Land Securities Annual Results Presentation

Wednesday 19 May 2010

Speaker: Francis Salway – Chief Executive
Slide 1 – Title slide
Good morning and welcome.

Today's presentation is about our results for the past year but, just as importantly, it is a forward looking statement of intent – about how we are set up to deliver strong performance in the future.

We have done a lot of work in the last year, and we are clear on direction and opportunities.

Slide 2 – Land Securities
In London, supply is tightening and the outlook for rental value growth is extremely favourable. This makes development attractive and we have the largest development pipeline in London. Rob will talk more about this.

In Retail, our story is more evenly spread across investment assets, developments and acquisitions. But there is a common theme across all three disciplines which is that it will be the right lettings to the right retailers which will drive performance. Richard will expand on how key lettings have driven performance in the last year and how they have the potential to do so in the future.

And if you were to eavesdrop in the business, you might be surprised just how much time we are spending talking about actions to deliver growth in revenue profits in the medium term.

We have a clear plan, and we have the management team and the financial capacity to deliver it, as you will hear from Martin.

Slide 3 – Income growth outlook
Our plan to grow revenue profit in the medium term will come through a combination of:

- Leasing up voids
- Increases in rent upon review in a couple of years time – and we will achieve that as rental value growth returns because we have a number of major assets with very limited over-renting
- Delivering new development projects at a yield above our cost of debt
- And making dormant development sites productive in revenue profit terms - whether through selective sales or re-starting dormant sites

In the current financial year, these initiatives are likely to be masked by the full year effect of sales in 2009/10 and lease expiries on pre-development properties in 2010/11. But, thereafter the fruits of these initiatives will come through into our revenue profits.

Slide 4 – Financial summary
In terms of the formal figures. We delivered a profit before tax for the year of some £1.07bn, which mainly consisted of the valuation surplus of £864m or 10.3%.

Combining the valuation surplus with balance sheet gearing delivered NAV growth of 16.5% over the full year - and 22.3% over the second half.

Revenue profit was slightly ahead of consensus expectations at £251.8m, but down 20% on the prior year. Adjusted diluted earnings per share reflected both the movement in revenue profit and the additional shares in issue for the full year after our capital raising.

We are proposing a final quarterly dividend of 7.0 pence per share, making 28.0 pence for the year. We expect to maintain our dividend at this level of 28.0 pence for the current year, but going forward we will look to grow the dividend as revenue profit growth returns.

Slide 5 – Portfolio valuation results
Looking now at our overall valuation surplus of 10.3%, you can see from this chart that ongoing developments, in grey in the middle, did better – up 11.9%. But the sites of future developments, in green, were, over this period, a drag on performance.

At a time when investment properties leapt ahead, sites generally trod water – and, indeed, were slightly negative, which reflected the burning off of income under expiring leases and the fact that preparatory capex was not necessarily matched by an equal movement in valuation.

Slide 6 – Investment portfolio performance relative to IPD
In overall terms, our portfolio performed in line with our benchmark, which is the IPD Quarterly Universe.

You can see that we delivered very strong out-performance in shopping centres, out performing the benchmark by 6.9% on a relative return basis. Our retail warehouses also outperformed by 0.75% on a relative return basis. In both cases, it was down to lettings and lettings to the right retailers. Richard will give you examples.

On London offices our performance was below the benchmark. There are two reasons for this. Firstly, Queen Anne's Gate: this is our third largest property and we took most of our capital and all of the income out of the property, through the £360m bond issue last summer. If the performance analysis was adjusted for the capital taken out of Queen Anne's Gate, this would improve our total return on London offices by 1.2% - and on the overall portfolio by 0.6%.

The second factor is that our London offices were impacted by the flat or even slightly negative capital value movement on pre-development properties which I have just referred to. But I think it is a case of flat now and strongly up in the future, as Rob will describe.

Slide 7 – Like-for-like portfolio
This bar chart shows rental and capital value growth on our like-for-like investment properties over the two halves of the year.

For me, the real story comes in the middle of the chart which is the second half of the financial year – and in those scarcely visible brown bars showing rental value change. The fact that these bars are scarcely visible signifies a turning point for rental values: bottoming out and with increases on some individual assets.

I will now hand over to Martin.

Speaker: Martin Greenslade – Group Finance Director
Slide 8 – Title slide
Thank you Francis. Good morning everyone. Francis has taken you through the financial headlines so let me start by highlighting how the actions we have taken are reflected in our results.

Slide 9 – Financial highlights
Over the course of the year, we took a number of measures to strengthen the financial position of the company:

- We completed our programme of asset sales;
- We raised new non-recourse debt including Queen Anne's Gate bond; and
- We extended £650m of bank facilities.

What that now gives us is the ability to fund developments at competitive rates at a time when development finance is scarce; and it also gives us the flexibility to make acquisitions without the need to raise further funding.

I will talk a little more about our gearing in a minute, but I'm comfortable that it's at an appropriate level for this stage in the cycle.

And in line with what I explained at this time last year, our revenue profit is down by 20%, reflecting market conditions and the actions we took to strengthen the balance sheet.

Let me explain this last point in more detail.

Slide 10 – Movement in revenue profit

What I have set out on this slide are the main components behind the 20% decline in revenue profit from £314.9m last year to £251.8m this year.

