Shareholder Annual Review

Covering the extended period

19 September 2017

-

31 March 2019

Table of Contents

Appendices

Foreword

During the last 18 months, the Company has purchased two high quality, high performing investment properties situated in the affluent Thames Valley – Marlow and Bracknell.

Valued at almost £60m, the out-of-Borough property portfolio provides a secure net income and meets the Company's budgeted expectations.

This allowed the Company to pay its sole shareholder (the Council) a final dividend of 4.240 pence per share for the year ended 31 March 2018 (a payment of £424,063).

A dividend of 4.334 pence per share (a payment of £1,045,235) has also been paid for the year ended 31 March 2019.

The dividends reflect the Company's strong financial standing and the Directors look forward to exploring further opportunities as they arise.

K Beldon
M Shephard
L Duffy
R Brown

29 March 2019

Shareholder Annual Review

1. Background

Epsom & Ewell Borough Council (the "Shareholder") established EEPIC (the "Company") on 19 September 2017 following an Extraordinary Council meeting of the same date.

Epsom & Ewell Borough Council is the sole shareholder of EEPIC and the Company is therefore a 100% wholly owned trading company of the Council.

EEPIC provides the Shareholder with the flexibility to undertake commercial trading activities in property investment. This includes out of Borough investment acquisitions and the holding of residential properties.

The objectives and anticipated annual activities of EEPIC are defined (as previously approved by Extraordinary Council) in the Company's Business Case and Annual Business Plan respectively.

EEPIC's current objective is to acquire prime, well located investment properties let to financially strong tenants. The Company takes advantage of its ability to arbitrage, that is, generate a net rental income where rental income exceeds the cost of borrowing.

All acquisitions must be compliant with the Shareholder's approved Property Investment Strategy 2017-20.

2. Acquisitions

The Company has acquired two high quality, well located commercial property investments:-

- <u>The Cobham Centre, Globe Park, Fourth Avenue, Marlow SL7 1TF</u>

  High quality HQ office building let for 20 years to Chelton Ltd – a world leader in the design and manufacture of aviation communication systems and navigation antennas. The lease is subject to annual fixed uplifts of 2.5% pa and is guaranteed by Cobham PLC.

  It provides the Company with long term secure net rental income.

Cobham Centre - External Elevation

Cobham Centre – Office Accommodation

- <u>Venture House, 2 Artlington Square, Downshire Way, Bracknell RG12 1WA</u>

  High quality HQ office building let for 10 years to Bracknell Arlington Square Centre Ltd trading as the serviced office provider, Regus. The lease is guaranteed by Regus PLC for a period of 1 year following tenant default during the lease term.

The property is located in the heart of the town centre next to The Lexicon Bracknell, a recently opened £240m retail and leisure destination. It provides the Company with good quality, long term net rental income.

Bracknell - External Elevation

Bracknell – Office Environment

Both properties are located within the prosperous Thames Valley and offer the following income profiles:-

	Purchase	Price	Rent	Income Yield
Marlow	13/10/17	£31,000,000	£1,733,531 (2.5% pa uplift)	5.25%
Bracknell	20/11/17	£25,500,000	£1,770,300 (Jan 21 Rent Review)	6.5%
Total		£56,500,000		

In addition, the properties offer the potential for capital growth over the Company's 50-year investment horizon. UK demographic trends indicate an increasing population which will continue to place upwards pressure on property asset values over the longer term.

Further detail of each property's tenancy and financial business case is summarised in the next two sections.

3. The Cobham Centre, Globe Park, Fourth Avenue, Marlow

Description

The Cobham Centre is situated on the well-established Globe Park which is the premier office location in Marlow, situated in the heart of the Thames Valley on the border of Berkshire and Buckinghamshire.

It is a highly desirable and affluent commercial and residential location by virtue of its close proximity to Henley and the River Thames together with excellent communications to London and the wider South East area. This combination has attracted a wide range of major multi-national corporate occupiers to Marlow including TNT, Dun & Bradstreet, Veolia, Allergan, Data Select, Emerson Network Power and HPS Group.

The Cobham Centre provides high quality HQ office accommodation with an ancillary R&D facility providing a total area of 80,974 sq ft (7,523 sq m). The Grade A office specification includes open plan offices arranged over ground and first floors, air conditioning, suspended ceilings, raised floors, 13 person passenger lift and full height entrance / reception area.

