Land Securities

Half-yearly results 2009

Francis Salway, CEO, and Martin Greenslade, Group FD

Overall performance

Q: Your statement today seems to be much more upbeat in tone compared to six months ago and compared to your peers. Is that confidence a bit premature?

Francis Salway (FS): I think the easy way to answer the question is to say that the cycle has turned and value trends have gone from being negative to positive. But our confidence is much more about Land Securities. If we go back to the time of our Rights Issue, trends in the market had been broadly consistent with our view then on peak-to-trough falls in values. And the actions we've taken have been consistent with what we said we'd do. So we are very much where we wanted to be in terms of balance sheet ratios, capacity to invest and some interesting development opportunities.

Q: And the actions you've taken, what has that done to your results for the last six months?

FS: If I pick out three areas, the first is about balance sheet management. We've got our LTV ratio almost exactly where we wanted it to be, at around 50 per cent. We've extended the average duration of our debt by some two years. And we've preserved an AA credit rating. The second area I'd pick out is around income. We've talked a lot about getting lettings in this market. We achieved over £29m per annum of lettings in the six months. And lastly, of course, we always like to deliver relative out-performance and we've outperformed the IPD benchmark by 1.1 per cent over the six months at a time when values were just slightly negative.

Q: And Martin, do you think that out-performance against IPD is sustainable?

Martin Greenslade (MG): I think our out-performance against IPD has been down to our high-quality portfolio. We would like to outperform over the medium term. A six-month period is quite a short period against which to be judged, but we do have good high-quality assets.

Q: But some of the financials would suggest otherwise because your earnings and NAV are down.

MG: Well our earnings are down in line with what we said at the Rights Issue and at the time of the results presentation in May. Those underlying earnings, or revenue profit, as we call it, are down just over 15 per cent, at £128.4m. And that's largely due to the sales we've made to put our balance sheet in the great shape that it's in. Adjusted NAV is down over the period by 4.7 per cent to 5.65p. The reason for that is largely the valuation decline of 1.4 per cent. But as Francis says, that was out-performance against the market decline of 2.5 per cent.

There's also a one-off item in there. And we cancelled some interest rate swaps and that was worth about 10p a share. Without that, our NAV would only have been down 3 per cent over the six-month period, and I think you'll see that's a very good performance compared to others.

Q: And the disposals you mentioned have impacted the gross income line. So what does that mean for earnings and future dividend cover because some of those disposals were quite recent?

MG: They were quite recent. And we've seen the impact of that in our earnings over the six-month period. But there's still dividend cover there, it's 1.2 times in the six-month period. But importantly we're prepared to flex our dividend cover as we go through the cycle, and particularly we have in mind earnings-accretive acquisitions as we look to the future.

Q: And Francis, just to be clear in terms of strategy, have you stopped selling assets now?

FS: We absolutely will be net investors over the next period. Does that mean never say never on sales? No, it doesn't, because we do believe in portfolio rotation. We've got one more sale transaction to finally go through that was agreed earlier in the year. And there could be a couple of other small ones. But our focus is on net investment, whether through buying income-producing investment properties or putting money into development.

Business performance

Q: Turning to business performance in more detail, Francis, your London portfolio rose in the period but Retail is down. So what should we read into that?

FS: I think there are two things. If we look first at demand for investments in London, one of the themes of this year has been very strong buying demand from overseas investors who've been attracted by currency falls in value. And international investors tend to focus on capital cities, so they have been concentrating particularly on the London market. And I think that's provided the real support and then turn-up of values in the London market.

If we go to Retail, our retail warehouse assets were only fractionally below zero in terms of change over the period. The weaker performance was in shopping centres. And I think that reflected buyers being cautious about short-term income risks from possible further insolvencies. But since the half-year end date, we have seen stronger buying interest coming through on shopping centre investments which have been marketed by others.

Q: And Martin, voids and units in administration remains a hot topic. So how is the portfolio coping?

MG: If we look at the period, our voids have been relatively stable, at 5 per cent. And our units in administration have come down from around 3.5 per cent turnover to 2.1 per cent. So there's been an improvement there, and I think that's largely down to the lettings that Francis has just mentioned. If we then drill down into the retail portfolio, voids there were 4.8 per cent. But we've also got some temporary lettings of 1.3 per cent, which you could knock off that figure, plus we've agreed a further 1 per cent of terms post the 30th September cut-off.

Q: And Francis, in terms of the lettings you've achieved, what kind of terms are you having to offer on those?

FS: The general view on the London office market is that it's about 15 months' rent-free period for each five years term certain. But it's lovely to buck the trend. And we, with Cadillac Fairview, let 200,000 square feet or thereabouts to News International at Thomas More Square, a five-year lease but only six months' rent-free period. And that was actually the largest letting of second-hand offices in London since 2003.

