CITY NORTH N4

- Mixed use development incorporating access to Finsbury Park station
- Joint venture with the Business Design Centre
- Includes 355 apartments and 109,000 sq.ft of commercial space

Computer generated image

CHIEF EXECUTIVE'S REVIEW

DEVELOPING IN LONDON: A POSITIVE OUTLOOK

'In addition to strong financial results for the year to 31 March 2017, our growing reputation as a build to rent partner is unlocking an exciting source of future growth.'

Performance

I am delighted to report record levels of revenue and profit for the year to 31 March 2017. Pre-tax profits continued to increase, reaching £34.1 million (2016: £32.2 million), slightly ahead of the level anticipated at the beginning of the year due to more open market completions in the second half of the year and additional build to rent profit recognition. The gross margin before interest charges of 22.3 per cent and the operating margin before interest of 13.4 per cent were in line with expectations. Both reflect the increasing mix between developments sold to individual buyers and build to rent transactions secured at lower margins in exchange for enhanced capital returns.

Despite uncertainty in relation to the outcome of the EU referendum and tax changes impacting primarily UK based individual investors, our underlying market has remained resilient. Any potential dampening effect of these factors has been outweighed by the structural imbalance between supply and need for new homes in London, particularly at our typical price point.

Our forward selling strategy continues to be at the heart of our model. We sell homes early in the development cycle as a means of de-risking projects and advancing investment into new opportunities. This means that trading activity undertaken in each financial year will typically deliver revenue and profit over the following two to three years, giving the Board substantial visibility over future profit levels and expected cash flows. We receive deposits when contracts are exchanged for individual properties and, as at 31 March 2017, £68.1 million of deposits had been taken in advance of future completions. This additional funding supports further investment in the development pipeline and reduces the need to draw down debt finance. We start the financial year with a substantial order book of forward sales of £546 million (1 April 2016: £579 million). This secure and de-risked position is underpinning our stated expectations for growth over the next few years.

Following some recent land acquisitions, our development pipeline stands at £1.5 billion of future revenue and represents more than five times the revenue generated in the year to 31 March 2017. The average anticipated price of the open market homes within the pipeline is £527,000 (2016: £513,000). This is in line with our model of seeking non-prime opportunities where the average sales price is below £1,000 per square foot, and hence the majority of homes are priced between £350,000 and £700,000.

Jon Di-Stefano
Chief Executive

CHIEF EXECUTIVE'S REVIEW

THE FORGE E6

- Residential development of 192 homes currently under construction
- 125 homes sold to M&G Real Estate for build to rent
- 67 affordable homes sold to East Thames Housing Association

Computer generated images

In February 2017, we added to the pipeline with the acquisition of a sizeable development site, the former London Electricity Board (LEB) building on Cambridge Heath Road, E2 for £30.2 million. The anticipated gross development value of the site is approximately £95.0 million. Subject to planning consent, we expect to start work on site in 2018 and to finish in 2021. Post year end we have exchanged contracts to acquire Stone Studios in Hackney Wick for 120 homes plus commercial space, and have been selected as the preferred partner of the London Borough of Brent to develop 236 homes in South Kilburn. Both sites have full planning consent and we expect to start on site later this year.

Customer mix

The Group's customer mix for the year to 31 March 2017 has moved significantly towards institutional build to rent investors, with this sector representing 77 per cent of sales generated (2016: 24 per cent) compared with individual investors from the UK and overseas at 20 per cent (2016: 69 per cent) and owner-occupiers at three per cent (2016: seven per cent). In total, including build to rent transactions, we exchanged contracts for the sale of 501 open market properties in the year to 31 March 2017 (2016: 463).

Individual open market sales

As our build to rent business has grown, and we have continued to pursue our forward sales strategy, we have naturally seen lower numbers of sales to owner-occupiers. Unless they are cash buyers, owner-occupiers are typically unable to purchase more than six months ahead of completion. However, there is clearly significant demand from this part of the market and over the last few weeks we have had a very encouraging response to the launch of the residual availability at Bermondsey Works leading to 22 owner-occupier reservations, 20 of which are being purchased under the Government's Help to Buy scheme.

We have seen robust demand from individual investors underpinned by a thriving rental market primarily caused by an imbalance between supply and demand for rental properties at the right price point. Amongst these sales it is pleasing to see a number of repeat purchasers, who often opt to wait for the launch of the next Telford Homes development rather than investing elsewhere. In the 2016 calendar year, we achieved a 99 per cent customer recommendation rate, an outstanding performance that sustains the high levels achieved in previous years (2015: 99 per cent).

Our last significant launch to individual investors was the second phase of City North, Finsbury Park, in November 2016, which secured 73 new sales for a combined value of over £43 million. The success of this is evidence that high quality homes in desirable locations remain sought after by investors across the world. Subsequent to City North, developments that could have been more widely launched for sale have instead been sold to build to rent investors as part of our new strategic focus. Notwithstanding this we are confident that there remains a healthy market for our typical product from individual buyers.

