

Chief Executive's report

A clear and decisive line

—Francis Salway, Chief Executive, reports

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This year the UK commercial property sector saw the sharpest fall in capital values on record. Occupiers and property investors were affected by wider economic, financial and commercial dynamics, and this impacted property values profoundly. We have not been immune to these exceptional conditions, experiencing a write-down on the valuation of our investment properties of 34.2% which created a very substantial pre-tax loss.

The reduction in property values was driven largely by yield repricing. However, as the economy moved into recession in the second half of the year, we also saw weaker demand from occupiers and pressure on rental values. Rental values were down 9.3% across our portfolio, ranging from a reduction of 3.8% on our retail assets to 19.8% on our London offices.

Our portfolio underperformed our benchmark, the IPD Quarterly Universe, in terms of ungeared total property returns (-29.7% versus -25.5%) [Table 8](#). However, some four-fifths of this underperformance was attributable to our portfolio mix, as shopping centres, retail warehouses and London offices have been the weakest performing segments of the UK market. Our relative performance was also affected by our development projects and pre-development sites which have been hardest hit by the downturn.

Our response to the downturn was guided by two clear priorities – to protect shareholder value today while ensuring we are well positioned to compete and thrive tomorrow. Our actions were decisive and pragmatic. We made an early decision to defer key developments. We continued to make disposals, achieving over £500m of property sales in a deteriorating market. And we moved quickly to reduce the Company's administrative cost base by some 10%. We were not afraid to stop our proposed demerger and we made the tough but correct decision to sell Trillium. At the same time, we used our exceptional asset management skills to maintain revenue, we successfully opened two major retail developments and we laid the foundations for future opportunities as the economy recovers.

The tough decisions that we have taken over the year have strengthened our balance sheet and created resilience in a difficult and deteriorating environment. As in previous downturns, the Company sought to navigate a clear and decisive line through the turbulence and we are in sound shape as a result.

Rapidly evolving market

We had anticipated some degree of slowdown in the commercial property market in spring 2007 and, in response, sold £1.56bn of assets in the year to March 2008. These sales assisted us as conditions weakened further in 2008. In September 2008 we saw an extraordinary acceleration of the decline in the property market and in the economy, and this brought our earlier actions into sharp focus. We recognised that we needed to respond further and we did.

First, we continued to make sales despite fewer buyers and anxiety around pricing. These disposals helped to strengthen our balance sheet. Long-term success in our market requires a steady nerve through all points of the cycle, but particularly when selling in a downturn. We will continue to make disposals and recycle our capital effectively, both to maintain balance sheet strength and to ensure that our portfolio is positioned for growth as the market turns and recovers.

In January we also sold Trillium for a cash consideration of £444m, to generate total income and capital receipts from this business since April 2008 of £750m (including the buyer's assumption of Trillium's debt). Trillium has played a tremendous role in the evolution of Land Securities over recent years, but it was clear that the capital we could realise from the disposal of this specialist business would prove invaluable in current conditions. Relatively few disposals of property businesses went through during the year, so this successful transaction again underlines our ability to complete sales in a challenging environment. Under our management Trillium produced a return on capital materially better than conventional investment property, and I would like to thank the employees of Trillium for their dedication and contribution.

Successful Rights Issue

Early in 2009 we made the decision to strengthen our financial position further through a Rights Issue. Our effective actions during the year meant we were able to minimise our call on shareholders' resources, and the issue closed on 24 March 2009 having raised the targeted £756m. This fresh capital has helped to restore the balance of our equity and debt capital, and it will help mitigate the effect on shareholders' funds of any further falls in property values. It will also ensure we are ready and able to react quickly when we identify opportunities beneficial to shareholders.

Given the Rights Issue, the sale of Trillium and the challenging market conditions facing the Group, the Board took the decision to reset the dividend and the final quarterly dividend has been proposed at 7.0p per share. This was done to ensure that our dividend remains realistic and sustainable in light of the factors which will affect our future earnings. We believe the new level will provide a secure platform from which we can work to deliver future growth in dividends over time.

