Appendix SA09-A06
RIIO-ED2 Investor Questionnaire Responses

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Appendix A06 - RIIO-ED2 Bank Investor Questionnaire - Responses

As part of the process of assessing the financeability of our RIIO-ED2 plan we consulted with our core banking group and some of our key investors. This questionnaire sets out the questions designed to gather key feedback from our investor community, and a summary of responses, on an anonymous basis.

As can be seen from the following results investors expect RIIO-ED2 will clearly facilitate the DNOs to deliver their work to support the Government's net zero legislated requirements. Investors are expecting RIIO-ED2 to provide the required investment in a timely way to DNOs in RIIO-ED2 to facilitate a range of future scenarios. In the RIIO-ED2 SSMD, Ofgem recognised the additional uncertainty faced by electricity distribution in delivering net zero and set out that Ofgem "will set allowances for investment in the networks, but we must do so in a way that enables plans to flex so that any pathway to Net Zero can be supported"[1].

1. What specifics does your institution take into account when investing in the UK Electricity Distribution sector?
• Regulatory risk, nationalisation risk (less so following the recent General election), broader credit fundamentals, financeability of individual companies and leverage, long-term sector horizon, ESG considerations and alignment with bank strategy, Pricing and returns • Allowed regulatory returns, allowed regulatory asset growth, length of regulatory period, WACC. Regulatory penalties and incentives and bias towards upside or downside. Creditworthiness and external credit rating of the entity, total asset size and RAB of the entity, gearing level of the entity, interest cover, operational and financial efficiency. • Stability of the regulatory regime, current credit metrics and expected future credit metrics across RIIO-1 and RIIO-2 periods for network companies, capital structure of network owning groups, strategies/financial policies of owners, performance of network companies against regulatory targets, track record of management teams, ESG related factors. • Regulation, Government policy, returns and sustainability. • ESG considerations. Position relative to other sector companies. • Overall regulatory strategy for the sector, the sector's financing requirements, the credit quality of industry participants and other developing factors such as the role in the Energy Transition and ESG.

2. What specifics do you consider that bond investors take into account when investing in the UK Electricity Distribution sector?
• Level and stability of ratings, regulatory risk, in particular the extent to which major changes in incentives and rewards can impact the predictability and financeability of the business, ESG factors, Long term viability of assets, Growth prospects • Level of allowed returns. Financial strategy of the companies and targeted leverage. Derivative liabilities. Libor transition. Commitment to external rating levels. Media coverage (positive/negative). ESG and drive of sector to get to net zero. • Capital structure: analysts will be concerned with the entity and position within the capital structure i.e. is this a regulated operating company, or a MidCo / HoldCo? Some will have appetite for higher risk / higher yielding instruments, where others will be more focussed on the relatively more stable regulated operating companies • Regulatory backdrop: particularly the potential for impact on metrics / ratings & Covenants, which we have seen play out in the water sector in the recent past. Certainty of outcome and ratings is a positive for investors. In addition, some of the political noise e.g. the Labour policy for nationalisation of regulated utilities can have an impact on investors' appetite in certain sectors

[1] p.5, RIIO-ED2 Methodology Decision: Overview, Ofgem, 17 December 2020.

- Performance in the sector: operational performance relative to the rest of their peer group. Material fines / headlines would likely be perceived negatively
- Ownership / Sponsor relationships: as we know from the most recent WPD OpCo issuance investors were focused on their position in the event of the sale i.e. what would happen if the entity was acquired by a less supportive equity owner. In addition the structure (unsecured, listed vs secured, private) can feed into this
- ESG: increasingly investors are focused on commitment to ESG, whether there is a specific framework or not
- Regulation, Government Policy, returns and sustainability.
- Rating, ESG credentials, peer comparisons, competing supply.
- The long term stability of the sector, a consistent regulatory framework, the ability to generate defensive yields, stability of cashflows, the ability of companies to finance necessary totex expenditure (particularly with a view to the Energy Transition) - among many other factors.

