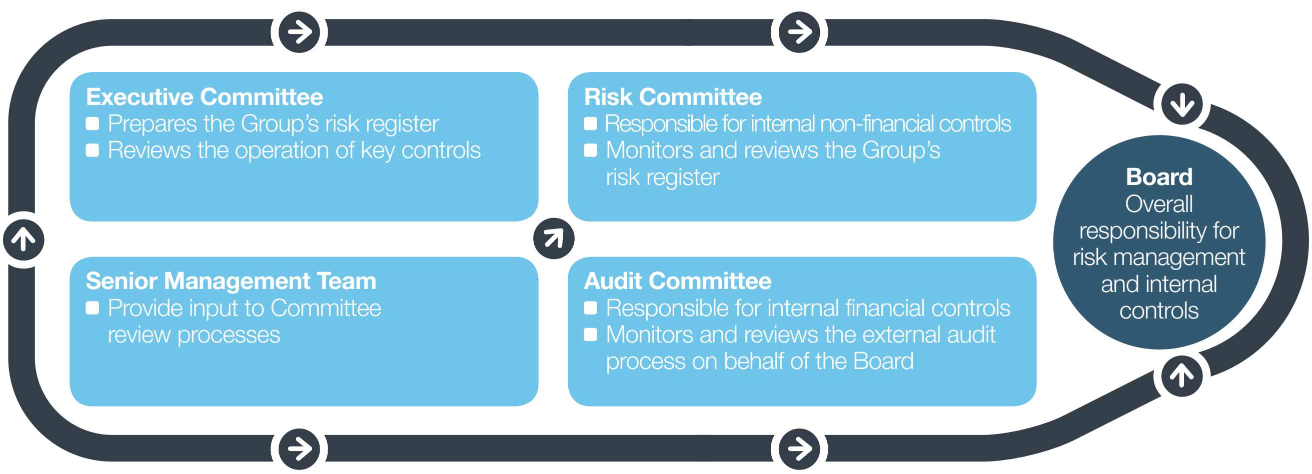
RISK MANAGEMENT

Risk is an inherent part of running a business and, whilst the Board aims to maximise returns, it needs to understand and manage the associated risks.

Risk organisation structure



Risk is an inherent part of running a business and, whilst the Board aims to maximise returns, it needs to understand and manage the associated risks. Whilst overall responsibility for this process rests with the Board it has delegated responsibility for assurance concerning the risk management process to the Audit Committee and the Risk Committee, the latter having been established at the end of 2011. Executive management is responsible for designing, implementing and maintaining the necessary systems of internal control.

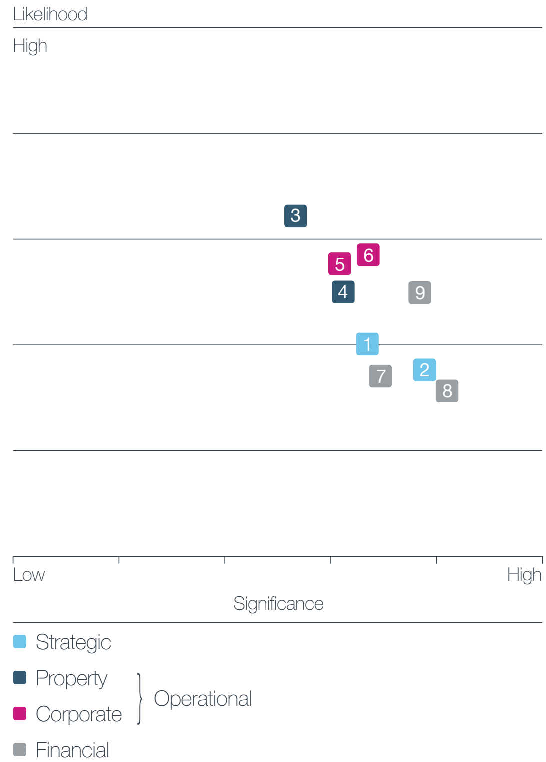
The Group operates principally from one central London office with a relatively flat management structure. This enables members of the Executive Committee to be closely involved in day-to-day matters and therefore able to quickly identify and respond to risks.

A key element in the system of internal controls is the Group's risk register which is reviewed formally by the Board once a year. The register is prepared by the members of the Executive Committee which, having identified the risks, collectively assesses the severity of each risk, the likelihood of it occurring and the strength of the controls in place. This approach allows the effect of any mitigating procedures to be considered and recognises that risk cannot be totally eliminated at an acceptable cost. It also recognises that there are some risks that, with its experience and after due consideration, the Board will be prepared to accept.

The register, its method of preparation and the operation of the key controls in the Group's system of internal control, is reviewed throughout the year by the Risk Committee, which periodically receives presentations from senior management to gain a more in-depth understanding of the control environment in certain areas of the business. The register was updated between December 2012 and February 2013 and includes 43 risks across the following categories: strategic risks, corporate risks, property risks and financial risks.

