

The continued pressure of investment demand for UK property has resulted in further tightening of yields and consequently higher values.

Views on the property market

Current conditions

Investors across a broad range, including overseas purchasers and new property funds, find **UK property attractive** because:

- over the last 10 years total returns from property have been higher at 11.2% per annum than those from equities and gilts at 8.1/8.8% per annum
- income yield on property is higher than both gilts and equities, and above inflation
- property returns have been much less volatile
- well let property remains readily financeable with income yield remaining above the cost of borrowing
- property provides diversification benefits in an investment portfolio
- further rental and capital growth is expected.

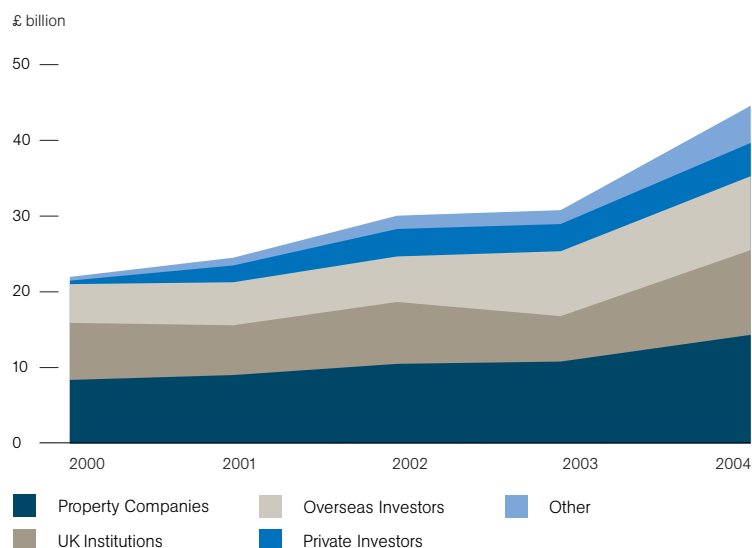
In addition, readers familiar with the UK real estate market will already be aware of these **key structural features**:

- lease contracts usually have a term of between 10 and 25 years, regular rent reviews, typically every five years and upwards only, with tenants fully responsible for repairs and insurance
- demand drivers, from the UK's overall density and population growth, with a growing open market economy and a flexible labour force, particularly in London's experienced multinational financial sector
- supply constraints due to limited availability of land and a restrictive planning regime which tend to create barriers to new supply and support land values (although the pre-requisite work and costs of submitting planning applications have risen)
- transparency of the market with an established legal and transactional system, open access to land registry and a regulated and established valuation profession.

These current attractions and fundamentals of the market have been and are still resulting in **competition between buyers** for available property, and increasing upward pressure on market prices. UK institutional weighting to property has been low and is being re-rated, with institutions seeking to match commitments with bond-like income and growth potential. Overseas purchasers represented about one-third of total property acquisitions and European investors are now meeting competition from US and Australian purchasers.

As we anticipated at the interim report, the continued pressure of investment demand for UK property has resulted in further tightening of yields and consequently higher values. This yield shift has affected higher yielding secondary properties to a greater extent than for prime assets, as strong investor demand has led to the greater risk factors in secondary property being heavily discounted. Investors have reviewed their approach to UK property as an asset class and there is now a more favourable appreciation of its merits and investment qualities.

Purchases – strong investor demand for property



Source: Property Data

Retail

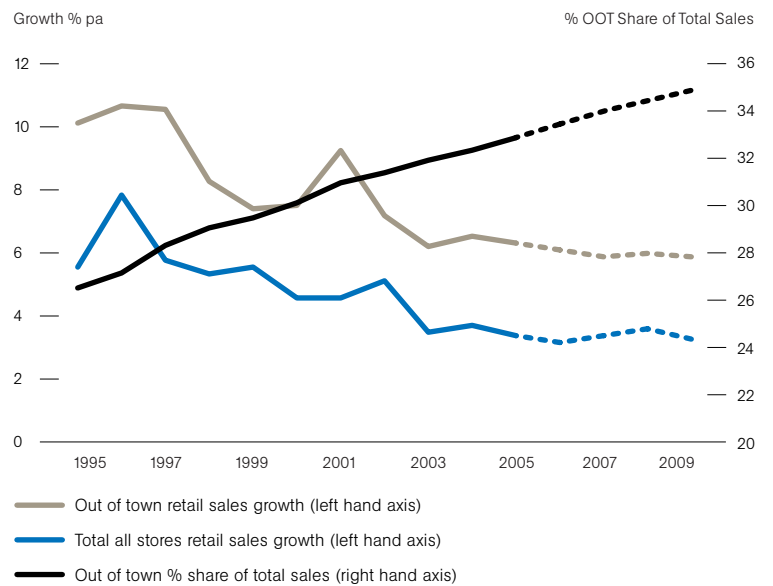
Retail sales have been much in the news recently and it is widely reported that in many cases the rate of sales growth has slowed. The high levels of consumer expenditure have paused as individuals' earnings growth has moderated and discretionary spending power has come under some pressure. For the retailers, overall operating margins have built up some resilience and rents as a proportion of sales is steady, so rents are not too high.

