Tritax Big Box - FY 2022 Results
Thursday 2 March 2023

Transcript

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Ian Brown:

Good morning. Welcome to Tritax Big Box's full year results presentation. I'm Ian Brown, Head of Corporate Strategy and Investor Relations. Before I pass you over to our Chairman, Aubrey Adams, I wanted to mention two things. Firstly, today's presentation is being recorded and a replay and transcript will be available on our website afterwards. Secondly, there will be an opportunity for investors and analysts to ask questions at the end of the presentation. There are two ways you can put questions to us, either directly into the webcast window, or if you prefer to speak directly, please use the conference call dial-in, the details of which are in this morning's results announcement. In the interest of time, we will try and aggregate similar questions from the webcast. And finally, the team and I are always available to answer any subsequent questions you may have, and you can find our contact details on our website to get in touch. Thank you.

Aubrey Adams:

Good morning, everyone, and welcome to Tritax Big Box REIT's annual results presentation for the year ended 31 December 2022. 2022 has provided us with an opportunity to demonstrate the quality of our portfolio and the strength of our operational performance set against a rapidly changing macroeconomic backdrop. Whilst we have not been immune to the weakening of the investment market, which is evidenced through the decrease in our asset value in the second half of the year, we have continued to generate income growth and maintained a strong balance sheet. This reflects our strategy of focusing on portfolio quality, sustainability and operational excellence, which underpins the delivery of resilient and growing income to our shareholders.

Turning to the board, we are pleased to appoint Karen Whitworth as Senior Independent Director. She replaces Alastair Hughes, who continues in his role as a Non-executive Director. I would like to thank them both alongside our fellow board members for their continued contribution over the last 12 months. I would also like to take a moment to thank everybody at Tritax for their support throughout the year. Our ability to deliver consistently against our strategy is testament not only to the quality of our portfolio, but also to the hard work of our team. I will now hand over to Colin and Frankie for the formal part of the results presentation.

Colin Godfrey:

Good morning, everyone. I'm pleased to be presenting the 2022 full year results for Tritax Big Box and to provide you with an update on the further excellent progress that we are making. My name's Colin Godfrey, and I'm CEO to Tritax Big box. I'm joined, as usual, by Frankie Whitehead, our Chief Financial Officer, and Ian Brown, Head of Corporate Strategy and Investor Relations. I'll start by setting the scene, Frankie will then walk you through our financial results, and I'll return with the strategic and operational update. Ian will then coordinate Q&A. But before we start, I want to echo Aubrey's thanks to the team at Tritax, who have been critical to delivering the operational performance that we present today. And on behalf of the management team, I would also like to thank Aubrey and the board for their support and input over the course of the last year.

2022 was a year in which we delivered strong operational performance. Despite macroeconomics impacting adversely on our NAV in the second half, and therefore total returns, our strong

operational performance captured record earnings growth, and we've reached new development milestones. Alongside this, we've prudently managed the balance sheet to support our strategy, and this is delivering, as you will see from today's results. The investment market weakened in the second half, but is now showing signs of stabilization. And this contrasts with the occupational market, which has remained strong throughout the year, supported by long-term structural drivers. This has underpinned attractive income growth for us in the period, and we're well positioned to capitalise on the long-term growth opportunities offered by our market and which are already baked into our business.

You can see here that despite challenging macroeconomic influences, our business is delivering. We are doing what we said we would do. Looking across the top row, we said that we would accelerate development starts to three to four million square feet, grow rents, improve our leading ESG credentials and deliver attractive performance. Turning to the middle row, in 2022, we deliver 2.9 million square feet of development starts, despite purposely reducing activity later in the year, increased our income at a faster rate, achieved improved ESG ratings, and grew our dividend by 4.5% to 7p per share. And on the bottom row, looking forwards, we see more opportunity to enhance sustainability, continue development, and increase rental income to support attractive dividend growth. This all stems from our strategy and how this positions us to maximize the opportunities inherent within our business and our market. More on our strategic delivery later. For now, I'll hand over to Frankie to run you through the financial results. Over to you, Frankie.

Frankie Whitehead:

Thank you, Colin, and good morning, everyone. This year, our 2022 financial results exhibit two distinct themes. First is our strong operational performance, led by our development activity and a record level of new lettings, which is going to further benefit our earnings performance through 2023 and 2024. And the second is driven by the macroeconomic factors which have led to a reduction in asset values during this second half. But as you'll see, despite these valuation declines, our balance sheet is in a robust position, allowing us to continue investing in our strategy to drive growth in earnings and deliver strong total returns into the future.

