Tritax Big Box - H1 2022 Results

Thursday 4th August 2022

Transcript

Ian Brown: Good morning and welcome to Tritax Big Box's H1 2022 results presentation. I am Ian Brown, Head of Investors Relations. Before we begin, a few points to note. Firstly, this morning's presentation is being recorded and a replay and transcript will be made available on the Investors section of the Tritax Big Box website. A PDF of the presentation itself is also available to download. And secondly, after the presentation there will be a Q&A session for analysts and investors. To ask a question through the webcast, please type and submit your question in the question box. If you have joined by phone, please follow the instructions from the operator. In the interests of time, we will aggregate similar questions we receive from the webcast.

Ian Brown: With that I will hand over to Colin.

Colin Godfrey: Thanks Ian, and good morning everyone. I'm pleased to present the 2022 first half results for Tritax Big Box, and to provide you with an update on the further strong progress we are making.

Colin Godfrey: My name is Colin Godfrey, CEO at Tritax Big Box, and I am joined as usual, by Frankie Whitehead our Chief Financial Officer, and Ian Brown, our Head of Investor Relations.

Colin Godfrey: I'll kick off with a brief introduction, Frankie will run through our financial results for the first half together with a view on our outlook, and I will conclude the presentation with a strategic update. Ian will then coordinate Q&A.

Colin Godfrey: In March this year we reported record results for 2021 and expressed continued confidence about the outlook for our business. And my key message today is that we remain confident, despite a changing external environment. This view is supported by our first half results; and I want to start by highlighting five key factors: Firstly, we are delivering against our strategy. We achieved a record level of new letting activity in the first half of the year. This will add £17.8 million of annual rent to our business, underpin future earnings growth in 2023 and 2024, and support our decision to accelerate construction starts.

Colin Godfrey: Secondly, the powerful structural drivers to our market continue. Supply chains have never been more important. There is a clear desire to increase operational reliability, efficiency and resilience. Against this strong demand, there remains a lengthy planning process and a scarcity of consented sites in the UK, which continues to constrain supply; together underpinning attractive levels of rental growth. And we are very well placed to help our customers achieve these ambitions, both through our investment portfolio and our large development portfolio, which includes a significant amount of planning consented land available for near-term delivery of logistics warehousing.

Colin Godfrey: Thirdly, this attractive combination of delivering our strategy, and the strength of the market, continues to support our performance. We are very excited about the range of opportunities we have to create fantastic and sustainable buildings for our customers, and enduring an attractive income and capital growth both from our investment and development activities. Additionally, and this is the fourth factor, we founded this business on the principle of providing our shareholders with resilient and growing income through the economic cycle, and we remain true to that principle nearly nine years later. Resilience is built into our business on several levels. There has been a deliberate decision to focus on the best logistics assets, let on long leases to strong customers. This is evidenced by a 100% rent collection rate during Covid and continued 100% occupancy of our investment portfolio. This resilience is being strengthened by the significant work we are undertaking on ESG and how we are embedding ESG into all aspects of our operations and thinking.

Colin Godfrey: And, to the final factor, we complement this resilience in our capital structure with a prudent approach to risk, demonstrated by a very strong balance sheet, low leverage, significant liquidity, no near-term refinancing requirements plus an attractive cost of debt secured through fixed or capped instruments. This financial strength positions us well to weather a more challenging geo-political and macro-economic backdrop, and to continue taking advantage of the strong growth opportunities embedded within our business and our market.

Colin Godfrey: And on that note, I will now hand you over to Frankie to talk through our financial performance. Frankie…….

Frankie Whitehead: Thank you Colin, and good morning everyone. This morning I will be walking you through the strong results we have posted for the first half of 2022. And in doing so, I also want to emphasise that the excellent operational progress made in the period, particularly with regards to new construction and letting activity, is something that will further benefit our earnings through 2023 and 2024. And, as Colin has said, we are conscious of the current macro environment and I'll set out why we are well placed to perform strongly as we move forwards.

Frankie Whitehead: Turning to our first half 2022 key financial highlights: Our Adjusted EPS excluding additional DMA income has risen by 1.1% to 3.73 pence, with development completions and like-for-like rental growth more than offsetting the impact from the increased share count in the period. We have increased our dividend by 4.7% to 3.35 pence per share for the six months. And once again, our portfolio has performed strongly which has helped us to deliver a 9.1% increase in EPRA NTA to 242.9 pence. All elements of our strategy are performing well, leading to a Total Accounting Return of 10.7% over the six-month period. And, finally, and this is a key message from today's presentation, future income growth is now truly embedded within our development pipeline and wider portfolio. As you can see from the chart here, the rent now secured within our development pipeline means that our contracted position rests 9% above todays passing rent, and with the added rental reversion within the portfolio – the ERV sits a further 15% ahead of todays contracted rental position, indicating the attractive prospects for our future earnings growth.

Frankie Whitehead: Further strong progress has been made in terms of delivering growth in net rental income and this supports the underlying growth in our dividend. The Group net rental income increased by 16.1%. Once again, this was predominantly driven by development completions over the last 12 months. The total contracted annual rent has increased to £216 million, with 86% of the growth since December generated from the development component of our strategy. Our EPRA cost ratio has increased, albeit temporarily, to 15.2%. We expect this ratio to return to the level seen in previous periods as further contracted rent translates into passing rent. And we also have the positive impact to come from the recent change in management fee structure, which becomes effective from 1 July 2022 and further details can be found on slide 28 of the presentation.

Frankie Whitehead: Our headline Adjusted earnings per share fell by 7%, reflecting the fact that there was no exceptional DMA income received in the period, hence therefore, there being no difference between this and our Adjusted earnings excluding exceptional DMA for this first half at 3.73p. And it is this which we consider to be our recurring earnings metric. This has increased by 1.1%, despite the average share count growing by nearly 9%. We have increased our dividend per share for this first half to 3.35 pence. And we sit comfortably with a pay-out ratio of 90%, providing us with future flexibility as we continue to target sustainable dividend progression over the long-term.

Frankie Whitehead: Slide 8 highlights the level of underlying earnings growth, in absolute terms, driven by our development activity. Starting with last year's headline Adjusted earnings figure on the left-hand side and removing the exceptional DMA income of £6.3 million which was received in H1 2021, getting us to the recurring earnings position of £63.1 million for the first half of last year. You can see that top line growth in net rental income is the significant driver to this growth in recurring earnings. The like-for-like rental growth of 3.3% has added £2.2 million to current period earnings, alongside a further £1.1 million contribution from last year's investment activity which has now been held for the full period.

