

Bond Investor Conference Call 7 February 2022

Good morning and thank you for taking the time for this call.

Since our last conference call in November, we announced the settlement of the Site Review process with the MoD which was signed on the 15 December 2021. On the 27 January 2022 we made an announcement responding to the MoD's statement that it was seeking to "explore the exercise of its statutory leasehold enfranchisement rights to buy out Annington's interest" in the Married Quarters Estate (the "MQE").

In the first half of this call we want to take this opportunity to address both the Settlement of the Site Review process and to further update you on the MoD's actions regarding enfranchisement and Annington's response to the MoD.

In the second half of this call we will answer questions that we have received in advance. Given the volume of questions we have already received we will not be taking any additional questions on this call, however, if there are any clarification questions we are happy to receive these by email. We will keep you apprised of any material developments

We will include a transcript of the call on our website together with a recording of this call.

Settlement Agreement

Starting first with the Site Review. On the 15th December 2021 we were delighted to agree a settlement of the site review process with the MoD.

The key terms of the Settlement Agreement are:

- The MoD discount to market rent was reduced from 58% to 49.6% across all sites in the MQE. This represents a c.£36m increase in rent which will be phased in over the period to 2024. In aggregate this equates to approximately a 20% increase on the current rent.
- In addition, it was agreed that this discount will also apply at the next site review in 15 years' time, so the discount is now fixed for the next 30 years.
- It was also agreed to reduce the number of properties which the MoD need to release in order to qualify for the dilapidations waiver from 500 to 375 on a rolling average basis. In addition the MoD has also agreed to release a minimum of 250 properties per annum.
- Finally, Annington also agreed to the handback by the MoD of certain properties with a waiver of all associated dilapidations in relation to those properties. This consists of 87 properties at a site in Brize Norton and 85 properties at a site in Uxbridge.

In summary the settlement increases the level of rent paid across the portfolio and provides a high level of certainty regarding rental income for the next 30 years. In addition, the Settlement Agreement saves both parties the substantial costs that would have been incurred had the site review process continued to its conclusion now and had to be repeated again in 15 years' time.

The MoD has publicly stated that it considers the settlement “*achieves value for money*”, “*removes ongoing uncertainty for the Department*” and is “*a good outcome and a fair settlement*”.

MoD Announcement re: Enfranchisement

What have the MOD done?

Subsequent to signing the site review settlement; on the next day, 16th December 2021, Annington unexpectedly received a notice from the MoD stating that it wanted to enfranchise one of Annington's properties, the property in question being at 1 Sycamore Drive in Cranwell, but it was unclear what their plans were beyond this as no further details were provided.

Annington was well progressed in preparing its formal response to the MoD to this first notice when Jeremy Quin, Minister for Defence (Procurement) submitted a written statement to Parliament on Thursday 27th January stating that the MoD was exploring enfranchisement of the MQE via two test cases.

On Friday 28th January, we received a second notice of enfranchisement of a property on the same site in Cranwell. This was for the house next door to the first property. This notification indicated that the Secretary of State for Defence had sold the freehold interest to a new wholly owned company 'Defence Infrastructure Holdings' for £1. These steps are being taken by the MoD in order to attempt to sidestep one of the legal restrictions on enfranchisement which would otherwise prevent them from making a claim.

Are the MOD able to enfranchise?

Without waiving privilege, Annington is very firmly of the view that the MoD is not legally entitled to exercise leasehold enfranchisement rights and so acquire Annington's properties, and have requested that the MoD withdraw its enfranchisement claims. This is the case irrespective of the transfer of the freehold interest to the new wholly owned company.

On 1 February 2022 Annington responded to the MoD with two 'Letters Before Action' setting out the reasons why Annington believes that the MoD will not succeed and seeking a speedy withdrawal of its enfranchisement claims.

There are two groups of issues which mean that its claims should not succeed.

Firstly there are specific issues under the relevant enfranchisement legislation. The legislation was designed for leaseholders to be able to gain control of the freehold interest related to their leasehold property. However, there are a number of property law related provisions which mean both (a) that the MoD does not have the right to enfranchise without Annington's consent, and (b) the MoD is not entitled to enfranchise at all, as it was a term of the 1996 deal (when the transaction was originally entered into with the MoD) that the leases were business tenancies, and business tenancies cannot be enfranchised unless they meet certain requirements (which these do not).

Secondly, the MoD's status as a public body means it is subject to duties and obligations which commercial counterparties are not. Where a public body breaches these additional obligations, any decisions it has taken which breaches those obligations can be set aside. Annington believes that the MoD has acted in ways which breaches its public law obligations.

Annington will seek to challenge the MoD's attempt to enfranchise through Judicial Review.

