

Business Unit Review – Retail Portfolio

Our retail business represents 44.7% of the combined portfolio by value, and includes 28 shopping centres and 29 retail parks. With over 1,600 occupiers and 1.7 million m² of retail accommodation, the Retail Portfolio has a 5.1% share of the UK's retail commercial property market. Many of our retail properties form the central shopping districts of major cities and towns across the UK and we are investing some £1.2bn to create the next generation of retail schemes through a 380,000m² development pipeline.

National sales data has shown that retail conditions have remained broadly similar over the past 12 months and our experience of leasing conditions on new and existing shopping centres and retail parks is consistent with this, demonstrating continuing demand for our retail development pipeline.

Across our like-for-like portfolio, we saw rental income growth of 4.7%, primarily driven by rent review settlements. These rent review settlements reflect increases in rental value over the last five years. In the last six months, rental values have continued to increase, but at much more modest levels, namely 0.8% for the half year. In line with the wider investment market, valuation yields have increased, particularly for secondary assets and retail warehouses and this depressed capital values. However, we have benefited from strong performance from completed developments and also the greater resilience to adverse yield change of some of our high quality shopping centres. As a result, we have seen only a small decline in the value of the Retail Portfolio of 2.2%. The reversionary potential of the portfolio remains strong at 12.0% and void levels are below market average at 4.0%.

Sales, acquisitions and asset management

We have continued with an active sales programme. We sold £589.1m of retail assets, the largest of which were the Whitefriars shopping centre in Canterbury and our 50% stake in the East Kilbride Shopping Centre in Scotland. Our sales also included £121.9m of retail warehouse assets. On average the sales were at prices 4.1% above March 2007 values (before disposal costs).

Retail investment acquisitions were not our priority during this period, but we have agreed to acquire a major development opportunity by establishing a partnership with Caddick Developments regarding its £80m Trinity Shopping Centre in Leeds. This centre which will be integrated with our Leeds Shopping Plaza, an asset we acquired in 2005 as part of our corporate acquisition of Tops Estates plc. This scheme is planned for completion in 2010. The combined development incorporating our refurbished Leeds Shopping Plaza will provide a total of 83,640m² of retail floorspace in a prime location in the centre of Leeds.

We have secured some £10.3m p.a. of rent in new lettings within the portfolio, all of which have either driven rental growth or improved tenant mix.

Our void levels have increased slightly on a like-for-like basis and are now at 4.0% of ERV. 26% of these are currently in solicitors' hands and a further 17% are being held vacant pending redevelopment or refurbishment work.

We continue to create additional revenue opportunities from within our Retail Portfolio. As an example of this, 14 of our shopping centres have entered into an advertising partnership with Sky which will generate some £3.5m over the next five years.

Development

We made excellent progress on our retail development programme, completing 59,710m² of retail floor space with an annual rent roll of £16.7m and letting some 18,000m² across our major schemes.

We successfully launched our 44,600m² mixed use regeneration scheme at Princesshay, in Exeter city centre in September 2007. Introducing 35 new retailers to the region and providing retail accommodation for 14 independent traders, the scheme demonstrated that the right retail product attracts strong demand from retailers. Christs Lane, Cambridge and the first phase of Corby's regeneration also achieved significant retail pre-lets ahead of their openings.

The 140,000m² Cabot Circus scheme is set to transform the heart of Bristol upon its launch in September 2008. Together with our development partner, Hammerson, we have secured 59,000m² of lettings bringing it to 79% pre-let or in solicitors' hands by floor area or 68% by income, 12 months ahead of opening. The retail led mixed use scheme will establish Bristol as one of the leading fashion and leisure destinations outside London.

In Cardiff we are progressing the St David's 2 development with Capital Shopping Centres to regenerate the city centre with 106,400m² of retail, leisure and residential accommodation. The first phase of the catering units is fully let. The scheme will bring the first John Lewis department store to Wales and is on schedule for an autumn 2009 opening.

