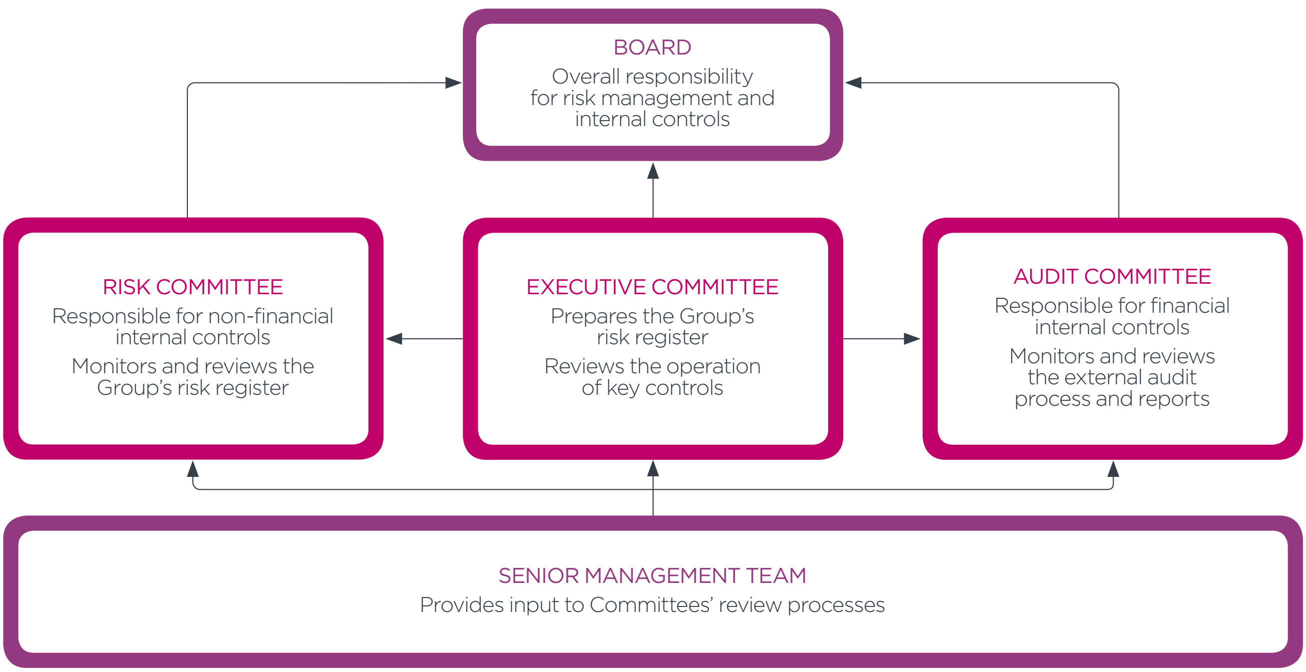
RISK MANAGEMENT

The Board recognises that risk is an inherent part of running a business and, whilst it aims to maximise returns, the associated risks must be understood and managed.



Whilst overall responsibility for the risk management process rests with the Board it has delegated responsibility for assurance to the Audit Committee and the Risk Committee. 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 relatively short management reporting lines. Consequently, members of the Executive Committee are closely involved in day-to-day matters and able to identify areas of increasing risk quickly and respond accordingly.

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. During 2013, the Group's processes for preparing the risk register and reporting the results both internally and externally were reviewed by a third party. Whilst no major points were identified a number of recommendations were made which were implemented in preparing the register this year. The register is prepared by the members of the Executive Committee who, having identified the risks, collectively assess 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 reflected in the final assessment. It also recognises that risk cannot be totally eliminated at an acceptable cost and that there are some risks which, with its experience and after due consideration, the Board will choose to accept.

