Notes to the Financial Statements

For the year ended 31 December 2006

1 GENERAL

Prosperity Real Estate Investment Trust ("Prosperity REIT") is a Hong Kong collective investment scheme authorised under section 104 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and its units have been listed on The Stock Exchange of Hong Kong Limited (the "HKSE") since 16 December 2005. Prosperity REIT is governed by the deed of trust dated 29 November 2005, as amended by a first supplemental deed dated 12 December 2005 (collectively the "Trust Deed") made between ARA Asset Management (Prosperity) Limited (the "Manager") and HSBC Institutional Trust Services (Asia) Limited (the "Trustee"), and the Code on Real Estate Investment Trusts issued by the Securities and Futures Commission.

The principal activity of Prosperity REIT and its subsidiaries (the "Group") is to own and invest in a portfolio of offices and commercial properties located in Hong Kong with the objective of producing stable and sustainable distributions to unitholders and to achieve long term growth in the net asset value per unit.

The addresses of the registered office of the Manager and the Trustee are Units 5508-5509, 55 Floor, The Center, 99 Queen's Road Central, Hong Kong and 1 Queen's Road Central, Hong Kong, respectively.

The consolidated financial statements are presented in Hong Kong dollars, which is also the functional currency of Prosperity REIT.

The Group has entered into various service agreements in relation to the management of Prosperity REIT and its property operations. The fee structures of these services are as follows:

(a) Property management fees

Under the Property Management Agreement, the Property Manager, Goodwell-Prosperity Property Services Limited, will receive from each of the property holding subsidiaries a fee of 3% per annum of gross property revenue for the provision of property management services and lease management services.

Gross property revenue means the amount equivalent to the gross revenue less rental related income and car park income.

(b) Marketing services

For the marketing services, the property holding subsidiaries will pay the Property Manager the following commissions:

- one month's base rent for securing a tenancy of three years or more;
- one-half month's base rent for securing a tenancy of less than three years;
- one-half month's base rent for securing a renewal of tenancy irrespective of duration of the renewal term; and
- 10% of the total licence fee for securing a licence for duration of less than 12 months.

(c) Trustee's fees

The Trustee is entitled to receive a trustee's fee not exceeding 0.05% per annum on the value of the real estate properties (subject to a minimum of HK$50,000 per month), currently at 0.03% per annum.

Notes to the Financial Statements

For the year ended 31 December 2006

1 GENERAL *(CONTINUED)*

(d) Manager's fees

Under the Trust Deed, the Manager is entitled to receive the following remuneration for the provision of asset management services:

Base fee

The Manager will receive a base fee from Prosperity REIT at 0.4% per annum on the value of the properties on a quarterly basis. The base fee will be paid a quarterly in arrears and in the form of units in Prosperity REIT during the first five years after the units are listed on the HKSE. Thereafter, the Manager may elect whether the base fee is to be paid in cash or in units.

Variable fee

The Manager will receive from each property holding subsidiary a variable fee of 3% of its net property income (before deduction therefrom the base fee and variable fee) on a quarterly basis. The variable fee will be paid in units during the first five years after the units are listed on the HKSE, and thereafter, may elect whether the variable fee is to be paid in cash or in units at the election of the Manager.

2. APPLICATION OF NEW AND REVISED HONG KONG FINANCIAL REPORTING STANDARDS ("HKFRSs")

In the current year, the Group has applied, for the first time, a number of new standard, amendments and interpretations ("new HKFRSs") issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), which are either effective for accounting periods beginning on or after 1 December 2005 or 1 January 2006. The adoption of the new HKFRSs had no material effect on how the results for the current or prior accounting periods have been prepared and presented. Accordingly, no prior period adjustment has been required.

The Group has not early applied the following new standard, amendment or interpretations that have been issued but are not yet effective. The Manager anticipates that the application of this standard, amendment or interpretations will have no material impact on the results and the financial position of the Group.