Frankie Whitehead: Development completions are by far the biggest contributor to net rental income growth. With £10.8 million attached to new lease completions, this is offset by an unwind of approximately £6 million from licence fee income in relation to one building at Littlebrook, which has now reached practical completion.

Frankie Whitehead: Finally, net of the other admin and finance costs, this gets us to the Adjusted earnings for this period of £69.7 million, which is a 10.5% increase on a like-for-like basis over the same period last year. And, just to recap, this is shown in absolute terms here, on a pence per share basis this growth is 1.1% when factoring in the dilution from our 2021 equity issue.

Frankie Whitehead: Our income performance has been coupled with an even stronger delivery of capital growth across the period. Another milestone was reached with the Portfolio value crossing £6.0 billion at the half year point, the valuation surplus recorded was 7.0% across the half. We have invested approximately £150 million of capital during the period into our attractive development pipeline, we expect this to accelerate in the second half and therefore retain our guidance of £350 to £400 million of development capex this financial year.

Frankie Whitehead: Our EPRA NTA increases to over £4.5bn, which equates to 242.9 pence per share. And with an LTV relatively unchanged at below 24%, this provides us with the balance sheet capacity to commit to near-term opportunities, both from within our existing pipeline and externally should the opportunities arise. This financial performance culminates in another strong six months, with a Total Accounting Return, as I said before, of 10.7%.

Frankie Whitehead: Turning to the detail behind our strong capital growth. The Equivalent Yield on our portfolio has remained stable at 4.1%. The ERV growth itself has continued to progress at attractive levels, increasing by 5.8%, this half. This Investment portfolio performance has therefore added 15.6p to NAV.

Frankie Whitehead: Whilst our development pipeline is a key driver to income growth, the development profit realised is also becoming a bigger feature of NAV growth, a further 5.0 pence has been added to performance through increasing levels of development activity. When noting the impact of the operating profit and dividends paid in the period, this takes us to the closing EPRA NTA of 243 pence per share, or plus 9.1% over the 6 months.

Frankie Whitehead: So, the first half has been another period of compelling financial results. And more importantly, our strong operational performance has led to our near-term outlook for income growth looking even more attractive. This rental income bridge illustrates the potential we have to grow today's passing rent from £198 million shown on the left-hand side, by approximately 2.5 times, to an estimated £510 million, as shown on the right. This includes £18 million of rent which is contracted and sits within our Current development pipeline. This is all targeted for delivery by Q3 2023 and will add 9% to passing rent.

Frankie Whitehead: We have a further £15 million of potential rent within the current development pipeline which is currently unlet, although one-third of this is under offer. And we have £4 million of potential rent attached to planned development starts during the second half of this year. Further ERV growth has led to an improved mark-to-market rental position. This rental reversion now stands at 15% or £32 million of further opportunity to grow our income.

Frankie Whitehead: Taking all of this into account, this gets us to the green bar totalling £267 million. So, including our current development pipeline, the targeted development starts from the second half of the year and the rental reversion, we have the opportunity to grow passing rent by £69 million or 35% over the near-term which, from a timing perspective we would expect to translate into an acceleration in our earnings growth from mid-2023 onwards.

Frankie Whitehead: Moving further out, we will continue to benefit from our near-term and future pipeline, which is unique and has significant embedded value. And to remind you, there is no future rental income growth factored into this chart. And it is important to remember, our land pipeline is largely held under option. This provides us with significant flexibility over the long-term, allowing us to alter the pace of development to suit prevailing market conditions.

Frankie Whitehead: Slide 12 is a reminder that the strength of our Balance Sheet provides further resilience across our business, which is particularly important noting today's macro environment. At the half year, our Loan to Value ratio stood at 23.7% and we had £475 million of available liquidity. As you can see, our debt book remains diversely funded with a laddered maturity profile averaging 6.2 years, our earliest refinancing event does not fall due until in December 2024. With the last few months seeing us move into a new interest rate environment, our work on the capital structure over the last few years stands us in good stead. Approximately 70% of our debt is fixed rate and our remaining drawn balance is fully hedged. Our average cost of debt remains attractive at 2.5% at the end of the period.

Frankie Whitehead: And finally, I want to finish by reaffirming the guidance set out at the time of our 2021 annual results in March.

Frankie Whitehead: Our high-quality investment portfolio underpins our core income return and we are confident that we will continue to deliver low risk and sustainable income growth including through the significant portfolio reversion.

Frankie Whitehead: We will continue to maintain our financial strength by managing our balance sheet efficiently. And, as I said, our fixed term and hedged position means that we are less exposed to higher interest rates when taking a medium-term view.

Frankie Whitehead: We have plans to recycle capital this year – but we are mindful of managing investment disposal timings with the delivery of income from our developments. And with investors likely to be pausing for breath over the summer months, any disposals are therefore likely to fall towards the latter part of the year. Our longer-term guidance on disposals remains at £100-200 million per annum.

Frankie Whitehead: We intend to continue investing for growth ensuring we continue to maintain strict financial discipline around our deployment of capital.

Frankie Whitehead: We maintain our development Capex target for 2022 of £350 - 400 million this year. From a yield on cost perspective, we maintain our target of the lower end of our 6-8% range in the near term, with rental growth continuing to act as the key mitigant to cost pressures. I've set out how a large part of the expected acceleration in earnings growth for 2023 and 2024 has already been secured and therefore is significantly de-risked. And with a strategy founded on income quality, alongside a highly flexible growth engine through development, we expect this to translate into attractive returns over the longer-term.

Frankie Whitehead: So that concludes the financial review – And I shall now hand you back to Colin.

Colin Godfrey: Thanks Frankie, Our confidence in delivering the numbers that Frankie talked to is based on our strategy, combined with the continuing strength of our market, and that is what I want to update you on here:

Colin Godfrey: As shown Top Left, a record level of lettings, at 22.6 million sq ft was recorded in the first half of 2022, 10% up on the first half of 2021. This deep demand has come from a broad range of occupier types. The level of new supply in construction has increased slightly to 33 million sq ft as at 30 June; much of this supply has been either pre-let or let during construction. Across the market as a whole, 19 million sq ft was under offer at the end of the first half, leaving an estimated 5.0 million sq ft of the future development pipeline currently available. Against this, the level of unsatisfied demand remains exceptionally strong, equivalent to around 2 years of recent average annual take-up.

