Property Review

Top: Liam Gillick
***Reciprocal Passage Work, 2003* – Triton Square Mall**
Gillick's work complements the architectural aesthetic of the structure it is designed for. Often his pieces take the form of screens or dividers, as with this ceiling installation whose coloured panels add warmth and brightness to a functional environment.

Above: Michael Craig Martin
***Big Fan, 2003* – Triton Square**
This huge work 16.4m by 12.4m, the colours brilliantly lit, is a development of Michael Craig Martin's celebrated wall-drawings and sees him working with light for the first time. The artist responded to the challenge of designing for an outdoor situation with characteristic vigour and inventiveness, creating a piece which at night also illuminates the surrounding buildings and square in which it is set.

Sales and Purchases

The investment market continued to be buoyant with strong competition between purchasers. The increase in medium-term swap rates has had only a limited effect in reducing the capacity of those reliant on gearing and there remains keen interest from a wide range of international and local institutions, corporates and individual investors. In this climate, we have been active in reviewing and bidding on acquisition opportunities. We are not willing to chase the market, where we believe some higher bids do not fully reflect the risks involved. We have a well balanced, high quality portfolio, which is strongly positioned in sectors that conform to our strategy. We do, however, continue to seek opportunities where we can find value.

We have also continued to review our portfolio and have again been active sellers, taking advantage of the current market. Our trend of achieving sale prices above the latest valuation has been maintained, at 11% in the half year (9% last year). This confirms the ongoing strength of the investment market.

Sales of £192 million, including joint venture properties and our share in the Cherrywood Properties joint venture were completed in the six months to 30 September 2003. These disposals involved 36 properties (excluding residential units) and included our remaining interest in St Stephen's Green Shopping Centre, Dublin for £44.8 million, 14 retail (mainly high street) units in BL Universal for a total of £47.6 million and 11 pubs (at auction) for a total of £16.3 million. Since September, we have completed or exchanged contracts for sales totalling a further £91 million, also at prices well above valuation.

Purchases of £17 million, including joint ventures, were completed in the six months and have been valued at September 2003 at 12% above cost. A further £4.5 million of residential investment acquisitions have been made in October.

On 17 November 2003, British Land acquired the 50% share in **BL Universal PLC** held by GUS plc. This joint venture company was established in February 1997 when it acquired 982 properties, being mainly high street shops with an average lot size of £900,000, from the Great Universal Stores group. Since then, the joint venture portfolio has been repositioned:

- 894 properties have been sold (or relinquished) for a total of £768 million,
- the proceeds have been reinvested during the course of the joint venture in the acquisition and retention of 13 properties, primarily retail warehousing, at a total cost of £357 million, with funds also utilised to repay debt and return cash to the joint venture shareholders,
- a range of redevelopments and refurbishments have been carried out to improve retained assets,

- the portfolio now comprises 101 properties, with an average lot size of over £7 million, some 80% retail warehousing and shops, and 20% offices, with net rental income of some £50 million per annum.

This preferred portfolio has been managed and selected by us over the last six years in the joint venture. The purchase price was based on the independent valuation of ATIS REAL Weatheralls at £761 million as at September 2003. The purchase of shares is an efficient form of acquisition where transaction costs are low. Taking into account income and capital returns to British Land from the joint venture since inception and its November 2003 market value, the venture has shown a 12% annualised ungeared return before tax.

BL Universal owned a 40% interest in the **St Nicholas Centre**, a 10,700 sq m (115,000 sq ft) Shopping Centre in Aberdeen with a strong tenant mix, mainly let to national multiple retailers. In a series of transactions, on the day of our acquisition of the GUS share in BL Universal, British Land purchased both the outstanding 60% interest in St Nicholas Centre for £31 million and the remaining long leases of a further two prime shops in the Centre for £11.6 million. We are pleased to have been able to piece together these interests, which will enable us to consider plans for the future development of the entire Centre.

Property Asset Management: annualised net rents £539.1 million

We continue to grow rental income from active management of the portfolio. Annualised net rents at September 2003 were £539.1 million. This compares to £545.8 million as at March 2003 but reflects a reduction of £18.975 million per annum due to a rent free period granted to the European Bank for Reconstruction and Development in exchange for an extension of lease term and removal of a tenant's break clause. EBRD rent payments will recommence in November 2006. After taking into account sales, annualised net rents have increased by £18 million due to rent reviews, new lettings and expiry of rent free periods.

At Meadowhall we have concluded 23 new lettings and seven rent reviews increasing income by £1.6 million per annum. Total rental income is now £69.9 million per annum. The major refurbishment of the popular 'Oasis' foodcourt has been completed, providing some 400 additional seats giving a total capacity of 1,400 (in addition to the separate restaurant and café units). We now expect increased turnover at the units in the foodcourt, which will result in additional rents.

At Broadgate, in the half year, rent review settlements have been reached on four tenancies, totalling 41,800 sq m (450,000 sq ft), increasing the passing rent by over £1.1 million per annum.

Further income	Contracted £m	Not Contracted £m	Total £m
Annualised net rents, 30 September 2003	539.1		539.1
Reversions within five years	31.9	27.3	59.2
Committed developments	19.4	21.6	41.0
Development prospects		103.4	103.4
Total	590.4	152.3	742.7

Voids in the portfolio are very low at 2.4% of total rental value, including areas under offer and those subject to asset management initiatives.