Turning to our 2022 key financial highlights. Our adjusted EPS, excluding additional DMA income, has risen by nearly 2% to 7.51p driven by development completions and like-for-like rental growth. This year we have increased our dividend by 4.5% to 7p per share. And driven by the expansion of property yields through the second half, a reduction in our overall portfolio value has led to the fall in APRA NTA to 180.4p per share.

And finally, to reiterate something that I said at our half year results, the chart here shows the significant positive arbitrage between our current passing rent and the ERV of the portfolio. As you can see, the rent secured within our development pipeline means that our contracted position rests 9% above today's passing rent, whilst the ERV of the portfolio sits a further 19% ahead of today's contracted rental position, providing us with good visibility over the future growth in our income, and I'll come back to this later.

At this stage, it's important to put the current year performance into its longer term context. Here, we set out our track record of performance demonstrating strong delivery over the last eight years.

Over 92% of our capital is invested in a high quality, low risk investment portfolio, which has delivered attractive annual growth rates across both contracted rent and earnings. The darker blue columns reflect the period which development has formed a greater part of our strategy, and this move has driven the acceleration in earnings over this period. Whilst we cannot control the extent of the market induced yield shift that we've recently seen, we will continue to be disciplined with the way that we allocate capital and continue to make intelligent operational decisions to drive growth through the business. And you'll hear more as we go through the presentation on why we expect this strong performance to continue.

Further good 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 nearly 12%. Once again, this was predominantly driven by development completions, and there was strong progression in the total contracted annual rent, which has increased to £224 million over the year. The upper cost ratio has temporarily increased to 15.7%. We expect to see this revert back to previous levels in the immediate term, and I will outline the factors behind this in a moment.

Our headline adjusted earnings per share fell by 5% to 7.79p, reflecting the lower level of DMA income received this year. When removing the additional level of DMA income received in both periods, so reporting on a like-for-like basis, the adjusted earnings per share has risen by just under 2% to 7.51p. Not withstanding a 6% higher average number of shares in issue. And in terms of dividends declared, these total 7p for the year, which equates to a dividend payout ratio of 93%.

The center of slide 11 shows how our recurring earnings has grown in absolute terms this year. Starting on the left hand side and the 2021 adjusted earnings, excluding additional DMA income of 129.6 million. You can see that top line growth in net rental income is the significant driver to overall growth. We've delivered 3.6% of like-for-like rental growth from the investment portfolio with the biggest contributor to income growth coming from development and new lease completions, which added £14.4 million to earnings. This is offset by an unwind of approximately £7 million from license fee income, which is now converted into rent and an increase to admin costs linked to a higher investment management fee. And with an increase in construction activity this year, a greater level of interest has been capitalized, resulting in a small reduction in net finance costs. This gets us to the £140.3 million, as shown on the right, which is an 8.3% increase on a like-for-like basis compared to last year. Now, this is shown in absolute terms here. The growth is 1.8% when reported on a pence-per share basis.

Now turning back to the upper cost ratio, there are a few points to note as we look ahead. The reduced investment management fee was approved and effective from mid '22. The full annualized benefit of this will come through in the current year and is expected to reduce costs by £0.3 million. And the reduction in APRA NTA reported this morning will also lead to an immediate reduction in the investment management fee. On a proforma basis, this results in a further annual saving of £3.8 million. When combined, this reduction in operational cost would reduce the upper cost ratio by around 200 basis points to a proforma 13.7% based on current valuations. And as already set out, we have approximately £20 million of contracted income still to feed through into passing rent, which in due course will improve the ratio further. And so we see a clear path to achieving a cost ratio of between 12 and 13%.

Now turning to capital values, and as I said, these have been impacted during the second half of 2022. This was stimulated by a sharp adjustment to underlying interest rates, with property yields increasing to accommodate a higher risk-free rate and higher cost of capital for investors. As the left-hand chart shows, the first half of the year saw a stable yield environment, however, the extent of the yield shift in the second half can be seen by the portfolio equivalent yield moving out by approximately 120 basis points to 5.3% at December. Our portfolio capital performance was therefore sharply impacted by this movement in yields, and you can see from this middle chart how this generated a 20% valuation decline during half two.

