

# Chief Executive's Statement



“Even in tough markets our goal of **activist management**, adding value to our property assets, is seeing fulfilment.”

In difficult times, it is popular to retreat to the maxim that real estate (actually substitute the name of any industry you like) is a long-term business and should be judged as such. Well it may be popular, but it's also true. Nevertheless, while we manage for value creation over multiple years, we also need to deal effectively with the short term. This Annual Report seeks to highlight both perspectives.

We are in a stressed economic and market environment. The feed-through to commercial real estate of stress elsewhere is direct and significant to the investment values of our assets, and indirectly to near term rental growth prospects. Nevertheless, British Land has never been in better shape to weather the downturn and emerge with growth prospects intact or even enhanced. The anchor of our business – strong, secure cash flow, exceptional balance sheet security – is firmly in place. Our management actions ahead of market declines have significantly reduced their impact on the Company. Even in tough markets our goal of activist management, adding value to our property assets, is seeing fulfilment. And we have the financial and human capacity to take advantage of opportunities that may present themselves in the latter part of current market distress.

## 2007/8 Results

Underlying earnings per share grew 23% to 53 pence on the back of record underlying pre-tax profits of £284 million.

Our asset values declined by 10% which translated to a 20% decline in EPRA Net Assets per Share (to 1344 pence). The valuation decline reflected the impact of broader global market declines. In fact, at the asset level our management actions resulted in a 1.9% outperformance of capital values versus IPD. And while valuations are constantly moving and not an exact science, the realism of ours

was tested by £3.2 billion gross of disposals during the year across every operating sector, on average at or above the preceding quarter's valuation. There are many competitors who have not so tested their valuations.

The results overall were positively affected by like-for-like rental growth ahead of the market, falling interest costs which are fixed at an average 5.29% rate (the lowest in our sector) and reduced management/administration costs which at 10.9% of net rents and 0.5% of assets are the lowest of comparable companies.

### British Land's strategy and positioning

British Land's strategy is clear and designed to weather market cycles. We are focused on customer needs and intent on delivering outperformance for shareholders in areas where we have or can build competitive advantage. We seek to add value at each level of the business from an activist approach to:

- sector, market and asset selection;
- asset creation and management; and
- balance sheet management, partnership and deal structuring.

In many cases, the fruits of implementing this strategy can be seen year by year. The outperformance of rents and property values versus IPD and the debt structuring highlighted above are examples.

In other cases, strategic decisions are implemented whose effect may be seen over multiple years, not for some years or as avoidance of a negative. An example, apposite to current times, is financial gearing.

Property's predictable cash flows and asset-backing lend themselves to gearing which is an essential tool to achieve competitive returns on equity for public markets. Across cycles, property returns (rental yield plus rental growth) exceed the cost of debt, and so gearing clearly boosts returns. However in the occasional down market (last one for property was early 1990s) gearing works negatively, amplifying asset value reductions despite growing cash flow. Correctly, we saw markets as expensive and brought gearing down from a peak 59% debt/assets in 2005 to 41% in June 2007 (incidentally its lowest level since 1995) before market declines set in. However that decision represents partial avoidance of a negative, and the residual gearing still amplifies our Net Asset decline, though not by as much as it boosted Net Assets in prior years and will again in the future.

Importantly, contracted leases that are the longest, vacancy rates among the lowest, fixed interest costs and debt maturities the furthest out in our sector are all essential complements to gearing, ensuring resilience in the face of market cyclicity – the benefits of which are crystal clear in the current stressed environment.

A similar example of strategy in action is the reduction in the weighting of Offices in our portfolio from 50% in 2002 (the end of the last up-cycle for Offices) to 41% currently, achieved through £2.7 billion of asset sales 2005-8. In the long-run we believe that the industries powering London office occupation will grow faster than others. Coupled with a steeply rising replacement cost of buildings and increased density in London, it's not a sector to ignore. But at this moment in time, the cycle that boosted London office valuations over 20% in the 24 months to September 2007 will go backwards by an amount.

So, despite market turmoil and uncertainty, the activist strategy, built on enduring fundamentals of prime property, customer focus, predictable cash flows and careful risk management, remains the

right approach. Short-term pain can be mitigated but not avoided. And, with significant interest in British Land equity ourselves, your management team are completely aligned with shareholders and clearly motivated to deliver enduring value.

### Real estate markets

What is happening in real estate markets represents collateral damage from re-pricing of risk, liquidity fears and economic pressures more broadly. As such, the answer to when and at what level prices settle cannot be accurately given until the broader picture clears. But meanwhile, unlike most industries, the comfort of buildings that stand for decades, cash flow from upward only leases averaging nearly 15 years in duration and no refinancing requirements, is not to be sniffed at.

We believe that property pricing is now generally much more supportable than at the market peaks when we were large scale sellers and that the worst of yield correction 'should' be behind us. The slowdown of price declines in the last quarter supports this view. However, markets have often been known to overshoot in both directions and we do expect a further decline in the current year. And it is still possible that governments don't take sufficient avoiding action and stabilisation in financial markets is postponed. The extent of the feed-through of market turbulence to the 'real' economy and thereby to our customers is now an important risk factor.

So we have our tin hats on and are busy toiling in the trenches, both to further strengthen our defences and to lay the ground for appropriate offensive when the opportunity arises.

There is plenty of upside to aim for. Our management efforts can produce outperformance, our balance sheet leverages that result with security, we have capacity to take on new challenges if cheap, our customers and locations will give us long-term growth – and last but far from least, our stock price which currently exaggerates gloom can just as easily provide outperformance as gloom recedes.

### Our people

These times are punishing on our people, working hard in unforgiving markets. We have continued our determined efforts to renew management and to engrain an activist, performance culture. In short to ask more and get more from our people. My thanks go to all of them for rising to the challenge and for their work, past and future.

**Stephen Hester**

Chief Executive

19 May 2008