Spreading risk through a diverse tenant mix

The long-term nature of our contracts with customers provides us with resilience of income even at a time when rental values are falling. This is reflected in our revenue profit for the year of £314.9m, which is up 10.6% with broadly stable income and lower interest payments.

It is always regrettable when retailers go out of business and this year proved extremely demanding for many. Like other property owners, we have suffered from retailer insolvencies but, across the Group as a whole, only 3.8% of our total income is in administration. We have been proactive in response, working hard to support our tenants and protect our own position. We have continuing income from approximately 15% of the units currently in administration.

For some time we have mitigated risk by developing a diverse mix of customers. Our largest retail customer, Arcadia Group, represents just 1.7% of our total investment portfolio income. Our only substantial exposure to a single occupier is to the counterparty of choice, Central Government, who account for 9.5% of our total portfolio income. By maintaining close relationships with this diverse mix of tenants we kept the increase in underlying voids across our like-for-like investment portfolio to just 1.1% (from 3.5% to 4.6%) – another strong relative performance.

Pragmatic timing on development

In line with our medium-term planning, we entered the year with a significantly lower level of developments due for completion than at the peak of the market cycle in 2007. However, it was vital to achieve lettings success on the two principal developments completed in the year – the shopping centres in Bristol and Livingston. Here we achieved occupancy levels of 91% and 80% respectively at year-end, which confirms the attractive qualities of the two schemes. Quality was again recognised when Cabot Circus won The British Council of Shopping Centres' Supreme Gold Award and was named Best Shopping Centre of the Year in the MAPIC EG Retail Awards.

Leasing prospects for the developments coming through now – Dashwood House in the City and our St David's 2 joint venture with Liberty International in Cardiff – have proved more challenging. These were respectively 9% and 47% let or in solicitors' hands at year-end. It is helpful to put this in context. The projected income on unlet space at Dashwood House represents just 2.1% of our total London office portfolio income. And our share of the projected income on the remaining vacant space at St David's 2 represents 2.3% of the Retail Portfolio's total income. The pace of lettings at St David's 2 is increasing as we move towards opening in the autumn.

Our history shows that we are not afraid to take tough development decisions. In summer 2002, for example, we deferred New Street Square by 12 to 18 months and this proved enormously beneficial in terms of the total returns on the project. This year we again took bold decisions on timing, opting to defer the start dates for our schemes such as 20 Fenchurch Street, EC3, Trinity Quarter, Leeds and Ebbsfleet Valley in Kent. We remain ready to take further similar decisions as appropriate, despite their potential impact on earnings in the short term.

While we are cautious on timing today, we continue to create excellent opportunities for tomorrow **Chart 9**. This year we secured planning consent for substantial schemes in the West End, including the landmark Victoria Transport Interchange plan (VTI2), together with Selborne House and Wellington House in Victoria, SW1. The short-term outlook for the London office market remains challenging, but we expect tight development supply constraints in the West End to drive a resumption of growth in the medium term. The success of our office and retail development at Cardinal Place, SW1 confirms our ability to understand and lead the Victoria office market transformation.

Adding value for customers

Throughout the year we worked proactively to support our tenants and ensure our products are designed to meet the changing needs of businesses. To assist this, we moved our property management teams into the London and Retail Portfolios so they could work in closer partnership with customers and colleagues.

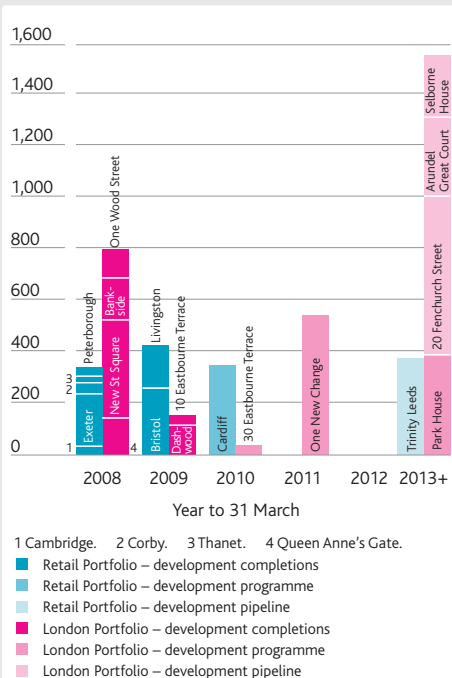
In London, we helped existing and prospective tenants respond to tough market conditions by offering flexible lease terms, addressing service charge costs, engaging in discussions on rate levels and offering some short-term cost-effective space opportunities. In Retail, we were one of the first organisations to propose a basis for switching to monthly rents for retailers and we worked in partnership with tenants to reduce service charges.

