Chief Executive's statement

Growth in action

Strong operational and financial performance. Delivering on strategy.

Our performance during the financial year to March 2022 has been positive, as our proactive approach to asset management and strategic decisions have started to bear fruit. At the start of the year, the UK was still in lockdown, with non-essential retail and hospitality closed and most office-based staff working from home. However, we have seen momentum build significantly across our estate since restrictions were lifted, as people seize on the attractions of spending time together in stimulating, inspiring places.

This is reflected in our operational results, with strong leasing in London and a recovery in occupancy and sales in retail, and in our financial results, with a total accounting return for the year of 10.5%. EPRA EPS was up 42% to 48.0 pence, driven by 4.1% growth in like-for-like gross rental income and the reduction in bad debt

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Mark Allan
Chief Executive

Offices
Retail
Urban

expense related to Covid-19 we recognised in the prior year. We are proposing a dividend of 13.0 pence per share for the final quarter, bringing the total dividend for the year to 37.0 pence per share.

We saw a 3.6% valuation uplift on our portfolio for the year. This reflects our strong leasing activity in both retail and London offices, with the latter driving 2.5% growth in ERVs; a number of major lease regears in London, highlighting the continued demand for high-quality office space; and upside from our profitable development activity and strategic investment decisions. Positively, virtually every part of our portfolio witnessed valuation growth in the second half of the year, with retail values up 1.7%, leaving them effectively flat for the full year. With Central London values up 3.7% for the year, this gave rise to a 7.9% increase in EPRA NTA to 1,063 pence per share.

At the same time, we have made strong progress against our strategic objectives. We invested £821m in the acquisition of a 75% stake in MediaCity, U+I Group PLC and a further stake in Bluewater, providing us with a mix of attractive income returns and future development upside. This was balanced by the sale of £445m of mature or non-core assets, including the £195m disposal of 32-50 Strand post the year-end. With clear visibility on expected future returns, we anticipate further capital recycling in the year ahead, as we start to invest in the higher return opportunities in our significant pipeline. Whilst our net investment increased LTV slightly to 34.4%, we expect this to reduce slightly to around last year's level in 2023.

Our strategy

Our strategy is focused on three key areas – Central London offices, major retail destinations and mixed-use urban neighbourhoods. Although the proportions of use differ, there is increasingly more that unites these areas than divides them, as the lines between where people work, live and spend their leisure time blur. What really binds these three areas together is the importance of a sense of place.

This is evident in Central London, where 15% of our portfolio comprises non-office space. It is this wide variety of restaurants, bars and shops in or next to our offices which create the vibrant places that make people want to spend time here.

Across major retail destinations, we expect c. 25% of space will not be retail in the future, as we will introduce more diverse food offerings, leisure and inner-city office space. Similarly, for mixed-use urban neighbourhoods, it is the blend of office, residential, restaurants, bars, shops and green space which creates the attraction of a place and ensures its enduring success.

Our strategy is grounded in our purpose; Sustainable places. Connecting communities. Realising potential. We have a sustainable or attainable competitive advantage in each of our three areas of focus which will help us create long-term value for all our stakeholders. With our achievements over the past year, we now have a significant pipeline of opportunities in each area and clear visibility on the potential returns on offer and risks associated with these and our existing portfolio.

Our focus is to deliver on the opportunities we have created. In doing so, we continue to be guided by three things; delivering sustainably, delivering for our customers and being disciplined with our capital. Since September 2020, we have sold £1.1bn of assets and over the coming years we plan to recycle a further c. £3bn of mature, low-yielding London offices and assets in sectors where we have limited scale, such as retail parks or hotels. As we reinvest our capital into our pipeline and selective retail acquisition opportunities, we expect delivering on our strategy to drive a meaningful increase in earnings and, on average, a mid to high single digit total return over time, whilst keeping LTV below the mid 30% level.

Central London – high-quality portfolio and unlocking of value via development driving returns

Central London makes up 65% of our overall portfolio by value. Of this, 56% is located in the West End, with the remainder in the City and Southwark. The quality of our investment portfolio is high; 49% of our assets have been developed over the past ten years, compared to c. 20% for the overall market, and 44% of our completed London offices have an EPC rating of 'B' or higher versus 15% for the market. This is a key competitive advantage, as customers increasingly focus on flexibility, the best quality space which offers the right amenities to attract talent, and buildings which have the right sustainability credentials.

This is borne out by our record leasing activity, with £63m of leases completed with new and existing office customers, on average 4% above valuers' assumptions, and a further £6m in solicitors' hands, 13% ahead of valuers' assumptions. We are also seeing strong interest in our Myo flexible offer, which we now plan to grow from 72,000 to c. 500,000 sq ft in the next five years. Vacancy for the overall London office market is elevated at 9.0%, but most of this is second-hand, so vacancy in our portfolio is only 4.7%. Office utilisation has continued to grow, especially mid-week, as London is becoming noticeably busier.

