Epic
Epsom & Ewell Property Investment Company Ltd

Shareholder Annual Review

Covering the accounting period

1 April 2019 - 31 March 2020

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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.

The objectives and anticipated annual activities of EEPIC are defined in the Company's Business Case and Annual Business Plan respectively.

At its Strategy & Resources Committee meeting held on 25 September 2018, the Shareholder suspended any further out-of-Borough commercial 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.

2. Property portfolio

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

- The Cobham Centre, Globe Park, Fourth Avenue, Marlow SL7 1TF

A high quality HQ office building let for 20 years from 29 September 2016 to Chelton Ltd – a world leader in the design and manufacture of aviation communication systems and navigation antennas. The current rent is £1,776,869 pa and subject to annual fixed uplifts of 2.5% pa. The rent is guaranteed by Cobham PLC.

The building 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).

- Venture House, 2 Artlington Square, Downshire Way, Bracknell RG12 1WA

A high quality HQ office building let for 10 years to Bracknell Arlington Square Centre Ltd trading as the serviced office provider, Regus. The current rent is £1,770,300 pa and is guaranteed by Regus PLC for a period of 1 year following tenant default during the lease term.

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

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

IWG (International Work Group) PLC, formerly Regus, is a multinational corporation that provides a global serviced office workplace. IWG PLC 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.

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	£1,776,869 (2.5% pa uplift)	5.37%
Bracknell	20/11/17	£25,500,000	£1,770,300 (Jan 21 Rent Review)	6.5%
Total		£56,500,000		

3. Property and financial 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.

2019/20 highlights:-

- There are no arrears by either tenant (contingent on Regus paying deferred rent later in the year – see Section 4 below).
- The rent payable for Marlow (The Cobham Centre) increased from £1,733,531.25 pa to £1,776,869.53 with effect from 29 September 2019. This represents the annual 2.5% fixed rental increase as per the terms of the lease. The next rental increase to £1,821,291.27 is due from 29 September 2020.
- The rent payable for Bracknell (2 Arlington Square) is £1,770,300 pa. A 5th year rent review takes effect from 15 January 2021 and the current rent reflects £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.
- Property valuations have increased by £2.66m over the year
- No capital expenditure or repairs incurred in the current year
- Full-year profit before tax (excluding revaluations) of £1.553m
- £1.399m dividend paid to the Shareholder (meeting budgeted expectations)

- Cash balance of £1.25m as at 31 March 2020

4. Covid-19 Pandemic

At the end of this Review's accounting period, the UK (in common with other countries) entered Covid-19 lockdown on 23 March 2020. This was followed by the announcement from the UK government that commercial tenants who could not pay their rent because of Coronavirus would be protected from eviction. This measure was enshrined in legislation as part of the emergency Coronavirus Bill and meant that no business would be forced out of their premises if they missed the 25 March 2020 quarter day rent payment.

The Managing Director duly sought (and received) Directors' agreement by email for EEPIC to adopt the same approach as its Shareholder in offering tenants a 3 month rent holiday with the rent payable in full within 12 months. EEPIC was advised by Cripps LLP (an external legal firm recommended by the Shareholder) to formally document the arrangements.

The offer would only be made to tenants who approached EEPIC with payment concerns and the rent would remain payable within 12 months i.e. it is not a rent free period but instead, a "breathing space" to assist tenants' cash flow during the Coronavirus Pandemic. The cost to EEPIC of taking this action was approximately £7k (based on loss of interest on cash held).

As a direct consequence of Covid-19 and the government's protection from eviction announcement, Regus (Bracknell's tenant) approached EEPIC to defer the 25 March – 23 June 2020 quarter's rental until the end of the financial year.

At Marlow, Chelton Ltd (Cobham) paid the March quarter's rent but has agreed to defer the June quarter's rent for payment until the end of the financial year.

Both arrangements have been documented by way of a signed rent deferment letter drafted by Cripps LLP.