HKAS 1 (Amendment)	Capital Disclosures[1]
HKFRS 7	Financial Instruments: Disclosures[1]
HKFRS 8	Operating Segments[2]
HK(IFRIC)-Int 7	Applying the Restatement Approach under HKAS 29 Financial Reporting in Hyperinflationary Economies[3]
HK(IFRIC)-Int 8	Scope of HKFRS 2[4]
HK(IFRIC)-Int 9	Reassessment of Embedded Derivatives[5]
HK(IFRIC)-Int 10	Interim Financial Reporting and Impairment[6]
HK(IFRIC)-Int 11	HKFRS – Group and Treasury Share Transactions[7]
HK(IFRIC)-Int 12	Service Concession Arrangements[8]

1 Effective for annual periods beginning on or after 1 January 2007
2 Effective for annual periods beginning on or after 1 January 2009
3 Effective for annual periods beginning on or after 1 March 2006
4 Effective for annual periods beginning on or after 1 May 2006
5 Effective for annual periods beginning on or after 1 June 2006
6 Effective for annual periods beginning on or after 1 November 2006
7 Effective for annual periods beginning on or after 1 March 2007
8 Effective for annual periods beginning on or after 1 January 2008

3 SIGNIFICANT ACCOUNTING POLICIES

(a) Basis of preparation of financial statements

The consolidated financial statements have been prepared in accordance with Hong Kong Financial Reporting Standards issued by the HKICPA. In addition, the financial statements include the relevant disclosure requirements set out in Appendix C of the Code on Real Estate Investment Trusts issued by the Securities and Future Commission and the Rules Governing the Listing of Securities on the HKSE.

The consolidated financial statements are prepared on the historical basis, except for certain properties and financial instruments, which are measured at fair values, as explained in the accounting policies set out below.

(b) Basis of consolidation

The consolidated financial statements incorporate the financial statements of Prosperity REIT and the subsidiaries controlled by Prosperity REIT. Control is achieved when Prosperity REIT has the power to govern the financial and operating policies of the subsidiaries so as to obtain benefits from their activities. The results of subsidiaries acquired or disposed of during the period are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. All significant intercompany transactions and balances are eliminated on consolidation.

(c) Business combinations

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and units issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combinations. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under HKFRS 3 Business Combinations are recognised at their fair values at the acquisition date, except for non-current assets (or disposal groups) that are classified as held for sale in accordance with HKFRS 5 Non-Current Assets Held for Sale and Discontinued Operations, which are recognised and measured at fair value less costs to sell.

Goodwill arising on acquisition is recognised as an asset and initially measured at cost, being the excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised.

A discount arising on acquisition represents the excess of the net fair value of an acquiree's identifiable assets, liabilities and contingent liabilities over the cost of the business combination. If, after reassessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the income statement.

(d) Investment properties

On initial recognition, investment properties, which are properties held to earn rentals or for capital appreciation or both, are measured at cost, including any directly attributable expenditure. Subsequent to initial recognition, investment properties are measured using the fair value model. Gains or losses arising from changes in the fair value of investment properties are included in profit or loss for the period in which they arise.

The gain or loss on disposal of an investment property is the difference between the net sale proceeds and its carrying amount, and is recognised in the income statement.

Notes to the Financial Statements

For the year ended 31 December 2006

3 SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(e) Financial instruments

Financial assets and financial liabilities are recognised on the balance sheet when a group entity becomes a party to the contractual provisions of the instrument. Financial assets and financial liabilities are initially measured at fair value. Transaction costs (which include origination fees) that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial assets

.

Receivables (including trade and other receivables, amount due from related companies and bank balances) are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. At each balance sheet date subsequent to initial recognition, receivables are carried at amortised cost using the effective interest method, less any identified impairment losses. An impairment loss is recognised in profit or loss when there is objective evidence that the asset is impaired, and is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the original effective interest rate. Impairment losses are reversed in subsequent periods when an increase in the asset's recoverable amount can be related objectively to an event occurring after the impairment was recognised, subject to a restriction that the carrying amount of the asset at the date the impairment is reversed does not exceed what the amortised cost would have been had the impairment not been recognised.

