

CANARY WHARF GROUP PLC

Extracts from the financial statements of the company for the year ended 31 December 2006. The report and financial statements are currently being produced and will be distributed to all shareholders at a later date.

HIGHLIGHTS

- **Net assets increased** from £2,377.2 million at 31 December 2005 to **£2,905.3 million** at 31 December 2006, an increase of **£528.1 million or 22.2%** (Note (i)) net of the dividend paid of £306.7 million.
- **Adjusted net asset value per share increased by £1.32 (34.0%)** from £3.88 to **£5.20** and adjusted triple net asset value ('NNNAV') per share **increased by £1.21 (35.9%)** from £3.37 to **£4.58** (Note (i)), net of the dividend paid of 48p per share.
- **The dividend** of £306.7 million **was equivalent to 48p per ordinary share** (Note (ii)), which brings the total dividend paid since 2004 to £1,002.0 million (£1.58 per share).
- The **market value of the property portfolio** at 31 December 2006 **was £6,737.4 million** against £5,658.5 million at 31 December 2005, an **increase of 17.6%** disregarding additions in the year (Note (iii)).
- In 2006 **the group completed approximately 1.4 million sq ft of transactions**, including 690,000 sq ft of lettings or pre-lets and 700,000 sq ft of pre-sales (Note (iv)).
- At 31 December 2006 **the estimated net present value of space sub-let** back to the group **had reduced to approximately £43.8 million** (31 December 2005 – £149.0 million) (Note (iv)).
- **Construction commenced on four new buildings:**
 - **an approximately 300,000 sq ft building** at 20 Churchill Place under an agreement **for sale** to Prudential Retirement Income Limited ('Prudential') **for a consideration of £199.5 million** (Note (iii)). Following completion the building will be occupied by SSB Realty LLC ('State Street').
 - **an approximately 400,000 sq ft building** at 15 Canada Square under an agreement **for sale** to KPMG **for a consideration of £260.0 million** (Note (iv)).
 - **an adjacent building of approximately 300,000 sq ft** to be constructed concurrently (Note (iv)).
 - **an approximately 300,000 sq ft building** to be constructed at 5 Churchill Place **of which 206,000 sq ft has been pre-let** to Bear Stearns Inc ('Bear Stearns') (Note (iv)).
 - in addition, **infrastructure works commenced** on the remaining site on Canary Wharf (0.4 million sq ft) and on Riverside (1.8 million sq ft) (Note (v)).
- At 31 December 2006 **the group's investment portfolio** totalling 7.9 million sq ft **was 95.6% let** (31 December 2005 – 7.9 million sq ft of which 89.6% was let) (Note (vi)).
- At 31 December 2006 **the weighted average unexpired lease term** for the investment portfolio **was 19.8 years** (or 17.1 years assuming exercise of break options) (Note (vi)).
- **Planning permission was granted on North Quay**, a site immediately north of the Estate for the development of **2.4 million sq ft** of office and retail space (Note (v)) and it is anticipated that application for the Wood Wharf scheme, in which the group has a 25% interest, will be made during 2007.

Notes:

- (i) See 'Business Review – Balance Sheet' for further details.
- (ii) See Note 7 of the Notes to these financial statements.
- (iii) See 'Business Review – Valuations' for a comparison with the carrying value for accounts purposes.
- (iv) See 'Business Review – Leasing' for further details.
- (v) See 'Business Review – Construction' for further details.
- (vi) See 'Business Review – Property portfolio' for further details.

RESULTS IN BRIEF

	2006	2005
	£m	£m
Rental income (Note (i))	213.7	229.7
Exceptional item:		
– sale of long leasehold property (Note (ii))	–	12.1
Operating profit	174.4	200.4
Operating profit excluding exceptional item (Note (ii))	174.4	188.3
Exceptional items:		
– profit on disposal of investment properties (Note (ii))	–	205.3
– gains/(charges) relating to repayment of debt (Note (ii))	123.3	(199.4)
Profit/(loss) before taxation (Note (i))	104.1	(1.6)
Loss before taxation excluding exceptional items (Note (ii))	(19.2)	(19.6)
Taxation – deferred tax (Note (iii))	(60.3)	89.2
Dividends per share (Note (iv))	48.0p	110.0p
Basic and diluted earnings per share (Note (v))	6.9p	14.1p

Notes:

- (i) Refer to 'Business and Financial Review – Operating results' of the accompanying financial information.
- (ii) Refer to Note 10 of the Notes to these financial statements for details of the profits on sale of properties and Note 4 for details of the charges relating to repayment of debt.
- (iii) Refer to Note 5 of the Notes to these financial statements.
- (iv) Refer to Note 7 of the Notes to these financial statements.
- (v) Refer to Note 9 of the Notes to these financial statements.

CHAIRMAN'S AND CHIEF EXECUTIVE OFFICER'S STATEMENT

2006 was a very successful year for Canary Wharf Group plc with new lettings and pre-sales being concluded on approximately 1.4 million sq ft of space, which is a new record for a single year for your company, as well as the commencement of construction on four buildings. Property valuations increased during the year by 17.6% from £5,658.5 million to £6,737.4 million at 31 December 2006. Net assets also increased from £2,377.2 million to £2,905.3 million at 31 December 2006, an increase of 22.2% net of the dividend of £306.7 million paid in the year. More detail is provided in the Business and Financial Review.

Leasing / pre-sales

Two of the four new buildings under construction were the subject of significant pre-sale transactions. In February the 300,000 sq ft building under construction at 20 Churchill Place, which will be occupied by State Street, was pre-sold to Prudential. This building will allow State Street to consolidate its various offices into one location. Meanwhile, in November an agreement for sale was concluded with KPMG for a 400,000 sq ft building located in 15 Canada Square. As part of this transaction KPMG has been granted an option to sub-let back to the group on completion of its new building approximately 103,000 sq ft in One Canada Square which it currently occupies. The remaining 38,000 sq ft occupied by KPMG in this building is subject to a break clause in December 2008. As a result of the continuation of strong market demand, speculative construction is now proceeding with the adjacent building of approximately 300,000 sq ft at 30 The North Colonnade to be completed in early 2009. KPMG has been granted call options over approximately 100,000 sq ft in this building, which are exercisable up to August 2007.

Bear Stearns has agreed to pre-let 206,000 sq ft of the 300,000 sq ft in the new building at 5 Churchill Place with options on the balance of the space. Bear Stearns also took 42,000 sq ft of short term leases in One Canada Square where lettings on a further approximately 48,000 sq ft were concluded to 9 tenants. 130,000 sq ft was let to Barclays Wealth Management in 1 Churchill Place. In addition, approximately 165,000 sq ft at 25-30 Bank Street has also been let to 5 tenants. This means that all the space previously sub-let back to the Group has now been re-let, with the exception of only 11,000 sq ft which can be called upon by an existing tenant. Finally, in 40 Bank Street lettings of approximately 100,000 sq ft were concluded during the year.

These lettings and pre-sales together mean that there is unlikely to be any speculative built space under the control of Canary Wharf Group available for immediate occupation until the completion in early 2009 of 30 The North Colonnade. Space is, however, likely to become available in 2008 and 2009 in One Canada Square, when Bear Stearns and State Street vacate to occupy their new buildings.

These lettings have led to a vacancy rate in completed buildings on the Estate at 31 December 2006 of 4.4%, down from 10.4% at the end of 2005. This tightness of demand and the quality of buildings at Canary Wharf has led to rental levels of more than £40 per sq ft being established in 2006, and we anticipate that continued rental growth into 2007 will drive head-line rents up to the mid £40s per sq ft.

Development - Canary Wharf Estate

As is apparent from the above, recent letting and pre-let activity has led to the marked increase in construction now visible on the Estate. There will be 1.3 million sq ft in the four new buildings, all of which are due to be completed by 2009. In addition to the construction of these office buildings, the redevelopment at the western end of Cabot Place Retail Mall is also proceeding. This redevelopment will increase the existing Cabot Place retail area by approximately 42,600 sq ft or 41%. Completion is anticipated in March 2008. Zara, River Island and Leon have already signed up for new units in this development. Further means of expanding the retail offering through the extension of existing facilities are also being considered.

Looking beyond the construction currently under way there is still further development capacity at Canary Wharf. 10 Churchill Place can accommodate approximately 0.4 million sq ft of new development. Uniquely, piling and sub-structure works for this development is being undertaken in such a way that it can accommodate up to 5 different building configurations, providing the greatest possible degree of flexibility to any potential occupier and accelerating the construction process. In addition to this, initial ground works are also under way for the 1.8 million sq ft of potential further development on Riverside. These preparatory works are expected to reduce completion time for these buildings by 18 months. During the year, planning consent for increasing the permitted density on North Quay to 2.4 million sq ft was also obtained. The North Quay site will be required for the construction of the planned Crossrail station at Canary Wharf and is therefore safeguarded under the Crossrail Bill. Subject to planning consent, there is also approximately 0.6 million sq ft of potential development capacity on Heron Quays West. Together these developments will provide an additional 5.2 million sq ft, and full development will only proceed subject to letting demand.

Development off the Estate

Concurrently with the developments at Canary Wharf, the group is working with its joint venture partners Ballymore and the British Waterways Board on the redevelopment of the Wood Wharf site, which is located immediately to the east of the existing Canary Wharf Estate. This project has set a target of 6.5 million sq ft gross of mixed commercial, residential and retail development and is currently at the master planning stage. It is envisaged that an initial formal planning application for this development will be made during 2007.

CHAIRMAN'S AND CHIEF EXECUTIVE OFFICER'S STATEMENT (Continued)

Future opportunities

The group is also actively considering development further away from the Estate. We are providing project management services to Ballymore on the Crossharbour mixed residential and commercial development and on the Millharbour residential developments. These two projects will include 2 residential towers of 40 and 50 storeys each and a further 8 buildings ranging from 7 to 43 storeys, which will together provide approximately 2,200 apartments within a total of approximately 2.3 million sq ft.

Property valuations

The generally strong London office market and the high level of letting activity during 2006 have been reflected in increases in property valuations. Net assets increased as a result of revaluation of the group's property portfolio, including land, by £1,007.5 million, or 17.6% to £6,737.4 million, up from £5,658.5 million at 31 December 2005. The increase in the market value of the investment property portfolio was £751.5 million, or 14.2%. This revaluation benefited from the new lettings and developments achieved in the year together with an increase in headline rents and from further yield compression in the market for properties let on long leases to creditworthy tenants.

Financial review

In November 2006 a dividend of 48p per share (£306.7 million) was paid to shareholders, bringing the total amount of dividends paid since 2004 to £1.58 per share. Net of the dividend, adjusted net assets per share at 31 December 2006 amounted to £5.20 (see 'Business Review – Balance Sheet'). After adding back the dividend of 48p paid in the period, adjusted net asset value per share increased from £3.88 to £5.68, an increase of £1.80 or 46.4%.

Rental income for the year ended 31 December 2006 was £213.7 million, following the successful disposal of seven properties in 2005, against £229.7 million for the previous year.

During the year the group acquired three finance leases, in connection with which it recognised an exceptional gain of £123.3 million. Excluding this exceptional item, the loss on ordinary activities before taxation for the year was £19.2 million (2005 – loss of £19.6 million). After tax the group recorded a profit for the year of £43.8 million (2005 – profit of £87.6 million). The prior year post tax profit was largely attributable to the release of a deferred tax provision, following certain property restructurings during that year.

Environmental & social responsibility

Your company takes pride in its long-standing record of involvement and engagement with the local community which has continued over the last twelve months through a series of sports, education and cultural programmes and events. In view of the high level of activity on the Estate, we are also working closely with our tenants to address any related environmental issues and establish new industry benchmarks so that environmental performance can be monitored more closely.

Conclusion

Strong progress was made on lettings and development during the year. The increase in valuations in 2006 was obviously also very encouraging. So, too, is the fact that the many thousands who work each day at Canary Wharf find it provides a pleasing environment with a continuously exciting atmosphere. We continue to be well placed to meet the needs of occupiers who are looking for high specification and value added space, tailored to meet individual needs. We are fortunate in having one of the most able teams in the property market and the success of the last twelve months would not have been possible without the whole-hearted commitment of staff at all levels, for which the board continues to be grateful.

Sir Martin Jacomb
Chairman

George Iacobescu CBE
Chief Executive Officer

BUSINESS AND FINANCIAL REVIEW

Central London office leasing market overview

Supply and development

Supply across Central London continues to tighten, standing at 14.2 million sq ft, which represents a reduction of more than 25% over the course of 2006 and 27% below the long term average. As a result of improved take-up levels and limited speculative development completions, grade A vacancy rates have come under increased pressure and at the year-end stood at just 1.7%. This relative shortage of prime units in a time of strong tenant demand will continue to fuel positive rental growth.

Developers are responding to the increase in demand and the realisation of rental growth by kick-starting construction on a number of new schemes. In 2006, construction of more than 4.4 million sq ft across Central London commenced on a speculative basis. However, a significant amount of this space is expected to be let prior to completion.

Demand and take-up

A strong performance from the financial sector during 2006 translated into increased levels of take-up and boosted the recovery of the Central London office market. Take-up reached 15.6 million sq ft for the year – an increase of 37% on the levels seen in 2005, and 30% higher than the long term average.

Demand from the financial sector, driven by expansion, totalled 3.9 million sq ft at the year-end which accounted for a third of all requirements. The professional sector remains active, accounting for almost a quarter of requirements across Central London. Despite healthy levels of take-up, occupier demand remained stable from 2005 levels. At the year-end, occupier demand totalled 11.6 million sq ft, indicating a strong rate of replacement as new requirements were activated throughout the year.

Rental profile

Prime headline rental levels across Central London rose considerably during 2006 in line with competition from occupiers for quality grade A units. In the West End, prime rents rose to £95.00 per sq ft, an increase of 12.5% over the course of the year, while in the City prime rents rose by 18.8% to stand at £55.00 per sq ft at the year-end.

Positive rental growth is expected to continue over the course of the next two years as improved market conditions support expansion-led requirements, particularly from financial sector occupiers (*source: Knight Frank*).

At Canary Wharf, the lettings achieved during 2006 confirmed headline rents of more than £40 per sq ft and it is anticipated that positive rental growth into 2007 will drive headline rents up to the mid-£40s per sq ft.