Build to rent

We have increased our presence in the London build to rent sector over the last year. Since February 2016 we have entered into four build to rent transactions comprising of nearly 500 homes, together worth over £230 million. Telford Homes is a valued partner to large-scale investors, given our record in delivering complex residential projects, and we are proud to have become recognised as a significant build to rent developer in such a short space of time.

In December 2016, we exchanged contracts for the sale of The Forge, Redclyffe Road, E6 to M&G Real Estate. The sale consisted of the freehold interest in the land and construction of 125 homes for a net consideration of £48.6 million. This was our third build to rent transaction, and the second with M&G. At the end of March 2017 our joint venture, Chobham Farm North LLP, exchanged contracts on our fourth significant build to rent transaction. Contracts were exchanged for the sale of 112 of the 297 open market homes at New Garden Quarter, Stratford E15, for a net consideration of £53.7 million. The sale, to a subsidiary of our joint venture partner Notting Hill Housing Group, was for the first phase of open market homes at this development and removed the need for third party debt finance.

As we have previously reported we are actively looking into establishing longer term relationships with build to rent investors. We anticipate that this type of partnership will enable Telford Homes to buy land with a secured build to rent sale already in place subject to any planning requirements. This will bring focus to our acquisition of build to rent opportunities, allowing us to move swiftly to secure sites and to take advantage of an increased desire for purpose built rental homes from local councils and the Mayor of London.

CHIEF EXECUTIVE'S REVIEW

Market context

The principal market developments in the year have been a level of nervousness created by the outcome of the EU referendum and tax changes, namely the three per cent stamp duty surcharge on second properties and the phased removal of tax relief on mortgage interest. The potentially negative impact of these factors on our performance has been mitigated by the chronic imbalance between the supply of and need for homes in London. Our business model of developing homes that people can afford to either buy or rent is built upon this fundamental and longstanding driver of demand.

Although the EU referendum result created a degree of uncertainty, this has not to date been a significant cause for concern for the Group. We chose to defer launches for a short period while the immediate furore died down, something that our focus on forward selling allows us the flexibility to do. Demand remained buoyant however and neither have we seen significant pressure on labour availability or materials due to the result, especially as there has not been a dramatic increase in the supply of homes in London. We will continue to monitor the negotiations with the EU, looking for stability throughout the process and assurances as soon as possible on the rights of EU workers to remain in the UK. We consider that these are already vital considerations for both sides, which supports our confidence in continuing with our current strategy for growth.

The shift of our business model towards build to rent has helped to cushion us from the impact of the tax changes. In any case sales to overseas investors have remained robust, evidenced by the launches of the Liberty Building just over a year ago and more recently City North. We have seen particular success over the last three years in selling to investors based in China. This is despite any potential tempering of demand in relation to leaving the EU or the additional three per cent stamp duty, both of which have been offset for some buyers by favourable movements in exchange rates.

We have, however, seen a reduction in the number of UK based individuals seeking to invest in buy-to-let properties. These investors have been more sensitive than overseas buyers to the uncertainty resulting from the EU referendum, and have also been deterred by the increase in stamp duty and the reducing ability to benefit from tax relief on mortgage interest. Despite these tax changes the attractive rental yields that are bringing institutional investors into the market should also encourage individuals to invest again once their confidence returns.

Objectives and strategy

Our primary objective is to build more homes in London and to grow in a controlled manner to meet some of the shortfall between supply and need in the capital. We are on track to achieve our stated ambition to generate significant growth in pre-tax profits over the next two years, and also to create a platform for sustaining a bigger business that can continue to grow in the longer term.

Our strategic priority is to further increase our activity in the build to rent sector. Our business is very capital intensive and this restricts our rate of growth if we are relying on our own sources of capital. A key attraction of build to rent is that forward funded developments do not require much, if any, of our equity, nor any debt finance. This allows us to accelerate the growth of the business, provided we have the operational capacity to do so, and to combine that with reducing our longer term reliance on debt.

As well as the focus on increasing our presence in build to rent, we are expanding our geographical reach beyond our historical heartland of boroughs in the East of London. We still expect to operate in our key boroughs, but as the business grows in scale we are looking to broaden the spread of individual sale and build to rent opportunities. An example of this in action is the South Kilburn site in partnership with Brent, a borough in which we have not previously developed.

We believe our skillset can be deployed to develop homes across London, maintaining a strong pipeline of developments for individual buyers in non-prime locations and for build to rent investors.

Another decision that has resulted from our increased scale is to target larger sites, typically of 50 or more units, in order to secure economies of scale. This also fits with the minimum scale of investment for most build to rent investors and ensures we are not spending time on smaller sites that historically contribute much less to profits and disproportionately take up operational capacity.