The net position across the course of the year shows an overall portfolio valuation loss of 13%, and it is worth noting that this loss would've been greater had it not been mitigated by the rental growth and development profit that we continue to generate across the business. And finally, on the right-hand side, you can see a record level of ERV growth, which has increased by 9.2% across the year. With levels of occupational demand still remaining strong, we expect attractive levels of rental growth to persist, albeit with some moderation when compared to the levels of growth seen over the last 24 months. Here we can see how those second half movements have impacted our key balance sheet metrics. The overall portfolio value has fallen to 5.1 billion pounds. The movement consists of the portfolio capital value decline as just highlighted, net of our capital expenditure of almost 340 million pounds. This capital deployed has almost entirely been channeled into our current development pipeline. The impact of the second half valuation movements led to a reduction in EPRA NTA of 19% to 180.4 pence per share. Although our LTV has increased to 31%, this remains at the lower end of our 30 to 35% medium term guidance. Values would have to fall by almost 50% further before we reach our corporate covenant, and so we maintain significant headroom to both LTV and interest cover covenant levels.

Finally, you'll see that the EPRA NTA movement has had a significant bearing on the negative total accounting return reported for the year. Notwithstanding this impact on capital values, our balance sheet continues to be in a very robust position. As I just noted, the year-end LTV remains in a comfortable position at 31%. Reflecting the prudence with which we've managed our leverage over the last few years.

We took the opportunity to top up our liquidity during the second half by adding 100 million pounds to each of our evolving credit facilities. In doing so, we added two new banking relationships, closing the year with over 500 million pounds of available liquidity.

Our debt book remains diversity funded with a lettered maturity profile. This further demonstrates support from a strong set of relationship banks and we continue to have good access to a broad pool of debt capital. Importantly, 99% of our drawn debt remains fixed or hedged, and we have maintained our attractive cost of debt position at 2.6%. And so, bringing this all together, we have an extremely robust and liquid balance sheet with our near term cost of debt significantly protected through our debt strategy.

You can see here how we are continuing to convert our land pipeline into growth in contracted income. This rental income bridge illustrates the potential we have to grow today's passing rent from 205 million pounds shown on the left-hand side to an estimated 594 million pounds, as shown on the far right. Moving from the left, this includes 19 million pounds of rent, which is contracted in relation

to assets under construction. The vast majority of this income will commence prior to the end of Q3 2023. We have a further 5 million pounds of potential rent within the current development pipeline, which is currently unlet.

Looking ahead to the anticipated 2023 starts, we have a potential 18 million pounds of rent attached to planned development starts this year on which we have a number of negotiations at an advanced stage. Further ERV growth has led to an improved market to market rental position. This rental reversion now stands at 19% or 43 million pounds of further opportunity. Taking all of this into account, this gets us to the green bar totaling 290 million pounds, which is some 41% ahead of today's current passing rent. So, a significant element of this near term growth has already been secured through lettings or is inherent within the existing portfolio reversion.

Moving further out, we continue to progress our near term and future development sites through the planning process and have added two new sites to the portfolio to replenish the pipeline. And to remind you, this chart assumes no future rental income growth beyond today's ERV level. It is also important to remember that our land pipeline is largely held under option, providing us with significant flexibility over the long term to alter the pace of development to suit prevailing market conditions.

Finally, I want to finish by outlining some financial guidance for the year ahead. Our high-quality investment portfolio underpins our core income return and we will be looking to maximize the opportunity inherent within the current portfolio reversion. We paused our disposal plans in half two 2022 due to market conditions. However, post the balance sheet date we have completed on a small asset sale at Little Brook, an exchange to sell a portfolio of assets with a combined consideration of approximately 150 million pounds. We see these as delayed 2022 disposals, and therefore, in addition, we aim to recycle a further 100 to 200 million pounds of capital in the current year. In line with our longer term guidance.

Our prudent management over the last few years puts our balance sheet in a strong position, taking the disposals recently executed into account. Our proforma balance sheet LTV reduces to 29%, and it provides the business with good optionality around our future funding needs. We expect our capital deployment to be focused on development, once again, and are reverting to our long-term guidance on development CapEx of 200 to 250 million pounds for 2023. I've set out how a large part of the expected acceleration in earnings growth across 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 to be able to continue to deliver attractive returns over the medium and longer term. So that concludes the financial review, and I shall now hand you back to Colin.

Colin Godfrey:

Thanks, Frankie. So, Frankie's described our resilience and explained why we are financially well positioned for the future. I'll now delve deeper into market dynamics, explain how we apply our strategy, explore the growth opportunity, and demonstrate why our future looks bright.

Let's start by looking at our market. As shown top left, rising interest rates resulted in expanding yields and lower investment volumes in the second half of last year. More recently, we see signs that the investment market is stabilizing and there remains significant capital seeking access to UK logistics real estate. The correction does, however, present an opportunity for us to acquire investments at a more attractive entry point.