Property portfolio

The activities of the group are focused on the development of the Estate (including Heron Quays and the adjacent sites at Canary Riverside and North Quay) and, through a joint venture with the British Waterways Board ('BWB') and Ballymore, land adjacent to the Estate known as Wood Wharf. The group is involved in both property investment and property development. At 31 December 2006 and 31 December 2005 the investment arm comprised 16 completed properties (out of the 30 constructed on the Estate) totalling 7.9 million sq ft of net internal area ('NIA'). The properties included in the total at 31 December 2006 are shown in the table below:

Property Address	Approx. NIA (sq ft)	% leased	External valuation £m	Principal tenants
One Churchill Place	1,014,400	100.0	850.0	Barclays, BGC, LOCOG
10 Cabot Square	639,000	100.0	333.0	Barclays Capital, WPP Group
20 Cabot Square	562,000	100.0	260.0	Morgan Stanley, Barclays Capital
One Canada Square	1,236,200	99.5	857.6	Daily Telegraph, KPMG, Mirror Group Newspapers, State Street, Bear Stearns, Bank of New York
33 Canada Square	562,700	100.0	427.5	Citigroup
20 Bank Street	546,500	100.0	500.0	Morgan Stanley
25-30 Bank Street	1,023,300	98.9	975.0	Lehman Brothers
40 Bank Street	607,400	45.3	328.0	Skadden Arps Slate Meagher & Flom (‘Skadden’), Allen & Overy, BGC, ANZ
50 Bank Street	209,800	100.0	175.0	Northern Trust, Goldenberg Hehmeyer
10 Upper Bank Street	1,000,400	100.0	800.0	Clifford Chance LLP (‘Clifford Chance’), Infosys, FTSE, Total
Cabot Place Retail	95,700	100.0	154.4	Various retail tenants
Canada Place Retail	72,200	100.0	169.9	Various retail tenants
Jubilee Place Retail	89,400	100.0	100.0	Various retail tenants
Churchill Place Retail	22,400	100.0	10.2	Barclays and various retail tenants
16-19 Canada Square	204,500	100.0	46.7	Waitrose Food & Home, Canada Square Health & Fitness, Conran Restaurants
Nash Court	8,900	100.0	12.4	Smollenskys, Carluccios
Car Parks	–	–	58.7	
Total	7,894,800	95.6	6,058.4	

BUSINESS AND FINANCIAL REVIEW (Continued)

At 31 December 2006 the investment property portfolio was 95.6% let (31 December 2005 – 89.6%), net of sub-lets back to the group.

As well as the rental income generated from completed properties, income is generated from managing the entire Estate which, in addition to the completed properties in the ownership of the group, includes fourteen properties totalling 6.3 million sq ft in other ownerships.

The properties of the group are under lease to high quality tenants which provide a diversified income stream. At 31 December 2006 the weighted average unexpired lease term for the investment property portfolio was 19.8 years, or 17.1 years assuming exercise of outstanding break options (31 December 2005 – 21.0 years or 18.0 years respectively). Of the square footage under lease, 71.0% does not expire or cannot be terminated by tenants during the next 10 years.

Leasing

During the course of 2006 the group announced transactions over a total of 1.4 million sq ft including lettings totalling approximately 690,000 sq ft. The lettings concluded during the year comprised the following:

- Bear Stearns agreed to pre-let 206,000 sq ft in a new 300,000 sq ft building to be constructed at 5 Churchill Place for occupation in 2009 (see 'Business and Financial Review – Construction' below). In addition Bear Stearns has been granted call options over the remaining space in the building exercisable in stages up to practical completion.
- Bear Stearns also agreed to lease a further 22,100 sq ft on level 50 of One Canada Square for a 7 year term and renewed its lease of 19,900 sq ft on level 25 until April 2013. These leases are subject to break options exercisable after July 2008 in the case of level 50 and, on three months' notice, at any time in relation to level 25. Bear Stearns has other leases over 87,500 sq ft in One Canada Square, expiring in April 2013.
- In One Churchill Place, Barclays Bank PLC ('Barclays') agreed to lease 97,100 sq ft to July 2014 and 33,400 sq ft to July 2019. These lettings were of part of the space originally sub-let back to the group by Barclays.
- In 40 Bank Street, Saxo Bank agreed to lease a total of 19,500 sq ft for a 7 year term; Duff & Phelps leased 7,300 sq ft, Language Line leased 6,000 sq ft and Iflex leased 5,000 sq ft, all until July 2010; and Skadden Arps Slate Meagher & Flom ('Skadden') leased 19,500 sq ft to March 2008. These lettings were of space which was previously sub-let back to the group by Skadden. In addition, Australia and New Zealand Banking Group Limited leased approximately 39,000 sq ft for 15 years and Situs Realty Services leased 6,100 sq ft, for 10 years. As a result of these lettings, occupancy in the building has increased to 45.3%.
- In 25-30 Bank Street, Morgan Stanley agreed to lease 25,200 sq ft for an 18 month term; Atos Euronext Market Solutions agreed to lease approximately 40,000 sq ft until 2013 and has a call option over a further 10,800 sq ft; Jones Lang LaSalle Incorporated leased 51,000 sq ft on a 7 year term; State Street leased 24,100 sq ft until July 2009 and the FSA took a further 25,200 sq ft until July 2008. These lettings were of space previously sub-let back to the group by Lehman Brothers.
- In One Canada Square, SWX Swiss Exchange renewed its lease over 13,000 sq ft and further lettings totalling 34,700 sq ft were achieved, including 11,000 sq ft let to Metlife on a 5 year term. Alvarez & Marsal, CFA Institute, Atkins, City University, Coutts & Company, Diligence and Satyam took the remainder of the space on terms ranging from 5 to 10 years.

Reflecting these lettings, the vacancy rate in completed buildings at 31 December 2006 reduced to 4.4%.

All space previously sub-let back to the group has now been re-let or is subject to call options. The estimated net present value of the sub-let liabilities has reduced markedly over the year. At 31 December 2005 the net present value in respect of 713,900 sq ft of sub-let space was estimated at approximately £149.0 million, discounted at 5.5% being the group's weighted average cost of debt at that date. At 31 December 2006 the estimated net present value had reduced to approximately £43.8 million, discounted at 6.1%, the group's weighted average cost of debt at that date. This reduction was primarily attributable to the lettings achieved during the year over 353,000 sq ft of the sub-let space. These sub-let commitments have been reflected in the market valuation of the group's properties.

Construction

Properties under construction at 31 December 2006 comprised the following:

Property address	Approx. NIA (sq ft)	Expected completion date	Status
20 Churchill Place	300,000	September 2008	Agreement to sell on completion
15 Canada Square	400,000	April 2009	Agreement to sell on completion
	<u>700,000</u>		
5 Churchill Place	300,000	May 2009	206,000 sq ft let to Bear Stearns
30 North Colonnade	300,000	July 2009	Available to lease
	<u>1,300,000</u>		

BUSINESS AND FINANCIAL REVIEW (Continued)

On 27 February 2006 the group announced it had entered into an agreement for the sale, upon completion, of 20 Churchill Place to Prudential for £199.5 million for occupation by State Street in early 2009. When completed in 2008 the building will comprise approximately 300,000 sq ft, excluding ancillary space. State Street currently occupies approximately 114,700 sq ft in One Canada Square. The new building will enable State Street to consolidate its offices in the West End, the City and Canary Wharf into one location. In connection with the sale agreement the group may take a surrender from State Street of two floors in One Canada Square totalling 57,000 sq ft which have break options in 2013. The remaining space occupied by State Street has break options in 2008.

On 6 November 2006 the group announced it had entered into an agreement for the sale to KPMG, upon completion, of 15 Canada Square, an approximately 400,000 sq ft building, for £260.0 million. KPMG currently occupies 140,800 sq ft in One Canada Square, of which 38,000 sq ft is subject to a break option on 31 December 2008. KPMG has been granted options to sub-let back to the group the remaining space on practical completion of 15 Canada Square.

In conjunction with the construction of this building, the group has agreed to construct the adjacent building totalling approximately 300,000 sq ft. KPMG has been granted call options over approximately 100,000 sq ft in this building exercisable up to August 2007.

As noted under 'Leasing' above, Bear Stearns has entered into an agreement to lease 206,000 sq ft in 5 Churchill Place.

In addition to the construction of new office buildings, the group is currently re-developing the western end of the Cabot Place retail mall, with completion anticipated in March 2008. This re-development will increase the existing Cabot Place retail area by approximately 42,600 sq ft and will introduce new retailers to the Estate including Zara, Massimo Dutti, River Island and Leon.

The remaining development site on the original Estate could accommodate approximately 0.4 million sq ft of new development and piling works have commenced on site. In addition, the group has development sites at North Quay and Riverside. At Riverside, initial ground works are under way which will serve to reduce the completion time for the development by approximately 18 months. At North Quay, in December 2006 the local authority granted consent for an increase in the permitted density to 2.4 million sq ft, adding to the 1.8 million sq ft of capacity at Riverside. There is further development capacity on Heron Quays West subject to planning consent. Construction of new buildings on these sites will commence as and when market conditions allow.

The following table summarises the development capacity at each of the above sites:

	NIA (million sq ft)
Based on existing planning permissions:	
– Canary Wharf	0.4
– Riverside South	1.8
– North Quay	2.4
	4.6
Subject to planning application:	
– Heron Quays West	0.6
Total⁽¹⁾	5.2

Notes:

(1) Total for development sites which are wholly in the ownership of the group.

In addition to the above, the group is working with Ballymore and BWB on the redevelopment of the Wood Wharf site which is immediately adjacent to the Estate. The master plan for the scheme, in which the group has a 25.0% interest, sets a framework for 6.5 million sq ft (gross) of mixed commercial, residential and retail development.

Valuations

The net assets of the group, as stated in its consolidated balance sheet as at 31 December 2006, were £2,905.3 million. In arriving at this total:

- (i) properties held as investments were carried at £5,715.9 million, which represents the market value of those properties of £6,058.4 million at that date as determined by the group's external valuers, CB Richard Ellis Limited, Surveyors and Valuers ('CBRE'), Savills Commercial Limited, Chartered Surveyors ('Savills'), or Cushman & Wakefield Healey & Baker, Real Estate Consultants ('CWHB'), less an adjustment of £342.5 million for tenant incentives as required by UITF 28;
- (ii) properties held for development were carried at £204.3 million, representing their cost to the group; and
- (iii) properties under construction to be retained by the group were carried at £46.2 million, representing their cost to the group.

BUSINESS AND FINANCIAL REVIEW (Continued)

Excluding additions, the valuation of the investment portfolio on the basis of market value increased by £751.5 million or 14.2% over the year. The increase in valuation over the six months to 31 December 2006 was £312.5 million or 5.4%. After allowing for adjustments in respect of UITF 28 the carrying value of the investment portfolio increased by £790.9 million over the year and by £331.4 million in the six months ended 31 December 2006. This increase was driven by a combination of yield shift in the market for properties let on long leases to creditworthy tenants, the benefit of new lettings achieved in the year and an increase in headline rents.

CBRE and Savills have provided a joint opinion as at 31 December 2006 that the market value of properties held for development was £415.0 million, in comparison with a carrying value for accounts purposes of £204.3 million. In valuing the properties held for development, the valuers have allowed for estimated costs to complete, including an allowance for fit-out. In addition they have allowed for letting, disposal, marketing and financing costs. The market value of £415.0 million represents an increase of 49.5%, excluding additions and transfers, over the market value at 31 December 2005, which reflects the improving prospects for further development.

The valuers also provided an opinion as at 31 December 2006 that the market value of properties under construction was £264.0 million, in comparison with historical cost of £115.3 million.

The market value of the entire property portfolio including investment properties, properties held for development and properties under construction, increased by £1,007.5 million or 17.6% over the year, excluding additions and transfers, and by £483.3 million or 7.7% for the six months ended 31 December 2006. This increase was driven by the factors referred to above.

As previously disclosed, a number of properties are subject to leases back to the group. These have been taken into account in the valuations summarised in the table below, which shows the carrying value of the group's properties for accounts purposes in comparison with the supplementary valuations provided by the external valuers.

	2006		2005	
	Carrying value £m	Market value in existing state £m	Carrying value £m	Market value in existing state £m
Investment properties	5,715.9 ⁽¹⁾	6,058.4 ⁽²⁾	4,919.6 ⁽¹⁾	5,301.5 ⁽²⁾
Property under construction	46.2	95.0	–	–
Properties held for development	204.3	415.0	255.7	357.0
	5,966.4	6,568.4	5,175.3	5,658.5
Property under construction held for sale	69.1 ⁽³⁾	169.0	–	–
	6,035.5	6,737.4	5,175.3	5,658.5

Notes:

(1) The carrying value of investment properties represents market value less an adjustment for UITF 28.

(2) Stated at market value in existing state before adjustment for UITF 28. The UITF 28 adjustment attributable to investment properties at 31 December 2006 was £342.5 million (31 December 2005 – £381.9 million).

(3) Represents historical cost to the group. The carrying value in the balance sheet at 31 December 2006 is stated net of £76.4 million transferred to cost of sales, £2.2 million transferred from payments on account and £9.5 million of costs accrued in accordance with Statement of Standard Accounting Practice 9 (Stocks and Long Term Contracts) ('SSAP 9').

Taxation

The group has Enterprise Zone Allowances ('EZAs') available to shelter future operating profits and taxable profits and gains arising on the sale of properties.

There is no uplift in the value of the group's investment properties attributable to EZAs because, as a result of an internal property restructuring in 2005, the interests to which the EZAs attach are of negligible value. Whereas the group can claim EZAs on the qualifying expenditure originally incurred, a third party purchaser would only be able to claim EZAs by reference to these negligible values. The £nil uplift in market value does not therefore represent the value of EZAs to the group.

In addition, as the assets to which the EZAs attach are of negligible value, a disposal of property will not trigger a clawback of any EZAs previously claimed. As a result, there is no longer any deferred tax liability provided in respect of prior year claims made by the group. However, as a result of the acquisition of two companies from a third party in the year, a deferred tax liability of £61.1 million has been recognised in respect of EZA claims made by those companies in prior years (Note 5).

BUSINESS AND FINANCIAL REVIEW (Continued)

If the group were to dispose of its property portfolio at the market value disclosed in this 'Business and Financial Review', a tax liability of £129.1 million would arise (31 December 2005 - £nil) after taking into account all available losses including capital losses of £6.9 million. This amount includes tax on trading profits and net chargeable gains that would arise on the sale of properties under construction and properties held for development, including land interests. In addition, had the group disposed of its property portfolio at the balance sheet date, the benefit of the remaining EZAs would have been crystallised as a balancing allowance. This benefit has been taken into account in calculating the tax liability of £129.1 million. In line with Financial Reporting Standard 19 (Deferred tax) ('FRS 19') neither the benefit of these allowances nor the capital losses has been recognised through the creation of a deferred tax asset in the balance sheet as there is no certainty as to the time period for the realisation of that asset.