Financial liabilities

Payables (including borrowings, trade and other payables, unitholders' funds) are subsequently measured at amortised cost, using the effective interest method.

In accordance with the Trust Deed, Prosperity REIT has a limited life of 80 years less one day from the date of commencement of Prosperity REIT. Accordingly, the units contain a contractual obligation upon the termination of Prosperity REIT to distribute a share of all net cash proceeds derived from the sale or realisation of the assets of Prosperity REIT less any liabilities to its unitholders, in accordance with their proportionate interests in Prosperity REIT at the date of its termination. The unitholders' funds are therefore classified as financial liabilities in accordance with Hong Kong Accounting Standard 32: Financial Instruments: Disclosure and Presentation. It is presented on the balance sheet as net assets attributable to existing unitholders.

In addition, in accordance with the Trust Deed, Prosperity REIT is required to distribute to unitholders not less than 90% of its distributable income for each financial period and it is the Manager's stated policy to distribute to unitholders 100% of the distributable income.

3 SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(e) Financial instruments *(continued)*

Derivative financial instruments and hedging

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated as an effective hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship.

(i) Hedge accounting

The Group uses interest rate swaps to hedge its exposure against changes in interest rates. Hedging relationships are classified as cash flow hedges when such relationships are used to hedge against exposure to variability in cash flows that are attributable to a particular risk associated with a recognised asset or liability and such variability could affect profit or loss.

At the inception of the hedge relationship the Group documents the relationship between the hedging instrument and hedged item, along with its risk management objectives and its strategy for undertaking various hedge transactions. Furthermore, at the inception of the hedge and on an ongoing basis, the Group documents whether the hedging instrument that is used in a hedging relationship is highly effective in offsetting changes in fair values or cash flows of the hedged item.

(ii) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are deferred in a hedging reserve. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss as part of other expenses or other income.

Amounts deferred in the hedging reserve are recycled in profit or loss in the periods when the hedged item is recognised in profit or loss.

Hedge accounting is discontinued when the Group revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. Any cumulative gain or loss deferred in the hedging reserve at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was deferred in equity is recognised immediately in profit or loss. The hedging reserve is presented within net assets attributable to unitholders.

Notes to the Financial Statements

For the year ended 31 December 2006

3 SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(e) Financial instruments *(continued)*

Derecognition

Financial assets are derecognised when the rights to receive cash flows from the assets expire or, the financial assets are transferred and the Group has transferred substantially all the risks and rewards of ownership of the financial assets. On derecognition of a financial asset, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognised directly in equity is recognised in profit or loss.

Financial liabilities are derecognised when the obligation specified in the relevant contract is discharged, cancelled or expires. The difference between the carrying amount of the financial liability derecognised and the consideration paid and payable is recognised in profit or loss.

(f) Cash and cash equivalents

Cash and cash equivalents comprise cash and overnight demand deposits with banks that are subject to an insignificant risk of changes in value.

(g) Unit issue costs

The transaction costs relating to the initial public offering and listing of units of Prosperity REIT are accounted for as a deduction from the proceeds raised to the extent they are incremental costs directly attributable to the transaction that otherwise would have been avoided. Other transaction costs are recognised as an expense.

(h) Leasing

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Rental income from operating leases is recognised in the consolidated income statement on a straight-line basis over the term of the relevant lease. Initial direct costs incurred in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense on a straight-line basis over the lease term.

(i) Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for services provided in the normal course of business, net of discounts and sales related taxes.

Rental related income, representing mainly air conditioning fee, management fee and promotion fee are recognised when the services and facilities are provided.

Interest income from a financial asset is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts the estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount.

3 SIGNIFICANT ACCOUNTING POLICIES *(CONTINUED)*

(j) Borrowings cost

Borrowings cost are recognised as an expense in the income statement in the year in which they are incurred.