5. 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.

At the request of the Shareholder (to provide consistency with their instruction to value the Shareholder's directly owned property), external valuations were undertaken by Wilks Head & Eve, a respected London firm of Chartered Surveyors.

Wilks Head & Eve were not involved in either EEPIC property acquisition and can therefore provide an independent, external assessment of the two property assets.

	Valuation @ 31/12/19	Purchase Price / Date	Variance
	£	£	£
Marlow	33,135,200	31,000,000 13/10/17	+2,135,200
Bracknell	27,326,700	25,500,000 20/11/17	+1,826,700
Total	60,461,900	56,500,000	+3,961,900

Whilst the Company's business case is specifically to hold property long term (to smooth out gyrations in the UK property market), it is welcome that the acquisitions have recorded a 4.6% capital increase on last year's valuation (£57,800,000) and an aggregate 7% capital increase since purchase (£56,500,000).

6. 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 year ended 31 March 2020.

Financial highlights include:-

- Property portfolio of £60.5m
- Gross profit of £3.5m
- Profit before tax (excluding property revaluations) of £1.55m
- Dividend paid of £1.40m

Williams & Co continue to provide 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.

7. Tenant Corporate Activity (Bracknell) – IWG plc

- IWG plc completed the sale of its Japanese operations to TKP Corporation in Japan (31 May 2019) raising £320m (paid in cash). The parties agreed an exclusive master franchise agreement for the country. Under the long-term agreement, TKP has exclusive rights to use IWG's Regus, Spaces and OpenOffice brands in Japan.

TKP, which is listed on the Tokyo Stock Exchange, is the leading provider of conference rooms and banquet halls for rental in Japan, operating from 249 locations across the Country.

- IWG announced (9 August 2019) that it had entered into a second strategic partnership with TKP Corporation ("TKP"). IWG will divest its Taiwanese operations to TKP and the parties have agreed an exclusive master franchise agreement for the country.

- The Transaction further demonstrates the strong momentum in IWG's franchising strategy and the interest from third parties wanting to operate IWG brands across a wide range of geographies, which will enable the company to grow more rapidly in this exciting market.

- IWG announced (4 November 2019) that it had entered into a third strategic partnership with respect to its workspace business in Switzerland. IWG will divest its interests in this market to an entity that is jointly owned by the J. Safra Group and the P. Peress Group and will enter into an exclusive master franchise agreement. This transaction follows similar deals completed earlier this year as detailed above.

- IWG released its record breaking Year End 31 December 2019 results on 3 March 2020 with key highlights including:-

    - Record profit and cash generation
    - Open centre revenue up 15% to £2.6bn
    - Record profit before tax of £489.5m
    - Operating profit up 8% to £137.7m
    - Record cash generation of £649.2m
    - £100m share repurchase programme announced
    - Increased cash to shareholders – up 14.7% to £107.7m
    - 3,388 locations in more than 110 countries
    - 277 new locations added
    - Rationalisation of 195 locations

- Following an equally positive start by the Group in January and February, IWG provided an update on 23 March 2020 in respect of Covid-19. IWG indicated that it expected there to be pressure on the Group's global business as countrywide lockdowns were implemented. It stated it would closely monitor the ongoing developments and take all appropriate actions to reduce costs, limit capital expenditure and optimise cash flows.

- A subsequent update confirmed; "*In order to provide investors and analysts with information in respect of April's trading in the light of Covid-19, the Board has decided to defer the Group's Q1 trading update from the provisional date of 28 April 2020 to 28 May 2020.*"

- Actions taken by IWG to preserve cash flow include:-

- To pull its final dividend in an effort to shore up its balance sheet - IWG said it would not pay the final dividend of 4.8p a share that was previously declared with the Group's 2019 full-year results.

- IWG is exploring the possibility of selling and leasing back more than 10 of its UK office buildings. This would potentially raise between £200m and £250m to ease the impact of Covid-19.

