 which would depress operating cash flow from FY2027/28 onwards. The largest penalties would be incurred for internal sewer flooding, followed by bathing water quality, which would more than offset expected rewards on external sewer flooding and pollution incidents. In its draft determination representation, UU is proposing adjustments to how certain regulatory targets are set, including for internal sewer flooding, where it proposes to take account of inherent differences between service territories and the impact of severe weather, and bathing water quality.

Exhibit 10

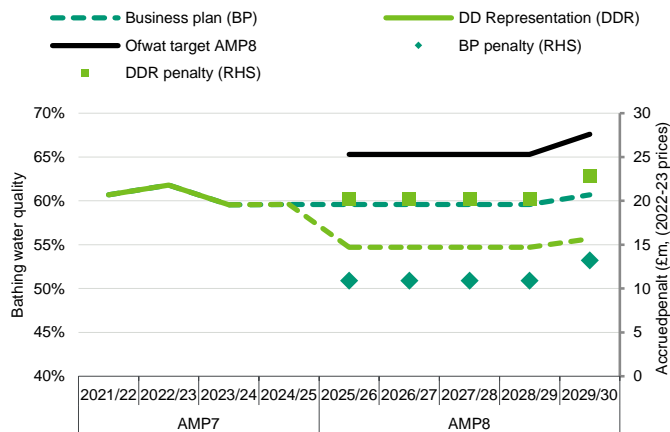
UU Water expects to accrue larger penalties for internal sewer flooding in AMP8 than AMP7
Performance on internal sewer flooding performance commitment



BP = October 2023 business plan
 Source: Ofwat, Company business plan submissions, Moody's Ratings

Exhibit 11

Like sector peers, UU Water now expect lower bathing water quality scores in AMP8 than originally forecast, in turn increasing projected penalties
Comparison of business plan (BP) and draft determination representation (DDR)



Bathing water quality score is derived using a weighted average of four category scores and has a range of 0% - 100%
 Source: Ofwat, Company business plan submissions, Moody's Ratings

Pollution investigations ongoing, but UU Water currently not in focus

In [November 2021](#), the UK government's Environment Agency (EA) launched an investigation into more than 2,000 sewage treatment works across all wastewater companies in England, "after new checks led to water companies admitting that they could be releasing unpermitted sewage discharges into rivers and watercourses." At the same time, Ofwat commenced a parallel investigation into sewage discharges from wastewater treatment works.

In [November 2022](#), Ofwat stated that it had opened enforcement cases against six companies, including Anglian Water, and, In July 2024, the regulator confirmed that all wastewater companies in England and Wales are now subject to open enforcement activities. [Three companies received provisional fines totalling £168 million](#) on 6 August 2024 and we expect further penalty proposals to be issued over the coming months.

We currently view the risk of material unforeseen fines as lower for UU Water than for some of its peers. The company has achieved a three or four star ranking, defined as a good company or industry leading, respectively, in the EA's annual environmental performance assessment for the English Water companies since 2011 and returned to a four star rating in the EA's most recent assessment.⁵

In August 2022, the UK Government's Department for Environment, Food and Rural Affairs (DEFRA) published its [Storm Overflow Discharge Reduction Plan](#). The plan requires English wastewater companies to invest to reduce discharges from combined sewer overflows, which was estimated at £56 billion between 2025 and 2050 in the plan.⁶ While the investment will be over 25 years, the proposed amount is large, and not equally split across all companies. UU Water will be one of the companies most affected and is forecast to carry around a third or almost £20 billion of the expected investment over the next 25 years, equivalent to around 1.5 times of its RCV as of March 2024.

Evolution of key credit metrics in AMP8 dependent on final determination and future financial policy

The evolution of UU's financial profile in the coming regulatory period will depend on (1) the final regulatory settlement, in particular key parameters such as allowed returns, regulatory cost allowances, and regulatory targets and incentive rates on ODIs; (2) operational performance during the AMP; and (3) future financial policy.

We believe that if the final regulatory settlement, expected on 19 December 2024, is not materially more favourable than Ofwat's draft determination, UU Water will be exposed to the risk of material cost overruns (predominantly on enhancement expenditure) and overall net performance penalties. Without measures to protect credit quality, this would likely result in credit metrics below our tightened guidance levels for the current ratings (an average AICR of at least 1.8x in AMP and net debt / RCV not above 60%).