The property is set within an attractive landscaped environment and benefits from 235 car parking spaces, reflecting an excellent car parking ratio of 1:270 sq ft.

Building	Sq Ft	Sq M
Office Ground Floor	32,087	2,980.96
Office First Floor	32,087	2,980.96
Total	64,174	5,961.91

R&D/Ancillary warehouse		
Ground Floor	16,800	1,560.76
Total	80,974	7,522.67

Tenancy

The property is let in its entirety to Chelton Limited on a 20 year lease from 29th September 2016 and guaranteed by Cobham PLC (March 2017 market capitalisation of £2.21bn).

The current rent is £1,733,531 per annum which reflects approximately £21.40 psf overall. By comparison, office rents in Maidenhead (nearest competing office centre) are c£30 psf and those in Epsom are c£25 psf. Marlow therefore offers good value office rents in the context of the South East.

The rent is subject to annual fixed uplifts of 2.5% pa as follows:-

Rent Review Date	Rent
29 September 2016	£1,650,000
29 September 2017	£1,691,250
29 September 2018	£1,733,531.25
29 September 2019	£1,776,869.53
29 September 2020	£1,821,291.27
29 September 2021	£1,866,823.55
29 September 2022	£1,913,494.14
29 September 2023	£1,961,331.49
29 September 2024	£2,010,364.78
29 September 2025	£2,060,623.90
29 September 2026	£2,112,139.50
29 September 2027	£2,164,942,99
29 September 2028	£2,219,066.56
29 September 2029	£2,274,543.22
29 September 2030	£2,331,406.80
29 September 2031	£2,389,691.97
29 September 2032	£2,449,434.27
29 September 2033	£2,510,670.13
29 September 2034	£2,573,436.88
29 September 2035	£2,637,772.81

The above annual uplifts are tabled in the lease and automatically take effect each year i.e. removing the need for the traditional rent review and thereby providing certainty of future income levels.

It is a Full Repairing & Insuring (FRI) Lease i.e. the cost of insurance, repairs / maintenance and all other outgoings are met by Chelton Ltd. There is no tenant option to break the lease and reflects the tenant's requirement to be located in the vicinity of its skilled workforce.

Chelton Limited (formerly Chelton (Electronics) Limited), is a world leader in the design and manufacture of communication systems and navigation

antennas to enable people and systems to communicate on land, in air and at sea.

Employing 200 staff, the business was founded in 1947. In 1989 Chelton (Electronics) Limited and its holding company, Chelton Limited, became a wholly owned subsidiary of Cobham PLC.

For the financial year ended 31st December 2015 Chelton Limited (company no. 00896823) reported a turnover of £80.60m, pre-tax profit of £17.16m and net worth of £40.6m.

The lease is guaranteed by the parent company, Cobham PLC (company no.00030470), which has a reported turnover of £2.21bn and market capitalisation of £3bn as at March 2017.

Cobham PLC is an international company engaged in the development, delivery and support of leading edge aerospace and communications components. The company has four principal divisions employing more than 11,000 people across five continents, with customers and partners in more than 100 companies.

In February 2013 Cobham launched a new product called Axell Wireless which is developed and run from the Marlow facility. The product is an in-building coverage solution for mobile phone operators to allocate capacity to locations where and when it is needed. The product is one the company's leading global sales products.

Cobham Centre Financial Business Case

The rent payable at the time of acquisition was £1,650,000 pa.

The property returns a secure long term income rental stream that commenced at a net initial income yield of 5% pa (based on the initial rent of £1,650,000) and inflates at a guaranteed 2.5% per annum.

As seen from the earlier rent review tenancy schedule, the current rent is £1,733,531 pa and reflects a current income yield of 5.25% pa.

The Company financed the acquisition by way of a secured loan from the Shareholder charged at a commercial interest rate of 5% per annum. The loan was for 60% of the purchase price with the remaining 40% provided by shareholder equity funding. A secure legal charge (debenture) is registered in favour of the Shareholder.

In compliance with the Shareholder's approved Property Investment Strategy, the property was assessed on the Scoring Matrix. The Matrix allows the relative merits of an investment opportunity to be measured and assessed against a minimum target threshold of 70%.

For the Cobham Centre, the Scoring Matrix achieved a very high 93%. Criteria preventing it achieving a maximum score included:-

- Location – the building achieved a weighted score of 16% (out of a possible 20%) to reflect the out of town location.

