GOING CONCERN & VIABILITY

In accordance with the 2018 UK Corporate Governance Code (the Code), the Directors and the senior management team have assessed the prospects of the Company:

- 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 2026) as required by the 'Viability statement' provision.

This statement also contains references to the longer-term threats to the Company's resilience.

Short-term

Under provision 30 of the Code, the Board is required to report whether the business is a going concern. In considering this requirement, the Directors have taken into account the following:

- the Group's latest rolling forecast (including sensitivity analysis) for the next two years, in particular the cash flows, borrowings and undrawn facilities;
- the headroom under the Group's financial covenants; and
- the risks included on the Group's risk register that could impact on the Group's liquidity and solvency over the next 12 months.

Our principal risks

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). It was noted that tenant lease expiries or breaks represented 8% of 2022 income. However, given the level of headroom, the Board agreed that none of the changes in risk likelihood or probability during the year (see page 101) had a significant impact on the Group's short-term viability.

Significant financial judgements, key assumptions and estimates

Any key accounting issues or judgements are monitored and discussed with the Audit Committee throughout the year. The table on page 151 provides information on the key issues discussed in 2021 and the judgements adopted. The key sources of estimation uncertainty in the next 12 months are considered to be:

- **Impairment of receivables:** a review of the receivable balances as at 31 December 2021 has been undertaken (see note 3 on page 215). It has revealed a charge of £0.8m in 2021 for impairment and write-offs compared with £10.1m in 2020. Areas of focus were tenants at higher risk (particularly in the retail or hospitality sectors), tenants in administration or CVA, the top 69 tenants by size and the remaining balances classified by sector. The methodology and assumptions used have been subject to review by the external Auditors and Audit Committee (see page 151).
- **Property portfolio valuation:** when determining the value of our portfolio, the valuers consider a range of assumptions. More information is provided in note 3 on page 215 and note 16 on page 227.

GOING CONCERN STATEMENT

Having due regard to these matters, and 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 2023. 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 2026 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; and
- the weighted average unexpired term of borrowings was 7.2 years as at 31 December 2021.

Assessment of viability

The Board's medium-term assessment included careful consideration of the Group's business model, strategy and internal controls. The assessment highlighted that the Group has:

- a proven business model which has allowed us to remain flexible and resilient during previous property cycles, periods of significant uncertainty and the recent Covid-19 pandemic;
- a high quality customer base of tenants, with none of our occupiers being responsible for more than 9.0% of total rental income and relatively low exposure to the higher risk retail and restaurant sectors;
- a known level of tenant lease expiries and breaks which is being actively managed by our Asset Management team;
- reasonable income visibility for the life of our leases which on average are 7.8 years (including rent-frees and pre-lets) with upward only or contracted rent reviews;
- a higher than usual amount of new space being delivered from 2022 to 2026 as developments and refurbishments complete which could cause void levels to increase;
- a strengthened financial position. In 2021, we raised £350m via a senior unsecured green bond for a term of 10 years. As at 31 December 2021, the Group had £608m of undrawn facilities and cash (2020: £476m);
- strong relationships with our debt providers. During 2021, we extended our two Revolving Credit Facilities for a further year to 2026; and
- a low loan-to-value ratio of 20.8%.

In addition, the business model and strategy were stress tested against various scenarios and other sensitivities.

Sensitivity analysis of our strategy

A detailed five-year strategic review was conducted which considers 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.

Qualifications and assumptions

The key assumptions which underpin our strategic plan are:

- the Group's business model remains broadly unchanged and continues to focus on the central London office market;
- we continue to operate a progressive dividend policy whilst targeting dividend cover in or above the range of 125% to 150%;
- our portfolio remains approximately the same size, at 5.57m sq ft (2020: 5.56m sq ft); and
- we will recycle capital by selling buildings when we have maximised their potential, or they no longer meet our investment criteria, and purchasing buildings where there is a development opportunity to replenish our pipeline.

We have the ability to flex our business model to react to unforeseen circumstances or changes in the property cycle by either selling a property to generate additional cash flow, or commencing or stopping development projects to manage our capital expenditure. Regular financial forecasting enables us to identify and plan for additional funding requirements in advance.

Stress testing our risk resilience

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 over the five-year review period. The six scenarios assessed were:

- a 'base case' scenario which was management's best estimate of market and business changes;
- a 'downside' scenario which showed a more negative outlook on property values, longer void and rent-free periods and poorer rent collection rates; and
- a further four scenarios based on different business cases in respect to the sale and purchase of potential properties, higher inflation, future dividend payments and refinancing activities.

The Directors' assessment considered the uncertainty surrounding the duration of the Covid-19 pandemic and its medium- and longer-term impacts on the global economy, our business and stakeholders. As part of our scenarios and forecasting, the Directors considered the cost of rent-free concessions offered to occupiers, its accounting implications and potential default and impairment provisions, as well as additional potential vacancies.

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. As at 31 December 2021, the value of the portfolio could fall by 63% without breaching the gearing covenants and our property income could fall by 69% before breaching the interest cover covenant.

For further information see the following disclosures:

Debt and financing pages 94 and 95 →
Supply chain risks page 107 →
Business continuity and cyber security pages 162 and 163 →

Principal risks

The Directors identified that, of the principal risks detailed on pages 108 to 119, the following are the most important to the assessment of the Group's ability to continue to operate and meet its financial liabilities as they fall due in the medium-term:

- **Income decline:** Based on our forecasts, our income would need to decline by 69% before we were at risk of breaching our financial covenants. When subjected to a 15% fall in both rental income and property values our interest cover remained above 300% and our loan-to-value ratio below 40%, both of which are comfortably within our financial covenants.
- **Our resilience to climate change:** rising global temperatures are a major risk factor for our business and the planet, increasing the likelihood of heatwaves, flooding and property damage. Although climate change will lead to an increase in costs as we take action to combat its impact on our business (both in monetary terms and management time), it would be unlikely to affect the viability of the Group within the five-year review period. The Group is committed to being net zero carbon by 2030.

The Directors considered that none of the individual principal risks would in isolation compromise the Group's viability over the five-year period to 31 December 2026.

Emerging risks

The Group's emerging risks are disclosed on pages 104 to 105. 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 review and identify emerging risks is on page 164.

The Directors considered that none of the individual emerging risks would in isolation compromise the Group's viability over the five-year period to 31 December 2026.

VIABILITY STATEMENT

Based on the Board's assessment, 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 2026.

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 (see page 150):

- agile working, the role of the office and the war for talent (see page 15);
- the nature of London's office cycle (see page 15);
- climate change risk and opportunities as we carry out our plans to reach net zero carbon by 2030 (see pages 68 to 73);
- changes in technology and tenant expectations; and
- increased availability of long-term funding: after the refinancing completed in recent years, the weighted average unexpired term of our borrowings was 7.2 years as at 31 December 2021.

Further information on how the Board promotes the long-term sustainable success of Derwent London is on page 130.