Chief Executive's statement

"Having made considerable progress on our strategy over the last couple of years, Landsec is well placed to drive long-term growth."

Mark Allan
Chief Executive

Actively executing on our strategy. Well positioned in a changing market.
The strategy we launched in late 2020 was based on two key principles of sustainable value creation: focusing our resources where we have a genuine competitive advantage, and maintaining a strong balance sheet. Back then, interest rates and property yields in many sectors were at or near all-time low levels, making asset values in these sectors look expensive, yet since then external market conditions have changed materially, in particular over the last 12 months. Despite enduring customer demand driving rents and occupancy higher, increasing interest rates meant the value of our portfolio was down 7.7% for the year, as an average 50bps rise in valuation yields offset an overall 3.6% ERV growth.

Whereas many slowed or paused activity in response, we have remained active, pragmatic and future-focused in executing our strategy during the year. We sold £1.4bn of London offices where our ability to add further value was limited, bringing total office disposals since late 2020 to £2.2bn, with an average yield of 4.4%, on average just 4% below book value. We selectively invested where we saw value, for example buying the debt secured on St David's, Cardiff at an implied property yield of 9.7%. We kept to programme on new developments by committing to early works during the political turmoil in the autumn whilst keeping flexibility on c. £400m of future spend, which we now expect to commit to shortly. And we issued a £400m Green bond, to pro-actively extend our sector-leading debt maturities even further.

Our areas of competitive advantage remain: i) our high-quality portfolio; ii) the strength of our customer relationships; and iii) our ability to unlock complex opportunities through our development and asset management expertise. Despite the change in market conditions, these strengths are clearly reflected in our strong operational performance during the year and we expect these to persist going forward.

This is supported by the strength of our capital base. With a 31.7% LTV and net debt/EBITDA of 7.0x at the year-end our leverage is low; at 10.3 years our average debt maturity is long; and we have no need to refinance any debt until 2026. We have also created more optionality in our attractive pipeline and as a result of our strategic choices and decisive action since late 2020, we are well placed to take advantage of the opportunities that will undoubtedly emerge in a new higher rate, higher yield environment.

Delivering continued growth in operational results

As people choose to spend time together in inspiring places, be it to work, shop or spend their leisure time, our customers increasingly focus on the best space in the best locations to attract the right talent and consumers. Building on the positive momentum our focus on growing customer relationships has started to drive over the past three years, we have delivered further growth in operational results.

EPRA EPS for the year increased to 53.1 pence, or 50.1 pence on an underlying basis, excluding the benefit of a £22m increase in surrender premiums received during the year. Underlying EPRA EPS was up 4.4% vs the prior year, towards the high end of our guidance of low to mid-single digit percentage growth. This was supported by growth in like-for-like net rental income of 6.0%, which more than offset the impact from our £1.4bn of disposals and our significant deleveraging. In line with growth in underlying earnings, our dividend for the year is up 4.3% to 38.6 pence, reflecting a dividend cover of 1.3 times.

Our strong leasing activity drove 3.6% ERV growth, with positive growth across all four segments of our portfolio, reflecting its enduring appeal to customers. Still, the sharp increase in bond yields over the past 12 months put upwards pressure on valuation yields, leaving our overall portfolio value down 7.7% for the year. Notwithstanding our strong operational results and growth in earnings, EPRA NTA per share therefore was down 11.9% to 936 pence, resulting in a total return on equity of -8.3%.

Our strategy

Our strategy is focused on three areas – Central London offices, major retail destinations and mixed-use urban neighbourhoods. Each of these benefits from growing demand for high-quality, sustainable space, which continues to drive rental growth. Whilst the proportions of use differ, there is increasingly more that unites these areas than divides them, as the lines between where people want to work, live and spend their leisure time blur. What binds these areas together is the enduring importance of a sense of place.

Whilst our strategic focus remains the right one, economic and financial market conditions have changed materially over the past year. Interest rates have risen sharply in response to higher inflation and credit conditions are tightening, resulting in reduced lending and increased credit margins. It is impossible for us to predict where interest rates will settle over time, but taking a long-term view, it seems clear to us that the ultra-low rates over the prior decade were the aberration, not the adjustment over the past year.

This is important for a number of reasons. Firstly, the strategy we set out in late 2020 was never built on a premise that low interest rates would persist forever. Neither are our actions now based on the hope that markets will just “return to normal” and interest rates come back down sharply if we wait long enough. They might, but this seems unlikely to us and hope is not a strategy, so we have not and will not base our decision-making on this. Our disposal of £1.4bn of mature offices over the past year is testament to this.

Secondly, and most importantly, this adjustment plays directly to the strengths we have been building since late 2020. At that time, it was difficult for us to find value in a world where excess liquidity and zero interest rates meant there was invariably someone prepared to borrow more at artificially low costs and pay more. However, since last summer, property values have been quick to adjust to the new reality of a higher cost of capital, similar to equities and bonds. The full effect of increased borrowing costs will likely only work its way through the system over time, but this should lead to attractive opportunities for us.