- Lot Size – the building achieved a weighted score 2% (out of a possible 5%) due to the purchase price being above the ideal range of £10m - £20m. However, the high acquisition cost reflects the long term security of 19 year income to a financially strong tenant. As the portfolio grows, it will become diversified in line with the Property Investment Strategy.

On all other criteria, the investment scored the maximum Matrix marks confirming the financial strength of the tenant and quality of the building.

4. Venture House, 2 Arlington Square, Downshire Way, Bracknell

Description

Developed between 1992 and 2008, Arlington Square is Bracknell's premier office location comprising four self-contained office buildings set within landscaped grounds.

Bracknell benefits from excellent transport communications and is strategically located within easy reach of the M4, M3 and M25 motorways. High profile Bracknell office occupiers include UK and European headquarters for 3M, Dell, Fujitsu, Honda, Honeywell and Hewlett-Packard.

The town centre has recently undergone a major £240m regeneration project – The Lexicon, a joint venture between Bracknell Forest Council and Legal & General - which has provided high quality retail and leisure accommodation. Retailers include M&S, Waitrose, Fenwicks, H&M, Primark, together with various well-known restaurant operators. The Lexicon will only add to the appeal of Bracknell as an attractive South East office location.

2 Arlington Square was built in 2001 and provides high specification Grade A office accommodation over ground and three upper floors, totalling 88,537 sq ft.

The Property offers the following accommodation:-

Floor	Sq Ft	Sq M
Third – Offices	21,442	1,992
Second - Offices	21,387	1,987
First – Offices	21,195	1,969
Ground – Offices	20,614	1,915

Reception – GF	899	84
Storage – GF	66	6
Atrium – GF	2,934	273
Total	88,537	8,226

Tenancy

The property is let in its entirety to Bracknell Arlington Square Centre Ltd (company number 8808394), trading as the serviced office provider, Regus. The lease is guaranteed by Regus PLC for a period of 1 year following default by the tenant to meet its lease obligations.

It is a Full Repairing & Insuring (FRI) Lease i.e. the cost of insurance, repairs / maintenance and all other outgoings are met by Bracknell Arlington Square Centre Limited.

Regus has been the sole occupant of the Property since its construction in 2001 (they agreed to pre-let it in 2000). Bracknell Arlington Square Centre Limited renewed its FRI lease from 15 January 2016 for a term of 10 years expiring 14 January 2026 i.e. c7 years unexpired. There is no tenant option to break the lease within the 10 year term.

A 5th year rent review takes effect from 15 January 2021 and the current rent is £1,770,300 pa reflecting £20 per sq ft. This is relatively low as prime rents in the town are approximately £24 per sq ft and therefore provides a realistic prospect of future rental growth.

By comparison, EEPIC's Marlow property rental equates to just over £21 psf, with Maidenhead (nearest competing office centre to Bracknell) at c£30 psf and those in Epsom at c£25 psf. Bracknell therefore offers competitive South East office rentals retaining its position as one of the Thames Valley's most established office centres.

IWG (International Work Group) PLC, formerly Regus, is a multinational corporation that provides a global serviced office workplace. IWG PLC reported 2016 group revenues of £2.2bn and includes the British serviced office brands, MWB Business Exchange Plc, HQ and Regus.

Regus operate each of their serviced office locations as standalone businesses and their business model becomes profitable when a building in its portfolio reaches 50% occupancy level.

A good performing Regus building would be expected to maintain 60% - 70% occupancy level and where this occurs in their portfolio, they typically remain at the location long term. Regus has confirmed that since 2008, 2 Arlington Square has consistently maintained occupancy in the 60% - 80% range, making it their Thames Valley flagship office complex.

Bracknell Financial Business Case

The Property represented an attractive opportunity to secure a well located, successful Regus facility at a favourable net initial yield of 6.5% pa. Whilst considered highly unlikely, EEPIC could not ignore the possibility that Regus may relocate in 2026.

Furthermore, if the serviced office sector was to fall out of favour (again, highly unlikely), the consequence of Regus leaving the Property would almost certainly be its conversion to a multi-let building. Whilst not EEPIC's preference, a multi-let building would carry the advantage of attracting higher rental levels – albeit at the cost of greater management resource. The financial projections on acquisition prudently allowed the sum of £1.75m for the possibility of major capital works in the event that Regus vacate the Property.

As with Marlow, the Company financed the acquisition by way of a secured loan from the Shareholder charged at a commercial interest rate of 5% per annum. The loan was for 60% of the purchase price with the remaining 40% provided by shareholder equity funding. A secure legal charge (debenture) is registered in favour of the Shareholder.