Net rental income from our property portfolio declined by £77.6m. I will cover this in more detail on the next slide but the main reason was due to the properties we sold. The loss in rental income from sales was only marginally offset by the interest savings of £10.4m shown here. And there were two reasons for this:

- The first is that sale proceeds pay down bank borrowings and the marginal cost of most of our facilities is still very low; and
- The second reason is a £32.7m reduction in capitalised interest. So we actually had a £43.1m decline in interest but completed and suspended developments (like Leeds) meant far less interest was capitalised.

And finally, a reduction of £4.1m in indirect property expenditure and central overheads makes up the bridge from last year's revenue profit to this year's £251.8m.

So let's now look at the rental income movement in more detail.

Slide 11 – Rental income analysis

Net rental income on our like-for-like properties declined by £19.6m or 3.0% for a number of reasons. In Retail, we had the full year effect of the failure of a number of retailers in the second half of 2008/09 as well as a £3.0m fall in income from the Accor portfolio, which is in line with trading performance in the hospitality sector. In London, we saw some lease expiries, the largest of which was at Portland House in Victoria. Our completed and on-going developments, such as Cabot Circus, Bristol and St David's, Cardiff, saw net rental income increase by £12.4m.

But by far the largest impact on net rental income came from the properties sold since 1 April 2008 with a decline of £68.6m. At the time of our Rights Issue, when we raised a proportionately smaller amount of equity than our peers, we explicitly stated that we would continue to sell assets in 2009 to strengthen our balance sheet and it is this that has been the main reason our net rental income declined by £77.6m or 12% overall.

Turning now to net assets.

Slide 12 – Movement in adjusted diluted NAV

This slide sets out the key items behind the increase in our adjusted net assets. Adjusted earnings were £257.8m. The next three items reflect the changes in the value of our assets;

the first is the revaluation surplus of £863.8m; the second shows the loss on investment property disposals during the year of £24.5m; and the third item is the impairment of our development land and infrastructure, all but £1m of which occurred in the first half of the year.

Dividends were £217.9m, comprising two amounts: £235.5m paid to shareholders in the year less £17.6m which was in the form of a scrip dividend.

During the year, we terminated a number of interest rate swaps at a cash cost of £104.9m, the majority of which relates to the first half. By crystallising these swaps, we bring them into the adjusted net assets calculation when previously they were excluded.

At the year end, our adjusted diluted NAV per share was 691p, up 16.5% over the year or 18.9% if we ignore the cancelled swaps.

So, let’s move from net assets to cash flow.

Slide 13 – Cash flow and debt
The full details of our cash flow can be found in the appendix section of your packs, but I thought it would be simpler to present it by way of the major moments in our net debt.

We began the year with net debt on our balance sheet of just over £3.9bn. During the year, the main cash outflows were the £217.9m in dividends we paid and the £219.6m we invested in our portfolio, largely on our development at One New Change. We also spent nearly £50m on acquisitions, the majority of which was deferred consideration from prior periods.

Cash from disposals brought in just under £1.1bn with the cancellation of the swaps accounting for most of the “other” category.

Now the summary of those movements is that, over the last 12 months, we reduced our net debt by 16.8% or £660.2m.

Let’s now turn to the shape of finances.

Slide 14 – Financing
We have taken a number of steps to strengthen our balance sheet since the Rights Issue announcement in February 2009. During the year we put in place £505m of new facilities, including the innovative AAA-rated Queen Anne’s Gate bond of £360m. We also refinanced and extended £650m of our existing bank facilities extending them to 2014. In total, our weighted average maturity of debt is now 11.8 years, up from 9.6 years at March 2009.

The graph on this slide shows our debt maturities in blue and our undrawn facilities in green. As you can see, apart from a £300m bond with an expected maturity of February 2011, we have a limited amount of debt expiring over the next three years. But we do have cash and committed, undrawn facilities of £2.4bn.

At the end of the year, our Group LTV was 43.5% which is at the top end of our inner range of 35% to 45%. We are not rigid about this range, recognising that gearing will vary over the cycle perhaps as high as 55% LTV or as low as 25% LTV – and these represent the limits of our outer range. So, for this point in the cycle, we're very comfortable with our gearing.

But it's not just about gearing. Our Security Group provides us with great flexibility. We're back in Tier 1, we've established the ability to secure partnership interests, we've had the AA rating reaffirmed, we raised facilities with excellent duration when others were struggling and, as a result of all these, we now have fire power to respond to opportunities. We can buy assets without having to raise asset-specific debt and we can finance our planned developments at competitive rates when such finance still remains scarce.

So let me summarise.

Slide 15 – Summary
The asset value declines of the first half of the year were more than made up in the second half giving an overall rise of 10.3%.

Our gearing translated this into a 16.5% rise in adjusted diluted NAV per share.

Our revenue profit is down 20% compared to last year largely due to the sales we made. The full year effect of these sales will continue into 2010/11 as we lose a further £31.3m of income recognised this year. Against this, we have the opportunity to reduce voids and service charge shortfalls, there's more to come from our developments and I'm sure there will be more acquisitions. Our revenue profit is very important to us because of its link to dividends and, as Francis outlined, growing it over the medium term is a clear priority.

