CONFERENCE CALL FOR THE YEAR ENDED 31 MARCH 2020

Introduction

Good afternoon and welcome to the investor update conference call to discuss the results for the year ended March 2020, as required under the EMTN Programme Notes issued in July 2017.

The call today will be presented by myself, James Hopkins, Annington's CEO and Andrew Chadd, Annington's CFO.

The commentary we are going to give is based on Annington Limited's Consolidated Financial Statements for the year ended 31 March 2020, which were posted on our website in September. The format for this call is that we will provide the update and then the moderator will open the floor to questions starting with any questions that have been submitted in advance of the call. The maximum time that this process will take is 60 minutes.

A link to a digital recording of the call will be on our website for approximately 7 days after this call. There will also be a transcript which will be available for the longer term.

Disclaimer

I trust you will all have been able to access the Annual Report and will have had the opportunity to familiarise yourselves with the contents. It is worth reminding ourselves, however, that the report and this telephone call contain forward looking statements which reflect our current views with respect to future events and anticipated financial and operating performance. Any such statements are made in good faith. By their very nature, forward looking statements involve known and unknown risks, uncertainties and other factors and depend on circumstances that may or may not occur in the future. We caution you that forward looking statements are not guarantees of future performance and may differ materially from what actually happens. Although we believe that the expectations reflected in these forward looking statements are reasonable, we can give NO assurance that they will materialise or prove to be correct. You are cautioned not to place any reliance on such forward looking statements which in any event only reflect any sentiment as of the date of this report. Nor do we have any obligation to publicly update or revise any forward looking statements whether as a result of new information, future events or otherwise other than as required by law or regulation.

Annual update

Operationally, 2019 marked a turning point for Annington. Under the terms of the Arbitration Agreement signed in March 2019, the MoD undertook to release 500 units per annum for seven years. Release levels have not consistently hit that mark for more than 15 years. While providing significant certainty on property numbers, the releases received provided a welcome challenge to the build team with substantial refurbishment projects at Bordon and Canterbury to add to existing new build projects, at Allington (24 - Wiltshire), Brize Norton (135) and Little Thetford (10 - Cambridgeshire).

At 31 March 2020, the Group owned 40,621 completed investment property units. Of these, the MQE Retained Estate comprised 38,460 units leased to the MoD, while 445 units were held in the MQE Surplus Estate and the remaining 1,716 were held in a separate property portfolio of Rental and PRS accommodation. At the reporting date, the Group had a further 117 units under construction and held 3 completed development units for sale.

The Group generated gross property rental income from this investment property portfolio of £199.4 million for the year to 31 March 2020 [Mar 2019: £196.8m] and sold 104 properties [94 investment properties (31 APL & 63 Rentals) + 10 development units] during the year ended 31 March 2020, generating £36.0 million in sales income [APL: £18.6m, Rentals £13.5m & development units £3.9m]. [Mar 2019: sales of 66 properties for £15.1m – APL – 10 units for £6.2m, rentals – 55 units for £8.9m & developments 1 unit for £0.3m].

The carrying value of the Group's investment properties was £7.7 billion, almost identical to 31 March 2019 values. Whilst at a comparable level, the valuation was impacted by the outbreak of COVID-19, which was declared by the World Health Organisation as a "Global Pandemic" on 11 March 2020. Global financial markets were impacted and travel restrictions were implemented by many countries, with lockdown measures introduced in the UK on 23 March. At year-end, business and economic activity was much reduced and a period of recession expected globally, and for the UK economy. As at the valuation date of 31 March 2020, the Group's valuer, Allsop Valuation Limited ("AVL"), could attach less weight to previous market evidence for comparison purposes, to inform opinions of value. The current response to COVID 19 means that AVL was faced with an unprecedented set of circumstances on which to base a judgement. AVL's valuation, as adopted by the Group, is therefore reported on the basis of 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global. Consequently, less certainty – and a higher degree of caution – should be attached to this valuation than would normally be the case.

Like everyone in the property industry, Annington was affected by the COVID-19 pandemic and lockdown. All operational sites were closed with immediate effect. Sales offices and rental outlets were closed but we continued to provide an emergency repair response throughout the period. All our contractors returned to site five to six weeks after lockdown commenced, thereby minimising the impact. All sites are now back up to 100% capacity in terms of output; build and sales rates are encouraging with good viewing and reservation data across a geographically diverse portfolio.

Our rental income has been maintained during Covid-19 pandemic, with more than 90% of rental income being Government backed rents on the MQE and further income being received from further bulk leasing arrangements with the MOD and local authorities, all of which have been paid on time. Sales to end September 2020 have been very much in line with budget and rental arrears and voids are back to pre-COVID levels.

