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Development Securities PLC  
Annual Report 2006



# Financial highlights

**£23.6m**

Profit after tax

**6.75p**

Annual dividends per share

**63.4p**

Earnings per share

**£231.4m**

Net assets

**£14.4m**

Net borrowings

**568p**

Net assets per share

## Net assets per share

06	568*
05	510*
04	472*
03	444
02	423
01	423

## Earnings per share

06	63.4*
05	54.8*
04	54.3*
03	4.2
02	26.9
01	24.0

## Dividends per share

06	675*
05	637*
04	60*
03	5.4
02	5.0
01	4.5

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\*stated in accordance with IFRS

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# Chairman's statement

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**I am pleased to report another very satisfactory year for your Company, resulting in a significant uplift in shareholder funds**

An increased contribution from our development activities, coupled with a strong performance from our property investment portfolio enables me to report a profit after tax of £23.6 million and earnings of 63.4 pence per share, compared to £20.1 million and 54.8 pence per share for the previous year.

Shareholder funds increased for the eleventh successive year, reaching £231.4 million, equivalent to 568 pence per share. This compares to £187.5 million and 510 pence per share 12 months earlier.

In light of this strong performance, the Board has recommended the payment of a final Ordinary dividend for the year of 4.50 pence per share, payable on 6th July 2007 to shareholders on the register on 8th June 2007. This brings the total Ordinary dividend coupon for the year to 6.75 pence per share, an advance of six per cent over the previous year.

The increased strength of our balance sheet of course reflects the £23.1 million Ordinary share placing in November 2006, when 3.7 million shares were issued at a price of 62.5 pence per share. As shareholders will be aware, the proceeds of the placing were principally utilised to acquire a 10-acre development site in Birmingham, thus allowing your Company to conserve its cash resources

for other potential property acquisitions. We were pleased with the strength of support demonstrated by both existing and new shareholders for this successful placing.

## **Strategy**

Shareholders will be aware that the strategic focus of our development activities over the last two years has been suburban London and the main provincial UK cities, rather than Central London. The City of London property market remains innately volatile, due to the dominance of its financial services sector and, together with the West End market, is always likely to become one of the most competitive in any development cycle upturn. For some time now, we have believed that a more attractive risk/return ratio would be available elsewhere. Indeed, 2006 was a year of considerable progress in pursuit of our chosen strategy, with project 'wins' in Birmingham, Hammersmith, Southampton and significant advances at recently acquired sites in North London, Huyton and Manchester.

We continue to search out developments we believe will give us a competitive advantage, due to the scale and complexity of urban regeneration, for which your Company has considerable proven expertise. It is likely that large-scale, multi-phase projects, such as Curzon Park in Birmingham, will be delivered over more than one economic cycle. This will offer good visibility to our future activity and, we hope, potential profitability over the medium term. Our development portfolio now comprises a number of similar projects, further underpinning what we believe to be a sustainable business model.

The growing size and strength of our balance sheet, recently augmented by the £23.1 million share placing, supports our adjusted business model, whereby we now consider it appropriate to secure direct ownership of land for development. Our recent £33.5 million acquisition of Curzon Park, in equal partnership with Grainger PLC, is a case in point. We also plan to take an equity interest in Beadon Road, Hammersmith. Acquiring land is relatively straightforward and can now be achieved within the constraints of our enlarged capital structure. However, the subsequent development is much more capital intensive. Therefore, we will continue to seek leading financial institutions as equity partners, either in an individual phase or possibly through the entire project, thus maintaining our risk-averse approach.

For a sixth successive year, I am pleased to report an excellent level of returns from our property investment portfolio, generated by Matthew Weiner and his team. In 2006, your Company achieved an 18.5 per cent IPD Total Portfolio Return\* which compares favourably to the average market return of 18.1 per cent. In broad terms, six per cent came from the rental income of the properties themselves and the balance from realised and unrealised surpluses over existing book values.

During the year, we realised gains from properties where we felt medium-term rental growth prospects were limited. However, reinvestment of these proceeds proved more challenging than ever due to the seemingly relentless weight of money seeking similar

\*Refer note 1(p)

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We continue to search out developments which we believe will provide us with a competitive advantage due to the scale and complexity that urban regeneration often entails and for which your Company has considerable proven expertise

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Roy Dantzic, Chairman

assets. As a result, allocation of our resources into the investment property portfolio fell below target levels. Income returns in the cash market now approach those available in the direct real estate market. In order to justify the risk inherent in property ownership, it is important that asset value grows through significant property-related initiatives. We have never believed market momentum to be the sole justification for property investment.

#### **Outlook**

Whilst we long ago gave up predicting an end to the current investment market boom, we find it difficult to believe that the total investment returns of recent years will be sustainable in 2007. However, we will continue to seek superior performance through active management both of our existing portfolio and of acquisitions.

At such points in the property cycle superior returns may be more readily obtained in the development arena. This is increasingly understood by our traditional institutional development and joint venture partners, banks and by those with adequate financial and professional resources to compete alongside us. The strength of the current development cycle will benefit from continuing employment growth, a benign economic outlook and declining office vacancy rates. Prospects for the medium term encourage us to further expand our project portfolio, which presently has a completed investment value in excess of £1 billion.

In this regard, your Company will pursue two tactical options. First, we believe our resources will be more efficiently employed by continuing to focus on urban development opportunities in suburban London and the main UK provincial cities, where our brand strength and reputation continue to grow. Second, we remain keen to expand our regional joint venture relationships with those whose expertise best complements our own. In some instances, our partners will be of equal financial strength, in others we may take the financial lead while the appropriate regional specialist heads the development project. We look forward to establishing more such relationships in the near and medium term.

#### **Board composition**

As previously reported, Bill Grant retired from the Board in May 2006. Earlier this month, Paul Willis stood down as a member of our Board for family reasons. We wish him well for the future. After four years as your Chairman, I shall not be seeking re-election at this year's Annual General Meeting. I shall be succeeded by David Jenkins, who joined the Board in February. David retired three years ago as a senior audit partner of Deloitte & Touche LLP where he specialised in the property sector for most of his career. I have no doubt that he will make a significant contribution to the Company's further progress.

#### **Conclusion**

The strength of the property investment market and the returns now emerging from our development portfolio resulted in our 2006

financial performance exceeding even that of 2005. We do not yet discern any credible or significant threats to the property sector as an asset class, unless values are driven still higher in 2007, which would make us more apprehensive. Global growth may slow marginally in 2007, but this might be of benefit, allowing interest rates generally to fall slightly as any perceived inflationary threats recede.

Given the structure and timing of our development activity, we may well have to wait until 2008 for the next meaningful contribution to our financial results. We will endeavour to extend our pipeline of projects in the medium term. Our financial resources remain available to support any new opportunities that we consider will provide the returns we seek.

It remains for me to thank all of our Directors, management and staff for their valued contributions to our performance to date. Their professionalism and reputations have been an undoubted important feature of our success so far. Long may it continue.

I am certain we have the executive and management teams to meet the challenges that lie ahead.

