



# Sustainable Growth

**By implementing proactive and well-planned business strategies, we continued to outperform the forecast in Prosperity REIT's offering circular .**

# Management Discussion and Analysis

## Performance Highlights

The Manager is pleased to announce Prosperity REIT's strong performance for the year ended 31 December 2006, which continued to outperform the Forecast. Key performance highlights are summarized as follows:

	Year ended 31 Dec 2006	Forecast*	Percentage change Increase/(Decrease)
Distribution per unit	HK\$0.1201	HK\$0.1146	4.8%

Operation data	Year ended 31 Dec 2006	Forecast*	Percentage change Increase/(Decrease)
Revenue	HK\$217.1 million	HK\$211.5 million	2.6%
Net property income	HK\$167.5 million	HK\$158.7 million	5.5%
Cost-to-revenue ratio	22.8%	25.0%	(8.8%)
Occupancy rate (as at 31/12/2006)	97.4%	93.8%	3.8%
Tenant retention rate	74.9%	70.0%	7.0%
Average effective unit rent	HK\$11.98 per sq. ft.	HK\$10.08 per sq. ft.**	18.8%

\* As disclosed in the Offering Circular

\*\* Based on the average effective unit rent for the period from 16 December 2005 (the "Listing Date") to 31 December 2005

Key financial figures	As at 31 Dec 2006	As at 31 Dec 2005	Percentage change Increase/(Decrease)
Net asset value per unit	HK\$2.38	HK\$2.26	5.3%
Property valuation	HK\$4.864 billion	HK\$4.548 billion	6.9%
Gearing ratio***	35.04%	38.30%	(8.5%)

\*\*\* This excludes the origination fees and is calculated based on total borrowings

# Management Discussion and Analysis

## Operation Review

Prosperity REIT owns a diverse portfolio of seven high-quality commercial properties in Hong Kong, comprising all or a portion of three Grade A office buildings, three industrial/office buildings and one industrial building, totaling a gross rentable area of approximately 1.2 million sq. ft.

Information on the properties in the portfolio as at 31 December 2006 is summarized as follows:

	Location	Gross rentable area (sq. ft.)	No. of car park spaces	Valuation (HK\$ million)	Occupancy rate
<b>Grade A Office</b>					
The Metropolis Tower	Hunghom	271,418	98	1,910	96.5%
MLC Millennia Plaza	North Point	217,955	43	990	100.0%
Harbourfront Landmark (portion)	Hunghom	77,021	–	350	100.0%
<b>Industrial/Office</b>					
Modern Warehouse	Kwun Tong	240,000	60	577	96.5%
Trendy Centre	Cheung Sha Wan	173,764	79	518	94.1%
Prosperity Center (portion)	Kwun Tong	134,307	105	389	97.4%
<b>Industrial</b>					
New Treasure Centre (portion)	San Po Kong	86,168	22	130	100.0%
<b>Total</b>		<b>1,200,633</b>	<b>407</b>	<b>4,864</b>	<b>97.4%</b>

In 2006, the office and industrial/office markets in Hong Kong expanded further, fueled by the continuous growth in economy. Coupled with the Manager's professional expertise, Prosperity REIT was able to deliver impressive performance during the reporting year.

Under the Manager's effective leasing strategies, a high tenant retention rate of 74.9% was attained, outperforming Forecast by 7.0%. Occupancy rate also stood at a high 97.4% as at 31 December 2006, up by 5.6% year-on-year or 3.8% above Forecast.

	Occupancy rate (%) As at 31 Dec 06	Occupancy rate (%) As at 31 Dec 05	Percentage change Increase/(Decrease)
<b>Grade A Office</b>			
The Metropolis Tower	96.5	98.2	(1.7%)
MLC Millennia Plaza	100.0	94.4	5.9%
Harbourfront Landmark (portion)	100.0	100.0	0.0%
<b>Industrial/Office</b>			
Modern Warehouse	96.5	88.2	9.4%
Trendy Centre	94.1	88.8	6.0%
Prosperity Center (portion)	97.4	79.6	22.4%
<b>Industrial</b>			
New Treasure Centre (portion)	100.0	98.5	1.5%
<b>Portfolio</b>	<b>97.4</b>	<b>92.2</b>	<b>5.6%</b>

As a result of proactive marketing strategies, a high rental reversion rate of 56.7% was achieved for leases successfully renewed in 2006. New letting area of 252,561 sq. ft. plus lease renewed area of 463,380 sq. ft. have surpassed the total lease expired area by 15.7% during 2006. The average effective unit rent of the portfolio also grew to HK\$11.98 per sq. ft., which was 18.8% higher than that of the period from the Listing Date to 31 December 2005.