We expect that UU will be able to maintain an average AICR of at least 1.8x in AMP8 in a scenario where operational performance is in line with the regulatory settlement. This reflects that interest coverage metrics will be supported by the company's continued low interest costs, compared to both peers and regulatory assumptions, and, at the start of the period, the receipt of sizeable performance rewards earned in the current regulatory period (paid with a two year lag). The UU Group's average cash interest cost was around 2% as of March 2024, supported by the high proportion of index-linked debt within UU Water's capital structure (45% as of March 2024, of which over 70% was RPI-linked with the remainder CPI-linked). UU Water's regulatory gearing has been, on average, nearly four percentage points lower than the sector average over the first four years of AMP7.

UU's current financial and dividend policy is to maintain consolidated group net debt to RCV in the range of 55-65% and to grow the dividend in line with prevailing CPIH inflation. In the current AMP, UU's reported consolidated gearing has been in the middle of its published range and slightly higher on a Moody's adjusted basis. This difference reflects that UU, like listed sector peers, include future RCV true-ups in their measure of RCV while Ofwat only formally recognise these at the end of the AMP (through the so-called 'midnight adjustment').

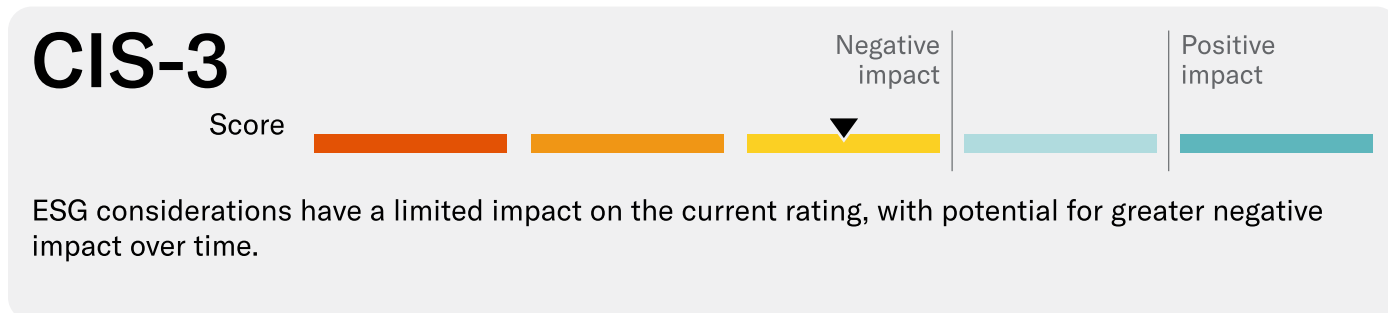
Given UU's current gearing and UU Water's aforementioned large investment programme, we expect the company will need to take mitigating action to maintain gearing at or below 60% in AMP8. We expect UU to provide clarity on its capital structure and future financial framework for AMP8 when it announces whether it will appeal its final regulatory determination to the Competition and Markets Authority (CMA). We expect the deadline for making an appeal will be 17 February (60 days after the final determination is published).

ESG considerations

United Utilities Water Limited's ESG credit impact score is CIS-3

Exhibit 12

ESG credit impact score

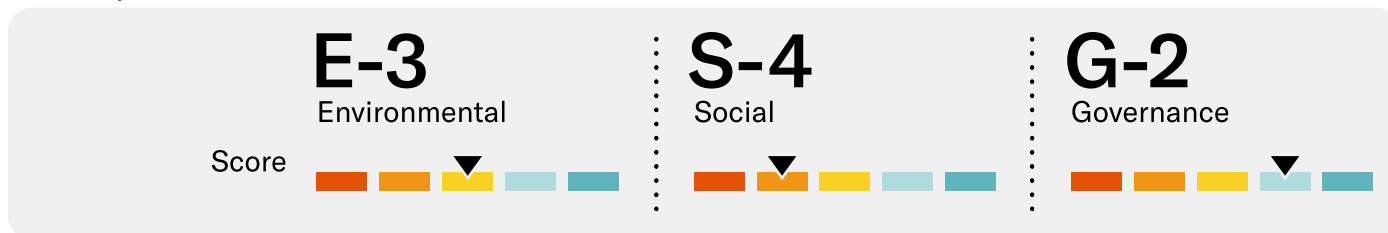


Source: Moody's Ratings

The **CIS-3** ESG Credit Impact Score for United Utilities PLC (UU) and its subsidiary United Utilities Water Limited (UU Water) indicates that ESG considerations have a limited impact on the current credit ratings with potential for greater negative impact over time. This reflects the companies' exposure to water management and pollution risks, but also recognises mitigating factors, in particular the regulated nature of water companies' activities and their investment requirements, including a forward-looking allowance for efficient cost. However, as investment needs continue to grow to tackle climate change and population growth, the resulting increase in regulated assets and their remuneration will have to continue to be supported by the regulatory tariff framework in order to avoid negative credit implications in the future.

