

# Property Review

Property is continuing to be an attractive investment class, combining a regular income flow from committed rents with longer term capital appreciation from rental growth and/or tightening of yields. Institutional and private investor demand has increased substantially across all property sectors.

## Valuation: up 3.8%, adding £400 million

The external valuation of the British Land portfolio, including its share of joint ventures at 30 September 2004 was £11,065.9 million, an increase in the six months since 31 March 2004 of 3.8% (£400 million: including the valuation movement in developments, purchases and capital expenditure, and excluding sales).

Values have increased in every sector of the portfolio. Our retail assets have risen by 4.3% in the six months: retail warehouses continue to outperform, ahead 9% and high street shops are up 5.7%. The office portfolio increased in value by 3.4%, with the City, despite a testing letting market, putting on 3.2% primarily due to the quality of the properties and the successful letting of the developments.

Details of the valuation by use and data for the portfolio's long lease profile and current reversions are shown on the tables at the front of this section. Due to negotiation of new long leases and active management, the weighted average lease term has been maintained at 16.9 years (15.7 years to first break).

The majority of the property valuations were carried out by ATIS REAL Weatheralls, whose commentary on the commercial property market follows this review.

## Activity: investment in preferred sectors

**Purchases of £153 million**, including joint venture properties, were completed during the six months to September 2004, and acquisitions of a **further £491 million** of property were completed in October 2004. Principal transactions were:

- the investment of £97.1 million in Songbird Estates plc, representing 15.8% of the consortium which acquired 66.3% of Canary Wharf Group PLC;
- the Queensmere and Observatory Shopping Centres, two adjacent freehold covered malls forming the major part of the retail centre in Slough, purchased in October for £192 million. The Centres provide 52,490 sq m (565,000 sq ft) of prime shopping with an office element, plus two car parks with 1,600 spaces. Tenants include Littlewoods, Woolworths, New Look, Top Shop, Primark, TK Maxx and Argos. The major Marks & Spencer store links to Queensmere and has a return frontage to the scheme. British Land already owns the 7,430 sq m (80,000 sq ft) Alders anchor department store which also links to Queensmere. We believe there is considerable scope for improvement of these investments through asset management initiatives;
- 65 freehold public houses were acquired from Spirit Group for £174 million. Spirit, the largest and leading managed pub operator in the UK, will continue to occupy the properties on a 30 year lease with minimum annual rental uplifts for 20 years, but with a landlord's

option to revert to open market rents from year 15. This purchase adds to the leisure portfolio good quality public houses, with a higher average lot size than our previous pub investments and offers asset management opportunities to enhance value;

- 223 residential units purchased during the year to date for £35 million. These are in the main forward purchases of developments acquired at a discount to final retail prices;
- the joint venture BL Davidson Limited acquired the 50% interest it did not already own in four high quality retail parks and a new industrial/warehouse development, together valued at £122 million.

**Sales of £274 million**, including joint venture properties, completed in the six months to September at **£15 million above valuation**, with a **further £47 million** completed in October, also significantly above March valuation. Principal transactions were:

- the joint venture BL West Limited sold the City office properties at 100 New Bridge Street and Watling House, Cannon Street, London EC2 for £151 million. We considered these two particular properties had medium term risk to capital value due to their lease and rent profiles. Accordingly, these sales were based on stock selection criteria and do not reflect any change in strategy; we remain confident in the City office market;
- the joint venture BL Davidson Limited sold offices at Bonhill Street, EC2 and smaller office properties in EC1, SE1 and W1 for a total of £59 million. These secondary properties achieved £8.8 million above valuation;
- 32 residential units sold for £11 million;
- 17 public houses sold for £22 million from the remaining portfolio held by the joint venture with Scottish & Newcastle plc;
- The Swiss Centre, Leicester Square, London W1 was sold in October for £47 million. This mixed use freehold property in a prime position on Leicester Square was acquired by British Land in phases, reaching 100% ownership in 1999. Since then, our asset management strategy has been to 'empty' the building, including the relocation of the Swiss Tourism Office, in order to be able to offer effective vacant possession to potential purchasers. Income in the meantime was generated by short term lettings. The sale price realised £12 million in excess of the March valuation.

## Developments: letting success

The projects in progress at March 2004 have all completed, **on time and within budget**. In what has been a testing market, we have achieved considerable letting success at these high quality office developments.

Plantation Place, 30 Fenchurch Street, EC3 was launched in July 2004 and all the office space has already let at headline rents of £46-54 per sq ft: Accenture had a pre-letting of 34,840 sq m (375,000 sq ft); Royal & SunAlliance has taken 3,160 sq m (34,000 sq ft) as new group head offices; 4,550 sq m (49,000 sq ft) is let to Aspen Re, an international insurance company and 4,550 sq m (49,000 sq ft) is let to Wachovia, a major US bank.