Colin Godfrey: As shown Top right, demand and constrained occupational supply, have driven down vacancy to a record low of only 1.2%, representing around 5.7 million sq ft against a total UK stock of around 484 million sq ft.

Colin Godfrey: Turning to the bottom left chart: This acute supply and demand imbalance continues to drive rental growth across all 6 regions of the UK, with investor forecasts strengthening, and we have plenty of opportunities to capture this.

Colin Godfrey: And Bottom right: Strong investment demand for logistics warehousing has continued. Whilst we saw a slowing of volumes in Q2, the first half of 2022 recorded £4.2 billion of transactions, significantly ahead of the 5-year first half average of £2.7 billion. We believe that there remains a wall of unsatisfied capital seeking investment into logistics real estate, given the attractive medium-term attributes offered.

Colin Godfrey: Against that market backdrop I wanted to spend some time highlighting the first key element of our strategy, the strength of our investment portfolio, which makes up 91% of our GAV. Since we launched Tritax Big Box in 2013, we have been disciplined and focused with our aim of creating the highest quality logistics portfolio possible. By doing so, we attract high-quality customers on long-leases, providing greater security of income, which we know is very important to many of our shareholders. Nearly nine years on, our investment portfolio benefits from: An increasingly broad range of large, well known and financially strong customers, as shown here on the left, from a wide range of business sectors that are often market leaders in their field, noting that to ensure resilience through the economic cycle we have deliberately limited our exposure to SMEs; Geographically diverse assets which are well-located, modern and highly sustainable; And assets that are crucial to our customers in supporting their complex supply chains.

Colin Godfrey: ESG is increasingly important in both protecting and enhancing investment value. With 95% of our assets rated A to C, we have limited capex requirements, estimated at only £4.2 million, to ensure our portfolio meets the minimum EPC rating of B by 2030, as legislated by the UK government.

Along with the high quality and modernity of our investment assets, our development activities allow us to integrate ESG performance throughout the lifecycle of a building, from design to construction, with the objective of reducing embedded carbon and delivering buildings which are net zero in construction. And we are also working with our customers to reduce carbon emissions from their operations. Our contractors now source most building materials from within the UK, further reducing the environmental impact and supply chain risk, and helping us deliver buildings on time. All our new developments are targeting a minimum standard of EPC grade A and BREEAM 'Very Good'. We are increasing renewable power and producing biodiversity net gains, and our focus on social impact is supporting communities through job creation and charity partnerships. And this leads me neatly to…

Colin Godfrey: Slide 17 and the second key element of our strategy, active asset management, which we employ to continually enhance and improve this high-quality investment portfolio. Activity in the first half has been in line with our expectations, having completed 8 rent reviews relating to 15% of our rent roll, and a lease renewal, which have together secured an additional £2.7 million in annual rent. EPRA like-for-like rental growth was 3.3%; noting that most rent reviews are 5 yearly and backward-looking, so we expect our rent review performance to improve as we capture recent stronger levels of rental growth and higher inflation.

Colin Godfrey: And we have an attractive blend of upward only rent review types, as shown here on the left pie chart: Over half of our investments are subject to inflation linked reviews and thanks to our development pipeline, we have increased potential exposure to open market rent reviews, from 36% to 40% of rents over the past 6 months.

Colin Godfrey: As to timing, 20% of our rents are subject to annual rent reviews with the remainder reviewed 5-yearly, as shown on the right pie chart. The opportunity for income growth comprises several components: As shown here top right, the growth in market rents is embedding within our portfolio, with rental reversion up from 6% just a few years ago to 15% as at 30 June. We have plenty of opportunity to capture this reversion as shown bottom right. In any given year we have around a third of the portfolio subject to rent review. In addition, around 18% of our portfolio is subject to lease expiry over the next 5 years. In the intervening period we expect rents to continue growing, supporting an increasingly attractive rental reversion.

Colin Godfrey: And our development pipeline provides a third way to capture rental growth. This is important because our development lettings also create positive evidence that we can use to produce growth from our investment portfolio rent reviews. So, through active management of our high-quality investment portfolio, we are driving both attractive income and capital growth.

Colin Godfrey: And here is a case study that brings this to life. It is a great example of our investment activity and active management strategy in action and demonstrates the understanding we have of the UK's logistics market and our ability to capture the increasing reversion within our portfolio. Located near Southampton and let to Tesco, we purchased this reversionary asset at the end of 2020. It was an off-market transaction, as we identified an institutional owner who needed liquidity quickly. This enabled us to achieve advantageous pricing for a rare cold-storage asset in a great location where supply is acutely tight. The lease only had three months left until expiry, but our knowledge of the customer and the market mean that we were confident that Tesco would want to stay, but also that there would be strong alternative market demand if Tesco vacated.

Colin Godfrey: I'm pleased to say that the combination of our due diligence, detailed customer supply chain analysis and working in partnership with Tesco, has resulted in us securing a new 10-year lease to Tesco earlier this year. In addition to which we have increased the passing rent by 23%, thereby creating additional value for our shareholders both through income and capital growth. So, while much of our emphasis is on our development activities, we continue to create opportunities to enhance our investment portfolio, through active asset management, and in turn support the ambitions of our customers.

Colin Godfrey: Turning then to Slide 19 and the third key element of our strategy, our significant development programme. This slide outlines the scale and indicative timings of our development pipeline. I will not dwell on it here as we have covered this before, so please refer to the replay of our development focused seminar, which is available on the investor relations section of the Tritax Big Box website.

Colin Godfrey: I will, however, reiterate that this is the UK's largest logistics land portfolio, and it gives us the ability to support our customers by creating modern, highly sustainable, and well-located assets in a range of sizes and locations. We have guided to a long-term aim of delivering 2 to 3 million sq ft of development starts per annum over the next 10 years, and last year we announced we would accelerate this in 2022 in the face of exceptionally strong occupier demand.

Colin Godfrey: As to activity so far in 2022, I am pleased to report excellent progress and strong performance. Actually, the numbers speak for themselves.