Operating results

The following review of the group's operating results relates to the year ended 31 December 2006 ('2006'). The comparatives relate to the year ended 31 December 2005 ('2005').

Turnover of the group is generated primarily by the rents and service charges earned from its property interests on the Estate. Turnover for 2006 was £370.4 million, against £305.5 million for 2005, of which rental income was £213.7 million (2005 - £229.7 million). The impact of UITF 28 was to reduce rental income by £42.0 million compared with £39.7 million for 2005. Excluding the impact of UITF 28, rental income reduced by £13.7 million from £269.4 million in 2005 to £255.7 million in 2006 (5.1%), primarily attributable to rent foregone on the buildings sold in 2005, partly offset by the benefit of rent reviews.

Service charge income increased from £50.2 million for 2005 to £53.6 million for 2006, an increase of £3.4 million or 6.8%. The increase over 2005 was attributable to higher occupancy on the Estate. Miscellaneous income (which includes insurance, rents and the provision of tenant specific services outside the standard service charge) increased from £25.6 million for 2005 to £26.7 million for 2006.

Turnover for 2006 also included £76.4 million recognised in accordance with SSAP 9 in connection with the agreements to sell 20 Churchill Place and 15 Canada Square (Note 10) which are under construction.

Cost of sales includes rents payable and property management costs, movements on provisions for vacant leasehold properties, and certain other lease commitments, as well as costs allocated to cost of sales on the construction of 20 Churchill Place and 15 Canada Square. Rents payable and property management costs were £82.2 million for 2006 in comparison with £86.4 million for 2005. Taking into account service charge and miscellaneous income totalling £80.3 million for 2006, void costs were £1.9 million for 2006 (2005 - £10.6 million). The reduction in void costs mainly derives from recent lettings (2005 - £75.8 million) and the consequent increase in occupancy on the Estate. In addition, 2005 included £4.4 million of costs incurred on vacant leasehold properties, including 200/202 Aldersgate Street and Little Britain (together 'Aldersgate Street') while in the group's ownership.

In 2006, a vacant leasehold property was sub-let. The sub-let resulted in a net release of provision held in respect of this liability of £2.1 million which was taken to cost of sales. In 2006 cost of sales also included £76.4 million of costs recognised on the construction of the two buildings subject to agreements for sale (2005 - £nil).

For 2006 net property income was £214.5 million, compared with £219.1 million for 2005, a reduction of £4.6 million attributable to the property sales in 2005.

Administrative expenses for 2006 were £41.7 million in comparison with £34.1 million for 2005. The increase in administrative costs incurred was partly attributable to costs associated with the lettings achieved and partly to fees relating to certain internal property restructurings undertaken in the year. In addition the increase was in part attributable to the payment of higher bonuses to management and staff, reflecting the group's strong performance during the year. For 2006, administrative expenses included £0.5 million (2005 - £1.7 million) of amortisation relating to the investment in Songbird Estates plc ('Songbird') class B ordinary shares ('B Shares') held in connection with the group's deferred share plan.

In 2005 the group recorded a pre-operating exceptional profit of £12.1 million on the disposal of its long leasehold interests in Aldersgate Street.

For 2006 operating profit excluding exceptional items was £174.4 million, in comparison with £188.3 million for 2005.

In 2005 the group also recorded a net profit of £205.3 million on the disposal of seven investment properties. The profit on disposal has been shown as an exceptional item after operating profit in accordance with Financial Reporting Standard 3 (Reporting financial performance).

Net interest payable for 2006 excluding exceptional items was £193.6 million, against £207.9 million for 2005. No interest was capitalised for 2005 whereas capitalised interest totalled £0.7 million for 2006. The reduction in net interest payable excluding exceptional items was primarily attributable to lower levels of debt resulting from the property sales during 2005. In 2006 the group recognised a gain of £123.3 million in connection with the acquisition of three finance leases (Note 16(1)) which was treated as an exceptional item. In 2005 there were exceptional charges totalling £199.4 million incurred in respect of the early payment of debt in the period (Note 4).

BUSINESS AND FINANCIAL REVIEW (Continued)

The loss on ordinary activities after interest excluding exceptional items for 2006 was £19.2 million in comparison with £19.6 million for 2005. Including exceptional items the group recorded a profit before taxation of £104.1 million in 2006 (2005 – loss of £1.6 million).

Taxation for 2006 is primarily attributable to an increase in the deferred tax provision of £110.3 million arising from the acquisition of finance leases in the year (Note 16(1)) although, following an internal property restructuring, the provision subsequently reduced to £61.1 million. Taxation for 2005 was attributable to a reduction of £89.2 million in the deferred tax provision recognised in respect of EZAs claimed.

Basic and diluted earnings per share for 2006 was 6.9p in comparison with 14.1p for 2005 (Note 9).

The adjusted basic and diluted loss per share excluding exceptional items and deferred tax for 2006 was 2.9p (2005 – earnings of 11.2p). The adjusted loss per share for 2006 has been calculated on the loss after taxation excluding the exceptional gain on the acquisition of finance leases and the deferred tax thereon of £18.4 million (2005 – profit of £69.6 million) and on the weighted average of 639.0 million shares in issue (2005 – 620.5 million). In 2006 exceptional items comprised the gain of £123.3 million on the acquisition of finance leases referred to in Note 16(1). For the purposes of this calculation, £61.1 million of the deferred tax charge for 2006 (Note 5) has also been excluded as it relates to the acquisition of the finance leases. In 2005, exceptional items comprised the profit on the sale of Aldersgate Street of £12.1 million, the profit on sale of investment properties of £205.3 million and the charges relating to repayment of debt of £199.4 million. The movement on deferred tax for 2005 resulted from an internal property restructuring and is therefore included in the calculation of the adjusted basic and diluted earnings per share for that period. There were no instruments giving rise to a dilution of earnings as defined by Financial Reporting Standard 22 (Earnings per share) ('FRS 22') at 31 December 2006 or 31 December 2005.

In 2006 the company declared an interim dividend of 48p per ordinary share (£306.7 million) which was paid on 7 November 2006. During 2005 the company declared interim dividends of 65p per ordinary share (£407.7 million) and 45p per ordinary share (£287.6 million).

Balance sheet and key performance indicators

On the basis of the group's statutory balance sheet, which does not reflect any revaluation of properties held for development or under construction, net assets at 31 December 2006 were £2,905.3 million in comparison with £2,377.2 million at 31 December 2005. The increase in net asset value was attributable to the revaluation surplus of £790.9 million and the profit for the year of £43.8 million, offset by dividends paid of £306.7 million.

The group's main objective is to maximise growth in net assets from increases in investment property values and property development activities. Accordingly the board considers that the most appropriate indicator of the group's performance is growth in adjusted net asset value per share prior to payment of dividends. This measure serves to capture the board's judgements concerning, inter alia, letting strategy, redevelopments and financial structure.

Adjusted net asset value takes into account the valuation of properties under construction and properties held for development which are held in the balance sheet at cost. It also adds back the provision for deferred taxation required by accounting standards but which, in management's judgement, is unlikely to crystallise.

BUSINESS AND FINANCIAL REVIEW (Continued)

Adjusted net asset value per share at 31 December 2006 is set out in the table below, which for comparison purposes also includes adjusted NNAV per share.

	2006	2005	Change
	£m	£m	%
Net assets per statutory balance sheet	2,905.3	2,377.2	
Add back deferred tax provision	60.5	0.2	
Net assets prior to deferred tax provision	2,965.8	2,377.4	
Revaluation of property portfolio:			
– properties held for development ⁽¹⁾	210.7	101.3	
– properties under construction ⁽¹⁾	148.7		
Adjusted net assets⁽²⁾	3,325.2	2,478.7	34.2
Fair value adjustments in respect of financial assets and liabilities less tax relief at 30% thereon ⁽³⁾	(159.2)	(323.7)	
Contingent tax on property disposals ⁽⁴⁾	(129.1)		
Undiscounted deferred tax ⁽⁵⁾	(112.1)	(0.5)	
Adjusted NNAV⁽²⁾	2,924.8	2,154.5	35.8
Cumulative dividends paid since completion of the offer process ⁽⁶⁾	1,002.0	695.3	
Adjusted NNAV before dividends	3,926.8	2,849.8	37.8
Adjusted net assets per share⁽⁷⁾	£5.20	£3.88	34.0
Adjusted net assets per share before dividends	£6.77	£4.97	36.2
Adjusted NNAV per share⁽⁷⁾	£4.58	£3.37	35.9
Adjusted NNAV per share before dividends	£6.15	£4.46	37.9

Notes:

(1) Stated at market value in existing state.

(2) Excludes the potential value to the group of EZAs (refer to 'Business Review – Taxation').

(3) Refer to Note 16(9).

(4) Refer to 'Business Review – Taxation'.

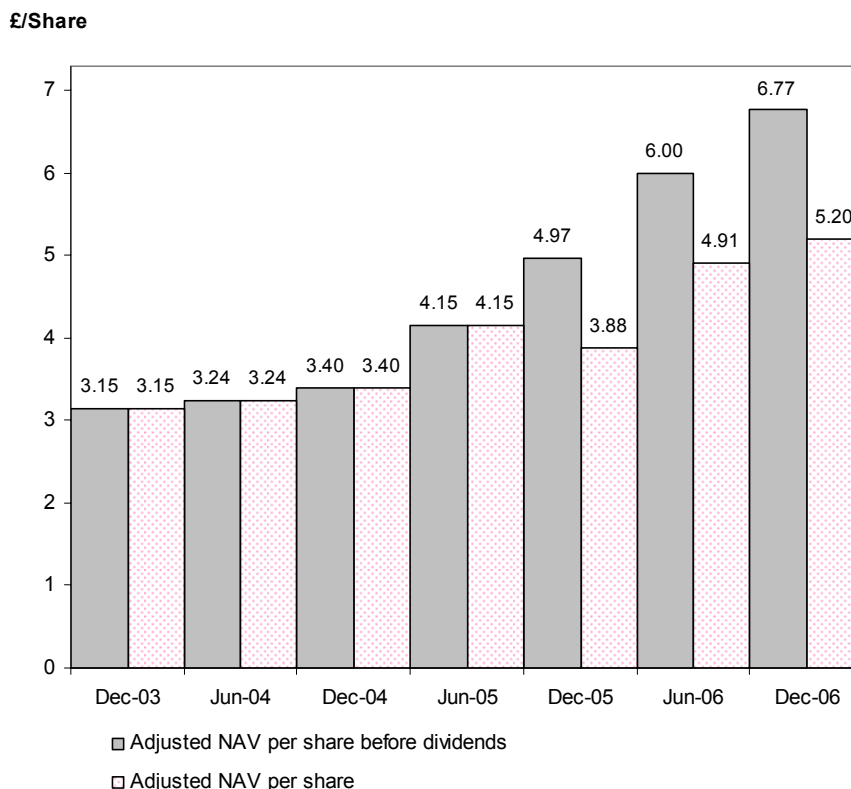
(5) Refer to Note 17.

(6) The company paid interim dividends as follows: 8 September 2005 – 65p per ordinary share (£407.7 million); 30 December 2005 45p (£287.6 million); 3 November 2006 – 48p (£306.7 million).

(7) Calculated by reference to the closing number of shares of 639.0 million (2005 – 639.0 million). There were no dilutive instruments outstanding at either date.

BUSINESS AND FINANCIAL REVIEW (Continued)

The growth in net asset value per share from December 2003 to December 2006 is shown in the following chart which shows the position both before and after dividends:



In arriving at adjusted net asset value per share the provision recognised in accordance with FRS 19 has been added back. FRS 19 requires, inter alia, provision for deferred tax on capital allowances claimed, notwithstanding that no tax would become payable unless the related properties were disposed of. In contrast no provision is required for the tax which would become payable if the group was to dispose of its properties at their revalued amount. This inconsistency in the standard has therefore been reversed in calculating the adjusted net asset value per share. In calculating the NNNAV per share, however, the full undiscounted liability has been deducted along with the contingent tax payable on disposal of properties at their revalued amount.

NNNAV per share also factors in the fair value of financial assets and liabilities and any contingent tax payable in the event of disposing of the property portfolio.

Treasury objectives

The principal objectives of the group's treasury function are to ensure the availability of finance to meet the group's current and anticipated requirements and to minimise the group's cost of capital. The treasury function operates as a cost centre rather than a profit centre and does not engage in the trading of financial instruments.

The group's financial instruments, other than derivatives, comprise borrowings, cash and liquid resources and various items such as trade debtors and trade creditors that arise directly from its operations. The group enters into derivative transactions (principally interest rate swaps and collars) only in order to manage the interest rate risk arising from the group's variable rate borrowings. The board reviews and agrees policies for managing the risks associated with the group's financial instruments and these policies, which have been applied consistently throughout the period, are summarised below.

Interest rate risk

The group finances its operations through a mixture of surplus cash, bank borrowings and debentures. The group borrows principally in sterling at both fixed and floating rates of interest and then uses interest rate swaps and collars to generate the desired interest profile and to manage the group's exposure to interest rate fluctuations. The group's policy is to keep the majority of its borrowings at fixed rates, and at 31 December 2006 99.3% (31 December 2005 – 90.8%) of the group's borrowings were fixed after taking account of interest rate hedging and cash deposits held as cash collateral (see Note 16(8)).

Liquidity risk

The group's policy is to ensure continuity of funding and at 31 December 2006 the average maturity of the group's debt was 14.7 years. Shorter term flexibility is achieved by holding cash on deposit and through construction facilities typically with a term of 3 to 6 years arranged to fund the development of new properties.

BUSINESS AND FINANCIAL REVIEW (Continued)*Exchange rate risk*

Although the group's policy is to maximise all financing in sterling, it currently has some borrowings in US dollars. Such borrowings are fully hedged with all principal and interest liabilities swapped into sterling at fixed rates.

Borrowings

In February 2006, the group acquired three finance leases secured on certain properties on the Estate, funded by the release of charges over £836.7 million of cash deposits as described in Note 16(1). As a result, the group recognised a gain of £123.3 million which has been included in interest payable and treated as an exceptional item.

During 2005 the group completed a comprehensive refinancing exercise, the objective of which was to provide increased flexibility in pursuing the group's strategy of maximising shareholder value by refinancing fixed rate long term debt with medium term bank debt. In connection with this refinancing the group entered into a three year £750.0 million bridge facility to refinance the assets released from the securitisation structure. At 31 December 2005, £546.4 million of this loan had been repaid, primarily following the sale of certain properties. In March 2006 the remainder of the loan was repaid and the group's retail assets were refinanced with a new £300.0 million facility (Note 16(3)).