(k) Taxation

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the period. Taxable profit differs from profit as reported in the consolidated income statement because it excludes items of income or expense that are taxable or deductible in other periods and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited to profit or loss, except when it relates to items charged or credited directly to net assets attributable to unitholders, in which case the deferred tax is also dealt within net assets attributable to unitholders.

4 FINANCIAL INSTRUMENTS

(a) Financial risks management objectives and policies

Credit risk

Credit risk is the potential financial loss resulting from the failure of a tenant or counterparty to settle its financial and contractual obligations to the Group, as and when they fall due.

The Manager has established credit limits for tenants and monitors their balances on an ongoing basis. Credit evaluations are performed by the Property Manager on behalf of the Manager before lease agreements are entered into with tenants. In addition, the Manager reviews the recoverable amount of each individual trade debtor regularly to ensure that adequate impairment losses are recognised for irrecoverable debts. Cash and fixed deposits are placed with reputable financial institutions.

The credit risk on liquid funds is limited because the counterparties are banks with high credit ratings assigned by international credit-rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a number of counterparties and customers.

Notes to the Financial Statements

For the year ended 31 December 2006

4 FINANCIAL INSTRUMENTS *(CONTINUED)*

(a) Financial risks management objectives and policies *(continued)*

Interest rate risk

The Group's exposure to changes in interest rates relates primarily to interest-earning financial assets and interest-bearing financial liabilities. Interest rate risk is managed by the Manager on an ongoing basis with the primary objective of limiting the extent to which net interest expense could be affected by adverse movements in interest rates.

The Group has put in place interest rate swap arrangements to minimise the variability in cash flows attributable to changes in interest rate. This involves fixing the portion of interest payable on its underlying debt liabilities via financial derivatives.

Liquidity risk

The Manager monitors and maintains a level of cash and cash equivalents deemed adequate to finance the Group's operations. In addition, the Manager observes the Code on Real Estate Investment Trusts issued by the Securities and Futures Commission concerning limits on total borrowings and monitors the level of borrowing to be within the permitted limit.

(b) Fair value

The fair value of financial assets and financial liabilities are determined as follows:

- the fair value of other financial assets and financial liabilities (excluding derivative instruments) are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions;
- the fair value of derivative instruments is determined based on discounted cash flow analysis using the applicable yield curve for the duration of the instruments.

The Manager considers that the carrying amounts of financial assets and financial liabilities recorded at amortised cost in the financial statements approximate their fair values.

5 REVENUE

	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 to 31 December 2005 HK$'000
Gross rental from investment properties		
Rental income	**166,148**	5,900
Car park income	**14,201**	583
	180,349	6,483
Rental related income	**36,778**	1,719
	217,127	8,202

6 PROPERTY OPERATING EXPENSES

	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 to 31 December 2005 HK$'000
Building management fees	20,812	1,410
Utilities	5,834	63
Government rent and rates	879	376
Car park operating expenses	4,053	181
Marketing service fee	3,405	–
Lease commission	1,546	13
Landlord provision	2,508	4,654
Repairs and maintenance	1,230	–
Legal cost and stamp duty	1,021	45
Secretarial fee	883	–
Valuation fees (paid to principal valuer)	140	45
Audit fee	638	201
Tax fees	128	120
Back-office support service fee	693	–
Others	834	103
	44,604	7,211

7 TRUST AND OTHER EXPENSES

	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 to 31 December 2005 HK$'000
Audit fee	590	346
Trustee's fee	1,413	60
Bank charges	291	80
Legal and professional fees	2,200	–
Registrar fee	1,600	70
Trust administrative expenses	5,203	1,263
	11,297	1,819

Notes to the Financial Statements

For the year ended 31 December 2006

8 FINANCE COSTS

	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 to 31 December 2005 HK$'000
Interest expense on:		
– Secured term loan	**87,861**	3,855
Equalisation of interest expense through cashflow hedges	**(7,554)**	–
	80,307	3,855
– Secured revolving loan	**1,937**	259
	82,244	4,114