Our aim this year was to provide the business with a strengthened balance sheet and put behind us questions on refinancing risk and maturing facilities. Our refinancing is done – but that cannot be said of the industry as a whole. As a result, we think there will be an increasing flow of opportunities driven by all manner of refinancing issues. Our balance sheet, debt structure and committed facilities give us plenty of scope to exploit the opportunities.

Now let me hand you over to Richard.

Speaker: Richard Akers – Managing Director, Retail Portfolio
Slide 16 – Title slide

In this presentation I will give you some colour on our performance over the last year in the Retail Portfolio including some specific examples, and I will give you a clear understanding of our plan to create value in the future.

Slide 17 – Context
We are alive to the uncertain outlook for the consumer.

We are alive to the structural changes flowing from the impact of the internet.

And we are encouraged by retailers beginning to compete for space, particularly new international brands.

Best Buy are not just taking units themselves, they are forcing the pace of their competitors.
It will be possible to get growth but not solely from market rent movements. You will see us capturing that growth and then recycling capital.

Slide 18 – Perfromance
We are pleased with our level of outperformance of IPD in both shopping centres and retail warehouses, which we attribute to our strong leasing performance and the asset management initiatives which we have delivered. We have concluded some 350 lettings during the year with a rent of £27m per annum and that leasing capability is based on our established strong relationships with key occupiers.

Slide 19 – Lettings, voids and insolvencies
Dealing with the vacancies created by the 2008/09 insolvencies has been a major priority for us and we have made significant progress. Across our like-for-like portfolio we have seen a 2.6% fall in combined voids and units in administration. The proportion of our voids subject to temporary lets has increased from 0.6% to 1.8% and we have a further 1.2% in solicitors' hands for reletting. This accounts for about half of the void % in the right bar of the chart.

Slide 20 – Where we have created value – shopping centres
So how have we created value?

At Gunwharf Quays retail sales up 6.7% and 26 new lettings or regears have driven rental growth. With more recognition for delivering performance in all market conditions yield shift has combined with this growth to give a valuation surplus of 32.4%.

Bon accord in Aberdeen is a different story; here we had the threat of competition from Hammerson's Union Square and our response has been firstly to put in big stores for next, River Island and Top Shop, and then add some key mid-market retailers such as Hobbs, Phase8 and Jo Malone. These actions have delivered a valuation surplus of over 11%, significantly above the market level of 2.5%.

Slide 21 – Where we have created value – retail warehouses
DSG responded to the best buy threat by opening a new superstore at Lakeside retail park. This Curry's store has the highest sales and gross profit in the UK. We've let 5 other units, are now fully let and have driven a 32.5% increase in capital value.

At Poole we finished our various projects including the new John Lewis and this has delivered a valuation surplus of over 46%.

Slide 22 – Where we will create value – asset management
So where is the value going to come from in the future? Here are a couple of examples:
The Galleria, like Gunwharf Quays, has shown its resilience in the past year and with new lettings to Gap, Jaeger, Laura Ashley and Gant, we expect it to grow its income in the medium term. Indeed, in the seven weeks since the beginning of April The Galleria has shown sales up on last year by over 9%.

Adjacent to the recently opened Tesco Homeplus in Bracknell we have let part of the MFI store to next and will utilise the remaining space to create smaller units for other fashion retailers. This scheme will now start to see significant gains as it emerges as a strong fashion-led destination.

Slide 23 – Where we will create value – development
Our development activity will have two very distinct elements to it. We will selectively develop in major city centres where we can create exceptional destinations such as Leeds Trinity, where we expect to achieve our pre-letting target later in the year with a top class line-up of retailers and a scheme which will generate a very attractive gross yield on cost. We have also given a new focus to out-of-town development, partly through our joint venture with Sainsbury, and will be starting two stores for Sainsbury imminently, 115,000 sq ft in Lincoln and 90,000 sq ft in Livingston. Our out-of-town development strategy will also be targeting Marks and Spencer and John Lewis as well as the other major foodstore operators.

Slide 24 – Where we will create value – acquisitions
We have said that we will selectively acquire new assets.

We acquired the bulk of the Atlas site in Glasgow for less than £10m. It has 60 metres of frontage to Buchanan Street, the prime pitch in the country's top retail city after London. We're hearing from retailers who want major flagship stores here.

The O2 provides secure income and a host of asset management opportunities and the long-term potential of 11 acres in London.

In Oxford there is an opportunity to unlock a major development which is right at the top of the requirements list for John Lewis, but the centre has been bought on an asset management basis in a city which probably has the most favourable relationship between demand and supply of any city in the UK.

Slide 25 – Retail Portfolio
Our plan is to move assets up the retail hierarchy through development or asset management. We will exploit the opportunities we see in our market and then recycle capital.

Expect us to be providing space for the top fashion retailers in major city centres like Leeds.

Expect us to be delivering opportunities to the major foodstore and department store retailers out of town.

Expect to see us buying assets that have growth potential in strong markets.

And expect to see us opportunistically buying more vulnerable assets where the swift asset management plan such as lettings to retailers like Primark, New Look or TK Maxx can transform a location.

But don't expect us to be holding on to more vulnerable assets for the long term.

I will now hand over to Robert…

Speaker: Robert Noel – Managing Director, London Portfolio
Slide 26 – Title slide
Thank you Richard.

Despite economic uncertainty, the London office occupational market is turning, we are heading into a supply constrained market and rental growth should result.

