Viability statement

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 2025.

Time period

In accordance with the 2018 UK Corporate Governance Code, the Directors and the senior management team have assessed the prospects of the Company over a longer period than the 12 months required by the 'Going Concern' provision.

The Directors challenge the time period over which to assess viability on an annual basis. The Directors determined that the five-year period to 31 December 2025 remains an appropriate period over which to assess its viability 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; and
- 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.

Although the Board's viability review focused on a five-year period, it did consider a number of longer-term factors when considering the Group's future prospects, including:

- the weighted average lease length of 7.9 years (including rent-frees and pre-lets);
- after the refinancing completed during 2019 and 2020, the weighted average unexpired term of our borrowings was 6.8 years;
- the impact of Covid-19 pandemic on home working, the future of office space and our resilience;
- the nature of the property cycle and our expectations of how this impacts us (see page 18); and
- changes in technology and tenant expectations.

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 retail and restaurant sectors;
- income visibility for the life of our leases which on average are 7.9 years (including rent-frees and pre-lets) with upward only or contracted rent reviews;
- good interest in our space with strong pre-let interest in our schemes;
- strong relationships with our debt providers. During 2020, a new five-year £100m unsecured Revolving Credit Facility (RCF) was signed with Wells Fargo and we extended our main £450m RCF with our UK banking partners for a further year to 2025; and
- a low loan-to-value ratio of 18.4%.

Assessment of risks

Principal risks

The Schedule of Principal Risks is 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 agreed that none of the changes in risk likelihood or probability during the year (see page 85) had a significant impact on the Group's viability. The Directors identified that, of the principal risks detailed on pages 88 to 99, the following are the most important to the assessment of the viability:

- Implications of Brexit: as a predominantly London-based Group, we are particularly sensitive to factors that impact upon central London's growth and demand for office space. London's economy, and its place as one of the world's leading financial centres, could be damaged if an adverse agreement is reached in respect of financial services. The Group will continue to monitor international trade negotiations, including the UK application to join the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP). Due to our contingency planning, the short-term impact of Brexit on Derwent London has been minimal.
- Income decline: the uncertainty and economic disruption caused by the pandemic has increased the risk of tenant defaults and could lead to a drop in occupier demand, and as such, has increased the risk of a fall in income. Based on our forecasts, our income would need to decline by 68% before we were at risk of breaching our financial covenants. In the scenarios tested, our net interest cover remained above 385% 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 has 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 2025.

Emerging risks
The Group's emerging risks are disclosed on page 87. Emerging risks involve a high degree of uncertainty and are therefore factored into the Board's viability assessment. The methodology used to review and identify emerging risks is on page 140.

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 2025.

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 5.56m sq ft (2019: 5.64m sq ft); and
- we will recycle capital by selling buildings when we have maximised their potential, or it no longer meets 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. We aim to maintain an adequate level of cash and available financial facilities. Regular financial forecasting enables us to identify and plan for additional funding requirements in advance.

Assessment of viability

To assess the Group's viability, 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.

Strengthened financial position
After an active year of refinancing in 2019, and the signing of a new 5-year £100m unsecured Revolving Credit Facility signed with Wells Fargo during the year, the Group had £476m of undrawn facilities and cash at 31 December 2020 (2019: £511m) and a weighted average term of borrowings of 6.8 years (2019: 7.8 years).

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 Board reviewed the following scenarios:

- 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, future dividend payments and refinancing activities.

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 2020, the value of the portfolio could fall by 67% without breaching the gearing covenants and our property income could fall by 68% before breaching the interest cover covenant.

Covid-19 scenarios
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. This assessment took into account the adverse financial impact already experienced by the Group and the disruption caused to our occupiers and suppliers.

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 outcome of these scenarios indicated that the potential cost under both the 'base case' and 'downside scenario' would not prohibit the Group from continuing its operations. The Group continues to closely monitor cash collection rates and tenants at risk of experiencing financial difficulty with the impact of any material changes assessed in revised forecasts.

It was also noted that the availability of further government support was not a factor which impacted on the Group's viability, as to date we had not required governmental financial assistance, however it could be a significant factor for some of our occupiers and supply chain. Activities on our development sites continue with stringent social distancing and safety measures in place, and productivity is closely monitored to assess any potential programme delays.

Despite the uncertainty and disruption caused by Covid-19, the business has traded well. Further information on our response to Covid-19 and our business model resilience is on pages 6 to 13.