Reversionary income from the current investment portfolio is expected to increase rents by £59.2 million within the next five years, of which £31.9 million is already committed (£18.975 million from EBRD and the balance arising on the expiry of rent free periods and minimum rental uplifts contracted under existing leases). Further income will be generated from the development programme, where £19.4 million is already contracted under pre-lets.

Principal sectors

Retail represents 49% of the total portfolio by value. Our primary focus is on out of town investments which account for 80% of the retail portfolio, the remaining 20% being in high street and town centre shopping schemes. Retail sales are continuing to grow (for the three months to October 2003 at 3.7% higher than a year ago) although at a slower rate than previous years. Out of town shopping continues to take an increasing share of total retail spend, current sales growth is projected at 6% per annum. Consumer preference and a limited supply of these properties have resulted in sustained retailer demand, improved rents and increased values.

Supermarkets have been the best performing class in the portfolio this half year with prime estimated rental values continuing to rise and yields tightening. Store size is critical to operators who are continually expanding their range of goods. The average size of the Superstores, which represent 95% by value of the overall supermarkets portfolio, is now 6,450 sq m (69,500 sq ft) and we continue our programme of extensions.

At Meadowhall, visitor numbers between April and September 2003 are 1.9% higher than the equivalent period in 2002, reaching a total of 24.4 million for the year. The average spend per party has risen in each month surveyed, April to September 2003, over the same month in 2002.

Offices represent 46% of the total portfolio by value and, of this, 95% is in Central London. The Central London investment market remains strong with £4.4 billion of transactions recorded in the first three quarters of 2003. However, letting activity remains subdued. At the end of Q3 2003, agents' research indicates the City market vacancy rate had increased to around 14% of total office space. It is expected that the small amount of new supply in hand will complete in 2004 and thereafter no further significant new supply is anticipated. We are encouraged by the recent increase in 'viewings' by tenants and that the job losses in the City appear to be at an end, with some sectors now considering recruitment. Recent research indicates that employment in existing businesses in the City is expected to increase over the next four years. If take up of space even at the historically low 2003 levels is achieved, the vacancy rate is forecast to fall and in 2005/6 we can expect rental growth to return.

British Land's City office investments are of high quality and in the best locations, and have income generated from long leases with upward only rent reviews from strong covenants. The weighted average lease length of the City office portfolio is 12 years to first break and 14 years to expiry. With upward only rent reviews, rental income can only fall at lease expiries or on tenant breaks. Accordingly, capital values are protected by this long lease profile.

Controlled Development Programme

At 30 September 2003	Net Area sq m	Rent† (est) pa £m	Construction cost £m	Cost to complete £m
Completed				
Total	8,680	1.0	5.2	–
British Land Share		1.0	5.2	–
Committed				
Total	**80,490**	**41.0**	**312.8**	**109.3**
British Land Share		41.0	312.8	109.3
Development prospects				
Total	362,300	113.8	761.7	732.1
British Land Share		103.4	686.7	660.7
Total	442,790	154.8	1,074.5	841.4
British Land Share		144.4	999.5	770.0

†Headline rent

During the last six months, the third phase of the distribution warehouse development at Heathrow Gateway was completed. Negotiations with potential tenants are in hand.

Committed projects are now limited to 1 Plantation Place, EC3 (part pre-let to Accenture), 2 Plantation Place, EC3, and 10 Exchange Square, EC2 (Broadgate). These office developments are proceeding on programme and budget.

Development prospects are sites and properties where opportunities for development have been identified and are being progressed through design and planning. Examples from the half year include achievement of improved planning consents at 201 Bishopsgate, EC2 (offices), Thatcham, Berkshire (distribution) and York House, W1 (offices and residential). 84% (by area) of development prospects now have detailed or outline planning consents.

These projects will be undertaken in stages, in line with our strategy of adding quality assets to the portfolio, with construction commitments made either on pre-lets or on the basis of anticipated market demand.

Valuation

All the properties owned by British Land and the joint ventures were valued by independent valuers, principally ATIS REAL Weatheralls, whose commentary on the commercial property market follows this review.

The portfolio, including British Land's share of joint ventures, was valued at £9,649.1 million, a small increase (on a like-for-like basis, after adjustment for purchases, sales and capital expenditure) of 0.2%. This valuation benefited from the stamp duty relief in respect of properties in defined 'disadvantaged areas' provided in the April 2003 Budget, to the extent of some £120 million.

The portfolio valuations by use and by sector, and the changes over the half year, are shown on the highlights at the front of this section.

Outlook and Strategy

The retail sector has continued recent trends, with growth in rents, particularly for out of town properties, and with good tenant demand. Office rents in Central London have softened. The investment market overall remains buoyant with demand from a wide range of UK and overseas investors and support from lenders.

The portfolio as a whole, due to its balance between retail and offices, coupled with the long lease profile, has shown resilience to the softening of Central London office rents and values, our retail portfolio effectively underpinning office value declines over these first six months.

We maintain our approach to portfolio review and anticipate further sales over the remainder of the year. We expect to continue to seek acquisitions, where we find the right value opportunities.

Robert Bowden Property Investment Director
25 November 2003