

Schroders
capital

50 years in
Real Estate

24 April 2023

***GROUND RENTS INCOME FUND
PLC ('GRIO')***

EGM presentation

Background

Unaudited portfolio valuation, regulatory reform update, and shareholder consultation

Key points for shareholders to note are:



As at 30 September 2022, 21% of the portfolio by value was subject to a Material Valuation Uncertainty Clause (MUC), with a negative valuation adjustment for building safety regulatory reform of £11.4 million. Further progress since the 30 September 2022 valuation date means that the relevant percentage of assets impacted is now approximately 17% (proforma). The valuation also includes a negative valuation adjustment for residential leasehold regulatory reform of £3.8 million.



The Building Safety Act 2022 (BSA) received Royal Assent in April 2022 and the Board and Manager endorse its aims of improving building standards and protecting leaseholders in their homes. In addition and consistent with the "polluter pays" principle, 43 of the UK's largest developers have recently signed legal contracts obliging them to pay to remediate building safety defects in relevant buildings they have constructed/refurbished (representing 12 of the Company's 26 assets with defects outstanding).



The BSA has increased the challenges associated with resolving building safety issues, despite the Company having not developed any of its assets. Ongoing work relating to verifying the valuation adjustment has resulted in a continued delay in producing the audited results for the year ended 30 September 2022, and may lead to qualified audit opinion. Notwithstanding, since Schroders' appointment in mid-2019, and subsequent Board appointments, progress is being made in protecting both leaseholders' interests and our shareholders' investments.



The Board and Manager have consulted with shareholders on the forthcoming continuation vote and changes to the Company's investment policy. Positive support received for our strategy to optimise value. All shareholders consulted agreed that an alternative to the extant 'Wind-up Resolution' was required, and all but one was supportive to amend the Investment Policy to enable a realisation of assets in a controlled, orderly, and timely manner.



BUILDING SAFETY REFORM

Building Safety Reform and impact on the Company

Material Valuation Uncertainty and potential for audit report modification

- The recently introduced BSA aims to improve building standards and protect leaseholders in their homes
- The new building safety framework relies on a risk-based code of practice (PAS9980) that aims to clarify existing guidance and standardise assessments to recommend (where relevant) proportionate remedial measures. This potentially reduces unnecessary works and costs recommended under the previous compliance-based approach. This may be expected to reduce future valuation adjustments.
- Consistent with the "polluter pays" principle, 46 of the UK's largest developers have recently signed legal contracts obliging them to pay to remediate building safety defects in relevant buildings they have constructed/refurbished (representing 12 of the Company's 26 assets with defects outstanding). This may be expected to reduce future valuation adjustments.
- The Company's independent valuer, Savills, continue to maintain a MUC in relation to assets with building safety issues. As at 30 September 2022, the aggregate valuation adjustments for building safety and residential leasehold reforms are £11.4 million and £3.8 million respectively, or £15.2 million in total (previous totals: 31 Mar 2022, £18.6 million; 30 Sep 2021, £7.2 million)
- The introduction of the BSA, and ongoing work to more accurately verify the assumptions supporting the building safety valuation adjustment, has resulted in a continued delay in producing the Company's audited results for the financial year ended 30 September 2022 (the "Accounts"), and may still result in a qualified audit opinion.
- The verification exercise may lead Savills to change its valuation adjustment, which could increase or decrease the valuation of the Company's portfolio as at 30 September 2022. The Board currently estimates that 26 assets are impacted by the MUC, representing approximately 16.9% of portfolio value, reduced from 30 assets or 21% of portfolio value as at 30 September 2022. Preparation of the Company's audited accounts to 30 September 2022 is ongoing.

Source: Schroders, April 2023.

Building Safety Reform and impact on the Company

BSA increased complexity of challenges facing the Company but progress being made

- Robust processes in place to manage building safety issues and determine any likely residual liability for the Company, including regular communication with leaseholders who are understandably frustrated by issues impacting their homes
- Across the ‘Managed’ and ‘Non-managed Estate’ (where a Residents Management Company (‘RMC’) is responsible for managing the building), we are progressing, or are aware of, approximately £56 million of developer or Government funded remediation projects at 17 properties. This includes four properties where works have already been completed (over and above the 30 referenced as at 30 September 2023), at no significant cost to the Company
- ‘Managed Estate’ - eight out of the 30 properties referenced above, we are actively pursuing six developers under the new BSA powers
- ‘Non-Managed Estate’ - 22 out of the 30 properties referenced above, we are assisting leaseholders (and their RMC where appropriate) wherever possible, such as sharing due diligence, providing consents and leveraging warranties,

Progress being made dealing with legacy issues as well as managing leasehold reform risk

- Having resolved the litigation at Beetham Tower in Manchester in August 2021, the Board and Manager continue to deal with other legacy issues relating to historical transactions and portfolio activity carried out prior to the current Board and Manager’s appointments with the Company
- Continued progress implementing the doubling ground rent asset management programme, which was voluntarily initiated by the Company in 2017, well before the Government’s associated pledge. ‘Improved Offer’ since provided to those residential leaseholders with 10- and 15-year doubling rents
- Against the backdrop of the cost-of-living crisis, we are demonstrating the benefits of institutional ownership through activity such as bulk buying utilities and competitive building insurance premiums

Source: Schroders, March 2023.