Why does Annington think the MOD has taken this action?

Annington does not have any confirmed insight into why the MoD has started this action. However, Annington believes that the MoD does not like the fact that the properties were sold by the Government back in 1996 (at which time the majority of the proceeds of sale went to HM Treasury and not the MoD), and would prefer to have complete control of the assets. Annington also believes that the MoD feels that Annington has benefited from higher than expected increases in house prices and rental levels since 1996.

However, it is unclear as to how the MoD's strategy, of potentially buying back the estate, could fit with the Government's oft-stated aim to reduce borrowing and divest assets.

It is also unclear why the MoD has decided to take this action now, particularly in light of the constructive negotiations between Annington and the MoD that were undertaken to agree the settlement of the site review process. At no point during these negotiations did the MoD give any indication that it intended to subvert its 1996 agreement.

In summary, the MoD's attempt to subvert the original terms of the transaction, as indicated by the announcement that it is going to try to use enfranchisement, is a way to seek to expropriate properties from Annington.

This behaviour is underhanded in the extreme and tarnishes the UK Government's reputation with the investor community worldwide

What is the potential timetable?

Annington remains confident that there are no grounds for successful enfranchisement by the MoD and will make every effort to ensure that any process is concluded as quickly as possible.

Annington believes that once the legal papers are filed, a Judicial Review process could take at least 9 -12 months, with then possible appeals and other actions thereafter. It could take several years to exhaust all appeals.

If the MoD was ultimately successful in the Judicial Review process, there would then be individual claims to establish the compensation applicable to each property which the MoD sought to enfranchise. If claims continue to be taken property-by-property this would take many years.

Annington's business will continue as normal while these actions are undertaken.

What is the intention behind the £105m maintenance fund?

It is possible that the MoD will be amenable to some sort of settlement of this issue, but we do not yet know how this might evolve. We have made an offer to the MoD with this in mind whereby we will establish a £105m fund with the intention of upgrading the estate. We do not at this time know if this will be acceptable.

To reiterate our position, we expect to ultimately succeed in the courts. That said, all litigation carries some risk and there is a clear benefit to both Annington and the MoD in resolving this issue as quickly as possible.

In the unlikely event that the MoD's claim was successful what would be the financial impact on Annington?

If the MoD's enfranchisement claim is successful, ultimately the compensation that the MoD would have to pay would be determined by an independent tribunal with both Annington and the MoD providing supporting evidence.

The MoD has indicated in a letter to Annington that it expects the amount it would have to pay to enfranchise the estate to be broadly equal to market value.

What does this mean to plans for a sale by Terra Firma?

The conclusion of the Site Review was intended to provide the certainty required in order to progress towards a sale process. Annington understands that Terra Firma was in the early stages of preparing for this. However, the actions by the MoD has meant that Terra Firma has put all exit plans on hold for now.

This concludes the first part of our presentation. We will now go through responses to the submitted questions. Where we have received overlapping questions we have attempted to group these together.

Q&A QUESTION SUBMITTED**Enfranchisement:****1. Can you please explain why the MoD does not meet the criteria for enfranchisement rights?**

As we have mentioned (without waiving privilege) there are both strong arguments from a property law perspective as well as a public law perspective that mean the MoD cannot enfranchise. The legislation was designed for leaseholders to be able to gain control of the freehold interest related to their leasehold property. However, there are a number of property law related provisions which mean both (a) that the MoD does not have the right to enfranchise without our consent and (b) the MoD is not entitled to enfranchise at all, as it was a term of the 1996 deal (when the transaction was originally entered into with the MoD) that the leases were business tenancies and business tenancies cannot be enfranchised unless certain requirements are met (which these do not). Secondly, as we have mentioned, we believe that the MoD has acted in ways that breaches its public law obligations.

Annington will seek to challenge its attempt to enfranchise through Judicial Review.

2. Is there anything in the lease agreement between the MoD and Annington that supports Annington's view?

It was a term of the 1996 deal that the leases were business tenancies, and both parties applied to court for an order that the leases would be treated as business tenancies. Without waiving privilege in our advice, it is our position that business tenancies cannot be enfranchised in this way in these circumstances. There is nothing in the lease agreements which gives the MoD any rights beyond what the statutes provide, and as such it is Annington's view that the MoD does not have leasehold enfranchisement rights in relation to these leases..

- 3. The bond documents' risk factors section highlights the enfranchisement risk. It cites "certain obstacles to such an approach which would make it difficult". What are these obstacles?**

We have elaborated as fully as possible in the earlier section of this call. To reiterate, there are both property law and public law impediments to the Government successfully enfranchising.

