Land and Property Committee

TRANSPORT FOR LONDON
EVERY JOURNEY MATTERS

Date: 18 October 2022

Item: TTL Properties Limited Half-Year Performance

This paper will be considered in public

1 Summary

1.1 This paper summarises the financial and operational performance of TTL Properties Limited (TTLP) in the first half of 2022/23. It should be considered in conjunction with the paper on Investment, Business and Corporate Planning 2023/24, elsewhere on the agenda, which sets out the strategic activity TTLP is undertaking over the next six months to be ready for the financial year 2023/24.

2 Recommendation

2.1 **The Committee is asked to note the paper.**

3 Market Context

3.1 The economic outlook in the first half of 2022/23 has been increasingly challenging. For most of this year, the real estate market has remained resilient, however rising interest rates and inflationary pressures feeding through to a cost-of-living crisis are worsening the short-term outlook.

3.2 Property forecasts from Property Market Analysis LLP (PMA), a leading independent real estate research consultancy, indicate capital values falling substantially over the next three years as yields move out, with income driving positive total returns before values rise from 2025. London is forecast to perform more strongly than the rest of UK, with the residential sector expected to out-perform commercial property.

3.3 House prices are expected to fall over the next two years before recovering. Significant pricing pressures are being experience in the residential lettings market, particularly in central London (see the tables below).

Table 1 – House Price Projections (Source: Knight Frank)

	2022	2023	2024	2025	2026	5-Year Change
UK	6%	(5%)	(5%)	2%	4%	1.5%
Greater London	3%	(6%)	(4%)	3%	5%	0.5%
Prime Central London	3.5%	(3%)	0%	3%	4%	7.5%
Prime Outer London	5%	(4%)	0%	2.5%	2.5%	5.9%

Table 2 – Rent Level Projections (Source: Knight Frank)

	2022	2023	2024	2025	2026	5-Year Change
UK	5%	4%	4%	3%	3%	20.5%
Greater London	7%	5%	3%	3%	3%	22.8%
Prime Central London	15%	6%	3.5%	3%	3%	33.9%
Prime Outer London	12%	6%	3.5%	3%	3%	30.4%

3.4 Despite the volatility being witnessed in the financial and capital markets, London's office leasing markets continue to be relatively stable. Active demand for office space has increased, vacancy levels have fallen, and pre-letting remains healthy on new office space, demonstrating occupiers' continued willingness to commit to the best located and most sustainable offices.

3.5 Retail is showing increasing signs of slowing demand, especially given the pressure on household budgets. For businesses, the impact of the cost-of-living crisis is twofold: a reduction in footfall and customer spend, and a higher cost of operating due to rising fuel, electricity and commodity prices.

3.6 There are continued shortages of labour and rising materials and construction costs as well as cost of funds. TTLP is closely monitoring the potential impact on its development programme given the intention to start construction on over 2,700 homes in the next six months (see paragraph 7.3 below).

4 Financial Performance

Operating Profit and Margin

4.1 The Investment Strategy and Business Plan paper, shared with the Committee at its meeting on 30 June 2022, set out the following Sustainable Net Income targets for TTLP: increase gross annual operating income from £69m in 2021/22 to £187m in 2030/31; and achieve a market-competitive operating margin.

4.2 Year-to-date net income is £9.9m, £3.0m (43 per cent) higher than budget and £3.1m (46 per cent) higher than the same period last year. The net income is driven by income of £37.6m exceeding budget by £1.5m (4 per cent) and costs of £27.6m being below budget by £1.5m (5 per cent) – see Table 3 below.

Table 3 – TTLP Net Income

	Mid-Year			Full-Year	
	Actual (£m)	Budget (£m)	Variance (£m)	Q1 Forecast (£m)	Budget (£m)
Total Income	37.6	36.0	1.5	98.1	95.5
Total Costs	(27.6)	(29.1)	1.5	(66.4)	(67.4)
Net Income	9.9	6.9	3.0	31.6	28.1
Operating Margin	26%	19%		32%	29%

4.3 TTLP's operating margin stands at 26 per cent against a mid-year budget of 19 per cent. While progress has been made, the improvement in operating margin will need to be maintained with TTLP targeting a 50 per cent operating margin by 2025/26. The plan to address property income and operating margin is outlined in the Investment, Business and Corporate Planning 2023/24 paper elsewhere on the agenda.