Construction is underway on The Elements, Livingston, where we are extending the existing shopping centre to provide an additional 32,000m² of retail space, 5,670m² of leisure, residential accommodation and new public spaces. Debenhams and Marks & Spencer will anchor the scheme which is on schedule for an autumn 2008 completion.

In our retail warehouse portfolio we completed 22,350m² of new space including the 13,380m² Peterborough Retail Park, which was 91% pre-let to B&Q and Matalan, with one remaining unit under offer. At Thanet we completed a 8,970m² leisure park, which is 100% pre-let, and is adjacent to our Westwood Cross fashion park improving the mix of uses and the overall car parking provision.

In April we submitted a joint planning application with Henderson Global Investors for the 65,000m² expansion of Buchanan Galleries, Glasgow, and a resolution to grant outline planning consent was passed in early November. The new scheme will create further retail space in the UK's second ranked shopping destination, and will also provide residential accommodation and upgraded transport facilities for the city centre.

Business Unit Review – London Portfolio

During the last six months we have continued to implement the strategy we set several years ago. We have executed our programme of sales of mature, potentially ex-growth assets. We have also continued to deliver strong performance from our development properties with some market-leading leasing transactions.

Our London Portfolio represents 54.9% of our overall investment portfolio by value. This 1.1 million m² London Portfolio represents a 5.1% share of London's total office accommodation. We continue to invest in our mixed use development clusters across the capital, creating innovative buildings in improving areas. We currently have over 600 occupiers in our London Portfolio accommodating more than 50,000 people.

The London Portfolio delivered a strong performance with a valuation surplus of 3.6%. This was driven by a 7.5% surplus on our developments. The valuation increase for the like-for-like assets was 2.7%. We saw growth in rental values of 9.5%, and the portfolio is now 19.1% reversionary. Void levels have declined from 4.8% in March to 4.4% in September on a like-for-like basis.

Sales, acquisitions and asset management

During the first half of the year we have sold £333.3m of London property, including Greater London House, NW1 and 20 Blackfriars Road, SE1. Our properties sales were, on average, at 15.3% above March 2007 values. We purchased £537.1m of investment properties with a focus on the areas to the east of the City, which we had already identified as providing future growth potential, namely Harbour Exchange, E13 and Thomas More Square, E1. This latter complex provides over 52,000m² on a 4.2 acre site and is let at low rents averaging £28psf. We also completed the purchase of a further 50.5% interest in Times Square, EC4, in Queen Victoria Street in the City, taking our holding to 95%.

With the recent disposal (after 30 September) of our Lime Street Estate in EC3, we have largely completed the sale of assets identified for disposal 18 months ago. We believe the balance of the portfolio provides a strong blend of investment assets and buildings offering medium-term development opportunities.

In terms of asset management, we have focused on two key areas: firstly, maximising income, in the short-term on assets targeted for redevelopment in the next cycle; and, secondly, improving the performance of our Central London retail assets with a particular focus on customer relationship management.

Development

We have delivered excellent performance from our developments. We initiated our development programme early in the cycle, anticipating improving market conditions. We have been rewarded for this early commitment to development by the levels of development surpluses and the fact that we have already let 93% of our schemes which are due for completion in the current financial year.

The London Portfolio has secured strong development lettings totalling 60,800m² over the six month period. These include the letting of Bankside 2&3, SE1 to Royal Bank of Scotland, 35% of the office space at One New Change, EC4 to K&L Gates, and further lettings at New Street Square, EC4. The office space at New Street Square is now 87% let and has set record rents for the Mid-town market, establishing the location as a leading destination for the legal and professional community. The offices at Cardinal Place, SW1 are now fully let to occupiers including 3i and Microsoft; and One Wood Street, EC2 has been handed over to the occupier, Eversheds, for fitting out.

With the good progress of lettings on the latest phase of developments, we have moved on to focus on the new generation of schemes to be delivered beyond 2010.

At 20 Fenchurch Street, EC3 we received notification that the Secretary of State has confirmed the grant of planning consent for our proposed tower building. Demolition works are already underway and will complete in March 2009. At that time we will review how we will take the project forward.