Turning to the occupational market on the top right, 2022 was another very strong year for lettings, the third highest on record and significantly above the 10-year average. Demand continues to be driven by the long-term structural drivers of e-commerce, supply chain resilience, efficiencies, and sustainability.

And whilst demand has softened, the terracotta bar shows that current inquiries remain above recent take up levels. And this is echoed within our business where we continue to see high inquiry levels for new space. Bottom left, supply levels increased a little but have remained controlled. And this has resulted in vacancy edging up very slightly from a record low of 1.6% to only 2%, which is still remarkably limited.

Finally, as shown in the bottom right-hand chart, and despite the economic backdrop, strong fundamentals mean that our market remains confident in attracting rental growth over the medium term. This is reflected in our own development experience where we've witnessed strong double-digit rental growth in some locations, well ahead of our original expectations.

In summary, despite turbulence within the investment market, the occupational market remains strong and offers us significant opportunity. So, how do we continue to capture it? Well, you are familiar with this chart which shows how we designed our strategy in anticipation of the long-term structural trends that underpin our market. We deliberately built a portfolio focused on high quality assets, attracting great customers. With the weakening economy, this quality factor has never been more important, providing a higher degree of income resilience.

We also have the capabilities to add value to these investments through direct and active management, in addition to recycling capital by selling mature investments and reinvesting the proceeds into high returning opportunities. And we apply our skills, insights, and innovation to develop our land portfolio at a very attractive yield on cost. And of course, underpinning everything that we do is a very disciplined approach to capital allocation and embedding ESG across all of our activities.

And I'm glad to report that we are making excellent progress on ESG. Our portfolio already screens well, but we will continue to improve our ESG performance across our investment properties, our developments, and our corporate activities. As shown here, this approach is being recognised in consistent improvements to our ESG ratings. We are particularly proud of our industry top-rated award from Sustainalytics, the Global Leader in Development Award from GRES and our gold and most improved acknowledgements from EPRA. And I'm pleased to announce our new AA rating from MSCI for 2022, which is a significant improvement from the BBB rating in 2021.

Our approach to ESG is one of applying insights and evidence to set targets that we believe are achievable. With this in mind, we set ourselves new improved ESG targets with effect from the beginning of this year. Designed to firstly, deliver buildings which are fit for the future by further

integrating our ESG targets across our investment and asset life cycles, and expanding renewable power and reducing carbon emissions through development and asset management.

Secondly, decarbonize, where our new targets are 2025 for scope 1 and 2, 2030 for scope 3 construction and 2040 for the remainder of scope 3. Thirdly, enhanced levels of biodiversity and natural capital across the portfolio by improving the environments around our buildings to enhance the wellbeing of our customers and local communities. And finally, increasing social impact by supporting local communities through job creation and local charity partnerships. So ESG remains at the very heart of our thinking, and as I say, it's embedded into all of our activities.

Turning back to our strategy, I said earlier that the first key element is a high quality portfolio. This includes our customers, our buildings, and the terms on which they're leased. Looking specifically at the characteristics of our properties, they're modern and well configured with significant eaves heights, providing flexibility. They have excellent ESG performance reflected in the high proportion of A and B EPC rated buildings, and they're well located to serve their markets. And are next to critical transport infrastructure.

It's also worth mentioning that we have an attractive range of building sizes from 41,000 square feet all the way up to 2.3 million square feet. And the quality of these buildings typically means that they form a critical component of our customers' supply chains.

Turning to the quality of our customers, you can see here on the left some of the high caliber customers that lease our buildings and the diverse range of sector exposures shown by the sizes of the boxes. New development assets have continued to diversify our customer lineup, and we show here our top 10 high caliber customers with Amazon being the largest. Our customers want to take long leases to provide security in their operations, given the critical role that they fulfill in supply chain management, noting that our average unexpired lease term is 12.6 years. With new leases in our developments typically achieving 15 years. The economy and our market have influenced how we think about rent reviews, with hybrid or open market rent reviews being preferred over inflation linked rent reviews. Noting that we purposely increased our investment portfolio, potential exposure to open market rent reviews from 37% to 39% during the year.

The combination of high quality assets let to strong customers on a range of long-term leases, underpins the resilient and growing income characteristics of the portfolio and is reflected in our ongoing 100% rent collection. So we have high quality assets and customers. The second key element of our strategy is how we optimize performance. Now this slide highlights how we're delivering income growth through active management. During the period, 33% of rents were reviewed, including 4.5% percent held over from 2021. And together with one lease renewal, these generated a 5.1 million pounds increase in annual passing rent, reflecting annualized like for rental growth of 3.6%. With market rents continuing to rise at attractive levels, our rental reversion increased from 11% at the start of 2022 to a very healthy 19% at the year-end. And together with lease expiries, this will continue to be an important driver of both income and capital growth in our investment portfolio.

