Our resilience

In accordance with the 2018 UK Corporate Governance Code (the Code), the Directors and senior management team assessed the prospects of the Company and potential threats to our resilience:

- **in the short-term (over the next 12 months as required by the 'Going concern' provision); and**
- **in the medium-term (a five-year period to 31 December 2028) as required by the 'Viability statement' provision.**

This statement also contains references to the longer term threats to the Company's resilience (beyond the five-year period).

Short-term

Under provision 30 of the Code, the Board is required to report whether it considers it appropriate to adopt the going concern basis of accounting in the preparation of our financial statements. The assessment focused primarily on the short-term and at least the next 12 months to February 2025.

The Directors' assessment included consideration of:

- the Group's current financial position;
- the latest rolling forecast for the next two years, in particular the cash flows, borrowings and undrawn facilities;
- the timing of repayment of existing financing facilities;
- potential sources of replacement financing;
- lease expiry profile; and
- any material uncertainties or assumptions.

The Group is in a strong financial position. At 31 December 2023, the Group has:

- £466m of undrawn facilities and cash (2022: £577m);
- a low EPRA loan-to-value ratio of 28.0% (including share of joint ventures);
- a low overall cost of debt with a weighted average interest rate of 3.29% as at 31 December 2023;
- 98% of our borrowings either fixed or hedged;
- significant headroom on our financial covenants; and
- strong interest cover of 414% (inc. share of joint ventures).

The Group has sufficient access to finance in the short-term and medium-term.

At 31 December 2023, our average maturity of borrowings is 5.0 years and average maturity of facilities is 4.5 years. The Group's next loan maturity is the £83m secured loan with Mass Mutual, which matures in October 2024. We are in early discussions with the existing lender, and also speaking to a number of other potential debt providers who have expressed interest in developing a lending relationship with us.

Alternatively, we have sufficient headroom on our revolving credit facility to repay the secured loan. Whilst the debt capital markets remain challenging for real estate, we have remained close to our existing lenders and continue to engage with new possible debt providers. We are also reviewing pricing and the availability of debt in the secured lending markets, which are currently looking more favourable for businesses with stronger credit profiles.

With interest rates rising considerably over the past six months, the Group benefits from having strong interest cover and substantially all borrowings are either fixed or hedged. Additionally, the Group can make use of a £75m forward-starting swap which has a fixed rate of 1.36% and runs to April 2025.

Material uncertainties or assumptions

The Directors did not identify any material uncertainties to the Company's ability to continue to operate as a going concern over the period of its assessment. The key sources of estimated uncertainty in the next 12 months are considered to be:

Tenant default or failure

The economic situation, high interest rates and cost inflation continue to cause a heightened risk of financial difficulty among some of our tenants. The impairment review of outstanding trade receivable balances and amounts due under the spreading of lease incentives has been carried out for our largest tenants and others where we believe the risk is greatest. It has resulted in a decrease of £0.4m in our overall impairment provision and a net charge to the income statement of £2.0m in the year. This is mainly due to write-offs of certain tenants' balances.

Fall in property values

Sentiment towards office real estate has weakened in 2023, driven mainly from the US. Together with higher interest rates, this has impacted property yields. The impact of yield changes on the Group's financial covenants and performance are monitored and are subject to sensitivity analysis and testing against severe yet plausible 'downside' scenarios to ensure that adequate headroom is preserved. The Group's low loan-to-value ratio reduces the likelihood that falls in property values have a significant operational impact on our business. Property values would need to fall by a further 53% before our funding covenants would be breached.

Related information is on the following pages:

Significant financial judgements/**See page 146**

Property review/**See page 62**

Group's risk register

The Schedule of Principal Risks contains the risks which are currently impacting on the Group or could impact the Group over the next 12 months. These risks are routinely subject to a comprehensive review by the Executive Committee, Risk Committee and the Board. Consideration is given to the risk likelihood, impact and velocity (speed at which the risk could impact on the Group). The Board agreed that, given the level of headroom, none of the changes in risk likelihood or probability during the year had a significant impact on the Group's short-term viability.

Going concern statement

After making appropriate enquiries, the Directors have a reasonable expectation that the Group and Company have adequate resources to continue in operational existence until at least February 2025. Therefore, the Board continues to adopt the going concern basis in preparing the financial statements.

Medium-term

The Directors challenge the time period over which to assess the Company's medium-term viability on an annual basis. The Directors determined that the five-year period to 31 December 2028 remains an appropriate period based on the following:

- for a major scheme, five years is a reasonable approximation of the time taken from obtaining planning permission for a typical development to letting the property;
- most leases contain a five-year rent review pattern or break options. Therefore, five years allows for the forecasts to include the reversion arising from those reviews while also assessing the potential impact of income lost from breaks exercised. Our weighted average unexpired lease term is 7.4 years ('topped-up' including rent-frees and pre-lets); and
- our average maturity of borrowings is 5.0 years as at 31 December 2023.