Colin Godfrey: Let's start with lettings.

Colin Godfrey: So far this year we have secured 2.4 million sq ft of lettings; some of these buildings are being constructed now and are reported in our Current Development Pipeline, and some have yet to start construction and feature in our Near-Term Development Pipeline.

Colin Godfrey: These lettings secured an additional £17.8 million of contracted annual rent, a record first half for us, which, as Frankie highlighted, will begin contributing to earnings by mid-2023, with the full effect felt in our 2024 earnings as these buildings reach practical completion. This strong letting activity significantly de-risks our future earnings growth.

Colin Godfrey: Turning then to our Current Development Pipeline (shown in the green section on this chart) that captures buildings currently in construction: here we are making excellent progress, with 2.2 million sq ft commencing in the first half of the year, a significant majority of which has been let already, so we are more than half-way to achieving our accelerated target for 2022 of 3 to 4 million sq ft.

Colin Godfrey: When adding this to the 1.2 million sq ft of construction already underway at the start of the year, we now have 3.4m sq ft in our Current Development Pipeline (noting that 1.8 million sq ft is let and will contribute £12.7 million of annual rent). This leaves 1.6 million sq ft under construction and available to let, which has the potential to add a further £14.9m to our rent roll in the near-term.

Colin Godfrey: And looking further out to our Near-Term Development Pipeline, at the bottom here, relating to construction which we anticipate starting within 36 months from now, this has the potential to produce nearly 9 million sq ft. And we are making good progress here also, having already achieved planning for and pre-let 0.6 million sq ft that is set to commence construction in the second half of this year.

Colin Godfrey: Critically, we have been able to offset much of the inflationary pressures we are seeing with higher rents, thanks to the strong market fundamentals I've already mentioned. As Frankie stated, this means that our projects remain within the lower end of our targeted 6 to 8% Yield on Cost range, supporting attractive returns and our decision to accelerate development activity in 2022. So, our development programme is making excellent progress, on track with our delivery expectations, and we are optimistic about the potential opportunities looking forwards.

Colin Godfrey: To summarise, and reiterate what I said at the start, we remain as confident and excited today as we did in March. As these results show, we are delivering on our strategy. The occupational market remains exceptionally strong, supported by long-term structural drivers. Our rental reversion and new development lettings are embedding continued high-quality growth in our business which further reinforces the resilience of our portfolio assets and recurring earnings. And, we have the financial strength to continue to deliver our strategy and take advantage of opportunities in our market.

Colin Godfrey: Thank you for listening. Ian will now open the call for your questions.

Ian Brown: Great. Thanks so much. Good morning, everyone. There are two ways to ask questions. You can put your question through on the webcast. There should be a text box where you can type the question. And if you're on the phone, you need to press star one, and then we'll be able to see your question.

Ian Brown: We'll begin with the webcast just while we wait for some questions to come through on the phone. First question on the webcast relates to yields. Question is, "With risk-free rates rising, what are your views on the future path of logistics yields?"

Colin Godfrey: Thanks, Ian. It's Collin speaking. Well, look, like a lot of markets, we think investors are pausing their activity to see where things settle at the moment. In the last few weeks, investment activity has reduced, buyers have been pausing for breath, sitting on their hands. And it's difficult, therefore, to form a very real clear view on current pricing, given the limited evidence that we have in the marketplace, let alone trying to speculate on future pricing. However, I think at the moment we're not seeing any signs of distress in our market or forced selling. That's the first thing to say.

Colin Godfrey: We are aware of some transactions that haven't progressed because the buyers and sellers haven't been able to agree terms and there has been some sort of price chipping potential. But, just to counter that, last week, by way of example, we were aware of a completion of an investment transaction in a few sold portfolio of seven assets. From memory, it had a 10 year WAULT with a mix of review types and credit qualities, and that was a 3.5% net initial yield, which is very strong. I think it sort of underpins the levels that we were seeing in the first half.

Colin Godfrey: Overall, of course, much of this is going to depend upon the cost of capital, and obviously that's increased significantly over the last six months, but I think the key point here is the quality of our own portfolio. We think that our assets are highly liquid and will be very resilient. And of course, one's got to have a mind to the structural drivers of our market supporting occupational demand and rental growth, and they're still exceptionally strong. These fundamentals are really likely to continue to attract investment interest, I would say. We're aware that there is still a lot of uninvested capital destined for logistics real estate.

Colin Godfrey: So, I think the outlook in the mid to long term remains very positive, but I think taking a pause in the near term. Hopefully that sort of covers that point.

Ian Brown: Great. Next question is, "If all the caps were met, what would your cost of debt rise to?"

Frankie Whitehead: Thank you, Ian. Yes, so the average cost of debt as at 30 June is 2.5%. On the interest rate cap side, the strike rate sits just outside of where we were at balance sheet date, so they all kick in and in the short term and the average cost of debt would move to around 2.6%. So not significantly above where we were trending at 30 June.

Ian Brown: Okay, great. Next question relates to expectations for development activity. Question is: what are expectations for development activity in 2023? Will you maintain the current accelerated levels?

Frankie Whitehead: One for me. Thanks, Ian. So heading into 2022, we obviously saw an increased level of occupied demand for our space and with our portfolio well positioned, we increased our expectations for this year to three to four million square feet. I think we've demonstrated this morning that we're on track to meet that. Our longer-term guidance remains at two to three million square feet per annum, although we continue to position our portfolio to allow us to accelerate that, should the occupation demand be there. So the flexibility we have in the land pipeline, it will remain driven from the bottom up and we will react to any occupational demand in order to increase that, should that be there.

Ian Brown: Great. Next question, "Congratulations on a great set of results." Thank you. "What is the average length of your fixed debt? How confident are you can achieve your rental increases in this uncertain macro-environment?”

Colin Godfrey: Okay. It's Colin. Should we maybe take that in reverse order? Shall I start, Frankie?

Frankie Whitehead: Sure.

Colin Godfrey: So probably the first way to think about this is to talk to our like-for-like rental growth. Look, I think looking at the composition of our portfolio, we've got a really good balance of rent reviews in the portfolio, 40% linked to open market and 50% of our rents are inflation linked. Now, the open market reviews are uncapped, typically five-yearly, and most of our inflation link leases do have a cap and collar arrangements, of course.