Exhibit 13

ESG issuer profile scores



Source: Moody's Ratings

Environmental

UU Water's **E-3** score primarily reflects the company's moderate risk exposure to water management and natural capital, which both also take into account the effects of water pollution. According to an analysis by the UK government's Environment Agency (EA), overall water supply in England will need to increase by around 25% between 2025 and 2050. The Water Resources West region, which includes UU Water's service territory, will require an additional 640 million litres a day by 2050 (roughly 13% of current distribution input), but has some excess water available and – with further efficiency measures – could free up more water for cross-regional transfer. As a wastewater company, UU Water is also exposed to the risk of pollution and associated fines. In November 2021, the UK government's Environment Agency and water regulator Ofwat launched investigations into wastewater treatment works, with companies more at risk of greater penalties than in the past. However, UU Water is among the strongest performers, achieving the maximum (four star) rating (industry leading) in the Environment Agency's 2023 environmental performance report, published in July 2024.

Social

UU Water's **S-4** score reflects elevated risk that public concern over environmental, social or affordability issues could lead to adverse regulatory or political intervention. While the risk is common to all regulated utilities, it is particularly acute for UK water companies,

with public perception at an all-time low and heightened scrutiny over operational performance and dividend payments. Materially growing investment requirements to improve environmental performance and increase drought resilience will require bills to rise, exacerbating affordability concerns. The risks associated with societal trends and responsible production are balanced by UU Water's solid performance track record.

Governance

The **G-2** score reflects the widely diversified ownership and relatively simple corporate structure of the listed UU Group PLC as well as a balanced financial and dividend policy. In the context of UU's main operating subsidiary, UU Water, we also take into account regulatory requirements that ensure that independent directors account for the largest single group on the company's board and the company's regulatory licence prescribing a minimum credit profile. The moderate risk score for compliance and reporting reflects an ongoing investigation by the regulator and the UK's Environment Agency into potentially illegal wastewater discharges into rivers by the wastewater companies in England and Wales.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moody's.com. In order to view the latest scores, please click [here](#) to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Liquidity analysis

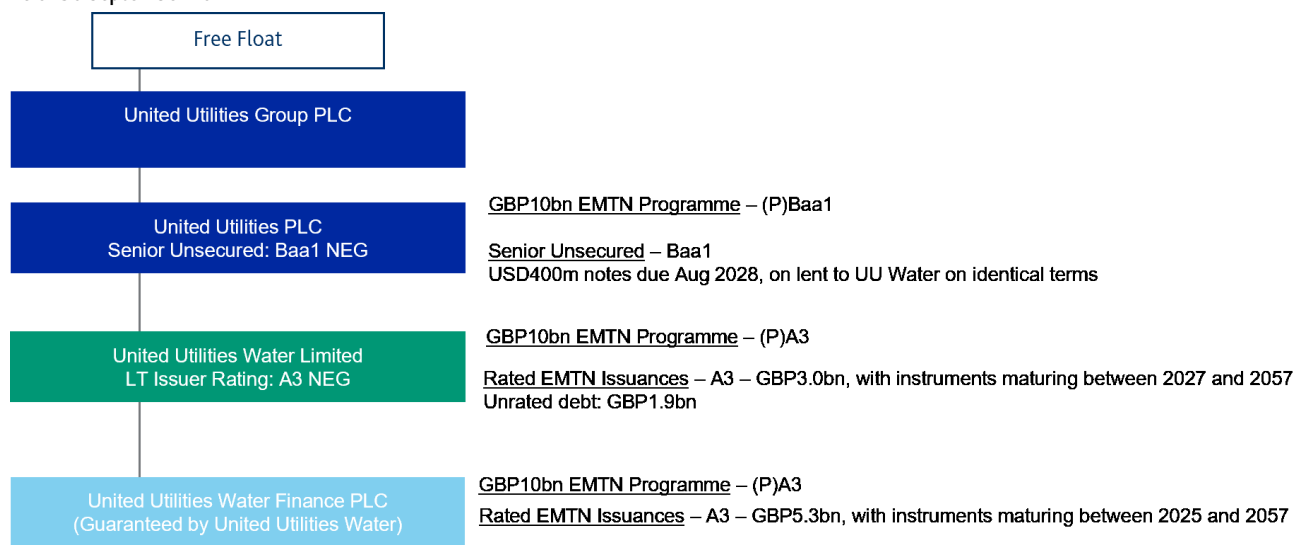
The UU Group demonstrates a solid liquidity profile, underpinned by the stable and predictable cash flow generated by its regulated utility activity. As of 30 September 2024, the group had cash and short-term deposits of around £1.8 billion, with a further £106 million of net proceeds received from funding raised in October 2024, and undrawn amounts under medium-term committed bank facilities of around £800 million. The currently available liquidity is sufficient to cover the group's overall requirements until at least March 2026.