Due to the Manager's efficient streamlining of operations, cost-to-revenue ratio improved to 22.8% from Forecast's 25.0%. Gearing ratio was also able to come down to 35.0% as at year end from 38.3% of 2005.

## Investment Review

With a view to deliver improved returns for unitholders, the Manager has been actively looking for yield accretive acquisition opportunities. In the fourth quarter of 2006, we purchased the entire 10th floor and additional units on the 26th floor in Prosperity Center. The transactions were successfully completed in January 2007, thereby enabling the Manager to increase ownership shares in Prosperity Center to 53.4% from 49.0%, strengthening our management control in the building.

The acquisitions were consistent with the Manager's investment strategy. We believe that the purchase will contribute higher efficiency in operation management and will achieve better cost effectiveness.

The Manager has been operating Prosperity REIT in accordance with its asset management, financing and acquisition strategies set forth in the Trust Deed dated 29 November 2005 (as amended by a first supplemental deed dated 12 December 2005) (collectively, the "Trust Deed") and the Offering Circular. The Manager will continue to diligently lead Goodwell-Prosperity Property Services Limited and manage the assets of Prosperity REIT for the benefit of the unitholders. Given the strong momentum of Hong Kong's leasing market as underpinned by the buoyant finance, insurance, real estate and business services sectors, we are confident that Prosperity REIT will continue to perform well in 2007.

# Management Discussion and Analysis

## Financial Review

The revenue and net property income of each property in the portfolio for the year ended 31 December 2006 are summarized as follows:

	Turnover HK\$'000	Rental related income HK\$'000	Revenue HK\$'000	Net property income HK\$'000
<b>Grade A Office</b>				
The Metropolis Tower	56,783	14,353	71,136	55,565
MLC Millennia Plaza	32,430	10,262	42,692	32,032
Harbourfront Landmark (portion)	13,864	2,161	16,025	14,486
<b>Industrial/Office</b>				
Modern Warehouse	29,588	347	29,935	22,575
Trendy Centre	21,497	5,455	26,952	20,154
Prosperity Center (portion)	18,301	2,510	20,811	15,820
<b>Industrial</b>				
New Treasure Centre (portion)	7,886	1,690	9,576	6,903
<b>Total</b>	<b>180,349</b>	<b>36,778</b>	<b>217,127</b>	<b>167,535</b>

### Revenue

During the year, revenue stood at HK\$217.1 million, which was HK\$5.6 million or 2.6% higher than Forecast.

The revenue was made up of HK\$180.3 million of rental and car park income, plus HK\$36.8 million of rental related income. Rental and car park income was HK\$6.7 million or 3.9% above Forecast. The increase was mainly due to an increase in average occupancy rate.

### Net Property Income

Net property income was HK\$167.5 million, exceeding Forecast by HK\$8.8 million or 5.5%. The growth was attributed to higher revenue and lower total property operating expenses.

The total property operating expenses was HK\$49.6 million, which was HK\$3.2 million lower than Forecast. The improvement was a result of the Manager's cost control measures.

Net property income represented approximately 77.2% of the revenue, after the deduction of property management costs and property operating expenses. The cost-to-revenue ratio has improved to 22.8% from Forecast's 25.0%.

### Distributable Income

The annual distributable income to Prosperity REIT's unitholders for the reporting year amounted to HK\$151,549,000, which exceeded Forecast by 5.0%. The annual distributable income is calculated by the Manager as representing the consolidated net profit of Prosperity REIT and the subsidiaries of Prosperity REIT for that distribution period, after provision for tax, as adjusted to eliminate the effects of adjustments (as defined in the Trust Deed) including finance cost of HK\$74,998,000 (equivalent to HK\$0.0595 per unit) due to the interest rate swap, which have been recorded in the consolidated income statement.