Throughout 2020, in response to the COVID-19 pandemic, Annington's staff demonstrated dedication and flexibility in embracing the changes required of them and are continuing to deliver their best, in spite of the difficult circumstances. The Group was not forced to lay off or 'furlough' any staff; the key concern has always been to look after our employees and ensure whatever we do is done safely – their health and safety is paramount. Ensuring that the business maintains full operational tempo in a safe way whilst adhering to all Government and industry guidelines remains our priority.

Market Performance

The 2019/2020 financial year began with annual house prices on the same flat to slightly downward trajectory which had been in evidence since January 2018. The market up to December 2019 remained in a state that might best be described as 'lacklustre'. Total price growth in 2019 was 1.4% according to Nationwide, broadly in line with market expectations, and an improvement on the 0.5% growth in 2018. The headline numbers again obscured significant regional variations with Wales and the North outperforming – the North East, West Midlands and Scotland were all up c.2.7% over the year – and London and the South East the primary drag, down 1.8% and 1.0% respectively.

It is worth noting that in real terms, the average UK home was worth the same at the end of the decade as it was at the beginning (December 2009 to December 2019) – in fact, average values fell by 0.8% when adjusted for inflation (Savills). This is in stark contrast to the previous decade (2000 – 2010) during which prices rose by 67% in real terms, and the decade preceding that (1990 – 2000) where prices fell by 14%.

Brexit uncertainty weighed heavily on market sentiment and transactions were subdued, in spite of a supportive employment and mortgage environment. It was clear that greater clarity would be needed in order for the housing market to break out of this trend. The certainty resulting from the decisive Conservative Party majority which emerged from the December General Election lived up to these expectations and appeared, briefly, to be the encouragement both buyers and sellers needed with stronger price gains and increasing momentum in the market during the fourth quarter of 2019 and into the first quarter of 2020.

Expectations at the start of the calendar year were that house price growth would be marginally stronger in 2020. Rightmove expected a modest increase in house prices of 2% during the year on the basis of greater certainty following the General Election, the continuing trend of demand outstripping supply, and the continuation of a supportive economic backdrop (low interest rates, willing mortgage lenders, wage growth and high employment). This was mirrored by other commentators with house prices rising in Q1 2020 at their strongest for some time. Both Halifax and Nationwide reported annual house price growth of 3% to the end of March. Rightmove ended the financial year with even higher numbers, recording house price growth of 3.5%, the highest annual rate of house price growth for its dataset since December 2016. Activity levels were up too with Rightmove reporting that the number of sales agreed has increased 17.8%, that properties were selling an average of 6% faster nationally and 18% more quickly in London.

Rents also performed well, increasing nearly twice as fast over the 2019/2020 year as they did in 2018 (Hamptons International), with the average monthly rent now £989, 2.1% up over the year. In direct contrast to house price inflation, rent inflation has been greatest in the Greater South (London, East Anglia and the South East) at c.4%, while in the North rents have increased by just 0.2%. Savills reports 1.4% annual rental growth across the UK with the same regional divergence and notes that this is the strongest performance since 2017.

The property market officially reopened on 13 May but market commentators consider that eight weeks of construction and sales activity was lost. Nevertheless, Knight Frank forecasts a loss of 526,000 sales in 2020 as the economic impact of the COVID-19 pandemic plays out. However, in the first few days following the Government's announcement that transactions could resume, Knight Frank reported that the number of new buyer registrations reached the highest level since the second week of March and the housing market had its best ever week outside London, with prices in June higher than before the lockdown. Demand has continued to rebound strongly, but with a shift in preference away from city locations as buyers are keen for more space. In spite of this, the City consensus says that, once that demand is met, prices will fall but the Chancellor of the Exchequer's announcement of an SDLT holiday until 31 March 2021 has caused some commentators to reconsider.

Operational Environment

Site review:

You will be aware that under the original terms of the lease, in addition to the Beacon Unit Rent Review cycle, each Site's discount would be reviewed to open market value over a four-year period commencing in December 2021 (the "Site Review"). The Site Review would subsequently be repeated on the 15th anniversary of the initial Site Review, with the five-yearly Rent Reviews continuing alongside and between each Site Review.

On 7 March 2019, an agreement was reached with the MoD to carry out an expedited process to complete the 2021-2024 Site Review rounds. This accelerated process is designed to produce an equivalent result to the Site Review, but in a shorter period and at a significantly lower cost for both parties. It will also give Annington and the MoD certainty in relation to the future rents payable for the MQE sooner.

In terms of the new process, the 488 sites in the MQE have been divided into 27 baskets of sites that share similar characteristics and a new rental adjustment, in place of the pre-determined discount of 58% to full market value rent, will be agreed for each of the baskets. Each basket's new rental adjustment will apply to all of the sites within that basket. The MoD will continue to pay rent at the current rate until the dates on which new rents are payable under the terms of the Underleases, which fall between 2021 and 2024.

