Independent auditor's report to the members of Custodian REIT plc

Report on the audit of the financial statements

1 Opinion

In our opinion:

- the financial statements of Custodian REIT plc (the 'parent company') and its subsidiaries (the 'group') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 March 2021 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006, and International Financial Reporting Standards (IFRSs) as issued by the International Accounting Standards Board (IASB);
- the parent company financial statements have been properly prepared in accordance with international accounting standards in conformity with the requirements of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the consolidated statement of comprehensive income;
- the consolidated and parent company's statements of financial position;
- the consolidated and parent company's statements of cash flows;
- the consolidated and parent company's statements of changes in equity; and
- the related Notes 1 to 21.

The financial reporting framework that has been applied in the preparation of the group financial statements is applicable law, and international accounting standards in conformity with the requirements of the Companies Act 2006, and IFRSs as issued by the IASB. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and international accounting standards in conformity with the requirements of the Companies Act 2006.

2 Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the group and parent company for the year are disclosed in Note 5 to the financial statements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

3 Summary of our audit approach

Key audit matters	The key audit matter that we identified in the current year was: • Valuation of investment property. Within this report, key audit matters are identified as follows: Newly identified Increased level of risk Similar level of risk Decreased level of risk
Materiality	The materiality that we used for the group financial statements was £8.4m, which was determined on the basis of 1.5% of gross assets.
Scoping	The group audit team performed full scope audit procedures giving a coverage of 100% of the group's net assets value and net profit for the year.
Significant changes in our approach	In the current year the financial performance of the group demonstrated higher than forecast rent collection, strength within the industrial portfolio valuation and compliance with all covenants. Both management actions and the recovery of the economy following vaccination rollout and reopening of businesses, resulted in stronger than forecast results for the group. In the previous year, impact of COVID-19 on going concern was identified as a key audit matter based on a combined assessment of forecast covenant and REIT regime compliance, liquidity and ability to pay dividends. Since the group continued to perform strongly and met all bank covenants and REIT regime compliance and its reverse stress testing represents a highly unlikely scenario, we no longer consider the impact of COVID-19 on going concern as a key audit matter in the current year.

4 Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the group's and parent company's ability to continue to adopt the going concern basis of accounting included:

- obtaining an understanding, of the relevant controls relating to the going concern assumption;
- testing the clerical accuracy of the model used to prepare the going concern forecasts;
- assessing the historical accuracy of forecasts prepared by management and actual performance in the subsequent period;
- evaluating management's assessment of the impact of COVID-19 and Brexit within the forecast;
- agreeing the available financing facilities to underlying agreements and assessed accuracy of covenant calculation forecasts performed by management;
- assessing the accuracy of the REIT regime calculation forecasts performed by management;
- assessing the reasonableness of management's reverse-stress testing; and
- assessing the adequacy of disclosures made in the financial statements.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the group's and parent company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

In relation to the reporting on how the group has applied the UK Corporate Governance Code, we have nothing material to add or draw attention to in relation to the directors' statement in the financial statements about whether the directors considered it appropriate to adopt the going concern basis of accounting.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5 Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Independent auditor's report to the members of Custodian REIT plc continued