In line with our view this time last year that prime rents would remain resilient and yields could tighten, ERVs for our Central London offices rose 2.5% and equivalent yields fell 4bps to 4.6%, driven by our successful lettings including a number of major lease regears. Central London retail and other values softened in the first half of the year, but this fully recovered in the second half, as the return to the city gathered pace. Including development, overall capital value growth in London was 3.7%. Over the next 12 months, we expect office ERVs to grow by a low to mid single digit percentage and the continued weight of capital to keep yields broadly stable, assuming bond yields do not rise materially from here.

Chief Executive's statement continued

Our 1.0m sq ft committed pipeline is 56% pre-let, with recent evidence on rents ahead of our underwriting assumptions. We are seeing good interest in the remaining space, even though part of this will not complete for another year. Construction costs for our committed projects are 97% fixed, but we have seen c. 5-7% cost inflation on future schemes over the past 12 months. The upside to ERVs implied by current negotiations offsets the impact this had on total development cost, which also includes land, and rising costs arguably put further pressure on the shortage of prime, sustainable space. Subject to continued demand, we could start up to three new schemes with c. £1bn total development cost and an attractive 6.4% yield on cost in the next 12 months.

Investor competition for development sites remains high, so we are pleased to have been able to unlock two new development opportunities totalling 507,000 sq ft off-market, one via the acquisition of U+I and the other via a major lease-regear with Deloitte at New Street Square, taking our total future pipeline to 1.8m sq ft. We sold Harbour Exchange during the period and exchanged contracts shortly after the year-end to sell 32-50 Strand, with combined proceeds of £392m reflecting a 4.1% yield and 13% premium to the March 2021 book value. As investment demand remains strong, we expect to recycle more capital in the year ahead, in line with our plans to reduce our Central London weighting to 55-60% over time.

Major retail destinations – improved operational performance driving growth in best locations

Major retail destinations make up 16% of our portfolio, c. 60/40% split between prime shopping centres and outlets. The pandemic accelerated the pre-existing trend of retail sales moving online, which combined with lockdowns has had a marked impact on our portfolio. However, our performance over the past year has made us increasingly confident that the prospects for prime retail destinations are positive, with a growing polarisation between our assets and those facing structural obsolescence.

We maintain our view there is c. 25% excess retail space across the UK, but most of this is secondary where vacancy remains high. Inflation is putting further pressure on low-margin stores, which could lead brands to accelerate the rationalisation of the tail-end of their portfolios. Conversely, prime destinations are getting stronger, with occupancy in our portfolio up 170bps to 93.2% over the year. For many leading brands, online and physical channels are now viewed as firmly inter-connected, so we have seen existing brands upsize, new brands opening stores as they move from nearby locations to benefit from higher footfall, and digital-native brands opening physical stores to grow customer connectivity and experience.

During the year, we restructured and strengthened our retail team to focus more on growing our brand relationships and enhancing guest experience and less on asset management, investing in new capability and experience from a range of global retailers to complement our existing property skills. The feedback from brand partners on this has been positive and as retail continues to become more operational, we believe this differentiated approach will allow us to deliver genuine added value in the future.

Our proactive approach to leasing during the pandemic, prioritising occupancy and supporting customers, is now yielding results. We signalled a year ago that after a material decline over the previous five years, prime retail rents were approaching sustainable levels. Our results over the past year have confirmed this, as the £29m of rent signed during the year or currently in solicitors' hands is on average 2% above ERV. While lease terms are generally shorter and there is more turnover-linkage than a few years ago, incentives are down too. We expect occupancy to grow further, so despite some selective over-renting, we expect like-for-like income to be broadly stable this year, before returning to growth in the medium term. Meanwhile, like-for-like retail sales in our portfolio are now 1% above the 2019/20 pre-Covid level.

This positive performance supported a return to capital value growth, with values up 1.7% in the second half, leaving them effectively flat for the year as a whole at -0.1%. With confidence in the sustainability of income growing, we think yields of c. 7-8% for prime shopping centres look attractive and may well start to come in. During the year, we acquired a further 18.75% stake in Bluewater for £126m at an 8.15% initial yield and we are actively exploring new opportunities. We maintain our view that major retail destinations could grow to 20-25% of our portfolio, but as we recycle capital out of subscale sectors such as retail parks and leisure, our overall retail exposure would remain relatively stable.

Mixed-use urban neighbourhoods – clear visibility to grow to 20-25% of portfolio

At our strategic review in late 2020 we set out that we saw an opportunity to materially grow our exposure to mixed-use urban neighbourhoods. Many parts of today's built environment need remodelling to make sure they are fit for changing consumer expectations on how we live, work and spend our leisure time and the growing demands on sustainability. The latter has been a strong focus for Landsec for years, evidenced by the fact that we were the first commercial real estate business in the world to set a science-based carbon reduction target in 2016. Combined with our extensive experience in creating thriving urban places in Central London and for example Oxford and Leeds via some of our major retail destinations, we are well positioned to deliver on the opportunity to reshape urban neighbourhoods in a sustainable way.

Over the past year we have made significant progress on these mixed-use ambitions. We have grown mixed-use urban neighbourhoods to 7% of our portfolio, up from 3% a year ago and have now created a pipeline of profitable development opportunities, deliverable in the near term. With potential capex of c. £1.5bn, this could see mixed-use grow to 20-25% of our portfolio in the next five years.