Roy Dantzic  
Chairman  
30th March 2007

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# Balance and diversity

The emphasis on measured risk is at the heart of our management philosophy

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**Development Securities is one of the UK's leading property development and investment companies. Its objective is to generate consistent superior returns for investors by the creation and recycling of development gains and investment surpluses but always subject to prudent financial management.**

The emphasis on measured risk is at the heart of our management philosophy, it assists the achievement of consistent results over time and the protection of the business and its investors from the effects of major market fluctuations

## **Balance and diversity**

Our balanced business model, which we have applied consistently since the present management team began to come together in the mid 1990s, has delivered positive returns for shareholders. Maintaining balance between short- and long-term returns, large-scale multi-phase projects and smaller scale developments, across office, retail and industrial sectors, with sites across the UK, provides the necessary diversity to minimise the risks inherent in property development.

In our experience, large and complex development projects offer greater profit potential than smaller ones, without significantly increasing the inherent risk profile. Our strategy enables the Company to focus its efforts on these major projects, which would otherwise be beyond our capability to finance with internally generated funds

## **Forward-funding**

The single most important component is the appropriate and balanced sharing of risk in the complex and very substantial development projects in which we are involved. These projects include our schemes at Paddington Central, Cambourne Business Park, The Royals Business Park, Heart of Slough and Curzon Park in Birmingham, comprising over three million sq. ft. and we do not believe it is appropriate for a company of our size to accept sole development risk in relation to this scale of activity. Accordingly, we endeavour to share the majority of such development project risk with financial institutions and partners who are the more appropriate long-term investors for real estate projects of this scale.

## **Investment portfolio**

The profits and cash flow from large developments can be uneven because they are influenced substantially by market conditions.

The Company allocates a significant element of its equity to the ownership of a diverse investment portfolio, consisting of properties spread across the UK, covering office, retail and industrial sectors. This mix is driven by market conditions, availability and stock selection.

The investment portfolio provides a steady and predictable flow of funds, contributing significantly towards interest costs and central overheads. Furthermore, these funds enable the Company to retain its small team of high quality professionals during a property market

downturn. The Company has built an excellent team which has delivered value to investors, and that must be maintained.

## **Conservative use of debt**

While cash resources are generally available to allow us to capitalise on appropriate development and investment opportunities, balance sheet management and the conservative use of cash and debt apply an additional discipline to the Company as a further prudent method of risk control. As a matter of policy, Development Securities does not have a fixed gearing limit, although in recent years its level of net borrowings as a percentage of shareholders' funds has been amongst the lowest in the property sector. Consistent with our policy of running an efficient balance sheet, from time to time surplus cash may become available to return to shareholders. The timing is related to the completion of major development projects when we benefit from substantial cash inflows. If circumstances allow, funds are returned to shareholders by special dividend or a share buy-back programme. The timing and nature of such action will be determined after taking into account prevailing market conditions and projected cash requirements.

<b>Five Year Summary</b>	<b>2006*</b>	<b>2005</b>	<b>2004</b>	<b>2003</b>	<b>2002</b>
	<b>£'m</b>	<b>restated £'m</b>	<b>£'m</b>	<b>£'m</b>	<b>£'m</b>
<b>Results</b>					
Revenue	48.7	25.5	23.7	32.2	33.5
Profit before taxation	22.8	23.3	18.8	1.2	10.0
Net assets	231.4	187.5	173.2	125.1	121.5
<b>Statistics</b>					
Earnings per share	63.4p	54.8p	54.3p	4.2p	26.9p
Net assets per share	568p	510p	472p	444p	423p

\*The 2004, 2005 and 2006 results have been determined in accordance with IFRS

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# Balance and diversity

## Funding and partnerships

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**Development Securities differs from most property companies in that it seldom owns the major developments that it is working on, although it may, on some schemes, have a modest financial or even equity involvement. This low-risk financial structure, known as forward-funding, is central to the Company's progress and assists in providing a clear view of potential earnings and cash flow streams for a number of years ahead. Such a strategy also provides leveraged returns for your Company's expertise and financial commitment.**

Your Company has considerable expertise in the creation and management of major, complex, mixed-use property developments. Such schemes include Paddington Central, the exciting project on the old goods yard adjoining Paddington Station, and The Royals Business Park, a 50-acre site with a one mile frontage onto the Royal Albert Dock, one of the foremost regeneration areas in the UK.

Our team uses its expertise to identify a potential major development, prepare detailed drawings and financial appraisals and seeks any necessary variation to planning consents. In parallel with this activity, we present the scheme to leading financial institutions, inviting them to invest in the development of the project.

Once the funding and institutional ownership of a new development has been secured, Development Securities is normally responsible for project managing the construction process, delivering the building on time and within budget. As part of its agreement with the project's investors, Development Securities also assumes responsibility for letting the completed building, usually on institutional terms to quality covenants. The Company's profit comes from project management fees and a participation in any uplift arising to the investors in the final investment value of the project when compared to the total development cost. Forward-funding imposes limited contractual liability on Development Securities should the completed building not be let profitably. This is a key benefit and highlights one of the main differences between forward-funding and conventional financing of property development. That our strategy is also successful for funding institutions is illustrated by our list of funding partners.

At this stage in the development cycle substantial sums of money are increasingly required to secure significant sites. Our risk capital in the development part of our business will be increasingly allocated to direct interests in land, rather than in development activity itself. Each subsequent phase could, if appropriate, be developed together with institutional partners on a more traditional forward-funded basis. In line with our risk-averse strategies we will invariably seek joint venture partners to share even the initial land risk for our large scale projects. Curzon Park in Birmingham, which we recently joint ventured with Grainger PLC, is a good example.

On small- and medium-sized projects, the

Company may assume complete ownership of assets directly, but will seek wherever possible to secure significant pre-let arrangements that reduce exposure to the occupier market.

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### Our funding partners have included

Standard Life Investments  
The Prudential Assurance Company  
Legal & General Assurance Society  
Universities Superannuation Scheme Limited  
Morley Fund Management  
DEKA Immobilien Investment GmbH  
Commerz Grundbesitz Investmentgesellschaft  
Deutsche Grundbesitz Investmentgesellschaft  
Pillar Property PLC  
DIFA Deutsche Immobilien Fonds AG

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# Balance and diversity

## Regional urban regeneration

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**In line with our strategy of balance and diversity, the emphasis of our business has broadened in recent years, from undertaking individual developments in Central London, in two important respects**

Following our success at PaddingtonCentral, we have continued to seek out projects that involve significant regeneration. Not only does urban regeneration offer those direct stakeholders in the property itself a significant reward for the risks and complexities undertaken, it also benefits those communities adjacent to these developments and the people working within them. With such projects taking place in locations which have perhaps been undervalued, it is often the case that rental levels improve significantly. Additionally, investment yields will often also improve, reflecting the perceived improved status of the location.