Proposed new development at 122 Leadenhall Street, EC3

Following the success of Plantation Place, marketing has commenced for Plantation Place South, 60 Great Tower Street, EC3. At the recently completed building at 10 Exchange Square, Broadgate, EC2, following the letting of 4,000 sq m (43,500 sq ft) to Herbert Smith, solicitors, the remaining 11,180 sq m (119,000 sq ft) of new offices has been launched to the market and currently a further 2,320 sq m (25,000 sq ft) is under offer.

#### Completed Projects, since 31 March 2004

Project	Prime use	Size sq m	Rent, pa		Cost <sup>1</sup>
			total estimated	of which let	
Plantation Place	Offices	50,170	£27.0m	£26.0m	£198.7m
Plantation Place South	Offices	14,950	£6.7m	£0.1m	£60.2m
10 Exchange Square	Offices	15,180	£7.0m	£2.0m	£53.2m
Thatcham, Berks <sup>2</sup>	Distribution	23,770	£1.9m		£9.0m
		104,070	£42.6m	£28.1m <sup>3</sup>	£321.1m
<b>British Land share:</b>			<b>£41.6m</b>	<b>£28.1m</b>	<b>£316.6m</b>

<sup>1</sup> Construction cost

<sup>2</sup> BL Gazeley joint venture

<sup>3</sup> Further lettings under offer at £1.8 million pa

We are pleased to have reached agreement for a pre-let with Willis Group, the leading risk management and insurance intermediaries, for a new development at 51 Lime Street, EC3. An application has been made to amend the existing planning consent and customise the buildings to meet the requirements of the tenant, with a target date for first completion at the end of 2006. The development will provide Willis with 43,200 sq m (465,000 sq ft) of high quality accommodation under a 25 year lease (without break). There are no take backs of property vacated by Willis nor any put backs should their space requirements change.

#### Committed Projects

Project	Size sq m	Rent (est) pa	Cost <sup>1</sup>	PC <sup>2</sup> (est)	Pre-lettings (sq m)
<b>Offices</b>					
51 Lime Street, EC3	44,120	£21.4m	£166.8m	Q4 2006	Willis (43,200)
<b>Business Park</b>					
Blythe Valley Park, Solihull	4,920	£1.0m	£8.4m	Q4 2005	
	49,040	£22.4m	£175.2m		£21.0m pa (94%)
Cost to complete:			£166.3m		

<sup>1</sup> Construction cost

<sup>2</sup> Practical completion of construction

Development prospects, as shown on the table opposite, are those sites and properties where we have identified opportunities and are progressing with design, planning applications and site preparation. At Ludgate, EC4, demolition has been completed and substructure works commenced. At York House, W1, demolition is in progress in preparation for an office and residential scheme.

A Resolution to Grant detailed planning consent was made by the City of London Corporation for the new 47 storey tower at 122 Leadenhall Street, EC3, a spectacular but practical design by Richard Rogers to provide 55,870 sq m (601,000 sq ft) of office accommodation. The existing building on that site is presently held as an income producing investment and a decision to proceed with redevelopment will only be taken when circumstances are favourable. Although we have planning consent for 201 Bishopsgate, EC2 we intend to seek a revised consent for a larger development of a tower building together with a low rise building centred around a new piazza.

#### Development prospects, as at 30 September 2004

Project	Principal use	Size sq m	Planning status
Ludgate West, EC4	Offices	11,670	Detailed
York House, W1	Offices	12,830	Detailed
201 Bishopsgate, EC2	Offices	69,360	Detailed
122 Leadenhall Street, EC3	Offices	55,870	Resolution to Grant
Regent's Place, NW1			
(North-East quadrant)	Offices/Residential	56,500	Pending
(Osnaburgh Street site)	Offices/Residential	50,720	Pending
Daventry, East and Central <sup>1</sup>	Distribution	123,530	Outline/Detailed
Blythe Valley Park, Solihull	Business Park	69,390	Outline/Detailed
Theale, Reading <sup>2</sup>	Residential	26,260	Pending
Redditch, Worcestershire <sup>3</sup>	Distribution	34,890	Outline/Detailed
Meadowhall Casino Complex	Leisure	40,240	Pending
Dumbarton	Retail	1,860	Detailed
New Century Park, Coventry	Offices	33,860	Outline
		586,980	

	Rent (est)	Cost <sup>4</sup>
Total:	£161.3m	£1,276.8m
<b>British Land share:</b>	<b>£157.0m</b>	<b>£1,250.4m</b>

<sup>1</sup> BL Rosemound joint venture (DIRFT – Daventry International Rail Freight Terminal)

<sup>2</sup> Countryside Properties has a participation through a Development Agreement

<sup>3</sup> BL Gazeley joint venture

<sup>4</sup> Construction cost

#### Property asset management: more new lettings

In addition to the significant lettings of the recently completed developments, we have agreed new leases at Broadgate, EC2: an entire refitted floor of 3,590 sq m (38,600 sq ft) in 155 Bishopsgate has been let to HBOS; 1,900 sq m (20,500 sq ft) in Exchange House has been let to F&C Management; and 1,170 sq m (12,600 sq ft) at 6 Broadgate has been refitted and let to Ambac, a major US financial group, for its new London head offices. Broadgate offices (apart from the newly completed 10 Exchange Square), comprising 355,000 sq m (almost 4 million sq ft), are fully let.

