

## Management Discussion and Analysis

### Operation Review

Prosperity REIT was listed on the Main Board of the Stock Exchange on 16 December 2005. The results of Prosperity REIT for the Reporting Period cover the period from 16 December 2005 to 31 December 2005.

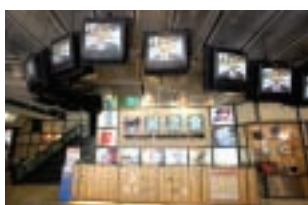
Upon listing, Prosperity REIT completed the acquisition of interests in seven properties, as well as a finance company for a total purchase price of HK\$4,459 million.

industrial/office buildings and a portion of one industrial building totaling a gross rentable area of approximately 1.2 million sq.ft. as at the period end date.

Prosperity REIT owns a diverse portfolio of seven quality commercial properties in Hong Kong, comprising three Grade A office buildings, all or a portion of three

information on the properties in the portfolio as at the period end date is summarized as follows:

	Location	Gross Rentable Area (sq.ft.)	No. of Carpark Spaces	Valuation HK\$ Million	Occupancy Rate
<b>Grade A Office</b>					
The Metropolis Tower	Hunghom	271,418	98	1,790	98.2%
MLC Millennia Plaza	North Point	217,955	43	940	94.4%
Harbourfront Landmark (portion)	Hunghom	77,021	–	350	100.0%
<b>Industrial/Office</b>					
Modern Warehouse	Kwun Tong	240,000	60	550	88.2%
Trendy Centre	Cheung Sha Wan	173,764	79	460	88.8%
Prosperity Center (portion)	Kwun Tong	134,307	105	350	79.6%
<b>Industrial</b>					
New Treasure Centre (portion)	San Po Kong	86,168	22	108	98.5%
		<b>1,200,633</b>	<b>407</b>	<b>4,548</b>	<b>92.2%</b>



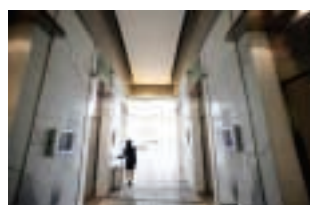
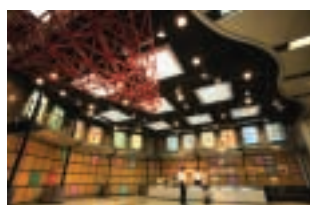
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The revenue and net property income (before landlord provision) of the properties portfolio during the Reporting

Period were HK\$8,202,000 and HK\$5,468,000 respectively.

	Turnover	Rental Related Income	Total Revenue	Net Property Income (before landlord provision*)
	HK\$000	HK\$000	HK\$000	HK\$000
<b>Grade A Office</b>				
The Metropolis Tower	1,971	704	2,675	1,844
MLC Millennia Plaza	1,154	414	1,568	1,031
Harbourfront Landmark (portion)	559	112	671	549
<b>Industrial/Office</b>				
Modern Warehouse	1,187	53	1,240	701
Trendy Centre	784	244	1,028	718
Prosperity Center (portion)	525	107	632	369
<b>Industrial</b>				
New Treasure Centre (portion)	303	85	388	256
	<b>6,483</b>	<b>1,719</b>	<b>8,202</b>	<b>5,468</b>

\* The Manager has proactively commenced landlord provision works in the amount of HK\$4,654,000 in order to enhance the competitive edge of the properties. Through early commencement of some tenant improvements, the downtime period between tenancies will be shortened.



## Management Discussion and Analysis

2005 was a tremendous year for the Grade A office market which saw rents rising by around 70% on average due to strong demand from the finance, business services, trading and manufacturing sectors. Given the lack of new office space expected to come on stream in 2006, the imbalance between supply and demand is not expected to ease anytime in the near future, fuelling further growth in rental levels in the office sector. With a substantial proportion of Prosperity REIT's leases, which account for 54.7% of total rental income, becoming due for renewal in 2006, it is expected that rental income for Prosperity REIT will significantly improve. Prosperity REIT is well positioned to benefit directly from the continued economic growth of Hong Kong in 2006 and beyond.

As at the year end date, Prosperity REIT's property portfolio recorded an investment property revaluation surplus of HK\$10 million, based on a professional valuation performed by an independent valuer, Chesterton Petty Limited.

During the Reporting Period, interest income in the amount of HK\$29,920,000 was earned, mainly due to the over-subscription of units during Prosperity REIT's initial public offering. The finance cost of HK\$4,114,000 was accrued due to the banking facilities used.

