Shareholder Annual Review

Covering the accounting period

1 April 2020 - 31 March 2021

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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 £1,821,291.27 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	£1,821,291.27 (2.5% pa uplift)	5.51%
Bracknell	20/11/17	£25,500,000	£1,770,300 (Jan 26 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.

2020/21 highlights:-

- Full-year profit before tax, excluding property revaluations, of £1.453m (prior year £1.553m)
- £0.868m dividend paid to the shareholder (prior year £1.0399m)
- £0.465m retained earnings at 31 March 2021 (£0.064m at 31 March 2020)
- At Marlow, the tenant has an agreement to defer the June 2020 quarter rent (£442k) until June 2021. All other rent has been paid.
- The rent payable for Marlow (The Cobham Centre) increased from £1,776,869.53 to £1,821,291.27 with effect from 29 September 2020. This represents the annual 2.5% fixed rental increase as per the terms of the lease. The next rental increase to £1,866,823.55 is due from 29 September 2021.
- At Bracknell, it was agreed to defer March 2020's rent of £443k until March 2021. Furthermore, agreement has been reached for a 15-month rent-free period, spread over 30 months at half rent, from September 2020 to March 2022. This is in exchange for extending the lease by 5 years and all rent has been paid.
- No capital expenditure or repairs incurred in the financial year

- EEPIC's cash balance at 31 March 2021 was £0.97m (£1.25m prior year)

- The 2020/21 external audit was completed by William & Co within the agreed budget.

- The Bracknell tenant is Bracknell Arlington Square Centre Ltd trading as the serviced office provider, Regus.

- The continuing pandemic has had a major short-term operational impact on the Regus serviced offices business model. Long-term, Regus remains well capitalised and is ideally 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.

- A Deed of Variation between EEPIC and Regus was subsequently completed on 23 December 2020 as reported to the Shareholder Sub-Committee on 24 November 2020 and made the following variations to the existing lease:-

    - Remaining length of the lease increased from 5 years to 10 years, in exchange for an initial 15 month rent free period (spread over 30 months at half rent). The headline rent payable under the existing lease does not change; remaining at £1,770,300 per annum.

    - The existing lease allowed for the rent to be reviewed on 15 January 2021. This date was moved to January 2026 in line with the 5 year lease extension.

    - Following a corporate restructuring of its business (and as part of the proposed lease variation), Regus Holdings plc replaced Regus plc as EEPIC's new lease guarantor. The new company provides EEPIC with the same level of financial guarantee that the Company previously received. The new lease guarantor had already been accepted in other lease re-negotiations by major landlords including Columbia Threadneedle, Crown Estate, Langham Estate and Orchard Street.

- The current rent becomes £885,150 pa equating to a half rent quarterly payment of approximately £221,000 for 30 months from September 2020. The lease is now subject to an upwards only rent review on 15 January 2026.

- The additional 5 year lease term doubles the unexpired term of the existing lease with no change to the level of rent. The rent generated by the additional 5 year term equates to £8,851,500 (annual rent of £1,770,300 x 5 years) and ignores any additional rent that might be generated by the rent review process. The 15 month rent free period proposed to be granted equates to £2,212,875 (£1,770,300 pa x 15 months). The net benefit to EEPIC is an additional income stream totalling £6,638,625. This provides the Shareholder with long-term assurance that the Company can meet its Shareholder objectives.

- Accounting standards (FRS102) require that the 15 month rent free period must be spread evenly over the whole 10 year lease term in the statutory accounts. Consequently, reported income and retained earnings for 2020/21 are higher than the actual rent collected in the year.

- In addition to its reporting requirements to the Shareholder Sub-Committee, EEPIC required the consent of the Council (acting in its capacity as its Lender), to vary by deed the existing lease of its property at Bracknell.

- The Council formally provided its consent to EEPIC by approving the Company's request under Agenda Item 8 at its Strategy & Resources Committee meeting held on 22 December 2020.

4. 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 of EEPIC's property acquisitions and can therefore provide an independent, external assessment of the two property assets.

	Valuation @ 31/12/20 (last year's valuation) £	Purchase Price / Date £	Variance (since purchase) £
Marlow	33,571,500 (33,135,200)	31,000,000 13/10/17	+2,571,500
Bracknell	25,044,700 (27,326,700)	25,500,000 20/11/17	-455,300
Total	58,616,200 (60,461,900)	56,500,000	+2,116,200

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 Marlow has recorded a 1.3% capital increase on last year's valuation.

In contrast, Bracknell has recorded an 8.3% capital decrease on last year's valuation due primarily to the immediate effect of the 15-month rent free period as part of the Regus Deed of Variation.

It should be noted that despite the Bracknell capital decrease, EEPIC's portfolio (i.e. both properties together) has recorded capital growth in excess of £2m since purchase.

5. 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 2021.

Financial highlights include:-

- Property portfolio of £58.6m
- Gross profit of £3.44m
- Profit before tax (excluding property revaluations) of £1.45m
- Dividend paid of £868,000

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.

6. Tenant Corporate Activity (Bracknell) – IWG plc

- Following a 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.