Since late 2020 our focus has been on i) focusing our new investment where we have a genuine competitive advantage that enables us to create long-term value; ii) the sale of £2.2bn of London offices where yields were low and we had little opportunity to add further value; and iii) maintaining capital discipline. As a result, we are well placed now.

To further support this, improve scalability and increase pace, we started a review of our operating model a year ago, with a view of creating a more agile, efficient culture, with less internal complexity and more external focus. We have built, or are on track to build, market-leading operating platforms in each of the three areas we operate in. We have started to see the benefits from this so despite high inflation, we expect overhead costs for the current year to reduce slightly vs last year. Supplemented by ongoing investment in our systems, we have clear visibility on the further efficiencies this will drive over time.

Whilst part of the property market is busy looking backwards to deal with leverage or refinancing issues, we have the rare opportunity to look forward to future growth. Part of this will be funded by our significant headroom and residual c.£1.6bn

Chief Executive's statement
continued

capital recycling programme. However, the extent of the opportunity in our office and mixed-use pipelines, and for accretive external growth, is such that this will likely exceed our own balance sheet capacity over time. Capital discipline remains our priority, so we plan to explore opportunities to enhance our own investment in future growth with other sources of capital, to accelerate our overall growth, capitalise on the platform value we are creating, and enhance our return on equity.

Creating value through our competitive advantages

Our value creation remains underpinned by our key competitive advantages: our high-quality portfolio; the strength of our customer relationships; and our ability to unlock complex opportunities. Customer demand continues to bifurcate, with growing demand for modern, sustainable space in those locations with the best amenities in London and fewer, but bigger and better stores in key locations in retail. Supply of both is limited, which is driving growth in rental values across our core portfolio.

In London, where 74% of our portfolio is now located in the vibrant West End and Southwark markets, up from 58% in 2020, we completed £43m of leases, on average 3% above ERV, with a further £6m in solicitors' hands, 19% ahead of ERV. As a result, occupancy increased 110bps to 95.9% and at 99.5% occupancy our West End offices are effectively full – both substantially ahead of the wider market. This drove 4.7% ERV growth, which is at the high end of our guidance. As demand for grade A space remains strong and supply is low, we expect continued low to mid single digit percent ERV growth this year.

Across our major retail destinations, where we selectively expanded our presence with our investments in Bluewater in late 2021 and St David's in March, we signed £27m of new lettings, on average 8% above ERV. This was 35% higher than the prior year and occupancy of 94.3% was up 110bps during the year, highlighting the value our revitalised platform and growing brand relationships are starting to drive. Despite cost of living challenges, we continue to see few signs of any let-up in demand for space, with £11m of lettings in solicitors' hands 11% above ERV, up 28% vs this time last year. Our portfolio saw 0.9% ERV growth last year and we expect low to mid single digit percentage ERV growth this year.

Our positive outlook for rental value growth reflects the high quality of our portfolio, as we expect overall demand for space will continue to rationalise in both retail and offices. We expect this will start to lead to a growing divergence in asset pricing. Investment activity remains thin and so the emerging stabilisation of values in recent months needs to be viewed in that context, yet we expect values for the best assets to stabilise and return to growth well before those where long-term structural demand is questionable.

This is supplemented by our ability to unlock complex opportunities, such as the discounted purchase of the debt on St David's from two separate lenders; the resolution to grant planning consent we obtained for our 1,800-homes masterplan at Finchley Road; the deal we agreed with our JV partners at Mayfield, which gives us full control of the first phase of this unique site; our success at 21 Moorfields, where our well-timed sale crystallised £145m of profit on cost; the 17.5-year lease extension with one of our top-10 customers, temporarily moving them across our estate whilst we undertake net-zero upgrade works to their existing offices; or the pre-letting of 60% of our current London pipeline well ahead of ERV.

Looking ahead, this also provides us with a clear competitive advantage in terms of future opportunities. We now have a 1.1m sq ft consented office pipeline in the West End and Southwark, deliverable into a window of a significant shortage of sustainable Grade A supply, and we could potentially start on site with two major mixed-use regeneration schemes later this year. In addition, we continue to see value in major retail destinations, where asset values have already repriced materially and our differentiated platform provides us with the ability to drive income growth. We also anticipate refinancing events could potentially unearth other opportunities, such as to acquire and upgrade well-located London offices in need of repositioning.

Driving returns

We remain decisive in our capital allocation decisions – focusing squarely on the future returns we expect our investments to generate, rather than any historical book value. The £1.4bn of offices we sold during the year are a good example of this. The two principal assets in this had generated an attractive 10% IRR over the period we had held them, but our expected forward return from the price on offer was in the mid-single digits. As this is below our return ambitions and other investment opportunities available to us, such as those outlined above, we decided to sell. We will maintain this clear discipline in the future.

Overall, we now target a total return on equity of 8-10% over time, reflecting a combination of income returns and capital growth driven by rental value growth and development upside. Short-term market fluctuations in valuation yields, which are outside of our control, mean that our return on equity is unlikely to be exactly within this range every individual year, as we have seen over the past 12 months, but this return target is what we base our medium-term decisions on.