The refinancing completed in March 2006 resulted in initial net proceeds of approximately £95.0 million net of financing expenses. The new loan initially carried interest at LIBOR plus a variable margin subject to, inter alia, prevailing loan to value and interest cover rates tests. In October 2006 the loan was hedged by means of an interest rate swap which serves to fix the interest rate on the loan at 5.15% until maturity in March 2011.

In December 2006 the group extended the maturity of its £369.4 million loan facility secured against 10 Cabot Square and 20 Cabot Square from April 2008 to January 2013.

At 31 December 2006, net debt (after cash in hand and cash collateral) stood at £2,971.0 million, down from £3,034.6 million at 31 December 2005 and comprising:

	2006	2005
	£m	£m
Securitised debt	2,492.5	2,507.8
Loans	1,269.2	1,178.9
Finance lease obligations	42.0	1,002.0
Total borrowings	3,803.7	4,688.7
Less: cash collateral for borrowings	(288.2)	(985.6)
Less: other cash collateral	(24.7)	(2.3)
	3,490.8	3,700.8
Less: cash deposits	(519.8)	(666.2)
Net debt	2,971.0	3,034.6

The reduction in total borrowings from £4,688.7 million to £3,803.7 million reflects the acquisition of three finance leases and the repayment of the remaining balance on the £750.0 million loan facility referred to above, partially offset by the draw-down under the new retail facility. The reduction in total borrowings was accompanied by a reduction in cash and term deposits from £1,654.1 million to £832.7 million, primarily as a result of the cash used to acquire the finance leases described above, and the dividend of £306.7 million paid in November 2006, partially offset by the net proceeds from the draw-down of the new retail loan and the amounts received under the agreements to sell 5 Churchill Place and 15 Canada Square.

At 31 December 2006 the fair value adjustment in respect of the group's financial assets and liabilities (excluding debtors and creditors falling due within one year) calculated in accordance with Financial Reporting Standard 13 (Derivatives and other financial instruments) ('FRS 13') was £227.3 million before tax relief (31 December 2005 – £462.4 million).

At 31 December 2006, the group's weighted average cost of debt was 5.9% excluding credit wraps (or 6.1% including credit wraps) in comparison with 5.4% excluding credit wraps (or 5.5% including credit wraps) at 31 December 2005. The increase in the group's weighted average cost of debt is attributable to the acquisition of the finance leases which were previously fully cash collateralised and incurred interest at a rate linked to LIBID.

BUSINESS AND FINANCIAL REVIEW (Continued)

Cash flow

Net cash inflow from operating activities for 2006 was £223.9 million in comparison with £178.5 million for 2005. The increase was primarily attributable to changes in working capital, partly offset by rental income foregone on buildings sold in 2005.

Returns on investments and servicing of finance totalled £195.5 million for 2006 compared with £439.9 million for 2005. 2006 included £4.5 million of fees on loans drawn-down and repaid in the period compared with £219.9 million of breakage costs and fees in respect of the restructuring of the group's financing facilities during 2005.

Dividends of £306.7 million were paid in 2006, in comparison with £693.3 million in 2005.

Capital expenditure and financial investment for 2006 resulted in a cash inflow of £215.5 million, compared with £1,161.6 million for 2005. 2006 included £274.8 million of payments on account received in connection with the agreements to sell 20 Churchill Place and 15 Canada Square and £27.0 million of deferred consideration received in January 2006 from the sale of 30 South Colonnade in 2005. These inflows were partly offset by development expenditure of £68.5 million, property acquisition expenditure of £7.2 million and funding of the group's associated undertaking by £10.5 million. Proceeds of £1,175.6 million on the disposal of seven investment properties were included in 2005, together with £110.0 million on the sale of Aldersgate Street, less £52.8 million cash expenditure on the acquisition of Aldersgate Street and £68.5 million of development expenditure.

The financing cash outflow for 2006 was £758.6 million compared with an inflow of £347.4 million for 2005. 2006 included £836.6 million expended on the acquisition of finance leases by the group, funded by the removal of restrictions over certain cash collateral accounts totalling £836.7 million (Note 16(1)). 2006 also included repayment of £203.6 million remaining on the group's £750.0 million loan facility (Note 16(3)), funded by the proceeds of a new £300.0 million retail facility. 2005 included a net inflow of £142.6 million in respect of the exercise of warrants and £2,093.7 million resulting from loans drawn-down in the year, partly offset by £1,888.9 million expended on loan repayments.

CONSOLIDATED PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	2006 £m	2005 £m
Turnover – rents and service charges		370.4	305.5
Cost of sales:			
– rents and property management costs		(155.9)	(86.4)
GROSS PROFIT		214.5	219.1
Administrative expenses		(41.7)	(34.1)
Other operating income:			
– before exceptional items		1.6	3.3
– exceptional item - net profit on sale of long leasehold property	10	–	12.1
OPERATING PROFIT	2	174.4	200.4
Exceptional item:			
– net profit on sale of investment properties	10	–	205.3
Interest receivable	3	43.4	90.5
Interest payable:	4		
– before exceptional item:			
– group		(236.7)	(298.4)
– associated undertaking		(0.3)	–
– exceptional item – gains/(charges) relating to repayment of debt	4	123.3	(199.4)
		(113.7)	(497.8)
PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION		104.1	(1.6)
Taxation	5	(60.3)	89.2
PROFIT ON ORDINARY ACTIVITIES AFTER TAXATION FOR THE YEAR	19	43.8	87.6
Basic and diluted earnings per share	9	6.9p	14.1p

The above results relate to the continuing activities of the group and its share of its associated undertaking.

The Notes numbered 1 to 26 form an integral part of these financial statements.

Movements in reserves are shown in Note 19 to these financial statements.

**CONSOLIDATED STATEMENT OF TOTAL RECOGNISED GAINS AND LOSSES FOR THE YEAR ENDED
31 DECEMBER 2006**

	Note	2006 £m	2005 £m
Profit for the financial year after taxation:			
– group		44.1	87.6
– share of loss of associated undertaking		(0.3)	–
Unrealised surplus on revaluation of investment properties	10	790.9	946.6
TOTAL RECOGNISED GAINS AND LOSSES		834.7	1,034.2

NOTE OF HISTORICAL COST PROFITS AND LOSSES

	2006 £m	2005 £m
Reported profit/(loss) on ordinary activities before taxation	104.1	(1.6)
Realisation of property revaluation gains of previous years	–	390.3
HISTORICAL COST PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION	104.1	388.7
HISTORICAL COST LOSS FOR THE YEAR RETAINED AFTER TAXATION	43.8	477.9

The Notes numbered 1 to 26 form an integral part of these financial statements.

CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2006

	Note	2006 £m	2005 £m
FIXED ASSETS			
Investment properties	10	5,715.9	4,919.6
Property under construction	10	46.2	–
Properties held for development	10	204.3	255.7
Other tangible fixed assets	11	0.4	2.4
Investments	12	13.3	3.8
		5,980.1	5,181.5
CURRENT ASSETS			
Debtors: due in more than one year	13	342.5	381.9
Debtors: due within one year	13	53.3	75.1
Cash at bank and in hand	14	832.7	1,654.1
		1,228.5	2,111.1
CREDITORS: Amounts falling due within one year	15	(438.1)	(210.4)
NET CURRENT ASSETS		790.4	1,900.7
TOTAL ASSETS LESS CURRENT LIABILITIES		6,770.5	7,082.2
CREDITORS: Amounts falling due after more than one year			
Provisions for liabilities	16 17	(3,763.8) (101.4)	(4,648.1) (56.9)
NET ASSETS		2,905.3	2,377.2
CAPITAL AND RESERVES			
Called up share capital	18	6.4	6.4
Reserves:			
– share premium	19	146.2	146.2
– revaluation reserve	19	3,032.7	2,241.8
– capital redemption reserve	19	0.7	0.7
– special reserve	19	264.8	264.8
– profit and loss account	19	(545.5)	(282.7)
SHAREHOLDERS' FUNDS – EQUITY	20	2,905.3	2,377.2

The Notes numbered 1 to 26 form an integral part of these financial statements.

Approved by the board on 21 March 2007 and signed on its behalf by:

A. Peter Anderson, II
Managing Director, Finance

COMPANY BALANCE SHEET AT 31 DECEMBER 2006

	Note	2006 £m	2005 £m
FIXED ASSETS			
Investments	12	<u>2,461.1</u>	<u>1,861.1</u>
CURRENT ASSETS			
Debtors	13	1,015.4	873.2
Cash at bank and in hand		0.1	0.1
		<u>1,015.5</u>	<u>873.3</u>
CREDITORS: Amounts falling due within one year	15	<u>(8.5)</u>	<u>(8.0)</u>
NET CURRENT ASSETS		<u>1,007.0</u>	<u>865.3</u>
TOTAL ASSETS LESS CURRENT LIABILITIES		<u>3,468.1</u>	<u>2,726.4</u>
CREDITORS: Amounts falling due after one year	16	<u>(477.2)</u>	<u>(455.7)</u>
NET ASSETS		<u>2,990.9</u>	<u>2,270.7</u>
CAPITAL AND RESERVES			
Called up share capital	18	6.4	6.4
Reserves:			
– share premium	19	146.2	146.2
– capital redemption reserve	19	0.7	0.7
– special reserve	19	2,081.8	1,481.8
– profit and loss account	19	755.8	635.6
SHAREHOLDERS' FUNDS – EQUITY	20	<u>2,990.9</u>	<u>2,270.7</u>

The Notes numbered 1 to 26 form an integral part of these financial statements.

Approved by the board on 21 March 2007 and signed on its behalf by:

A. Peter Anderson, II
Managing Director, Finance

CONSOLIDATED CASH FLOW STATEMENT FOR THE YEAR ENDED 31 DECEMBER 2006

	Note	2006 £m	2005 £m
NET CASH INFLOW FROM OPERATING ACTIVITIES	22	223.9	178.5
Returns on investments and servicing of finance	23	(195.5)	(439.9)
Capital expenditure and financial investment*	23	215.5	1,161.6
Equity dividend paid		(306.7)	(695.3)
		(286.7)	26.4
Cash (outflow)/inflow before management of liquid resources and financing		(62.8)	204.9
Management of liquid resources	23	675.0	(528.3)
Financing	23	(758.6)	347.4
(DECREASE)/INCREASE IN CASH IN THE YEAR	24	(146.4)	24.0

The above cash flows relate to the continuing activities of the group.

Notes 22 to 24 form an integral part of this cash flow statement.

*Capital expenditure and financial investment for 2005 included £1,175.6 million proceeds from the sale of investment properties.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006

1 BASIS OF PREPARATION AND PRINCIPAL ACCOUNTING POLICIES

A summary of the principal accounting policies of the group, all of which have been applied consistently throughout this and the preceding year, save for the adoption of Financial Reporting Standard 20 (Share-based payment) ('FRS 20'), is set out below. No restatement of the comparatives for the year ended 31 December 2005 was required to comply with FRS 20.

(1) Accounting convention

The financial statements have been prepared under the historical cost convention, as modified by the revaluation of investment properties in accordance with Note 1(4) below, and in accordance with applicable United Kingdom law and accounting standards.

(2) Basis of consolidation

The consolidated financial statements incorporate the assets and liabilities of all subsidiary undertakings at 31 December 2006 and their results for the year then ended.

(3) Profit and loss account

Turnover, which is stated net of VAT, comprises rental income and service charges. Marketing and administrative costs which are not development expenses are charged to the profit and loss account when incurred.

(4) Property interests

The group's property interests comprise investment properties, properties under construction and properties held for development.

Investment properties

Investment properties are revalued at the balance sheet date and, in accordance with SSAP 19 (Accounting for Investment Properties), no provision is made for depreciation. This departure from the requirements of the statutory accounting rules (which require all properties to be depreciated) is, in the opinion of the directors, necessary for the financial statements to show a true and fair view. Depreciation is only one of the factors reflected in the annual valuation and the amount attributable to this factor is not capable of being separately identified or quantified. Surpluses or deficits on investment properties are transferred to the revaluation reserve, unless a deficit is expected to be permanent and exceeds previous surpluses recognised on the same property, in which case the excess is charged to the profit and loss account.

Properties under construction and properties held for development

Properties held for development and properties under construction which are to be retained are categorised as fixed assets and included in the consolidated balance sheet at their fair value at the date of acquisition by Canary Wharf Estate Limited ('CWEL') of the Canary Wharf Holdings Limited ('CWHL') group in December 1995, together with subsequent additions at cost, less subsequent disposals, subject to any provision for impairment.

Properties under construction which are to be retained are transferred to investment properties on an individual building basis when construction is complete and the properties are substantially let.

Properties under construction or held for development where the group has entered into an agreement for sale are categorised as current assets and stated at the lower of cost (namely fair value at the date of acquisition plus subsequent additions at cost) and net realisable value. Profits on sale of such properties are recognised when earned in accordance with Financial Reporting Standard 5 (Reporting the Substance of Transactions) ('FRS 5') and SSAP 9.

Additions to properties under construction or held for development include all expenses of development, including attributable interest where appropriate. Interest capitalised is calculated by reference to the rate of interest payable on the borrowings drawn-down to finance the development.

Disposal of properties

Profits or losses arising from the sale of investment properties are calculated by reference to the carrying value at the end of the previous year, adjusted for UITF 28 and subsequent capital expenditure and are included in the profit and loss account as an exceptional item.

Properties acquired with the intention of re-sale are categorised as current assets and stated at the lower of cost and net realisable value. Profits or losses arising on sale of such assets are included in the profit and loss account as an exceptional item.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

(5) **Lease incentives**

Lease incentives include rent-free periods and other incentives given to lessees on entering into lease agreements. Under UITF 28 the aggregate cost of lease incentives is recognised as an adjustment to rental income, allocated evenly over the lease term or the term to the first open market rent review if earlier. The cost of lease incentives is included within debtors due in more than one year and spread on a straight line basis over a similar period. Accordingly the valuation of investment properties is reduced for these incentives.

(6) **Other tangible fixed assets**

Other tangible fixed assets are stated at cost net of depreciation and any provision for impairment. They are depreciated so as to write-off the cost in equal annual instalments over the expected useful economic lives of the assets concerned. The principal annual rates used for this purpose are:

Computer equipment	33%
Fixtures and equipment	25%

(7) **Debt**

Debt instruments are stated initially at the amount of net proceeds. The finance costs of such debt instruments are allocated to periods over the term of the debt at a constant rate on the carrying amount. The carrying amount is increased by the finance cost in respect of the reporting period and reduced by payments made in respect of the debt in that period. Finance costs are charged to the profit and loss account, except in the case of development financings where interest and related financing costs are capitalised as part of the cost of development.