The first six months of the 2019/20 financial year, from April to September 2019, were largely focused on completing the unit inspections across the 27 representative sites, involving some 1,200 properties. Completion of the inspection phase triggered work leading to the exchange of without prejudice opening bids with the MoD in October 2019 for Beacon Unit Rents, Site Rents and Site Adjustment Factors for all 27 sites. In accordance with the Arbitration Agreement, both the MoD and Annington then selected two sites each for the first batch of four to be the subject of Panel adjudication.

The second half of the financial year was utilised preparing for two Panel hearings, the first addressing legal matters in November and the second on condition issues in January. At the same time, preparations for the hearings on the first four sites continued, with the Group working with its expert witnesses in connection with the preparation of expert valuation reports and preparing and briefing lawyers to appear at the hearing.

Drafting of submissions continued right up to the actual hearing in June/July. The hearing was postponed from May as one of our QCs became seriously ill with COVID-19 shortly before the initial hearing date. Significant efforts are being made by both Annington and the MoD to keep the programme on track. The hearing for the second batch of eight sites will be heard in February/March 2021. This is later than anticipated by the arbitration agreement, and the delay results from the consequences of adjourning the first batch hearing. The remainder of the timetable will be elongated by a similar amount.

The panel has now come to a judgement and made awards on the first four of these groups of sites. As we are just at the start of this process, it is not possible to give precise information about a consolidated outcome from these deliberations. There will come a point when it will become clear but that is not now.

MoD Property Releases:

During the year, 266 units were released to Annington by the MoD, compared to 243 in 2019. In the 7 March 2019 Arbitration Agreement, the MoD committed to release 500 units per year, measured on a two year rolling average, and this is incentivised by a waiver on the first £7,000 of dilapidations costs for up to 500 units per year. It was agreed the first year for this purpose would be extended to include certain units released during at Bordon and Canterbury during March 2019 and end on 31 March 2020. On this basis, the MoD released 501 units in the first year of this agreement.

The revised arrangements concerning releases and dilapidations materially improves the predictability of the timing, and number, of released units and incentivises the MoD to release consistent numbers of units year-on-year. This both enables the MoD to address the long standing voids issue that it has faced, and substantially reduces the possibility of Annington having to deal with large or volatile release numbers.

Many of the sites identified for future release are dependent on moving out the sub-let tenants and also completing alterations to security perimeters, which are not without their problems. On 10 September, we became aware that the MoD had instructed Orchard & Shipman (as agents) to serve 347 notices to tenants across multiple sites giving them 6 months' notice to vacate MQE homes on 14 sites, citing the need to hand these back to Annington as a reason for the notice being served. Annington was completely unaware of this move and also of the sites involved. The MoD's decision to do this was inspired by the desire to hand back units by 31 March 2021, in addition to the 500 targeted handbacks under the Arbitration Agreement. This understandably caused widespread outcry from the tenants as well as local politicians, MPs and the media. The MoD publicly suggested Annington consider taking back sitting tenants, and has since privately entered into dialogue with us on the topic, noting this would only be possible for non base dependent sites. This is not as simple as articulated and not a desirable option, however we remain in conversation with the MoD regarding this issue.

I will now hand over to Andrew to discuss the results for the year.

Financial Performance

Rental income:
As mentioned earlier, gross property rental income for the year to 31 March 2020 amounted to £199.4 million, a 1% increase over 2019 [(2019 196.8 m)]. The majority of this was through APL, where the MQE Portfolio (including Surplus Estate) generated rental income of £180.3 million in the year [(2019: £180.9 m)]. The increase in rental income is driven largely by the Non-MQE Portfolio, where gross rents for the year to March 2020 have increased to £19.1 million [(2019: £15.9 million)], following the expansion of the Group's PRS portfolio. There having been no MQE rent review in December 2018, as this was a fallow year, the uplifts on the December 2019 review have been offset by the effects of releases of units received at March 2019 and during the current year.

Property Disposals:
During the year, 94 investment properties were sold by the Group (2019: 65 properties). APL generated income of £18.6 million (2019: £6.2 million) through the external sale of 31 units (2019: 10 units). A further 63 properties (2019: 55 properties) in the Non-MQE Portfolio were sold, resulting in income of £13.5 million (2019: £8.9 million). In addition, ten development properties were sold from inventory for £3.9 million (2019: 1 property for £0.3 million). These results are reflective of the nature (condition, location and size) and number of units released by the MoD and subsequently made available for sale. The larger volume of releases in March 2019 provided a greater stock of properties available during the financial year, compared to recent years where relatively low levels of releases have effectively capped the number of units available for sale, reflected by volatility in the reported performance.

