GREAT PORTLAND ESTATES

Great Portland Estates

Annual Results 2017/18

Interview with Toby Courtauld, CEO and Nick Sanderson, FD

Q: Toby, the full-year results delivered today are stronger than anticipated. Why is that?

TC: First of all, the results are strong. We're delighted to be able to report NAV up 5.8% and earnings up 17.9%. I think the reason they are strong is because we have been delivering what we said we were going to deliver, which is: good rental growth, like for like up 7%; lots of lettings; some very good sales £329 million worth of sales across the year, at a good premium to the underlying book value of about 5.4%. I think they're stronger than expected, and slightly ahead of consensus, because, principally, the rents that we have been achieving have been better than were expected and we've made some great sales as well, slightly ahead of expectation. Plus, into the mix we've also returned, successfully to shareholders, more than £400 million of capital, which is added to our performance for the year.

Q: Nick, how do you view the financial performance and the strong earnings growth?

NS: I think it's a good performance. Let's bear in mind we're in a market that is broadly tracking sideways, so the performance that we're delivering is as a result of our actions. As Toby touched on, our key financial performance metric - NAV per share - was up just under 6% over the course of the year. There were some one-offs within that. On the one hand, the increase through the share consolidations associated with capital return, on the other, some reductions to NAV through our liability management activities. Crucially, we saw the values moving up by 2.9%. Within that, we had yield compression, which we'd created through delivery of developments and pre-lettings. EPS, as Toby touched on, up 18%, driven by strong NRI growth and what that has allowed us to do is to grow the final dividend, up by 14%, bringing the full-year dividend up by 12%, and, all the while, maintain our exceptionally strong financial position. The profitable sales allowed us to give back, through the course of the year, £416 million to shareholders. At the same time, LTV remains low today, at 12%. We have more than £600 million worth of liquidity and cash resources and we've been busy on the refinancing side, bringing our cost of debt down to only 2.3%, we believe, the lowest of any UK-only REIT.

Q: Toby, how do you feel about the demand for office and retail space in Central London? You said that it's difficult to gauge. Is it still pretty much that way?

TC: I think there are some slightly confusing aspects of the market in London at the moment. On the one hand, you have got measures of confidence, as shown by, for example, the Deloitte CFO Survey, which suggests that confidence levels are down. On the other hand, you have got take-up which has been running ahead of the 10-year average, so that's offices being leased up. You have got identified demand for offices running slightly ahead of the 10-year average as well. Our own leasing statistics, as Nick has just highlighted, suggesting that we are at, or near, record territory in the amount of space we're letting. You've got these slightly conflicting statistics, which is a little confusing.

I think what's really happening in London at the moment is it's playing on its global strength. We're still pulling people into London to work, despite all the uncertainties that are out there. I don't think that's necessarily slowing down at the moment. I feel, if we look at our leasing statistics today, we're still generating good interest for our space. We have about £5 million worth of rent either done, or under offer at the minute, since the year end. We're still beating ERV and, so, we're still seeing tenants wanting to come and lease space from us, which is encouraging for the future.

It is, however, still a little unclear as to the way markets will trend for the rest of this year. That's why, rather like last year, the range that we're forecasting is down a little bit, to up a little bit. We think we'll be at the better end of that spectrum, but it isn't significant decline, nor is it significant growth.

Q: Have you been priced out of the investment market? If so, are you likely to give more cash back to shareholders?

NS: There is no doubt the investment market is incredibly competitive at the moment. We think there's around £37 billion of equity looking to invest within Central London at the moment. We made one acquisition in the year. It was in Whitechapel. It's now part of the development programme. It's right next door to a Crossrail station, so there's lots of opportunity to come from it. Most of the things that we've been looking at, either we've been outbid by others, or, more regularly, we found vendors holding out for aspirational pricing that we just can't meet. One of the things that we certainly won't be doing is lowering our investment hurdles, moving away from our capital allocation discipline. It will mean that we will need to retain the patience which we have. That's fine.

In terms of further returns of capital to shareholders, let's wait and see. We expect to be a net seller again over the course of the next 12 months. Let's see how they play out. We've got nothing in the market at the moment of scale, so I wouldn't be expecting a further return of capital any time imminently. However, let's see how things go. As you know, we're happy to give capital back to shareholders if it ensures that, on the one hand, we maintain an efficient balance sheet. Also, shrinking the size of the business to us, we see as a plus, rather than a minus. It particularly allows us to push forward with our developments, which will have a bigger impact on the overall results of the business.

Particularly, bearing in mind, today, 48% of the portfolio is in the development programme, either on-site, or potentially to be committed over the next 5 to 10 years. We already have the pipeline of opportunity which will drive organic growth, from here, through the next cycle.

Q: Toby, what guidance are you giving today?