3. How does your institution rate the UK Electricity Distribution sector against those in the following jurisdictions?

	Less risk	Similar risk	More risk
US	✓✓✓	✓✓	✓
Australia	✓✓	✓✓✓✓	
Northern Europe	✓✓✓	✓✓✓	
Southern Europe	✓✓✓✓✓	✓	

Comments from respondents:

- As a UK focused institution, we have limited exposure in these jurisdictions, but generally regard the UK to be among the most stable and supportive regulatory environments, despite the recent challenging price determinations
- Marginally less risk compared to Northern Europe on average, though depends on which specific country it is compared to.

4. Please rate your institution's perception of the risk of the UK Electricity Distribution sector relative to the regulated sectors listed below:

	Less risk	Similar risk	More risk
Electricity Transmission		✓✓✓✓✓✓	
Gas Transmission	✓✓✓	✓✓	✓
Gas Distribution	✓✓✓	✓✓	✓
Water	✓✓	✓✓✓✓	
Airports	✓✓✓✓✓		✓
Communication networks	✓✓✓✓	✓✓	

Comments from respondents:

- Although we view gas broadly in line with electricity given the shared underlying regulatory regime under RIIO-2, we also note that longer term there is greater obsolescence risk in the gas sector.
- Gas distribution has moved slightly in the risk spectrum given question marks about the future role of gas in a net zero landscape. Water would have been perceived as similar risk but for the regulatory challenges of the last price review. Airports are higher risk in any case, but particularly in the current environment.

5. Please set out your institution's view of the 3 largest risks facing the UK Electricity Distribution sector:

1.	• Regulatory Risk • Risk of adverse regulatory tightening, especially on allowed return. • Unfavourable RIIO-2 outcome • Change in regulation • ESG impact

	• A less favourable regulatory environment
2.	• Totex outperformance • Risk of higher levels of leverage of distribution companies. • Significant failing in operational performance • Upgrading of infrastructure • Local storage management • Ability to finance expenditure needed for the energy transmission
3.	• Funding risk - interest rate, inflation, Cost of Debt outperformance • Financial Mismanagement i.e. resulting in inability to retain investment grade credit ratings • Demand • EV capability of the network • Declining credit metrics and ratings

6. Please rank your institution's perception of the following risk factors for the UK Electricity Distribution sector going forward, with 1 being lowest risk:	
Management	5,2,7,2,2,6
Ofgem regulation	7,6,8,4,3,8
Other regulation e.g. H&S, Environmental, Legal, etc.	2,4,3,4,3,5
Transition to Distribution System Operator	2,4,4,3,2,7
Net zero	4,4,2,4,3,7
Cyber security	4,5,5,5,4,5
Weather	2,3,1,3,2,2
Other – (Specified by respondent) Actual company performance levels	6
Comment from respondent:	For specific companies, we would also view their individual financing structures as a key risk consideration

7. Moody's and Standard & Poor's rate the four Western Power Distribution companies at Baa1 and A- respectively.	
Please comment on how an upgrade from the ratings agencies would impact:	
a. Your institution's appetite to lend	• Viewed positively, however our institution's appetite is based on our own independent credit analysis and internal ratings. Our total appetite is based on a sliding scale, determined by our own internal ratings. An upgrade in our internal rating would therefore result in increased appetite (subject to pricing and returns). • This would increase our lending appetite. • Largely unchanged • Maintain or increase • Increase • Positively
b. Debt investors' existing holdings	• Credit investors face a dearth of A-rated investments for long term holdings. Stable ratings at A- or higher with both agencies would results in a material increased in appetite for long term debt. We would expect credit spreads to be 5-10bps tighter if both agencies were at A- equivalent. • Increase liquidity in the bonds due to stronger creditworthiness. • slight improvement

