Shareholder Annual Review

Covering the accounting period

1 April 2022 - 31 March 2023

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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 was 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:-

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

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 £1,913,494.14 pa and subject to annual fixed uplifts of 2.5% pa (the rent will increase to £1,961,331.49 from 29 September 2023). The rent is guaranteed by Cobham PLC.

A Reversionary Lease between EEPIC and Chelton Ltd was approved by the Shareholder Sub-Committee on 22 November 2022 and completed on 26 July 2023. The 10 year reversionary lease takes effect from the expiry of the existing lease on 29 September 2036 in exchange for the reversionary lease adopting standard 5 yearly open market rent reviews. This provides Chelton Ltd with the long term certainty to invest in the property and benefits EEPIC by providing further long term secure income (guaranteed by Transdigm Inc).

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).

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

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.

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

A Deed of Variation between EEPIC and Regus was completed on 23 December 2020 (as reported to the Shareholder Sub-Committee on 24 November 2020) and varied the existing lease. The 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).

A further Deed of Variation (approved at the Shareholder Sub-Committee on 13 April 2023) extended the length of the lease by an additional 5 years to expire on 14 January 2036. This provides EEPIC with further long-term income security in exchange for the tenant being granted an initial 12 month rent free period (spread over 24 months at half rent).

The rent reverts to the full rent of £1,770,300 pa from 29 March 2025 with an additional rent review on 15 January 2031 in line with the extended lease.

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

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 55% - 75% 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	£1,913,494.14 (2.5% pa uplift)	5.78%
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.

2022/23 highlights:-

- Full-year profit before tax, excluding property revaluations, of £1.42m (prior year £1.40m).

- £0.60m dividend paid to the shareholder (prior year £0.60m).

- £1.4m retained earnings at 31 March 2023 (£0.9m at 31 March 2022).

- The rent payable for Marlow (The Cobham Centre) increased from £1,866,823.55 to £1,913,494.14 with effect from 29 September 2022. This represents the annual 2.5% fixed rental increase as per the terms of the lease. The next rental increase to £1,961,331.49 is due from 29 September 2023.

- No capital expenditure or repairs incurred in the financial year.

- Property valuations have decreased by £8.6m over the year.

- EEPIC's cash balance at 31 March 2023 was £1.15m (£1.24m prior year).

- The 2022/23 external audit was completed by William & Co within the agreed budget.

Marlow

The Marlow tenant is Chelton Ltd and in 2022 achieved 75 years of trading, having been first established in 1947. Chelton defined the avionics industry with a number of world firsts; from novel static discharger designs, radio silent tuneable antennas through to the first airborne mission critical public safety radio.

A Reversionary Lease between EEPIC and Chelton Ltd was approved by the Shareholder Sub-Committee on 22 November 2022 and completed on 26 July 2023. The 10 year reversionary lease takes effect from the expiry of the existing lease on 29 September 2036 in exchange for the reversionary lease adopting standard 5 yearly open market rent reviews. This provides Chelton Ltd with the long term certainty to invest in the property and benefits EEPIC by providing long term secure income until September 2046.

Bracknell

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). It increased the length of the lease 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 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.

A further Deed of Variation between EEPIC and Regus was agreed by the Shareholder Sub-Committee on 28 March 2023. This increased the unexpired term of the lease by an additional 5 years to 14 January 2036, in exchange for 12 months rent free at half rent for 24 months.

The further 5 year lease term generates an additional £8,851,500 (annual rent of £1,770,300 x 5 years) in exchange for foregoing 1 year's annual rent (£1,770,300 pa spread over 24 months at half rent).

The rent reverts to the full rent of £1,770,300 pa from 29 March 2025 with an additional rent review on 15 January 2031 in line with the extended lease.

Long-term, IWG (Regus parent company) remains well capitalised at £1.5bn 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.

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 @ 31/12/22 **(last year's valuation)**	**Purchase Price / Date**	**Variance (since purchase)**
	£	£	£
Marlow	30,181,800 (33,996,100)	31,000,000 13/10/17	-818,200

Bracknell	20,719,500 (25,525,400)	25,500,000 20/11/17	-4,780,500
Total	50,901,300 (59,521,500)	56,500,000	-5,598,700

The Company's business case is specifically to hold property long term and attention is drawn to the 18.8% capital decrease at Bracknell and the 11.2% capital decrease at Marlow (compared to last year's valuations).

The property valuations have dropped in line with the property market as it adjusts to higher UK bond yields. It is for this precise reason why the properties are held long term to smooth out gyrations in the UK property market and economy.

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 2023.

Financial highlights include:-

- Property portfolio of £50.9m
- Gross profit of £3.40m
- Profit before tax (excluding property revaluations) of £1.422m
- Dividend paid of £602,928

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. Shareholder Approval

At its Shareholder Sub-Committee meeting held on 23 November 2022, the Shareholder received and noted EEPIC's Report to Shareholder and Annual Review.

In accordance with the Shareholder Agreement, the Shareholder approved the following:

- Annual Business Plan 2023-2024
- Appointment of Clare Lawrence to position of Development Director. (Note - the appointment was never formally made to Companies House as Clare resigned from the Shareholder shortly after Sub-Committee).

- A recommendation to fill the Director vacancy will be made to the next Sub Committee.

