**Land and Property Committee**

**Date:** **23 March 2023**

**Item:** **TTL Properties Limited Investment Strategy**

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## This paper will be considered in public

## 1 Summary


1.1 This paper summarises the updated Investment Strategy which reflects the significant economic headwinds experienced over the past year and also looks ahead to potential new sectors and opportunities.

1.2 The strategy continues to build on a sector-led approach, which will increasingly be reflected in TTLP's organisational structure and performance reporting.

1.3 The Investment Strategy should be considered in conjunction with TTLP's other strategy documents, particularly the Corporate and Environmental, Social and Governance (ESG) Strategies, elsewhere on the agenda for this meeting.

1.4 We will be consolidating and condensing the contents of the strategies, and these will be used in a number of ways, including in the materials to accompany the launch as well as the future TTLP website. We will issue the finalised version to the Committee in due course.


## 2 Recommendation

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

## 3 Strategic Context

3.1 TTLP created its first consolidated Investment Strategy last year to enable consistent investment decisions to be made across the organisation. The committee reviewed the previous investment strategy in their meeting on 30 June 2022. The Investment Strategy was drafted on the basis that it would be reviewed, and where necessary, updated annually. This year's review has focused on the following:

(a) investment and objectives by sector;

(b) new market sectors – including industrial and logistics and Electric Vehicle (EV) charging; and

(c) target returns and investment metrics.

3.2 In addition, this revision reflects lessons learnt and is updated in response to current market conditions.

3.3 The principles of the Investment Strategy focus on activity over the next five years and consider a longer-term view to drive long-term value.

3.4 The global and UK economies have seen seismic shifts over the past 12 months. Still recovering from a global pandemic, the UK has also experienced the impacts from the war in Ukraine, a cost-of-living crisis, political instability and double-digit inflation. All of this has led to market uncertainty and volatility. Specifically for real estate, there has been a change in sentiment from investors as they seek higher returns to mitigate inflation and to offset scope for higher returns in the bond market.

3.5 TTLP's diverse portfolio, with well-positioned assets across London, has demonstrated resilience in its recovery from the pandemic. Despite the uncertain landscape, there is still significant opportunity for TTLP to deliver value and create thriving, connected places in London.

3.6 The core principles of the existing Investment Strategy still hold in the current challenging macro environment. The resulting impact on investor appetite and property returns do, however, highlight areas where TTLP needs to evolve, and areas of the emerging strategy that need careful consideration. Work has begun on much of this but will continue to iterate over the next six months, as the scope of activities is clarified, and the Business Plan is finalised.

3.7 TTLP's portfolio comprises over 4m square feet of real estate and has a Total Investment Portfolio Value of £1.44 bn[1] (excluding Head Office assets and Development land). The portfolio is unique in nature due to its organic growth and intrinsic interface with the transport network. This results in the enviable benefits of having an estate with significant footfall and historic legacy, providing a unique brand and aesthetic.

3.8 TTLP has over 2,000 commercial tenancies, with a gross rent roll of more than £65m per annum (c. £80m per annum including car parking income). The portfolio includes Retail (current asset value £675m[1]), Arches (£155m[1]), Commercial Office (£115m[1]), Car Parks (£170m[1]) and legacy Residential (£90m[1]) portfolios. Our Industrial and Infrastructure portfolios account for the remaining c. £240m[1] in value.

3.9 The portfolio consists of a diverse range of non-operational land and property across London. This has now been consolidated and transferred from the relevant TfL ownership into TTLP. This process and the setting up of TTLP as a well-capitalised, self-financing entity, enable us (working with TfL) to structure and operate in a way to best manage and invest in the assets. Our shareholder objectives (explained further in our Corporate Strategy,

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[1] Draft March 2023 Valuation figures – a more detailed update will be provided once the valuations are formally finalised

elsewhere on the agenda, will help us to ensure we are working with TfL to deliver returns.

3.10 Working closely with TfL, TTLP will continue to identify additional properties that can transfer to TTLP, driving growth in the portfolio and returns to TfL. This requires us to work together with TfL to identify commercial real estate opportunities within the TfL operational estate, including as part of TfL-led and / or commercial-led projects.

3.11 Given the ability to plan decades in advance, including taking account of future extensions of the transport network, TTLP will seek to undertake strategic land assembly, notwithstanding an initial focus of optimising value from the existing portfolio.

## 4 Investment by sector

4.1 Over the past 12 months the business has worked towards a sector-led structure to better compartmentalise the portfolio and set out relevant sector strategies responding to the overarching Investment Strategy.