Structural considerations

The current A3 rating for UU Water and its guaranteed financing subsidiary [United Utilities Water Finance PLC](#) takes into account the consolidated financial profile of the UU Group. The one-notch differential between A3-rated UU Water and Baa1-rated UU reflects the structural subordination of holding company debt relative to the operating company debt.

Exhibit 14

Debt structure at United Utilities Group As of 30 September 2024



The £68 million of lease liabilities and £10 million of book overdrafts have not been allocated to group entities.

Source: Company reports, Moody's Ratings

Rating methodology and scorecard factors

Our assessment of UU Water's and UU's credit quality is based on our Regulated Water Utilities rating methodology. The below scores represent the positioning of UU Water, which generates almost all of the underlying group's operating profit, against the qualitative factors, but in assessing the company's credit quality we also take into account the debt at the wider UU Group.

The below scorecard includes 0.5 notches of uplift from regulatory ring-fencing provisions, which UU Water benefits from as part of its licence. However, such uplift does not apply to the holding company within the group. The consolidated credit quality of the wider group is reflected within the A3 rating assigned to the operating company, while the Baa1 rating of UU reflects structural subordination of creditors at the holding company.

Exhibit 15

Rating factors

United Utilities Water Limited

Regulated Water Utilities Industry Scorecard	Current FY Mar-24		Moody's 12-18 Months Forward View	
	Measure	Score	Measure	Score
Factor 1 : Business Profile(50%)				
a) Stability and Predictability of Regulatory Environment	A	A	A	A
b) Asset Ownership Model	Aa	Aa	Aa	Aa
c) Cost and Investment Recovery (Sufficiency & Timeliness)	A	A	A	A
d) Revenue Risk	Aa	Aa	Aa	Aa
e) Scale and Complexity of Capital Programme & Asset Condition Risk	A	A	A	A
Factor 2 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 3 : Leverage and Coverage (40%)				
a) Adjusted Interest Coverage Ratio (3 Year Avg)	1.7x	Baa	1.9x - 2.0x	Baa
b) Net Debt / Regulated Asset Base (3 Year Avg)	65.9%	Baa	66% - 69%	Baa
c) FFO / Net Debt (3 Year Avg)	9.0%	Ba	8% - 10%	Ba/Baa
d) RCF / Net Debt (3 Year Avg)	5.3%	Ba	7% - 9%	Baa
Rating:				
Scorecard-Indicated Outcome Before Notch Lift		Baa1		Baa1/A3
Notch Lift		0.5		0.5
a) Scorecard-Indicated Outcome		Baa1		Baa1/A3
b) Actual Rating Assigned				A3

All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Moody's forecasts for FY2024/25 are Moody's opinion and do not represent the views of the issuer.

