

Andrew Beaver  
Director of Regulation and Assurance  
Northumbrian Water Limited  
Northumbria House  
Pity Me  
Durham  
DH1 5FJ

28 September 2023

Dear Andrew,

**PR24 Financeability Assessment: Assurance**

We have examined the way in which Northumbrian Water (NWL) has approached the assessment of its ability to finance its activities during the period 2025-30. We have also examined the conclusions that NWL has drawn from its analysis as it relates to the ability of the Directors to sign the assurance statement in respect of financeability.

Our view is that NWL has adopted an appropriate overall methodology:

- NWL has focused its analysis on Ofwat's notional company and a notional level of gearing;
- NWL has considered its ongoing ability to obtain new debt finance by modelling the financial ratios that ratings agencies refer to when assigning ratings to water company debt. The assumptions feeding into this modelling, as regards gearing levels, revenues, dividends and interest costs, as laid out in the populated financial model, follow logically from NWL's business plan. The thresholds that NWL uses for a BBB+/Baa1 rating are also reasonable; and
- NWL has considered its ability to access new equity finance by comparing its expected return to its cost of capital and by examining other relevant equity metrics. The assumptions feeding into the quantification of expected returns, as regards revenues, expenditures, interest costs and service performance, are identified clearly. NWL has also clearly laid out its estimate of the cost of equity capital.

Our assessment is that NWL has been able to arrive at robust conclusions in relation to its ability to finance its activities:

- NWL's assessment of its ability to access new debt finance follows logically from its assessment of its ability to maintain at least a BBB+/Baa1 rating, which

in turn is based on an appropriate comparison of its projected financial ratios to the relevant ratings agency thresholds; and

- NWL's assessment of its ability to access new equity finance follows logically from its comparison of its expected return to its estimate of the cost of equity capital.

Taking the above into account, we agree that the Directors' conclusion that the appointee is not likely to be able to finance its activities if Ofwat applies the 'updated early view WACC' is rational and well justified. We also agree that the Directors' conclusion that the appointee is likely to be able to finance its activities if Ofwat applies the 'NWL Alternative WACC' is rational and well justified.

Yours sincerely,



**John Earwaker**  
**Director**