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# Chairman's statement

## Introduction

I am pleased to report that, notwithstanding the challenging conditions which emerged in the UK property market in the second half of 2007, Liberty International has fared extremely well with record occupancy levels at our UK regional shopping centres and a tremendous contribution from our non-shopping centre business which has been completely transformed over the last 18 months and now includes such prime assets as the Covent Garden Estate in London's West End.

Four key attributes of Liberty International came very much into evidence in 2007 – a business of exceptional quality, a high degree of specialisation on prime retail which constitutes nearly 90 per cent of our assets, the benefits of scale and our financial strength. Looking forward, our experienced property management teams and our low debt to assets ratio position the group well to identify and crystallise investment opportunities emanating from the current market correction.

February 2008 is too early to form a view on the length and the breadth of the turbulence now evident in the property market as a whole. 2007 was certainly a transitional year when, particularly in the second half, investor enthusiasm for UK property diminished rapidly with negative sentiment abounding as the US sub-prime mortgage market contagion spread across the Atlantic and credit market conditions deteriorated rapidly.

Under International Financial Reporting Standards ("IFRS"), we include revaluation movements in our Income Statement which introduces a considerable degree of volatility into our reported profits. After several years of buoyant market conditions, the second half of 2007 saw a more cautious view of UK property being reflected in valuations. While our Income Statement for 2007, after a revaluation deficit of £316 million reduced by £37 million of gains on disposals, shows a loss before tax of £125 million, the underlying profit before tax excluding valuation movements and one-off trading profits increased from £122 million to £129 million and adjusted earnings per share increased by 6 per cent from 33.9p to 36.0p.

Adjusted net assets per share reduced by 5 per cent from 1327p to 1264p, giving a total return for the year including dividends of minus 2.2 per cent. By way of comparison, the IPD monthly index for the year, an ungeared measure, showed a 10 per cent fall in capital values and a negative total return of 5.5 per cent. The successful relative outcome delivered by Liberty International in 2007 vindicates our focus over a long period on the highest quality real estate, in particular on super-prime and prime regional shopping centres, which has generated a compound per annum total return of 12.4 per cent for the last 10 years.

In order to address the requirements of investors for up-to-date information on a more frequent basis, we moved to quarterly reporting with effect from the first quarter of 2007, including external independent property valuations. This has given shareholders an excellent insight into the unfolding changes in property market conditions in 2007.

We moved rapidly in 2007 to take advantage of conversion at the end of 2006 to a tax transparent status as a UK Real Estate Investment Trust ("REIT"). We recorded £340 million of disposals in 2007 at an aggregate surplus over book values at 31 December 2006 of £37 million as well as £426 million from the 40 per cent reduction in our interest in MetroCentre, Gateshead at £16 million above book value. These were matched by additions of £1,062 million in the year, comprising development expenditure and strategic acquisitions at our UK regional shopping centres and in Central London including materially increasing our ownership in Covent Garden, purchases by the Great Capital Partnership and the £375 million Earls Court and Olympia transaction.

## Property valuations

Evidence remained strong in 2007 that super-prime and prime regional shopping centres, which are well managed and properly marketed, attract considerable investor interest; such centres are noticeably outperforming secondary centres with the gap in valuation yields widening as investors factor in the much greater risks of lower quality assets. Furthermore, the yields applied by valuers to prime regional shopping centres have proved far less volatile than other prime UK property asset classes.

## Chairman's statement (continued)

As an illustration of this point, indicative UK property market valuation yields, as provided by one of our valuers, CB Richard Ellis, are set out below, together with the notional impact of these changes on property values over the year:

	31 December 2006	31 December 2007	Notional impact on valuations of yield shift in the year
<b>Retail</b>			
Prime shops	4.00	<b>4.75</b>	(16)%
Prime shopping centres	4.75	<b>5.00</b>	(5)%
Secondary shopping centres	5.50	<b>6.25</b>	(12)%
Prime retail parks	3.85	<b>4.75</b>	(19)%
<b>Offices</b>			
Prime West End of London	3.75	<b>4.75</b>	(21)%
Prime City of London	4.25	<b>5.25</b>	(19)%

Valuation yields for CSC's UK regional shopping centres increased overall from 4.84 per cent at 31 December 2006 to 5.07 per cent at 31 December 2007 and were the main contributory factor to an overall like-for-like valuation deficit of 3.9 per cent. This benign outcome in the circumstances confirms the defensive merits of our UK regional shopping centres, with resilient income streams and relatively undemanding valuation yields.

Capital & Counties also performed particularly well in valuation terms in 2007 in this environment, with an overall decrease in like-for-like valuations of just 0.2 per cent in our UK non-shopping centre properties and an increase of 6.5 per cent in the USA.