Source: Moody's Financial Metrics™ and Moody's Ratings forecasts

Exhibit 16

Rating factors

United Utilities PLC

Regulated Water Utilities Industry Scorecard	Current FY Mar-24		Moody's 12-18 Months Forward View	
Factor 1 : Business Profile (50%)	Measure	Score	Measure	Score
a) Stability and Predictability of Regulatory Environment	A	A	A	A
b) Asset Ownership Model	Aa	Aa	Aa	Aa
c) Cost and Investment Recovery (Sufficiency & Timeliness)	A	A	A	A
d) Revenue Risk	Aa	Aa	Aa	Aa
e) Scale and Complexity of Capital Programme & Asset Condition Risk	A	A	A	A
Factor 2 : Financial Policy (10%)				
a) Financial Policy	Baa	Baa	Baa	Baa
Factor 3 : Leverage and Coverage (40%)				
a) Adjusted Interest Coverage Ratio (3 Year Avg)	1.7x	Baa	1.9x - 2.0x	Baa
b) Net Debt / Regulated Asset Base (3 Year Avg)	62.2%	Baa	63% - 66%	Baa
c) FFO / Net Debt (3 Year Avg)	9.6%	Ba	9% - 11%	Ba/Baa
d) RCF / Net Debt (3 Year Avg)	5.8%	Ba	8% - 10%	Baa/A
Rating:				
Scorecard-Indicated Outcome Before Notch Lift		Baa1		Baa1/A3
Notch Lift		0		0
a) Scorecard-Indicated Outcome		Baa1		Baa1/A3
b) Actual Rating Assigned				Baa1

All ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Moody's forecasts for FY2024/25 are Moody's opinion and do not represent the views of the issuer.

Source: Moody's Financial MetricsTM and Moody's Ratings forecasts

Ratings

Exhibit 17

Category	Moody's Rating
UNITED UTILITIES WATER LIMITED	
Outlook	Negative
Issuer Rating	A3
Senior Unsecured	A3
PARENT: UNITED UTILITIES PLC	
Outlook	Negative
Senior Unsecured	Baa1
UNITED UTILITIES WATER FINANCE PLC	
Outlook	Negative
Bkd Senior Unsecured	A3

Source: Moody's Ratings

Appendix

Exhibit 18

United Utilities Water Limited
Peer Comparison

(in £ millions)	United Utilities Water Limited A3 Negative			United Utilities PLC Baa1 Negative			Severn Trent Water Limited Baa1 Stable			Northumbrian Water Ltd. Baa1 Negative		
	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY	FY	
	Mar-22	Mar-23	Mar-24	Mar-22	Mar-23	Mar-24	Mar-22	Mar-23	Mar-24	Mar-22	Mar-23	Mar-24
Revenue	1,845	1,799	1,948	1,863	1,804	1,950	1,809	1,966	2,122	780	861	919
EBITDA	1,003	859	935	1,039	925	1,051	935	901	892	302	345	385
Regulated Asset Base (RAB)	12,336	13,414	13,969	12,336	13,414	13,969	10,261	11,325	11,899	4,613	5,161	5,509
Total Debt	8,371	9,025	10,451	8,064	8,528	10,107	6,536	7,351	7,980	3,233	3,857	4,098
Net Debt	8,189	8,787	9,195	7,823	8,188	8,708	6,458	7,342	7,554	3,173	3,701	4,048
Adjusted Interest Coverage Ratio	2.9x	1.4x	1.2x	3.0x	1.3x	1.3x	1.7x	1.2x	1.0x	1.4x	0.8x	0.7x
FFO / Net Debt	10.8%	8.4%	8.0%	11.4%	9.0%	8.5%	10.6%	8.8%	8.2%	7.7%	5.9%	5.7%
RCF / Net Debt	6.7%	3.2%	6.0%	7.6%	5.3%	4.8%	8.3%	3.0%	4.2%	-3.0%	2.9%	4.1%
Net Debt / Regulated Asset Base	66.4%	65.5%	65.8%	63.4%	61.0%	62.3%	62.9%	64.8%	63.5%	68.8%	71.7%	73.5%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations.

Source: Moody's Financial Metrics TM

Exhibit 19

United Utilities Water Limited
Moody's-adjusted net debt breakdown

(in £ millions)	2020	2021	2022	2023	2024
As Reported Total Debt	9,029	8,716	8,371	9,025	10,451
Leases	0	0	0	0	0
Non-Standard Public Adjustments	(618)	(407)	0	0	0
Moody's Adjusted Total Debt	8,411	8,309	8,371	9,025	10,451
Cash & Cash Equivalents	(502)	(649)	(182)	(238)	(1,256)
Moody's Adjusted Net Debt	7,910	7,660	8,189	8,787	9,195

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Periods are financial year-end unless indicated. UU Water's financial year ends on 31 March.

Non-standard adjustments relate primarily to the removal of derivatives held in fair value hedge relationships or as cross currency hedges. Adjustment is only made, where material.