4.2 A sectoral structure enables focus on a strategic-led target portfolio weighting. The table below illustrates the long-term (10-year) aspiration of diversifying and improving the quality of TTLP’s income:

| | TTLP Portfolio Mix by Gross Property Income | |
|---|---|---|
| | Current (per cent) | Year Ten (per cent) |
| Retail | 48 | 35-45 |
| Office | 3 | 10-15 |
| Arches | 14 | 10-15 |
| Residential | 1 | 20-25 |
| Car Parks | 22 | 5-10 |
| Infrastructure (including industrial) | 11 | 10-20 |

4.3 In addition to the above target portfolio weighting, the Investment Strategy sets out a high-level, sector-level investment focus:

| Sector | Invest / Retain | Rationalise / Divest |
|---|---|---|
| Retail | • In-station retail Zones 1 to 3 (incl. Elizabeth line)<br>• Out-of-station retail close to transport hubs and in central locations | • Out-of-station retail Zones 4+ not near transport hubs |
| Residential | • Delivery of housing target (20k homes)<br>• Build-to-Rent purpose-built assets<br>• Build for Sale residential joint ventures to generate capital | • Existing secondary residential portfolio with high vacancy rates and significant capex requirement |
| Arches | • Priority assets and arch runs<br>• Compliance and ESG<br>• Place-making enhancements | • Review outer London arch portfolio (potential significant capex to meet ESG requirements) |
| Offices | • Joint venture development portfolio of purpose-built market leading assets<br>• Core central London existing office stock | • Secondary existing office portfolio with high vacancy rates and significant capex requirement |
| Car Parks | • Green energy initiatives<br>• Diversify income - meanwhile uses and environmental enhancements | • Redevelopment or disposal of sites with limited value and high operational costs |
| Infrastructure | • Bus garages<br>• Review value engineering opportunities in existing long leases | • Large number of low value non-core assets to be reviewed<br>• Review commercially poor performing assets to consider transfer back to TfL as operational assets |

4.4 A key next step in moving to a mature sector-led business is to produce sector level profit and loss accounts (P&Ls). This is a significant move from TTLP's current financial reporting and requires infrastructure updates. These have now been mapped with a plan to deliver them over the next 6-12 months. The P&Ls will help TTLP set sector-level target returns, which in turn will improve capital allocation and risk diversification. The principle will be that the overall portfolio targets will take precedent but will be delivered by a range of sector level targets.

4.5 The estate includes concentrations of mixed-use assets around central London transport nodes, providing opportunities for substantial repositioning and redevelopment. Examples include Baker Street, Victoria and Liverpool Street, and key development opportunities such as Earl’s Court and Edgware. Where this is the case, these assets will be considered as a whole and not primarily from a sector-led approach.

4.6 The TTLP portfolio also supports a significant residential and mixed-use development programme and pipeline. There are three principal Investment Strategy rationales underpinning TTLP’s development activity:

(a) the first is to deliver against TTLP’s commitment to provide new homes for Londoners, including a target of 50 per cent affordable housing across the programme. In most cases (where in line with strategy), TTLP will invest and share in the development risk and profits from the delivery of homes on major sites through joint ventures with carefully selected market leading companies specialising in the delivery of residential homes. The profits from these projects are reinvested back into TTLP to unlock future development schemes, delivering more homes, and much needed upgrades and maintenance projects across the existing estate;

(b) the second is to create high-quality revenue-generating assets to enhance and diversify TTLP’s investment portfolio (in line with the long-term portfolio weighting targets) to deliver long-term sustainable income and asset value growth to TfL. Two examples are Connected Living London, TTLP’s joint venture with Grainger plc delivering 1,591 Built to Rent homes across five sites; and the recent selection of Helical plc as TTLP’s preferred commercial office joint venture partner to deliver a pipeline of 600,000 sq. ft of exemplar office space across three sites in central London locations, subject to contract negotiations and a ten-day standstill period; and

(c) the third is unlocking or facilitating operational improvements across the estate through commercially led development. Demonstrated at projects such as Edgware, which includes plans to re-provide a modern, fit-for-purpose bus garage supporting the decarbonisation of London.

4.7 As outlined above, one area of continued focus is sector level strategies. In the short-term, these will prioritise stabilising our Asset Management portfolio. We will then drive towards improving our operating margin and net operating income through proactive asset management and the embedding of a research-led approach to selection, prioritisation and delivery of projects.

**Multi-Use Hubs**

4.8 Where assets are co-located, particularly around transport nodes, they will be considered not as individual sectors but collectively as multi-use hubs. These hubs, where space can flex over time to meet market demands, will be viewed at a premium by TTLP and will always be assessed as a priority for investment. These are key portfolio assets with significant opportunities to enhance local environments and capitalise on income potential.