More significantly for British Land's portfolio positions, **out of town retail**, where our retail portfolio is focused, continues to take an increasing share of the total consumer spend; out of town sales grew 6% in 2004 with further growth forecast over the next five years, such that by 2009 out of town is expected to take over 34% of total retail sales. Fashion retailers need open A1 planning consents and these properties, which have good potential, represent 59% of our out of town retail warehouse portfolio. All retailers are continuing to require the large floorplate units provided on good out of town sites where they achieve on average a higher ratio of the value of sales per cost of rent. At the same time, the planning regime continues to limit the supply of new retail parks, concentrating both occupier and investor demand and maintaining pressure on rental and capital values. The introduction later this year of further planning restrictions relating to mezzanine levels, which has prompted a flurry of construction, will further add to the limitation of floorspace at these preferred locations.

In town retail still has an important position in the portfolio, where we concentrate on the best towns and high streets, and assets which have good opportunities for growth under our management.

Retailers' demand for trading space remains strong and overall retail rents have continued to grow, particularly out of town, and while the retail climate is feeling more challenging, we expect the supply and demand factors to continue to be favourable for our assets.

Out of town continues to take an increasing share of total retail sales



Source: Verdict on out of town retailing 2005



Meadowbank, Edinburgh

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Finsbury Square, Broadgate EC2

Offices

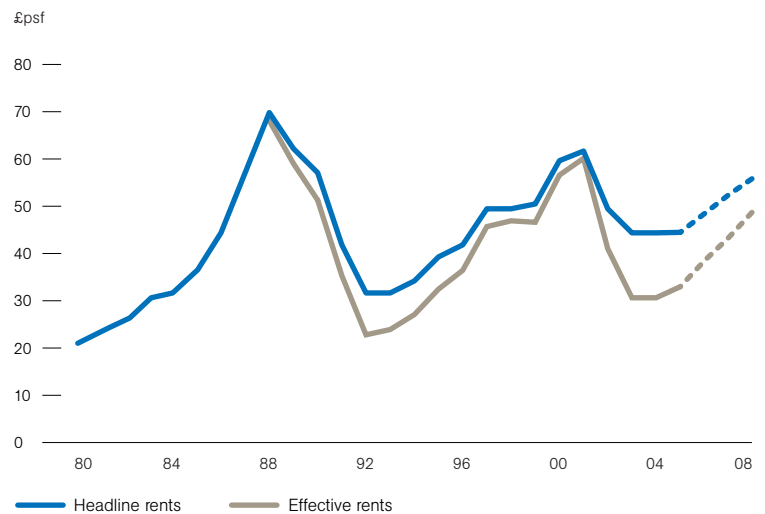
London is a financial centre of global importance with competitive advantages including its highly skilled and flexible labour force, ideally located time zone, stable political, economic and legal system and a workable regulatory environment.

The Central London office occupier market has been through a testing few years with tenant demand subdued and rental values declining. During the last 12 months tenant demand has picked up and is now running at a level around the average for the last 10 years. Occupiers are seeking well designed and high quality space. British Land design and development standards have met these requirements and our developments have let well. Overall in the year we have agreed lettings of 63,000 sq m (680,000 sq ft) of City office developments.

Projected City rents:	Agents' consensus		BL City rent reviews % of rent roll
	Range £psf	Average increase	
2005	45.00-48.00	+1.9%	14
2006	47.50-50.40	+5.1%	19
2007	52.50-55.40	+9.3%	14
2008	57.00-59.00	+8.3%	23
2009	59.75-63.00	+5.1%	28