We expect further progress this year as we seek to conclude reviews relating to 6.8% of contracted rent carried over from 2021 and 2022 plus 19% of rents due for review and 2.6% of rents subject to

lease expiry in 2023. So, in total, up to 28.4% of our rents have the potential for growth this year. So that's the income component, now let's look at the capital side of our activity.

As we've said before, another key element of active management is the ability to recycle capital into higher yielding opportunities. And despite challenging market conditions, we've recently been able to dispose of four non-core assets at attractive prices reflecting full book value of these sales. One has already completed and the other three will complete early this year. In January, we completed the sale of an 83,000 square foot terraced warehousing scheme at Little Brook Dartford for 25 million pounds.

These are very small unit sizes and have produced an attractive profit on cost for us. And this week we also exchanged contracts on the sale of three investment assets in line with the December 2022 valuation. They are DHL at Skelmersdale, Cerealto at Worksop, and Matalan at Knowsley. These assets have performed well for us, delivering a time weighted blended IRR of 12.8% per annum over the whole period. The quality of our investment portfolio and our expertise provide the foundation from which to drive. The third key element of our strategy development, noting again that we control the UK's largest, the logistics focused land portfolio, which took over 10 years to curate.

And there were just a couple of points I want to remind you of here. Firstly, the scale of the opportunity at the year-end, our portfolio split was 93% investment and 7% development assets. And as you can see here, these development assets provide the opportunity to more than double the size of our business and perhaps more importantly provide very significant income growth potential. And secondly, the power of option agreements. Our land is held primarily through options which are capital efficient and flexible. Now this means that the potential of our development portfolio is far greater than the current capital allocation suggests.

Now let's look at what we've been achieving in development. The progress I'm about to highlight is consistent with our guidance and increases confidence in our near-term delivery. Utilising proceeds from the September 2021 equity raise, we accelerated development activity in 2022 into strong occupational demand procuring 3.1 million square feet of new lettings. In line with our guidance, this added a record 23.3 million pounds of additional contracted rent, which will benefit earnings this year. And next we started 2.9 million square feet of new construction in the year. Although we slowed activity a little in the second half due to market conditions and as shown on the pie chart top right, 53% of our development stock was pre let and a further 27% was let during construction demonstrating how our careful approach and customer relationships reduce risk and these developments will further enhance the quality of our investment portfolio.

You can see on this slide that we are delivering an attractive combination of building sizes, locations, and lease lengths. We've also increased the waiting to open market rent reviews and higher inflation caps and collars. And we've done this with some great new and existing customers. The average yield on cost in the year was 6.2%, which remains within our guidance range of six to 8%. And more recently we've seen this improving and it's worth noting that we continue to replenish our stock of consented land during the year by securing new planning consents capable of supporting 1.6 million square feet of new development underpinning the near term delivery. Capitalising on the continued strength of the occupational market, we've reverted to our long-term guidance of 2 to 3 million

square feet of construction starts per annum and we benefit from a high degree of flexibility to ramp this up or down depending on changes in the market conditions.

A great example of delivering value through development is what we've done with Iron Mountain this year. Iron Mountain is the global leader in storage and information management services and is now our fourth largest customer, a great addition for our business. In total, we let five new state-of-the-art buildings to Iron Mountain totaling 1.3 million square feet and all on 15 year leases. At Rugby, Iron Mountain leased two buildings very shortly after we commenced speculative construction. And this engagement resulted in them pre-letting two further built to suit warehouses at the same time providing a four building campus. The first two buildings complete next month with the final two buildings due to complete at the end of this year. Now at Kettering, we commenced speculative construction of a building in April 2022. This was let during construction in July 2022 and Iron Mountain took occupation in February this year following construction completion.

All five of these buildings are rated BREEAM excellent or very good and will be rated EPC, grade A with roof solar, EV charging, and other sustainability features, supporting Iron Mountain's commitment to be carbon net-zero by 2040. This is another great example of our insight led approach to development and our customer focus and it demonstrates the opportunity from our development operations.

So to sum up, I want to emphasize four key points from today; structural change continues to benefit our market, occupational demand remains high, whilst new building supply is constrained, driving strong rental growth and the investment market is showing signs of stabilization with significant capital, seeking an opportunity to invest at RE-based pricing. Our strong balance sheet, modest LTV, range of funding options and financial discipline means that we can take advantage of the recent market correction and we'll continue to deliver attractive and sustainable performance.

