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Development Securities PLC
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Development Securities PLC

("Development Securities" or the "Company")

Interim Management Statement

Development Securities today releases its Interim Management Statement ("IMS") for the period from 1 January 2011 to date.

KEY POINTS

- Activity and investment levels remain high as property market dislocation continues
- Strong investor appetite for prime and upper secondary property underwriting target exit returns;
- £125m equity invested or committed out of net £188m raised since July 2009, acquiring assets to the value of approximately £300m across 35 transactions; equity of £31m committed since the beginning of the period;
- Net debt £124m (including share of joint ventures) as at 30 April, representing gearing of 37% against net asset value as at 31 December 2010;
- Planning consent secured for the Hammersmith Grove development and construction is likely to commence this year following strong interest from potential institutional funding partners;
- Ready supply of Central London office space falling; currently appraising a number of opportunities where entry price properly reflects value and risk; and
- Two IPD / IPF Property investment awards won in April

David Jenkins, Chairman, said:

The UK economy continues to struggle to generate meaningful growth. With GDP remaining flat for the six months to March, and Government austerity measures beginning to take effect, the macro environment offers little clarity or comfort that the position will change materially any time soon.

In our sector, all-property rents continued sideways along their recent plateau with a sustained underlying divergence between material rental growth in Central London and weakness in the regions. Conversely, yields have continued to fall marginally, driven by continuing strong international and domestic investor appetite, especially for prime property. While net bank lending to property was marginally positive in the first quarter for the first time since Q1 2009, the availability of bank finance remains tightly constrained, being open only to the strongest borrowers and almost invariably only for well-let investment property.

It was to take advantage of the dislocation created by these market conditions that we raised our second tranche of new equity in August 2010. We have continued to appraise an increasing stream of opportunities as we seek to apply our cash and expertise into those stressed areas of the market that lack adequate capital. I am pleased to report that we have made several further investments since the year end, and continue to review a number of additional potential projects. Investor wariness of non-prime property is sustaining a yield gap of some 300bps between secondary and prime, which presents a continuing opportunity for the redevelopment, refurbishment, regeneration or repositioning of failing or complex secondary assets into the near-prime or upper secondary category, where cash-rich investors can invest. Whilst we are encouraged by the apparent increasing appetite for prime and upper secondary property, which seems to underwrite our target exit values, we do not expect this yield gap to close meaningfully in the near term as economic growth stutters and the banks continue to withdraw their capital from the marketplace. We perceive an unprecedented opportunity for arbitrage, as we deploy our equity and expertise to migrate assets from secondary to near-prime.

Low market values for secondary properties and the lack of equity available for these projects generally mean that the appraisal margins on which we are able to purchase these assets offer significant protection in the event of further market declines, which might reduce our anticipated proceeds but are unlikely to take them below the cost of acquisition.

In the 21 months since July 2009 (the date of the first equity issue), we have invested or committed some £125m of the net £188m raised in the two issues, acquiring assets to the value of £300m (both directly and with partners). The equity has been allocated across some 35 transactions and over a range of sectors and regions, thus diversifying portfolio risk.

The projects acquired each have a detailed asset management or development plan, and a hold period averaging just over three years; we have however recently been pleased to receive initial enquiries in respect of some assets, considerably in advance of our original schedule, at levels which support our appraisal returns.

Whilst proceeding with caution in areas of the market outside of our core competencies, we have continued to broaden our operations by working with partners who bring specific expertise. We have, over the past 18 months, considerably expanded this mode of operation, thus extending our reach and capability. Our track record of partnership with both institutions and private investors, together with our transparency as a regulated, publicly listed entity, means that we are increasingly seen as an appropriate partner, both for those in need of capital, and those with equity to invest. Since July 2009 we have added £6.4m pa to the rent-roll of our directly held investment portfolio and are also earning additional rent of approximately £4.8m pa from properties acquired for development and trading, thus continuing to reduce the deficit in our recurring income. In many cases, the projects we have acquired come to us with a promoter attached, to whom we devolve the day-to-day operation of the project, whilst retaining appropriate oversight and control. The increased level of activity has thereby been achieved without any increase in our operational expenses, thus considerably improving the efficiency of our operating model.

Whilst we remain cautious on major development in this phase of the economic cycle, we note that the ready supply of prime office space in Central London is steadily falling. We continue to appraise further significant opportunities in London, where we consider the entry price properly reflects value and risk.

Our investment portfolio continues to perform well, with good progress in our asset management strategies in particular at The Broadway, Bexleyheath, Atlantic Village, Bideford and The Furlong, Ringwood. We were also pleased to receive two prestigious IPD/IPF Property Investment Awards, for the best risk-adjusted ten year return in the IPD Universe and the highest relative return over three years in our category.

