



Property Review

Sales: £612 million during the year

With continuing emphasis on quality properties we have pursued our strategy of portfolio review and selection. In a climate of low interest rates and finer yields, we have disposed of properties which have not been expected to meet our performance criteria, taking advantage of buoyant prices being achieved in the investment market. During the year we have completed sales of £612 million, including joint ventures and involving 181 properties (excluding residential units). Aggregate sales prices in each class of property, offices, retail, leisure, industrial and residential, have exceeded the relevant March 2002 valuations, in total by some £48 million, or 9%.

Significant disposals were:

- the BL Rank leisure portfolio of bingo clubs, leisure parks and centres and a cinema, which concluded our sales programme from this joint venture and significantly reduced our investment in the leisure sector;
- the programme of 24 auction sales by the Public House Company and the sale of a portfolio of a further 79 public houses to Scottish & Newcastle;
- 29 retail units with total sales prices of £56 million, predominantly in high street locations, from the portfolio and that of the BLU joint venture;
- residential properties totalling some £53 million, to capitalise on exceptional prices, particularly in London;
- two department stores at Doncaster and Perth (where House of Fraser assigned their lease), the BL Fraser joint venture realising prices well above valuation;
- two distribution units at Nursling, Southampton, of 36,700 sq m (395,000 sq ft) for £36.7 million, let to Tesco and Christian Salvesen. The premium price achieved reflected the good covenant and low yield in the market, despite limited rental growth prospects for the property;
- sales by BL Davidson of five retail parks totalling £62 million;
- distribution units at Thatcham and Enfield by BL Gazeley at significant surpluses, which are reported further under Developments below.

Since the year end, we have also sold our 50% interest in Cherrywood Properties Limited, which owns a mixed use development near Dublin, to our former joint venture partner, Dunloe Ewart.

Purchases: £328 million during the year

We have selectively added to our balanced portfolio in both the retail and office sectors.

Retail acquisitions during the year totalled £71 million including:

- Meadowbank Retail Park, Edinburgh, with a total of 13,950 sq m (150,000 sq ft) arranged in eight retail warehouse units, anchored by a Sainsbury's superstore of 4,050 sq m (43,800 sq ft), plus two smaller units and a restaurant;
- Cuckoo Bridge Retail Park, Dumfries, comprising nine retail warehouse units and a restaurant totalling 11,900 sq m (128,000 sq ft) anchored by a 4,460 sq m (48,000 sq ft) Homebase. Adjoining the park is a site owned by Tesco with planning consent for a store of 5,400 sq m (58,000 sq ft);
- the purchase of the 70% interest in the Sainsbury's superstore at Purley Way, Croydon (where we already owned the 30% interest) and the funding of an extension of 2,050 sq m (22,000 sq ft) to the store.

Further acquisitions included:

- the purchase of the virtual freehold interest held by Deutsche Bank at 1 Appold Street, completed the assembly of the entire Broadgate office estate, in the City of London, into our ownership. The offices and ancillary accommodation of 17,200 sq m (185,100 sq ft) are leased back to Deutsche Bank for 15 years without break;
- during the restructuring of Railtrack to form Network Rail, we took the opportunity of buying out Railtrack Development Limited's 50% interest in the joint venture that we had with them in respect of 201 Bishopsgate, London EC2, with a resolution for planning consent for a 69,500 sq m (747,800 sq ft) proposed development. The raft over the railway line had already been completed by the joint venture company, thus eventual construction costs are limited to the structure above ground;
- residential investments through the purchase of FRP Group and our joint venture partner's interest in London & Henley, which each own a portfolio of residential investments primarily in Greater London.

These properties, purchased at a total of £328 million, have risen in value during the period since acquisition averaging approximately four months by £45 million.

Property Asset Management: annualised net rents up £21.2 million

Settlement of 317 rent reviews during the year across the portfolio including joint ventures produced an increase in rental income of £31.2 million per annum, 34% above the previous passing rent. Further new income of £16.5 million per annum was achieved on 84 lease renewals and relettings in the year.