5 **Key audit matters** continued

5.1. Valuation of investment property

Risk

Key audit matter description	The group's principal activity is to invest in commercial properties and secure income from tenants of those properties. As disclosed in Note 10 the group's investment property portfolio is valued at £551.9m as at 31 March 2021 (2020: £559.8m). The group's accounting policy in Note 2 states that investment property is held at fair value and Note 2.4 describes key judgements made in valuation of investment properties. In determining the fair value, the external valuers make a number of key estimates and significant assumptions, in particular assumptions in relation to market comparable yields and estimates in relation to future rental income increases or decreases. Certain of these estimates and assumptions require input from management. Estimates and assumptions are subject to market forces and will change over time. Valuation of investment property is an area of judgement which could materially affect the financial statements. The valuations were carried out by third party valuers. The valuers were engaged by those charged with governance and performed their work in accordance with the Royal Institute of Chartered Surveyors (RICS) Valuation – Professional Standards. The estimation of yields and estimated rental values (ERVs) in the property valuation is a significant judgement area, underpinned by a number of assumptions relating to the size and location of the property as well as certain attributes of the lease. Given the high level of judgement involved, we determined that there was a potential for possible manipulation of these key inputs to the valuation. The inherent subjectivity in relation to estimation of yields and ERVs, coupled with the fact that only a small percentage difference in individual property valuations, when aggregated, could result in a material misstatement on the Statement of Comprehensive Income and the Statement of Financial Position, warrants specific audit focus in this area and we have considered it as a key audit matter. The Audit and Risk Committee report on pages 88-90 discloses this as a primary area of judgement.
How the scope of our audit responded to the key audit matter	We obtained an understanding of the relevant controls over the valuation process, including assessing management's process and control for reviewing and challenging the work of the external valuers including management's experience and knowledge to undertake this activity. With the involvement of our real estate specialists who are Chartered Surveyors we identified items subject to testing and met with the third party valuers appointed by those charged with governance with the aim of challenging the valuation methodology adopted. We assessed the competence, capabilities and objectivity of the external valuers and read their terms of engagement with the group to determine whether there were any matters that might have affected their objectivity or may have imposed scope limitations on their work. We assessed and challenged the reasonableness of the significant judgements and assumptions applied in the valuation model for each property in our sample, focusing in particular on the yields and ERVs assumed and assessing the sensitivity of the valuation to changes in assumptions. We assessed the completeness and accuracy of the data provided by the group to the valuers for the purposes of their valuation exercise. With the assistance of members of our audit team who are Chartered Surveyors, we reviewed the significant assumptions in the valuation process, tested a sample of properties by benchmarking against external appropriate property indices and understood the valuation methodology and the wider market analysis. We reviewed the information provided by the valuers both in the meetings and contained in the detailed valuation report; and we undertook our own research into the relevant markets to evaluate the reasonableness of the valuation inputs and the resulting fair values. We have also tested the integrity of the model which is used by the external valuers. We also considered the adequacy of the group's disclosures around the degree of the estimation and sensitivity to key assumptions made when valuing these properties, including the impact of the COVID-19 pandemic.
Key observations	The results of our tests were satisfactory and we concluded that the key assumptions applied in determining the property valuations were appropriate. The testing performed in relation to the final property valuations proved satisfactory.

6 Our application of materiality

6.1 Materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

	Group financial statements	Parent company financial statements
Materiality	£8.4m (2020: £8.7m)	£8.39m (2020: £8.69m)
Basis for determining materiality	1.5% of gross assets (2020: 1.5% of gross assets) for the Statement of financial position testing. This percentage takes into account our knowledge of the group and parent company, our assessment of audit risks and the reporting requirements for the financial statements.	
Rationale for the benchmark applied	We have used the gross assets value as at 31 March 2021 as the benchmark for determining materiality, as this benchmark is deemed to be one of the key drivers of business value, and is a critical component of the financial statements and is a focus for users of those financial statements for property companies. In addition to gross assets, we consider EPRA earnings as a critical performance measure for the group that is applied to underlying earnings. We have also benchmarked these percentages and our approach to materiality to other listed REITs based on information publicly disclosed in the audit reports and found them to be consistent.	

A lower materiality of £1.9m (2020: £2.9m) which was determined on the basis of 8% (2020: 10%) EPRA earnings was used for amounts in the statement of comprehensive income. We consider EPRA earnings to be the most appropriate benchmark due to it being one of the key focus areas for both investors and management. Refer to Note 21 for a reconciliation to IFRS earnings. We reduced the percentage applied to EPRA earnings for the purpose of determination of lower focused materiality in response to uncertainties brought by COVID-19.

6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole.

	Group financial statements	Parent company financial statements
Performance materiality	70% (2020: 70%) of group materiality and parent company materiality (respectively).	
Basis and rationale for determining performance materiality	In determining performance materiality, we considered the following factors: a. our cumulative knowledge of the group and its environment, including industry wide pressure on valuation of property portfolio; and b. our past experience of the audit, which has indicated a low number of corrected and uncorrected misstatements identified in prior periods.	