As part of its assessment, the Board considered the Group's emerging risks (page 102), including how these were being addressed. Emerging risks involve a high degree of uncertainty and are therefore factored into the Board's medium-term viability assessment and the long-term sustainability of the Group. The methodology used to identify, assess and monitor emerging risks is described in the risk management framework on pages 160 and 161.

The Directors concluded that none of the individual emerging risks would in isolation or collectively compromise the Group's viability over the five-year period to 31 December 2028.

The Board's medium-term assessment focused on our strategy, finance and operations.

Viability of our strategy

The Board formally reviews its strategy on an annual basis to ensure it remains capable of sustainable value creation and is responding appropriately to changing macroeconomic conditions, work practices and stakeholder expectations.

When assessing the viability of the Group's strategy, the Board's key qualifications and assumptions were:

- a continued focus on the central London office market;
- a strategy of recycling capital by selling buildings when we have maximised their potential, or they no longer meet our investment criteria, and purchasing buildings where there is an opportunity to replenish our development pipeline or add value via asset management or refurbishment;
- maturing debt facilities could be refinanced, albeit generally at a higher cost than the prevailing rate;
- a property portfolio which remains approximately the same size, at 5.39m sq ft (2022: 5.46m sq ft); and
- a progressive dividend policy, whilst targeting dividend cover in or above the range of 125% to 150%.

The Board agreed that we have a proven business model which has allowed us to remain flexible and resilient during previous property cycles and periods of significant uncertainty. Additionally, we have the ability to flex our business plan to react to unforeseen circumstances by either selling a property to generate additional cash flow or commencing, stopping or scaling back projects to manage our capital expenditure.

Given the political and economic uncertainties, there has been a slowdown in the investment market although the letting market remains resilient. The Directors noted that occupier demand remains good for the right product. Our strong financial position and proactive stakeholder-focused approach will help us to weather the economic and political uncertainty.

The Board agreed that no material change was required to its strategy, which continued to generate sustainable returns.

GOING CONCERN & VIABILITY continued

Viability of our strategy continued

Sensitivity and scenario testing

A detailed five-year strategic review was conducted which considered the Group's cash flows, dividend cover, REIT compliance and other key financial ratios over the period. These metrics were subjected to sensitivity analysis to assess the Group's ability to deliver its strategic objectives.

The Directors stress tested our strategy against various scenarios to determine whether they were likely to have a significant impact on the Group's solvency and liquidity in the short- and medium-term. In addition, a reverse stress test scenario was modelled to determine the circumstances under which we would breach our covenants.

The scenarios are amended each year as required, to reflect the key areas of concern identified by the Board. The four scenarios assessed were:

- a 'base case' scenario which was management's best estimate of market and business changes; and
- three scenarios (two downside and one upside) of varying movements in property values, costs and income, or a combination thereof.

In all scenarios, our net interest cover remained above 3.45 times and our EPRA loan-to-value ratio below 35%, both of which are comfortably within our financial covenants. The modelling indicated that under all scenarios the Group would still be able to execute its strategic plan over the next five years without breaching any covenants or experiencing any liquidity concerns.

Nature of office occupation

The Directors considered changing work practices and tenant demand for amenity-rich sustainable space which has been identified as an emerging strategic risk for the Group.

The Board was satisfied that the business was:

- responding appropriately to the changing needs of our occupiers via bespoke solutions which recognise the differing demands of our diverse customer base. For larger occupiers, typically on longer leases, this might mean a combination of core and flex space with some optionality. For smaller occupiers looking for greater flexibility, our 'Furnished + Flexible' product provides an attractive solution;
- delivering well-designed, adaptable and amenity-rich workspace. Our customer-focused approach led us to initiatives such as DL/Lounges and DL/Service (see pages 23 and 133); and
- being proactive to ensure the achievement of our net zero carbon ambitions, operating a continuous upgrade/refurbishment programme to improve the sustainability credentials of our older buildings, investing in Intelligent Building infrastructure to create sustainable spaces for our occupiers, and investing in software for effective ESG data capture.

Viability of our finances

Derwent London would become unviable if we were unable to meet our financial covenants. If this occurred, we would need to repay our debt borrowings, and this would likely require the sale of assets to meet these liabilities. As at 31 December 2023, we have significant headroom over our covenants, as shown below:

	Covenant	31 Dec 2023
Loan to value (specific assets)	≤ 60%[1]	**44%**
	≤ 70%[2]	**34%**
Ratio of unencumbered assets to unsecured net debt	≥ 1.6 times	**3.8 times**
Group NAV gearing	≤ 145%	**38.7%**
Consolidated interest cover[3]	> 145%	**414%**

1 6.5% secured bonds.
2 3.99% secured loan.
3 Includes joint ventures.

Our covenant headroom was subject to sensitivity analysis and scenario testing as part of the Group's strategy review. Even in the most extreme 'downside' scenario we modelled, the covenant ratios are covered and there is sufficient cash and unutilised facilities available.