Amounts receivable and payable, arising from derivatives which hedge interest rate exposures, are treated as part of financing costs.

(8) **Investments**

Fixed asset investments are stated at cost less any provision for impairment.

Investments in associates are included in the financial statements using the equity method. In the consolidated balance sheet, investments in associates are stated at the group's share of net assets. The group's share of the associates' profits or losses after tax is included in the consolidated profit and loss account.

(9) **Finance leases**

Sales and leasebacks (where the leaseback is treated as a finance lease, as defined by Statement of Standard Accounting Practice 21 (Accounting for leases and hire purchase contracts) and FRS 5) are recorded in the balance sheet as assets and as obligations to pay future rentals. Rents payable are apportioned between the finance charge and a reduction in the outstanding obligation for future amounts payable.

The total finance charge, which includes the amortisation of deferred expenses relating to finance leases, is allocated to accounting periods over the lease terms so as to produce a constant periodic charge on the remaining balance of the obligation for each accounting period.

(10) **Vacant leasehold property**

Provision is made for the present value of the anticipated net commitments in relation to leasehold properties where there is a shortfall in rental income receivable against the rent and other costs payable.

(11) **Pensions**

The group operates two defined contribution pension schemes. Pension contributions in respect of these schemes are accrued as they fall due.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

(12) **Accounting for share options**

Class B ordinary shares in Songbird Estates plc ('B Shares') are held in trust in connection with the group's share scheme. A number of the options granted under this scheme outstanding at 31 December 2006 allow the holders to opt for a cash settlement, calculated in accordance with the terms of the grant at the end of the vesting period and linked to the market price of the B Shares at that date. For cash-settled share options, a liability is recorded based on the market value of the shares at each balance sheet date. The cost of equity-settled share options is measured at the grant date and is based on the market value of B Shares at that date. In both cases the associated cost is charged to the same expense category as the employment cost of the relevant employee, spread on a straight-line basis over the relevant vesting period. Previously the historical cost of the B Shares was amortised over the vesting period of relevant schemes on a straight-line basis. The carrying value of the B Shares held in trust continues to be recorded as a fixed asset investment at historical cost.

The change in accounting policy did not give rise to a material adjustment to the carrying value of the B Shares or the liabilities of the group at 31 December 2005.

(13) **Deferred taxation**

Deferred tax assets and liabilities arise from timing differences between the recognition of gains and losses in the financial statements and their recognition in the corporation tax return. Under FRS 19 deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued, unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the financial statements.

Deferred tax is measured on a discounted basis to reflect the time value of money over the period between the balance sheet date and the dates on which it is estimated that the underlying timing differences will reverse or, where the timing differences are not expected to reverse, a period not exceeding 50 years. Discount rates of 3.3% to 3.5% have been adopted reflecting the post tax yield to maturity that can be obtained on government bonds with similar maturity dates and currencies to those of the deferred tax assets or liabilities.

2 OPERATING PROFIT

	2006	2005
	£'000	£'000
The operating profit is stated after charging:		
– depreciation (Note 11)	180	613
– amortisation of investment in B Shares (Note 12)	459	1,708
– directors' emoluments (Note 8)	5,930	2,227
– operating lease rentals:		
land and buildings	4,752	9,061
– remuneration of the auditors:		
– audit fees	45	45
– audit of subsidiaries	357	305
– pursuant to legislation	40	40
fees for other services:		
– corporate finance transactions	63	15
– taxation	213	283
– other	154	100
– pension fund audit	12	4
other pension fund services	40	18

The operating lease rentals relate to the vacant leasehold properties referred to in Note 17.

Audit fees

Audit fees of £402,500 were incurred in 2006, of which £45,000 were incurred by the company (2005 – £45,000 out of £350,000). In 2005, fees totalling £143,000 were paid to the auditors in connection with certain refinancings and charged to interest payable.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

3 INTEREST RECEIVABLE

	2006 £m	2005 £m
Bank interest receivable	<u>43.4</u>	<u>90.5</u>

4 INTEREST PAYABLE

	2006 £m	2005 £m
Notes and debentures	154.6	169.7
Bank loans and overdrafts	78.4	83.5
Finance lease charges	4.4	45.2
Share of associated undertaking	0.3	–
	<u>237.7</u>	<u>298.4</u>
Less:		
Interest at 6.1% on development financings transferred to development properties	(0.7)	–
Interest payable before exceptional items	<u>237.0</u>	<u>298.4</u>

	2006 £m	2005 £m
Exceptional items:		
– gain relating to repayment of finance leases	(123.3)	–
– charges relating to early repayment of debt:		
– prepayment and breakage costs	–	194.1
– write-off of deferred financing costs and other accounting adjustments	–	5.3
	<u>(123.3)</u>	<u>199.4</u>

During 2006, the group recognised gains on the acquisition of finance leases totalling £123.3 million as detailed in Note 16(1). These gains have been taken to the profit and loss account as an exceptional item. As a result of the property interests acquired, the group has recognised a deferred tax provision (Note 17).

During 2005, the group incurred prepayment and breakage costs totalling £194.1 million in relation to the prepayment and refinancing of certain loans, principally the group's first securitisation. These costs were charged to the profit and loss account as an exceptional item.

Financing costs relating to the inception of the group's debt are deferred and amortised to the profit and loss account over the term of the debt at a constant rate based on the carrying amount of the debt in accordance with Financial Reporting Standard 4 (Capital Instruments) ('FRS 4'). In addition any premium on issue of debt is deferred and amortised over the term of that debt. As a result of prepaying certain of the group's borrowings, the unamortised portion of the financing costs relating to the debt prepaid, totalling £5.3 million, was written-off to the profit and loss account in 2005 and shown as an exceptional item. There was no deferred tax as a result of any of the transactions in 2005.

For 2006, interest payable of £0.7 million was transferred to properties under construction (Note 10). The amount transferred was attributable to the cost of funds forming part of the group's general borrowings which were utilised in financing construction. No interest payable was transferred to development properties in 2005.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

5 TAXATION

	2006 £m	2005 £m
Current tax:		
UK corporation tax (see below)	–	–
Deferred tax:		
Origination and reversal of timing differences:		
– current year	(60.2)	89.3
Net effect of discount	(0.1)	(0.1)
Total deferred tax (Note 17)	<u>(60.3)</u>	<u>89.2</u>
Total tax on profit on ordinary activities	<u>(60.3)</u>	<u>89.2</u>
Tax reconciliation:		
Group profit/(loss) on ordinary activities before tax	104.1	(1.6)
Tax on loss/(profit) on ordinary activities at UK corporation tax rate of 30%	<u>31.2</u>	<u>(0.5)</u>
Effects of:		
Tax losses and other timing differences	(32.5)	0.6
Expenses not deductible for tax purposes	1.3	(0.1)
Current tax charge for the year	<u>–</u>	<u>–</u>

The charges and credits for 2006 and 2005 relate solely to deferred tax.

In accordance with FRS 19 the group provides for the potential clawback of EZAs claimed in the event of the sale of the property interest to which those claims relate. In connection with certain refinancings during 2005, various property interests were restructured and transferred between companies within the group. As a result of this internal property restructuring, the potential for clawback of EZAs was reduced and provisions for deferred tax totalling £158.4 million, net of a discount of £68.7 million, were released to the profit and loss account.

As a result of the acquisitions referred to in Note 16(1) the group has acquired property interests where it is possible that a clawback of EZAs may arise in the event that those property interests are sold. Under FRS 19 a provision was required in respect of this potential liability at 31 December 2006 of £185.4 million, net of a discount of £75.1 million, resulting in a charge to the profit and loss account of £110.3 million. Subsequently, as a result of an internal lease restructuring, the potential clawback of EZAs was reduced by £72.7 million, net of a discount of £23.5 million. Other movements in deferred tax of £0.8 million resulted in a total charge to the profit and loss account for the year of £60.3 million.

No provision for corporation tax has been made in the consolidated results of the group for 2006 or 2005 due to the availability of tax losses and other tax reliefs arising in those years. It is anticipated that remaining capital losses and other tax reliefs including EZAs will reduce future tax charges.

6 PROFIT FOR THE FINANCIAL YEAR

For 2006, of the consolidated profit transferred to reserves of £43.8 million (2005 – profit of £87.6 million) a profit of £1,206.9 million (2005 – profit of £313.6 million), is dealt with in the company's financial statements. For 2006, the company's profit included £440.0 million (2005 – £1,361.0 million) attributable to subsidiary dividends receivable and a £600.0 million release of the provision against the company's investment in subsidiaries. As permitted by Section 230(3) of the Companies Act 1985, no profit and loss account is presented for the company in respect of 2006.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

7 DIVIDENDS

	2006 £m	2005 £m
Dividend at 48p per ordinary share	306.7	–
Dividend at 45p per ordinary share	–	287.6
Dividend at 65p per ordinary share	–	407.7
	<u>306.7</u>	<u>695.3</u>

On 30 October 2006, the company declared an interim dividend of 48p per ordinary share totalling £306.7 million which was paid on 7 November 2006.

8 DIRECTORS AND EMPLOYEES

(1) Staff costs

All employees of the group, including directors:

	2006 £m	2005 £m
Wages and salaries	45.7	38.5
Social security costs	5.2	4.3
Other pension costs (Note 21)	2.6	2.1
	<u>53.5</u>	<u>44.9</u>

A deferred cash incentive plan has been established to retain and incentivise the executive directors and senior members of the management team. Initial payments under this plan were made in July 2006. Further payments are linked to participants remaining employed by the group and to two sets of performance related milestones which include leasing, financial and operational targets.

The average monthly number of employees, including directors, of the group during 2006 was 760 (2005 – 751) as set out below.

	2006	2005
Construction	114	103
Property management	517	511
Administration	129	137
	<u>760</u>	<u>751</u>

(2) Directors' remuneration

	2006 £'000	2005 £'000
Emoluments (including bonuses)	5,930	2,227

The amounts shown above exclude benefits arising on the exercise of options granted to the executive directors under the Canary Wharf 2004 Deferred Share Plan, details of which are set out at (4) below.

No contributions were made by the company during 2006 or 2005 to any pension plan for the benefit of the executive directors. Contributions made by the company during earlier years either remain within the company's money purchase pension plan or have been transferred into another arrangement at the election of the director.

(3) Highest paid director

The amounts set out at (2) above include remuneration in respect of the highest paid director as follows:

	2006 £'000	2005 £'000
Emoluments (including bonuses)	3,256	1,048

No contributions were made by the company during 2006 or 2005 to any pension plan for the benefit of the highest paid director. Details of share-based payments received by the highest paid director during 2006 are disclosed at (4) below.

(4) **Directors' share options**

No director held any options to subscribe for ordinary shares in the company during the year. The aggregate emoluments disclosed above do not include any options granted under the Canary Wharf 2004 Deferred Share Plan to subscribe for B Shares in the company's ultimate parent undertaking, Songbird. The following table provides details of the executive directors' share options both during the year and as at 31 December 2006.

The Canary Wharf 2004 Deferred Share Plan (the 'Deferred Plan')

Further information about the Deferred Plan, under which options have been granted over B Shares in Songbird, may be found in Note (5).

	Date of grant	Exercisable from	01/01/06	Exercised during year	31/12/06	Date of expiry
Peter Anderson	23/09/04	21/05/06	379,975	379,975 ⁽¹⁾	–	–
George Iacobescu CBE	23/09/04	21/05/06	439,970	–	439,970	23/09/07

Notes:

- (1) The date of exercise was 2 May 2006, when the shares were sold at a price of 210p per share. The pre-tax benefit received by Peter Anderson (after deducting the £1 aggregate cost of exercise) amounted to £929,455.85, including a distribution of £131,509.35 which represents the dividend paid on 379,975 B Shares between the date of grant and the date of exercise of the option.
- (2) Options granted under the Deferred Plan do not benefit from HM Revenue and Customs approval for income tax and national insurance purposes.

(5) **Share based payments**

During the year the company operated the Deferred Plan, in conjunction with the Canary Wharf Employees' Share Ownership Plan Trust ('the Trust').

The Deferred Plan is a discretionary plan, which does not benefit from approved status for income tax purposes. Under the terms of the Deferred Plan, options over B Shares in Songbird are granted to participants at the discretion of the Remuneration Committee. No consideration is payable for the grant of an option under the Deferred Plan, and an exercise price of £1 is payable upon exercise in full or in part of the option. Unless the Remuneration Committee determines otherwise, an option may normally be exercised on or after the first anniversary of the grant date in respect of 50% of the B Shares to which it relates. The balance of the option may normally be exercised on or after the second anniversary of the grant date. Options normally lapse on the third anniversary of the date of grant. Upon exercise or part-exercise of an option, the participant also receives a distribution equating to the net dividend received since the date of grant by the trustee of the Trust on the corresponding number of B Shares. In December 2005, the rules of the Deferred Plan were amended to allow participants who were granted options in or after December 2005 to elect to take a cash equivalent value in substitution for exercising their options.

During the year options over 1,279,200 B Shares were exercised under the Deferred Plan, and participants with options over a further 121,750 B Shares elected to take a cash sum in substitution for exercising their options. An option over 23,000 B Shares lapsed during the year, whereupon options over these same 23,000 B Shares were granted to two new participants on 5 December 2006. At 31 December 2006, options over 938,970 B Shares were outstanding.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

Date of Grant	Exercise period	Outstanding at 31 December 2005 Shares	Exercised Shares	Lapsed Shares	Surrendered for cash alternative Shares	Aggregate net value ⁽¹⁾ of shares at date of exercise or surrender £	Distribution ⁽²⁾ made by Trustee out of dividend income £	Outstanding at 31 December 2006 Shares
23/09/04	21/05/06 to 22/09/07	1,677,920	(1,237,950)	-	-	2,599,682 ⁽³⁾	428,455	439,970
03/05/05	21/05/06 to 22/09/07	60,000	-	-	-	-	-	60,000
20/12/05	20/12/06 to 19/12/08	301,000	(35,500)	(11,500)	(116,000)	456,842 ⁽⁴⁾	27,270	138,000
20/12/05	20/12/07 to 19/12/08	301,000	-	(11,500)	-	-	-	289,500
05/12/06	20/12/06 to 19/12/08	-	(5,750)	11,500	(5,750)	75,162 ⁽⁵⁾	-	-
05/12/06	20/12/06 to 19/12/08	-	-	11,500	-	-	-	11,500
		2,339,920	(1,279,200)	-	(121,750)	3,131,686	455,725	938,970

Notes:

- (1) Market value of shares less cost of exercise.
- (2) Dividend received on shares under option is distributed to participants as and when the options are exercised or a cash equivalent value is taken in substitution for exercising the option.
- (3) Options over 1,237,950 shares were exercised on 2 May 2006. All of the shares were sold immediately upon exercise, at a price of £2.10 per share.
- (4) Options over 35,500 shares were exercised on 20 December 2006. The price obtained upon immediate sale of sufficient shares to meet the related tax and national insurance liability was £3.250242 per share. On the same date, options over a further 116,000 shares were surrendered in exchange for cash payments equivalent to £3.2685 per share, calculated by reference to the closing mid-market quotation over the preceding five days. On 21 December 2006, options over 23,000 shares were surrendered in exchange for cash payments equivalent to £3.2680 per share, calculated by reference to the closing mid-market quotation over the preceding five days.
- (5) An option over 5,750 shares was exercised on 20 December 2006, and on the same date a further option over 5,750 shares was surrendered in exchange for a cash payment. See Note (4) above for details of the values used.