Source: Moody's Financial Metrics TM

Exhibit 20

United Utilities Water Limited
Moody's-adjusted Funds From Operations (FFO) breakdown

(in £ millions)	2020	2021	2022	2023	2024
As Reported Funds from Operations (FFO)	816	826	850	755	778
Pensions	86	3	1	3	6
Leases	0	0	0	0	0
Capitalized Interest	(41)	0	0	0	0
Alignment FFO	(92)	(86)	(138)	(539)	(296)
Unusual Items - Cash Flow	(11)	0	(82)	0	0
Non-Standard Public Adjustments	263	54	256	520	252
Moody's Adjusted Funds from Operations (FFO)	1,022	797	887	738	739

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Periods are financial year-end unless indicated. UU Water's financial year ends on 31 March.

Non-standard adjustments relate primarily to accretion of index-linked debt and, prior to 2021, the reclassification of IRE expenditure.

Source: Moody's Financial Metrics TM

Exhibit 21

United Utilities Water Limited

Selected historical Moody's-adjusted financial data

(in £ millions)	2020	2021	2022	2023	2024
INCOME STATEMENT					
Revenue	1,850	1,798	1,845	1,799	1,948
EBITDA	1,259	1,012	1,003	859	935
EBITDA margin %	68.1%	56.3%	54.4%	47.7%	48.0%
EBIT	650	608	603	453	513
EBIT margin %	35.1%	33.8%	32.7%	25.2%	26.3%
Interest Expense	266	195	379	653	481
BALANCE SHEET					
Cash & Cash Equivalents	502	649	182	238	1,256
Total Assets	13,095	13,123	13,944	14,044	15,276
Total Liabilities	11,060	10,776	11,781	12,517	13,997
CASH FLOW					
Funds from Operations (FFO)	1,022	797	887	738	739
Cash Flow From Operations (CFO)	1,030	944	870	794	744
Dividends	513		339	454	189
Retained Cash Flow (RCF)	509	797	548	284	550
Capital Expenditures	(781)	(635)	(628)	(689)	(737)
Free Cash Flow (FCF)	(264)	310	(97)	(349)	(182)
INTEREST COVERAGE					
EBITDA / Interest Expense	4.7x	5.2x	2.6x	1.3x	1.9x
Adjusted Interest Coverage Ratio	2.5x	2.0x	2.9x	1.4x	1.2x
LEVERAGE					
Debt / EBITDA	6.7x	8.2x	8.3x	10.5x	11.2x
Net Debt / EBITDA	6.3x	7.6x	8.2x	10.2x	9.8x
Debt / Book Capitalization	71.1%	69.0%	66.4%	72.1%	76.8%
Regulated Asset Base (RAB)	11,791	11,681	12,336	13,414	13,969
Net Debt / Regulated Asset Base	67.1%	65.6%	66.4%	65.5%	65.8%
FFO / Net Debt	12.9%	10.4%	10.8%	8.4%	8.0%
RCF / Net Debt	6.4%	10.4%	6.7%	3.2%	6.0%

All figures and ratios are based on adjusted financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Periods are financial year-end unless indicated. UU Water's financial year ends on 31 March.

Source: Moody's Financial Metrics TM

Endnotes

- 1 See <https://www.unitedutilities.com/business-plan-documentation#:~:text=PR24%20Business%20plan%20update%20%E2%80%93%20October%202023&text=What's%20clear%20is%20that%20we,healthier%20North%20West%20for%20everyone.>
- 2 Representation documents submitted in August 2024 are available at <https://www.unitedutilities.com/corporate/about-us/our-future-plans/our-business-plan-submissions/our-business-plan-submissions-for-2020-21-2024-25/proposed-plan-supplementary-documents/Representation-documents/>
- 3 These were (1) HARP Community Connectors: Acciona, Dragados and Iridium; (2) More Water: FCC Construcción, SNC-Lavalin, FCC Aqualia, Webuild and BeMo Tunnelling; and (3) Strabag-Equitix Consortium
- 4 Assuming a typical project finance structure with project gearing of around 90%, the difference between these two approaches is likely to be minimal.
- 5 Please see: <https://www.gov.uk/government/publications/water-and-sewerage-companies-in-england-environmental-performance-report-2023>
- 6 Policy on water and wastewater services is devolved to the regions, and the Welsh Government is responsible for companies operating in Wales.

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