For the Group to breach the NAV gearing limit, the value of our portfolio would have to fall in excess of £2,572m (or by a further 53%). This is significantly higher than we have seen in recent market down cycles, the worst of which was following the Global Financial Crisis where the value of our underlying portfolio fell 34% but still outperformed the MSCI Central London Office Index which fell 43%. Moreover, we have the ability to move properties between the facilities to optimise headroom under covenants.

To assess the Group's liquidity and financial resilience, the Directors also reviewed:

- a detailed five-year strategic review which included assessment of the Group's cash flows, dividend cover, REIT compliance and other key financial ratios. These metrics were subjected to sensitivity analysis to assess the Group's ability to deliver its strategic objectives under varying market conditions;
- the risks which could impact on the Group's liquidity and solvency over the next 12 months, five years and the longer term; and
- the Group's emerging risks.

The Board's assessment highlighted that, despite the macroeconomic environment deteriorating during 2023, the Group benefits from:

- reasonable income visibility for the life of our leases which on average are 11.5 years (including rent-frees and pre-lets) with upward-only or contracted rent reviews. In addition, the Group has a known level of tenant lease expiries and breaks which is actively managed by our Asset Management team; and
- a high quality customer base of tenants, with none of our occupiers being responsible for more than 8% of total rental income and relatively low exposure to the retail and restaurant sectors.

Refinancing risk

Refinancing risk has been classified as a principal financial risk for the Group. The availability and cost of financing has changed significantly in the past year and is a wider industry issue. Lenders are being more selective in terms of who they support and how much they lend with an impact upon liquidity. We have positive relationships with our lenders and, to date, we have had positive discussions on refinancing with existing and new lenders. The Directors considered that refinancing was unlikely to compromise the Group's viability over the five-year period to 31 December 2028.

Viability of our operations

The Board received an update from the Chairs of the Audit and Risk Committees on the work performed during 2023 in respect to risk monitoring and reviewing the effectiveness of internal controls (see page 92).

We have a robust approach to cyber security which is routinely subject to independent testing (see pages 162 and 163). Our Intelligent Building Programme is a medium- to long-term initiative which will assist with meeting our net zero carbon ambitions, the strengthening of our portfolio's cyber security and cost savings for our occupiers.

Of the Group's emerging risks, the Board considered EPC compliance to have the greatest potential impact on the Group in the medium-term. Our approach to product and service, in a market where the demand for high quality amenity-rich buildings is increasing, is detailed on pages 18 to 23.

Based on the Board's assessments, none of the operational principal or emerging risks currently facing the Group were likely to have a material impact on the Group's operations or cause it to become unviable in the short- to medium-term.

Related information is on the following pages:

- Business continuity and disaster recovery / **See page 163**
- Investing in our employees / **See page 184**
- Mandatory compliance training / **See page 165**

Viability statement

Based on the Board's assessments, the Directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the five-year period to 31 December 2028.

Long-term

The Board considered a number of longer term factors (which could impact on the Company and its business model in the next five to 10 years) and how these were being addressed. These factors included the impact of climate change and technology advancement.

Related information is on the following pages:

- Business model & strategy / **See pages 28 to 36**
- Regeneration projects / **See pages 26 and 27**
- Right product, right location / **See pages 18 to 23**

Climate change

Derwent London is committed to be net zero carbon by 2030. The Group has conducted risk assessments against varying temperature scenarios (~1.5°C, ~2°C to 3°C, >4°C) to identify and assess our key transition and physical risks. The time frames used for these assessments have focused on our short-, medium- and long-term resilience (see page 105).

Of the risks identified, none were likely to have a substantial impact on the viability of our business, although our cost profile could increase.

The Board receives updates on our progress to net zero carbon by 2030. The factors which could impact on our ability to become net zero carbon by 2030 have been identified as:

Newly acquired properties: one of the ways we add value through our business model is by acquiring poorer quality buildings to regenerate. As a result, there is likely to always be an element of our portfolio which is progressing towards becoming net zero carbon.

Unmanaged portfolio: within our portfolio we have a number of single-let buildings, with long leases, where the occupier is responsible for maintaining the property and ensuring its energy efficiency (currently 19% of our portfolio). As we are not responsible for the management of the building, this could be an area of challenge to achieving net zero carbon by 2030. We are actively engaging with these occupiers to promote the benefits of net zero carbon.

Emerging regulation and science: our strategy to becoming net zero carbon will need to adapt in line with emerging regulation, planning policies and science.

- Building climate resilience / **See pages 104 to 117**

Intelligent buildings

Adoption of technology is an emerging risk for the Group. Technology in our sector is advancing at a rapid pace.

The Executive Committee has monitored the phased roll-out of Intelligent Building infrastructure during the year. The Derwent London Intelligent Building Programme seeks to enable our buildings (where appropriate) to be digitally monitored and operated more efficiently, driving down equipment faults (and consequential maintenance) and delivering energy and operational carbon savings.

- Digital strategy risks / **See page 163**