	• N/A • Increase • Positively
c. Debt investors' ability to buy further bonds	• See above • This would increase capacity from a creditworthiness perspective, balanced against that, returns to bond holders would be lower, reflecting the lower risk. • slight improvement • N/A • Increase • Positively
d. Your thoughts about the UK Electricity Distribution sector	• We recognise individual companies may be upgraded or downgraded from time to time for either company specific, or broader sector reasons. An upgrade in WPD's rating would not necessarily change our view of the broader sector, unless for a sector reason that was reflected similarly in other DNO ratings (e.g. material improvement in regulatory allowances). UK electricity distribution remains a core sector for our institution. • A strong creditworthy sector. • slight improvement • Positive • Positive • Positively - reverses a current trend of declining ratings in the sector
Please comment on how a downgrade from the ratings agencies would impact:	
e. Your institution's appetite to lend	• Viewed negatively, however our institution's appetite is based on our own independent credit analysis and internal ratings. A drop below BBB- would however would result in a material reduction in appetite. • Reduce lending appetite. • slight worsening • Maintain • slight decrease • Less favourable, although maintianing IG is key
f. Debt investors' existing holdings	• We would not expect material sales or spread widening for WPD paper if both ratings were at BBB+ equiv, as this is largely baked into current expectations. Debt capacity would not change materially at Baa1/BBB+. At Baa2/BBB, we would expect a material drop in demand for long term bonds (15yr+). • Increase likely returns, reduce liquidity. • Slight worsening • N/A • Decrease • Less favourable
g. Debt investors' ability to buy further bonds	• See above • Reduce appetite from a risk perspective, albeit returns woukld be higher. • slight worsening

	• N/A • Neutral • Less favourable
h. Your thoughts about the UK Electricity Distribution sector	• We recognise individual companies may be upgraded or downgraded from time to time for either company specific, or broader sector reasons. An upgrade in WPD's rating would not necessarily change our view of the broader sector, unless for a sector reason that was reflected similarly in other DNO ratings (e.g. material improvement in regulatory allowances). UK electricity distribution remains a core sector for our institution. • An intrinsically stable and safe sector. • slight worsening • Neutral • Less favourable - investor want to see a good one or two notch buffer to any risk of sub investment grade

8. What are your institution's expectations about the outcome of RIIO-ED2? E.g. lower returns, greater scrutiny of expenditure plans, increased capital expenditure requirements, increased focus on decarbonisation, enhanced data sharing, etc.

- Lower returns, lower RAV Growth, greater pressure on ICR and leverage covenants and ratings, greater risk of Totex under-performance, greater focus on electrification, energy transition and ESG.
- Lower returns, reduced capital expenditure allowances, increased focus on net zero and ESG.
- Outcomes to be in line with GD/GT/ET outcomes post CMA process. Lower returns than RIIO-1, lower outperformance opportunities, challenge on spending plans and potential for having to use reopeners to deliver the full plans, focus on Net Zero and no outperformance wedge.
- Lower returns and increased capex. Impact on WACC. Higher penalties and transition risk.
- lower returns, scrutiny on dividends and shareholder distributions, intense scrutiny on ESG credentials,
- All of the above [WPD note – this seems to relate to the respondent's answer to the previous question as respondents were not able to see others' answers]. We are watching the CMA appeals closely. Our expectation is companies willl be constrained and it will be a much more challenging review period, but overall we remain positive on the sector

9. In general what tenors appear to be the most attractive to investors at present?

- Demand currently deepest in the 10-20 year range. Little spread advantage for going shorter than 8/9 years as spreads are floored for many high quality issuers.
- From a corporate, unsecured perspective, 5 years. This briefly dipped to 3 years during 2020, due to Covid, but has now recovered to 5 years.
- GBP investors: wide spectrum of appetite, often in 10 years+ - we frequently see issuers e.g. housing associations, utilities borrowing up to 30 years or longer in the GBP market. For higher risk assets e.g. subordinated, tenor appetite will likely be shorter, typically up to 10/12 years maximum
- EUR: as investors hunt for yield, there has been some extension in tenor appetite, but this tends to become more limited after 20 years. ~ 7-12 years has greater depth, particularly for names which the European investor base is less familiar
- N/A
- 7-12 years
- This varies at times, but investors continue to see electricity as investable over a long term horizon (perhaps more so than other regulated sectors at present) - 10-15 years continues to provide the best balance between tenor and pricing