Successful property investment requires a long-term perspective. While the indications are that upward pressure on valuation yields in the UK has continued into 2008, we believe that many positive factors for real estate as an asset class are still relevant; first, consistent economic growth; secondly, investor demand for long-term, stable, income producing and inflation-proofing assets to meet retirement needs; thirdly, relatively benign long-term interest rates; and finally, limited over-supply issues in the real estate industry.

While credit market conditions have put upward pressure on lending margins and unsettled UK property investors, one favourable consequence has been a lowering of interest rate expectations. The 10 year UK interest rate swap fell substantially in the second half of the year from 5.92 per cent at 30 June 2007 to 5.02 per cent at 31 December 2007, below its starting position for the year of 5.11 per cent. Liberty International is relatively insensitive to interest rate movements in the short term as our borrowings are mostly long-term fixed-rate. However, the impact of lower interest rates on the wider UK economy and property market should be beneficial over time.

We are confident that Liberty International's concentration on super-prime and prime large-scale and predominantly retail real estate will be advantageous in any overall flight to quality by UK property investors. Additionally, the valuation process values each asset individually and takes no account of the extra portfolio value of our assets which could not now be assembled individually on any sensible timescale.

Furthermore, although shareholders buying our shares only pay stamp duty at 0.5 per cent on share transactions, the assumption contained within the valuations is that our assets would be sold individually to purchasers who would pay the full 4 per cent stamp duty land tax applicable to large property transactions and other notional acquisition costs. Adjusting for this factor would increase our net asset value by £390 million, representing 104p per share over and above our published net asset value per share figure of 1264p producing a more realistic number for shareholders of 1368p.

### Capital Shopping Centres

CSC's business has continued to perform robustly. Like-for-like growth in net rental income amounted to 3.5 per cent for the year and the occupancy rate continued at the high level of 98.7 per cent (31 December 2006 – 97.7 per cent). In the year to date, we have recorded 138 tenancy changes, 7 per cent of 2,021 total retail units, increasing the annual rents from these tenancies by £7 million (2006 – 124 tenancy changes increasing rents by £1.5 million).

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## Chairman's statement (continued)

Asset management initiatives are a constant feature of the business. In particular, the Boardwalk development at Lakeside, Thurrock, of 11 restaurants overlooking the lake and a refurbished cinema, has traded strongly since opening in June 2007, enhancing activity throughout the centre. At MetroCentre, Gateshead, we have, with our partners, GIC, acquired the adjoining 220,000 sq. ft. Metro Retail Park for £82.5 million, increasing our overall ownership to over 2 million sq. ft. We have obtained planning permission for the intended upgrade of the leisure and dining facilities in the Yellow and Blue Quadrants, with a view to continuing our improvement programme, most notably delivered by the successful 370,000 sq. ft. Red Mall extension which opened in Autumn 2004.

CSC's development activities are progressing according to programme with two major projects under way, the 967,500 sq. ft. extension of St David's, Cardiff, opening in Autumn 2009, and the 480,000 sq. ft. extension of Eldon Square, Newcastle, where the largest phase opens in Spring 2010. In both cases, we have entered into fixed price construction contracts to ensure control of costs, we have secured anchor tenants and lettings are in line with expectations. We anticipate ample retailer requirements for the attractive and well-configured retail space.

The compulsory purchase order inquiry for the 750,000 sq. ft. Westgate, Oxford, refurbishment and extension took place in December 2007 and, subject to a satisfactory outcome, we will be in a position to commit to the project in 2008 for an opening in 2011. We are pleased to have satisfied the principal stakeholders that our proposals fit well in this unique and architecturally-sensitive city-centre location. In 2007, we restructured the arrangements with our investment partner, moving our potential ownership from 50 per cent to an interest of not less than 75 per cent, the final percentage dependent on the amount our partner elects to contribute.

CSC is a retail property business, not a retailer. Our net rental income growth is more correlated to rent reviews, typically on a five year cycle in the UK, and active asset management initiatives, than short-term fluctuations in retail sales. In terms of rent reviews, 2007 was relatively quiet with 11 per cent of CSC's net rental income coming up for review. These reviews are progressing in line with expectations.

In terms of the overall retail environment, UK non-food retail sales, as measured by ONS, continued to grow steadily with year-on-year growth of 3.4 per cent for the year ended 31 December 2007. The last quarter of 2007 saw some signs of weakening in this measure but successful retailers are continuing to look to expand and trade from high quality space such as CSC offers.

### Capital & Counties

We have continued the dynamic realignment of the business of Capital & Counties, with gross assets now increased to £2.2 billion compared with £1.1 billion as recently as 30 June 2006, the last quarter date before the major acquisition of the Covent Garden Estate.