TC: We're giving guidance, at the rental level, of down 2.5%, to up 1% for the year. That's from March 2018 through to March 2019. In November last year we were guiding down 2.5%, to plus 1.5%, and we ended up delivering plus 0.3%. I think this year given the experience we're having at the minute in leasing, I suspect that we will be towards the top end of that range. As I said earlier, let's wait and see. I think the other guidance that we're giving, that's just as important, is the net sales guidance. I don't think we are likely to see much by way of acquisition.

We think there's not a huge amount of value out there at the moment for the sorts of things that we like to buy. There's a lot of competition for those sorts of assets. Whereas, we have identified a number of buildings that we have improved significantly over the past few years, and which will sell very handsomely today, and I suspect we'll be doing that as this year progresses.

Disposals and Acquisitions

Q: You talked about delivering a £400 million disposal programme. How has that gone?

TC; It's gone well. We've delivered it. We sold £329 million in the year. Since the year, we've sold just shy of another £50 million. They're all well ahead of book value. They are assets that we developed ourselves and created the value through planning and leasing and development. They're all buildings where we see limited future upside for us and little amounts of activity for us to bring to those assets, so they don't hold much for us. They're better in somebody else's hands. With that capital, we can then redeploy it much more productively into our existing pipeline of developments. We have started three new schemes in the most recent few months which will consume several hundred million pounds worth of capital. Obviously, we've got another 13 projects that we're working on in our longer-term pipeline, which will also need capital to bring them into production over the next couple of years.

Q: So, Nick, what's next, because as you've said you're going to be net sellers?

NS: We've been a net seller now for the last five consecutive years. There have really been two reasons behind that. One - we've had very elevated pricing in the investment market. We still have that today. Two - we've been delivering our business plans. We re-underwrite every asset, every quarter, look at the prospective returns, and if those returns don't deliver a sufficient premium to our cost of capital for the risk associated with them, they typically find their way into the investment market for sales. If we look at the portfolio today, we have around 16% in our long-dated bucket. These are assets that we created. They're typically shiny, long let to strong covenants.

On most cases we've captured all of the reversion, so I think there's a good chance that these assets will find their way into the sales hopper over the course of the next 12 months. With the investment market being as tight as it is, and so too the opportunities to buy in the market, I think we do expect to be a net seller for the next 12 months.

Q: Toby, acquisitions have been hard to come by. When do you think that's going to change?

TC: That's an impossible question to answer. I think for it to change in the sort of area that we like buying in - let's just be clear what that is. We're not interested in the shiny product. That's typically what we create and then we can sell. We're looking for raw material that we can improve and create value through the planning process, the development process, the re-arrangement process of some sort. We call it repositioning. Those sorts of buildings at the minute are actually very aggressively bid over. The forward rates of return off the prices being offered at the minute, typically, are not as attractive as the rates of return we can make through putting that capital into our own business. We're far happier investing internally at the moment, for internal growth, organic growth as we call it. That will be in development and it will be in refurbishment.

Until such time as that relative balance changes, and, suddenly, you can pick up assets at prices in the market that are accretive to our existing business, we're going to carry on being an investor internally, rather than in the market. The question, I guess, is, what will change that balance. I would imagine it's - it could be a number of things. It could be interest rates rising much more quickly than people expect. It could be sterling recovering, pushing away overseas buyers, who, quite often, are coming in to pick up some of these assets. It could be a loss of confidence. It could be something that just creates a downdraught of confidence that means prices move in our favour. Until that happens, we don't need to buy, so we won't buy. Instead, we'll invest in our existing business for growth, which is going very well at the moment.

Portfolio Management

Q: Nick, talk me through your leasing activity in the year and what it's delivered for you.

NS: It's been an exceptionally good leasing year; new lettings of £31 million; on average, just shy of 3% premium to ERV. Within that, a record year for investment lettings; £19 million of rent secured. On the development side, two major pre-lets, both to blue-chip covenants, both on 15-year leases, one at Old Street, one at Hanover Square, together, securing more £11 million worth of new rent. The team has also been very successful in capturing reversion. We've settled rent reviews totalling £18 million this year, on average, at a 30% premium to the previous passing rent. As we look forward from here, there's more to come. Reversion, today, sits at around 12% potential, so plenty to go for there. Our average office rent today is only £55 a square foot. Don't forget, 88% of the portfolio is within walking distance of a Crossrail station, and Crossrail opens later this year, so there's plenty more for us to go for on the leasing side.

TC: In the middle of which, one of the things we're also doing when we think about leasing space as attractively as we can, is giving over some of it to, what we're calling, a flex space idea, in which we're offering fully-fitted space to new occupiers who come to join us. They can walk in and plug and play straight away. That's a product that we haven't had before and it's one that's already generating revenue growth that's significantly faster than we've been generating from our more traditional means, circa 35% ahead of what we call net effective ERV, so that's a positive addition to the leasing space for us too.