Having a solid foundation of forward sold properties now allows us the flexibility to hold back some open market homes until later in the development time frame, should we wish to take advantage of an active owner-occupier market, supported in some instances by Help to Buy. We have seen recent success with Help to Buy at Bermondsey Works, having held back the residual availability with that objective.

We do not expect Help to Buy to become as fundamental to Telford Homes as it is to many other developers, but it will help us to maintain support for those who still wish to purchase their own home.

We are planning dedicated sales centres on more of our sites, working together with our central sales location in Stratford. In these instances, including at Bow Garden Square, St Pauls Way, E3 and the remainder of New Garden Quarter, we will be commencing sales much later in the development process than would normally be the case. We expect this to bring a healthy balance to our overall sales mix ensuring that we are able to flexibly adjust to any future demand changes across our various customer segments.

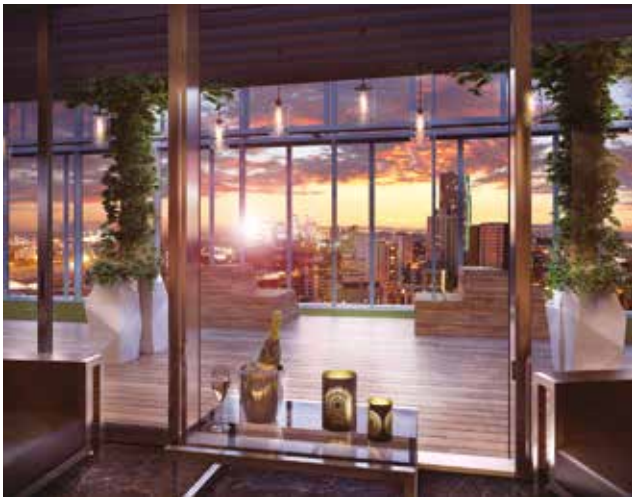
In the last 12 months we have taken a big step forward in terms of our commitment to sustainability. We now have a Head of Sustainability and a fully-fledged strategy, 'Building a Living Legacy', including a commitment to achieving a range of targets over the next seven years.

SOUTH KILBURN NW6

Computer generated images

- Selected as the preferred partner to redevelop a 3.2 acre site
- Detailed planning consent for 236 homes close to Kilburn Park station
- Intend to start work later in 2017 with completion in 2021

CHIEF EXECUTIVE'S REVIEW



These targets address economic, social and environmental aspects of building a sustainable business for the benefit of all our stakeholders. You can read more about this on page 38.

Ever mindful of needing to work as efficiently as possible, we have increased our adoption of modern methods of construction to speed up the delivery of certain developments, something the Government has been encouraging the sector to do. Not only is this beneficial to our customers and investors but it also improves our return on capital. Examples include the off-site construction of brick cladding at our Manhattan Plaza development and the use of a lightweight metal frame structure at The Pavilions, one of our build to rent schemes. Along with the rest of the industry, we will be looking at how we can increase the use of these methods and others to deliver homes more quickly and efficiently.

More detail on our strategy is available on page 12.

Outlook

We anticipate that the lack of supply of new homes relative to need in non-prime areas of London will continue to provide ample opportunity for the growth of Telford Homes in the foreseeable future. Our increased focus on build to rent, with de-risked sales requiring reduced levels of equity and no debt finance, allows us to evaluate ways to grow at a faster rate. Although build to rent projects generate a moderately lower net margin, our return on capital is much improved and longer term debt requirements will be lower.

We expect to continue our successes in the build to rent sector due to the increasing appetite of a range of potential investors. In particular, we will pursue longer term partnerships whilst also maintaining an awareness of other opportunities.

We anticipate that over the next few years build to rent could represent as much as half of our total revenue pipeline.

The Board is comfortable with the development pipeline, and we have avoided acquiring land at inflated prices. We have equity and debt available to add to the pipeline, and will do this where opportunities are consistent with our strategy and meet our financial hurdles. Prospects spanning a variety of locations are being evaluated on an ongoing basis and in greater numbers than in 2016. This, together with the successful tenders for our recent acquisitions, is encouraging in terms of securing access to our most important raw material.

We are confident in our product and market place as we look to the future. Over 80 per cent of the anticipated gross profit for the year to 31 March 2018 has been secured, and Telford Homes is on track to deliver over £40 million of profit before tax. In addition, for the year to 31 March 2019, we have secured over 60 per cent of the anticipated gross profit and expect profit before tax to exceed £50 million.

The strength of our performance and outlook are testament to the hard work and commitment of everyone at Telford Homes. I am proud of our way of working, our exemplary rate of employee retention and our excellent health and safety record and all the more so in view of the exceptional growth we have achieved in the last few years. I want to thank everyone that makes Telford Homes a special place to work and I look forward to another exciting period of growth ahead.

Jon Di-Stefano
Chief Executive
30 May 2017

STRATOSPHERE E15

- 36 storey tower in the heart of Stratford
- All 307 open market homes and 34 affordable homes sold
- Under construction with completion due in 2018

Computer generated images