

Business Opportunity and Risk Management

Business strategy

British Land's strategy seeks to achieve long-term growth in shareholder value by:

- focusing on prime assets in the office and retail sectors;
- creating exceptional long-term investments with strong covenants, long lease profiles and growth potential;
- enhancing property returns through active management and development; and
- maximising equity returns through optimal financing and joint ventures.

The key to high returns is flexibility, both in terms of business organisation and financing to take advantage of shifts in the property market.

Risks and rewards

The Company generates profits for shareholders through long-term investment decisions relating to both income and capital growth. These decisions include exploiting opportunities arising out of natural market volatility with respect to supply and demand imbalances in the following core areas:

- demand for space from occupiers against available supply (including new developments);
- differential pricing for premium locations and buildings;
- alternative use for buildings (particularly redevelopment);
- demand for returns from investors in property, compared to other asset classes;
- price differentials for capital to finance the business;
- legislative initiatives, including planning consents and taxation (such as the Government's consultation on introducing a tax transparent property vehicle (REIT) in the UK);
- economic cycles, including their impact on tenant covenant quality, interest rates and inflation; and
- mis-pricing of property assets by the equity markets (for example, share buy-backs or opportunistic investments).

These opportunities can also represent risks. Demand for property and the ability of tenants to pay rent can be affected by general economic conditions at both a macro and local level. Excessive levels of supply of property can also lead to falling rental levels. Rising interest rates may impact the security of the tenant base, lower development margins significantly and reduce investment appetite. Property values are also affected by changes in planning, taxes, technology and lease structures. Interest rates, bond yields and the relative attractions of other asset classes also impact property values. These risks in the UK property sector can be amplified by development exposure and gearing.

Internal control

The Company's management structure and internal control environment are influenced by British Land's nature as an entrepreneurial property Company. As such it is a capital rather than people intensive business with assets under management of £13.9 billion, managed by a Group executive of approximately 60 people. Entrepreneurial success requires speed of action to catch the moment in the markets – to buy or sell property, to raise funds on the best terms.

The directors are responsible for the maintenance of a sound system of internal control. The Board continues to apply the internal control provisions of the Combined Code through a continuous process for identifying, evaluating and managing the significant risks the Group faces. The process has been in place throughout the year from the start of the year to the date of approval of this report and is in accordance with Internal Control: Guidance for Directors on the Combined Code published in September 1999. The Board is responsible for the Group's system of internal control and for reviewing its effectiveness. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Group applies two fundamental control principles:

- a defined schedule of matters reserved for decision by the Board; and
- a detailed authorisation process which ensures that no commitments are entered into without competent and proper authorisation by more than one approved executive.

In compliance with the provisions of the Combined Code, the Board continuously reviews the effectiveness of the Group's system of internal control. The key risks that the Group faces and features of the internal control system that operated throughout the period covered by the accounts are described below:

Identification and evaluation of commercial risks and related control objectives

British Land has undertaken a comprehensive risk assessment, which has identified over 50 individual risks that affect the Group. The responsibility for management of each key risk has been clearly identified and delegated by the Board to specific executive directors and senior executives within the Group. The executive directors have close involvement with the day-to-day operational matters of the Group. In addition to the main Board of directors, there are operational boards which are responsible for specific areas of the Group's activities.

These include:

- Group management and operations;
- management of property assets;
- management of development activities; and
- financing activities.

The Board and the operational boards consider the risk implications of business decisions. These include matters such as new treasury products and major transactions. The control environment is supported by the various committees of the Board and the operational boards, including the Audit Committee, the Corporate Responsibility Committee and the Derivatives Committee. The way each risk is managed within the Group is considered at least annually by the executive directors and the Audit Committee. The Group re-assesses these risks on a regular basis to ensure that any risks arising from changes in the Group's operations or the external environment are identified and appropriately managed. The detailed individual risks have been categorised into the following areas:

- property investment and management;
- property development;
- taxation;
- management; and
- financing.

In order to provide relevant and timely information to the executives with responsibility for managing risks, the Group has the following key information systems which generate reports as follows:

- a management reporting system which includes regular working capital reports and forecasts;
- operational reporting on property purchases, sales and portfolio management; and
- regular reporting to the Board on financial and treasury matters.

The nature of the specific risk areas and related controls are as follows:

Property investment and management risk

Principal risk

Property values may decline and returns not be optimised; uneconomic investments may be made or under-performing properties retained; significant tenant defaults may reduce income and property values; and property insurance may be inadequate.

Principal control

These include regular reviews of current and future market potential; reviews of each individual property at least twice a year including internal and external assessments, considering current and future values and yield prospects as the basis of sell or hold decisions; benchmarking portfolio performance against peer groups using IPD statistics; consideration of tenant mix covenant strength across the portfolio; and reviewing insurance cover.

Property development risk

Principal risk

Letting risk for speculative developments; construction cost and time overruns; adverse changes in planning and/or planning policy which may cause delay and affect profitability.

Principal control

These include limiting the amount of speculative development; assessing letting potential and prospective profitability of developments prior to commencement of construction; on-going assessment of development expenditure by quantity surveyors with regular comparisons of costs against budget; and ensuring executives are kept up to date with planning policies.

Taxation risk

Principal risk

The Group is exposed to financial risks from increases in tax rates and changes to the basis of taxation including corporation tax, VAT and SDLT.

Principal control

These include regular monitoring of legislative proposals and participation in discussions with Government directly and through trade bodies to understand and, if possible, mitigate the impact of changes and the engagement of experienced executives and professional advice.

Management risk

Principal risk

The Group is reliant on its small, high calibre team of executives.

Principal control

These include the assurance that knowledge of all processes and projects is shared by at least two employees; that the Group recruits and develops high-calibre employees; and that the Board considers succession-planning issues.

Financing risk

Financing policy and risk management are dealt with in the next section.

Monitoring

The Audit Committee meets regularly throughout the year and has reviewed the Group's internal controls. The Audit Committee has agreed a schedule of internal audit reviews of various of the Group's processes and controls to be undertaken, and has reviewed the results of those reviews already completed. The Head of Internal Audit reports directly to the Audit Committee.