In the supermarket portfolio, significant progress continues to be made with rent reviews, resulting in record levels of rent at Chiswick, £23.15 per sq ft and £23.11 per sq ft at Croydon. The supermarket operators desire for increased trading floor areas (and the restrictive planning regime for new stores) has channelled demand to concentrate on extensions. During the year, ten extensions with a total of 16,100 sq m (173,000 sq ft) have been added, at a cost of £39.6 million and generating additional rents of over £2.9 million per annum.

Voids in the portfolio remain a very low total of 2.7% by rental value; 0.3% is under offer and 0.1% is the subject of our asset management initiatives, so just 2.3% is vacant where tenants are being sought.

Reversionary income from the current investment portfolio is expected to increase rents by £58.0 million in the next five years, including £21.6 million already committed on the expiry of rent free periods and contracted minimum rental uplifts. Further income will be achieved from the development programme, of which £19.4 million per annum is committed under a pre-let.

| Further income | Contracted £m | Not Contracted £m | Total £m |
|-------------------------------------|------------------|----------------------|-------------|
| Annualised net rents, 31 March 2003 | 545.8 | | 545.8 |
| Reversions, within 5 years | 21.6 | 36.4 | 58.0 |
| Committed developments | 19.4 | 23.5 | 42.9 |
| Development prospects | | 104.4 | 104.4 |
| Total | 586.8 | 164.3 | 751.1 |

At Broadgate in April 2003, just after the year end, the lease to EBRD of the 34,100 sq m (367,000 sq ft) building at One Exchange Square was restructured. The tenant's break clause in 2006 was removed and the new lease extended from 2016 to December 2022, while the office rent was maintained at £18,975,000 (£52.50 per sq ft) per annum. Upward only rent reviews are due next in 2006 and every five years thereafter. The cost to British Land is a tax efficient three years and five months nil rent period from June 2003, with a net present value of £41.5 million. There are no take backs or other put options. We are pleased to have retained this very good covenant for an extended term at Broadgate. The removal of the tenant's break clause in 2006 will have a positive effect on valuation since the reduction in value which would have occurred as the break in 2006 approached has been avoided. The value of the investment should also increase as the nil rent period runs off.

Retail: 48% of the total portfolio by value

Our primary retail focus is on out of town which accounts for 80% of the retail portfolio, while the remaining 20% is in high street and town centre shopping schemes.

While the rate of increase of total UK retail sales has been slower recently, the level of such sales has continued to grow, at the rate of 4.2% per annum for year to December 2002. Out of town retail has continued to take an increasing share (out of town sales growth in 2002 was 6.4%) benefiting from both consumer preference for this type of shopping experience and the limited supply of such property. These factors have resulted in sustained retailer demand, improved rents and values.

The department store properties are performing well. We reported at the interim stage our payment to House of Fraser for major works as part of their refurbishment of the Rackhams store in Birmingham, which produced a substantially increased rent.

At Meadowhall we have continued our policy of enhancing tenant mix and have achieved 28 new lettings to excellent retailers, including Zara, Tucci, USC, Elle, Holland & Barrett, The Model Centre, Pumpkin Patch and Sony. Rents achieved on these lettings and the 29 rent reviews completed in the year have been in line with our expectations. Total income has increased over the year by £5.6 million per annum to £68 million per annum. Visitor numbers have risen marginally over the year while the spend per party, in the off peak June survey and to a greater extent during the peak December survey, has increased considerably on the equivalent period last year.

Offices: 47% of the total portfolio by value

Central London investments represent 94% of our office portfolio. It is clear that during the year letting activity relating to Central London offices has declined significantly. There have been few transactions, although the recent letting to ICAP, at a rent of £48 per sq ft for 9,000 sq m (96,900 sq ft) from Lehman Brothers at Broadgate, is an excellent endorsement of our premier City estate. This transaction also enabled us to amend the headleases relating to the 31,260 sq m (336,000 sq ft) building let to Lehman Brothers under which the tenant pays rent calculated as a percentage of open market rental value. The rent receivable at the rent review will be calculated at 95% of open market rental value (up from 90%).