7. Tenant Corporate Activity (Marlow) – Chelton Ltd / TransDigm Group

- 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 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 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.

- On 27 April 2021, Cobham Aerospace Connectivity rebranded to Chelton;

  "*More than 20 successful years have passed since Chelton joined the Cobham brand and now it is set to go full circle and return to its brand roots as Chelton.*

  First established in 1947, Chelton defined the avionics industry with a number of world firsts; from novel static discharger designs, radio silent tuneable antennas through to the first airborne LTE mission critical public safety radio. Having achieved many more world firsts as part of the Cobham family, it is now set to go full circle and return to its brand roots as Chelton. Continuing its founders' principles to overcome immensely complex communication challenges and deliver failsafe, pioneering technology to some of the world's most formidable militaries and public safety agencies.

  Chelton is a powerful presence in the aerospace and defence sector, and while our tenure as Cobham Aerospace Connectivity was fruitful, going back to our heritage with a modern twist will help further secure our established foothold in the industry. Chelton has been a trusted and reliable avionics designer and manufacturer for over 70 years and we look forward to continuing to serve our customers with the same drive and smart thinking as its original founders."

- On 29 November 2021, Chelton opened a new facility at Redhill Aerodome to support its life saving research and development (R&D), including IED detection and radio for public safety applications.

The Mayor of Reigate & Banstead officially opened the facility at the inaugural ceremony along with representatives from humanitarian mine clearance charity The HALO Trust.

The new facility does not affect EEPIC's property which remains the main HQ site for operations.

- On 6 March 2022, Chelton achieved 75 years of trading, having been first established in 1947. Chelton has; "*Spent the past seven decades defining and advancing the avionics and defence industry with a number of world firsts; from novel static dischargers and radio silent tuneable antennas through to the ground-breaking airborne 4G public safety radio, pioneering stand-off explosive ordnance detection systems using Ground Penetrating Radar and a trailblazing land-based Air Traffic Management System to be used at sea.*"

8. Tenant Corporate Activity (Bracknell) – IWG plc

- On 7 March 2023, IWG announced its annual results for the year ended 31 December 2022 under the banner;

  "*IWG delivers highest ever revenue in its 34 year history*"

- Attention is drawn to the following key highlights:-

  - *24% growth in system wide revenue to £3.1bn reflecting increased demand for flexible working and higher pricing.*
  - *Network footprint of more than 65 million sq ft – market leader worldwide by far with 3,345 locations.*
  - *Operating profit of £147m in 2022 (£87m operating loss in 2021)*
  - *EBITDA increase of 442% to £317m (2021: £59m) driven by a combination of higher revenue and cost focus*
  - *26.5% of building capacity remaining with occupancy at 73.5%*
  - *Record signing of 462 new capital light contracts completed in 2022 delivering both further capacity increases across the network and an even more unrivalled global network.*

- Mark Dixon, Chief Executive of IWG plc commented,

  "The growth juggernaut in hybrid working continues and 2022 has been a record year for IWG with our highest-ever revenue produced in our 34-year history, up 24% from 2021. We have delivered this through our multi-brand strategy, primarily Regus and Spaces, and continue to have the largest global network of hybrid workspace by far. We have also shown that we can deliver both high levels of growth and profitability alongside EBITDA and cash flow generation. We have done this through a combination of higher demand for flexible work products, higher pricing

and continued cost discipline, and I am looking forward to continuing this momentum in 2023.

During 2023 we will continue building on our capital-light growth strategy which allows us to capitalise on the growing pipeline of property investors seeking to maximise their returns by partnering with IWG. We continue to be well-placed to deliver further revenue, profitable growth and reducing leverage as more companies permanently embrace hybrid working as their preferred model, with IWG set to benefit most as by far the leading global player."

- IWG is promoting a new "capital-light contract" operating model with landlords where landlords share in the profit generated by Regus. Whilst this has the potential to provide the landlord with greater income returns, it is essentially a capital risk transfer exercise for IWG.

- Under the new model, the landlord carries the full or majority cost of the operation's capital expenditure i.e. fitting out the accommodation. Furthermore, as it is a service agreement and not a lease, Regus is not committed to the obligations contained in a lease, namely, the payment of a fixed rent. For the landlord, this means that its share of the profit can fluctuate depending on the success of the centre and the prevailing economic conditions.

- Whilst IWG has undoubtedly benefited from the general increase in flexible working, it is not immune to UK / global economic challenges. Analysts are concerned that rising inflation / debt costs and the gloomy global economic outlook will hamper its recovery.

- This is picked up in IWG's own outlook which remains cautiously upbeat;

  "*The demand for hybrid working solutions continues to grow as businesses globally seek to reduce their real estate costs and respond to the needs of their employees. Whilst there are macroeconomic headwinds around global growth, which can impact demand, plus challenges for the Group from inflation and interest rates impacting costs, we remain cautiously optimistic about the outlook for 2023.*"

- IWG plc shares closed on 19 May 2023 at 147.60p down approximately 38% on the previous year (19 May 2022 at 238.50p). This reflected the wider economic and inflationary challenges affecting UK corporate growth. However, IWG remains a £1.509bn company well positioned to take advantage of the post pandemic hybrid working environment.

Appendix A

EEPIC Financial Statements

For the Year Ended 31 March 2023