We control the UK's largest logistics focus land portfolio, which is highly scalable but also flexible and this has the potential to significantly enhance earnings growth, deliver attractive capital profits, and create new high-quality investments. And finally, our high quality portfolio of investments generates attractive and resilient income. Our active management enhances this income and we're recycling capital into higher returning development activity. And as our operational performance demonstrates, our strategy is really delivering.

Thank you for listening. That concludes today's presentation and I'll now hand over to Ian. He will coordinate the Q&A session.

Moderator:

Our first question today comes from Mike Prew of Jeffries. Please go ahead.

Mike Prew:

Yes, Mike Prew. Good morning, everybody. Hopefully you can hear me.

Colin Godfrey:

Good morning, Mike.

Mike Prew:

Morning. Very strong operationally and so you sort of disappointed on the capital side, but you can't control that. A couple of observations from me, the portfolio sales, it's good to see that companies, like yourself, aren't wedded to the assets. Can you just sort of go through your thinking in terms of selecting the assets or the package of three assets you've just sold? So speeding on from that, look at your tenant roster. How do you think about say the Ocado and the Argos covenants at the moment? And then lastly, Colin, just picking up on your last comment about good value entry points in the market etc. And the recent shakeout of capital values. Obviously got to take us back to how you think about share buybacks and you're at nearly 5% given yield and the implied yield across your portfolio is probably just a bit over 5%. Isn't a stock buyback got to be on the agenda or a little bit higher up on the agenda than it has been in the past?

Colin Godfrey:

Okay, thanks Mike. So, look firstly on the portfolio sales and we screen all of our assets regularly. Obviously we think about the way that they sit within the portfolio. Every asset is measured against total return expectations, whether we've concluded our asset management initiatives, etc. etc. So it is very much a risk return consideration. The first thing I would say is that these assets, in our view, the unexpired lease term is sub 10 years. They're old real estate. The locations we felt were not as strong as some of the assets in our portfolio and more particularly, there were their covenant strength considerations with a couple of those assets and one in particular. So they were the reasons they were selected in addition to the growth prospects that we felt that they offered. And of course the whole context behind the recycling capital from investment assets is in the first instance to deliver that into our high yielding development opportunities. Essentially recycling from a 4.6% yield initially that we're selling these investments at immediately into a sort of 6.5% percent development opportunity on a brand new asset, an asset that we are creating to really high quality. So that's the arbitrage that we are benefiting from there.

The second bit of your question I think was sort of the tenant roster looking at covenants. Look, we appraise all of our covenants regularly. Obviously we keep an eye on what's happening in the press. We talk to our customers, understanding their business, most importantly how our properties fit into those business, those business operations. And clearly, we look at the accounts regularly as well. But I think the important thing to remember is that we look behind that in terms of the quality of the real estate offer. And obviously that interlinks with our ability to capture the reversion potential that's currently vested in our portfolio at 19%. So it's really about having the strength of understanding of not just your tenant covenants, but also the quality of the real estate and what that offers for you in terms of long-term potential. Frankie, do you want to take the last part of Mike's question.

Frankie Whitehead:

Yeah, yeah, morning Mike. On share buybacks, that's something that we regularly appraise with the board. As a company stands clearly share price positioning is a big factor to that in terms of sort of broader deployment of capital opportunities, clearly we have good opportunities within the

development pipeline. As it stands today, the deployment of capital down into that channel is more accretive than share buybacks, including all risk adjusted factors. So that's the current position we will continue to monitor, but that's how we see it today.

Mike Prew:

Okay, thank you very much.

Moderator:

Thank you. And our next question comes from Allison Sun of Bank of America. Please go ahead.

Allison Sun:

Hi, good morning. I have a following up question on this disposal. Thanks. So, I understand you disposed three non-core assets, but in the future have you thought of selling maybe more mature, good quality assets where the cap rate is relatively low and use the money to invest in a higher yield generating pipeline. Thanks.

Colin Godfrey:

Thanks Allison. And the short answer is yes, we have. I think it's important to reckon... and this is a balance really for us, ensuring that we don't degrade the quality of our portfolio. We think we've got the highest quality investment portfolio in the UK. But it's also obviously playing to the market, and remembering we're coming out from a market, this was a transaction, the terms of which we agreed in December when the market was pretty weak. And in fact, if you look at the major agency benchmarking, they suggested that the market continued to soften during the course of January.