Table 8
Total property returns (%)

	Land Securities	IPD
2008	-3.2	-9.1
2009	-29.7	-25.5

Source: IPD

Chart 9
Timing of completion of development programme (total development cost £m)



Of course, we want to do even more, and we continue to focus on removing unnecessary cost for tenants to help them in the current climate. I am pleased that all our efforts on customer service were recognised when we were named Retail Landlord of the Year 2008 in the Property Managers Association awards. Recent independent customer satisfaction surveys have confirmed our standing, with one measure recording a 97% 'willingness to recommend' Land Securities as a shopping centre landlord¹.

Sustainability remains a priority

We see no conflict between sustainability and profitability. Quite the reverse. Good practice makes us a stronger business. By combining a long-term view with innovative action today we are able to meet the changing needs and expectations of tenants, local authorities, our employees and the general public. This approach produces clear commercial benefits; helping us gain permission for new developments, reducing property running costs, attracting new tenants and mitigating risks around future environmental legislation.

Our work has earned widespread recognition. We have been included in the Dow Jones Sustainability Index each year since its launch in 2000 and are now the global leader for sustainability in the Real Estate sector. This year Cabot Circus became the first major shopping centre to be awarded an 'Excellent' rating in the BREEM environmental assessment scheme, and The Elements in Livingston was the first enclosed shopping centre in the UK to achieve this accolade. We believe the groundbreaking work on energy generation and distribution planned for our new developments, such as the Victoria Transport Interchange plan, will underline our position as a leader on sustainability.

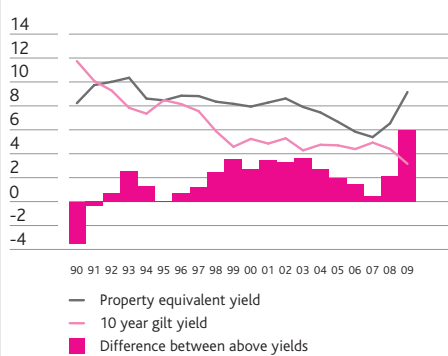
Outlook

We expect property market conditions to remain challenging, with vacancy rates rising as businesses fail or contract and, as a result, rental values weaken. These trends will put downward pressure on our rental income. Occupational markets will display the full impact of economic conditions relatively late in the cycle, so we expect the period of recovery in our sector to be extended. Investment property pricing may reach a turning point ahead of the rental markets, and the yield gap between property yields [Chart 10](#) and gilts or cash on deposit can be expected to stimulate some buying interest. Indeed, this is just beginning to become apparent for well-let prime properties. Whether the market cycle changes quickly or slowly, we will remain patient, making well-timed transactions that fit with our strategy, skills and strengths.

In the meantime, we will continue to take a positive and pragmatic approach to managing through the downturn – acting decisively, protecting value and planning for the future. We will respond to changing conditions quickly. We will take difficult decisions as and when required. And we will use our strengthened balance sheet to address future growth opportunities at the right point in the cycle.

This has been an exceptionally turbulent period in our market, but our experience tells us that out of adversity comes opportunity, and that the companies who manage successfully through the downturn emerge even stronger in the upturn. I believe Land Securities' ability to react to the challenges of today while maintaining a long-term perspective on value generation for tomorrow stands us in good stead.

Chart 10
Property yield pricing relative to gilt yields (%)



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¹Kingsley Lipsey Morgan Retailer Satisfaction Study 2008. The 2008 figure represents an increase of 3% on 2007.