The more large-scale projects we undertake successfully, the more we are recognised as responsible and capable partners to local authorities seeking effective regeneration. The quality of our professional team coupled with our ability to externally fund large-scale projects, limiting the risks for all parties, is increasingly making us the preferred regeneration partner. To some extent, a virtuous circle is created. Whilst our track record in large-scale projects continues to expand, significant scale brings with it a requirement for an extended vision of the character and environment of the development to be created and with it, invariably, a considerable amount of construction and legal complexity. These factors represent significant barriers to entry for competing developers.

It is, of course, not just in London where regeneration activity is needed and, over the last few years, we have secured similar schemes in provincial cities and towns with the same strategic objectives. The Heart of Slough project entails circa 350,000 sq. ft. of prime office accommodation alongside a much larger residential component. In Birmingham, we acquired in 2006 an 11-acre site which will ultimately contain over one million sq. ft. of mixed-use accommodation. In many ways, this site is similar to the PaddingtonCentral scheme in Central London in that it is a large tract of land close to a major rail terminus, bordered both by a railway line and a canal.

As our track record shows, we are not limited to any geographical area in the UK, but we will tend to focus on the major conurbations where large-scale urban regeneration projects are sourced.

One of the benefits of a regional approach to urban regeneration is that land tends to be more affordable. This reduces specific asset risk and competition to acquire additional projects is less intense than that experienced in London. Such a strategy self-evidently also provides a geographically diversified risk profile. Finally, large-scale regeneration is frequently of a mixed-use nature, which also diversifies risk into different market sectors.



# Balance and diversity

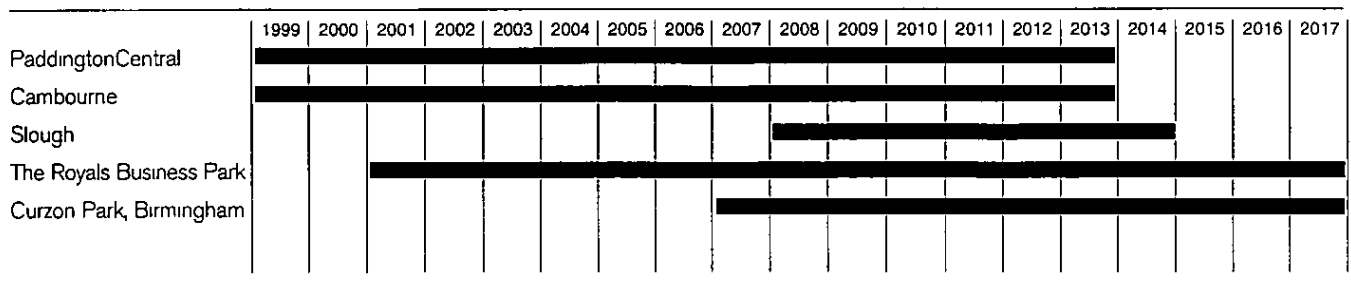
## Short-term and long-term visibility

**The challenge for a development business such as ours is to provide a sustainable business model through the vagaries of the property and business cycles. This requires combining short-term development gains with a long pipeline of multi-phase projects**

Development Securities has assembled a significant portfolio of large-scale development projects that offer the prospect of opportunity and reward spanning, in a number of cases, an extended period. Many of our projects are multi-phased and have stretched, or are likely to stretch, over a number of property and economic cycles, giving us an unusual degree of visibility of future earnings.

However, we also seek to identify smaller, individual and self-contained developments and when these are overlaid on the larger-scale, multi-phased schemes, it is our view that a more sustainable business model emerges.

### Development pipeline



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# Review of operations

2006 represented the fourth consecutive year of divergence between the property investment market and the occupational market

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**Sustained and strong investment demand was reflected in 2006 with capital values rising almost as much as they had in 2005**

Investors were seemingly willing to accept the further compression in yields that this represented. Whilst it remains to be seen whether these investment ratings are sustainable in the medium to long term, it is comforting to observe that the fundamentals underpinning the real UK economy remain supportive of property values. In particular, office rents are now growing at their fastest rate for five years, albeit that this positive trend owes much to the considerable improvement witnessed in the Central London market. Employment growth is expected to remain fairly constant over the next few years, supported by an economy which might be expected to return to trend growth in 2008 and 2009, after a possible slight deceleration in 2007. Interest rates in 2006, both in the UK and the US, have trended upwards largely in response to inflationary indications and have probably all but peaked. Even so, the rise in property values continued uninterrupted in 2006 and may well be sustainable in the medium term if investors feel confident regarding economic fundamentals and the prospects for rental growth.

Through this period of rising property investment prices, we have maintained our strategy of realising surpluses where we felt we were no longer able to extract additional value rather than expecting market momentum to generate further gains. Conversely, it has been a much more difficult market in which to source new investment product. Competition in the market place in 2006 was even less discerning in the

relationship between quality and value. Accordingly, during 2006, the investment markets became less attractive to us in general terms than the development arena.

**Current development programme**

2006 has seen considerable activity in our development programme with successes achieved on a number of existing projects and some further deals which either extend, or have a significant possibility of extending, our pipeline of future work. We are encouraged that institutional investment support is increasingly available to fund development projects, since it is precisely this class of long-term, patient capital that is the best underpinning for market stability and growth. A concern with any development activity must be that developers and institutions engender such a significant oversupply of product that the current upswing ends prematurely. Whilst we are always mindful of such events, we believe there is some way to go to the end of this development cycle, especially if UK and global economic growth continues. The Central London markets are, unsurprisingly, currently demonstrating the largest increases with strong rental and asset value growth in both the City and West End markets. It remains to be seen whether demand here can be sustained and to what degree the supply side response may act as a brake on rental growth. The lead times involved in large-scale, urban development are considerable and there is little margin for error especially if site acquisitions are made at values which reflect current short-term investor demand rather more than those predicated on economic fundamentals.

#### **PaddingtonCentral**

Few projects can better illustrate the cyclical nature of the property markets in Central London than our large-scale, urban regeneration scheme adjacent to London's West End, which has turned a derelict former railway yard into a dynamic living and working environment, supported by retail and leisure amenities. The substantial first phase commenced in 2000 and was fully-let on completion, some two years later, with your Company's share of profit easily surpassing the anticipated level due to strength in both the letting and investment markets. A further period of four years was to follow until the property markets were strong enough to support construction of the second phase, beginning in April 2006. The intervening years have not been entirely unproductive, as both the completion of the £30 million 'Crossrail Deck' and the reopening of the newly widened six-lane, 175-metre long Paddington Bridge on Bishops Bridge Road provided vital new infrastructure to underpin future phases.

The current phase under construction, a 250,000 sq. ft. office building at One Kingdom Street and a 206-room Accor hotel, is scheduled for practical completion in 2008 and is funded by our development partners Morley Fund Management and DIFA Deutsche Immobilien Fonds AG. Phase three, a 366,000 sq. ft. prime office building known as Two Kingdom Street, has already been granted detailed planning consent and represents a substantial pre-let opportunity in a market where occupiers for large space face limited choice from existing buildings.