Overall, market take-up in the City for the first quarter of 2003 was still below average. The vacancy level has increased to around 10.8% (end Q1 2003) of City office space and is expected to rise further over the next year or so, as a result of new supply and releases by tenants of existing space. However, given take-up even at the existing low levels, by 2006 the market is predicted to return to a balance of supply and demand and we can then expect rental growth to return.

Open market rental values have softened over the year but our income from the Central London office portfolio is generated from long leases with upward only rents from strong covenants. The weighted average lease length of the office portfolio is 11.8 years to first break and 14.2 years to expiry. With upward only rent reviews, rental income can only fall at lease expires or tenant breaks, thus our long lease profile means that despite rental value falls, capital values are not equivalently adversely affected.



Centre West, East Kilbride

Development: adding quality assets to the portfolio

Completed projects during the year totalled 91,300 sq m (983,000 sq ft), in our preferred investment sectors of retail and business parks. The three largest completions were:

- Centre West, a 26,500 sq m (285,000 sq ft) shopping centre in East Kilbride, adjoining and complementing our existing Plaza Centre. The centre is 89% by area let or under offer and is anchored by an 11,150 sq m (120,000 sq ft) Debenhams department store;
- Mill Park, Thatcham (held in the BL Gazeley joint venture) a 33,060 sq m (356,000 sq ft) distribution centre completed and let to Scottish & Newcastle, now sold creating a significant surplus over cost;
- Delta Park, Enfield (also BL Gazeley) where on completion of a further 23,950 sq m (257,700 sq ft) of distribution units, the substantially let park was sold to Legal & General, again realising a significant surplus over cost.

Committed developments now comprise four projects, as set out in the table below, all progressing within programme and budget, with remaining costs to complete of £184.6 million.

Committed Projects, as at 31 March 2003

| | Size sq m | Rent† (est) pa | Cost* | PC* (est) | Pre-lettings (sq m) |
|--------------------------|---------------|-------------------|----------------|--------------|----------------------------|
| Offices | | | | | |
| 1 Plantation Place EC3 | 50,150 | £26.8m | £201.3m | Q2 2004 | Accenture (34,840) |
| 2 Plantation Place EC3 | 14,930 | £7.4m | £59.6m | Q2 2004 | |
| 10 Exchange Square EC2 | 15,180 | £7.7m | £53.2m | Q2 2004 | |
| Distribution | | | | | |
| Heathrow Gateway Phase 3 | 8,680 | £1.0m | £5.2m | Q2 2003 | |
| Total | 88,940 | £42.9m | £319.3m | | £19.4m pa (45%) |
| Cost to complete | | | £184.6m | | |

* Construction cost

• Practical completion of construction

† Headline rent

Controlled Development Programme, summary

| As at 31 March 2003 | Net Area sq m | Rent† (est) pa | Construction cost | Cost to complete |
|------------------------|------------------|-------------------|----------------------|---------------------|
| Completed: | | | | |
| Total | 91,300 | £13.1m | £115.4m | |
| British Land Share | | £10.5m | £98.2m | |
| Committed: | | | | |
| Total | 88,940 | £42.9m | £319.3m | £184.6m |
| British Land Share | | £42.9m | £319.3m | £184.6m |
| Development prospects: | | | | |
| Total | 358,360 | £114.5m | £792.7m | £760.9m |
| British Land Share | | £10.4.4m | £716.6m | £689.9m |
| Total | 447,300 | £157.4m | £1,112.0m | £945.5m |
| British Land Share | | £147.3m | £1,035.9m | £874.5m |

† Headline rent

Development prospects are those sites and properties where we have identified opportunities for development and are progressing design and planning stages. As an example, during the year we have reached agreement with the Mayor's office regarding provision of a walkway on the site at 201 Bishopsgate, EC2 and have achieved a resolution to grant an improved planning permission. We will undertake these projects in controlled stages, in line with our strategy of adding quality assets to our investment portfolio, with construction commitments made either on pre-lets or on the basis of anticipated market demand.

The sale of our 50% interest in the mixed use development site at Cherrywood, Dublin, has removed a significant element from the programme, although further areas of Regent's Place where master planning is being progressed are now included.