9 TAXATION

	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 to 31 December 2005 HK$'000
Current tax credit	**(292)**	(615)
Deferred tax (note 17)	**57,703**	111
	57,411	(504)

Hong Kong Profits Tax is calculated at 17.5% of the estimated assessable profit for the year/period and the taxation for the year/period can be reconciled to the accounting profit as follows:

	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 To 31 December 2005 HK$'000
Income tax expense at statutory rate of 17.5%	**64,427**	41,858
Tax effect of excess of fair value of identifiable assets and liabilities acquired over the cost of acquisition of subsidiaries	**–**	(29,979)
Tax effect of increase in fair value of two investment properties acquired upon listing	**–**	(9,417)
Tax effect of increase in fair value of investment properties at year/period end	**(8,750)**	(1,750)
Tax effect of non-taxable income	**(397)**	(5,257)
Tax effect of non-deductible expenses	**2,589**	3,841
Underprovision in respect of prior period	**1**	–
Tax effect of tax losses not recognised	**162**	200
Utilisation of tax losses previously not recognised	**(178)**	–
Utilisation of deductible temporary differences previously not recognised	**(443)**	–
Taxation for the year/period	**57,411**	(504)

10 EARNINGS PER UNIT

The earnings per unit is calculated by dividing the profit for the year/period, before transactions with unitholders of HK$310,744,000 (16 December 2005 to 31 December 2005: HK$239,690,000) by the weighted average of 1,255,196,023 (16 December 2005 to 31 December 2005: 1,250,962,222) units in issue during the year.

The diluted earnings per unit is calculated by dividing the profit for the year/period, before transactions with unitholders of HK$310,744,000 by the weighted average of potential units (units issued for manager's fee) of 1,257,622,735 units issued during the year.

11 INVESTMENT PROPERTIES

	31 December 2006 HK$'000	31 December 2005 HK$'000
FAIR VALUE		
At beginning of the year/period	**4,548,000**	4,538,000
Increase in fair value of investment properties	**316,000**	10,000
At end of the year/period	**4,864,000**	4,548,000

On 31 December 2006, an independent valuation was undertaken by Knight Frank Petty Limited. The firm is an independent qualified professional valuer not connected to the Group and having appropriate professional qualifications and recent experience in the valuation of similar properties in the relevant locations. The valuation of the properties was arrived at using the basis of capitalisation of the net income and by reference to sales evidence as available on the market.

All of the Group's property interests in properties located in Hong Kong are held under medium-term leases to earn rentals or for capital appreciation purposes. They are measured using the fair value model and are classified and accounted for as investment properties.

All of the Group's investment properties as at 31 December 2006 have been pledged to secure banking facilities granted to the Group.

Notes to the Financial Statements

For the year ended 31 December 2006

12 DERIVATIVE FINANCIAL INSTRUMENTS

	31 December 2006 HK$'000	31 December 2005 HK$'000
Cash flow hedges – interest rate swaps	**190,375**	283,799

The Group uses interest rate swaps to minimise its exposure to movements in interest rates in relation to its floating rates term loan by swapping from floating rates to fixed rates. The interest rate swaps and the corresponding term loan have the same terms and the Manager considers that the interest rate swaps are highly effective hedging instruments. Major terms of the interest rate swaps are set out below:

Notional amount	**Maturity**	**Swaps**
HK$885,000,000	16 December 2010	From 3 months HIBOR+0.49% to average rate of 1.40% per annum over 5 years
HK$885,000,000	16 December 2010	From 3 months HIBOR+0.49% to average rate of 1.40% per annum over 5 years

The above derivatives are measured at fair value at the balance sheet date.

13 TRADE AND OTHER RECEIVABLES

	31 December 2006 HK$'000	31 December 2005 HK$'000
Trade receivables	**162**	607
Deposits and prepayments	**7,326**	6,094
Other receivables	**367**	26,121
	7,855	32,822

Ageing analysis of the Group's trade receivables at the balance sheet date is as follows:

	31 December 2006 HK$'000	31 December 2005 HK$'000
Current – 1 month	**162**	431
2 – 3 months	**–**	176
	162	607

The Group maintains a defined credit policy. The collection is closely monitored to minimise any credit risk associated with these receivables.