- Suspension of its £100m share repurchase programme previously declared with the Group's 2019 full-year results.

- IWG considers the market has underestimated the positive opportunity offered by Covid-19 to the serviced office sector. Regus considers it is well placed to gain from the future flexibility occupiers will demand as the traditional office environment adjusts to increased remote working and different ways of connecting people.

8. Tenant Corporate Activity (Marlow) – Cobham plc

- Cobham settled a long-standing tax dispute with the UK government. This was in connection with the availability of interest deductions on one of the Group's internal financing structures, which was in place between 2008 and 2014. Cobham has agreed to make a one-off tax payment of £55m, together with a one-off interest payment of £14m, to settle the matter.

- Unrelated to the above tax settlement but considered prudent practice by the Group, Cobham continues to monitor developments relating to EC State Aid investigations. In April 2019, the EC's final decision on the UK Government's Controlled Foreign Company regime was that it partially represents State Aid. The UK Government has yet to announce how it might seek to recover State Aid, which if recovered, has been estimated by Cobham plc to be up to approximately £60m.

- During the early summer of 2019, the Group's corporate news was dominated by an approach from US private equity firm Advent International Corporation to acquire Cobham plc.

  On 25 July 2019, Cobham shares shot up around 35% as Advent offered to pay shareholders 165p per share valuing the Group at about £4bn. Cobham's closing share price the day before was 122.75p advancing to close £165.76 a day later on the announcement.

  Cobham Chairman, Jamie Pike told investors the Cobham board is unanimously recommending the offer from Advent as it "*represents an opportunity for shareholders to realise their investment in Cobham in cash in the near term. We believe that Advent would provide a complimentary partner for Cobham's stakeholders.*" He confirmed that Artemis Investment Management, a 5% shareholder, was backing the deal.

  Advent managing director, Shonnel Malani, said; "*We are pleased the board of Cobham has agreed unanimously to recommend the acquisition of Cobham*

by Advent. We strongly believe in the importance and potential of Cobham's businesses and look forward to bringing our long track record of successful stewardship of companies to ensure that Cobham flourishes under our ownership."

- On 17 September 2019, the government announced its intention to intervene in Advent's takeover of Cobham, citing national security concerns. This was partly in response to intensive lobbying by Lady Nadine Cobham, 76, the widow of Sir Michael Cobham, who built up the firm over 25 years. Lady Cobham spoke of her concerns about the takeover deal, telling the Mail on Sunday that Cobham "*deserves to be protected*" by the government.

  "*Following careful consideration of the proposed takeover of Cobham, I have issued an intervention notice on the grounds of national security";* said Business Secretary Andrea Leadsom.

  "The Competition and Markets Authority (CMA) will investigate and carry out a review on the national security implications of the transaction. The government has the power to veto the deal if the CMA finds there are sufficient concerns. It must report the results of its decision by 29 October 2019."

- The takeover was approved by the government on 20 December 2019. In a statement issued by Business Secretary Andrea Leadsom, she confirmed she was satisfied the risks had been identified and mitigated to allow the deal to go ahead.

- As a condition of government approval, economic undertakings will be legally binding on Advent to reflect their commitment to the UK and to safeguard the important role Cobham plays in the UK economy and the defence sector. Crucially, this includes the level of Cobham's employment of employees in the UK.

- The takeover of Cobham plc by Advent International was completed on 17 January 2020 with shares closing for the final time at 164.60p.

- Founded in 1984, Advent International is one of the largest and most experienced global private equity firms; "*it seeks to invest in well-positioned companies and partner with management teams to create value through sustained revenue and earnings growth.*"

- Advent is an active investor who seeks to build a collaborative relationship with management teams; "*we typically sit on the company's board and are involved in developing and overseeing strategy. We do not take part in day-to-day operations, however, as we believe that is the role of the leadership team*".

Appendix A

EEPIC Financial Statements

For the Year Ended 31 March 2020