The principal risks and uncertainties that the Group faces in 2013, together with the controls and mitigating factors, are set out on the following pages.

Major risks



Key to risk table below

- Risk increase
- Risk slight increase
- Risk unchanged
- Risk slight decrease
- Risk decrease

Strategic risks

That the Group's strategy does not create the anticipated shareholder value or fails to meet investors' expectations.

Risk effect and progression	Controls and mitigation	Action
1 Inconsistent strategy ■ The Group's strategy is inconsistent with the state of the market in which it operates. **2 Inconsistent development programme** ■ The Group's development programme is not consistent with the economic cycle. The Group currently benefits from a strong central London market which could be adversely affected by a number of high level economic factors. This would reduce the value of the Group's portfolio. KPIs affected: – Total return – Total property return The Board sees the level of this risk as broadly unchanged from last year.	■ The Group carries out a five-year strategic review each year and also prepares an annual budget and three rolling forecasts which cover the next two years. In the course of preparing these documents the Board considers the effect on the Group's KPIs and key ratios caused by changing the main underlying assumptions to reflect different economic scenarios. ■ The Group's plans can then be set so as to best realise its long-term strategic goals given the expected economic and market conditions. This flexibility arises from the policy of maintaining income from properties for as long as possible until development starts. ■ Over 50% of the Group's portfolio has been identified for future redevelopment. This enables the Board to delay marginal projects until market conditions are favourable. ■ The risk remains significant and therefore in forming its plans the Board pays particular attention to maintaining sufficient headroom in all the Group's key ratios, financial covenants and interest cover.	■ The last annual strategic review was carried out by the Board in June 2012. This considered the sensitivity of six key measures to changes in underlying assumptions including interest rates and borrowing margins, timing of projects, level of capital expenditure and capital recycling. ■ The three rolling forecasts prepared during the year focus on the same key measures but consider the effect of varying different assumptions to reflect changing economic and market conditions. ■ The timing of the Group's development programme and the strategies for individual properties reflect the outcome of these considerations. ■ At the year end the Group's interest cover ratio was above 350%, the REIT ratios were comfortably met and its loan-to-value ratio was 30%.

RISK MANAGEMENT
CONTINUED

Operational risks[1]

That the Group suffers either a loss or adverse consequences due to processes being inadequate or not operating correctly.

Risk effect and progression	Controls and mitigation	Action
3 Reduced development returns ■ The Group's development projects do not produce the anticipated financial return due to one or more of the following factors: – Delays in the planning process. – Delays due to contractors/ sub-contractors defaulting. – Increased construction costs. – Adverse letting conditions. KPIs affected: – Total return – Total property return Taken as a whole the Board considers this risk to be at the same level as last year.	■ Standardised appraisals including contingencies are prepared for all investments and sensitivity analysis is undertaken to ensure that an adequate return is made in all circumstances considered likely to occur. ■ The scale of the Group's development programme is managed to reflect anticipated market conditions. ■ Regular cost reports are produced for the Executive Committee and the Board that monitor progress of actual expenditure against budget. This allows potential adverse variances to be identified and addressed at an early stage. ■ Post completion reviews are carried out for all major developments to ensure that improvements to the Group's procedures are identified and implemented.	■ The Group is advised by top planning consultants and has considerable in-house planning expertise. ■ Executive Directors represent the Group on a number of local bodies which ensures that it remains aware of local issues. ■ The procurement process used by the Group includes the use of highly regarded firms of quantity surveyors and is designed to minimise uncertainty regarding costs. ■ Development costs are benchmarked to ensure that the Group obtains competitive pricing. ■ The Group's style of accommodation remains in demand as evidenced by the 49 lettings achieved in 2012, which totalled 340,300 sq ft. ■ The Group has secured significant pre-lets of the space in its current development programme which significantly "de-risks" these projects.
4 Tenant default ■ The Group suffers a loss of rental income and increased vacant property costs due to tenants vacating or becoming bankrupt. The continuing lack of growth in the UK economy could lead to an increase in business failure. KPIs affected: – Tenant receipts – Void management – Total return – Total property return – Interest cover ratio } if significant The Board considers this risk to have increased over the past year due to the effect that the prolonged austerity measures are having on businesses.	■ All prospective tenants are considered by the Group's credit committee and security is taken where appropriate either in the form of parent company guarantees or rent deposits. ■ The Group's property managers maintain regular contact with tenants and work closely with any that are facing financial difficulties. ■ The Group's credit committee regularly reviews a list of slow payers and considers what actions should be taken.	■ The Group has a diversified tenant base. ■ The credit committee meets each week and considered 98 potential tenants during the year. ■ In total the Group holds rental deposits amounting to £10.8m. ■ On average during the year, the Group has collected 97% of the rents due within 14 days of the due date.
5 Reputational damage ■ The Group's cost base is increased or its reputation damaged through a breach of any of the legislation that forms the regulatory framework within which the Group operates. This risk would most directly impact on the Group's total shareholder return – one of its key metrics. Indirectly it could impact on a number of the formal KPIs. The Board considers the risk to have increased over the year due to increased legislation covering more areas of the Group's business and an increased ability of pressure groups to gain publicity for any breaches.	■ The Group's Risk Committee reports to the Board concerning regulatory risk. ■ The Group employs a health and safety manager. ■ A sustainability committee chaired by Paul Williams and advised by external consultants addresses risk in this area. A sustainability manager was recruited in January 2013. ■ The Company's policies including those on the Bribery Act, Health and Safety, Equal Opportunities, Harassment and Whistleblowing are available to all staff on the Company intranet. ■ All new members of staff benefit from an induction programme.	■ A Health and Safety report is presented at all Executive Committee and main Board meetings. ■ The Group pays considerable attention to sustainability issues and produces a sustainability report annually.