Developments and Balance Sheet

Q: As you said, you've committed to three new developments. Are you feeling more bullish about your pipeline?

TC: No, I wouldn't say we're feeling more bullish. I think we're pretty much the same as we were in November. In fact, even this time last year we were talking about bringing forward these three projects. Certainly, in the case of Hanover Square - our largest of those three - it's a project we've been working hard on to bring into production. The thing that's changed since this time last year, of course, is that we've let a good proportion of it, roughly a quarter of it, in a single office letting, at new rents for this micro-location, right above a Crossrail station. That's a huge positive endorsement for this scheme before we even own the land on which we're going to develop the building. That's a big change since this time last year.

I think, overall, these have been very high-quality projects in the planning for a while. We've always wanted to get on and do them, in the case of Hanover, above Crossrail, in a great Mayfair location. The other two being Oxford Street east, at the east end, right beside our Rathbone Square project that was so successful a few years ago, and, again, opposite Crossrail. Then, in Whitechapel, a building we bought last year, again, within walking distance of Crossrail, off a good entry price, so we're giving ourselves lots of flexibility there. All three, very high-quality schemes that will stand us in good stead for some while to come.

Q: What about beyond those three schemes?

TC: There are another 13 projects in the pipeline, some 1.3 million square feet. A real mix, all in Central London, obviously, exposed to Crossrail, roughly a third of them, core West End. A couple of schemes in the Southbank, again, very near great transport interchanges. We reckon we'll have four planning applications going in this year, so quite a lot of work to get those ready to go. The timing of each of those projects will depend upon planning. It'll depend upon local market dynamics. Of course, it'll depend upon the macro story as well. It's a great position to be in. As Nick said earlier, with nearly 50% of our portfolio in our development programme, either near-term three, or, longer-term 13, we've got a huge amount of raw material for us to be working with. That's a great place to start.

Q: Nick, your debt is at relative lows. How do you view the leverage and the strength of your balance sheet?

NS: It's fair to say that, at the year end, LTV was at an unprecedented low of 2%. Since then, transactions, including the payment of £306 million to our shareholders, means that LTV today is at 12%. That feels like a great place to be in the context of where we are in the cycle and also the new development commitments that we've made. What's been particularly pleasing has been some of the refinancing that the team has done over the course of the last 12 months, taking out expensive legacy-secured debt, replacing it with low-coupon flexible unsecured debt. As a result of that, our debt metrics are as good as they've ever been. Our weighted average interest rate, today, is at the lowest-ever level, of 2.3%. Nearly 90% of our debt is on a flexible unsecured basis. We've pushed out our debt maturity to just under six years. We have more than £600 million of cash and liquidity. The balance sheet is in great shape.

Q: That's today. Where do you see the debt leverage going forward?

NS: One thing I can say with great confidence is the leverage will not be shooting up aggressively from where it is today. As I said, 12% LTV today. We like to move it within a band of 10% at the bottom, 40% at the top. If we look at the recent development commitments that we've made, and overlay a little bit of refurbishment CapEx, that would take LTV to around 20%, all else equal, which leaves us plenty of acquisition capacity, should opportunities emerge. At the same time, we expect to be a net seller over the course of the next 12 months, so it could well be the leverage stays at similar levels as it is today, or even lower still. If that were to transpire, would we give back more capital to shareholders? As I said earlier, maybe we will do. Let's wait and see how things play out. What I would say about our leverage is that it's low cost, it's flexible and, perhaps, most importantly of all, it gives us optionality.

Outlook

Q: Toby, what's the outlook?

TC: I think the outlook is very good. The context within which we put out our outlook is, clearly, uncertain. There are many unknowns out there from a macro-economic standpoint, let alone our relationship with Europe and other trading nations. If you just put that aside for a second, and look at the shape of the company as it stands today, I think we can be very confident about the outlook for GPE. We've got a fantastic collection of assets, raw material that we can create value from. It's all in Central London, which is still an economy that, consensus forecasts suggest, will grow quicker than the UK overall, by some margin. It's still attracting people to come and work in it. It's got a huge amount of investment that's about to open, in fact, the largest investment in public infrastructure since the Victorian era, in Crossrail.

We have more exposure to Crossrail than any of the other listed office REITs. Within our portfolio, as I say, lots of potential for growth off relatively rents, in the mid 50’s £ per square foot. I think we can feel very confident about our outlook. If you wrap around all of that, the financial strength that Nick has just outlined, we've got the ability to exploit market weakness if we find it. If we don't find it, because it doesn't exist, we've got a portfolio that we can invest in for organic growth for many years to come.

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