Income

4.4 Year-to-date income is higher than budget by £1.5m. This is driven by increased income from both car parking and the arches estate. Car parking utilisation has increased as people have returned to work following the pandemic. The arches portfolio has benefited from an integrated and focused approach on lettings, rent reviews and lease renewals – and a similar model will now be rolled out to other sectors. Retail has performed less well in difficult trading conditions.

4.5 Reducing voids is key to driving income further in the short term. TTLP has a void rate of 9.4 per cent against a market level of 9.7 per cent as measured by the MSCI[1]. One key focus is empty units which are classified as 'project voids,' i.e. those needing major works to bring them back into usage. The budget did not adequately reflect the time taken to mobilise these projects (see 6.16 below). With additional resource and targeted procurement support, TTLP will accelerate its work in this area. Similarly, TTLP has properties that are under offer and the new TTLP Asset Management function will be working to improve the speed at which these move into contract.

4.6 While it is expected that income will hit the budget for the year, there is further opportunity for growth even over the short term.

Costs

4.7 Year to date costs are below budget by £1.5m. Utilities, maintenance and rates costs from void properties are above budget by £1.2m. Utilities costs reflect the volatility in the market for energy; maintenance is impacted by the long-term

[1] MSCI Inc. is a leading global provider of tools and services for the global investment community, including real estate indexes.

under-investment in the estate driving reactive maintenance, which is harder to control and predict, and voids are a key contributor to rates costs recovery and, as noted above, a key management focus. These costs have been offset by lower than anticipated professional and management fees. Furthermore, some Property Development feasibility and TTLP programme costs have been rephased into next year.

4.8 The bad debt charge is £1.5m against a budget of £2.2m, due to improved collection performance. The overall bad debt provision is currently £18.8m. TTLP is applying a very prudent assumption of 100 per cent of overdue rents. This will be reviewed in the next business plan and budget.

4.9 Work is underway to get a much more granular view of costs, including being able to allocate cost by sector (e.g. retail) and by unit. The Investment, Business and Corporate Planning 2023/24 paper elsewhere on the agenda sets out key areas of focus to strategically review TTLP's cost base.

5 Capital

5.1 During the first half of this year, capital expenditure of (£18.5m) has been incurred on projects against a budget of (£71.5m). Capital income was £3.6m against a budget of £55.8m. The overall net capital position is (£14.8m) versus a budget of (£15.7m) – see Table 4 below.

Table 4 – TTLP Net Capital

	Actual (£m)	Budget (£m)	Variance (£m)	Q1 Forecast (£m)	Budget (£m)
Development Receipts	0.1	44.0	(43.9)	75.5	65.2
Disposals Receipts	3.5	11.8	(8.3)	31.5	39.2
Total Capital Income	**3.6**	**55.8**	**(52.2)**	**107.0**	**104.4**
Asset Management	(4.3)	(21.4)	17.1	(33.9)	(53.9)
Property Development	(13.8)	(49.1)	35.3	(101.0)	(99.7)
TTLP Corporate	(0.4)	(1.0)	0.7	(1.0)	(2.2)
Total Capital Expenditure	**(18.5)**	**(71.5)**	**53.1**	**(136.0)**	**(155.9)**
Net Capital	**(14.8)**	**(15.7)**	**0.9**	**(28.9)**	**(51.5)**

5.2 The main variance is due to movement in the timing of the Build to Rent sites at Montford Place, Nine Elms and Southall, all delayed by market factors but still expected to be delivered during the remainder of 2022/23 (see paragraph 7.6 below). It was anticipated that land receipts of £43.7m would have been achieved on these schemes, along with a corresponding £26.2m reinvestment as equity into Connected Living London (CLL), TTLP's Build to Rent joint venture with Grainger.

5.3 In addition, significant underspends occurred in Asset Management with delays in a number of projects including at Whitechapel and Liverpool Street (see Projects below).

5.4 Some reductions in capital expenditure were also experienced in In-Station Retail (ISR) as the ISR capital programme was reprioritised to support the letting of existing units rather than the development of new units, given wider challenges in the retail sector.

5.5 An improvement in the ability of TTLP to drive forward capital delivery is now a critical workstream for TTLP, and this is discussed below. Delays to projects have a direct impact on the income growth outlined in TTLP's Business Plan.