[1] Incorporates the corporate and property risks from the Group's risk register

Operational risks (continued)

Risk effect and progression	Controls and mitigation	Action
6 Shortage of key staff ■ The Group is unable to successfully implement its strategy due to inadequate succession planning or a failure to recruit and retain key staff with appropriate skills. No KPIs affected. The risk is seen as unchanged over the year.	■ The remuneration packages of all employees are benchmarked regularly. ■ Six-monthly appraisals identify training requirements which are fulfilled over the next six months. ■ The Nominations Committee reviews the Group's succession planning for both executive and non-executive Directors.	■ The Group recruited 11 new members of staff during 2012. The key appointment of a sustainability manager was made in January 2013. ■ Staff turnover during 2012 was low at 7% (9% including retirees). ■ The Executive Committee considers non-Board succession issues.

Financial risks

That the Group becomes unable to meet its financial obligations or finance the business appropriately.

Risk effect and progression	Controls and mitigation	Action
7 Breach of financial covenants ■ A substantial decline in property values or a material loss of rental income could result in a breach of the Group's financial covenants. This may accelerate the repayment of the Group's borrowings or result in their cancellation. KPIs affected: – Total return (property values) – Total property return (property values) – Interest cover ratio (rental income) The Board considers this risk to be slightly lower this year as it has considerable headroom within its covenants and expects the business cycle to be less volatile.	■ The Group's secured borrowings contain financial covenants based on specific security and not corporate ratios such as overall NAV gearing. Treasury control schedules are updated weekly whilst the rolling forecasts enable any potential problems to be identified at an early stage and corrective action to be taken. The Group has considerable headroom under its financial covenants, operates at a modest level of gearing and has a substantial amount of uncharged property that could be secured if necessary.	■ The Group tests its compliance with financial covenants regularly and operated comfortably within these limits throughout 2012. Property values could decline by around 40% at the balance sheet date before there would be a breach of financial covenants. ■ Compliance with the financial covenants is one of the matters monitored as part of the sensitivity analysis undertaken when preparing the annual strategic review and the rolling forecasts. ■ At 31 December 2012 the Group owned £624m of uncharged properties.
8 Sub-optimal financing structure ■ The Group's cost of borrowing is increased due to an inability to raise finance from its preferred sources. KPI affected: – Interest cover ratio The Board considers this risk to have decreased over the past 12 months as the Group has increased the diversity of its funding sources and there have been improvements in the health of the banking sector.	■ The Group's five-year strategic review and rolling forecasts enable financing requirements to be identified at an early stage. This allows alternative sources of finance to be evaluated and the preferred one to be identified. To a degree, the funds can then be raised when market conditions are favourable.	■ The Group's financing comes increasingly from a number of different sources/providers and has a varied maturity profile. The proportion of the Group's borrowings provided by bank loans decreased from 59% at 31 December 2011 to 50% at the year end. ■ The refinancing of the facilities maturing in 2013 that was started in 2011 was completed in August 2012. The focus in 2011 was to renew or refinance revolving bank facilities. Then in August 2012, the remaining £150m bank loan expiring in 2013 was prepaid and cancelled and a new £83m loan was signed with Cornerstone/Mass Mutual for a term of 12¼ years at a fixed rate of 3.99%. ■ As at 31 December 2012, the weighted average duration of the Group's debt was 6.1 years. ■ At the year end the Group had £333m of unutilised, available, committed bank facilities.
9 Higher interest rates ■ Financing costs are higher due to increases in interest rates. KPI affected: – Interest cover ratio The Board sees this risk as unchanged over the year.	■ The Group uses interest rate derivatives to "top up" the amount of fixed rate debt to a level commensurate with the perceived risk to the Group.	■ During the year the Group terminated three interest rate swaps which were at historic rates and initiated new instruments which have locked in the lower rates that were available at that time. ■ 92% of borrowings were fixed or hedged at the year end.

Spread overleaf:
1 Oliver's Yard EC2