So with that in mind, I think we are particularly pleased that the pricing on that investment sale held during that period. And of course, what we did when we selectively approached... well, we were selectively approached by a number of parties, but in discussing with those parties, it's about the intelligence of understanding where the hot capital is at any point in time, and playing to the strength of that for the benefit of our shareholders. There was no point in us trying to sell something that wouldn't necessarily achieve best value at that time. So that's part of the reason why we selected those assets. But yes, we will of course look to consider the disposal of longer leased inflation-linked assets in the fullness of time.

Moderator:

Thank you. And up next we have a Neil Green of JP Morgan. Please go ahead.

Neil Green:

Hey, good morning. Could I just please ask around the guidance for 2 to 3 million square feet of development starts in '23, given the strong operational backdrop book, what's the flex around this? Are there any conditions out there that you'll be looking for as to pushing this higher or perhaps even lower, please?

Colin Godfrey:

Yeah. Okay, thanks Neil. Into the face of a really strong occupational market, we increased our guidance to 3 to 4 million square feet for 2022. That was obviously the correct decision. You've seen from our numbers that we played into the strength of that occupational market, and that's performed very, very well for us. As the economy started to weaken, we became a little more cautious in the second half of the year. We've most certainly not put our foot on the foot break, but that gave rise to what we've actually, during the course of last year, several times said that we would be reducing our guidance to 2 to 3 million square feet for 2023.

But nonetheless, we do have a very flexible platform. And so, if we manage to capture a significant amount of pre-lets, for example, or we see very strong demand for buildings in the locations where we have sites and we can respond to that with speculative activity, and those speculative buildings get let out quite quickly, then of course yes, there's the opportunity to flex up to a higher level. So, we are not being rigid about that. We will obviously react to the market circumstances and take full advantage of it through our development activity and our flexibility.

Neil Green:

Perfect, thank you.

Moderator:

Thank you. And now we're moving on to Denese Newton at Stifel, please go ahead.

Denese Newton:

Morning. Yes, just a quick question on the composition of the portfolio and development strategy. So obviously, it's four years now since you bought the Symmetry, land bank and options. I think it's fair say that the vast majority of what's been developed out of that is not bigger than half a million square foot big box. In fact, there are a substantial number of much, much smaller assets. Has that been a function of where you've been able to get planning? Has that been a function of where you've seen demand? And this diversification and assets size away from what you traditionally started doing, is that something that you see continuing in the future?

Colin Godfrey:

Should I take that one? Yeah, it's a great question Denise. And look, I think it plays to the way that we think about the market more generally. Obviously, our cornerstone strength is in the larger scale buildings. We've got very strong relationships with customers. We understand that market well. There's definitely a move to efficiency, economies scaling up efficiencies, productivity enhancements from the larger buildings through automation, etc. but we do have sites that can accommodate various sizes of buildings. We are playing to that. That gives us the opportunity to provide a full scale offer right the way through the size banding framework to all of our customers, and indeed that's enabled us to capture new customers as well. So we think it gives us greater flexibility, greater capture, improved relationships, and of course some of those smaller buildings can be just as

profitable to us as others. So we will continue to grow our ownership and development within the smaller scale category right the way through the size bands, as well as the larger scale buildings.

Denese Newton:

Thanks.

Colin Godfrey:

Pleasure.

Moderator:

Thank you. And now we're moving on to Paul May of Barclays. Please go ahead.

Paul May:

Hi team. We've got a few questions. Probably take them one or two at a time, if that's okay. Just wondered how you are looking at the broader outlook including vacancy picture, given increased spec supply, slowing demand, some subleasing, vacating from some major tenants that we've seen in some of the anecdotal commentary; just wondered how that factors into your decision making around speculative developments that you're looking to start. And then kind of link to that, how you're seeing the rental growth, which obviously slowed over the second half last year. I just wondered how the 2.3 million of deals that you signed year to date, has that been indicative of further rental growth, or is that at year-end '22 rental levels? So I've got a couple of others after that. Thanks.

Colin Godfrey:

Okay, we'll do a tag team on that one perhaps. I'll start with the vacancy level. So vacancy, as I said, moved from 1.62%. It's a pretty minor movement, quite frankly. In terms of the way we think about spec, well actually, spec is coming down. If you look at the statistics, and I think this is one of the really key points, given that most of the land is in the control of investor developers, we are seeing more prudence being applied, partly I think because the stock that had achieved planning consent was being eroded quite quickly, because of the really high levels of lettings that were taking place in the marketplace.