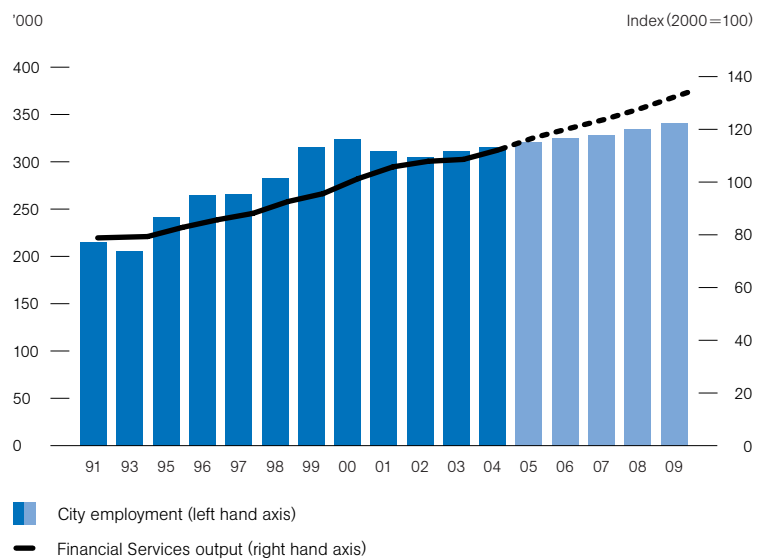
As the City office market is now considered to be in the early stages of recovery with demand for space at trend levels, the take up of space is expected to increase. Due to reduced availability of required accommodation as a result of new speculative developments all but ceasing in 2003, rising rental values can be expected from 2006. Agents' forecasts show an average increase in headline City office rents in the range of 5-9% per annum over the next three/four years. We are aware of early indications of new development starts increasing, but any potential increased supply will only arise in the longer term cycle.

City office headline and effective rents – forecast to rise



Source: Property Market Analysis (PMA)

City employment set to rise



Source: centre for economics and business research (cebr) Spring 2005

British Land is positioned for growth through investment in prime assets, principally out of town retail and Central London offices.

Outlook

Looking at the principal features of the UK property investment market we see that:

- rents are affordable in most sectors across the UK economy
- global competitiveness issues may restrain occupancy and rental growth, except where supply and demand imbalances exist
- the yield shift seen for property has been supported by fundamentals of comparison of the risks versus returns from alternative asset classes; this yield correction is now slower but continuing
- investor demand is still exceeding supply as property reweighting is in progress, which REITs can only reinforce.

Sentiment towards the property sector overall is also affected by the UK's economic performance and, in particular, levels of interest rates. There are no signs of rate increases at present and UK property yields overall remain significantly above market spot and 10 year interest rates.

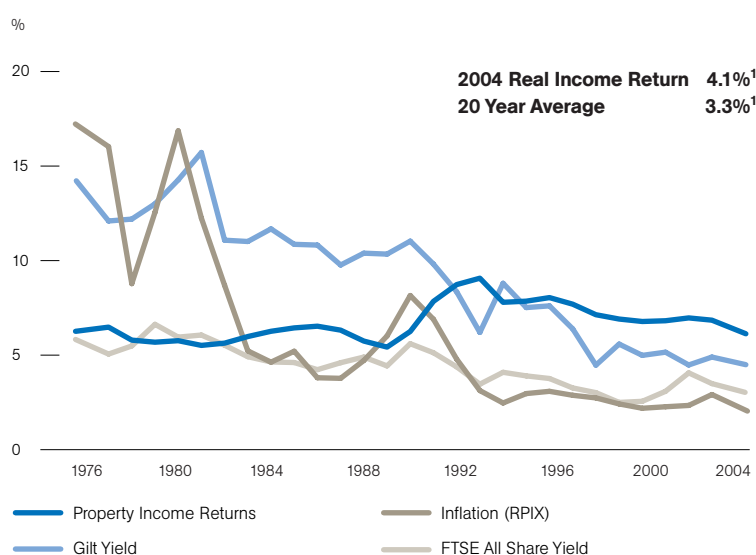
Property Market Analysis LLP, Europe's largest independent property research consultancy, has identified Central London offices and out of town retail as the sectors with the best prospects for total returns over the next five years. British Land's portfolio is strongly weighted in these sectors.

Portfolio positioned for growth with security

PMA* forecast – next 5 years	Average ungeared total return % pa	British Land's weighting %
Shopping centres	5.5	20
Retail warehouses	10.1	26
High street	6.0	10
Central London offices	7.9	37
Provincial offices	5.9	2
Industrial	6.6	2

*Property Market Analysis LLP
 †including superstores

Property continues to offer relative value



¹Real income return is property income return less inflation.
 Source: IPD, National Statistics, Datastream

British Land is positioned for growth through investment in prime assets, principally out of town retail and Central London offices. Security against any downside risk is provided by the quality of the assets, let on long leases to strong tenants, including a significant proportion of guaranteed minimum rental uplifts.