5.6 There was a shortfall on other capital receipts of £8.3m relating to disposals of land. Contracts have been exchanged with completion subject to planning consents being achieved – and these are still awaited from the relevant Local Planning Authorities. TTLP is forecasting disposal receipts of £39.2m by year end, and these are an important part of the funding of TTLP's investment plan.

Valuation Movement and Asset Transfers

5.7 TTLP's gross asset value stands at £1.86bn, up from £1.76bn in March 2022. The growth has been achieved through the transfer of £95.7m of assets into the balance sheet since the year end, largely comprising Hackney Arches assets and the Wembley Park development site. By year end it is forecast that a further £80m of income-producing assets and £145m of development assets will be transferred from TfL into TTLP.

5.8 There is a clear expectation that year-end valuations will fall on a like-for-like basis as yields move out due to cost of debt and inflation. This will however have no material bearing on the long-term performance of TTLP, given the prudent assumptions and strong capital discipline targets maintained in TTLP's financing.

6 Operational Performance

6.1 Alongside TTLP adopting a new organisational structure based on the TfL Value Chain, there is a plan to move to an operating model where asset classes or 'sectors' – such as retail, arches or commercial office – are effectively operated as businesses in their own right.

6.2 The profit and loss of each sector will be independently monitored, and each sector's results will be directly comparable with the external market. Critically each sector will have access to the resources and systems it requires to deliver the targets in the TTLP Investment and Environmental, Social, and Governance (ESG) Strategies. This follows a successful pilot on the Arches estate, where the team has been increasingly integrated and operating as a single function under unified management.

Health and Safety

6.3 Improving the monitoring of health and safety was an early priority of TTLP. In April 2022, a new compliance function was created. Since then, there have been 1,158 completed safety visits (72 per cent of the portfolio). The team has issued 20 severe non-compliance warning notices to tenants where there was evidence of imminent risk to life or the potential to cause serious harm to persons or requiring the closure of the station and / or unit.

6.4 Tenants have generally responded promptly to the notices raised. In two cases however the concerns were sufficiently serious and the responses wholly inadequate – and these tenancies at will are being terminated as a matter of last resort.

6.5 It is becoming evident that a proportion of the tenants have limited knowledge of their statutory responsibilities and / or hold only limited statutory compliance documents. There is a clear requirement to educate tenants on their responsibilities and to ensure they have all the information they need provided to them in an easy and understandable format. TTLP is also reviewing which elements of health and safety practice are best undertaken by TTLP rather than tenants, given TTLP’s additional resources and experience.

Sectors – Arches

6.6 Over the last six months the Arches operating margin and net operating income have improved as a result of active asset management. The Arches team is now targeting to exceed its budgeted income by £2m (22 per cent).

6.7 The team has been concentrating on the recovery of arrears of 90+ days debt, on time completion of rent reviews, completion of both legacy and due lease renewals prior to lease expiry date, and development schemes (including ensuring revenue is received up to the point of construction for sites that will be undergoing capital investment).

Sectors – Retail

6.8 In the year to date, there have been 16 new retailer openings on the estate. However, there has been a softening of the market in new deals being agreed due to the prevailing market conditions. Collection rates across retail continue to improve; though there are localised areas that require additional support where improvement has been less marked.

6.9 There are currently three different teams undertaking retail work in Asset Management. Over the last six months the three retail teams have been coming together into a single unified retail team. Recruitment is underway to ensure the team is the right size for the scale of work needed to deliver capacity going forward.

Sectors – Car Parks

6.10 A competitive tender process has now concluded with two new partners appointed to operate and manage TTLP's car park portfolio. Saba Parking will be responsible for the management and maintenance of the estate, while PayByPhone will provide a new digital cashless payment platform. This new contract, which goes live in January 2023, will provide lower operating costs, improved customer experience, and grow both parking and non-parking revenue.

Projects

6.11 Significant projects are underway at Victoria, Liverpool Street, Whitechapel and Baker Street.

6.12 At Victoria, works to the arcade have been completed and these works secured a heritage award following the refurbishment of the listed structure. Five of the six units in the arcade are currently under offer to new occupiers for lease. The buildings at the east of the estate, previously impacted by the London Underground Victoria Station Upgrade, are now in delivery with terms agreed for a pre-let to Flat Iron restaurant on the main site. The remaining workstreams are at feasibility stage and include the upgrade of Victoria Street retail parade and an office refurbishment programme.