14 AMOUNT DUE FROM (TO) RELATED COMPANIES

The amount due from related companies as at 31 December 2005 arose from the collection of property rental on behalf of the Group by certain subsidiaries of a unitholder. The amount is unsecured, interest-free and repayable on demand.

The amount due to related companies as at 31 December 2006 arose from expenses accrued on back-office services, property management services and car park management services provided by related companies. The amount is unsecured, interest-free and repayable on demand.

15 BANK BALANCES AND CASH

	31 December 2006 HK$'000	31 December 2005 HK$'000
Cash at bank	**7,730**	176
Fixed deposits with financial institutions	**34,007**	88,713
	41,737	88,889

Fixed deposits with financial institutions consist of overnight deposits bearing interest at approximately 3.6% (31 December 2005: 3.8%) per annum.

Deposits and bank balances and cash are placed with The Hongkong and Shanghai Banking Corporation Limited, a related company of the Trustee.

16 BORROWINGS

	31 December 2006 HK$'000	31 December 2005 HK$'000
Long-term borrowing:		
Secured term loan	**1,770,000**	1,770,000
Origination fees	**(15,004)**	(18,050)
	1,754,996	1,751,950
Short-term borrowing:		
Secured revolving loan	**20,000**	130,000
	1,774,996	1,881,950

Under the banking facility agreement, the Group has been granted a facility of HK$1,900,000,000, comprising a HK$1,770,000,000 term loan and a HK$130,000,000 revolving credit facility.

Notes to the Financial Statements

For the year ended 31 December 2006

16 BORROWINGS *(CONTINUED)*

The term and conditions of the facilities are as follows:

(i) HK$1,770,000,000 term loan bearing interest at floating interest rate of HIBOR+0.49% per annum and repayable in full in December 2010.

(ii) HK$130,000,000 revolving loan bearing interest at floating interest rate of HIBOR+0.49% per annum and repayable on demand.

The term loan carried interest, after hedging, at an effective rate of approximately 5% per annum for the year/period.

Both the term loan and revolving loan were secured by the Group's investment properties with a carrying value of HK$4,864,000,000. In addition, Prosperity REIT and certain of its subsidiaries provide a guarantee for the term loan and revolving loan granted to a subsidiary.

The fair value of the Group's borrowings which was approximate to the carrying amount was estimated by discounting their future cash flows at market rate.

The origination fees consist of advisory fee and front-end fee in respect to the banking facility and are measured at amortised cost.

17 DEFERRED TAX LIABILITIES

The followings are the major component of deferred tax liabilities and assets recognised and movements thereon during the period:

	Accelerated tax depreciation HK$'000	Revaluation of Investment properties HK$'000	Tax losses HK$'000	Total HK$'000
As at 16 December 2005	–	–	–	–
Acquisition	64,045	96,840	(22,153)	138,732
Charge to income statement for the period	5,053	–	(4,942)	111
As at 31 December 2005	69,098	96,840	(27,095)	138,843
Charge to income statement for the year	6,901	46,550	4,252	57,703
As at 31 December 2006	75,999	143,390	(22,843)	196,546

At the balance sheet date, tax loss amounting to approximately HK$1,006,000 (31 December 2005: HK$1,099,000) were not recognised, due to unpredictability of future profits stream.