In compliance with the Shareholder's approved Property Investment Strategy, the property was assessed on the Scoring Matrix. The Matrix allows the relative merits of an investment opportunity to be measured and assessed against a minimum target threshold of 70%.

For 2 Arlington Square, the Scoring Matrix achieved a solid 79%. Criteria preventing it achieving a maximum score included:-

- Tenant Covenant – as the Regus PLC covenant is only applicable for 1 year, it was considered necessary to down grade the rating from "good" to "acceptable".

- Occupational Lease Length – achieved a "good" rating as opposed to "excellent" as the lease term is less than 10 years.

- Build Quality – achieved an "acceptable" rating to reflect the potential for capital expenditure at lease expiry in 8 years.

- Lot Size – achieved a "marginal" rating due to the relatively large lot size of £25.5m.

On all other criteria, the investment scored the maximum Matrix marks confirming the quality of the building's location and the FRI nature of the lease.

5. Property Management

Day to day property management is currently provided by the Shareholder's Property Services Team and includes property inspections, service charge

administration, general tenant liaison and asset management strategy.

The Company retains the option to appoint an external managing agent should Directors consider this to be in the best interests of the Company. Whilst no such appointment is being considered, the Directors will continue to monitor the existing arrangement at its quarterly board meetings.

Management highlights:-

- There are no arrears by either tenant.

- Regus queried the level of insurance premium charged by EEPIC on the Bracknell building. The matter was successfully resolved and the insurance premium was paid.

- The rent payable for Marlow (The Cobham Centre) increased from £1,691,250 pa to £1,733,531.25 pa with effect from 29 September 2018. This represents the annual 2.5% fixed rental increase as per the terms of the lease. The next rent increase to £1,776,869.53 is due from 29 September 2019.

- The rent payable for Bracknell (2 Arlington Square) is £1,770,300 pa. It is subject to an upwards only rent review on 15 January 2021.

Tenant corporate activity:-

- During the year, Bracknell's guarantor IWG (formerly Regus and worth £2.8bn) was the subject of potential takeover activity. Several prominent private equity groups showed interest including Guy Hands' Terra Firma Investments, Onyx, and Brookfield Private Equity.

- Several prominent private equity investment groups including Terra Firma Investments (Guy Hands), Onyx, Prime Opportunities (Los Angeles based group) and Brookfield submitted takeover bids to IWG. By the end of August 2018, all were rejected and shortly afterwards, IWG terminated all discussions with potential suitors.

  In anticipation of a takeover, the shared price had risen by approximately 20% over summer 2018 and not surprisingly, fell back to its previous level following withdrawal from takeover discussions.

  IWG justified its withdrawal on the basis that potential bidders had not fully valued IWG's positive interim results (issued during takeover discussions). They showed a rise in revenue of 7.4% to reach £1.204bn and whilst operating profit was 29% lower at £60m, this was partly due to the major investment that the business made in pursuing growth opportunities and increased marketing. It expects to meet forecasts for the current year in which shares will record a rise in earnings of 13%. Further growth of 21% is due next year as the business continues to perform well.

- EEPIC's other tenant guarantor for Marlow, Cobham PLC, continues to trade consistently in the £1 - £1.40 per share range. Its Interim Results Highlights for the half year ended 30 June 2018 were released in August and included growing order intakes from £0.92bn to £1.3bn with full year 2018 underlying profit expectations remaining unchanged.

- More recently, trading updates have been released by Cobham and IWG.

- Cobham PLC released its trading update covering the period 1 January 2018 to the end of October 2018 on 14 November 2018 and stated:-

  "At a Sector level, underlying operating profit in Mission Systems and Communications and Connectivity has been stronger than in the prior year, which offsets weaker performances in Advanced Electronic Solutions and Aviation Services.
  Overall, the Board's expectations for the full year 2018 remain unchanged from those set out in the Interim Results on 3 August 2018. As in prior years, there remains significant trading activity in the final two months of the year."

- IWG PLC (International Workplace Group), released a 3rd quarter trading update on 6 November 2018 and included the following highlights:-

  - Strong Q3 open centre revenue growth of 13.2% at constant currency
  - Improvement in Q3 mature revenue growth, up 3.9% at constant currency and a further improvement on Q2
  - Mature occupancy improved 70 basis points to 74.3% in Q3
  - Underlying cash generation for the year to date of £120.3m
  - Net debt of £433.9m after net growth investment of £204.9m year to date
  - 204 new locations added year to date
  - The Board remains confident that the Group will deliver a full year result in line with management's expectations

- Both IWG's and Cobham's corporate activity is monitored as a matter of good management practice.