Since the year end, further acquisition activity has reduced our cash balances, taking our net debt to £124m (including share of joint ventures) as at 30 April, representing gearing of 37%

against our net asset value as at 31 December 2010 of £333.1 million. We have continued to use cash for acquisitions, taking advantage of the speed and flexibility which this allows, and are now in advanced negotiation to refinance with debt a number of the properties acquired. Despite the very tight lending conditions for the sector, we continue to be able to secure debt finance for both investment and development activity. The weighted average maturity of our existing debt as at 30 April was virtually unchanged from the year end at 8.3 years (including share of joint ventures).

Major development portfolio

In March, we were pleased that Hammersmith and Fulham council resolved to grant consent for our revised proposals at Hammersmith Grove, comprising two prime office buildings totalling 275,000 sq. ft., together with associated restaurants and cafes and significant new public open space. We have received strong interest from potential institutional funding partners for the first building of 105,000 sq.ft. and expect to commence work on site later this year.

At Two Kingdom Street, PaddingtonCentral we leased 26,000 sq. ft. to Rio Tinto in April, further underlining the quality of this product and demonstrating its suitability for major occupiers, in particular those with international operations. The next phase of this development is likely to be Four Kingdom Street, a 140,000 sq.ft. office building. We are planning to start this later in the year.

Other development and trading activity

In March, we secured planning permission for the redevelopment of the shopping centre at Hale Barns, Greater Manchester, which we acquired 12 months earlier. In January, we signed an agreement for lease with Booths, the food retailer, for a 30,000 sq. ft. store. The scheme will also comprise a further 12,000 sq. ft. of retail development together with 24 residential apartments.

Also in March, we received planning permission for a fifth apartment at our luxury waterside development at Sandbanks, Poole, and project enabling works have now commenced, with practical completion scheduled for Q2 2012.

In April, we were granted planning permission by Greenwich Council for the regeneration of the derelict Greenwich Industrial Estate in partnership with Cathedral Group PLC, a specialist Public Private Partnership developer. The consent, which is subject to a satisfactory s106 agreement, comprises 181 residential apartments, 358 student apartments, education and administrative space, a health and fitness club and a nursery, together with associated retail and small business units.

At Littlehampton we have contracted to sell the site to a major foodstore operator, subject to obtaining planning permission for the redevelopment.

Also in April, we acquired the 18-acre London Gate business park in Hayes, Middlesex, again in partnership with Cathedral Group PLC. We are finalising plans for a major mixed-use redevelopment of the site, and expect to submit a planning application later this year.

In May we purchased a 3.7 acre vacant industrial site in Abbey Wood, South East London, for £2.75 million from a receiver acting on behalf of Lloyds Banking Group. We have entered into a joint venture with the adjoining landowner, Gallions Housing Association, and intend to seek planning permission for a food store led development.

HDD

One of our subsidiaries, HDD, specialises in the development of convenience, food-led retail centres, in particular within new residential schemes.

Following the completion of the sale to Morrison at Stanground, Peterborough, we have significant interest in the adjacent retail units, and in April sold the pub plot to Marstons.

Pre-letting interest continues to be strong in respect of the 50,000 sq. ft. leisure development in Llanelli, Carmarthenshire, and we will commence work on site later this month. At Bannerbrook, Coventry, we have let the final retail unit and sold 13 of the 20 flats. Negotiations are proceeding for an institutional sale of the commercial areas in the second half of the year.

Investment portfolio

In April we were delighted to win two IPD/IPF Property investment Awards. We achieved the best risk-adjusted ten year return of 11.0% pa on our investment portfolio, compared with an IPD ten year average of 6.7%. In addition, for the second year running, we achieved the highest relative return over three years in the sub-£500 million Specialist Pooled Funds and Traditional Estates category. Both awards underline the success of our risk-averse stock selection and highly active asset management.

In March we acquired a 54,000 sq. ft. office property, Elizabeth House and the Cornerstone, in Woking, Surrey, for £6.55 million, at an initial yield of 6.8 per cent. The property comprises a well located office building, offering a good income stream and long term redevelopment potential.

In April we completed a new ten year letting of 1,500 sq. ft. to Fenn Wright Manson at Ringwood, building on the fashion brands at the centre and further enhancing the rental tone. In Bexleyheath we have secured planning permission for Primark's 40,000 sq. ft. store extension and works are on schedule for an opening in November. In Nailsea we have re-anchored one end of the scheme with key lettings to Dominos and JD Wetherspoon, having achieved planning permission for a 5,000 sq. ft. extension.

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Forward-looking statements

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