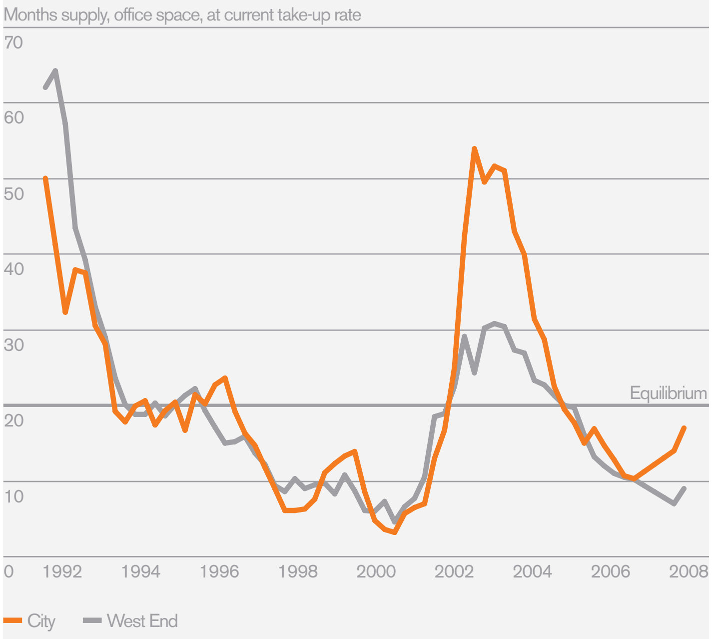
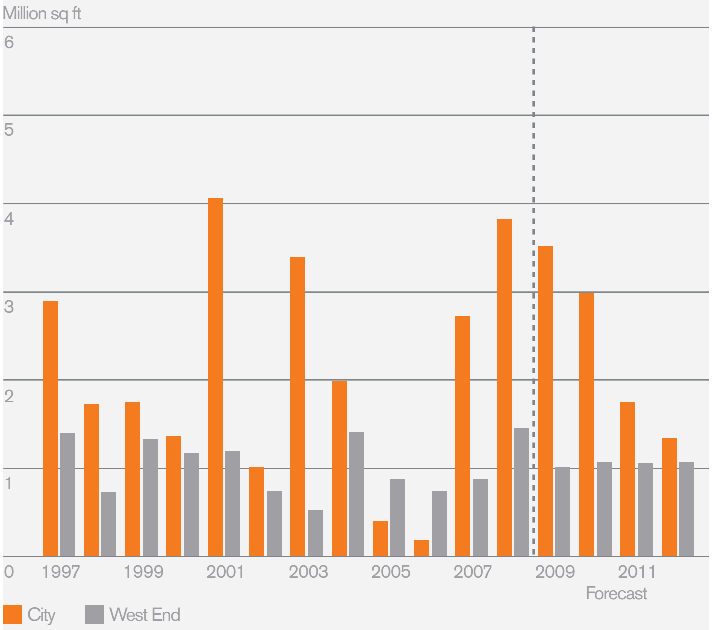
Our market

1. Market balance in key sub-markets



Source: PMA

2. Development completions – City and West End



Source: PMA

London
London is our market. Throughout 2007, the Capital continued to consolidate its position as a global city, dominating the European finance and business services (F&BS) sector. For the eighteenth year in succession, it was voted Europe's number one city for business; it attracted more foreign direct investment than any other European country, providing the headquarters for one-third of the world's largest corporations, and generating around 20% of the UK's economic activity.

In part because of its world financial status, London has not been immune to the dramatic events in global capital markets, particularly since last summer. In the short term, although the extent of the impact on London's economy is difficult to gauge and will be influenced by the duration of the credit crunch and the policy response, we expect the demand for office space, particularly from the F&BS sector to moderate from last year's high levels. Longer term, we remain firm believers in the prospects for London's economy and its real estate markets.

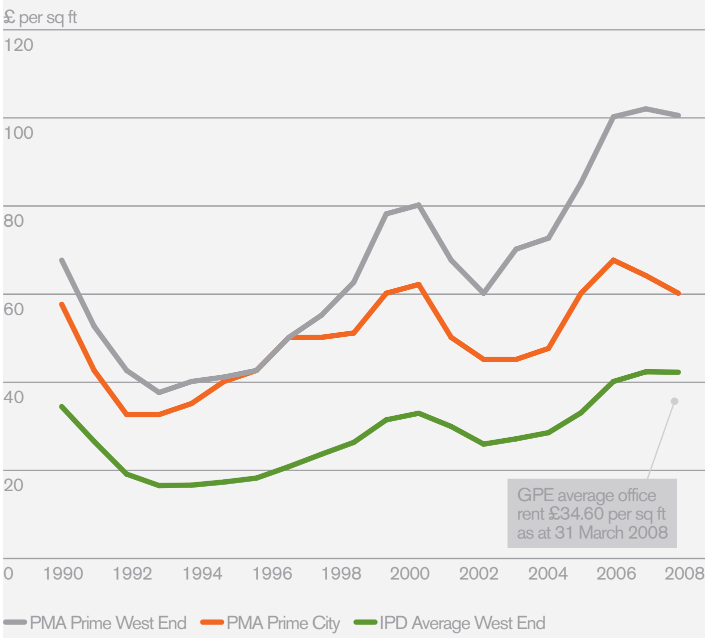
Occupational markets
West End
For much of 2007, strong demand from a broad range of tenants across the West End sub-markets combined with constrained supply of new office space to keep the market balance favouring the landlord at only seven months supply at December (Chart 1). Since then, take-up has slowed and availability has increased marginally to leave the year end balance slightly higher at nine months.