- The Managing Director is not aware of any financial or operational issues with EEPIC's direct tenants at either Marlow or Bracknell.

6. Balance Sheet Asset Valuations

To comply with its financial reporting obligations, the Company is required to have its investment property portfolio valued on an annual basis. The basis of

valuation for investment properties is fair value and is the same as market value.

External valuations were undertaken by Epsom based firm of Chartered Surveyors, Huggins Edwards & Sharp (HES). At the request of the Shareholder, HES were instructed to provide consistency with their instruction to value the Shareholder's directly owned property assets.

HES have not been involved in either EEPIC property purchase and can therefore provide an independent, external assessment of the two acquisitions.

	Valuation @ 31/12/18	Purchase Price / Date	Variance
	£	£	£
Marlow	32,000,000	31,000,000 13/10/17	1,000,000
Bracknell	25,800,000	25,500,000 20/11/17	300,000
Total	57,800,000	56,500,000	1,300,000

The valuation returns a portfolio value increase of £1.3m for the last 14 months. Whilst the Company's business case is specifically to hold property long term (to smooth out the inevitable gyrations of the UK property market), it is nevertheless welcome that the acquisitions have recorded a 2.3% capital increase. This is in addition to the strong current income running yields of 5.25% and 6.5% for Marlow and Bracknell respectively.

Although underlying property valuations have increased by £1.3m since acquisition, the 2018/19 accounts are expected to show a downward revaluation of £2.1m, as previously capitalised stamp duty and other acquisition costs (such as legal and investment agent costs) totaling £3.4m are written out from the company's balance sheet.

Valuation highlights include:-

"The South East letting market is viewed as resilient with net take up of stock in a sector that is characterised by a severe lack of speculative development and stock eroded by Permitted Development. This is considered likely to continue to drive returns and draw investors into the office sector.

The Thames Valley is reported as seeing a welcome surge in leasing activity in 2018 with well over 1.7m sq ft transacted, 26% up on the previous year and the highest level since 2011.

With availability dropping and the lack of speculative schemes under construction there are predictions of demand outstripping supply in 2021/22 for the first time in 20 years."

7. Company Accounts

The Company's accounts are externally prepared by Williams & Co, an Epsom based firm of Statutory Auditors.

The accounts are attached at Appendix A for the period 18 August 2017 to 31 March 2018 and for the year ending 31 March 2019.

Financial highlights for the period 18 August 2017 to 31 March 2018 include:-

- Property portfolio of £59.9m (this is higher than the actual property acquisition prices described above due to financial reporting requirements. Please not the combined total property acquisition price was £56.5m).
- Profit before tax of £0.5m
- Dividend proposed of £0.42m

Financial highlights for the year ending 31 March 2019 include:-

- Property portfolio of £57.8m (this reflects the true property valuations indicating a combined capital value increase of £1.3m (£57.8m - £56.5m).
- Profit before tax of £1.53m
- Dividend proposed of £1.05m

Williams & Co have provided the Company with a first class accounting service at a competitive price. It is therefore envisaged that Williams & Co will be retained by the Company to prepare future year-end accounts.

8. Future Acquisitions

At its Strategy & Resources Committee meeting held on 25 September 2018, the Shareholder suspended any further out-of-Borough property investment acquisitions until further government guidance or case law is published. This is necessary to ensure the Shareholder can comply with the MHCLG's new Statutory Guidance on Local Government Investments introduced from April 2018.

The guidance aims to restrict the ability of Local Authorities to purchase out of Borough investment properties, through the following clause 46:-

"Authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed".

The new guidance means that future out of Borough acquisitions that are funded by borrowing and where the intention is purely to profit from the investment, would not meet the requirements of the guidance in terms of borrowing.

However, there could be circumstances where out of Borough investments may be acceptable if, for example, the property was close to the Shareholder's boundary and the main purpose for the investment was not for profit, but for regeneration.

The new guidance does not affect EEPIC's existing property acquisitions.

Appendix A

EEPIC Financial Statements

For the Period 18 August 2017 to 31 March 2018

For the Year Ended 31 March 2019