#### **CityPark, Manchester**

This mixed-use site was acquired towards the end of 2004 for £3 million. Whilst outline planning existed for a 94,000 sq. ft. hotel and a 177,000 sq. ft. office building, variation in mix and quantum of space was sought and achieved in 2006. That part of the site on which the hotel will be developed has been sold to a reputable hotel operator. We are close to finalising the forward-funding arrangements for the sale and development of the office component.

#### **Colindale, London NW**

In November 2006, we were pleased to note that our proposals to redevelop Oriental City, at 399 Edgware Road, London NW9, received a unanimous resolution from the London Borough of Brent to grant planning consent for a new mixed-use scheme to include 300,000 sq. ft. gross retail space and 340,000 sq. ft. of private and affordable housing, along with associated retail and residential car parking. It is particularly beneficial that the development will also include a new 80,000 sq. ft. primary school for 420 pupils, the first primary school to be built in Brent in the last 50 years. Marketing of the available accommodation to retail and residential third parties has begun and we are cautiously optimistic that our original value expectations will be met. This 7.5-acre property, currently comprising 100,000 sq. ft. of retail accommodation with 750 car park spaces was acquired in June 2005.

#### **Cavendish Walk Shopping Centre, Huyton**

2006 ended with a more than satisfactory outcome with the completion of this new 110,000 sq. ft. retail scheme in Huyton, near Liverpool. Acquired by your Company in January 2005, and constructed by our joint development partner, CTP Limited, this scheme achieved practical completion in December 2006. This was immediately followed by the disposal to a private investor for £24.0 million reflecting an initial yield of 5.5 per cent and generating a net surplus of £5.8 million. On our acquisition of the site, Wilkinsons PLC was the sole pre-let anchor tenant, with the majority of the space letting up during construction and against the background of a weakening retail market, mostly to well known High Street names. We believe that retailers prefer such thriving and cost-effective locations over expensive prime pitches, and will continue to seek out similar opportunities in the future. This project is a good illustration of the synergy between our development and investment skills. As momentum in the investment market slows, such a combination of our skill base will prove key to further successful projects.

#### **Curzon Park, Birmingham**

In November 2006, in equal partnership with Grainger PLC, we acquired the 10-acre Curzon Park site for £33.5 million. The proposed 1.4 million sq. ft. mixed-use project, with a gross development value of over £350 million, will comprise approximately 800,000 sq. ft. of office and 400,000 sq. ft. of residential accommodation, together with a 180-bed hotel and 30,000 sq. ft. of retail space. The development strategy includes the securing of planning consent, delivery of £12 million of infrastructure works and a phased development of the site over a period of approximately 11 years. It is intended that your Company will project manage the planning process and construction of the infrastructure and commercial phases, with Grainger PLC project managing the residential component.

#### **The Royals Business Park**

In June 2006, our funding partner, Standard Life Investments, secured the first letting of some 10,000 sq. ft. at Building 1000, the 252,000 sq. ft. new Grade A office accommodation completed speculatively in 2004. Whilst Standard Life have a number of other live enquiries, the level of demand for offices in this location has clearly not met initial expectations, and we are in discussion with the London Development Agency with a view to introducing other users to the site in order to create a truly mixed-use and sustainable environment. We continue to be cautiously optimistic that discussions with parties interested in some of the remaining accommodation will be successful.

#### **Luneside, Lancaster**

In mid-2006, a compulsory purchase order was confirmed in respect of this 17.5-acre urban regeneration project. A land remediation strategy and detailed planning application are being devised, with a view to starting on site in 2007. The development will comprise 350 new homes, 90,000 sq. ft. of new offices and a hotel.

#### **Cambourne Business Park**

In July 2006, we leased further space on phase two of this 750,000 sq. ft. development, leaving only 30,000 sq. ft. available to let. Located nine miles from Cambridge, this business park is an integral part of the new Cambourne settlement, a 1,040-acre scheme of 3,300 houses with town centre, hotel, retail and leisure facilities. Discussions are presently in hand with the institutional market to forward-fund the next 50,000 sq. ft. phase.

#### **Hammersmith Grove, London W6**

In October 2006, following a detailed selection process, Development Securities was selected by Transport for London as its preferred development partner for the 1.5-acre Hammersmith Car Park Site immediately adjacent to Hammersmith Underground Station. Consultation with the relevant planning authority is underway, with the anticipation that construction on site can commence by the end of 2007, in order to deliver the completed 350,000 sq. ft. building to include offices, retail, and a cinema by the end of 2009.

#### **West Quay III, Southampton**

Significant milestones have been achieved at the West Quay Road site in the centre of Southampton. Firstly, in the autumn, we signed an Agreement to Lease with Carnival PLC to develop their new 150,000 sq. ft. UK headquarters building and then, early in 2007, we secured detailed planning consent for this project, the first of what we hope will be a two phase mixed-use scheme adjacent to the existing West Quay Shopping Centre. Finally, in March 2007, we exchanged contracts with Lime Property Fund LP to fund the site and development of the building. Practical completion of the first phase is estimated for 2009. If our current negotiations are successful, the second phase of this urban regeneration project is expected to provide a further 50,000 sq. ft. of office, 75,000 sq. ft. of residential or hotel use and 5,000 sq. ft. of retail accommodation together with a 20,000 sq. ft. casino.

#### **Broughton**

In the first half of 2006, Flintshire County Council approved the resolution to grant planning consent for both the 170,800 sq. ft. extension to the existing Broughton Retail Park and the related highway link from the A55. Whilst realisation of any profit potential from this phase will ultimately await the conclusion of discussions with British Land PLC, we did move ahead in November 2006 by acquiring not only the land necessary to construct the interchange that will provide enhanced access to the expanded retail facilities, but also the 10 acres of land required to construct a reservation for the existing, protected local population of greater crested newts.

In October 2006, Flintshire County Council ratified in their emerging Unitary Development Plan (UDP) the status of our 19-acre site as allocated for residential purposes. The number of units that the Council considered could be accommodated on the land was increased by 35 to 260 dwellings, in line with our earlier planning application. At the same meeting in October, the Local Authority confirmed within the emerging UDP, that a further two acres of our land has been designated for non-retail commercial use. The emerging UDP is expected to be ratified within the next 15 months.

#### **Heart of Slough**

During 2006, English Partnerships gained approval for a £17 million gross infrastructure investment to enable the Heart of Slough regeneration scheme. We are now preparing the outline masterplan alongside our joint venture partners, Berkeley Homes, Slough Borough Council and English Partnerships, with a view to commencing development in 2008, with completion of the first phase anticipated two years later. In September, we acquired Compar House, a key strategic site that will permit the permanent relocation of the existing town centre bus station, thus releasing the existing facility for redevelopment to provide approximately 300,000 sq ft. of commercial space adjacent to the town's transport hub. We are encouraged by the continued gradual reduction in the office vacancy rate in Slough and expect still further strengthening of the local occupational market in the medium term.