Total income for the Reporting Period was HK\$8,202,000, which was HK\$738,000 below the forecast as disclosed in the offering circular dated 5 December 2005 ("**OC Forecast**"). This was mainly due to the frictional vacancy in some of the properties.

The total property operating expenses (before landlord provision) for the Reporting Period was HK\$2,734,000, which was HK\$904,000 higher than the OC Forecast mainly due to the implementation of enhancement works that we have proactively commenced in all the properties during the Reporting Period. In order to achieve strong rental growth and maximize returns for our unitholders, the Manager has proactively implemented asset enhancement works for the properties which is in line with one of the asset management strategies of property enhancement opportunities.

The Manager has also proactively commenced landlord provision works in the amount of HK\$4,654,000 in order to enhance the competitive edge of the properties. Through early commencement of some tenant improvements, the downtime period between tenancies will be shortened.

The distributable income for the Reporting Period was HK\$29,039,000, which was 5.6 times over the OC Forecast mainly due to the interest income earned during the initial public offering.

The Manager has been operating Prosperity REIT in accordance with the asset management strategy and will continue to manage the assets of Prosperity REIT for the benefit of the unitholders.

## Management Discussion and Analysis

### Financial Review

#### Liquidity and Financing

Upon listing, a total number of 1,250,962,222 units were issued. The issue price per unit was HK\$2.16. The total proceeds of approximately HK\$2,702 million were received through the issue of units.

As at the Reporting Period end date, Prosperity REIT had a facility of HK\$1,900 million, comprising a HK\$1,770 million term loan facility and a HK\$130 million revolving credit facility, each for a term of five years. The whole facility was fully drawn on the Listing Date. The term loan is repayable five years from the date of the drawdown. The revolving facility will be repaid on each maturity date and can be redrawn upon maturity.

Each of the term loan facility and the revolving credit facility bears interest at a variable rate. In order to hedge against fluctuations in interest rate under the term loan, effective on the Listing Date, Prosperity REIT's finance company entered into interest rate swap agreements for a total notional amount equivalent to HK\$1,770 million. Under the terms of the interest rate swap arrangement, the interest rate of the term loan portion of the facility will be fixed from the Listing Date until 16 December 2010 at an average interest rate of 1.4%.

The total borrowings of Prosperity REIT as a percentage of Prosperity REIT's gross assets was 38.3% as at the period end date. The gross liabilities of Prosperity REIT as a percentage of Prosperity REIT's gross assets was 43.4% as at the period end date.

Prosperity REIT had HK\$89 million cash balance as at the Reporting Period end date and has sufficient financial resources to satisfy its commitments and working capital requirements.

#### Charges on Assets

As at the Reporting Period end date, the seven properties of Prosperity REIT, with aggregate carrying value of HK\$4,548 million, were pledged to secure bank loan facilities of Prosperity REIT's finance company.

Prosperity REIT and its subsidiaries have provided guarantees for the loan facility of HK\$1,900 million, comprising a HK\$1,770 million term loan facility and a HK\$130 million revolving credit facility. The whole facility was fully drawn on the Listing Date and the outstanding amount at the end of the Reporting Period was the same as the drawn down amount.

#### Employees

Prosperity REIT is managed by the Manager. Prosperity REIT does not employ any staff itself.

### Major Real Estate Agents and Contractors

There was no commission paid to any real estate agents during the Reporting Period and the total value of service contracts of the top five contractors engaged by Prosperity REIT during the Reporting Period was HK\$ 4,093,000.

#### Top Five Contractors

The top five contractors and their respective value of service were as follows:

Contractors	Nature of Services	Value of Contract	Percentage
<i>HK\$000</i>			
Jetworld Engineering Ltd	Landlord provision	1,994	46.8%
Citybase Property Management Limited	Building management	749	17.6%
Goodwell Property Management Limited	Building management	718	16.9%
Onway Engineering Ltd	Landlord provision	455	10.7%
Goodwell-Prosperity Property Services Limited	Property management	177	4.2%
		<b>4,093</b>	<b>96.2%</b>





**R**espect  
**E**xcellence  
**I**ntegrity  
**T**eamwork

The Manager's Philosophy





Prosperity REIT is managed by ARA Asset Management (Prosperity) Limited. Key managers of the ARA group of businesses are highly experienced professionals who have extensive experience in real estate industry in Hong Kong and elsewhere in Asia.