### Distribution

It is the policy of the Manager to distribute to unitholders an amount equal to 100% of Prosperity REIT's annual distributable income for each financial year. Pursuant to the Trust Deed, Prosperity REIT is required to ensure that the total amount distributed to unitholders shall be no less than 90% of Prosperity REIT's annual distributable income for each financial year.

The distributable income of the half year from 1 July 2006 to 31 December 2006 is HK\$78,913,000, equivalent to distribution of HK\$0.0624 per unit. The interim distribution



for the six months from 1 January 2006 to 30 June 2006 was HK\$0.0577 per unit, and the total distributable income per unit for the year is HK\$0.1201, outperforming Forecast of HK\$0.1146 by 4.8%. This distribution will be paid on Friday, 27 April 2007.

### Liquidity and Financing

As at year end, 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 term loan facility was fully drawn on the Listing Date and revolving credit facility amounted to HK\$20 million was drawn down. 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% per annum.

The total borrowings of Prosperity REIT, excluding the origination fees, as a percentage of Prosperity REIT's gross assets was 35.0% as at year end, whereas the gross liability of Prosperity REIT as a percentage of Prosperity REIT's gross assets was 41.9%.

Prosperity REIT with a cash balance of HK\$41.7 million and available revolving credit facility of approximate HK\$110 million as at 31 December 2006, has sufficient financial resources to satisfy its commitments and working capital requirements.

### Balance Sheet Highlights

#### Investment properties and property valuation

For the year ended 31 December 2006, Prosperity REIT's portfolio recorded an investment property revaluation surplus of HK\$316 million, based on a professional valuation performed by independent valuer, Knight Frank Petty Limited. The movements of fair values are tabulated below:

	31 Dec 2006 HK\$'million	31 Dec 2005 HK\$'million
Fair value at the beginning of financial year/period	4,548	–
Acquired upon listing	–	4,538
Increase in fair value during the year/period	316	10
Fair value at the end of year/period	<b>4,864</b>	<b>4,548</b>

### Charges on Assets

As at 31 December 2006, the seven properties of Prosperity REIT, with aggregate carrying value of HK\$4,864 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.

# Management Discussion and Analysis

## Employees

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

## Closure of Register of Unitholders

The register of unitholders will be closed from Thursday, 19 April 2007 to Thursday, 26 April 2007, both days inclusive, during which period no transfer of units will be effected. In order to qualify for the distribution, all unit certificates with completed transfer forms must be lodged with Prosperity REIT's unit registrar, Computershare Hong Kong Investor Services Limited at Shops 1712-1716, 17/F., Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not later than 4:30 p.m. on Wednesday, 18 April 2007. The payment of final distribution date will be on Friday, 27 April 2007.

## Major Real Estate Agents and Contractors

The commission paid to the top five real estate agents during the year was HK\$1,235,000, and the total value of service contracts of the top five contractors engaged by Prosperity REIT was HK\$ 35,321,000.

## Top Five Real Estate Agents

Respective commissions to the top five real estate agents to secure new tenants are summarized as follows:

Real Estate Agents	Commission paid HK\$'000	Percentage
Centaline Property Agency Limited	447	28.9%
Midland Realty	445	28.8%
Hong Yip Properties Agency Limited	173	11.2%
Fast Property Agency	92	6.0%
Savills (Hong Kong) Limited	78	5.0%
	<b>1,235</b>	<b>79.9%</b>

## Top Five Contractors

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

Contractors	Nature of services	Value of contract HK\$'000	Percentage
Citybase Property Management Ltd	Building management	13,872	36.0%
Goodwell Property Management Ltd	Building management	13,602	35.3%
Goodwell-Prosperity Property Services Ltd	Property management	4,988	12.9%
Onway Engineering Ltd	Repairs and maintenance/ Landlord provision	1,471	3.8%
E-park Parking Management Limited	Car park operation	1,388	3.6%
		<b>35,321</b>	<b>91.6%</b>