Valuation: total portfolio up by 0.7%

All the properties owned by British Land and the joint ventures were valued by independent valuers, principally Chartered Surveyors, ATIS REAL Weatheralls. A commentary on the commercial property market by ATIS REAL Weatheralls appears later in this report.

The Portfolio, including British Land's share of joint ventures, was valued at £9,645.6 million. On a like-for-like basis (after adjustment for purchases, sales and capital expenditure) the Portfolio showed an overall increase in value of 0.7%. Offices, primarily in the City, decreased in value overall by 6.1%, while our retail portfolio performed well, up by 7.9%. Retail warehouse investments increased by 11.7%, shopping centres increased by 3.3%, supermarkets and shops rose by 11.0% and 11.7% respectively.

The Chancellor in his 2003 Budget in April gave full unlimited stamp duty relief on properties in defined 'disadvantaged areas'. This may have a beneficial effect on the valuations of such properties, which could be enhanced by up to 4%. Our portfolio will benefit from this change in that significant properties now free from stamp duty include Meadowhall, the Eastgate Centre, Basildon, Teesside Retail Park, Stockton, Serpentine Green, Peterborough and a further 150 properties with a value in the region of £3 billion. Our portfolio valuation being dated 31 March 2003 does not take account of this relief. We are already seeing that the benefit of this saving to purchasers is resulting in higher prices being paid. This concession on stamp duty, which required EC approval, is to be reviewed by the EC in 2006.

Performance benchmarking

For several years the Group has used Investment Property Databank ('IPD') to provide independent benchmarking of property returns as one tool in assessing portfolio performance.

The statistics provided below relate to ungeared total property returns of the Group, including our share of joint venture properties and excluding overseas properties, in comparison to the index of fund performance.

Ungeared Total Returns

| | British Land* | IPD** | Threshold to enter IPD Upper Quartile | |
|---------------------------|----------------------------|----------------------------|---------------------------------------|-------|
| | % pa | % pa | % pa | |
| 10 years to 31 March 2003 | 12.7 | 11.9 | 12.3 | |
| 1 year to 31 March 2003 | 6.8 | 9.3 | 11.7 | |
| 1 year to 31 March 2002 | 6.9 | 6.7 | 8.8 | |
| | 12 months to 31 March 2003 | 12 months to 31 March 2002 | British Land* | IPD** |
| | % pa | % pa | % pa | % pa |
| Offices | (0.9) | 1.6 | 4.0 | 6.4 |
| Retail | 14.6 | 14.6 | 9.5 | 6.3 |
| Industrial | 11.9 | 10.6 | 14.2 | 8.0 |
| Other commercial | 12.4 | 10.9 | 7.7 | 9.1 |
| Total portfolio | 6.8 | 9.3 | 6.9 | 6.7 |

* British Land and share of joint ventures

** IPD December Universe (extrapolated to March 2003) – formerly called "IPD All Fund Universe March (unfrozen)"
Source: IPD

Over the one year period to 31 March 2003 British Land has underperformed the benchmark primarily due to its higher weighting of London office properties compared with the benchmark.

British Land's long term ungeared total returns for the ten years to 31 March 2003 have outperformed IPD and place the portfolio's performance in the upper quartile of funds included in the benchmark.

Strategy

The UK occupational property market over the last year has been categorised by a softening of office rents coupled with some growth in retail rents, more particularly for out of town retail. However, the property investment market saw an increase in demand from investors ranging from high net worth individuals through to property companies and institutions. This has resulted in a downward shift on yields, especially for properties with secure and long income flows. Interest rates remaining low and poor returns from the equities market have contributed to this increase in demand for property investment.

Our strategy, combining an emphasis on retail investments and Central London office investments to form a balanced portfolio, coupled with our philosophy of long secure income flows has proved sound; the increase in value of our retail investments has more than compensated for the downturn in value of the Central London offices. The City of London, a principal world financial centre, has excellent long term prospects.

We will continue to stress and analyse our property holdings and anticipate further sales in the forthcoming year. We will seek out new acquisitions within our overall investment strategy, being selective and opportunistic across all the sectors and buying only where we perceive true value.



Robert Bowden

Property Investment Director
27 May 2003