4.9 The initial projects identified as having potential for this approach are Victoria, Whitechapel, Liverpool Street and Baker Street. A capital allowance has been included in the Business Plan for strategic acquisitions to strengthen our ownership at such locations.

4.10 TTLP will seek targeted acquisitions at these hubs to ensure consolidated ownership unlocking additional value and optionality to develop and manage these assets. This approach will also enable the assets to better support operational requirements at these locations.

**Retail**

4.11 TTLP's retail portfolio consists of units within TfL stations, which require close coordination with operational teams, and out-of-station units. In-station retail is a unique element of our investment portfolio. These encourage targeted interventions that generate income, deliver an enhanced customer experience, and improve the ambience and safety of TfL's transport network.

4.12 As the market begins to recover from the pandemic and consumers change their spending patterns, retail now enters the unknown. With inflationary pressures, the evolution of the retail sector is more important than ever. The structural change from traditional shops to online retailing and experiential retail continues to intensify. Our traditional approach to convenience and "grab & go" retail serviced by commuters is no longer appropriate.

4.13 Over the next 12 months, we will carefully consider the retail landscape for the future by reviewing our tenant mix, engaging with our customers, and building partnerships to provide convenient services to the communities we serve by repurposing and investing in our existing retail spaces.

**Residential**

4.14 Currently only a small part of our existing investment portfolio, residential is a major focus of our development programme, in line with our wider Mayoral commitments. There remains a significant undersupply of new homes across a variety of tenures and price points in the capital. There are increasing design and sustainability requirements in the planning process which require successful schemes to deliver healthier and greener, resilient, and better-connected buildings. TTLP have a design guide, based on the London Plan, which is regularly reviewed to reflect new requirements and our own strategic objectives, and this is guide is used as part of the governance of all our projects to ensure we deliver good quality design.

4.15 TTLP's Property Development team is responsible for one of our primary Investment Strategy objectives: to deliver 20,000 homes over the next ten years with a target of 50 per cent affordable housing.

4.16 As part of this housing target, Build to Rent is a key delivery component. It represents TTLP's single most important investment category delivering both high-quality homes (across tenures and price points) and sustainable long-term income that, importantly, is defensible in volatile markets.

4.17 Build to Rent is currently delivered through Connected Living London, with five active sites delivering 1,591 homes. There are numerous opportunities across the housing delivery programme to increase our investment in Build to Rent. A residential strategy to enable TTLP to select the best of these opportunities and deliver on them will be developed over the next 12 months.

4.18 TTLP's existing disparate residential portfolio, comprising some 200 units, is geographically spread across London with varying degrees of connection to the transport network. The portfolio requires significant investment and provides poor returns, with significant void rates and high operational costs. Where these assets are not required for future development or are not part of a multi-use hub, they will be disposed of, with receipts reinvested into core assets.

**Arches**

4.19 TTLP's arches portfolio is worth £155m1 and generates over £11m per annum. The Arches Strategy will provide and future-proof the right spaces for London's small business entrepreneurs.

4.20 TTLP's arches portfolio offers unique commercial spaces, home to restaurants, cafés, gyms and maker spaces – and has the potential to do much more to enhance local communities.

4.21 With very high levels of small and medium enterprise occupants, from music studios to mechanics, the portfolio is agile and can react to market conditions. This has been evident through the recent market turmoil, with the arch portfolio demonstrating resilience through rent collection and void rates.

4.22 The portfolio will generate and grow sustainable net income through partnership and mutual growth plans. As with much of the estate, however, there has been a historic underspend on maintenance works. Given the intrinsic operational interface and nature and condition of arches, this needs rectifying with significant capital investment and will be a short-term focus.

4.23 In the medium-term, TTLP will review the opportunity to introduce alternative uses in appropriate locations. The strategy will take a proactive approach to understanding demographics and local needs to help ensure we encourage a tenant mix that creates diverse and connected spaces.

**Offices**

4.24 As part of TfL's head office rationalisation strategy, a number of secondary office buildings have or will potentially be transferred to TTLP. These buildings represent the majority of TTLP's existing moderately sized office portfolio. These offices are largely located around transport hubs.

4.25 Agile working is here to stay, which will continue to have a dampening effect on the growth in demand for secondary office space. Less desirable offices in less accessible locations are increasingly becoming harder to let. Market sentiment sees a clear ‘flight to quality’ among London office occupiers, driving demand for prime Grade A office space.

4.26 In the short-term, we will review our Office Strategy and focus investment on core office development and the repurposing of existing office buildings that could support a flexible or co-working provision in core locations. Other assets will be reviewed for disposal, in line with our capital recycling plan.

