CHIEF EXECUTIVE'S STATEMENT

Our strategy is to deliver the growth prospects from our development and asset management opportunities, while ensuring the business does not incur undue risks.

JOHN BURNS
CHIEF EXECUTIVE

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Last year's achievements reinforced the Group's strong position as we consistently look to improve our long-term income prospects. This approach has seen us assemble a portfolio that has significant opportunities to benefit from improving locations, hands-on asset management and regeneration. We start 2016 with £141.0m of estimated reversion. Just over half of this potential growth derives from developments and refurbishments with a total cost to complete of £569m (equivalent to 11% of the December 2015 property portfolio) which will be phased over the next four years. The completion of this programme will add net lettable area and will signify a major upgrade to our portfolio ensuring it meets the latest occupational demands and environmental standards. In the medium term our strategy is to deliver these growth prospects while ensuring the business does not incur undue risks.

Portfolio positioned for future earnings growth

Our strategy ensures that whilst our portfolio contains a wealth of future value enhancing opportunities the vast majority remains income producing (at the year end this was 77% by area). Approximately 53% consisted of property which we have already regenerated, but which have opportunities for growth through asset management, and another 24% was occupied buildings that form our stock of future redevelopment and refurbishment schemes, where we retain control over a project's timing. The remaining 23% of the portfolio is subject to development or refurbishment projects which we continue to de-risk as they progress. During the year the EPRA vacancy rate, which is based on the space available to let, was reduced from 4.1% to 1.3%. Dependent on future pre-letting activity, this could rise in the second half of 2016 as projects are completed.

Although we achieved new rental levels at a number of properties in 2015, we believe our buildings continue to offer occupiers good value with the average ERV of our central London office portfolio still only £51 per sq ft, and with 56% of our portfolio by area let below £50 per sq ft on a 'topped-up basis'. These lie comfortably at the lower end of our middle-market range of £45-£80 per sq ft.

The current development and refurbishment programme will benefit from the opening of Crossrail. The additional estimated £569m capital expenditure to complete these projects, which includes £48m of capitalised interest, will be spread over the next four years. Construction cost inflation remains high, and capacity constraints on many contractors have seen delays across the industry including at some of our schemes. The cumulative ERV of these projects (including pre-lets) is £78.9m of which half will not be completed until 2019.

We phase the timing of the capital expenditure on our developments to ensure that it is appropriate to the Group's risk appetite. During last year we completed 226,000 sq ft of projects which are now 97% let or sold. In the next two years we expect to deliver 728,000 sq ft, which is currently 32% let by area. This includes pre-lets in the current year of all the office space (87,150 sq ft) at The Copyright Building W1 to Capita, and 28,600 sq ft at White Collar Factory EC1 to Adobe. The remaining part of our development programme totalling 620,000 sq ft relates to two West End developments: 80 Charlotte Street W1 and Brunel Building W2. Neither building completes until 2019, but we are already having preliminary discussions with potential occupiers for part of this space.

We have taken steps to unlock potential major schemes that we could start from 2018 onwards. We are particularly pleased to have agreed terms with Crossrail, which enable us to gain access to redevelop above the Crossrail site at 1 Oxford Street W1, one of London's most prominent locations.

Disciplined approach to acquisitions and disposals

We have an opportunistic approach to acquisitions within our strategic plan and were pleased to acquire two substantial Tech Belt properties last year at attractive prices of around £545 per sq ft. Both present short-term refurbishment opportunities and together will contribute 40% of our 2016-17 projects. In the longer term, both buildings offer the opportunity for regeneration and the creation of additional space in the next decade.

Overall the proceeds from property sales of £277m exceeded the cost of new acquisitions. Typically we sell investment assets when we have identified better relative growth elsewhere. In 2015, our disposals included a number of properties as part of a property swap, and a sale to an owner-occupier after we had obtained planning consent for a major hotel development. In addition we have completed and sold most of our available residential units. Following our decision to refurbish 25 Savile Row W1 as offices, our residential exposure remains modest and primarily consists of ancillary space connected with our larger commercial projects. In accordance with our usual approach, we expect to continue to recycle capital with over £100m of investment property sales planned in the current year.

Finance

Underpinning our business is a flexible financial structure and last year we took steps to strengthen this further. In January 2015 our £175m convertible bonds 2016 were converted early thereby raising new equity and reducing debt. Later in the year, we increased the level of our unsecured revolving debt by refinancing a secured loan and extended the maturity of our principal bank facility. The Group's year end financial ratios are strong with interest cover of 3.62 times and an LTV ratio of 17.8%. Since the year end we have also arranged £105m of new long-term debt which will increase the level of undrawn facilities.

The year ahead

Occupier and investment demand remains strong in Derwent London's markets and we have started the year well increasing contracted income with a significant number of new lettings at good levels. We have also enhanced our financial structure. The general economic environment has shown signs of nervousness and volatility in 2016 and, if conditions were to deteriorate, our balance sheet strength would give us considerable resilience. However, providing occupier demand remains solid, we expect to see further good letting activity as the year unfolds thereby locking in significant income growth.

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25 FEBRUARY 2016