Building Safety Reform and impact on the Company

Key risk non-recoverable costs and impact on cashflow

Remediation, as of 30-Sept-22	Number of Assets		% of Portfolio Value (30-Sept-22)	
	MEST / NMEST / Total		MEST / NMEST / Total	
Assets Requiring Remediation:	8 / 22 / 30		8.9% / 12.0% / 20.8%	
Building safety remediation works completed:	0 / 4 / 4		0.0% / 5.0% / 5.0%	

Remediation, as of Mar-2023	Number of Assets		% of Portfolio Value (30-Sept-22)	
	MEST / NMEST / Total		MEST / NMEST / Total	
Assets Requiring Remediation:	6 / 20 / 26		5.9% / 11.1% / 16.9%	
<i>Analysed as:</i>				
<i>Committed Pledged Developer</i>	3 / 9 / 12		4.9% / 4.6% / 9.5%	
<i>Government funding applications ongoing:</i>	4 / 10 / 14		1.4% / 7.1% / 8.5%	
<i>Remedial Work Commenced:</i>	1 / 6 / 7		0.5% / 6.3% / 6.7%	

Clarifications

- Managed Estate (**MEST**) - properties where GRIO is responsible for management, repair and maintenance
- Non-Managed Estate (**NMEST**) - those properties where a third party, such as a Residents' Management Company is responsible for management, repair and maintenance

Key observations

- As at 30 September 2022, approximately **21%** of portfolio valuation subject to a Material Valuation Uncertainty Clause as a result of the BSA, representing a negative valuation adjustment for building safety regulatory reform of **£11.4m***
- As at today, the number of assets requiring remediation decreased to **26**, representing approximately **17%** of the portfolio valuation
- Good progress is being made protecting shareholders' investments and leaseholders' interests

Next steps

- Conclude verification strategy
- Independent valuation as at 31 March 2023

Source: Schroders, March 2023.

*Based on the independent portfolio valuation as at 30 September 2022.



*SHAREHOLDER CONSULTATION
AND EGM*

Continuation Vote

Consultation included speaking with 67% of GRIO shareholders

- The Company's Articles of Association (the 'Articles') contain provisions that provide shareholders with a vote on the future of the Company, commonly known as a 'Continuation Vote'. Such Continuation Votes are relatively common in investment trusts as a means of enabling shareholders to realise their investment at, or close to, NAV where, as in the Company's situation, the shares have traded at a persistent and material discount to NAV per share.
- Continuation Votes can be structured in different ways. In the Company's case, there is a requirement for the Board to convene a general meeting between the tenth and the eleventh anniversary of Admission, meaning that the meeting must take place no later than 13 August 2023. The Articles provide that:
 - i. the Board must table a proposal for shareholders to vote on a resolution for a voluntary wind-up of the Company (the '**Wind-up Resolution**') and liquidation of the Company's assets; and
 - ii. **any single shareholder who votes for the Wind-up Resolution is deemed to hold sufficient voting rights so as to ensure that the resolution is passed**
- This means that the Wind-up Resolution can be passed with the vote of one shareholder irrespective of the number of shares it holds in the Company. The effect is that, **in the absence of any alternative proposal approved by shareholders, it is highly likely that the Wind-up Resolution will be passed.**
- **The Articles allow for the Board to be released from its obligations to propose a Wind-up Resolution if a special resolution is passed prior to 13 August 2023.** The Articles do not specify the terms of such a special resolution. Therefore, the Board and its advisers have consulted with shareholders about proposals to facilitate the passing of a special resolution.
- **In the absence of an alternative, special resolution, a single shareholder voting in favour of the Wind-up Resolution will lead to the immediate winding up of the Company. If a Wind-up Resolution is passed, the Company would cease activities and all management powers would pass from the Board to an appointed Liquidator with immediate effect, which would constitute an event of default under the Company's loan facility with Santander and result in an immediate suspension of the shares. Given general market uncertainty, and based on the views from the Company's advisors, the impact would likely be a forced sale of the underlying portfolio (in whole or in parts) at depressed prices.**