Land Securities portfolio of prime assets, let at conservative rents, are set to benefit. And rather than compete in today's hot investment market we have plenty of development opportunity within our portfolio to invest in.

Slide 27 – Market context
Today, I will show that vacancy rates have peaked at lower levels than previous cycles and that over the next couple of years, there will be a very limited number of development completions.

Just at a time when demand, despite these uncertain times, is set to increase significantly creating supply constrained market conditions.

This will lead to rental growth and our portfolio is well positioned to benefit. Just as those buildings that are in the sweet spot have done this year.

Slide 28 – London offices – valuation growth
Here are two examples. New Street Square, on the left, is now fully let. It has seen the combined benefit of the removal of letting risk, return to rental value growth and a functional investment market.

Park House, on the right, a great example of how land values bounce back strongly as schemes move from break even to profitability.

The valuation here benefited from the combination of settlement of the judicial review giving us timing certainty, lower construction costs, and, again a return to rental value growth.

And rental value growth is one of the themes of my presentation today.

Slide 29 – London offices – Conservative average rents, positioned for growth
Even though market rental values have fallen over 25% from the peak, our passing rents are relatively well placed.

And to put some colour on this. These four schemes, which make up 31 % of the London Portfolio, are all let at conservative rents for their markets. These should perform well as the balance between supply and demand changes.

Slide 30 – Central London office vacancy rates
Supply first then. And this slide shows the vacancy rates for the City, in pink, and West End, in green, going back over the last 3 cycles.

As you can see, the vacancy rate has peaked at a lower level this time and, note, the proportion of new space available is relatively low and there is not much new space being built.

Slide 31 – London office development pipeline
This slide, from CBRE, shows development completions due in the City, on the left, and the West End on the right, compared to previous cycles.

The next two years are interesting because there is very little anyone can do to significantly accelerate the provision of new space.

To produce a new building of scale in central London by mid 2013 you need - a vacant site or building, a planning consent and the finance to build and we all know where these are.

And if you add projected development completions to current vacancy levels, you have barely enough new space to keep up with demand, which has been fairly robust considering the wider economic conditions, as it has been historically.

Slide 32 – Central London office take-up

This chart shows take up through the cycles in central London - City in pink, West End in green.

You can clearly see the troughs of the early 90's recession, the early noughties post dot com crash and the recent banking crisis. Equally you can see the peaks of the good times.

The white line represents 5% of the central London office stock in each particular year.

Office buildings generally have an economic life of around 20 years. So we expect 5% of occupiers to be on the move at any one time. A bit more in the good times as people plan for expansion, a bit less in the more difficult times when horns are pulled in and expensive moves are delayed.

And you can see this is pretty much the case

And we think demand will soon pick up.

Not because of economic growth. It is to do with the significant increase in the number of lease expiries on the horizon, the need for efficiency and changing attitudes.

Slide 33 – London office lease breaks and expiries

And this slide shows lease expiries in the City.

They rise significantly in 2014 and beyond mainly due to the combined effect of the end of the 25 year leases from the 1980's office boom, and the 15 year leases from the1990's office boom.

The larger requirements will be looking 2 to 3 years in advance of their move. Just at a time when the development pipeline is looking thin.

The position is similar, but on a lower scale, in the West End.

As only 25% of take up in the West End is in units of over 20,000 sq ft, as opposed to around 50% in the City, it is much more difficult to get the data.

For larger requirements though, planning restrictions mean the options will be very limited as only very few sites are suitable for buildings of scale.

Will tenants move? We think they will

Slide 34 – Property costs over time
This slide shows rent as a proportion of salary cost. The latest data was 2008, since when rental values fell a further 20%, salaries did not. Rent in real terms have never been cheaper, while productivity from the same area has improved beyond measure. Occupiers are paying low rents because they have choice. As soon as that choice evaporates, rents are likely to rise and tenants should be less sensitive to these rises than ever before.

So what are we doing about it? Building. And I have inherited a great programme.

Slide 35 – One New Change image
Starting at One New Change, this photo was taken early last month and you can see this entire city block has now taken shape.

Slide 36 – Committed developments – One New Change
The 550,000 sq ft scheme will reach practical completion in October. The retail element will be open for trading in November. We are already 90% let or in solicitors' hands. The offices will be completed to shell and core and can be ready for occupation from July next year. As you know we are 38% pre-let and we have been holding back on marketing the remainder of the space as we see the market conditions being more in our favour at PC.

Slide 37 – Committed developments – we are already building..
At Wellington House, Buckingham Gate, demolition is underway, and we will be building 59 apartments for delivery in July 2012.

We see residential as becoming more important to us. All central London developers are required to produce it and we are turning this necessity into a virtue as the core market is deep and liquid.

We already have interest in these flats at Wellington House, off plan, at above our forecast levels.

Park House, our 308,000 sq ft mixed use development will be delivered in November 2012. Park House is the largest speculative scheme built in Mayfair since before the Second World War. We already have good interest, in line with our forecasts, in all the retail space and all of the residential space.

Finally, At 62 Buckingham Gate, we are demolishing the existing Selborne House and will start construction of the new 270,000 sq ft building in the autumn.

Slide 38 – Consented schemes

We have plenty more where they came from. During the year we secured 2.9 million sq ft of planning consents and here are three examples.