6.3. Error reporting threshold

We agreed with the Audit and Risk Committee that we would report to the Committee all audit differences in excess of £420,000 (2020: £435,000), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit and Risk Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

Independent auditor's report to the members of Custodian REIT plc continued

7 An overview of the scope of our audit

7.1. Identification and scoping of components

Our group audit was scoped by obtaining an understanding of the group and its environment, including group-wide controls, and assessing the risks of material misstatement at the group level. All audit work to respond to the risks of material misstatement was performed directly by the group audit engagement team.

The group consists of the parent company and subsidiaries that were inactive by the year end. We carried out a full scope audit of the group.

7.2. Our consideration of the control environment

We obtained an understanding of the relevant controls in relation to key business processes as well as IT systems that were relevant to the audit. We however did not rely on controls due to nature of the group's business and processes.

8 Other information

The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. The directors are responsible for the other information contained within the annual report. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon. Our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the course of the audit, or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.	We have nothing to report in this regard.

9 Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

10 Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

11 Extent to which the audit was considered capable of detecting irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1. Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the group's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- the group's own assessment of the risks that irregularities may occur either as a result of fraud or error that was approved by the board on 26 May 2021;
- results of our enquiries of management , internal audit, investment manager and the Audit and Risk Committee about their own identification and assessment of the risks of irregularities;
- any matters we identified having obtained and reviewed the group's documentation of their policies and procedures relating to:
  - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
  - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
  - the internal controls established to mitigate risks of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and relevant internal specialists, including real estate specialists, regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the following areas: valuation of investment property. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the group operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, and REIT legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the group's ability to operate or to avoid a material penalty. These included the environmental regulations.

11.2. Audit response to risks identified

As a result of performing the above, we identified the valuation of investment property as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the Audit and Risk Committee and external legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance and reviewing internal audit reports; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members, including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

Independent auditor's report to the members of Custodian REIT plc continued

Report on other legal and regulatory requirements

12 Opinions on other matters prescribed by the Companies Act 2006

In our opinion the part of the directors' remuneration report to be audited has been properly prepared in accordance with the Companies Act 2006.

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the Strategic report and the Directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic report and the Directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the group and the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic report or the Directors' report.

13 Corporate Governance Statement

The Listing Rules require us to review the directors' statement in relation to going concern, longer-term viability and that part of the Corporate Governance Statement relating to the group's compliance with the provisions of the UK Corporate Governance Code specified for our review.

Based on the work undertaken as part of our audit, we have concluded that each of the following elements of the Corporate Governance Statement is materially consistent with the financial statements and our knowledge obtained during the audit:

- the directors' statement with regards to the appropriateness of adopting the going concern basis of accounting and any material uncertainties identified set out on page 97;
- the directors' explanation as to its assessment of the group's prospects, the period this assessment covers and why the period is appropriate set out on page 73;
- the directors' statement on fair, balanced and understandable set out on page 103;
- the board's confirmation that it has carried out a robust assessment of the emerging and principal risks set out on page 73;
- the section of the annual report that describes the review of effectiveness of risk management and internal control systems set out on page 70; and
- the section describing the work of the Audit and Risk Committee set out on pages 88-90.

14 Matters on which we are required to report by exception

14.1. Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion: • we have not received all the information and explanations we require for our audit; or • adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or • the parent company financial statements are not in agreement with the accounting records and returns.	We have nothing to report in respect of these matters.

14.2. Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made or the part of the directors' remuneration report to be audited is not in agreement with the accounting records and returns.	We have nothing to report in respect of these matters.

15 Other matters which we are required to address

15.1 Auditor tenure

Following the recommendation of the Audit and Risk Committee, we were appointed as auditor by the directors in 2014 to audit the financial statements for the period ended 24 March 2014 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is eight years, covering the periods ended 24 March 2014 to 31 March 2021.

15.2 Consistency of the audit report with the additional report to the Audit and Risk Committee

Our audit opinion is consistent with the additional report to the Audit and Risk Committee we are required to provide in accordance with ISAs (UK).

16 Use of our report

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

James Wright (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
Crawley, United Kingdom
15 June 2021