18 TRADE AND OTHER PAYABLES

	31 December 2006 HK$'000	31 December 2005 HK$'000
Trade payables	**567**	2,496
Tenants' deposits		
– Outside parties	**56,601**	46,719
– Related parties	**996**	994
Rental received in advance		
– Outside parties	**881**	1,692
Other payables	**15,745**	52,299
	74,790	104,200

Ageing analysis of the Group's trade payables at the balance sheet date is as follows:

	31 December 2006 HK$'000	31 December 2005 HK$'000
Current – 1 month	**96**	1,833
2 – 3 months	**275**	663
Over 3 months	**196**	–
	567	2,496

19 ISSUED UNITS

	Number of units	HK$'000
Creation and issuance of new unit on 16 December 2005 and balance at 31 December 2005	1,250,962,222	2,702,078
Payment of Manager's base fee and variable fee through issuance of new units during the year	9,964,974	18,711
Balance at 31 December 2006	1,260,927,196	2,720,789

Subsequent to the balance sheet date, 2,889,281 units at HK$1.6973 per unit and 797,318 units at HK$1.7053 per unit were issued to the Manager as settlement of base fee and variable fee for the period from 1 October 2006 to 31 December 2006.

20 NET ASSET VALUE PER UNIT ATTRIBUTABLE TO UNITHOLDERS

The net asset value per unit is calculated based on the net assets attributable to unitholders excluding hedging reserve and the total number of 1,260,927,196 units in issue at 31 December 2006 (1,250,962,222 units in issue at 31 December 2005).

Notes to the Financial Statements

For the year ended 31 December 2006

21 ACQUISITION OF SUBSIDIARIES

Upon listing, Prosperity REIT acquired five investment properties and a finance company through the acquisition of 100% issued share capital of property holding companies using the purchase method. The excess of the fair value of identifiable assets and liabilities of the assets acquired over the cost of acquisition of HK$171,308,000 was recognised in the income statement for the period from 16 December 2005 to 31 December 2005. The fair value of the net assets acquired is as follows:

	HK$'000
Investment properties	3,728,000
Derivative financial instruments	315,814
Trade and other receivable	46,544
Bank balances and cash	1,671
Trade and other payables	(57,452)
Secured revolving loan	(130,000)
Tax liabilities	(1,764)
Secured term loan	(1,770,000)
Deferred tax liabilities	(127,317)
Net assets acquired	2,005,496
Excess of fair value of identifiable assets and liabilities acquired over the cost of acquisition	(171,308)
Total consideration satisfied by cash	1,834,188
Net cash outflow arising on acquisition:	
Cash consideration	1,834,188
Bank balances and cash acquired	(1,671)
	1,832,517

22 MAJOR NON-CASH TRANSACTION

During the year, the Manager earned a fee of HK$24,104,000. An amount of HK$17,840,000 had been settled through the issuance of units to the Manager while the balance of HK$6,264,000 will be paid in units subsequent to the year end.

23 KEY SOURCES OF ESTIMATION UNCERTAINTY

In the process of applying the Group's accounting policies, which are described in note 3, management has considered the following key sources of estimation uncertainty at the balance sheet date, that would have significant risk of causing a material adjustment to the carrying amounts of assets within the next financial year.

As described in note 3(d), investment properties are stated at fair value based on the valuation performed by independent professional valuers. In determining the fair value, the valuers have based on a method of valuation which involves certain estimates. In relying on the valuation report, the management has exercised its judgment and is satisfied that the method of valuation is reflective of the current market conditions.

As described in note 3(e), the fair value of derivative financial instruments that are not quoted in active markets are determined by using certain valuation techniques. Where valuation techniques are used to determine fair values, they are validated and periodically reviewed by qualified personnel. All models are certified before they are used, and models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical, models use only observable data, however, areas such as credit risk (both own and counterparty), volatilities and correlations require management to make estimates.

24 NET CURRENT LIABILITIES

At the balance sheet date, the Group's net current liabilities, defined as current assets less current liabilities, amounted to HK$135,085,000 (31 December 2005: HK$130,751,000). Under the banking facility agreement entered into by the Group, the Group has in place a revolving credit facility to meet its liabilities as they fall due.

25 TOTAL ASSETS LESS CURRENT LIABILITIES

At the balance sheet date, the Group's total assets less current liabilities amounted to HK$4,919,290,000 (31 December 2005: HK$4,701,048,000).

26 SEGMENTAL REPORTING

Prosperity REIT's business is investing in offices and commercial properties located in Hong Kong.