#### **Princes Road, Wells**

In early 2006, in joint venture with respected town centre developer Centros Miller, Development Securities acquired three strategic sites at the edge of Wells town centre. The sites form part of a wider area identified by Mendip District Council for a comprehensive, retail-led, mixed-use development in excess of 100,000 sq ft. The joint venture has recently signed a Lock Out Agreement with the Local Authority which is the significant first step in the preparation of a masterplan for the wider project. We are also working with the adjoining occupier, Tesco PLC, to incorporate an enlarged food store into the master plan, to the benefit of all parties.

#### **Telford Place, Crawley**

Towards the end of 2006, we entered into a further joint venture with Centros Miller under which Development Securities has now acquired two parcels of land adjacent to the town centre in Crawley. Working with English Partnerships, the joint venture will promote the sites for a 200,000 sq ft. residential-led, mixed-use development. A planning application has been submitted and we are hopeful to have secured all the required consents by the end of 2007.

This transaction strengthens our relationship with Centros Miller and is a further advance into an increasingly favoured area in which value is added via the planning process. This is a complex aspect of the development process, but one where we feel our core skills and risk-focused strategy will allow significant returns to shareholders.

#### **Hartfield Road, Wimbledon**

In February 2006, in a joint venture with Fornavon Limited, conditional contracts were exchanged to acquire the 1.25-acre development site at Hartfield Road. We expect our planning application for a 159,000 sq ft. scheme to comprise 63,000 sq ft. of residential accommodation, a 30,000 sq ft. hotel and 66,000 sq ft. of retail space together with car parking for 220 vehicles to be considered in the next few weeks. Practical completion is targeted for 2009.

#### **Frimley and Marlow**

In November 2006, Development Securities and Equitable Life Assurance Society entered into an Agreement to Lease the entire 180,000 sq ft. office campus to Siemens Holdings PLC for a 20-year term. Simultaneously, we sold our equity stake in this scheme and our residual equity stake at Globeside, Marlow to Equitable Life, generating a combined surplus of £2.9 million over book values.

#### **Staines**

In the first half of 2006, we reached agreement with the adjoining land owner to jointly promote for planning our combined land holdings in this significant development site which could accommodate a 250,000 sq ft. office building. A planning application has been submitted and is awaiting determination.

# Property investment portfolio

**2006 marked another strong year in the property investment market with total returns reaching 18.5 per cent. This is the third consecutive year where returns have reached these exceptional levels and against a backdrop of solid, if not spectacular, economic growth, the future would appear to be set fair**

Once again, financial performance was driven primarily by falling investment yields as the weight of money targeting the real estate sector remained strong. Yield compression has been a global phenomenon, reflecting the glut of savings in Asia and energy-producing countries. This further compression continued in the face of rising interest rates, such that the IPD Initial Yield\*, of 4.6 per cent finished the year 70 basis points below the five-year finance swap rate, making the leveraged investor a reticent participant. Risk aversion may return if perceptions change regarding UK monetary policy.

We are beginning to see the early signs of this particular reverse yield gap impacting on secondary property values, which comprise the bulk of investment stock, as the market becomes more selective where rental growth prospects look limited and where yield compression is no longer seen to be the apparent indiscriminate driver of enhanced returns. Yield differentials will eventually adjust to reflect the realities of the occupational market as compared to the current exuberance of the investment market. We have sought to close out our exposure

in this sector of the market since values of these assets may deteriorate rapidly, depending on the cost and availability of money. It is worth reflecting that whilst markets can take a long time to rise, they can reverse at a more alarming rate.

The value of prime property, by virtue of location, covenant or asset management opportunities, will remain stable. There remains a wall of money chasing a finite property supply. We have increasingly focused our portfolio towards assets with one or all of these characteristics.

As the capital markets plateau, the focus will once again turn to the income-related element of returns which involves the demand and supply balance in occupational markets. Encouragingly, 2006 saw rental growth contributing to returns, with offices doing notably well relative to retail and industrial property.

We feel that the Company's exposure to the office market is best achieved through its development business where we can, through new build and refurbishment projects, provide high quality accommodation which will have enhanced letting and performance prospects. We are uncertain as to whether the recovery in this sector will spread to Grade B and C quality buildings which form the bulk of investment grade stock.

Despite a softening retail sector, we remain focused within our investment portfolio on the

convenience shopping market, where consumer expenditure, by its nature, is more stable. The key component of the strategy is a food retail offer either within or adjoining the scheme. Since this is the one area of the retail market enjoying both volume and value growth, our focus remains on shopping centres which offer a combination of secure income and significant asset management opportunities compared to the traditional High Street, which we feel is more threatened. We have sold all of our remaining unit shop exposure during the course of 2006 except those assets with short-term value potential.

These various themes make the investment market difficult to predict. We therefore remain even more committed to our three key investment principles of sector rotation, stock selection and proactive management. Of these, we remain convinced that stock selection is the key to performance. In addition, we remain focused on releasing value from the assets we own.

In general, 2006 could be characterised as a year in which we reduced exposure to vulnerable assets, replenished our pipeline of opportunities and above all maximised value through our management activities. In total during 2006, we disposed of £45 million of property in eight transactions which included the Princess of Wales Centre, Dewsbury. The key to achieving future out-performance will be the intensive asset management of each holding and we believe, perhaps justified

\*Refer note 1 (p)

by our long term out-performance of the investment market, that we possess the requisite skills to achieve this

A remarkable £40 million of value was created over the year at The Furlong Centre, Ringwood where 2006 saw the continuation of our active strategy to take back units and re-let to aspirational retailers, thereby driving rental values further. Rental levels have broken through the £60 per sq. ft. Zone A level and we are hopeful of achieving in excess of £70 per sq. ft. Zone A with our next letting. In addition, the turnover provisions that we secured in some leases, based on our confidence in the trading potential of the Centre, are starting to generate additional income and should increase the rental levels to an effective £100 per sq. ft. So successful have we been in recent years, that we now have few units remaining with which to implement this strategy. Consequently, we have secured adjoining land for further phases of development at The Furlong Centre. The additional critical mass thus created will improve dwell times within the scheme and further improve the rental tone. This process of further land assembly is almost complete and we are hopeful of securing planning consent and commencing on site during 2007.

We continue a similar process at Thatcham where, during 2006, we also acquired adjoining land. Here again we hope to make a planning application shortly and are close to securing those final land acquisitions required for

implementation. We have been encouraged by the lettings achieved in 2006, which have seen rents improve by 11 per cent, and believe there is latent demand for the new space to be created.

At Swanley Shopping Centre, we intend to submit a planning application shortly for the comprehensive redevelopment of the entire scheme. Not only is a positive dialogue underway with the Local Authority and local interest groups, but pre-letting interest is encouraging us to maintain the initiative.

This retail development strategy coupled with a defensive investment strategy is an evolving area of our business in which we prefer to work in conjunction with smaller, specialist partners who assist in facilitating these opportunities. We have long recognised the need to ensure that we have a clear pipeline of opportunities that will deliver value whether or not the investment market continues its current strength. Sourcing these deals is the current challenge and we are pleased with our progress to date.