Colin Godfrey: We've delivered, as I said in the presentation, like-for-like rental growth of 3.3% of the period. And just to remind you, that is a five-year backward looking process. And over that five-year period, the average underlying CPI inflation rate was 3.1, so to that effect, we're sort of on track.

Colin Godfrey: But probably more importantly is the way that we think about the current capture. And it is almost a case of sort of catching up with, and this delayed timing point, in relation to how we are capturing what is happening in the market right now. So, we think about that view in the context of our ERV growth, which has been progressing very well at 6% for the last six months, up 14% over the last 12 months. And I talked about that embedded reversion in our business at 15%, which of course to some degree embeds the ability to capture future growth in our business without reliance on further growth in the market.

Colin Godfrey: So it's very much a timing point between underlying market growth and the path to us securing that reversion. In addition to which we do have an opportunity to capture 18% of our portfolio with lease expiries during the course of the next five years. So I think our investment portfolio delivers strong, high quality income growth potential given the relatively low risk and high quality foundation of our assets.

Colin Godfrey: And I think probably the most important factor is the underlying income growth potential of the business, which of course includes asset management and the good work we're doing in development and the ability to drive those rates through in terms of rental and development.

Colin Godfrey: And just probably to mention there, to give you a bit of a feel, against the last six months, against our target rental tone that we set ourselves and particularly, say, for our speculative developments which we've leased in the intervening period, the rental tone we've been achieving is 10 to 20% head of target levels. So you can see this sort of, if you like, a growing curve of opportunity from the current like-for-like level we're achieving as we capture the growing levels of rental growth that we're seeing in the market.

Frankie Whitehead: Just on that first part of that question, the average length of the fixed component of our debt book which, to remind you is 70%, is seven and half years, including the full debt book. The average maturity is 6.2 years.

Ian Brown: Perhaps continuing the theme, a question around the current all-in marginal cost of debt with colour on different types of debt would be appreciated. "What is the rate on the 250 million RCF maturing in 2024? And what are your thoughts on replacing this and what rate would you get on that today?"

Frankie Whitehead: Thanks, Ian. I think there's a few elements there. I think just to reiterate what we said in the presentation, I think we are well set. The work we've undertaken on the capital structure and the debt book, particularly the last few years, puts us in a good position. 6.2 year average maturity, 70% is fixed, and the balance is aged at the moment, so long duration on that.

Frankie Whitehead: Speaking to the, I suppose, two components of the debt side there. Debt cap markets first, clearly underlying interest rates have moved out, as have bond spreads. We aren't immune to that. That will affect us on any new debt that we look to execute. I would say that for medium-to-long-term debt today, we would be pricing in the very high threes, low 4%. So that is a move up from where we were six months or so ago.

Frankie Whitehead: I think the other point is the more flexible debt, so the traditional corporate banking side. I would say that the cost there has been a lot more stable. So we will continue to fund our strategy through a blend of those forms of debt: debt capital markets and traditional corporate banking.

Frankie Whitehead: On the banking side, to remind you that we had a positive move in terms of the outlook of our corporate credit rating which we will feature in this. I would say where we stand today, that the margin will be very similar to when we originally agreed that a few years ago when it comes to refinancing, that's how we're currently seeing that.

Ian Brown: Okay, brilliant. Look, I think one more question from the webcast and we'll go over to the phone, as we've got a few questions waiting there. A couple of questions, I'll aggregate them here, but could you give more colour on term demand by sector? And do you think that demand is more sustainable now given the greater breadth of tenants looking to take space? And a couple questions around the reliance of logistics on eCommerce and how do you plan to reduce such dependency as was visible with Amazon-led stock price decline over the last few months? So, yeah, two questions there...

Colin Godfrey: Sounds like more than two in there.

Ian Brown: Well, a summary of questions.

Colin Godfrey: We'll give it a go. So it's really interesting, this. In the first half, take-up by sector, the largest component was the third-party logistics sector at 28% of take-up. Interestingly, online retail only comprised 14% of take-up. And I think that probably talks to the Amazon point. We can come back to that in a moment.

Colin Godfrey: The other retail was 9%; food was 13%; manufacturing was 20%; construction 3; and there are a number of others in there that comprise the remainder, which is 14%. It's really interesting, I think. When we reflect on the effect of Amazon's comments, it's important to remember that we do have the largest logistics focused land portfolio in the UK.

Colin Godfrey: Which is geographically diverse, and in strong locations. And it does provide us with really good real time insight into what we're seeing in the occupier market. And if we were to measure the occupational demand for our assets, I think Hamid at Prologis said, 12 out of 10 are moving to 10 out of 10, or something. But I would probably say it's been an exceptional market, at 10 out of 10 for the last 12 months. And we've probably now just edged up very slightly, sort of 9 out 10, but it's still very, very strong. If you look at the composition of that interest that we are seeing at the cold face, it's very deep, it's very broad. I think we're seeing the effect of Brexit coming in there a little bit. Reassuring, we can perhaps touch on that a bit later.

Colin Godfrey: But there are strong structural reasons why we are seeing a broad range of occupier types. And that I think is really quite gratifying. And it's stepped up really as a consequence of, as we come out of lockdown and COVID, and companies looking to invest for the longer term. So I think a healthy sort of broad range. And if we think about the timing of that take up, we are leasing our buildings particularly quickly now. If you think about the speculative development programme, by way of example, I think Savills reported their negative two months, which is the first time that negative number's been reported in history for speculative lettings.

Colin Godfrey: And that means that the average speculative developed building has been letting up two months prior to practical completion. Well, for our own activity in the first six months of this year, that equivalent numbers have ranged from negative six months to negative 12 months. In other words, we're letting our buildings up incredibly quickly. So I think it talks to not only the breadth, but also the strength and depth of the market, absent perhaps Amazon's reduced level of activity in the marketplace.

Ian Brown: Well, I think we'll turn to the phones now. I think we've got a number of questions there. The first, I think is from Neil Green at J.P. Morgan. Just as a reminder, if you want to ask a question, please press star one on your phone. Neil, can you hear us?

Call Moderator: Thank you. Neil Green, your line is now unmuted. Please go ahead.