At Regent's Place, NW1 we have completed leases at 350 Euston Road of 4,500 sq m (48,000 sq ft) to the General Medical Council and 1,440 sq m (15,500 sq ft) to Balfour Beatty, resulting in all office space at Regent's Place being fully let.

In the six months to 30 September, across the entire portfolio (including joint ventures) a total of 86 rent reviews produced an increase in rents of some £4.5 million pa, up 18% overall on the previous passing

rents. Lease renewals and new leases, a total of 130 transactions, will increase rent by £33.9 million pa over the next three years.

At the ILAC Shopping Centre, Dublin, owned in conjunction with Irish Life, we entered into an agreement to lease 1,300 sq m (14,000 sq ft) on two trading levels to provide a flagship store for H&M, one of Europe's leading fashion retailers. This transaction involves the remodelling of the principal Mary Street entrance, being the first element of the proposed phased refurbishment of the Centre.

Tenant mix has been improved and rental income increased as a result of asset management initiatives at the Peacocks Centre, Woking. The food court has been modernised and the customer facilities upgraded, together with the creation of additional retail space. A new unit of some 650 sq m (7,000 sq ft) has been formed by the amalgamation of three units and has been let to HMV, significantly increasing footfall and improving this area of the scheme. A new 1,300 sq m (14,000 sq ft) unit is being constructed and is pre-let to Tesco to trade as a Metro store.

At Meadowhall, following on from the completed refurbishment and extension of the Oasis, we are now upgrading The Lanes with new ceilings, lighting and flooring. We are planning further enhancements including remodelling of balconies, renewal of ceiling finishes, improved lighting, decoration and air handling of the whole Centre, to create a better shopping environment. These works will be phased over the next three years to allow uninterrupted trading.

Within the next five years, **further rents of £99.7 million pa** are expected from the existing investment portfolio, of which **£55.7 million pa is already contracted**, resulting from the expiry of rent free periods and minimum rental increases. Additional income will be generated from the development programme, outlined above.

Further rent	Total £m	of which contracted £m
Annualised net rents, 30 September 2004	565.0	565.0
Reversion*, five years	99.7	55.7
Committed developments	22.4	21.0
Development prospects	157.0	
<b>Total</b>	<b>844.1</b>	<b>641.7</b>

\* Includes rent reviews, expiry of rent free periods, lease break/expiry and letting of vacant space at ERV (as determined by independent valuers)

#### Portfolio sectors: 52% retail, 43% offices

**Out of town retail represents 77%** of the retail portfolio, with the balance being in selected good high street locations and main provincial town centre shopping schemes, where we consider the long term investment prospects are sound. Out of town shopping is continuing to achieve an increasing share of total retail spend (although growing at a lower pace recently). Our retail warehouses have performed well. Retailers are keen to take space in these locations and this demand, together with potential to improve the properties through asset management initiatives coupled with a restrictive planning regime, offers good prospects for growth in rents and values.

The superstores, where we calculate that we are one of the largest owners in the UK, other than the operators themselves, are also in demand from retailers who continue to require more and larger stores,



**The Peacocks Centre, Woking**



**The ILAC Shopping Centre, Dublin**  
Remodelled Mary Street entrance

where a wider range of goods can be sold, particularly clothes and household goods where profit margins are higher. Our superstore portfolio is well positioned in this trend with an average size of 6,500 sq m (70,000 sq ft) and 81% of the stores are over 3,700 sq m (40,000 sq ft).

**Central London offices form 94%** of the office sector of the portfolio, with high quality buildings in the best locations, let on long leases with contracted rents from strong covenants. The notable successes in achieving lettings in what has been a difficult market are, in the main, due to the quality and location of our product, designed to meet the needs of the modern tenant. These lettings will contribute significant additional rental income and are an encouraging confirmation of the improving take up in the market and increasing tenant demand for the best quality office space. We consider that these factors, coupled with very limited new supply, should result in vacancy rates (which have already started to fall) continuing to decline through 2005 and 2006, so we should see the beginnings of rental growth at the turn of 2005 into 2006.

#### **Outlook**

With retail expenditure still forecast to grow at above the rate of inflation over the next few years, we can anticipate further growth in retail investment values through rent increases and tighter yields.

The outlook in the short to medium term for Central London offices is positive, with the combination of improved demand and reducing availability of the required accommodation expected to produce rising rental values, and consequently capital growth.

The British Land portfolio is well placed to benefit from these trends. The focus is, as it has been for some considerable time, on the principal preferred sectors of Central London offices and Retail, with the emphasis on out of town but still with a strong selective presence in town through high street shops and shopping centres. We are also ready and able to be flexible in investing in additional areas where we see opportunities for growth. We will continue with our development programme with commitments to construction taken when we consider the circumstances to be favourable.

**Robert Bowden** Property Investment Director  
23 November 2004