We submitted outline planning applications for some 92,900m² of space at Ludgate Hill, EC4 and Fleetbank House, in Salisbury Square, EC4. In August we also submitted a joint planning application with Transport for London for the 'Victoria Transport Interchange', a 180,000m² regeneration of the area to the north of Victoria station, to include office, retail, leisure and residential accommodation. The application also sets out our proposals to improve the public realm and address the capacity constraints of the local transport network to create a world class transport interchange.

Business Unit Review – Property Partnerships

Trillium provides Property Partnership services in the outsourcing and Public Private Partnership (PPP) markets. In the six months under review it generated 19.9% of the Group's underlying operating profit, some £57.8m. This business now has 4.8 million m² of floor space under ownership or management. It is involved in 123 long-term partnerships, providing accommodation services to more than 455,000 people.

Trillium delivered strong results for the six months under review and made excellent progress on its new business pipeline with £65m invested in seven new PPP acquisitions and a further £209m invested since the period end. In addition to the underlying operating profit of £57.8m, the business also generated £25.1m of profits on disposal.

The outlook for Trillium is positive in terms of new business prospects. In its Pre Budget Report, the Government reiterated that £22.2bn worth of PFI projects (which are part of Trillium's PPP market) are expected to reach financial close before April 2011, and that PFI should continue to form a significant part of the Government's strategy for delivering high quality public services. As a leader in the education and health markets, we believe Trillium is well placed to take advantage of these opportunities.

In addition, the Government restated its objective of selling public sector assets totalling £30bn by 2011. This sales programme will include a significant amount of property assets and the Trillium partnership approach can offer long-term operating efficiencies as well as capital realisation, a potentially more attractive solution.

Trillium Financial Results

The results for the period are set out in the table below:

Table 1: Trillium financial results

	Six months ended 30 September 2007 £m	Six months ended 30 September 2006 £m	Year ended 31 March 2007 £m
Contract level operating profit			
- DWP	45.2	42.8	81.0
- Norwich Union	4.8	3.9	9.2
- Barclays	0.9	1.2	3.3
- DVLA	1.8	0.7	1.7
- Telereal II	7.6	7.0	16.1
- Accor	11.6	-	1.5
- Royal Mail	2.1	-	-
- BBC	-	-	2.8
Bid costs	(3.1)	(1.4)	(2.8)
Central costs	(15.4)	(5.7)	(14.0)
Other	2.3	3.3	-
Underlying operating profit	57.8	51.8	98.8
Net (deficit) / surplus on revaluation of investment properties	(8.8)	0.3	(13.6)
Profit on disposal of properties	15.1	8.5	7.5
Profit on disposal of a PPP project (Meterfit)	10.0	-	-
Segment profit	74.1	60.6	92.7
Share of profit / (loss) from Investors in the Community (IIC) (joint venture)	0.1	(1.1)	(3.0)

Capital employed	2,135.2	663.7	2,032.5
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Existing contracts

On the Department for Work and Pensions (DWP) contract, we disposed of 35,380m² of surplus leasehold space and 33,500m² surplus freehold accommodation. The proceeds from the freehold disposals were £46.9m, which showed a net profit on book value of £14.1m after gain share.

DWP issued vacation notices during the period on 67,026m² (63% leasehold and 37% freehold) and actual vacations during the period were in line with expectations. The negative impact of vacations on our profitability was offset by a one off payment for backdated services, and income growth due to indexation.

We have completed a programme of 13 refurbishment projects on the Royal Mail portfolio and let or disposed of 10,200m² of surplus space, which is ahead of our expectations at the time we won this contract.

On the DVLA contract, we have been awarded three scope extensions to provide an additional 7,000m² of accommodation with capital investment of approximately £26m over the next 18 months.

The turnover on the Accor hotels portfolio increased by 5.6% over the period. However, as a result of yield repricing in the property investment market, there was only a small underlying increase in investment value (excluding purchase costs) during the period.

The increase in central costs primarily reflects the inclusion of the SMIF and IIC businesses.