Site review costs
Included in operating profit are costs relating to the Site Review, which are considered exceptional in nature, due to the size and infrequent occurrence of Site Reviews. Having entered into the Arbitration Agreement and confirming the mechanisms to be applied in determining the rental adjustments, Annington has determined that a significant sum will need to be spent in this round of negotiations, as precedents will need to be developed between the parties as to the way in which a site review will operate. The Group estimates that the costs associated with this are of such a material nature as to require separate disclosure on the face of the Consolidated Income Statement. The £20.2 million of site review costs incurred in the financial year have been disclosed separately in the income statement.

Profit for the period

A profit of £770.2 million was reported for the year to 31 March 2020, compared to a profit of £457.1 million during the prior year. This has been driven by the release of the deferred tax liabilities of the group, leading to a total tax credit of £679.0 million for the year. The release of deferred tax balances followed information received during the year from Annington Limited's immediate parent entity, Annington Holdings (Guernsey) Limited ("AHGL"), which informed the Group that AHGL qualifies as a Collective Investment Vehicle for the purposes of Non-Resident Capital Gains Tax rules and that AHGL made an exemption election under this legislation. The exemption election under this legislation is designed to prevent multiple layers of taxation within a structure which would otherwise be borne by all investors and operates by centralising responsibility for Capital Gains Tax upon the investors in the Collective Investment Vehicle. A consequence of this is that responsibility for Capital Gains Tax is removed from subsidiary group entities, meaning that the Annington Limited Group has derecognised the previously recorded deferred tax liability related to capital gains. These unrealised gains arose on the property value uplifts over time and would have been realised only in the event of a disposal of those properties.

[**if asked:

- Other operating income relates to receipts from granting easements over land (mostly at Wittering)
- Other operating expenses relate to development activities]

<u>Balance Sheet Items:</u>

The Group's total assets amounted to £7,831.5 million (2019: £7,840.7 million)
The fair value of all the Group's investment properties, which are located in England and Wales, is reassessed annually. The Group's total investment properties were carried at £7.7 billion at 31 March 2020 (2019: £7.7 billion).

The fair market value of the Married Quarters Estate was £7.2 billion, with a further £20.0 million being accounted for in the book value to avoid a double count of the utility provision in the financial statements. The fair value of this portfolio increased £20.0 million, but covered 266 fewer units due to releases.

The Non MQE portfolio's fair value of £405.8 million (2019: £410.3m) includes 1,716 completed units (2019: 1,607). The valuation was impacted by the completion of units at Uxbridge which were listed as development units and valued at 70% of their to-be-completed state last year, the purchase of units at Canterbury from APL and the effects of COVID-19 on the property valuation.

The Group also uses a Special Assumption of Vacant Possession Value ("SAVPV") to help gauge whether the Group has been achieving reasonable value upon disposal of units released from the MQE Retained Estate and to provide management with a basis upon which to calculate an estimated value for the Retained Estate and potential value to be realised from future sales. At 31 March 2020, the SAVPV of the MQE Retained Estate was £9.3 billion, compared to £9.1 billion at 31 March 2020. The valuation basis for this changed during the year, with more information available in our annual report.

The Group held £103.7 million (2019: £162.8 million) of cash, following the declaration of a £100m dividend during the financial year.

The Group's combined liabilities totalled £3,487.8 million (2019: £4,162.9 million), mostly comprising short term operational balances and a mixture of long-term debt. The Group's long-term funding is arranged through AFP in the form of bonds and a term loan.

As noted above, the group's deferred tax liabilities were derecognised during the year. The Group now recognises a deferred tax asset of £19.9 million based on the foreseeable use of tax losses accrued in previous years. A further £209.5 million of deferred tax asset arising from unused tax losses remains unrecognised, with future recognition of this asset being contingent upon there being sufficient future taxable profits against which it can be utilised. At the balance sheet date, the Group has unused tax losses of £1,207.5 million (2019: £1,231.8 million) available for offset against future profits.

OEIC Conversion

As noted above, the sole shareholder of Annington Limited ("Annington"), Annington Holdings (Guernsey) Limited ("AH(G)L"), was converted into an Open Ended Investment Company. This conversion will have a number of positive benefits for the Annington Group, including the following:

I. It facilitates the raising of new equity by AH(G)L.

II. It will allow existing investors to redeem their shares at a price calculated with reference to NAV, provided in every case that this does not prejudice the fundamental credit standing of Annington.

Kempen & Co ("Kempen") are engaged as sole placement agent to support the raising of new equity by way of issuing new shares in AH(G)L.

Dividend policy

Subject to continuing reviews of the market in which the Group operates, Annington intends to continue paying a dividend. The Group remains committed to maintaining its strong investment grade rating.

Closing

That concludes the annual update. I will now hand back to the call moderator who will open for questions.