So I think developers are taking stock a little bit. So very crudely, Paul, I think what we are currently seeing on the ground right now is demand coming off very, very slightly from extraordinary levels that we saw before, to still very strong levels and very strong levels in the context of the longer term position. But also, the relationship between supply and demand, I think they're coming down in unison, and that's good news for rental growth. I think rental growth is... it couldn't be sustained at the level it was. It has responded to, obviously, cost price inflation as well. So that's another factor. But I think we do see the prospect of rental growth remaining attractive in the medium term, albeit at more normalised levels. Frankie …

Frankie Whitehead:

Should I just speak to the development piece? So obviously, reported ERV growth this morning of 9% over the last two years; we're around 17% of ERV growth. I think looking at the developments in-year, in terms of the 2022 starts, that is very much reflective of the headline ranks that we've captured. So broadly speaking, taking some of our spec developments where we obviously have a day one underwrite, a fixed cost base, construction cost wise, the ultimate rent that we've achieved during the construction period once let is reflective of that high single-digit, low double-digit level of growth.

Paul May:

Cool, thank you. And just following up on the vacancy, I appreciate it's low at the moment; how do you see that evolving over the next, say, 12 - 18 months given the supply demand pitch, or do you think that it will stay at very low levels?

Colin Godfrey:

Look, this is a sort of crystal ball question in some ways, Paul. I mean, we don't know what's going to happen with the economy. And I think that if the economy... if we move into recession and the recession is deeper and longer, then obviously that will have, I think, a bigger effect on vacancy. But fundamentally, the structural drivers in our marketplace remain incredibly powerful. And the customers we talk to are planning for the other side of that recession. These are longer term investments they're making with automation, etc. to optimize their business operations, to improve productivity, etc. as I mentioned. That's not going to change in the near term.

So when you think about those structural demand drivers against what I think is quite a controlled supply side actually, and if you think the backdrop to that is a planning system which is quite archaic, and it doesn't really change in terms of its flexibility. So with those dynamics in mind, I don't really see vacancy changing very, very significantly. It's probably going to track up a little bit, but not much. And that will likely remain a very favorable position for us in terms of rental growth prospects. And I do actually believe that once inflation moderates and moves to more normalized, stabilised levels, I think we do have the potential in our market for sustained medium to longer term rental growth outstripping inflation, which is a great place to be, and that will attract the investment community undoubtedly.

Paul May:

Cool, thanks very much. And then, a couple of others on... a couple on developments and one on funding. How are you looking at the outlook for capital allocation, just given development costs somewhere between five and six, depending on the tenure that you look at? That's obviously ahead of your income return, so buybacks don't really drive your income growth. Obviously, acquisitions on the short term probably don't drive income growth either, development, depending on the yield on costs that you get in terms of whether that drives income in the short term; just wondering how you're thinking about how income growth evolves from here given that funding environment.

Frankie Whitehead:

Yeah, I think broader capital allocation, we look at this on two bases. Obviously there's the income point that you mentioned, there's also the IRR point. Those developments continue to deliver very, very attractive IRRs for us. So not only are we looking to rotate capital out of the older buildings as we've done this morning, enhancing the portfolio, but we're also improving returns at the same time. So we look at it both on an income growth and an IRR perspective in terms of capital deployment, and we see our focus going forwards continuing to be weighted towards development.

Paul May:

Cool, great. And then, sorry, last two. Land options should be quite a quick one. How are those priced? Are they based on a 6% yield on cost, or an 8% yield on cost, or is it a negotiation still with the landowner? Just wonder how that pricing is. And then the final one, just a technical point, when you sell assets and you receive cash, do you receive a management fee on that cash that's being held, or are the management fees, excluding that cash?

Colin Godfrey:

Okay, I'll take the first one. So as you may recall, Paul, we don't own much land. We obviously own the land that we're developing. Most of the land we control is held under option agreements, and we buy that land, and then once we've got planning, we de-risk it, there's a value improvement point. But the price we pay for that land is subject to a discount, typically around 15% to 20% that's baked into the option agreement. So obviously, that gives us an immediate enhancement opportunity. And clearly, we don't press go on a development unless we are confident of hitting our target yield and cost range of 6% to 8%. So that's the primary driver. And more recently, it's been tracking up from the 6.5-point range towards the upper 6s.

Frankie Whitehead:

And just on the management fee question, it's NAV net of cash, and NAV excluding cash?

Paul May:

Great, thank you very much.

Ian Brown:

I'm afraid that's all the time we've got for questions. The fire alarm is about to go off, as I've been told. So I'm conscious there are a number of questions along the webcast we haven't had time to get to, but we will follow up on email to answer those. So apologies for those who've submitted questions through the webcast, but we will follow up.

Colin Godfrey:

Really appreciate everyone taking the time to join us this morning and for your questions. Thank you very much.