6.13 At Liverpool Street, the works include the refurbishment of the retail arcade along with an exterior maintenance and upgrade programme. A pre-let of the entire arcade to Boxpark has been secured on a base annual rent of £0.9m. Following a delay due to price re-negotiation, a contractor has been procured and the project will start on site in November 2022, with completion of the arcade works and lease commencement to Boxpark in June 2023.

6.14 At Whitechapel, activity includes critical health and safety works, external structural repairs and the refurbishment of the shopfronts and interiors. Working with the London Borough of Tower Hamlets, the project supports the regeneration of the High Street. It will bring empty units back into commercial use and provide space for new occupiers. The contract for works has been delayed but is now in the tender stage with appointment due in November 2022. The start on site is due in February 2023.

6.15 At Baker Street, significant structural issues have been identified due to water ingress impacting on the supporting steelwork that will need repair to maintain the long-term health and safety of the buildings. These works will require the phased closure of the shops that are part of the station along Baker Street over a 12-month period. A contractor has been appointed and start on site is due shortly once approvals for closure of the adjacent bus route have been formalised. The works will also include the refurbishment and upgrade of vacant units, with new shop fronts consistent with the heritage design approved by Westminster City Council. A second phase of the project to upgrade and install new shop fronts along Station Approach is currently subject to costing.

6.16 Additional resource and a more efficient approach to procurement is needed to accelerate TTLP's work in this area. There are seven posts currently being recruited which will increase TTLP's capacity to drive these projects forward. Also, joint activity is underway with TfL's Procurement and Commercial team to design and deliver a more efficient approach to procurement that will see projects mobilised more quickly while retaining all the controls and protections currently enjoyed across TfL's procurement activity.

7 Property Development

Homes

7.1 TTLP's ambitious housing programme continues to progress. Construction is almost complete on 350 homes at Blackhorse View. Good progress is also being made on TTLP's site of 619 homes at Kidbrooke and on 46 affordable homes at Fenwick, whilst the car park at Wembley Park closed on 4 September 2022, ahead of the main construction work for 454 homes on that site.

7.2 TTLP continues to evaluate and prioritise the investment programme to deliver the target of 20,000 homes. The programme currently includes:

(a) 2,034 homes on 12 projects already completed or started on site, including those listed above;

(b) 2,738 homes on 12 projects (including two small sites) due to start during the remainder of 2022/23;

(c) 11,713 homes on 33 projects (including 17 small sites) in delivery with partners contracted, identified and / or planning significantly progressed; and

(d) 7,000 homes on 19 projects in feasibility with work underway to progress design, strategic planning, policy, land assembly or operational interface.

7.3 The full list of the 12 sites planned to start this financial year is set out below.

Scheme	Partner	Homes	Affordable
Bollo Lane	TBC – being procured	852	50%
Nine Elms	Grainger	479	40%
Southall	Grainger	460	40%
Hounslow West	A2Dominion	360	100%
Barking London Road	Be First	196	36%
Arnos Grove	Grainger	162	40%
Montford Place	Grainger	139	40%

The Liberty	U+I	36	50%
Southwark Over Station	Southwark Council	21	100%
Brentmead Place	Metro Properties	2	0%
Upper Richmond Road	London Realty	4	0%
Hornchurch	Caerus	27	11
Total		2,738	51%

7.4 The procurement for a partner to deliver Bollo Lane is well underway with TTLP aiming to announce the preferred party in January 2023.

7.5 Key programme risks are rising interest rates and gilt yields, and the impact of the falling pound on imports of construction materials which are affecting the wider industry, and which may present viability challenges on some of the schemes. TTLP is working through what this means for its projects with partners and the GLA.

7.6 While there were delays as projects were reviewed, CLL remains committed to delivering all the projects in the current business plan. Tenders have been received for enabling works at Southall, Montford Place, Nine Elms and Arnos Grove. A preferred main contractor for Nine Elms has been identified and progress is being made with the Stage 3 design works. Even with market pressures, these projects still meet the required commercial returns.

7.7 TTLP is also dealing with project-specific risks, in particular the capacity issues with the electricity grid in west London. This could potentially delay several schemes, including 460 homes at Southall and 360 homes at Hounslow West. TTLP is working closely with its partners Grainger and A2Dominion to mitigate the grid capacity issues including examining the feasibility of a temporary supply that could still allow construction to start this financial year.