Neil Green: Thank you. Good morning, everyone. Thanks for the presentation. Just one question really. Obviously, with the rental growth and the uplift on renewals you're seeing. I'm just wondering if any tenants are talking about the affordability of rents, especially given the uncertain economic outlook please?

Colin Godfrey: To be honest, Neil, no, not really. I mean, we obviously have really high quality buildings. Typically, they're let to large scale robust occupiers that are recognising the importance and need for these buildings in producing solutions supply chain issues that they have. It is worth mentioning that, we've done some analysis on this. And if you look at the rental tone by way of example, for a retailer that it can amount to something like 1%, or even less of their total operational cost. So, the much bigger component part of their cost is for instance, in transportation and labor and those sorts of things. So if their rent goes out by 10%, it's potentially 10 bps on the bottom line.

Colin Godfrey: We're talking about relatively small increases in costs here. And in the context of that, it's much more important that they can solve the key things that they need to solve in their business, to optimise their business operations, to capture those economies of scale, potential cost savings, the flexibility that these buildings provide. And, as I said, the solutions to supply chain issues. So, we are not seeing much of that. And it's an interesting question, because obviously that's in the context of quite significant inflation that we've seen coming through into cost price inflation. And particularly in the UK, I think on top of the European scenario in labour.

Colin Godfrey: And more recently, and it has been a bit of a delayed reaction to this, because of course there's been an educational component to it. That our customers do recognise that we are simply looking to pass on to them the costs increases that we are seeing. And I would say if you look at the stats and the level of demand we're seeing, and the conversations we are having, they are fully appreciative of that. And they're recognising that it's just part of the backdrop of the economic environment. So short answer is no, we're not seeing much pushback on that at all.

Neil Green: Okay. Thank you.

Call Moderator: The next question comes in from the line of Paul May, calling from Barclays. Please go ahead, Paul.

Paul May: Hi team. Thanks for the presentation results. Just a couple for me, one of probably a number of questions, but focusing on the average cost of debt. Appreciate, you said, on the bond market, probably looking at high threes, low fours. On the bank market you mentioned, I think margins flat, but I assume cost is up 170 basis points relative to where we were back in the last year, just looking at the move in Libor. Is that what you are seeing as well in terms of conversations? And then also on your margins, we are hearing from some banks that they are looking to basically expand margins. I imagine margins have got compressed because of the low cost of the corporate bond market. That's obviously got significantly higher margins now, so we're hearing from some banks that they're looking to expand that.

Paul May: And then finally, on the cost of debt, I think if you look at your first half financing cost, and all the various bits and pieces that go in there, and you annualise that, your debt book hasn't really changed from year end to the first half. So dividing those through, we get to more like a 2.7/2.68% cost of debt on approved finance side is the average cost you mentioned net of capitalised interest, or what's it excluding, I suppose, to get down to two and a half? Thanks. Probably start with those on the debts side, and then I've got a couple of questions on the development side.

Frankie Whitehead: I'm trying to pick those up in order Paul. On the banking side, I would say margins at the moment seem to be relatively stable. So versus the 4% that I quoted for a longer term tenant, we'd been in around the 2% on the floating rate side, obviously caps in place on that. So, a blend of those different sources going forwards looking to finance our strategy. Cost of debt, I think we noted in the statement, the cost of debt that we quote is based on all debt commitments rather than drawn debt. So that would be the difference between your 2.7 and the 2.5.

Paul May: Cool. Perfect. Thanks. And on that, sorry, on the floating rate at 2%. So your margin, I mean, you're looking at Libor as currently 1.9ish, I think something around there, three months Libor. Is that sort of margin basically zero activity on bank debt, or should we be thinking 100 base points or so margin on top of the 1.9, plus a little bit on the fee side.

Frankie Whitehead: Yeah, sure.

Paul May: An all in cost.

Frankie Whitehead: Sure. So, margins are in around the 100 basis point mark you mentioned. We are borrowing over three months on the floating.

Paul May: Okay. Okay, cool. Thank you. And then, on the development side of things, just trying to get a sense of, I suppose, timing of income. And I appreciate you gave quite a bit of information, I think on slide 11 as to some sort of indication as to when that's likely to come through. But just to get a sense of where your top line could be growing through 2023, effectively. And I appreciate a lot of it is probably second half loaded, I think is probably fair to say, in terms of that coming through. But just to get probably some millions of pounds around the sort of numbers would be much appreciated.

Frankie Whitehead: Cool. So that is something that's a question for me as well. So looking at slide 11, Paul there. Obviously, passing rent and just stepping through the slide. Passing rent 198 at June, the 13 million and the 5 million, the £18 million, that's secured under construction, or shortly to commence, should all be passing by Q3 2023. So passing rent, Q3 2023, in and around the 216 from development, there are rent reviews and things between now and then as well. The £15 million, that's again currently under construction, that's un-let, those buildings again, there's a bit of a range, but again, by summer of next year, those should all have reached practical completions of subject to letting activity on that, between now and then some of that, or all that could also be passing. And then the £4 million that we're due to start in the second half of this year, that's more like an end of 2023 completion attached to that. So, hopefully that gives you a feel. But broadly speaking, a large part of that income, you can see it on the early phase of that chart there, should be flowing by Q3 23.

Paul May: Perfect. And in terms of the reversion potential, the 30 odd million. I mean, simple over the next five years you'd expect to capture the majority of that, or is there any, I appreciate you've obviously got the timing of rent reviews and various things coming through, but is a broad five to six million a year of reversion, not a bad starting point?

Frankie Whitehead: Yeah, I think that's probably fair, Paul. The only thing I would say to balance that a little bit, is that, obviously, the reversion sits within specific assets. And if you're sitting say for instance, with an inflation link rent review, and it's subject to a cap, you may not be able to capture the full amount of the reversion appertaining to that property within that five year timeframe, it could take a little bit longer. So, it may not all be absolutely delivered within a five year time horizon. I mean, you've got the slide there, which shows the timing of our rent reviews, with 20% in 23, 32% in 24, 27% in 25, and 43% of our rents in 26. I suppose, the biggest composition of that is IPI linked growth in that timeframe. But on top of that, we've got lease expiries roughly ranging between 3.5% and 4% of our rent role in each of those years as well.

Colin Godfrey: So, it does range between 25 and 47% overall in each of those years. Hopefully it gives you a bit more of a feel for the capture, but broadly I think that's a sensible assumption, yeah.