- On 3 November 2020, IWG released its Third Quarter Trading Statement under the banner;

  “*Strong cash performance in the quarter; continuing increased interest in flexible working*”

- Regus stated the impact of the pandemic has been greater than they had anticipated with the priority remaining the long term resilience of the business.:-

    - *£26.8m of net cash generation in the 3rd quarter*
    - *Positive net cash position of £10.9m at 30 September 2020*
    - *Liquidity headroom of £863.2m at 30 September 2020*
    - *In the 3 months to 30 September 2020, revenue declined to £583.3m compared with £680.3m in the same period last year, a decrease of 10.2% at constant currency.*
    - *On track to achieve targeted annualised cost savings of approximately £200m*
    - *Increasing demand from corporates, three-fold increase in conversations with large companies*
    - *Covid-19 related network rationalisation programme currently tracking in line with expectations*
    - *Net reduction of 33 locations in Q3, taking worldwide network total to 3,359 locations*

- Mark Dixon, Chief Executive Officer commented;

  “*2020 has presented the toughest challenge the Group has experienced since its formation 31 years ago. It is an unprecedented storm, but with the decisive actions we have taken across the business we are navigating its impact and look forward to entering 2021 as a stronger, more profitable business capable of increased cashflow generation supplemented with potential revenue recovery*.”

- On 2 December 2020, IWG announced the launch of a £300m convertible bond offering demonstrating confidence in the long term demand for flexible space. The seven year bonds will pay 0.5% pa and are convertible into ordinary shares at a premium of 40% to the volume weighted average price of the shares.

- 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.

- On 9 March 2021, IWG announced its annual results for the year ended 31 December 2020, stating;

  "*Whilst 2020 was a challenging year, our decisive action has reset the Group to take advantage of accelerating demand for hybrid working. COVID-19 created the most challenging year in our history but provides our greatest opportunity in 31 years.*"

- Annual results key highlights included:-

    - *Adjusted operating loss from continuing operations of £173.8m (2019: profit of £136.8m), in line with management expectations*

    - *Open centre revenue up 0.5% to £2,393.4m*

    - *Total revenue down 5.3% to £2,480.2m*

    - *Strong demand for products supporting hybrid working: Virtual Office and VO customer services revenue growth 6.4%*

    - *Strengthened financial position following £320m equity placing and £350m convertible bond offering*

    - *Net debt at 31 December 2020 of £351.1m; net debt reduced in Q1 2021 with return of £283.7m of investment*

    - *£802.3m of available liquidity as at 31 December 2020*

- Mark Dixon, Chief Executive Officer commented;

  "*This was a period of exceptional change for IWG, for our employees, our clients and for the overall business environment worldwide. Certainly, 2020 was very difficult, and I anticipate these challenging market conditions to prevail for a few months to come. Indeed, we made additional provisions for further network rationalisation as the recovery from the pandemic continues to take longer than we anticipated last summer. I believe this was a prudent* *decision that emphasises our commitment to doing what needs to be done for the greatest long-term benefit of the Group.*

But 2020 was also a year when our market underwent a decade of evolution in just 12 months. It was a year when companies across the world discovered first-hand that their workforces could be highly engaged and productive while utilising the hybrid way of working: at home, in a local office, and occasionally at corporate HQ. This trend is not new, but one that has been accelerated by the emergence of the COVID-19 pandemic. Today, we anticipate a massive surge in growth when we eventually emerge from the unprecedented downturn that the COVID-19 pandemic has created. The sheer scale of our global network positions us uniquely well to benefit from this surging demand. At the same time, our franchising and management agreement strategies are performing to plan as the spearhead of our capital-light expansion strategy. In summary, we are progressing well on our plans to strengthen our position as the leading service provider to the global flexible workspace industry and I firmly believe that the years ahead will be tremendously exciting for our business"

- 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.

7. Tenant Corporate Activity (Marlow) – Cobham plc

- As previously reported, 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*."

- It should be appreciated that EEPIC's tenant at Marlow is Chelton Ltd, a subsidiary of Cobham and itself a profitable world leader in the design and manufacture of aviation communication systems and navigation antennas. Cobham plc would only become involved as guarantor if EEPIC's tenant became insolvent.

- It was reported by Bloomberg (30 September 2020) that Advent International was exploring a sale of Chelton Ltd.

- It was announced on 24 November 2020 that Cobham Aerospace Connectivity was under offer to US based TransDigm Group Incorporated. The deal is understood to be worth $965m and is subject to regulatory approvals.

- TransDigm announced on 5 January 2021 that it had completed substantially all of its acquisition of Chelton Ltd, t/a Cobham Aerospace Connectivity. Its press release stated;

  "*Cobham Aero Connectivity is headquartered in Marlow, UK. CAC is a leading provider of highly engineered antennas and radios for the aerospace end market. The products are primarily proprietary with significant aftermarket content and have a strong presence across major defense platforms as well as select commercial applications. The Company generated approximately $225 million in revenue for the fiscal year ended December 31, 2020. Nearly 60% of CAC's revenue is derived from international sales and over 70% of CAC's revenue comes from the aftermarket. The Company has a strong presence across a diverse range of both helicopters and fixed wing aircraft. The Company operates from two primary facilities in Marlow, UK and Prescott, Arizona. CAC employs approximately 760 people*."

- TransDigm Group, through its wholly-owned subsidiaries, is a leading global designer, producer and supplier of highly engineered aircraft components for use on nearly all commercial and military aircraft in service today.

- Chelton announced on 21 March 2021 that it had been selected by Boeing to develop and deliver the next generation Ultra High Frequency SATCOM Mobile User Objective System (MUOS) conformal antennas. The equipment upgrade will be for approximately 319 aircraft with testing due to begin in Autumn 2021.

Appendix A

EEPIC Financial Statements

For the Year Ended 31 March 2021