Within this, we are focused on growing our high-quality earnings. Income has always been important, but especially so when valuations and hence NTAs reflect a greater degree of subjectivity, given that market evidence is thin. The fact that since last summer, our disposals made up c. 40% of all investment activity in the City and that there have been no transactions in major retail destinations underlines this. We are already in a strong position on this, with an attractive earnings yield at NTA of over 5%. This has now almost fully absorbed the reset in retail rents over the past few years, which has been offset by the recovery from the pandemic and growth in London. For the past year, this resulted in 4.4% growth in underlying EPRA EPS – towards the high end of our guidance of low to mid single digit growth for the year.

Looking forward, higher interest costs and cost inflation are a headwind to earnings across every sector, but this is compensated by the strengths of our business and the successful execution of our strategy:

- our long 10.3-year debt maturity, which provides visibility and underpins our sustainability of earnings;
- our capital recycling out of mature and subscale assets, into developments or acquisitions which offer greater potential to add value and generate higher income and total returns;
- our growth in like-for-like income, reflecting the strong demand for our high-quality space, especially from next year onwards once the last historically over-rented leases in retail have reset.

For the year to March 2024, we expect EPRA EPS to be broadly stable vs last year's underlying level of 50.1 pence, as we expect the positive impact from continued strong operational performance and like-for-like rental growth to be more or less offset by the fact that we have been – and in the near term will likely remain – a net seller of assets. This year we will also see the last over-rented leases in retail resetting, the start-up cost of opening three new Myo locations, and ongoing investment in our systems, which have a combined impact on earnings of c. £10m. We therefore expect EPRA EPS to return to growth for the year to March 2025. As our dividend cover is currently at the high end of our 1.2-1.3x range, we expect our dividend to grow by a low single digit percentage per year over these two years.

Delivering sustainably

Eighteen months ago we were the first UK REIT to set out a detailed net zero transition investment plan. We continue to progress the implementation of this, as delivery of this plan will ensure we stay ahead of the Minimum Energy Efficiency Standard Regulations, which require a minimum EPC B certification by 2030, as well as other regulatory requirements. So far our work has been focused on optimising building management systems and conducting the detailed design to install air source heat pumps in our office buildings. This is on track and the benefit of this in terms of higher EPC ratings will start to become visible from 2025 onwards, once our first new air source heat pumps become operational.

Shortly after the year-end, we also updated our carbon reduction targets to align with the Science Based Targets initiative's (SBTi) new Net-Zero Standard, as we remain committed to reaching net zero in the long term. We have committed to a near-term target of reducing our direct and indirect greenhouse gas emissions by 47% by 2030 from a 2020 baseline and have committed to reach net zero by 2040 from the same baseline year. This target now covers emissions from all sources, including all of our reported scope 3 emissions such as the emissions from our development pipeline, supply chain and customers.

During the year, the energy intensity of our portfolio increased marginally compared to last year, when utilisation was lower in the first months of the year after the emergence out of lockdown. Still our energy intensity was 16.6% below pre-pandemic levels and 33.2% below our 2013/14 baseline, so we remain firmly on track to reduce energy intensity by our targeted 45% by 2030. Aside from our net zero investments, we continue to focus on energy efficiency measures and have expanded the collaborative work with our largest customers to help them identify ways to save energy.

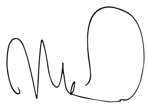
Outlook

Our strategy continues to be grounded in our purpose; Sustainable places. Connecting communities. Realising potential. In executing this, we continue to be led by three things: delivering sustainably, delivering for our customers, and being disciplined with our capital.

We expect global economic and financial uncertainty to remain elevated in the near future. The transition from a decade of ultra-loose monetary policy to a materially higher rate environment was never going to be a smooth one. The reversal of decades of globalisation and associated inflationary pressures will also continue to affect economic prospects, for the UK further exacerbated by the impact of Brexit. Positively, the political situation in the UK has stabilised somewhat since late last year and despite all uncertainties, our strategic decisions since late 2020 mean we are in great shape for any eventuality:

- our portfolio is well-located and its quality is high, which are decisive factors for our customers;
- our balance sheet strength is sector-leading, with 7.0x net debt/EBITDA and 10.3-year debt maturity;
- we have sold over £2bn of mature assets, creating capacity to invest in higher-return opportunities;
- we have created an attractive and profitable pipeline, with flexibility on future commitments.

Reflecting the continued strong demand for our best-in-class space, we expect to see low to mid single digit ERV growth in London and major retail destinations this year. We plan to continue to monetise assets where our ability to add further value is limited, so taking into account that we will likely sell more than we buy in the short term, we expect EPRA EPS for this year to be broadly stable at last year's underlying level, before returning to growth the year after. Having made considerable progress on our strategy over the last couple of years, Landsec is well placed to drive long-term growth and although we are mindful of the wider economic challenges, we are excited about the future.



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