Tenant take up in the West End for the year to March 2008 was 5.4 million sq ft (2007: 5.8 million sq ft) whilst vacancy rates have risen marginally to 4.5% (2007: 4.3%). Prime rental values rose around 12.8% in the year to March 2008 (2007: 15%) with the rental range between "superprime" small suites in Mayfair and mid market properties widening dramatically.

Looking forward, with limited new supply of offices coming on stream in the West End (Chart 2) and the challenging planning environment acting as a drag on future supply, the direction of rents will be principally determined by the level of demand for space. We monitor closely the level of requirements from occupiers and the latest data suggests a reduction in demand from companies actively seeking office space of around 15% since last December's high point. We expect rental values for "superprime" units to be impacted by this slowdown more than the mid-market, where rents remain at more affordable levels.

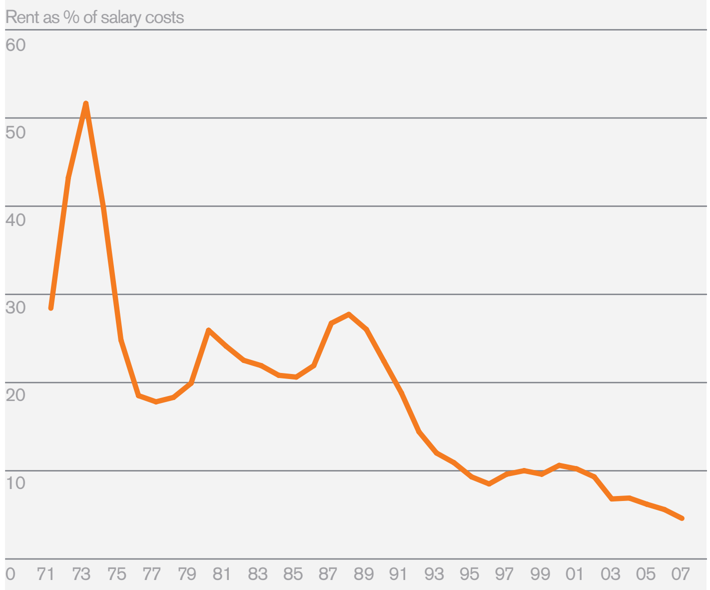
The Group's valuers estimate the rental value of our West End office portfolio to be an average of £54 per sq ft in its current state, compared to its average passing rent of £38 per sq ft, providing reversionary potential of 42%. The significant discount this rent passing represents to prime West End rental values provides the Group with the opportunity to generate significant increases over time as we invest in our portfolio, repositioning properties from the IPD average rent line up towards the PMA prime rent line (Chart 3). Interestingly, not only do average rents in the West End remain significantly lower than the small number of top rents paid (see Rental village map on page 18), but they have continuously taken a smaller share of London businesses cost base (Chart 4) implying a steady improvement in affordability over the past 35 years.

3. Central London office market rents



Source: PMA/GPE

4. London office rent as a % of salary costs



Source: ONS

The West End retail market (comprising 24.8% of our West End portfolio by rent roll) has also performed solidly in the year with retail sales in central London up 7.2% in the year to March 2008 (2007: 11.8%). Footfall in the three main retail thoroughfares of Oxford Street, Regent Street and Bond Street, where over 65% of our retail portfolio is located, was up during the year. Demand from international retailers for these key shopping streets remains strong.

City and Southwark

The first quarter of the financial year saw continued growth of the financial services sector with significant tenant requirements for new offices in the City and its neighbouring markets. Major dislocations in the world's capital markets since July 2007 have affected employment and expansion plans of many businesses throughout the City. This dampening effect, combined with new potential supply from speculative development schemes, has started to shift market balance away from the landlord.

Take up in the City market for the year to March 2008 was 8.3 million sq ft (2007: 8.8 million sq ft) and vacancy rates have risen to 7.9% (2007: 7.5%). Prime office rental values increased by 4.4% over the same period although they reduced by 5.5% in the three months to March and are forecast to soften further this year. We remain concerned about the effects of reduced tenant requirements and new development supply on rental levels in the City market.

Investment markets in central London

Central London real estate transaction volumes declined in the second half of the year due to the lower availability of debt capital and uncertainty over rental growth prospects leading to a lack of confidence by many market participants.

During the course of the year we predicted that rising yields in the wider global investment markets would have a negative impact on property valuations. This has proved to be the case as investors reappraised risk and sentiment deteriorated, particularly in the last six months of the financial year, putting upward pressure on investment yields.

Looking forward, investment market turbulence is forecast to continue, particularly for poorly located, secondary properties and where rental growth opportunities are limited.

In this environment the Group's portfolio of well located assets with low rents is well positioned.