EGM Resolution 1 - Continuation Vote

Summary

- The Company faces continuing headwinds relating to building safety and leasehold reform that are largely outside of our control, which have led to falling capital values and weak sentiment in the ground rent market sector more broadly. Whilst the Company has a clear strategy for managing the risks associated with these headwinds, until market conditions and liquidity improve, we believe that the portfolio may not be realisable on acceptable terms. Consequently, whilst progress is being made to improve liquidity of the underlying assets to satisfy more demanding buyer due diligence requirements, there is no certainty that the portfolio could be made 'ready for sale' to achieve optimum pricing over the short to medium term.
- Accordingly, the Board and the Manager proposed, in the Shareholder consultation, that any extension to the life of the Company granted by the release of the need to propose a Wind-up Resolution by 23 August 2023 would be used to improve liquidity and work towards crystallising an optimum return for all Shareholders. Notwithstanding the prevailing Ordinary Share price discount to NAV, every Shareholder consulted was supportive of using an extended time period to deliver a liquidity event more reflective of NAV.
- The shareholder consultation proposed the following two alternative options:
 1. Postponing the Company's obligation to hold a vote on the Wind-up Resolution to 31 December 2024* ('Option 1'); or
 2. Removing the Company's obligation to hold a vote on the Wind-up Resolution and replacing it with an alternative proposal and vote before 31 December 2024 to decide whether the life of the Company should continue (a 'Continuation Vote') which requires either (i) a simple majority of votes cast to pass; or (ii) a majority of not less than 75% of votes cast to pass. If this Continuation Vote is not passed, then the Board would be required to present alternative proposals to shareholders within an expedited timeframe ('Option 2').

- All Shareholders consulted agreed that the likely negative consequences of the Wind-up Resolution being passed meant that an alternative was required. Of the two alternatives proposed, all but one Shareholder consulted favoured Option 2 with an approval threshold for the Continuation Vote of a simple majority of votes cast. **The Board recommends the Articles be amended in line with Option 2, with the Continuation Vote acting as a milestone for the Board to provide Shareholders with an update on progress in implementing the Company's strategy relating to the realisation of assets.**

Source: Schroders, March 2023.

*Note that this was changed from 2025 to 2024 for the purposes of the formal Shareholder consultation.

EGM Resolution 2 - Changes to the Investment Policy

Summary

- Given the impact on the strategy of the Company of the alternative options to the extant Wind-up Resolution, the Shareholder Consultation also included proposals to amend the Company’s extant investment policy to enable a realisation of assets in a controlled, orderly and timely manner, with the objective of achieving a balance between periodically returning cash to Shareholders and optimising the realisation value of the Company’s investments. All but one Shareholder consulted was supportive of this change. The Board believes that an orderly realisation of the Company’s assets will return better value to Shareholders than putting the Company into a formal winding up process, or any other alternative proposal.

- The Company’s New Investment Policy is now proposed as:

“The assets of the Company will be realised in a controlled, orderly and timely manner, with the objective of achieving a balance between (i) periodically returning cash to shareholders at such times and from time to time and in such manner as the Board (in its absolute discretion) may determine; and (ii) optimising the net realisation value of the Company’s investments.

The strategy for realising individual investments will be flexible and may need to be altered to reflect changes in circumstances of a particular investment or in the prevailing market conditions. All material disposals of assets to be made by the Company will be approved by the Board.

Whilst implementing this realisation strategy, the Company will aim to deliver best-in-class residential asset management including fairness, transparency and affordability for leaseholders. The net proceeds of portfolio realisations will be returned to shareholders at such times and from time to time and in such manner as the Board (in its absolute discretion) may determine. The Board will take into consideration the Company’s working capital requirements (including, but not limited to, debt servicing and repayments), the cost and tax efficiency of returns of capital and the requirements of applicable law.

The Company may not make new investments, except where required to preserve and/or enhance the disposal value of its existing assets.

To the extent that the Company has not disposed of all of its assets by the time of the next shareholder vote to consider the Company’s future to be held on or before 31 December 2024, in accordance with the revised articles of association of the Company, shareholders will be provided with an opportunity to review the future of the Company. To that end, an ordinary resolution will be proposed on or before 31 December 2024 that the Company will continue as then presently constituted.

Any cash received by the Company as part of the realisation process but prior to its distribution to shareholders will be held by the Company as cash on deposit and/or as cash equivalents.”