New business

In July, Trillium announced the purchase of AMEC's Project Investments business for £163.5m which included AMEC's interests in nine signed PFI projects in healthcare, transport and education, one preferred bidder project, and the PFI/PPP bidding and asset management team. Some of the projects were in joint ownership and were subject to pre-emption clauses in favour of the joint owners. As a result of the exercise of pre-emption clauses on two small projects our acquisition now relates to seven signed projects and one at preferred bidder stage for a total net consideration of £152.4m. The purchase was completed after the period end. Since the period end, we have also completed on the purchase of nine new PPP health assets from United Medical Enterprises for a total consideration of £56.6m.

For the Northern Ireland Civil Service, the new Assembly Government has confirmed its support for the outsourcing proposal, and we now await the outcome of a legal challenge to the shortlist selection process. We are one of two shortlisted parties who will be invited to submit best and final offers once this has been resolved.

On the Defence Training Review (DTR) outsourcing contract, our Metrix consortium with Qinetiq remains as preferred bidder on Package 1. Good progress has been made and the Ministry of Defence (MoD) anticipates committing to the final developmental phase in spring 2008, with a view to financial close a year later. Metrix also remains as provisional preferred bidder for Package 2. However, having concluded that there are insufficient efficiencies to move forward with a "Whole Programme Solution" for DTR, the MoD continues to consider a range of options for Package 2, from adaptations of the Metrix proposal through to conventional procurement.

We are shortlisted for the Building Schools for the Future (BSF) projects in Birmingham and Kent where the initial phases involve in excess of £200m of PPP capital expenditure. It is anticipated that the preferred bidders will be announced this financial year.

PPP market update

Following the integration of the of SMIF and IIC businesses last year, the acquisition of AMEC's Project Investments business has further strengthened our position at the forefront of the UK PPP market. We now have an unrivalled team engaged in the development and acquisition of new business opportunities.

Our portfolio and our underlying asset and capital management activities have made significant progress. We are in the process of establishing our own debt aggregation vehicle, which will reduce over the long-term the cost of capital in our underlying investments. The completion of a major school refinancing, together with a 29% reduction in insurance premia through our consolidated buying programme, were also notable achievements.

In April, we commenced the establishment of a new joint venture fund, aimed at bringing in third party investors alongside our own long-term investment in the venture. Once established, this will be the largest venture of its kind in the marketplace. UBS have been appointed as our advisers on this initiative, which is intended to release in excess of £750m of capital and provide us with a further ongoing source of capital that will support our new business platform. Notwithstanding the turmoil prevailing within the credit markets, we have made good progress and expect to achieve a first closing this year with a final closing before our financial year end.

During the period we completed the disposal of Meterfit, one of the non-core utility businesses we acquired as part of the SMIF transaction generating a profit on sale of £10.0m.

Business Unit Review – Urban Community Development

Kent Thameside

Our focus here has continued to move towards delivery of development as the planning phase draws to a conclusion.

At Eastern Quarry, Dartford Borough Council resolved to grant Outline Planning Permission in July 2007 and it is anticipated that the Section 106 Agreement will be signed in November. This will allow the development of up to 6,250 homes and 232,000m² of office, retail, leisure and community space. It is anticipated that infrastructure works will commence in 2008 with construction of the first dwellings beginning in late 2009.

At Ebbsfleet, the new international train station opens on 19 November 2007 for Eurostar services providing a total of 12 trains a day to Brussels and Paris.

At Springhead, good progress is being made with our joint venture partners, Countryside Properties, on the delivery of the first 383 new homes of the 600 planned. The primary infrastructure and first homes are now under construction with first occupations targeted for autumn 2008.

Sales continue at our residential scheme at Waterstone Park with an agreement having been reached with Countryside Properties to deliver the final phase of the project.

Milton Keynes

With our joint venture partner Gazeley Limited, we completed the development of the 60,400m² distribution centre which had been pre-let to John Lewis and which we have now sold. Our share in the project generated some £35.0m of sale proceeds and a profit of £8.1m.