At 20 Fenchurch Street, we obtained a revised consent in October including the addition of an extra office floor at the top of the building.

Also in October, we secured approval for VTI2 - a transformational mixed use scheme for Victoria of over 900,000 sq ft. Most of the leases here are aligned for September 2012 and we have compulsory purchase powers to tidy up the remainder.

And in November, we received consent for our proposals to build 670,000 sq ft at Arundel Great Court. We are currently looking at ways to accelerate our plans for this important site.

Slide 39 – In design

And during the current financial year, we intend to submit planning applications at a range of properties across London for a further 1.2 million sq ft including:

- 123 Victoria Street, formerly Ashdown House
- Cannon Street, which will be vacated by K&L Gates as they move to One New Change next year
- Shoe Lane, the next phase of New Street Square,
- Ludgate Hill and Kingsgate House, in Victoria

Slide 40 – Development pipeline

And to set the near term pipeline out in full. The 4 schemes under construction total just under 1.2 million sq ft.

We have planning consent for a further 2.9 million sq ft, at four locations, a doubling of the existing floor area on the sites.

And we have six further schemes in design, where we intend to submit planning applications during the course of this year which should provide around 1.2 million sq ft, an increase on existing floor area of nearly a half.

A grand total of over 5 million sq ft - equivalent to roughly half the current floor area of our London Portfolio.

We will look to partner some of these schemes and we are going through a process to choose a partner or partners for 20 Fenchurch Street. Our aspiration here is to start on site in the New Year for delivery in early 2014, and we will update you with progress in November.

As you can see, there is no shortage of opportunity

Slide 41 – Well positioned for the cycle
To summarise:

The ingredients are in place for a supply constrained office market in the Capital.

The combination of quality property and conservative rents sees us well positioned for growth in rental value as we move into the next phase of the cycle.

We are building already, with over 1 million sq ft of retail, residential and office space on site at the moment for delivery over the next 3 years.

As Francis will say in a minute, we are in no hurry to buy. Rather, we have a huge pipeline of opportunity to work on within the portfolio along with a combination of balance sheet capacity, and the discipline to recycle capital out of these opportunities in order to invest in others when the time is right.

I will now hand back to Francis.

Speaker: Francis Salway – Chief Executive
Slide 43 – Market outlook and business actions
In terms of outlook, global economies and financial markets are now more stable, but not without uncertainty.

In the property investment market side, we are seeing an increasing number of properties being brought forward for sale. The very rapid pace of recovery in values over the last six months reflected an excess of buyers over sellers. As we see more sellers, we will move closer to equilibrium - or possibly even a little beyond. We remain confident in the five year trajectory of values, and if there are ripples, we see these more as being buying opportunities. We have been patient, having bought only selectively, and we are prepared to continue to be patient, but we do expect the range of opportunities to begin to widen.

Both Richard and Rob have talked about the outlook for their markets. Put simply, in London we expect strong double-digit growth in rental values for prime offices for a number of years, and we will access that growth through developing into the rising market.

In Retail, we expect a more delayed pick up in rental values and for growth to then be at more modest levels. But there is still potential for attractive returns in retail through leasing up vacancies and selective development. Indeed, some of our retail developments have the highest prospective returns of any of our projects.

Slide 44 – Land Securities' proposition

To conclude, we have a clear plan for delivering growth – both income and capital. And the organic opportunities within our portfolio give us a great head start.

We have the people in the business to execute the plan and our people are committed both to strong occupier relationships and capital recycling, which for me are the key ingredients for sustained out-performance.

Slide 45 – Land Securities' proposition

This is our proposition.

We will now take your questions.

Question 1

Kundayi Munzara – Investec

With respect to the development pipeline, can you give us a sense of the amount that is going to be spent and the expected yields? And on the residential conversion, you mentioned that the actual figures of that take up of pre-lets were ahead of budget, could you give us a sense of what you have?

Answer – Robert Noel, Managing Director – London Portfolio

In terms of our capex on the four schemes in site, it is in your pack set out in the statement today. In terms of the yield if you take the four schemes, including One New Change, our development yield is around 6.8%. If you strip out One New Change, which was started a couple of years ago, and concentrate on the three schemes that are coming out of the ground now, minus the cost of the residential, you are into the high 7's.

In terms of our residential space, our forecasts are for selling residential flats in Victoria at around £1,200 a square foot and we have had interest at higher than this level. In Oxford Street our forecasts are for selling residential space at around £2,100 per square foot and again we have had offers above this level.

Question 2

John Lutzius, Green Street Advisors

Regarding your construction costs for the projects that are committed, are you locked in on those costs now?

Answer – Robert Noel, Managing Director – London Portfolio
We are absolutely locked in on those costs. They are what the Australians would call, fixed dollar contracts and what we would call lump sum contracts. They have been secured at different times in the market and indeed one of the comments I made about the construction costs was how we benefited at Park House through the lack of construction costs and the competitiveness amongst contractors to gain the business. So absolutely locked in.

Further question
Can you put any colour on the extent to which you feel like you have a material cost advantage by being first out of the blocks on your construction costs?