7.8 Key to TTLP achieving its 20,000-homes target will be progress on its major sites, including Earls Court and Edgware.

7.9 At Earls Court, good progress is being made on the sale of the land occupied by the adjoining Lillie Bridge Depot (LBD) to Earls Court Partnership Limited (ECPL), TTLP's joint venture with Delancey and APG, the Dutch pension fund. The terms for the sale were approved by the Finance Committee on 23 June 2021, with the authority to enter the contracts delegated to the TfL Chief Finance Officer.

7.10 The proposed agreement with ECPL provides a mechanism whereby the cost of releasing LBD for development is funded from land value. The arrangements to plan for and bring LBD into the wider Earls Court site do not require any expenditure by TfL. Furthermore, the relocation of activities and assets away from LBD provides the opportunity for substantial investment in a re-planned and more efficient operational footprint.

7.11 Alongside the LBD agreement, ECPL will acquire land from Delancey and APG. Together, these transactions provide a means to consolidate land ownership in the Earls Court area under ECPL to create a strategic mixed-use development opportunity of over 40 acres located between three stations at Earls Court, West Brompton and West Kensington.

7.12 At Edgware, TTLP announced its partnership with Ballymore on 1 September, marking the culmination of months of detailed work between the organisations. The 7.5-acre Broadwalk Shopping Centre was acquired by Ballymore in 2020. By combining this with TfL’s neighbouring land, including the bus station and bus garages, it is possible to unlock a major regeneration scheme that would revitalise Edgware town centre. As well as delivering thousands of high-quality new homes and improved retail space, the programme would provide improved transport facilities, public realm, and community and leisure amenities.

Commercial Office

7.13 As well as delivering housing, the TTLP Property Development team has several significant commercial office projects. TTLP is well underway in a search for a joint venture partner to deliver our commercial office development and investment portfolio.

7.14 Initial bids have been received from prospective partners for the commercial office portfolio. These bids demonstrate a strong response from market-leading organisations. This leaves TTLP in a strong position to deliver the planned development programme, although market movements and commercial return rates will be regularly monitored. Subject to approval in due course from the Committee, TTLP expects to announce the joint venture partner early in 2023.

7.15 The initial seed sites for the commercial office joint venture are Bank, Paddington and Southwark over station developments, with a combined gross asset value of around £1bn. TTLP would have the option of adding further assets into the joint venture.

7.16 The joint venture will create high-quality, long-term investments generating annual income to TTLP from each of the three seed assets. In addition, these assets will help diversify the TTLP portfolio by creating high-quality, new-build office space at central London locations.

7.17 ESG performance will be a key design consideration. TTLP will ensure each asset is embedded with leading sustainability and wellbeing credentials, thereby helping attract a strong tenant base and positioning the portfolio in the top tier of central London office market investments.

8 Conclusion

8.1 The uncertain economic outlook provides challenges for TTLP and its tenants, many of whom are only now recovering from the pandemic. Despite these headwinds, TTLP’s increasingly diverse asset base helps protect revenue at the business level. The long-term approach of investment and steady asset growth also creates a more resilient business that can better withstand short-term economic downturn.

8.2 The papers shared with the Committee on 30 June 2022 set out that TTLP's capital commitments will be taken forward cautiously – reflecting the public ownership of the assets and the self-funding nature of TTLP – and to ensure resilience and liquidity through economic cycles. It was also stated that TTLP will aim to deliver throughout the property cycle, accepting that its returns will not always be as high as would otherwise have been the case. Nothing that has happened since is challenging those principles. While we will continue to review market conditions, in bringing forward medium-density, high-amenity, high-accessibility, low-carbon places that support vibrant life and commerce, we are confident that we will remain well placed to meet TTLP's long-term targets.

8.3 In the shorter-term, results from the first six months of this year show both income, costs and operating margin performing better than budget. In addition, the best performing sector, Arches, is the one that has recently piloted an integrated operating model that will now be rolled out to other sectors.

8.4 More, however, needs to be done to drive forward capital project delivery to unlock future revenue growth, and this will include investment in resource and a new, more efficient approach to procurement.

8.5 Housing delivery remains challenging in the current market, though TTLP is now starting to operate at or above the pace required to deliver 20,000 homes over the next ten years. The housing programme along with commercial office developments and investment in the existing estate will transform not only TTLP's finances but the city itself in the years ahead.

List of appendices to this report:

None

List of Background Papers:

None

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