Now, moving to the Retail sector, I'm sure that people want me to answer this question by reference to Cardiff. In the six months up to March of this year, the average rent-free period on the lettings we did in Cardiff was about two years. In the last six months, it's been about 29 months. But we had a real volume of lettings in the run-up to opening with over 30 lettings in the period. But you can see that there were none of the excess rent-free periods that were perhaps quoted in the press in the run-up to opening.

Q: What about the One New Change development?

FS: This is interesting because we've taken a rather different view on the offices and the retail. On the offices we could see a lot of competing schemes beginning to be let up and so we decided not to chase the market right now on lettings. I think by the time scheme completes in autumn next year. We'll have less competition and we expect shorter rent-free periods.

On the retail element we took the converse approach and we decided to make a real push on retail lettings to make sure that we're at critical mass by the end of January, so in the run-up to opening in autumn 2010. And as a result of that push we've agreed 10 lettings in the last couple of months. We're now 52 per cent let or in solicitors' hands.

Balance Sheet and investment

Q: Coming back to the balance sheet, Martin, because there has been a lot of activity in the last six months, talk us through the detail there.

MG: Well, first of all, we've sold well. We've sold over £750m worth of assets. We sold those at a 0.3 per cent decline on the March '09 valuation. If you compare that with a market, which fell 2.5 per cent over the same period, we've done very well.

Secondly, we've paid down a large amount of debt, we've paid down £1.75bn. And we've also raised new facilities. We've raised just over £550m of new facilities, including the first property bond of its type since the downturn. So doing that has enabled us to preserve our AA credit rating. And since 30th September we've also raised £650m of new facilities.

When you put all of that together, we've extended our debt maturities from 9.7 years on average to 11.9 years. And actually since 30th September we've pushed that out a further year to 12.9 years. So that gives us really long-term debt in place to take advantages of opportunities that will come up.

Q: What else can you tell us about the rationale behind those moves?

FS: I think there's three things. An AA credit rating gives us access to competitive cost of finance in the medium term. Our current balance sheet LTV ratio of 50 per cent gives our shareholders 2:1 conversion of property value increases into increases in shareholder net assets as values rise. And thirdly, we've got some £750m to £1bn to invest across a combination of development and acquisitions.

Q: Indeed, you are signalling your intention to start three developments in London in 2010. So what criteria has been applied there?

FS: We look to get growth in rents during the development phase to create really attractive profits from developments. And the market where we see the best prospects for recovery in rental values is the West End office market in London. And we've been quietly nurturing a number of prospective development opportunities in the West End, where it's very hard to get planning consent. And we expect to start three of those schemes during 2010. The three schemes are Park House in Oxford Street, Selborne House in Victoria Street and then a smaller residential scheme that's linked in planning terms with Selborne House, which is Wellington House on Buckingham Gate. And we're looking to start those three schemes next year.

Q: The emphasis does seem to be on development rather than acquisition. So is there a danger you're missing opportunities at the moment?

FS: We're absolutely in the market looking at investment opportunities. We've put forward proposals on some £500m worth in the last few months. However, we have a discipline about return requirements. We are expecting to get rather better returns on development than investment properties. And we won't get dragged down return-wise on acquisitions. We're not a distressed buyer. We're looking to get both an earnings contribution and a satisfactory total return on any acquisitions. I think some buying is driven purely from the income perspective at the moment.

Q: And Martin, you also said that one of the key forces in the market will be banks unwinding their property portfolios. So what are you doing to progress that?

MG: We're speaking to a large number of the banks. The banks have lent over £200bn worth to the property industry and it is a matter of time for property assets to come out of those portfolios. So we're discussing with them all kinds of opportunities. Some will be straightforward asset acquisition. Others will probably be workouts that we do with them. And the key for us is to be patient. This is not something that's going to happen over the next three to six months. It's something that'll happen over the next five years.

Strategy

Q: In the last six months there has been a lot of speculation about whether you're going to announce a strategic review. So what is happening with strategy? And what are you doing to position the remaining elements of the Company?

FS: We never intended to undertake a strategic review and we haven't done that. What we have done as a Board is think about how we will create relative out-performance as we move into the next decade. And we have a clear view as to how we will achieve that. It is by refining what we do, concentrating on our core sectors, using our expertise in those core sectors around customer relationships, development skills, portfolio rotation. And do remember, we have one of the most liquid portfolios, with 100 per cent ownership of some 87.5 per cent of the assets. And, of course, linked into that is a low cost of capital founded upon our AA rating.

Q: And you say that you're positioning the business in the short term to take advantage of medium-term opportunities, so what exactly do you mean by that?

FS: That's about everything we did in the last six months to set us up for the medium term. It is about getting our balance sheet gearing exactly where we wanted it to be. It's about having a competitive cost of finance. It's about having development opportunities that we can deliver into rising rental markets and a pipeline of further opportunities in the future. It's about having the funding capacity to put the capital behind those developments and to make some acquisitions.

And let's not forget our £9bn portfolio. There's some really interesting organic opportunities there. And it's a very liquid portfolio, so we can also look forward to some active capital rotation.