Answer – Robert Noel, Managing Director – London Portfolio
Well the cost that we managed to secure the building contracts at both Park House and 62 Buckingham Gate were between 25-30% below the latest estimate cost out turn of about 12 months before. So that is a material advantage. As competition increases there will be a propensity for building costs to inflate. So we are locked in at the low point.

Further question
There is clear evidence of a big move in net effective rents in the City, can you comment on the evidence of net effective rent movements in the West End?

Answer – Robert Noel, Managing Director – London Portfolio
It is very similar. The issue with the City at the moment is that the amount of quality space available is really very slim. There is more available in the West End. And traditionally tenants in the West End are more able to compromise on buildings, because they are smaller companies. People don't mind lower ceiling heights. They are generally taking space of between 5-10,000 square feet. I think 92% of transactions in the West End are below 10,000 square feet. So you are used to dealing with compromised buildings. As far as net effective rents are concerned and reading into incentives, they are falling all over London. They are here to stay because both Landlords and tenants are used to them, but they are lower than they were this time last year.

Further question
With respect to the shopping centre element of your Retail Portfolio, can you talk about your look forward expectations of growth there for net rental income growth? And the sources of that growth? For example, your tenant in administrations plus voids, I think, is about 9% today. What is a reasonable level for that three years hence? And then separately, where are your rents in place today versus current market net effective rents?

Answer – Richard Akers, Managing Director – Retail Portfolio
In terms of the look for shopping centres, clearly there is an opportunity to reduce the proportion of our income which is void or subject to leases in administration. And that certainly is a source of where we see some income growth coming. We are also very live to the fact that we are trying to reduce our direct costs and non recoverable costs and obviously letting up those voids and reducing the amount in administration helps with that as well.

In terms of the overall outlook for growth, as Francis has said, it is fairly subdued in the retail sector generally, but what we will be doing is trying to make sure that we are invested in the assets that have high growth potential. There is a big differential between growth potential in different locations and in different types of asset and so that is why I talked about capital recycling. And we will be selling some assets, we will be buying some assets and we will use that process to improve our overall occupancy rate and our net gross ratios.

Further answer – Francis Salway, Chief Executive
Can I just add on in place rents. The retail portfolio is actually on a net basis, very slightly reversionary at 0.7% with positive reversions at 8.5% offset by over renting of 7.8%; so probably slightly more favourable than you might expect after a downturn. I think peak to trough fall in rental values was a little bit more than that at about 9%.

Question 3
Harm Meijer, JP Morgan Cazenove
The outlook you are giving, has that changed over the last three months? Are you becoming a bit more cautious about what you are seeing in the market right now?

Answer – Francis Salway, Chief Executive
I think the statements we are making are extremely consistent with the statements we have been making for about 3 to 6 months. We referred to the possibility of ripples in terms of the investment market going back to November last year. Where I think the outlook is slightly better than we had guessed in the autumn, is on the occupier market side. We are moving to rental values bottoming out slightly sooner than we had expected. And I think the outlook for both Retail and London is that things are beginning to pick up again, which is slightly better than we had expected. Clearly much stronger in London than in Retail, but in both markets, things are looking a little better than we had expected.

Further Question
British Land said yesterday that they feel that the difference between prime and secondary assets is drifting a bit lower. What is your view on this?

Answer – Francis Salway, Chief Executive
We think that there is good investment demand for both prime and mid quality property. When you get to tertiary properties we would agree. But I think one thing that has happened is that

the buying interest which a year ago was very exclusively on prime, absolutely now is covering mid quality properties as well.

Further question
You mentioned that you are looking at some opportunities and you are sure that you are going to buy something later on in the year. What opportunities are you looking at this moment?

Answer – Francis Salway, Chief Executive
I think we are looking at a range of things. It is likely that in terms of London, a higher proportion of our investment is in the form of development capex. In Retail, weighted more evenly perhaps towards acquisitions. But we are looking at opportunities in both sectors.

Question 4
From the webcast (read out by Martin Greenslade, Group Finance Director)
The question is, what are the implications for the European Property Industry from the potential introduction of the EUAIFM directive?

Answer – Martin Greenslade, Group Finance Director
I don't think anyone knows the answer to that, but that won't stop me giving a reply. Broadly speaking, this is a piece of legislation that will come into being, and it almost certainly will catch the property industry. The reason it is difficult to say what the implications are for the UK is that it will be brought into legislation in different ways in different countries. If I had to guess today, I think it will come into the UK and I suspect it will mean a degree more regulation and some additional cost, but it certainly won't be fatal.

Question 5
From the webcast – read out by Francis Salway, Chief Executive
What is the average cost/margin of our undrawn debt?

Answer – Martin Greenslade, Group Finance Director
We have got two rather large chunks of undrawn debt. There is around £1.5 billion of our revolving credit facility. That has very low margins, sub 20 basis points over LIBOR and therefore the margin is up 20 basis points to LIBOR, depends on how long you are drawing that for. So you can certainly get sub 1% if you were drawing that today. The other cost of our debt is £750 million of bank facilities, is around 200 basis points over. That is the more recently implemented bank facilities that I spoke about. So sub 1%, around 200 basis points over. I will let you judge which ones we will draw first.

Question 6
Nicolas Lyle, HSBC
Your message on the offices and the retail are very clear in terms of where you are going to allocate capital expenditure. But I was interested in your office portfolio. If you could tell us what the average age of your buildings are, what rental growth you have seen in your portfolio to date versus the market? And also Francis, you mentioned in your interview this morning on the website that you believe that headline rents would rise more than incentives compression. Could you explain why you think that?