During the course of 2006, we acquired interests worth £4.3 million in two other schemes. In one, we are in advanced negotiations to pre-let a food store, with a favourable planning decision anticipated by mid-2007. The other project should provide medium-term pipeline product and, when considered alongside our projects at Ringwood, Thatcham and Swanley, is ample confirmation of an enviable stream of such projects.

Other asset management initiatives completed during 2006 included the restructuring of retail leases at Bexleyheath which contributed to the 23 per cent increase in the property's value. At our retail warehouse in Formby, we agreed with the tenant a surrender and re-grant of the occupational lease, which allowed us to agree a sale just before the year-end in a difficult market, thus removing a problematic covenant exposure from our balance sheet. Completion of this transaction occurred in February 2007.

Significant progress has been achieved at Peacock Place, Northampton, our joint venture shopping centre project with Capmark, acquired in December 2005. The refurbishment of the internal areas commenced in January 2007 and we are now starting to reposition and re-market the Centre to access latent demand within the town. Discussions are also ongoing with the major Centre occupiers to enlarge their holdings, thereby strengthening and re-anchoring the scheme.

We have completed the refurbishment of our vacant warehouse in Wigan, acquired early in 2006. Demand in the logistics market has been patchy, but we are beginning to see a resurgence in demand in the 100,000 sq. ft. size range as distributors look to acquire sub-regional facilities. In addition, there are tentative signs of demand from manufacturers seeking to upgrade facilities. We are optimistic that an occupier for the unit will be secured during 2007.

### Key performance indicators

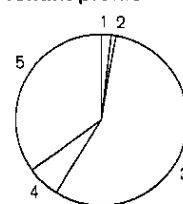
Since the business of property investment and development, especially that of Development Securities which has a considerable emphasis on development activity, can only properly be judged over a long period, probably a complete cycle, annual performance indicators are of less relevance in running our business. That said, Total Shareholder Return\* is a good guide to relative performance, but the importance of that measure needs to be moderated by both the risk profile which we are prepared to accept and the precise stage that has been reached in any cycle. Our compound Total Shareholder Return since January 2000, the date on which we would regard the present cycle to have commenced, is 18 per cent per annum. This compares to 21 per cent as similarly derived from the Real Estate sector index. One of the contributors to our comparative under-performance to date is the lower level of "gearing" with which Development Securities has operated over the current cycle. It is therefore perhaps not unexpected that the consequent reduction in exposure to volatility risk should lead to a lower actual and required level of returns. That said, we are of the view that the next stages of the current cycle should generate superior returns from development activity, rather than investment portfolios.

We also measure our overall investment portfolio performance against an appropriate IPD Index\* in order to assess relative performance of this asset class. In 2006, the total return generated from our investment portfolio was 18.5 per cent, compared to the IPD Index of 18.1 per cent. Over the last five years, our total return has been 19.0 per cent, as compared to 15.1 per cent of the IPD Index.

### Debt and equity structure

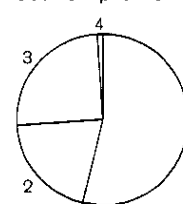
Our gearing continues to be low, at 6.2 per cent at 31 December 2006, compared to 16.9 per cent at the end of the previous year. Our gross debt totalled £102.9 million whilst we held £88.5 million of cash deposits. £6.9 million of those deposits were pledged as collateral to certain of our lenders. In November 2006, we issued 3.7 million Ordinary shares by way of a placing, raising gross proceeds of £23.1 million. These proceeds were principally used to fund the acquisition of the Curzon Park site in Birmingham. We continue to earmark a significant proportion of our cash balances to identified projects on which we are presently engaged and would expect our gearing levels to increase during 2007 if we are successful in securing all of the projects for which we are now in negotiation.

### Tenant profile



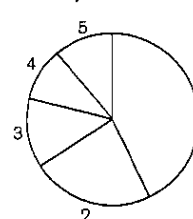
1 Government	2%
2 FTSE 100	1%
3 PLC/nationals	56%
4 Regional multiples	6%
5 Local traders	35%

### Location profile



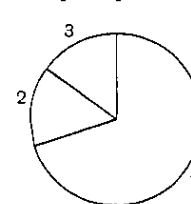
1 South East	54%
2 North	20%
3 London	25%
4 South West	1%

### Lease profile



1 0-5 years	43%
2 5-10 years	23%
3 10-15 years	13%
4 15-20 years	10%
5 20 years+	11%

### Analysis by sector



1 Retail	70%
2 Industrial	15%
3 Office	15%

As at 28th February 2007

\*Refer note 1(p)



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# Sustainability report

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## **We believe that maintaining our long-term financial performance depends on our corporate reputation**

Therefore, the social, economic and environmental impacts of our business are crucial to overall success. Our sustainability programme is developed in conjunction with our advisors, Faber Maunsell, and our activities are internally reviewed on an annual basis.

### **Principal objectives**

#### **Corporate**

- Complying, as a minimum benchmark, with all relevant legislation and working towards good practice in sustainability
- Seeking continuous improvement in performance and reporting progress on a regular basis
- Communicating our progress both internally and externally

#### **Urban regeneration**

- Seeking to enrich and improve communities
- As part of a mixed portfolio, develop mixed-use projects contributing to and creating diverse and balanced communities
- Developing relationships with and engaging with local stakeholders on our approach to sustainability

#### **Youth and education**

- Sponsoring and supporting youth programmes
- Co-operating in educational initiatives to improve skills and training

#### **The environment**

- Controlling and managing waste on our developments.
- Reducing energy and water consumption in our investment properties and development sites
- Continue devising travel to work plans for our developments

#### **Health & safety**

- Implementing our Health & Safety policy, thereby ensuring the health and safety of our employees and visitors
- Through liaison with contractors applying best practice procedures on our development sites

#### **The arts**

- Sponsoring and supporting project-related initiatives

#### **The property industry**

- Contributing through debate and sponsorship to the better working of the industry

Our sustainability targets can be found on our website [www.developmentsecurities.com](http://www.developmentsecurities.com)

The following describes a few of the key achievements this year

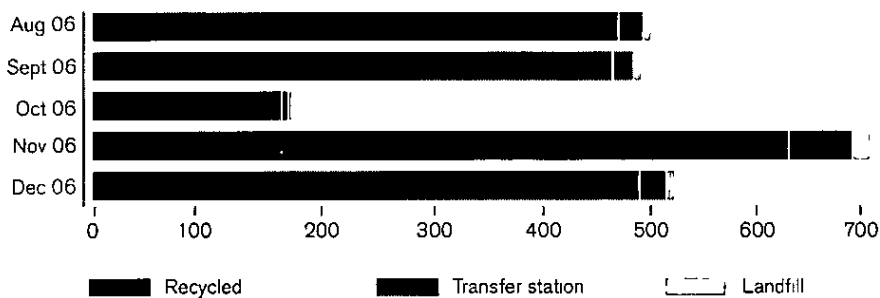
#### **Environment**

During 2006, environmental concerns and issues of social cohesion attained an ever higher profile. Our industry has been affected by these concerns. In particular, in the course of 2006, the issue of carbon emissions became a much higher priority for the occupier market, as well as for society at

large. For our industry, this means a step change, a responsible approach to CO2 emission reduction now leads directly to commercial competitive advantage. Once again new construction at PaddingtonCentral has achieved an Excellent BREEAM rating, the world's most widely used environmental assessment method for buildings. As reported last year, we are focusing more closely on one particular issue of concern to our industry, namely the control and management of waste generated by the construction process. At One Kingdom Street, Paddington our contractor, Skanska, reports that as a result of our combined initiatives, 97 per cent of waste generated at PaddingtonCentral has been recycled from site, with a further 2.7 per cent being sent to a transfer station for further recycling. This means that only 0.3 per cent of the waste from this site has gone to landfill (see figure 1 opposite).