- 4. The bond documents' risk factors section highlights the risk that the payment of compensation does not reflect the value to the group of affected land. Is there something specifically how land is valued in an enfranchisement process?**

If the MoD can enfranchise, the compensation would either be agreed between the parties, or determined by an independent tribunal. The MoD has indicated in a letter to Annington that it expects the amount it would have to pay to enfranchise the estate to be broadly equal to market value. Ultimately, if the parties cannot agree this figure, it will be determined by an independent tribunal.

- 5. Would it be feasible for the Government to buy back properties in stages to lessen the financial impact on the UK budget and that Annington debt would be reduced over a multi-year period?**

Again, Annington are firmly of the view that the MoD will be unable to enfranchise any of the properties in the MQE. However, in the unlikely event that it is successful, it is possible that the MoD could pursue an enfranchisement process over a multi-year period as each property would be subject to a separate enfranchisement process.

- 6. The offer of the £105m fund to refurbish homes is a significant amount of money. It seems to suggest that there is significant risk of the enfranchisement process being successful? How costly would lawyer fees be in comparison to put up a defence on a couple of enfranchisement test cases?**

Again, we are firmly of the view that the MoD does not have the legal right to enfranchise the MQE properties and that Annington would ultimately succeed in court but given that the Judicial Review process (taking into account appeals) could take years to resolve and be quite costly, there is a clear benefit to resolving this issue quickly

MoD relationship:

- 7. How closely was Jeremy Quin involved in the site review process? It seems surprising that the government waived the right of the next site review in 15 years' time and now questions the benefit of the sale and leaseback deal in its entirety?**

We agree it is surprising that the MoD is now taking this course of action as settlement of the site review at the end of last year was very constructive by and for both parties. At no point during negotiations did the MoD give any indication that it intended to subvert the terms of its 1996 agreement.

- 8. Where is the void/vacancy level now? Can Annington offer more support to improve the MoD's economics?**

According to the MoD's own figures, which it produces annually, the vacancy rate is c. 20% vs the MoD's target of 10%. As we mentioned in the presentation, as part of the site review settlement agreement we agreed to the handback by the MoD of 87 properties at a site in Brize Norton and 85 properties at a site in Uxbridge with a waiver of all associated dilapidations in relation to the properties. These properties are in a dire condition and we suspect that the potential dilapidations compensation the MoD would have been obliged to pay under the lease was preventing the MoD from handing them back earlier. As mentioned Annington has also agreed to amend the 2019 Dilapidations and Handbacks agreement to work better from the MoD's perspective but also continuing to provide dilapidations relief to the MoD provided it complies with the terms of that agreement. In terms of the MoD's economics, it is important to remember that even post the settlement of the site review the MoD enjoys a 49.6% discount to open market rent on all of the properties which in Annington's view is tremendous value.

Strategy change:

- 9. What is the feasibility of a strategy change to purchase open market properties with MoD proceeds, rather than reducing leverage? Would Annington's platform have to change significantly?**

We are currently focussed on resolving the enfranchisement claims and are not considering a strategy change at this time.

Financial policy:**10. How committed is Annington to its financial policy?**

Annington remains committed to its financial policies and BBB rating.

Any distribution of Free Cash Flow will continue to be subject to maintaining financial policies and suitable cash reserves to ensure that the Group's operational needs, including any costs associated with the enfranchisement claims of the MoD, are able to be met.

11. If the MOD is ultimately successful how will any cash proceeds be used?

We are currently focused on resolving the enfranchisement claim and without waiving privilege we are very firmly of the view that the MOD is not entitled to acquire Annington's properties.

As noted earlier any legal action could take a number of years.

In the event that the MoD was ultimately successful then we would provide bond holders with guidance on what the implications would be for Annington and bond holders and how cash proceeds will be applied by Annington.

12. Views on any scenario where the MoD would buy only part of the portfolio, below your book value etc – what's the point to make all this noise if that's at market value? I know you previously said you don't foresee that.

The MoD has not confirmed its intentions to us. In relation to the value that would be paid, we have commented on this earlier in the call.

13. What are the ICR and LTV at year end (and beyond) expected to be?

We will publish both of these ratios in our March 2022 audited annual accounts.

Terra Firma exit.

14. In case of an exit – would you be selling all the portfolio or in different parts? What would be the room for manoeuvre for a buyer to increase leverage (dividend lock-up etc)? Any colour on how you would structure a sale and your appetite for a sale (partial maturity of some of the funds) would be appreciated

We understand that Terra Firma has put all exit plans on hold as a result of the MoD's actions

That now concludes this call and thank you for taking the time to participate. We have attempted to provide as full an update as we are able to at this time and will provide further updates once there are any further material developments.