Answer - Francis Salway, Chief Executive
Our portfolio is now split between a range of very modern buildings and some extremely old buildings which are coming up for redevelopment or refurbishment. So the average age in a way is slightly misleading because we probably have almost no assets that are that average age. And I think that came out very strongly through Rob's slide about four key assets which were about 30% of the portfolio which have all been constructed within the last 5 or so years.

We have seen rental value growth. You will have picked up from that bar chart about like-for-like rental value growth in the second half, that it was fractionally negative. But actually that relates to a couple of assets either slightly older or in fringe locations where the rental values were off by perhaps 10%. But on the bulk of the portfolio it was either zero or beginning to move ahead on certain assets, both in City and in West End. And in terms of rents in incentive.

Further Answer – Robert Noel, Managing Director – London Portfolio
The rent movement you saw on the chart which is negative movement at around 9% over the year and only half in the second half of the year, effectively showed that we went through the turning point because rents were still falling in December. We have been through the turning point and we are bouncing back. It all relates to our like-for-like portfolio. It is only roughly half of the London Portfolio because we have got a lot of developments which are completed and they are not yet in the like-for-like portfolio because of the vagaries of our reporting. A lot of developments are in construction and they are benefiting quite strongly from rental growth. So if you included the whole lot we would be well into growth by now.

Further question
Can you tell us in the Retail Portfolio what your pre-let threshold is before construction plans?

Answer – Richard Akers, Managing Director – Retail Portfolio
I am not going to tell you what our pre-let threshold is on Trinity Leeds. I will say that it is slightly more complicated than just the pure percentage because what we are trying to do is establish levels of occupation in various areas of the scheme. There are three levels in certain different uses - food and beverage occupiers, retailers and of course the MSUs and the inline units. So we are trying to establish strength in all parts of the scheme and we have specific

targets for that. We have some very good lettings. We have concluded deals with Marks & Spencer to open more space into the scheme, a big store for Next. River Island have taken space. H&M. We have food operators, Carluccio's and Yo Sushi are committed and a leisure operator, Everyman Cinemas. So we are starting to build a very, very strong line up and we are very confident that we will achieve our pre-letting threshold very soon.

Question 7
Keith Crawford, KBC Peel Hunt
Firstly may I congratulate you on the retail results, very interesting. But the gist of the presentation is that there are some explosive possibilities in London.

In view of the fact that we have this currency devaluation which may not repeat, is it appropriate to lock into a large amount of the strange white hot money which is around at the moment from Sovereign and Analogous funds to start the programme on an even bigger basis or restart the programme in London, not just 20 Fenchurch Street, but maybe just to get as much of this and lock into as much of this demand over the next 2-3 years as quickly as possible?

Answer – **Robert Noel, Managing Director – London Portfolio**
Well I think we are doing pretty well.

Keith Crawford
You are doing very well. There isn't a comparable programme elsewhere.

Further answer – Robert Noel, Managing Director – London Portfolio
As ever there is a balance. There are certain levels up the risk curve and at some point you turn into a gambler which we definitely want to avoid. These buildings are very, very large and the reasons for partnering some of them are that we need to balance very carefully our leading exposure at any one time. So for example, if you take 20 Fenchurch Street, we believe it is a building that would best be built speculatively and speculative risk on 700,000 square feet is quite a lot. If we want to bring forward other developments at this stage in the pipeline, we should be sharing that risk.

Further question
For the initial period of the existence of the REIT, it has not really been true that the strongest companies have been the strongest on dividend. It has been a pretty dull period. It would be a great tragedy to see dividends cut in the next downturn. This does not seem necessary to me when the finances are locked in for 11.8 years on average, because the next downturn comes within 11.8 years. So can we be reasonably confident that dividends, with this outlook which is reasonably attainable, particularly in London, will be growing progressively and we don't face the same experience again on the next downturn?

Answer - Francis Salway, Chief Executive
I think we are much more confident about the outlook for revenue profit growth now than we were six months ago. Rental values have not fallen quite as far as we perhaps expected. So that the prospect of beginning to get growth and income from rent reviews has improved. I also think there are other areas where we will drive revenue profit growth. You then come to the point you are making about what is the risk of income falling? And here we have got to manage the amount that we distribute by way of dividend and there have been comments that REITs should distribute all of their income by way of dividend. It is not feasible to do that without occasionally cyclical downturns putting your dividend at risk. Our dividend cover ratio will vary through the cycle and we think that it should vary through the cycle.

Further question
Share outperformance is difficult among the leader group, however much one tries to analyse these companies. Are you reviewing or looking for that sort of event that has a sort of an additional and on top of affect outside the two core businesses you have at the moment?

Answer - Francis Salway, Chief Executive
We are very focused on our core areas. We would not necessarily rule something out that was outside the core areas. But we think it is pretty unlikely and we think the excess returns would have to be very significant to make it the right thing for us to do. I would say that the scale of our potential development pipeline in London is our real differentiator.

Further question
Would that preclude you for example, joining with one of these two unfortunate banks as a major contender or are there just too many people contending to be the major sort out of these two banks?