Details of the options held by the executive directors can be found at (4) above.

The Trust holds B Shares in Songbird Estates plc, which may be used to satisfy options granted under the Deferred Plan or any other share plan the company may adopt. The assets of the Trust are held separately from those of the company, and the trustee (the 'Trustee') of the Trust is Halifax EES Trustees International Limited. The Trustee of the Trust waives its entitlement to dividend (save for 0.01p per share) on any shares in excess of those required to satisfy outstanding options.

Where a participant has the right to take a cash alternative sum in substitution for exercising an option, the company has agreed to loan the necessary sum to the Trustee, and the Trustee has agreed to sell such shares as may be necessary to repay the loan.

At 31 December 2006, the Trustee of the Trust held 1,124,973 B Shares in Songbird Estates plc (2005 – 2,562,631).

At 31 December 2006 the group had accrued £1.0 million in respect of its liability under the Deferred Plan. Of this amount £0.5 million related to shares over which options had vested but had not been exercised at the balance sheet date.

9 EARNINGS PER SHARE

The basic and diluted earnings per share have been calculated by reference to the profit attributable to ordinary shareholders after taxation for 2006 of £43.8 million (2005 – £87.6 million), and on the weighted average of 639.0 million shares in issue (2005 – 620.5 million).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

10 INVESTMENT PROPERTIES, PROPERTIES HELD FOR DEVELOPMENT AND PROPERTIES UNDER CONSTRUCTION

Properties held as tangible fixed assets:

	Investment properties £m	Properties held for develop- ment £m	Property under construction £m	Properties under construction held for sale £m
1 January 2006 pre-adjustment for UITF 28	5,301.5	255.7	–	
Adjustment for UITF 28	(381.9)	–	–	
1 January 2006	4,919.6	255.7	–	
Transfers	–	(76.8)	40.7	
Additions (net of adjustment for UITF 28)	5.4	25.4	5.5	
Revaluation	790.9	–	–	
31 December 2006	5,715.9	204.3	46.2	
Adjustment for UITF 28 (Note 13)	342.5			
Market value at 31 December 2006	6,058.4			
Of which, subject to lease and finance leaseback arrangements	101.8			
Historical cost	2,550.8			
Sold freehold properties under construction				
Transferred from properties held for development				38.0
Additions				31.1
Transferred to cost of sales				(76.4)
Transferred from payments on account/accrued				7.3
				–

Investment properties are recorded at valuation less the cost of unamortised tenant incentives incurred at the balance sheet date in accordance with UITF 28. Remaining unamortised tenant incentives are held within prepayments in the balance sheet (Note 13).

Additions to properties for 2006 totalled £71.4 million. In the table above additions are stated net of £4.0 million of tenant works which have been classified as other tenant incentives for the purposes of UITF 28 (Note 13).

The group's investment properties have been revalued externally as at 31 December 2006 on the basis of market value. The valuation of office investment properties was undertaken by either CBRE or Savills. The valuation of retail investment properties was undertaken by CWHB. Each property has been valued individually on a free and clear basis and not as part of a portfolio, and no account has been taken of any intragroup leases or arrangements. Whilst allowance has been made for any purchaser's expenses, no allowance has been made for any seller's expenses of realisation nor for any taxation that might arise in the event of disposal. The allowance made by the valuers for purchaser's expenses was 5.75% at 31 December 2006 and 31 December 2005. The surplus arising on the valuations at 31 December 2006 of £790.9 million has been transferred to the revaluation reserve.

Properties held for development at 31 December 2006, and to be retained as investment properties, are carried at their fair value at the time of acquisition of the CWHL group in December 1995, less subsequent disposals plus additions at cost, subject to any provision for impairment.

In February 2006 the group entered into an agreement for the sale of 20 Churchill Place for a consideration of £199.5 million (see 'Business Review – Property Portfolio'). As a result the historical cost to the group of this site of £13.8 million has been transferred from properties held for development to freehold property under construction held as a current asset. At 31 December 2006 the carrying value is stated net of £35.6 million taken to cost of sales in accordance with SSAP 9 as the group fulfils its obligations under the sale agreement. The remaining balance of £2.2 million after additions in the year of £24.0 million has been offset against payments on account in creditors falling due within one year (see below).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

In November 2006 the group entered into an agreement for the sale of 15 Canada Square for an initial consideration of £260.0 million (see 'Business Review – Property Portfolio'). As a result the historical cost to the group of this site of £24.2 million has been transferred from properties held for development to freehold property under construction held as a current asset. At 31 December 2006 the carrying value is stated net of £40.8 million taken to cost of sales in accordance with SSAP 9. The remaining balance of £9.5 million after additions in the period of £7.1 million has been accrued.

The utilisation of the payments on account received in connection with the agreements for sale of 20 Churchill Place and 15 Canada Square is analysed in the table below:

	20 Churchill Place £m	15 Canada Square £m	Total £m
Amounts received	182.3	92.5	274.8
Recorded as turnover	(35.6)	(40.8)	(76.4)
Applied as an offset against long term contract balances	(2.2)	–	(2.2)
Deferred interest	5.2	0.2	5.4
31 December 2006 (Note 15)	149.7	51.9	201.6

At 31 December 2006 properties under construction held for investment included £0.7 million in respect of financing costs.

During 2005 the group completed the sale of seven properties which resulted in a total profit on disposal of £205.3 million shown as an exceptional item. There was no deferred tax charge as a result of these disposals.

In April 2005 the group acquired the long leasehold interests in Aldersgate Street. The valuation at the date of acquisition on this basis, ignoring intragroup leases, was £97.0 million. On 2 December 2005, the group disposed of its long leasehold interests in Aldersgate Street for a total consideration of £110.0 million and recognised a profit of £12.1 million after expenses attributable to the sale, which was taken to the profit and loss account and shown as an exceptional item. There was no deferred tax charge as a result of this transaction.

11 OTHER TANGIBLE FIXED ASSETS

	Fixtures and equipment £m	Computer equipment £m	Total £m
Cost:			
1 January 2006	13.8	1.0	14.8
Additions	0.1	–	0.1
Transfers to properties held for development	(1.9)	–	(1.9)
31 December 2006	12.0	1.0	13.0
Depreciation:			
1 January 2006	(11.5)	(0.9)	(12.4)
Charge for the period (Note 2)	(0.1)	(0.1)	(0.2)
31 December 2006	(11.6)	(1.0)	(12.6)
Net book amount:			
31 December 2006	0.4	–	0.4
At 31 December 2005	2.3	0.1	2.4

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

12 INVESTMENTS

	2006		2005	
	Group £m	Company £m	Group £m	Company £m
Subsidiary undertakings	–	2,461.1	–	1,861.1
Associated undertaking	12.6	–	2.5	–
Shares	0.5	–	1.0	–
Other investments	0.2	–	0.3	–
	<u>13.3</u>	<u>2,461.1</u>	<u>3.8</u>	<u>1,861.1</u>

In April 2005, BWB appointed the group, together with Ballymore, as its partner for the development of Wood Wharf, a site adjacent to the Estate. The Wood Wharf Limited Partnership ('WWLP') has been established to oversee the development of an approximately 6.5 million sq ft (gross) mixed use scheme in which the group has a 25.0% effective interest. The group has subscribed £1,000 of equity share capital in the partners of WWLP and has, in addition, provided interest free long term loans totalling £11.0 million to fund the working capital requirements of the partnership, which are repayable out of development profits.

The funding of WWLP has been accounted for as an investment in an associated undertaking. The investment in WWLP comprises an initial entry premium (plus expenses) of £1.9 million together with the group's share of the net assets of WWLP. The results of WWLP attributable to the group have been derived from WWLP's management accounts for the year ended 31 December 2006. The group's share of the results and net assets of WWLP is as follows:

	2006 £m
Loss before interest and tax	(0.7)
Interest receivable	1.3
Interest payable	(1.7)
	<u>(1.1)</u>
Taxation	–
Loss after tax	<u>(1.1)</u>
Group share (25%)	<u><u>(0.3)</u></u>
Net assets	43
Group share (25%)	<u><u>10</u></u>

The investment in shares represents the B Shares held in trust in connection with the group's share option schemes (Note 8).

Cost:	£m
1 January 2006 and 31 December 2006	<u>8.3</u>
Amounts amortised:	
1 January 2006	(7.3)
Amortised in the year	(0.5)
31 December 2006	<u>(7.8)</u>
Net book amount:	
31 December 2006	<u><u>0.5</u></u>
31 December 2005	1.0

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

Total amortisation for 2006 was £0.5 million (2005 – £2.0 million) and was charged to the profit and loss account. In 2005 £0.3 million related to employees of the group's contracting subsidiary and was charged as a development expense. Further details of movements in the investment in B Shares are given in Note 18.

In March 2001, the group acquired 52,079 £1 ordinary shares and 2,604 convertible shares in HighSpeed Office Limited ('HSO'), an unlisted company registered in England and Wales, being approximately 13.0% of its nominal share capital. The principal activity of HSO is the provision of broadband telecommunications services. The consideration paid was £2.1 million representing the historical cost to the group including fees. During 2006 the carrying value of the investment was held at £0.2 million (after a total provision of £1.9 million), based on the net asset value of HSO at 31 December 2006.

The company holds the entire issued share capital of Canary Wharf Estate Limited ('CWEL') comprising 651,778,264 ordinary shares of 1p each. The directors have considered the value of the company's investment in CWEL and at 31 December 2006 and the investment was stated at £2,461.1 million, net of a provision of £524.0 million (2005 – £1,861.1 million, net of a provision of £1,124.0 million).

At 31 December 2006 the company's principal subsidiary undertakings, all of which were incorporated in Great Britain and registered in England and Wales and wholly owned, were as follows:

Name	Description of shares	Principal activities
CWCB Investments (DS7) Limited ⁽¹⁾	£1 Ordinary	Holding company
Canary Wharf Estate Limited ⁽¹⁾	£1 Ordinary	Holding company
Canary Wharf Holdings Limited	£1 Ordinary	Holding company
	£1 Preferred Redeemable	
Canary Wharf Limited	£1 Ordinary	Property development
	£1 Preferred Redeemable	
Canary Wharf Investments Limited	£1 Ordinary	Property investment
	£1 Deferred	
Canary Wharf Contractors Limited	£1 Ordinary	Property construction
Canary Wharf Management Limited	£1 Ordinary	Property management
Heron Quays Properties Limited	£1 Ordinary	Property development
Norquill Limited	£1 Ordinary	Property investment
Canary Wharf Finance II plc ('CWFII')	£1 Ordinary	Investment company
CW Lending II Limited	£1 Ordinary	Investment company

Notes:

(1) Held directly by the parent company.

A complete list of the company's subsidiary undertakings will be attached to the company's annual return when it is submitted to Companies House.

13 DEBTORS

	2006		2005	
	Group £m	Company £m	Group £m	Company £m
Due within one year:				
Trade debtors	6.0	–	5.7	–
Other debtors	10.6	0.5	43.4	0.6
Amounts owed by subsidiary undertakings	–	323.8	–	338.2
Loans to subsidiary undertakings	–	690.1	–	533.2
Prepayments and accrued income	36.7	1.0	26.0	1.2
	53.3	1,015.4	75.1	873.2

Loans to subsidiary undertakings carry interest at a rate linked to LIBOR and are repayable on demand.

	Rent-free periods £m	Other tenant incentives £m	Total £m
Due in more than one year:			
1 January 2006	113.0	268.9	381.9
Transferred from properties held as fixed assets (Note 10)	–	4.0	4.0
Recognition of rent during rent-free periods	1.7	–	1.7
Amortisation of lease incentives	–	(43.7)	(43.7)
Unwind of discount/release of other lease provisions	–	(1.4)	(1.4)
31 December 2006	114.7	227.8	342.5

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

Debtors due in more than one year comprise the cumulative adjustment in respect of lease incentives required by UITF 28. Lease incentives include rent-free periods and other incentives given to lessees on entering into lease arrangements. Under UITF 28, the aggregate cost of lease incentives is recognised as an adjustment to rental income, allocated evenly over the lease term or the term to the first market rent review if earlier.

The cost of other lease incentives is included within debtors due in more than one year and spread on a straight line basis over a similar period. Accordingly the external valuation of investment properties is reduced for these incentives.

14 FINANCIAL ASSETS

The group's financial assets comprise short term trade debtors (Note 13) and cash deposits. Cash deposits totalled £832.7 million at 31 December 2006 (31 December 2005 – £1,654.1 million) comprising deposits placed on money market at call and term rates. Total cash deposits included £288.2 million (31 December 2005 – £985.6 million) held by third parties as cash collateral for the group's borrowings and a further £24.7 million (31 December 2005 – £2.3 million) charged to third parties as security for the group's obligations.

All cash deposits were invested at floating rates.