10. Does your institution consider that the cost of debt methodology adopted by Ofgem at RIIO-ED1 has impacted the length of tenor being issued by the UK Electricity Distribution companies and do you foresee any further impact going forward?
• Issuance has become shorter and more concentrated in the 10-15 year area (NPG being a notable exception). • No material impact. • There are a variety of approaches that we have seen for ED companies when choosing tenors to issue debt in the capital markets. We have seen ED companies (as well as other Ofgem regulated companies) be conscious of the trailing average period used by Ofgem, in addition to a number of other factors, when choosing the tenor of capital markets debt so that they minimise risk of underperformance against the cost of debt benchmark. We therefore see this as having had an impact and would expect this to continue whilst the trailing average approach is used by Ofgem for its cost of debt benchmark. • NA • Generally has reduced. • There has been a consistent focus on achieving better results than the iboxx average and tenor considerations play into that assessment, but otherwise we don't think the impact has been too material.

11. Does your institution anticipate any significant change in the supply and demand for utility bonds occurring within the short term and subsequently into the RIIO-ED2 period?
• No anticipated change in demand • No significant change currently foreseen. Issuance and demand may naturally reduce ahead of the final decision for the new regulatory period. • Hard to take a very long term view but no we do not anticipate any material change in the supply / demand dynamics in the near future • Some of the potential drivers that could impact on demand • All in yields: as underlying spreads & benchmark yields have been consistently compressed over the past few years, investors have been keen on any issuance that offers yield balanced with reasonable risk. Investors may re-assess their investment criteria and approach along with material changes in this regard • Net supply i.e. the balance between new issues & redemptions, which will have an impact on overall cash balances • NA • No significant change anticipated • The CMA process outcome many have some impact on this, but in general we think that the supply and demand dynamics remain strong, despite the less favourable regulatory environment.

12. WPD will need to raise a significant amount of debt during the RIIO-ED2 period. Does your institution perceive any impediments to this being achieved?
• We are highly confident that sufficient capacity exists, albeit WPD may have to diversify to USPP and or Euro to retain competitive tension in its offerings • An overly harsh judgment on allowed returns for the distribution companies may limit investor appetite. • We anticipate considerable depth in the capital markets for WPD to raise new funds & refinance existing indebtedness. An openness to new funding markets & diverse investor bases e.g. EUR, Asian MTNs, US Private Placements as well as the GBP public markets will increase overall liquidity • No issues with debt raising but price may be a key factor. • No significant change • Markets have demonstrated their resilience over the last year, particularly for issuers in certain sectors and the demand for Utility paper remains extremely strong - all things being equal we do not see this changing in RIIO 2, although most companies have more financing to do, so competing

trades could become an issue for pricing and some markets (such as sterling) may reach capacity levels on certain credits, so diversification will be important.

13. Do you have any comments not covered above that would impact your institution's desire to invest further in the UK Electricity Distribution sector?
We are a significant provider of debt to the UK ED sector. The expectations of the outcomes of RIIO-2 are a key risk, as seen in GD/GT/ET, where we expect returns to reduce for ED companies which in turns puts pressure on credit metrics and the resultant credit ratings both externally and for our own internal credit models. We are therefore slightly more cautious in view of this than we were in RIIO-1.

WPD note: changes to spelling and formatting have been made in the above extracts from the raw data in responses for presentational purposes.

Appendix A06 - RIIO-ED2 Bond Investor Questionnaire - Responses

As part of the process of assessing the financeability of our RIIO-ED2 plan we consulted with our core banking group and some of our key investors. This questionnaire sets out the questions designed to gather key feedback from our investor community, and a summary of responses, on an anonymous basis.

1. What specifics do you take into account when investing in the UK Electricity Distribution sector?

- Investment need, fairness of regulation, operational excellence
- Rates, operational perf', 5yr reg cycle, cost movements, capex, div's, ofgem, CMA, rating agencies, politics, other stakeholders and commentators
- The regulator's track record 2) Predictability of the regulator's methodology 3) How transparent is the regulatory process 4) The outcome of the price controls 5) Impact of price controls on ratings 6) Evidence of earnings stability 7) Quality of management team - relationship with regulator, communication with bondholders, understanding of the business

2. What specifics do you consider that bond investors take into account when investing in the UK Electricity Distribution sector?