Capital & Counties' activities are strongly focused on Central London with over £1.4 billion invested at 31 December 2007. We continue to regard Central London as a long-term beneficiary of globalisation, with its world-class financial services industry and historical, cultural and residential attractions. Three important investments now form the core of our London holdings. First, the Covent Garden Estate, where we have substantially consolidated our ownership during the year. Covent Garden is now the group's fourth largest investment at £664 million and we are making good progress working closely with stakeholders on the strategic plan for the area. Second, our 50/50 partnership with Great Portland Estates plc, The Great Capital Partnership, which has grown to £654 million, of which some two-thirds is focused on the Regent Street, London W1, area. Third, Earls Court and Olympia where we moved decisively in 2007 to secure 50 per cent ownership and effective control. These globally recognised London landmark venues offer over 1 million sq. ft. of exhibition and conference space with considerable opportunities to intensify use. The £381 million assets of Earls Court and Olympia are fully consolidated at 31 December 2007 reflecting the nature of the ownership arrangements.

Through Capco Urban, our mixed-use development business, the group continues its activities in other important regional locations.

### International

Capco USA is an established value-add developer of mixed-use properties with an emphasis on retail investment with total assets now amounting to £381 million. Our activities are focused on California and the business has performed well in 2007 with a 6.5 per cent revaluation gain driven by our flagship shopping centre, Serramonte, in the San Francisco bay area. This asset continues to provide a number of active management and remodelling opportunities which we are pursuing. Capital & Counties USA has converted to a US REIT, as the company has reached the stage in its development where US REIT status is considered beneficial.

Capco International has been formed to support broader group initiatives in the international marketplace. In 2007, we subscribed for a 25 per cent interest in an Indian shopping centre development company, Prozone, a 75 per cent subsidiary of the fast-growing Indian retailer, Provogue. In aggregate, we invested £39 million in Capco International activities in 2007 on which we recorded a revaluation surplus of £8 million for the year.

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# Chairman's statement (continued)

## Corporate responsibility

I am pleased to record that for many years Liberty International has had a strong commitment to Corporate Responsibility (CR), producing our first full annual report on the subject in 2002. We have reviewed and developed our CR activities year-on-year and our community programmes have grown with ongoing partnerships with a number of charities including Crime Concern and the Conservation Foundation.

Our community programme working near our shopping centres focuses on youth, education and the prevention of crime and anti-social behaviour, with some excellent local projects in hand. A growing strand of environmental awareness initiatives located on our Covent Garden estate complements our vision to regenerate and restore that unique urban area. Once again, in 2007 we have devoted substantial time and financial support via our CR partnerships to the benefit of all involved.

Our development programme has always been focused on brownfield land and Braehead near Renfrew, Scotland, formerly derelict industrial land by the Clyde, is a wonderful example of mixed-use urban regeneration. Overall we estimate that our shopping centres have generated employment directly at the centres for some 50,000 people, in addition to the indirect employment opportunities created.

In our development activities, we continue to apply the highest construction standards; and operationally at the shopping centres we have made further major strides in energy efficiency and waste reduction, with 2007 seeing the realisation of our goal to measure the carbon footprint of all our directly managed UK shopping centres. Work is in hand to understand the factors influencing that footprint so that we can take practical steps to reduce it and save on costs as well.

As an example of the external recognition of our activities in the CR field, we are rated as a BiTC top 100 company and sector leader in their Environmental Index.

## Dividends

The Directors propose a final dividend of 17.6p per share bringing the full year's dividend to 34.1p (2006 – 31.0p), an increase of 10 per cent. Liberty International has always pursued a progressive dividend policy distributing substantially all of the group's recurring income. We have shown consistent growth over a long period from 4.5p per share in 1985 to 34.1p in 2007. This progressive policy will continue under REIT status but additionally the 2007 dividend includes an extra increase out of the net tax savings from conversion to a REIT.

The group is an active developer and has a substantial pool of brought forward capital allowances. The required minimum Property Income Distribution ("PID") for the year is estimated at around 18p per share, substantially below the dividend proposed for the year. As the interim dividend of 16.5p was paid entirely as a PID, subject to withholding tax for certain shareholders, we have decided that for administrative simplicity the final dividend will be paid entirely as a non-PID dividend not subject to any withholding tax and the balance of the minimum PID requirement will, as permitted under REIT regulations, be met from the current year's dividends.

## Financial position

Liberty International's financial position is strong with gross property assets of £8.6 billion and net debt of £3.6 billion providing a debt to assets ratio of 42 per cent at 31 December 2007. Our debt structures are predominantly long-term in nature, asset specific and fixed-rate. The first material loan repayment is not until 2011.

## Board and management

Once again my thanks go to my Board colleagues for their active support during 2007. Along with the non-executive directors, I would like to thank the group's executive directors and staff both in the UK and the USA for their tremendous commitment and effort. We are pleased to have substantially strengthened the overall management team in 2007 with a number of senior level recruits to the group.

## Prospects

Through our exceptional assets, financial strength and quality management, we are well placed to continue on behalf of shareholders the measured growth of our high quality company.

We look forward to opportunities emerging from the unsettled financial and property markets of 2008.

## Sir Robert Finch

Chairman