15 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	2006		2005	
	Group £m	Company £m	Group £m	Company £m
Borrowings (Note 16)	39.9	–	40.6	–
Trade creditors	13.5	–	18.3	1.4
Amounts due to subsidiary undertakings	–	4.1	–	2.0
Taxation and social security costs	5.3	–	4.5	–
Other creditors	30.6	0.8	15.7	1.3
Accruals	92.1	3.6	88.0	3.3
Deferred income	55.1	–	43.3	–
Payments on account (Note 10)	201.6	–	–	–
	438.1	8.5	210.4	8.0

16 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

Creditors due after more than one year comprise:

	2006		2005	
	Group £m	Company £m	Group £m	Company £m
Securitised debt	2,473.6	–	2,486.8	–
Secured loans	1,248.2	–	1,159.3	–
Finance lease obligations	42.0	–	1,002.0	–
Amounts due from subsidiary undertakings	–	477.2	–	455.7
	3,763.8	477.2	4,648.1	455.7

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

The amounts at which borrowings are stated comprise:

	Securitised debt £m	Secured loans £m	Finance lease obligations £m	Total £m
1 January 2006	2,507.8	1,178.9	1,002.0	4,688.7
Drawn-down	–	300.0	–	300.0
Deferred financing expenses	1.7	(0.8)	(3.2)	(2.3)
Accrued finance charges	(5.1)	1.2	3.1	(0.8)
Repaid in period	(11.9)	(210.1)	(836.6)	(1,058.6)
Exceptional gain	–	–	(123.3)	(123.3)
31 December 2006	2,492.5	1,269.2	42.0	3,803.7
Payable within one year or on demand	18.9	21.0	–	39.9
Payable in more than one year	2,473.6	1,248.2	42.0	3,763.8
	2,492.5	1,269.2	42.0	3,803.7

- (1) On 1 February 2006, the group concluded the acquisition from Barclays of CWCB Finance Leasing (DS7B) Limited (formerly Barclays Capital Leasing (No 165) Limited) ('BCL (165)') and Canary Wharf Finance Leasing (BP1/DS6) Limited (formerly Barclays Capital Leasing (No 166) Limited) ('BCL (166)') for a consideration of £0.1 million in excess of net assets acquired. In September 1997, BCL (165) had entered into an agreement for lease in respect of certain floors in One Canada Square which were immediately leased back to the group from the date of acquisition on finance lease terms. As a result of the acquisition of BCL (165) cash deposits totalling £112.0 million held by the group as security for the finance lease were released from charge. BCL (165) has been consolidated in the accounts of the group from the date of acquisition, the effect of which was that finance lease receivables and payables totalling £111.9 million were offset.

In March 1998 BCL (166) entered into an agreement for lease in respect of certain floors in 33 Canada Square and in September 2003 it entered into an agreement for lease of One Churchill Place. In each case the respective property was subject to an agreement to lease back to the group from the date of acquisition on finance lease terms. As a result of the acquisition of BCL (166), cash deposits totalling £724.6 million held by the group as security for the finance leases were released from charge. BCL (166) has been consolidated in the accounts of the group from the date of acquisition, the effect of which was that finance lease receivables totalling £728.0 million were offset against finance lease payables totalling £852.2 million resulting in a gain of £123.3 million after fees which has been recorded as an exceptional item.

The consideration payable on acquisition of the two companies has been treated as a charge required to restructure the finance leases and shown as a component within interest payable in 2006.

- (2) In March 2005 the group drew-down £369.4 million under a new bank loan facility secured against 10 Cabot Square and 20 Cabot Square. The loan carried interest at a rate of 5.82% and was originally repayable in 2008. In December 2006 the group extended the repayment date of this loan from April 2008 until January 2013 upon payment of an arrangement fee of £2.4 million. The loan remains on a fixed interest basis until April 2008 when it becomes floating rate. The group has entered into a forward starting interest rate swap from April 2008 to January 2013 at a fixed rate of 5.031%
- (3) In May 2005, the group completed a refinancing of its securitised properties which involved the repayment of all debt outstanding under its first securitisation, the repayment of a bank loan facility of £85.0 million and repayment of £135.0 million of notes from its second securitisation. These repayments were funded by a bank loan facility of £750.0 million and a tap issue of £360.0 million of floating rate notes on the group's second securitisation.

The £750.0 million facility was drawn in full and carried interest at an initial rate of LIBOR plus 1%. During the course of 2005, £546.4 million of this facility was repaid primarily as a result of the disposal of four properties. Following these loan repayments, the margin on the loan had reduced to LIBOR plus 85 bps by March 2006 when the remainder of the loan was refinanced with a new £300.0 million facility secured against the group's principal retail properties. The retail loan facility carries interest at LIBOR plus a variable margin rate, subject to, inter alia, prevailing loan to value and interest cover ratio tests. At 31 December 2006 the margin was 70 bps. In October 2006 the group entered into an arrangement whereby the exposure to the movement in three month LIBOR rates on the facility was fully hedged with a fixed interest rate swap at 5.15%.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

- (4) At 31 December 2006 the following notes issued by CWFII, were outstanding:

Tranche	£m	Interest	Repayment
A1	1,215.0	6.455%	By instalment 2009 to 2033
A3	400.0	5.952%	By instalment 2032 to 2037
A5	221.5	Floating	By instalment 2012 to 2033
B	224.6	6.800%	By instalment 2005 to 2033
B2	104.1	Floating	By instalment from 2005 to 2030
C1	224.0	Floating	By instalment from 2006 to 2030
D1	25.0	Floating	By instalment from 2011 to 2033
	<u>2,414.2</u>		

The carrying value of the outstanding notes at 31 December 2006 was £2,483.4 million. Certain of the A1, A3 and B notes were issued at a premium which is being amortised to the profit and loss account on a straight-line basis over the life of the relevant notes. At 31 December 2006 £78.3 million remained unamortised.

The notes are secured on certain property interests of the group and the rental income stream therefrom.

Interest on the B2 notes is payable at three month LIBOR plus 0.35% and hedged at 5.032%. There is a step up in the margin on the B2 notes to 0.875% in July 2012. Interest on the C1 notes is payable at three month LIBOR plus 0.6% and hedged at 5.278%. There is a step up in the margin to 1.5% in July 2012. Interest on the D1 notes is payable at three month LIBOR plus 0.9% and there is a step up in the margin to 2.25% in July 2012. There is an interest rate collar on the D1 notes with a notional principal of £25.0 million, a floor of 5.0% and a cap of 9.0%.

The remaining A5 notes are in a principal amount of US\$315.1 million with interest payable at three month US\$ LIBOR plus a margin of 0.39% to July 2010 and thereafter 0.975%. These notes are hedged via cross currency swaps, whereby principal and interest liabilities are swapped into sterling providing a principal of £221.5 million. The weighted average interest rate payable under the A5 notes is 6.289% to July 2010 and 6.556% thereafter. The margin step up to 0.975% is not hedged.

The weighted average maturity of the debentures at 31 December 2006 was 15.9 years. The debentures may be redeemed at the option of the issuer in an aggregate amount of not less than £1.0 million (except the A5 notes which may not be less than \$1.0 million) on any interest payment date subject to the current rating of the debentures not being adversely affected and certain other conditions affecting the amount to be redeemed.

- (5) In December 2002, the group entered into a £608.8 million loan facility secured against One Churchill Place which was drawn-down in January 2005. The loan is fully amortising with a final maturity in July 2034. The loan carries a hedged interest rate of 5.82%. In 2006 £6.4 million of the loan was amortised in accordance with the loan agreement.
- (6) The group's obligations under its remaining finance lease are secured by first ranking fixed and floating charges over the property which is the subject of the finance lease and over certain cash deposits (Note 25). The rate of interest implicit in the finance lease was 4.9% at 31 December 2006 (31 December 2005 – 4.3%).
- (7) Loans and finance lease obligations (excluding accrued interest payable):

	2006		2005	
	Loans £m	Finance leases £m	Loans £m	Finance leases £m
In less than one year or on demand	21.6	–	18.3	–
In more than one year but less than two years	22.0	–	21.6	–
In more than two years but not more than five years	500.4	–	728.3	–
In more than five years	3,199.4	42.0	2,896.2	1,002.0
	<u>3,743.4</u>	<u>42.0</u>	<u>3,664.4</u>	<u>1,002.0</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

- (8) After taking into account interest rate hedging entered into by the group, the interest rate profile of the group's financial liabilities at 31 December 2006 (including accrued interest payable) was:

	2006			2005		
	Floating £m	Fixed £m	Total £m	Floating £m	Fixed £m	Total £m
Securitised debt	25.3	2,467.2	2,492.5	25.3	2,482.5	2,507.8
Secured loans	–	1,269.2	1,269.2	204.1	974.8	1,178.9
Finance leases	42.0	–	42.0	1,002.0	–	1,002.0
	67.3	3,736.4	3,803.7	1,231.4	3,457.3	4,688.7
Less: Cash collateral for borrowings (Note 14)	(42.4)	(245.8)	(288.2)	(890.2)	(95.4)	(985.6)
	24.9	3,490.6	3,515.5	341.2	3,361.9	3,703.1

In respect of the group's fixed rate financial liabilities:

	2006		2005	
	Weighted average interest rate %	Weighted average period fixed Years	Weighted average interest rate %	Weighted average period fixed Years
Securitised debt	6.2	15.8	6.2	17.1
Secured loans	5.9	14.6	5.9	16.4

- (9) The fair values in respect of the group's financial assets and liabilities (excluding debtors and creditors falling due within one year other than amounts relating to loans) at 31 December 2006 were £227.3 million before tax relief (31 December 2005 - £462.4 million) comprising the following:

	2006		2005	
	Book value £m	Fair value £m	Book value £m	Fair value £m
Primary financial instruments held or issued to finance the group's operations:				
– cash on deposit earning floating rates of interest	832.7	832.7	1,654.1	1,654.1
– short term financial liabilities and current portion of long term borrowings	(39.9)	(39.9)	(40.6)	(40.6)
– long term borrowings	(3,721.5)	(3,812.5)	(3,646.1)	(3,905.3)
– finance leases	(42.0)	(42.0)	(1,002.0)	(1,002.0)
Derivative financial instruments held to manage interest rate and exchange rate profile:				
– interest rate swaps	–	(48.4)	–	(121.4)
– interest rate collars	(0.3)	(2.2)	(0.3)	(3.3)
– currency swaps	–	(86.0)	–	(78.8)

The fair values of the interest rate swaps and sterling denominated fixed rate debt and deposits have been determined by reference to prices available on the markets on which they are traded. All other fair values shown have been calculated by discounting cash flows at the relevant zero coupon LIBOR interest rates prevailing at the balance sheet date.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

- (10) Unrecognised gains and losses on instruments used for hedging, and the movements therein, are as follows:

	2006			2005		
	Gains £m	(Losses) £m	Total net gains/ (losses) £m	Gains £m	(Losses) £m	Total net gains/ (losses) £m
Unrecognised gains and losses on hedges at 1 January	–	(203.2)	(203.2)	–	(176.0)	(176.0)
Gains and losses arising in previous years that were recognised in the year	–	–	–	–	2.6	2.6
Gains and losses arising before 1 January that were not recognised in the year	–	(203.2)	(203.2)	–	(173.4)	(173.4)
Gains and losses arising in the year that were not recognised in the year	9.2	57.7	66.9	–	(29.8)	(29.8)
Unrecognised gains and losses on hedges at 31 December	9.2	(145.5)	(136.3)	–	(203.2)	(203.2)
Of which:						
Gains and losses expected to be recognised in the following year	–	–	–	–	–	–
Gains and losses expected to be recognised after the following year	9.2	(145.5)	(136.3)	–	(203.2)	(203.2)

No gains or losses on instruments used for hedging were recognised in 2006.

- (11) Other than certain tranches of notes which have been swapped into sterling, the group has no material monetary assets or liabilities in currencies other than pounds sterling.

17 PROVISIONS FOR LIABILITIES

	Vacant leasehold properties £m	Other lease commitments £m	Deferred taxation £m	Total £m
1 January 2006	22.0	34.7	0.2	56.9
Utilisation of provision	(6.8)	(6.6)	–	(13.4)
Unwind of discount	1.0	1.1	–	2.1
Release of provision	(2.4)	(2.1)	–	(4.5)
Increase in provision	–	–	60.3	60.3
31 December 2006	13.8	27.1	60.5	101.4

Vacant leasehold properties

In February 2004 the group announced that it had signed agreements for lease relating to the pre-let to Reuters of approximately 283,000 sq ft of space in the building at 30 South Colonnade. As part of this transaction the group agreed to take over three of Reuters' leasehold properties from commencement of the lease on 30 South Colonnade in May 2005. In September 2005, the group paid a £3.1 million surrender premium in respect of one of these properties. In December 2006 break notices were served on the landlords of the two remaining properties and as a result these leases will determine in July 2009.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

In January 2006 £24.0 million was placed in cash collateral to fund these liabilities as a result of the sale of 30 South Colonnade. At 31 December 2006, £17.5 million remained in cash collateral after drawings to fund costs incurred on the properties.

At 31 December 2006 the provision for the estimated net liability under the remaining two properties, discounted at 6.1%, being the group's weighted average cost of debt at that date, was stated at £13.8 million (31 December 2005 – £22.0 million).

Other lease commitments

In March 2001 Lehman Brothers signed an agreement for lease in respect of 25-30 Bank Street, comprising 1,023,300 sq ft. The incentive package agreed with Lehman Brothers in connection with this lease included the following elements:

- (1) a contribution of £30.00 per sq ft towards the cost of refitting the 408,728 sq ft occupied by Lehman Brothers at Broadgate, capped at £12.0 million. This has been accrued for at 31 December 2006; and
- (2) a rent support commitment with Lehman Brothers under which the group may contribute a maximum of £10.00 per sq ft per annum towards the difference between the passing rent payable by Lehman Brothers on its leases at Broadgate and the rent achievable on any sub-lease. For 1 and 2 Broadgate, comprising 311,077 sq ft and where the leases expire in January 2017 and the passing rent is £46.86 per sq ft, rent support is only payable for the life of the first sub-lease; for the remaining space in 6 Broadgate, comprising 97,651 sq ft where the leases expire in September 2013, rent support of up to £5.00 per sq ft is payable by the group on any second sub-letting, but no further amount is payable thereafter. The passing rent on the space in 6 Broadgate varies between £44.00 per sq ft and £52.00 per sq ft but, on the majority of space, it is in the range of £44.00-£45.00 per sq ft. The terms of the Lehman Brothers' leases preclude sub-letting below market rent levels and no amount is payable by the group on space which Lehman Brothers does not sub-let.

Lehman Brothers has sub-let 100,303 sq ft in 1 and 2 Broadgate at a rent higher than the passing rent and therefore it has not been necessary to make any contribution as a result of this sublease. Lehman Brothers has sub-let a further 108,628 sq ft in 1 and 2 Broadgate at rents of between £34.00 and £37.50 per sq ft. Accordingly, the maximum amount payable in respect of the remaining space leased by Lehman Brothers at Broadgate has reduced to £26.6 million (nominal) with a present value of £20.9 million calculated on the basis of a discount rate of 6.1%. This amount has been provided for in full and will be subject to review at each subsequent balance sheet date.

In connection with the sale of certain properties during 2005 the group agreed to provide rental support either in respect of unexpired rent-free periods or, where there is a fixed uplift in rent, until the next rent review date. The group recognised a provision in respect of these commitments and at 31 December 2006 the remaining provision was £6.2 million calculated on the basis of a discount rate of 6.1%.