- Financial policy, investor protections, cash flow profiling
- As above, UK gov't, Ofgem. Spreads and market environment
- In addition to the above - preference for electricity over gas is growing due to fund requirements for responsible investing.

3. How do you rate the UK Electricity Distribution sector against those in the following jurisdictions?

	Less risk	Similar risk	More risk
US	✓	✓✓	
Australia	✓	✓✓	
Northern Europe	✓	✓✓	
Southern Europe	✓✓✓		

4. Please rate your perception of the risk of the UK Electricity Distribution sector relative to the regulated sectors listed below:

	Less risk	Similar risk	More risk
Electricity Transmission	✓	✓✓	
Gas Transmission	✓✓✓		
Gas Distribution	✓✓✓		
Water	✓	✓✓	
Airports	✓✓		✓
Communication networks		✓✓✓	

Comment from one respondent: Based on longevity of assets in the light of climate change and regulation.

5. Please set out your view of the 3 largest risks facing the UK Electricity Distribution sector:	
1.	• Failure to meet consumer needs • Energy transition • Capex
2.	• Resilience to climate change • Capex uncertainty and scale • Allowed returns
3.	• Integration of renewables • Politics • Recover of unexpected costs

6. Please rank your perception of the following risk factors for the UK Electricity Distribution sector going forward, with 1 being lowest risk:	
Management	7,2,2
Ofgem regulation	5,2,8
Other regulation e.g. H&S, Environmental, Legal, etc.	2,3,4
Transition to Distribution System Operator	3,5,4
Net zero	1,5,7
Cyber security	4,4,6
Weather	6,4,4
Other (please specify)	
Other (please specify)	

7. Moody's and Standard & Poor's rate the four Western Power Distribution companies at Baa1 and A- respectively.	
Please comment on how an upgrade from the ratings agencies would impact:	
i. Your existing holdings	• Bonds tighten as more buyers • None • Positive
j. Your ability to buy further bonds	• Higher risk limits for single A composite • Improve • Positive
k. Your thoughts about the UK Electricity Distribution sector	• No major impact • Strong credit sector, potential large issuance • Unchanged
Please comment on how a downgrade from the ratings agencies would impact:	
l. Your existing holdings	• Negative impact on valuation • Some forced sales • Reduce
m. Your ability to buy further bonds	• Risk limits reduce as moves towards edge of IG • Decreased • Reduce
n. Your thoughts about the UK Electricity Distribution sector	• Depends on why downgraded • Strong credit sector, potential large issuance • Negative

8. What are your expectations about the outcome of RIIO-ED2? E.g. lower returns, greater scrutiny of expenditure plans, increased capital expenditure requirements, increased focus on decarbonisation, enhanced data sharing, etc.
• Expect more investment and mechanisms for this to flexed upwards. Downwards pressure on returns, mitigated by investment need. • All of above. Tough review expected but commercial, fair and financeable. • Insufficient allowed returns to support current ratings.

9. In general what tenors appear to be the most attractive to investors at present?
• Flat curves indicate interest at long end for highly rated issuers • Longer dated - at present.

10. Do you consider the cost of debt methodology adopted by Ofgem at RIIO-ED1 has impacted the length of tenor being issued by the UK Electricity Distribution companies and do you foresee any further impact going forward?
• Likely yes as issuers should aim to keep in line with regulator. would expect growth investment to support trend to push out asset lives. • Expect cod to be based on index/peer cost and potentially reset • Not as much as expected.

11. Do you anticipate any significant change in the supply and demand for utility bonds occurring within the short term and subsequently into the RIIO-ED2 period?
• No • Other than market and macro cycles, no. No expectation of structural change. • A lot of £ funds are driven by ratings. A drop in ratings due to RIIO-ED2 outcomes will reduce demand.

12. WPD will need to raise a significant amount of debt during the RIIO-ED2 period. Do you perceive any impediments to this being achieved?
• The issuer may become quite large in GBP indices when combined with Nat Grid. • Other than market and macro cycles, no. • Not if ratings are neutral to better.

13. Do you have any comments not covered above that would impact your desire to invest further in the UK Electricity Distribution sector?
Capital structures - should remain simple. Highly leveraged structures and short term shareholders would be unwelcome.

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