This marked acceleration in potential growth has been driven by our acquisitions of MediaCity and U+I in late 2021. Both

MediaCity in Greater Manchester and the key U+I projects in London and Manchester already have planning consent, so this provides us with a clear opportunity to invest c. £800m-£900m in a combination of residential, work and leisure space across these schemes in the next five years. The integration of the U+I team also adds strong placemaking skills to our business.

Combined with our existing mixed-use opportunities in Glasgow and in Lewisham and Finchley Road in London, where we have made good progress in terms of planning during the year, we therefore now have an attractive pipeline of mixed-use projects. These provide us with the ability to adapt and, due to their diversified nature, geographical spread and flexible phasing of capex, offer a balanced risk profile.

Contrary to large individual developments which are by nature binary, this means our mixed-use business should start to deliver reasonably repetitive development returns in the coming years, whilst limiting our speculative risk. Capital values were -2.8%, as some of our future projects are still being valued based on their existing retail use and we are shortening leases to create future flexibility. Overall, we expect ungeared development IRRs to be in the low teens, with attractive longer-term income return and rental growth potential as we grow our mixed-use portfolio. We envisage starting on-site with the first phase of Mayfield, Manchester later this year and at MediaCity and, subject to planning, Finchley Road next year.

Creating a more agile, customer-focused and efficient culture

Our positive performance and strategic progress over the year reflect the capability and commitment of our people, who have continued to deliver despite the challenging operating environment during the first part of the year in particular. Changing the culture of our business is key to getting the most out of the substantial talent within Landsec and successfully delivering on our strategy in the long term. Whilst our progress to date means we have already become more agile, more customer-focused and better placed to respond to changes in external market conditions, there is more to do to ensure we deliver on potential opportunities in an efficient and effective way.

Building on our leading position on sustainability

Sustainability has been at the heart of Landsec for years and has become a key decision driver for many of our customers. To guide our sustainability initiatives, we recently launched our new Build well, Live well, Act well framework, which creates a clear link with our purpose – Sustainable places. Connecting communities. Realising potential – and sets ambitious targets on how we operate. For example, we have now set a target to reduce embodied carbon for our office developments by 50% by 2030, to below 500kgCO_2e/sqm, as part of our Build well ambitions; to focus our efforts on improving social mobility by supporting 30,000 people towards the world of work by 2030 as part of our Live well programme; and to link the remuneration of our people to our sustainability targets as part of our Act well pillar.

To ensure we remain at the forefront of everything the sector is doing to tackle the climate crisis, we were the first UK REIT to publish a net zero transition investment plan last year. This will see us invest £135m in our existing portfolio by 2030, optimising building management systems, installing air source heat pumps and increasing renewable capacity. This will ensure we deliver our 70% reduction in carbon emissions by 2030 versus the 2013/14 baseline and stay ahead of the Minimum Energy Efficiency Standards Regulation, which require an EPC 'B' certification by 2030, as well as other regulatory requirements.

During the year, we achieved a 20.7% reduction in embodied carbon across our development pipeline, reflecting amongst others the use of steel with a greater recycled content at 21 Moorfields. We saw an 18% reduction in energy intensity compared to 2020, although this partly reflects the lower utilisation of space, especially during the first part of the year. In London, 44% of our office portfolio is already rated EPC 'B' or higher versus c. 15% for the wider UK office market, which given the growing occupier focus on sustainability, underpins the good demand and positive rental value growth we are seeing.

Outlook

The recent surge in geopolitical risk has the potential to upend decades of relative international stability and increasing globalisation, which is adding further disruption to global supply chains already affected by the pandemic. It also is putting significant upward pressure on energy costs in the short term, and potentially in the long term through an accelerated energy transition. This clearly creates uncertainty around the economic outlook, with gilt yields having risen to the highest level in six years and UK inflation at its highest level in 30 years – something which will be felt by many in the months ahead.

Whilst we are alive to the risks this creates, we look forward to the future with confidence. In London, we offer high-quality, sustainable office space in places people want to visit and office yields are well above other key European cities, offering some cushion against rising interest rates; in retail, improved demand for space is supporting income and valuation growth; and in mixed-use we now have an attractive pipeline of opportunities. Across central London and mixed-use, we now have the opportunity to invest c. £2.8bn in capex over the next five years which could deliver c. 20% profit on total development cost, although we have flexibility about any future commitments. Meanwhile, with an LTV of 34.4% and only 18% of our drawn debt maturing in the next three years, our capital base remains strong.

Despite the macroeconomic challenges, we therefore remain confident that delivering on our strategy will allow us to deliver, on average, a mid to high single digit annual return on equity over time. Our strategy of recycling capital out of mature London offices and subscale sectors into our London and mixed-use pipeline has the potential to deliver c. £120m growth in rental income over time, whilst keeping our LTV at the low 30% level. We expect the impact of this on EPS growth to be relatively balanced over the coming years, as we balance new investment with disposals. For the current year, making some allowance for our planned capital recycling, we expect continued operational performance to drive EPRA EPS growth in the low to mid single digit percent range, supporting further growth in dividends.

Mark Allan
Chief Executive