4.27 In the medium-term, the portfolio presents opportunities to deliver market-leading office buildings, including Bank, Paddington and Southwark, which will deliver 600,000 sq. ft (Net Internal Area) of the highest quality office space in the capital, with world-leading sustainability and wellbeing credentials.

**Car Parks**

4.28 TTLP’s Car Park portfolio is worth £170m1, consisting of 78 car parks and over 10,000 bays. TTLP typically benefits from a monopolistic position of station parking in key locations adjacent to London Underground stations and therefore generates a steady income stream. The portfolio is diverse with sites ranging from less than ten spaces to over 500 spaces at sites such as North Greenwich, Epping, and Chalfont and Latimer. Overtime, however, this portfolio will decrease in size as we repurpose assets for alternative uses including residential development.

4.29 Following a recent procurement process there are now two strategic partnerships in TTLP’s Car Park sector. Saba Parking is responsible for the management and maintenance of the estate, while PayByPhone provides a new digital cashless payment platform. We will work with our new partners over the next six months to review the performance of our car parking assets and seek revenue generating and efficiency opportunities.

4.30 The portfolio also offers multiple opportunities for diversification. An assessment will be completed to look at non-parking revenue and potential green initiatives, such as EV charging and last-mile logistics.

**Infrastructure**

4.31 The TTLP portfolio includes a number of income-generating infrastructure assets (including bus garages, utilities, antennae, surplus operational land, air rights and long leases). Although this sector contains numerous assets, the majority of value (and income) is held within a small number of long leasehold interests and bus garages.

4.32 The short-term focus is to review assets of significant value for value optimisation. The medium-term strategy is to drive revenue and value-add opportunities, both commercial and operational, from these assets.

**Emerging Sectors**

4.33 An area of focus is reviewing scope for investment into emerging sectors. To date a series of sectors have been identified following initial market research and emerging opportunities across our estate.

4.34 In response to market conditions, TTLP is reviewing its appetite to invest and enter the following sectors to support its long-term aspirations and wider objectives:

(a) industrial and logistics;

(b) energy – including EV charging and solar;

(c) serviced office;

(d) student living; and

(e) heath, later living and care.

4.35 Although there is market sentiment to support investment into the life science and data centre sectors, we are not currently considering these. This is based on an initial evaluation considering existing strategy, market position and ESG credentials.

4.36 Over the next 6-12 months, further work to review TTLP's investment appetite in these sectors will be led by the relevant experts in the business, leveraging market leading external support.

## 5 Measuring Investment Performance

5.1 Commercial performance metrics have been a recent focus and will continue to be reviewed. A material step forward is the agreement of Shareholder Objectives (see Corporate Strategy paper). The project level hurdle rates below are not materially impacted by the Shareholder Objectives:

| Metric | How Measured | Our Target |
|---|---|---|
| Net Present Value (NPV) | Each project is assessed against an IRR hurdle rate equivalent to the market risk rate of return relevant to the asset class, risk and complexity of the project | > £0 |
| Ungeared Internal Rate of Return (IRR) | The average annual return, expressed as a percentage | > 7.0%<br>Will vary according to the project, taking into account levels of risk and the non-financial benefits, e.g. step-free access |

| Metric | How Measured | Our Target |
|---|---|---|
| Return on Capital Employed (ROCE) on development projects | Net operating profit or earnings before interest and taxes (EBITDA) divided by capital employed (all equity, excluding debt, invested in the delivery phase of a project including TTLP direct costs) | > 20% |
| Incremental Yield on Expenditure | The new rent post-capital investment minus the former passing rent divided by capital expenditure plus associated void costs (related to revenue-generating assets)<br><br>Where there is no passing rent, or projects materially change the income type (by use or risk profile) then the metric will not reflect the passing rent and will be a Yield on Expenditure only | > 3.6%<br>Taking into account levels of risk and the non-financial benefits |

5.2 In the first instance, all projects are tested against the above financial targets to secure investment from the business. However, in certain cases projects will be progressed even in the event they do not meet the target returns. Specific reasons to progress projects include:

(a) health and safety related investment – due to the historic lack of investment across the estate, there is sometimes a need to invest in making assets safe such that the project will not meet the investment targets listed above (albeit this will protect long-term income);

(b) key projects aligned to the wider business objectives and strategy, such as delivering housing throughout the property cycle; and

(c) projects that deliver wider Sustainability and Non-Financial benefits – as highlighted in the ESG Strategy paper, elsewhere on the agenda for this meeting, the approach to identifying and measuring these benefits will be assessed over the next 12 months.

**List of appendices to this report:**

None

**List of Background Papers:**

Land and Property Committee paper, Investment, Business and Corporate Planning 2023/24, 18 October 2022

Corporate and Environmental, Social and Governance (ESG) Strategies elsewhere on the agenda for this meeting.


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