Paul May: Yeah. No, exactly, it's trying to tally and reconcile the various numbers because as you say, we don't get, obviously, the exposure to the lease by lease items. So, headline movements are usually quite a useful start point. So, thank you very much and much appreciated.

Colin Godfrey: Pleasure, Paul.

Call Moderator: The next question comes in from the line of Colm Lauder calling from Goodbody, please go ahead.

Colm Lauder: Good morning all and thank you for taking my questions. I have a couple which actually follow on from Paul's just on the inflation linked reviews and how that might be evolving or changing. So firstly, and you can link perhaps two questions together. Firstly, what's your average cap across that 52 and a half percent chunk of the portfolio which is on inflation and leases? And then, for newer leases that you are agreeing, are you seeing any changes or tweaking to those cap and collar ranges, given obviously higher rates of current inflation? Thank you.

Colin Godfrey: Yeah, thanks Colm. So, the average cap is 3.4%, but that is expected to and will grow partly through our development activity. I mean, you've seen that during the six month period to 30 June, we increased our exposure to open market rent reviews from 36% of our rents to 40% of our rents. That was a conscious decision. If we think about the way that we are conducting rent review negotiations right now on our developments, there is a hierarchy of preference, which is really responding to the way that we think about the market. So, in the first instance our preference is a hybrid rent review, essentially the higher of open market, which is untapped, or inflation linked, which will be kept subject to a cap and collar. If we can't achieve that, then we're typically reverting to an unrestrained open market review profile, and if we can't achieve that and if we are desiring of capturing the occupier and we are prepared to let that building on inflation link lease, then the cap and collar arrangements will be much higher.

Colin Godfrey: Just to give you a feel, we're not on our own here. We've seen these numbers move up to capped at five, collared at two. Capped at six, collared at three, this sort of thing. I think in recognition of where inflation has been running, despite the fact that I think there's a general expectation that inflation will soften off again. So, those sorts of bandings, our expectation is that they will be fit for purpose in underpinning quite attractive rental growth for the medium to longer term.

Colm Lauder: Useful, thank you. And again, a similar question, just looking at the yield profile then in terms of your credit might be giving you for the various types of yield structures. Is that anything you can guide us to in terms of the divergence in yields or has there been any increased divergence in yields between the open market rent reviews book versus the inflation link book?

Colin Godfrey: I can't give you specifics on that breakdown, but I can give you a sentiment driven answer, Callum. If we go back 24 months or so and more, the market typically was, in the crudest possible way, paying a bit more for inflation linked reviews. I mean, we were obviously in a market where inflation was very low and inflation linked reviews typically provide a high level of transparency and clarity of delivery because you capture that review real time, year on year during the five year time horizon.

Colin Godfrey: Now, that compares to open market rent reviews, which can take some time to negotiate and agree with a customer. In absence to agreeing it, it could go to arbitration or an independent expert. Now, you get back rent and you get late payment interest and all those sorts of things, but the transparency and timing of delivery of that growth can be delayed on open market revenues.

Colin Godfrey: We've moved, obviously, to a new market dynamic and I think in this new world, the market is paying more attention to and paying more for the ability to capture the stronger rental growth that it's seeing evident in the market right now at preferring that to some degree to the constrained profiling of inflation linked rent reviews because obviously, rental growth has been running very fast, partly driven by the underlying inflationary pressures that we've talked about, particularly cost price inflation, which has been feeding into the rents that developments have been creating and of course, that is creating probably the best new and real time evidence for the rent reviews to take for comparable evidence in that review process.

Colm Lauder: Very useful. Thank you.

Call Moderator: The next question comes in from the line of Peter Runnebaum calling from Kempen. Please go ahead, Peter.

Peter Runnebaum: Good morning, team. Thanks for your presentation. Quick one from my side. You already briefly touched upon speculative pipeline. It's currently around 50% of pre-let. Is it fair to assume that all of this will be leased out upon completion?

Colin Godfrey: Yes, of course Peter. We don't have a crystal ball, but we approach speculative development very conservatively and on an information based approach. So, I think the first point of reference is, as I mentioned earlier, the speed at which the lettings that we have achieved on our speculative development program have been very fast. Minus six months to minus 12 months from the target date of completion. That is almost unheard of. Some of those buildings are being let out almost instantaneously when we break ground.

Colin Godfrey: Of course, we've still got further spec coming out of the ground. In some instances we are seeking to hold back on negotiations, preferring to capture the stronger rental growth during the course of the construction progress. And, of course, one of the things that we can benefit from here is locking into a fixed price building contract at the start of speculative development, and then benefiting from the upward rise in rental growth that we're seeing in the market subsequently compared to build to suit scenarios where we're pre-letting the building, where we're essentially back to back the pre-let lease with the fixed price building contract and therefore know exactly what our profit is on day one.

Colin Godfrey: But the other thing I think to mention about the spec programme is that we don't just put up a building in the hope that a tenant's going to come along and lease that in the future. We will only make a speculative start, and by the way the spec buildings are typically the smaller buildings in our programme. There is a geographically diverse range, so there's a risk profiling, across our portfolio. And finally, we don't start construction on speculative buildings unless we have line of sight on at least two occupiers who we know have a requirement for that size of building, approximately, in that location and we've got very clear understanding of any other sites that we might be in competition with, or whether we are the only show in town, to all intents and purpose, the timing requirement of those occupiers wanting that building and our view on the success rate of achieving letting to one or more of those occupies.

Colin Godfrey: Now obviously, if you've got competitive tension, that helps in terms of the rental tone as well. So, this is a highly informed process that we embark upon in our spec programme. So, we don't really view it in the way that much of the market considers spec. It's not really spec in that it's highly educated development. Hopefully, that gives you a good feel and some comfort.

Peter Runnebaum: Yes, this is very helpful. Thank you.

Call Moderator: The next question comes in from the line of Rob Verdee calling from Green Street. Please go ahead.

Rob Virdee: Good morning, gentlemen. The question is on online retailers, and not just Amazon. Are you seeing any reduced requirements for space for them? And the context of that question is really how the second derivative of eCommerce penetration in the UK is slowing and all that we read about inventories for some of these retailers being overstocked. That's the first question.

Colin Godfrey: Yes. So, would you like us to answer that one now?

Rob Virdee: Yeah, please.