- **The Board recommends changing the Company’s existing Investment Policy by adopting the New Investment Policy (it being noted that the passing of this Resolution is also conditional on Resolution 1 having passed)**

Continuation Vote

EGM Resolution 3 and other matters

Resolution 3 – Board fees

- Due to the volume of work associated with the headwinds and legacy issues facing the Company since the appointment of the Manager in 2019, and the appointment of a new, four-person, Board of directors, from 2019 onwards, Shareholders were also consulted on increasing the fees payable to the Board and the Manager. In recognition of these factors, all Shareholders consulted acknowledged the increased volume of work required from the Board and were therefore supportive of increasing the aggregate Board fee cap from £150,000 to £200,000 per annum with effect from 1 October 2022
- **As a result of this strong support, Resolution 3 includes the proposed change to increase the aggregate Board fee cap to £200,000 per annum. The Board is not recommending a vote for or against this resolution**

Manager fees

- Shareholders acknowledged the increased workload for the Manager due to the issues facing the Company. The Alternative Investment Fund Management Agreement (“AIFM Agreement”) between the Company and the Manager includes the ability for the Manager to charge the Company additional fees for a range of projects that are out of scope. **Whilst a majority of Shareholders consulted supported the principle of the Manager being paid additional management fees in either cash or Ordinary Shares, and the potential for a fee linked to the successful realisation of the Company’s assets, there was no consensus between Shareholders on the precise terms**
- **In light of this feedback, and Shareholder approval not being required, the Board will agree fees separately with the Manager**

Dividend policy

- Shareholders were also consulted on issues that could impact the longer-term sustainability of the Company’s dividend. Further to this, **the Board is proposing that the Company continues to pay dividends, but only when sustainable and in order to comply with relevant laws and regulations, including the distribution requirements relating to the Company’s UK REIT. A change to the dividend policy does not form part of the EGM proposals, however it will be addressed and put to Shareholders in the forthcoming Shareholder meeting relating to the approval of the Accounts.**

Current debt and potential refinancing

- In conjunction with supporting Resolutions 1 and 2 as described, all Shareholders were informed about the Board’s intention to secure additional flexibility by extending the loan. This is currently under discussion with Santander.



SUMMARY

*Continued headwinds
impacting performance and
liquidity*

*Progress being made
protecting shareholders'
investments and
leaseholders' interests*

*Positive support from
shareholders during the
consultation to our strategy
for optimising value*

Summary

Key points, next steps and timeline

- The BSA and leasehold regulatory reform continue to negatively impact the Company but the Government's introduction of more proportionate building safety assessment guidelines and legally binding remediation agreements with major developers, should reduce the risk of the Company incurring nonrecoverable associated costs
- The Shareholder Consultation relating to the continuation vote is set against this backdrop of a challenging regulatory environment, where we are working hard to protect both shareholders' investments and leaseholders' interests. As part of the consultation, the Board and Manager set out how we are addressing these challenges in order to improve the liquidity of the underlying portfolio and deliver best-in-class residential asset management.
- We are encouraged by the positive support from shareholders during the consultation to our strategy for optimising value in line with the proposed new investment policy.
- Since Schroders' appointment in mid-2019, and subsequent new Board appointments from late 2019, progress has been made to reduce risk and manage historical, legacy issues such as Beetham Tower
- Preparation of the Company's audited accounts to 30 September 2022 is ongoing

Source: Schroders, March 2023.

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Important Information



Ground Rents Income Fund Plc – Risk Factors:

The Company borrows for investment purposes. This will magnify any gains or losses made by the Company.

The Company has no maturity date. The Company may only be terminated by a continuation vote, a shareholders' voluntary liquidation or by a compulsory liquidation if the Company were unable to pay its debts. The Company owns a portfolio of assets with the income generated from the collection of ground rents.

Potential legislative reform may impact the Company's value and future income streams.

The Company invests in real estate which may be viewed as a higher risk and illiquid investment and may, therefore, be adversely affected by a decrease in market liquidity for the assets in which it invests

You may not be able to sell your product easily or you may sell at a price that significantly impacts on how much you get back. This product does not include any protection from future market performance so you could lose some or all of your investment.

The Company will invest solely in property located in the UK. This can carry more risk than investments spread over a number of countries. The performance of the Company would be adversely affected by a downturn in the property market in terms of capital value or a weakening of rental yields. The Company invests in real estate which may be viewed as a higher risk and illiquid investment and may, therefore, be adversely affected by a decrease in market liquidity for the assets in which it invests.

The Company has the ability to use gearing as part of its investment strategy. The use of gearing will increase the risk profile of the Company and the volatility of the value of Shares, and will amplify losses in the event of a decline in gross asset values. Gearing may create significant underperformance, particularly in times of a falling property market. Borrowing costs may, from time to time, exceed returns on property.

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