27 OPERATING LEASE COMMITMENTS

	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 to 31 December 2005 HK$'000
Minimum lease income under operating leases included in the income statement	**166,148**	5,900

	31 December 2006 HK$'000	31 December 2005 HK$'000
Commitments in respect of non-cancellable operating leases for the rental of investment properties were as follows:		
Future minimum lease payments receivable:		
Within one year	**159,668**	109,147
In the second to fifth year inclusive	**186,570**	121,491
Over five years	**–**	13,864
Total	**346,238**	244,502

28 POST BALANCE SHEET EVENT

The Group acquired certain investment properties from independent third parties for total cash consideration of HK$41,153,000 subsequent to the balance sheet date.

Notes to the Financial Statements

For the year ended 31 December 2006

29 CONNECTED AND RELATED PARTY TRANSACTIONS

During the year, the Group entered into the following transactions with connected and related parties:

	Note	Year ended 31 December 2006 HK$'000	Period from 16 December 2005 to 31 December 2005 HK$'000
Rent and rental related income from			
AMTD Financial Planning Limited	(a)	**1,850**	58
E-Park Parking Management Limited	(b)	**187**	7
e-Smart System Inc.	(b)	**2,068**	99
Fusion System Limited	(b)	**131**	1
Goodwell Property Management Limited	(b)	**853**	34
Tremayne Investments Limited	(c)	**16,025**	641
Carpark lease agency fee for the operations of the Group's carpark			
E-Park Parking Management Limited	(b)	**1,388**	77
Goodwell Property Management Limited	(b)	**29**	5
Property management fee			
Goodwell-Prosperity Property Services Limited	(b)	**4,988**	177
Marketing service fee			
Goodwell-Prosperity Property Services Limited	(b)	**3,405**	–
Trustee's fee			
HSBC Institutional Trust Services (Asia) Limited		**1,413**	60
Manager's fee			
ARA Asset Management (Prosperity) Limited		**24,104**	871
Back-office support service fee			
Cheung Kong Real Estate Agency Limited	(b)	**693**	–

29 CONNECTED AND RELATED PARTY TRANSACTIONS *(CONTINUED)*

		31 December 2006 HK$'000	31 December 2005 HK$'000
Balances with related parties are as follows:			
Amount due to related companies			
Cheung Kong Real Estate Agency Limited	(b)	**693**	–
Citybase Property Management Limited	(b)	**1,345**	–
Goodwell-Prosperity Property Services Limited	(b)	**2,217**	–
Goodwell Property Management Limited	(b)	**4,852**	–
Harbourfront Landmark Premium Services Limited	(c)	**106**	–
E-Park Parking Management Limited	(b)	**221**	–
Amount due from related companies			
Cheung Kong Property Development Limited	(b)	**–**	9,814
E-Park Parking Management Limited	(b)	**–**	1,644
Deposits placed with the Group for the lease of the Group's properties			
AMTD Financial Planning Limited	(a)	**485**	485
E-Park Parking Management Limited	(b)	**51**	49
e-Smart System Inc.	(b)	**191**	191
Fusion System Limited	(b)	**45**	45
Goodwell Property Management Limited	(b)	**224**	224

Notes:

(a) The company is the associate of Cheung Kong (Holdings) Limited ("CKH") which is a unitholder of Prosperity REIT.

(b) These companies are the subsidiaries of CKH.

(c) The company is a subsidiary of Hutchison Whampoa Limited ("HWL"), an associate of CKH and a unitholder of Prosperity REIT.

Under the Code on Real Estate Investment Trusts issued by the Securities and Futures Commission, the deed of mutual covenant which binds the Manager and all the owners of a development and their successors-in-title which include members of CKH group technically constitutes a contract between the Group and CKH group. Remuneration to the building managers, which are the wholly-owned subsidiaries of CKH, for the building management services provided constitutes a connected transaction. During the year, remuneration paid from the funds of the buildings, attributable to the properties owned by the Group, to the building managers amounted to HK$438,000 (16 December 2005 to 31 December 2005: HK$16,201).