Colin Godfrey: Look, let's paint a picture of time. Pre-COVID, online sales were 19% of total retail sales. They spiked at around 42%, depending on which metric you look at during lockdown, and they came back down to the low 30s. Now, whilst the rate of growth has naturally slowed as one would expect, there is still a continued trend to growth online and we expect that trend to continue with a continued shrinkage of the high street. All of our major customers that we are talking to who are already occupiers in our portfolio.

Colin Godfrey: Just to give you a feel by way of example, of those customers that we are currently talking to on our development programme, it's pretty well 50-50 between the buildings that we're talking to existing customers on and the buildings and sites that we're talking to potentially new customers on. So, we have a really good cross read as to what the market's thinking right the way across all of these sectors, including online. There's still quite a lot of expansion being planned. Partly, this is to do with some of the things I mentioned earlier about efficiencies and cost savings.

Colin Godfrey: Economies of scale need flexibility, at the move to increase levels of automation, to enhance the speed and reliability that these companies are offering their customers. So the large scale, big box logistics buildings are very, very important in delivering that component part, they're the hub in the supply chain framework, and of course, supply chains are becoming increasingly complex. So I think you will see online continuing as a very important component part of ongoing take up in this market. But as I said earlier, there's not an over-reliance on it because it only comprised around 14% of total take up in the first half of this year. So I think we've got a really good balance. Coupled with some of the other points I mentioned earlier, such as Brexit, etcetera, and the concept of the de-globalisation to some degree, accelerated by Brexit. And the fact that, of course, because of Brexit, we now have an exacerbation of labour supply issues in the UK, which again, are playing to these larger buildings and automation, even more so than they were before.

Colin Godfrey: So in some respects, there's a real-time imperative for automation to supplement the low labour availability levels that we are seeing. And of course, the increase in the cost of labor being a significant component part of that cost price inflation I mentioned earlier. So it will continue to be an important part, but there's not an over-reliance on it. So hopefully that gives you a bit of a feel for how we see that section of the market.

Rob Virdee: No, that's perfect. That's very helpful. Now, just moving a little bit onto the general market and expectations for spec supply, for everybody else. I was just wondering, given all the macro challenges that you've talked about, do you see spec development for others coming down?

Colin Godfrey: Look, I would describe the market as been really quite disciplined and I think we've seen that in the recent past. Firstly, if you look back, into the face of, and through the last GFC, number one, the level of debt that was supporting developers in the market was much higher than it is today. Secondly, the number of trader developers has reduced dramatically. Some of those have been subsumed into larger investment businesses. Our own business is a prime example of that when we acquired the Symmetry portfolio in February 2019. And there's a much more transparent level of data available now in the marketplace. So developers are being quite cautious. And the other thing, of course, is that they haven't built up huge land banks. And of the land that was acquired into the face of this explosive growth in occupier demand, quite a lot of that has been developed out already. Now, any developer out there is not going to want to run that well dry. You need a geographically diverse pipeline of opportunity that you can offer the market.

Colin Godfrey: No one wants to sit there paying their development team without a planning consented bucket to draw from. But that bucket's been eaten up very, very quickly because of the rate of lettings that we've seen in the marketplace in recent times. So we are seeing quite a lot of sensible activity from developers. And if you look at the stats, we've not seen an explosive level of supply, and indeed we're not expecting to see that. And to some degree, that's sort of embedded in the way that we think about the barriers to entry in the market, and the way that the planning system works. And very, very crudely, it kind of pops out the similar levels of planning consent every year. And of course, that is the starting point to the ability of the market to produce supply in the first place. So the short answer is no, we're not expecting to see that.

Rob Virdee: Super, thank you. And then just finally, just wondering about any conversations you're having at the moment with tenants on rising energy costs. And I'm thinking here, because you brought it up, cold storage, and are you seeing any signs of any distress from some of these tenants from deteriorating occupier health?

Colin Godfrey: Not so much distress, I think it's more a case of a recognition of the challenges that they face in a number of areas, and power, and the increased costs of power being one of them. And of course, the positive element there is that we, as an owner of modern, very large buildings, with large roof spaces, can help provide a solution to that. Now, there's two components to this firstly, the work we're doing in terms of the way we think about ESG, and this is once more component part of that. And there's lots of things that can go into that such as LED lighting, rainwater harvesting, etcetera. But the big win really, and the relatively easy win is solar. So we've made solar proposals to every single one of our occupiers on every single building, there's a rollout program. It's really good and increased take-up.

Colin Godfrey: Obviously, this provides occupiers with cheaper power, it also meets their ESG objective significantly. So that's a really positive attribute that helps to deal with that problem. The other thing that we are doing is that we've employed a power guru, I'd like to call him, in Tim O'Reilly, who we poached from the National Grid. He was their Head of Strategy and new product development. He brought in the interconnector from Norway. And he's helping us unlock sites, improve power delivery for our customers, and open up sites that currently don't have power capabilities. We think that power is going to be an increasingly important feature of occupational thinking in the future, particularly as we see a reliance on fossil fuels reducing and an increase in EV, both for cars, for staff, but also for vans and HGVs coming to these buildings.

Colin Godfrey: And that will be a very, very significant draw on electricity, and meeting that challenge, which the governments made very clear, it needs to be provided by the private sector significantly, given that it's going to take many, many, many years for the new focus on nuclear to kick in. And that's assuming that it doesn't reverse gear in relation to the political agenda. So we do need to be thinking about, and putting it into solutions for our customers, for the long term. And that is something we are working very hard at in terms of that intelligence-driven programme and all that we're doing in other parts of our business in understanding about battery technology. So I won't bore you with them now, but I'm happy to have a coffee with you at another time to explore that topic.

Rob Virdee: Yeah, definitely. I think a beer is more warranted, but thank you.

Ian Brown: Look, on that note, I think that concludes the Q&A session. That's certainly all the questions from the phone. I'll just remind everyone that this session is been recorded. There will be a replay on the website and a transcript made available afterwards. And, if you do have any further questions, please do drop us an email. I'll just hand back to Colin for quick closing remarks.

Colin Godfrey: Yes. Look, thank you very much, everyone for taking the time to join us this morning. We really appreciate your continued support for the company, and your interest, and for your excellent questions. We wish you a good rest of the day. Hopefully see you soon. Bye.