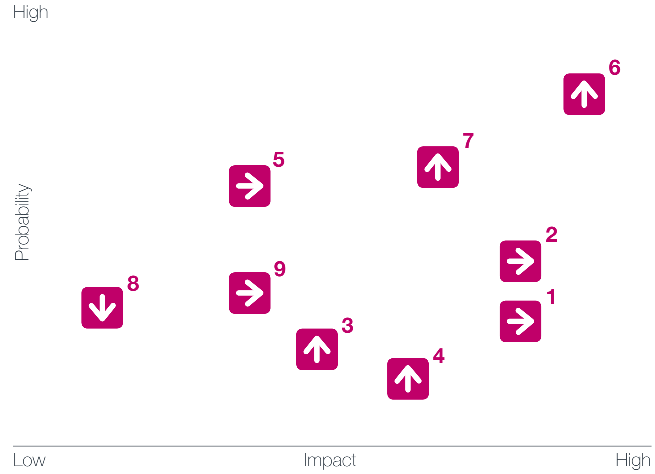
The register, its method of preparation and the operation of the key controls in the Group's system of internal control, are reviewed throughout the year by the Risk Committee which periodically receives presentations from senior management to gain a more in-depth understanding of the control environment in certain areas of the business. The register was updated between December 2013 and February 2014 and includes 42 risks spread between strategic risks, operational risks and financial risks.

These graphs show the probability and impact for our main risks together with the changes in the assessment of the risks since 2012. These movements are also split between the three risk categories and the third graph details the movement in the overall risk by category over the past five years.

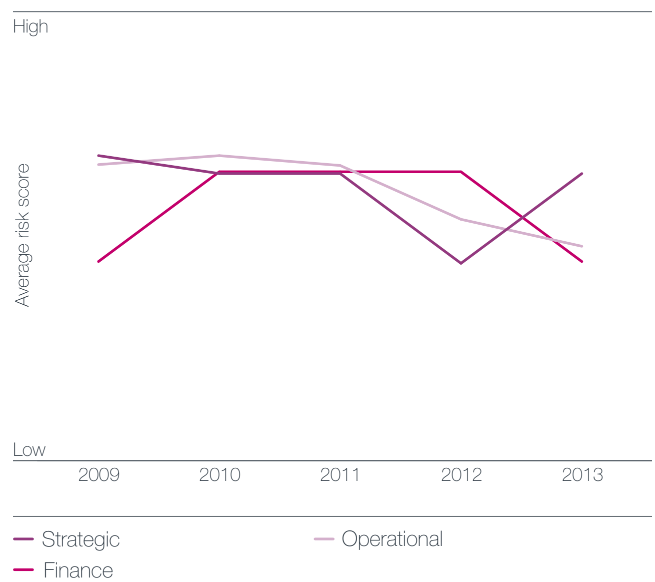
The principal risks and uncertainties that the Group faces in 2014, together with the controls and mitigating factors, are set out on the following pages.

For more information see pages 111 and 150

2013 major risks



Average risk by category



"As risk management continues to move up the business agenda, the activity of the Risk Committee has become more important and increasingly embedded in the Group's activities."