	2006 £m	2005 £m
Deferred taxation:		
Accelerated capital allowances claimed	(112.2)	(0.9)
Other timing differences	0.1	0.4
Undiscounted deferred tax liability	<u>(112.1)</u>	<u>(0.5)</u>
Discount	51.6	0.3
Discounted deferred tax liability	<u>(60.5)</u>	<u>(0.2)</u>
	31 December 2006 £m	31 December 2005 £m
At start of year	(0.2)	(89.4)
Deferred tax charge in the profit and loss account for the year	(60.3)	89.2
At end of year	<u>(60.5)</u>	<u>(0.2)</u>

As a result of the acquisitions referred to in Note 16(1), a deferred tax liability of £112.7 million, stated net of a discount of £51.6 million, was recognised at 31 December 2006 in respect of EZA claims made by these companies in prior years.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

In accordance with FRS 19, no provision has been made for deferred tax on gains relating to properties which are revalued in the balance sheet to their market values. If the group's investment properties had been sold at the balance sheet date at the amounts stated in Note 10, the amount of tax payable by the group would have been £59.0 million (31 December 2005 – £nil) after taking into account available tax losses and provisions. Corporation tax on chargeable gains in relation to the sale of completed properties held by group investment companies of £212.5 million (31 December 2005 – £133.7 million) has been reduced to £59.0 million (31 December 2005 – £nil) by EZA balancing allowances and capital losses. There is no corporation tax (31 December 2005 – £nil) on development surpluses in relation to completed properties that are held by group property development companies.

The group has received legal advice and is of the opinion that the capital losses brought forward are available to set off against capital gains arising. In line with FRS 19, the benefit of these losses has not been recognised in the deferred tax provided in the balance sheet.

18 SHARE CAPITAL

	Authorised		Issued, allotted and fully paid	
	2006 £m	2005 £m	2006 £m	2005 £m
Ordinary shares of 1p each	10.0	10.0	6.4	6.4

The authorised share capital of the company comprises 1,000,000,000 ordinary 1p shares, of which 639,015,845 were in issue at 31 December 2006. There were no changes to either the authorised share capital or the issued share capital during the year. The last remaining warrants over the ordinary shares of the company were exercised in November 2005. No options over the ordinary shares of the company were outstanding at 1 January 2006, nor were any granted during the year.

19 RESERVES

	Share premium account £m	Revaluation reserve £m	Capital redemption reserve £m	Special reserve £m	Profit and loss account £m	Total £m
Group:						
1 January 2006	146.2	2,241.8	0.7	264.8	(282.7)	2,370.8
Revaluation of investment properties	–	790.9	–	–	–	790.9
Dividend	–	–	–	–	(306.7)	(306.7)
Profit for the financial period	–	–	–	–	43.8	43.8
Transfer resulting from exercise of share options	–	–	–	–	0.1	0.1
31 December 2006	146.2	3,032.7	0.7	264.8	(545.5)	2,898.9

The capital redemption reserve arises from the purchase and cancellation of own shares.

The special reserve arose from a restructuring of the group which was completed on 4 December 2001 involving the introduction of a new holding company for the group by way of a scheme of arrangement in accordance with Section 425 of the Companies Act 1985.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

Options over 41,250 B Shares in Songbird exercised under the Deferred Plan in 2006 gave rise to a reserves transfer of £0.1 million based on the market value of B Shares on the exercise date.

Company:	Share premium account £m	Capital redemption reserve £m	Special reserve £m	Profit and loss account £m	Total £m
1 January 2006	146.2	0.7	1,481.8	635.6	2,264.3
Transfer from profit & loss account	-	-	600.0	(600.0)	-
Profit for the financial period	-	-	-	1,026.9	1,026.9
Dividend	-	-	-	(306.7)	(306.7)
31 December 2006	146.2	0.7	2,081.8	755.8	2,984.5

The directors consider that positive balances on the company's profit and loss account and special reserve are distributable.

20 RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

	Group £m	Company £m
Shareholders' funds at 1 January 2006	2,377.2	2,270.7
Revaluation surplus	790.9	-
Exercise of share options	0.1	-
Dividend	(306.7)	(306.7)
Profit for the financial year	43.8	1,026.9
Shareholders' funds at 31 December 2006	2,905.3	2,990.9

21 PENSION SCHEMES

The group operates two defined contribution pension schemes. The assets of these schemes are held in independently administered funds. The pension cost, which amounted to £2.6 million in the year (2005 – £2.1 million), represents contributions payable by the group to both schemes.

22 RECONCILIATION OF OPERATING PROFIT TO OPERATING CASH FLOWS

	2006 £m	2005 £m
Operating profit ⁽¹⁾	174.4	200.4
Depreciation charges	0.2	0.6
Provision against investment	0.1	0.1
Amortisation of share option costs	0.5	1.7
Profit on disposal of Aldersgate Street ⁽¹⁾	-	(12.1)
Increase in debtors	(0.2)	(10.1)
Increase/(decrease) in creditors	22.6	(18.8)
Expenditure charged to provisions	(13.4)	(23.0)
Movements in provisions	(2.3)	-
Amortisation of lease incentives	42.0	39.7
Net cash inflow from operating activities	223.9	178.5

Note:

(1) For the year ended 31 December 2005, operating profit included an exceptional profit of £12.1 million in respect of the profit on sale of the group's long leasehold interests in Aldersgate Street.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

23 ANALYSIS OF CASH FLOWS

	2006 £m	2005 £m
Returns on investments and servicing of finance		
Interest received	43.8	90.5
Interest paid	(229.7)	(263.8)
Interest element of finance lease rentals	(5.1)	(46.7)
Financing expenses on loans drawn-down	(4.0)	(25.8)
Financing expenses and breakage costs on loans repaid ⁽¹⁾	(0.5)	(194.1)
Net cash outflow	<u>(195.5)</u>	<u>(439.9)</u>

Note:

(1) For 2005 financing expenses of £194.1 million relate to breakage costs (Note 4).

	2006 £m	2005 £m
Capital expenditure and financial investment		
Additions to properties	(68.5)	(68.5)
Acquisition of property interests	(7.2)	(52.8)
Purchase of tangible fixed assets	(0.1)	(0.2)
Sale of leasehold property interests	–	110.0
Sale of investment properties ⁽¹⁾	27.0	1,175.6
Deferred income from sale of properties under construction	274.8	–
Investment in associated undertaking	(10.5)	(2.5)
Net cash inflow	<u>215.5</u>	<u>1,161.6</u>

Note:

(1) 2005 included £1,175.6 million of proceeds from the sale of investment properties (Note 10). A further £27.0 million deferred consideration from the sale of 30 South Colonnade was received in January 2006.

	2006 £m	2005 £m
Management of liquid resources		
Cash placed on deposit not available on demand	(180.0)	(634.3)
Cash withdrawn from deposit accounts	855.0	106.0
Net cash inflow/(outflow)	<u>675.0</u>	<u>(528.3)</u>

	Note	2006 £m	2005 £m
Financing			
Issue of ordinary shares		–	142.6
Repayment of secured loans	16	(210.1)	(1,015.3)
Repayment of securitised debt	16	(11.9)	(628.3)
Repayment of finance leases	16	(836.6)	(245.3)
Drawdown of securitised debt		–	360.4
Drawdown of secured loans and finance lease premiums	16	300.0	1,733.3
Net cash (outflow)/inflow		<u>(758.6)</u>	<u>347.4</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

24 ANALYSIS AND RECONCILIATION OF NET DEBT

	1 January 2006 £m	Cash flow £m	Other non- cash changes £m	31 December 2006 £m
Cash at bank	1,654.1	(821.4)	–	832.7
Amounts on deposit not available on demand	(987.9)	675.0	–	(312.9)
	666.2	(146.4)	–	519.8
Debt due after 1 year	(3,646.1)	(96.4)	20.7	(3,721.8)
Debt due within 1 year	(40.6)	40.6	(39.9)	(39.9)
Finance leases	(1,002.0)	837.9	122.1	(42.0)
	(4,688.7)	782.1	102.9	(3,803.7)
Amounts on deposit not available on demand	987.9	(675.0)	–	312.9
Net debt	(3,034.6)	(39.3)	102.9	(2,971.0)
Decrease in cash				(821.4)
Decrease in debt and lease financing				782.1
Change in net debt resulting from cash flows				(39.3)
Non-cash movement in net debt				102.9
Movement in net debt				63.6
Net debt at 1 January 2006				(3,034.6)
Net debt at 31 December 2006				(2,971.0)

25 CONTINGENT LIABILITIES AND FINANCIAL COMMITMENTS

At 31 December 2006 certain members of the group had given fixed and floating charges over substantially all of their assets as security for certain of the group's borrowings and finance lease obligations as referred to in Note 16. In particular, various members of the group had, at 31 December 2006, given fixed first ranking charges over cash deposits totalling £288.2 million.

As security for the issue of £2,414.2 million of securitised debt (see Note 16(4)) the company's indirect subsidiary, Canary Wharf Finance Holdings Limited, has granted a first fixed charge over the shares of CWFII and a first floating charge has been given over all of the assets of CWFII.

Commitments of the group for future expenditure:

	2006 £m	2005 £m
Under contract	387.0	16.0

The commitments for future expenditure relate to the completion of construction works where construction was committed at 31 December 2006. Any costs accrued or provided for in the balance sheet at 31 December 2006 have been excluded.

Commitments of the group for the next financial year in respect of other operating leases on land and buildings are analysed as follows:

	2006 £m	2005 £m
Annual commitment for which the leases expire:		
– within one year	–	–
– between two and five years	4.8	4.8
– after five years	–	–
	4.8	4.8

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

The group has, in the normal course of its business, granted limited warranties or indemnities to its tenants in respect of building defects (and defects on the Estate or in the car parks) caused through breach of its obligations as developer contained in any pre-let or other agreement. Offsetting this potential liability the group has received the benefit of warranties from the trade contractors and suppliers who worked on such buildings.

Sub-let commitments

Under the terms of certain agreements for lease the group has committed to take back certain space on the basis of short-term sub-leases at the end of which the space reverts to the relevant tenants. This space has been securitised, but insofar as the securitisation is concerned, the tenants are contracted to pay rent on the entire amount of space leased, whilst taking the covenant of the group on the sub-let space.

The existence of the sub-let commitments has been taken into account in the market valuation of the group's properties at 31 December 2006.

The table below summarises these sub-lets, including the rent payable for the next financial year, net of any rent receivable:

Property	Leaseholder	Original sub-let sq ft	Re-let ⁽¹⁾ sq ft	Net rent ⁽²⁾ £m	Rent review date	Rent review basis	Term commencement	Expiry or first break
10 Upper Bank Street	Clifford Chance	52,600	52,600	1.40	N/A	N/A	Jul 2003	Jul 2008
10 Upper Bank Street	Clifford Chance	52,100	52,100	1.82	Jul 2008	Fixed at £49/sf	Jul 2003	Jul 2013
25-30 Bank Street	Lehman Brothers	25,200	25,200	0.00	N/A	N/A	Jul 2003	Feb 2008
25-30 Bank Street	Lehman Brothers	50,400	50,400	0.61	N/A	N/A	Jul 2003	Jul 2008
25-30 Bank Street	Lehman Brothers	24,100	24,100	0.49	Nov 2008	Fixed at £53/sf	Jul 2003	Mar 2009
25-30 Bank Street	Lehman Brothers	100,900	90,100	3.35	Jul 2008	Fixed at £53/sf ⁽³⁾	July 2003	Jul 2013
One Churchill Place	Barclays	133,400	133,400	3.33	Jul 2009	OMR up only	Jul 2004	Jul 2019
One Churchill Place	Barclays	129,700	129,700	3.10	Jul 2009	OMR up only	Jul 2004	Jul 2014
One Churchill Place	Barclays	65,000	65,000	1.65	N/A	N/A	Jul 2004	Jul 2009
40 Bank Street	Skadden	19,500	19,500	0.18	N/A	N/A	Mar 2003	Mar 2008
40 Bank Street	Skadden	19,500	19,500	0.76	Apr 2008	OMR up only	Mar 2003	Sep 2010
40 Bank Street	Skadden	19,500	19,500	0.86	Apr 2008	OMR up only	Mar 2003	Mar 2013
Total		691,900	681,100	17.55				

Notes:

- (1) The group re-let 353,000 sq ft of sub-let space during 2006. In addition, a call option was granted on 10,800 sq ft of sub-let space in 25-30 Bank Street. With the exception of this space, all of the sub-let space has now been re-let.
- (2) The net annual sub-let rental obligations will decrease over time with the expiration of re-letting rent-free periods.
- (3) Followed by annual increases to £59.65 per sq ft in 2012.

26 ULTIMATE PARENT UNDERTAKING AND RELATED PARTY TRANSACTIONS

At 31 December 2006, the smallest group of which the company is a member and for which group financial statements are drawn up is the consolidated financial statements of the company. The largest group of which the company is a member for which group financial statements are drawn up is the consolidated financial statements of Songbird, the ultimate parent undertaking. Copies of the financial statements of both companies may be obtained from the Company Secretary, One Canada Square, Canary Wharf, London E14 5AB.

During 2006 the group purchased IT and telecommunications services totalling £111,184 from HSO, a company in which it holds an equity investment equivalent to approximately 13.0% of the issued share capital. £101,973 plus VAT was owed to HSO at 31 December 2006. In addition, during 2006, the group billed HSO £15,215 for access to the Canary Wharf telecommunications infrastructure. £107,224 plus VAT was owed by HSO at 31 December 2006, part of which related to prior years.

During 2006 a group company billed £198,857 to WWLP in which the group holds a 25.0% effective interest. These amounts remained outstanding at 31 December 2006 part of which relates to the prior year.

On 29 December 2004 the company entered into a provision of services agreement with Songbird and SAL (the 'Provision of Services Agreement'). Under the Provision of Services Agreement the company agreed to provide certain business and corporate administration services for a time based fee to SAL for an initial period of twelve months and to continue thereafter until terminated by either party on three months notice. No such notice has been served to date. At 31 December 2006, the group had accrued £332,818 as chargeable to Songbird under the Provision of Services Agreement.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2006 (Continued)

During 2005 the group entered into a consultancy services agreement dated 28 April 2005 between the company and MSREF IV International – GP LLC and Morgan Stanley European Real Estate Special Situations II Offshore Inc (together “MS”) under which the company appointed MS to provide consultancy services in respect of the management of the Estate and the provision of strategic advice in relation to all areas of the group’s business. The fees chargeable under this agreement are calculated on a time spent basis in accordance with daily rates notified to the company and subject to a maximum limit of £1.0 million in aggregate (exclusive of VAT), in any twelve month period. During 2006 no amounts were payable under this agreement.