

CHIEF EXECUTIVE'S REVIEW

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The economic uncertainty as a result of the Brexit process has been increasingly apparent over the last 12 months. It has not been helpful to the real estate sector, nor more widely to the occupational markets. Despite this, overall the property market held up well, with the MSCI UK Quarterly Property Index showing a total return of 4.6%.

The industrial sector has been the most resilient and the retail sector the least, suffering a marked deterioration as retailers struggle with rising costs and the impact of online competition. The CVA and pre-pack administration processes have become more widespread, enabling retailers to relinquish lease obligations, which have, in turn, accelerated the downward movement in rental and capital values.

Against this backdrop our portfolio performed well, as we continued to manage our assets effectively. We remain cautious in our use of debt, and with more limited transactional activity, we continue to evaluate ways in which we can invest in our assets, enhance the accommodation and in turn the income and valuation potential.

Occupier focused and opportunity led

Our occupier focused approach remains at the forefront of what we do. Enhancing occupancy and retention, thereby mitigating void risk, is key. Through this process we are continually looking at options to improve our income profile and extend it where possible.

We have also spent time redefining our Picton Promise for occupiers, focused on key commitments including Action, Support, Sustainability, Technology and Community, all of which we believe have relevance and importance to our occupiers in this evolving working

environment. We look forward to seeing the impact of this as it is rolled out during 2019.

Buy, manage and sell effectively

Transactional activity during the year was muted, reflecting the slowdown in investment activity and the availability of suitable opportunities. With a desire to maintain a prudent approach to gearing, no acquisitions were made during the period. In the wider market, it has been clear that a number of open ended funds had selling pressure and in the retail sector, in particular, there has been limited investor appetite.

We were opportunistic in making two disposals, coincidentally both to local authority purchasers, which reflected a combined 10% premium to their valuation at March 2018 and more than 45% to their valuation at March 2017, capturing the upside from earlier asset management initiatives.

While no acquisitions were made in the year, we think there may well be greater buying opportunities as we move through 2019 and into 2020. As ever stock selection remains key and identifying intrinsic value is paramount.

Focus on income and total return

We delivered a positive income return and capital growth from the portfolio during the year. Our conservative use of debt also had a positive impact.

7.5%

TOTAL PROPERTY RETURN

Cash flow remains hugely important and this is reflected in our income focus. An additional £1.1 million of other income was secured in the year in addition to rental income. This primarily came through asset management events where we chose to surrender leases ahead of expiry, in most instances to enable refurbishment and upgrading of space.

5.6%

PROPERTY INCOME RETURN

Despite our diversified occupier base and low exposure to the retail sector we were not immune to occupier failures. In one notable example the Homebase unit in Swansea has been successfully re-let and is further detailed in this report.

5.7p

EARNINGS PER SHARE**Creating space occupiers need**

We continue to invest in our assets, improving the quality of space and ensuring that it meets occupier demand. The timing of lease events was such that there were only a handful of key refurbishment projects undertaken during the year. Additional work was done to plan schemes for this coming year and beyond. In this market, it is more important than ever to have the right space that will attract high-quality occupiers and minimise vacancies.

The last 12 months have seen the marked deterioration of trading conditions for retailers and the well documented difficulties for long-established companies such as Debenhams, Homebase, New Look and House of Fraser to name but a few. These have impacted either directly or indirectly on all owners of commercial real estate operating in this sector.

Our occupancy has reduced during the year and now stands at 90%. This is, we expect, a short-term position and is driven by the timing of lease events. The major void, accounting for over a third of total portfolio vacancy, is a property in Covent Garden, a well known and busy location. This became vacant during the year ahead of a planned refurbishment and re-leasing programme. We are fortunate that because this is a Grade II listed asset, there is no empty rates liability. We are actively managing this to achieve an optimum outcome and already have leasing interest.

Managing our capital structure through the cycle

Debt was repaid during the year, partly using asset sale proceeds, which reduced overall borrowings by some £19 million. We have drawn down from our revolving credit facilities during

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the year, which proved a useful way of managing our cash flow position, ensuring an efficient use of the balance sheet and allowing us to adopt a more flexible approach to debt levels as market conditions change.

Effective and efficient operational model

We were able to have a positive impact on earnings through corporate efficiencies, such as our REIT conversion, which is expected to save more than £0.7 million in tax per annum relative to last year. This also needs to be viewed in the context of future tax changes which will impact offshore companies – if we had not converted, our tax liabilities would have been much greater. The full benefit of this change will be fully reflected in next year’s results.

Culture and alignment

We are fortunate to have a strong team at Picton and our culture is key in ensuring the team works well. We are guided by our shared vision and values and all of our staff are aligned with shareholders through our deferred bonus scheme and also our Long-term Incentive Plan. The 2016 LTIP awards will vest this year and staff will benefit from the success that we have delivered for shareholders over the preceding three years.

Outlook

Our focus will be on growing occupancy and income. We are aiming to create further value through investing in our assets and restructuring leases, either to capture higher rents or to provide greater income security. We expect this to underpin our progressive dividend policy and ensure we continue to be well placed to deliver on our vision of consistent outperformance.

Michael Morris

Chief Executive