ROBERT RAYNE
CHAIRMAN

RISK MANAGEMENT
CONTINUED

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 with a consequent effect on two of its KPIs – total return and total property return. The Board sees the level of these risks 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 risks remain 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 2013. 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. ■ During the year the Group's loan-to-value ratio remained below 30%, its net interest cover ratio was above 250% and the REIT ratios were comfortably met.
3. Regulatory non-compliance The Group's cost base is increased and management time diverted through a breach of any of the legislation that forms the regulatory framework within which the Group operates. An increase in costs would directly impact on the Group's total return KPI. A significant diversion of management time could affect a wider range of key metrics. This risk is seen to have increased over the year due to the increased scale of the legislative and regulatory environment and the number/frequency of changes made to the legislative and regulatory framework.	■ The Group's Risk Committee reports to the Board concerning regulatory risk. ■ The Group employs a Health and Safety Manager. ■ The Group employs a sustainability manager who reports to the sustainability committee which is chaired by Paul Williams. ■ 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.	■ The Risk Committee receives an annual report from the Group's legal advisors which identifies the expected legislative changes for the next 12 months. ■ A Health and Safety report is presented at all Executive Committee and main Board meetings. ■ The Executive Committee receives regular reports from the sustainability manager. ■ The Group pays considerable attention to sustainability issues and produces a sustainability report annually.
4. Reputational damage The Group's reputation is damaged through unauthorised and inaccurate media coverage. 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 because it considers that the importance of the Group's reputation/brand has risen.	■ All new members of staff benefit from an induction programme and are issued with the Group's Staff Handbook. ■ Social media channels are monitored. ■ The Group takes advice on technological changes in the use of media and adapts its approach accordingly. ■ There is an agreed procedure for approving all external statements.	■ The Group employs a Head of Investor Relations and retains the services of an external PR agency. Both maintain regular contact with external media sources. ■ The Group engages with a number of local community bodies in areas where it operates as part of its CSR activity.

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
5. Higher interest rates Financing costs are higher due to increases in interest rates. This risk would affect the Group's interest cover ratio KPI. 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 two interest rate swaps which were at historic rates and initiated new instruments which have locked in the lower long-term rates that are currently available. ■ 83% of borrowings were fixed or hedged at the year end. ■ Additional 15 and 20-year fixed rate debt was put in place in January 2014.
6. Increase in interest rates Increases in interest rates can lead to higher property yields which cause property values to fall. This would affect the following KPIs: ■ Loan-to-value ratio. ■ Total return. ■ Total property return. Interest rates have remained low for an extended period of time and yields are at or near historical lows. With the UK's improving economic background, gilt rates have already risen and a base rate rise is likely within the next two years. Though there is no direct relationship, this may cause property yields to soften in due course and therefore the Board considers this risk to have increased over the year.	■ The impact of such changes on the Group's financial covenants and performance are monitored regularly and are subject to sensitivity analysis to ensure that adequate headroom is preserved. ■ The impact of potential yield changes is considered when future projects are appraised.	■ The Group produces three rolling forecasts each year which contain detailed sensitivity analyses. ■ Quarterly management accounts report on the Group's performance against covenants and ratios. ■ Project appraisals are regularly reviewed and updated. ■ Changes to the Group's financing profile over the year has simplified the management of its financial covenants.

Key

Risk increase

Risk unchanged

Risk decrease

RISK MANAGEMENT
CONTINUED

Operational risks
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
7. 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. This would have an effect on the Group's total return and total property return KPIs. Taken as a whole the Board considers this risk to have increased since last year. This reflects that the scale of the Group's development programme and, therefore, its influence on the Group's results has increased.	■ 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. ■ Alternative procurement methods are being evaluated as a way of minimising the effect of increased construction costs.	■ 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 67 lettings achieved in 2013 which totalled 643,200 sq ft. ■ The Group has secured significant pre-lets of the space in its current development programme which significantly 'de-risks' these projects.
8. Tenant default The Group suffers a loss of rental income and increased vacant property costs due to tenants vacating or becoming bankrupt. This risk would have an immediate effect on the Group's tenant receipts and void management KPIs and, if significant, on the total property return, total return and interest cover ratio. The Board considers this risk to have decreased over the last year due to very low historic default levels, the increased diversity of tenants and the healthier outlook for the UK economy.	■ 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 (see pages 12 and 13). ■ The Credit Committee meets each week and considered 103 potential tenants during the year. ■ In total the Group holds rental deposits amounting to £11.2m. ■ On average during the year, the Group has collected 98% of the rents due within 14 days of the due date.
9. Shortage of key staff The Group is unable to successfully implement its strategy due to a failure to recruit and retain key staff with appropriate skills. This risk could impact on any of the Group's KPIs. 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 considers succession matters as a standard agenda item.	■ The Group recruited 10 new members of staff during 2013. The key appointment of a sustainability manager was made in January 2013. ■ Staff turnover during 2013 was low at 6% (7% including retirees).