Highlights this year also include the provision of land at Broughton to create a 10-acre nature reserve adjacent to our development sites, the continuing management of green travel plans at the Royal Docks, London and Cambourne, Cambridge, and the use of innovative piling and bore hole technology in our latest hotel and office buildings at PaddingtonCentral.

**Figure 1 – Total site waste at PaddingtonCentral (m³)**



#### Urban regeneration

Three of our projects rate a particular mention in relation to urban regeneration in 2006

- Oriental City, 399 Edgware Road, Colindale, London, NW This mixed-use scheme on an unexceptional part of the Edgware Road will combine Chinese and other Far Eastern community uses, retail and 500 new housing units. Development Securities will also develop its first school, to accommodate 420 pupils
- Curzon Park, Birmingham 1.4 million sq ft of offices and apartments is planned for this run-down area where we are working with Birmingham City Council's broad regeneration objectives, which include the provision of a significant new public park.

- Broughton, Flintshire We continue to work with Flintshire District Council to provide better transport links and infrastructure for the community as well as affordable housing

#### Youth and education

We were delighted to continue to support the Ascension Eagles, a cheerleading team from East London, who are also British Champions. We were happy to support this ambitious undertaking which promotes fitness and social interaction among young people in Newham.

We were also able to work with Richard House Children's Hospice, organising with them a float for the Lord Mayor's Show.

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# Board of Directors

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## **Executive Directors**

### **Michael Marx (Aged 59)**

Chief Executive and Finance Director  
Appointed to the Board in September 1994  
A Fellow of the Institute of Chartered Accountants in England and Wales and a Member of the UK Listing Authority Advisory Committee 2004 to 2007. Non-executive Chairman of Nationwide Accident Repair Services PLC

### **Julian Barwick (Aged 53)**

A Fellow of the Royal Institution of Chartered Surveyors. Joined the Board in May 1998. Formerly property advisor to the Bedford Estate from 1997 to 2003, Chairman of the Paddington Regeneration Partnership from 2000 to 2002 and Board Member of the British Council for Offices. Appointed to the Board of London & Continental Railways Limited in 2005.

### **Matthew Weiner (Aged 36)**

Appointed in March 2004. A Member of the Royal Institution of Chartered Surveyors. Joined Development Securities PLC in November 2000 as Director of Investments. A member of the University of Reading Real Estate Advisory Board and Trustee of the Manor House Trust.

## **Chairman and Non-executive Directors**

### **Roy Dantzic (Aged 62)**

Appointed Chairman in September 2003. Joined the Board as a Non-executive Director in May 2003. A member of the Institute of Chartered Accountants of Scotland. After spending the early part of his career in the City, joined the Board of Stanhope Properties PLC in 1989. Was Managing Director of British Gas Properties from 1996 to 2003. Is Non-executive Chairman of Interior Services Group PLC, Non-executive Director of Airplanes Limited and Blenheim Bishop Limited, a Council Member of the Architectural Heritage Fund, a Trustee of the Portman Estate and a former Member of the Government's Property Advisory Group.

### **David Jenkins (Aged 62)**

Appointed in February 2007. A Fellow of the Institute of Chartered Accountants in England and Wales. Previously a partner in Deloitte & Touche LLP, London and was Managing Partner of their Real Estate Practice until his retirement in May 2004. A Director of MITIE Group PLC and Renewable Energy Systems Limited. He is also advisor to several companies and is a Governor of Downe House School.

### **Paul Manduca (Aged 55)**

Appointed in August 2001. Former Chief Executive Officer of Deutsche Asset Management Europe until the end of March 2005 and a former Director of MEPC PLC. Currently Non-executive Chairman of Bridgwell Group PLC and a Director of Wm Morrison Supermarkets PLC, AON UK Limited, JPMF Euro Fledgling Investment Trust PLC, KazMunaiGaz E&P and other companies.

### **Victoria Mitchell (Aged 56)**

Appointed in August 2002. Currently Consultant Director to Savills PLC, Non-executive Director of The Berkeley Group Holdings PLC and The Golding Group (South Africa). Member of ING REIM Residential Property Fund Advisory Board. Trustee and Director of The Landmark Trust. Formerly an Executive Director of Savills PLC from 1988 to 2000.

### **Michael Soames (Aged 56)**

Appointed in August 2002. The Surveyor to The Mercers' Company and previously Group Corporate Development Director of Regus PLC and partner of Knight Frank. A Non-executive Director of the ISIS Property Trust Limited. A Fellow of the Royal Institution of Chartered Surveyors and past President of the British Council for Offices.

# Report of the Directors

## The Directors present their annual report and the financial statements of the Group for the year ended 31st December 2006

### Principal activities

The principal activities of the Group during the year were property development, investment and trading

### Business review

A review of the Group's operations, the current state of the business and future prospects are contained in the Chairman's statement and Review of operations and should be read in conjunction with this report. The information which comprises the Business review as required by Section 234ZZB of the Companies Act 1985 may be found in the Review of operations on pages 12 to 20 and in the Sustainability report on pages 22 and 23

### Results and dividends

The profit for the financial year attributable to shareholders amounted to £23,559,000 (2005 £20,090,000). An interim Ordinary dividend of £828,000 representing 2.25 pence per Ordinary share was paid on 26th October 2006 (2005 £778,000, representing 2.12 pence per Ordinary share). The Board recommends a final Ordinary dividend of 4.50 pence per Ordinary share amounting to £1,832,000 be payable on 6th July 2007 to shareholders on the register at 8th June 2007 (2005 £1,562,000 representing 4.25 pence per Ordinary share).

### Group structure

Details of principal subsidiary undertakings are disclosed on page 50

### Share capital

On 29th November 2006, 3,700,000 Ordinary shares were allotted following Placing at 625 pence per Ordinary share, raising gross proceeds of £23,125,000 principally to fund the Company's share of the consideration payable for the purchase of a 1.4 million sq. ft site at Curzon Park, Birmingham in an equal joint venture with Grainger PLC.

Three resolutions relating to share capital will be proposed as Special Business at the forthcoming Annual General Meeting. The full text of the resolutions can be found in the enclosed Notice of Annual General Meeting.