Answer - Francis Salway, Chief Executive
We certainly would not rule out large transactions with banks. In that instance if there was a good proportion of a portfolio that was in our core areas, we would be prepared to take on assets outside our core areas. I think it is always nice to do large transactions, what is important that we maintain discipline on the returns that come from them.

Question 8
From the webcast – read out by Francis Salway, Chief Executive
How will you decide what the right LTV ratio is at a certain point in time? What triggers will make you decide to decrease the LTV to the outer range and vice versa?

Answer – Martin Greenslade, Group Finance Director
We don’t have a specific LTV for a specific point in time. But let me talk generally about this. We do see gearing or LTV ratios varying across the cycle. And there are times when we should have high gearing, we said that at the times of the Rights Issue back in February

2009. If you de-gear too much at the wrong point in the cycle, shareholders suffer. But you have to be pretty confident in the direction of travel if your LTV is 55%. We had an LTV in the low 50s – we were comfortable with that. The market has since risen so I think we are right to be back in our inner gearing range at the moment and that that range is 35-45. We still have a medium term view of rises in asset values. Where I think we will go the other way is where we really do feel that the market has become quite rich, but that is the point at which we should be de-gearing, moving to the bottom end of our range and then in exceptional circumstances going down to the 25% LTV. So I do see it bounded by those inner and outer ranges.

Question 9
From the webcast – read out by Francis Salway, Chief Executive
You mentioned you could benefit from an increase in demand for office space linked to lease expiries and break clauses. Who would be the losers?

Answer - Francis Salway, Chief Executive
Interestingly, we have very few major lease expiries in that period of 2013/2014 for the reason I have just given. We have got a lot of older properties where the expiries are sooner, they are in the next couple of years and then we have got a lot of modern buildings in London where the leases extend longer than that. And we have actually over the last few years sold some buildings that fitted into that 13/14 expiry. I seem to remember that we used to own the old Warburg's building that no longer do.

Question 10
From the webcast – read out by Francis Salway, Chief Executive
Given that London Office assets appear to offer superior terms to the Retail Portfolio, is there an argument to review the demerger plans? In addition is it sensible to dilute future development returns with scrip dividends and to sell half of the Fenchurch Street project?

Answer - Francis Salway, Chief Executive
Demerger would be appropriate if it created value for shareholders. It wasn't going to have done at the time we considered it. We are very focused on running the business as is and make sure that we take advantage of all the opportunities we see in the market place.

Further Answer – Robert Noel, Managing Director – London Portfolio
20 Fenchurch Street is an extremely exciting project, but we see it as a speculative build. It is a 700,000 square feet. And if we do it on its own, it might impact on our ability to bring forward other schemes we would like to do in this cycle. And for that reason and that reason alone, we are seeking a partner.

Further Answer – Martin Greenslade – Group Chief Executive
The reason we offer a scrip dividend is that shareholders like it, it has certain tax advantages. It doesn't particularly dilute our earnings or our returns. But to the extent that we do issue

scrip dividends, what it does do is slightly increase our capital base and allows us to exploit the opportunities that we see. So actually we see it as adding value.

Question 11
Paul Pulze, Evolution Securities
You commented about further capital recycling in the Retail Portfolio. Could you give a bit of colour on any asset sales?

Answer – Richard Akers, Managing Director – Retail Portfolio
Yes we have some assets in the market and clearly when that situation is occurring, we don't want to talk too much about it. But I think the message I was trying to get across is that we are in a normal operating market now. We will be buying, we will be selling, we will be developing. And I think that is a very healthy place for us to be and it is the right place to be to maximise returns in the retail sector with the conditions we see going forward.

Further question
And I guess given Francis' comments about ripple effects going forwards and your comments about not holding onto vulnerable assets in the longer term, would you consider selling some of these more vulnerable assets given the strengthening markets at the moment?

Answer – Richard Akers, Managing Director – Retail Portfolio
We are very focused on executing asset management initiatives and maximising the returns from assets, but what we are saying is that when we feel we have done that and we feel we can get higher returns from investing that money in other assets, then we will do that. So we will not be holding onto assets for the long term just waiting for market rental growth to give us a return.

Question 12
Remco Simon – Kempen & Co (on the conference call)
Martin you mentioned you were quite comfortable with your current LTV. Now given the outlook of some additional acquisitions and some development capex that you gave, do you intend to free much outward sales or do you see yourselves being a net investor and keep the LTV basically at these levels or maybe slightly higher going forward?

Answer – Martin Greenslade – Group Chief Executive
Our facilities give us the opportunity to take advantage now without having to do any sales. So depending on the type of asset that we see, we may have a small net investment over the medium term, but our general philosophy is to recycle capital into our development programme and into other assets.

Further question
And Richard, could you comment on the incentives you are looking for with Trinity Leeds?

Answer – Richard Akers, Managing Director – Retail Portfolio
This is a proposed development, although we are very advanced with our pre-letting and with procurement. So we don't want to make too many detailed comments as it is commercially sensitive. But it would be a very attractive yield on cost. I think it will be close to 8% which we feel is a very good return on this type of development which where a lot of the risk will have been taken out in terms of our procurement process and in terms of the level of pre-lettings that we intend to achieve.

Francis Salway
If there are no more questions then thank you very much for joining us this morning. Thank-you.

- End -

Forward Looking Statements

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