**Special Resolution 8** The current authority for the Company to purchase its own shares expires at the conclusion of the forthcoming Annual General Meeting. A special resolution is to be proposed at the Annual General Meeting to authorise the repurchase of up to 6,066,000 Ordinary 50 pence shares, representing approximately 14.9 per cent of the Company's issued share capital. The Directors have no present intention of making any market purchases of the Company's shares, but if they considered such action would enhance net assets or earnings per share, they would consider exercising this authority. As at the date of this report, the Company has an unexpired authority to repurchase 5,473,000 Ordinary shares.

**Ordinary Resolution 9** The Directors will seek authority to allot relevant securities pursuant to Section 80 of the Companies Act 1985 up to a maximum aggregate nominal value of £7,058,999 being equal to one-third of the issued Ordinary share capital of the

Company, together with the number of share options outstanding.

**Special Resolution 10** The Directors seek authority to renew the disapplication of shareholders' pre-emptive rights under Section 89 of the Companies Act 1985 up to an aggregate nominal value of £1,017,791 being equal to 5.0 per cent of the issued Ordinary share capital of the Company. In the event that it is used, no more than 7.5 per cent of the issued share capital will be issued on a non pre-emptive basis in any three-year period.

### Share option schemes

During the year, options over 40,000 shares were granted under the Executive Share Option Plan 2005 and 25,368 options under the Company's Save As You Earn Option Plan 2005. Further details of the Share Option Schemes are contained on page 56 and in the Remuneration report on pages 68 to 75.

### Directors

The Directors serving during the year were as follows:

Roy Dantzig	William Grant – resigned
Michael Marx	11th May 2006
Julian Barwick	Paul Manduca
Matthew Weiner	Paul Willis – resigned
Victoria Mitchell	6th March 2007
Michael Soames	

David Jenkins was appointed to the Board as a Non-executive Director on 1st February 2007. Roy Dantzig, who joined the Board on 21st May 2003 and was elected Chairman on 17th September 2003 has resolved to stand down at the 2007 Annual General

Meeting David Jenkins will be appointed Chairman as from this date, provided he is elected at the Annual General Meeting. The Directors retiring by rotation at the Annual General Meeting are Michael Marx and Matthew Weiner, who being eligible, offer themselves for re-election.

#### **Directors' service contracts and interests in the Company's shares**

The unexpired period of Directors' service contracts and the interests of the Directors who were in office as at 31st December 2006 are fully disclosed in the Remuneration report on pages 68 to 75.

#### **Directors' and officers' liability insurance**

The Company maintains Directors' and officers' liability insurance, which is reviewed annually and is considered to be adequately insured.

#### **Other substantial interests**

At the date of this report, the Directors have been notified of the following interests in 30 per cent or more of the Company's issued share capital:

#### **Financial risk management**

Disclosures in respect of financial risk management objectives and exposures are set out in note 16 on page 53 and 54.

#### **Charitable and political donations**

Charitable donations during the year, principally to local charities serving the communities in which the Group operates, were £26,100 (2005: £24,800). No political donations were made during the year (2005: £Nil).

#### **Disabled employees**

It is the Group's policy to encourage good employment practices with regard to the disabled in accordance with Government recommended guidelines.

#### **Payment policy**

Amounts due to suppliers are settled promptly within their terms of payment, except in cases of dispute. The number of creditor days outstanding for the Company at 31st December 2006 was two days (2005: one day).

#### **Auditors**

A resolution to appoint Ernst & Young LLP as the Company's auditors will be proposed at the forthcoming Annual General Meeting.

#### **Disclosure of information to auditors**

Each Director has confirmed that:

- 1 So far as he/she is aware, there is no relevant audit information of which the Group's auditors are unaware, and,
- 2 He/she has taken all the steps that he/she ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Group's auditors are aware of that information.

This confirmation is given in accordance with Section 234ZA of the Companies Act 1985.

Approved by the Board of Directors

Signed on its behalf by

S A Lanes

Secretary

30th March 2007

	Number of shares	%
F & C Asset Management PLC	4,494,071	11.04
Aberdeen Asset Management PLC	3,194,000	7.85
BT Pension Scheme Trustees Limited as trustee of the BT pension scheme	2,241,370	5.50
Standard Life Group PLC	2,148,613	5.28
Legal & General Group PLC	1,423,795	3.49
Prudential PLC Group of Companies	1,401,086	3.44
Stichting Pensioenfonds ABP	1,305,000	3.21

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# Corporate governance

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**The Company complied throughout the financial year with the code provisions set out in Section 1 of the June 2006 FRC Combined Code on Corporate Governance, except that with effect from 8th December 2005, no member of the Audit Committee is considered to have recent and relevant financial experience as required under code provision C 3.1**

## The Board

The Board discusses and makes decisions relating to, but not limited to, strategy, executive performance and retention, remuneration and succession, financial performance, development opportunities, investment portfolio acquisitions and disposals, corporate reputation and communication, internal control and risk management and the Board's own effectiveness. It delegates certain defined tasks and responsibilities both to its various Committees, which report to the Board, and to individual Executive Directors.

The Board, which met 11 times during the year, currently consists of the five Non-executive Directors, each of whom is considered to be independent, and three Executive Directors. One of the Board meetings was specifically reserved to consider corporate strategy and two were held to consider the Placing.

All Directors have access to the services of the Company Secretary and may seek independent professional advice, as necessary, at the Company's expense and subject to the consent of the Chairman. Upon election, or re-election, Non-executives are invited to serve for three-year fixed terms. Their terms of appointment are available from the Company Secretary. Directors may receive appropriate training on introduction and whilst in office. W Grant remained as the Senior Independent Director until his stepping down as a Director on 11th May 2006, whereupon he was replaced in the role by P V S Manduca.

The Chairman and the Non-executive Directors met on one occasion during the year with no Executive Directors in attendance. In addition, the Senior Independent Director also met on one occasion with the Non-executive Directors, without the Chairman or Executive Directors present, to consider inter alia the appraisal of the Chairman's performance.

The Board has undertaken a performance evaluation of the Board itself, each of its Committees and of its individual Directors. This was conducted by questionnaire co-ordinated by the Company Secretary. The overall conclusions were considered by the Board and areas of significance have been addressed. The Non-executive Directors, led by the Senior

Independent Director separately considered the performance evaluation of the Chairman, taking account of the views of the Executive Directors.

The Board has established a number of Standing Committees:

- The Audit Committee comprises P V S Manduca as Chairman and V M Mitchell. Neither of the present members of the Committee are considered to have recent and relevant financial experience.
- The Nomination Committee comprises R M Dantzie as Chairman, P V S Manduca and M H Marx. If elected as a Director at the forthcoming Annual General Meeting, D S Jenkins will assume the role as Chairman of the Committee following R M Dantzie's stepping down as a Director.
- The Remuneration Committee comprises M S Soames as Chairman and V M Mitchell. W Grant was Chairman of the Committee until 11th May 2006. The Committee is authorised to determine remuneration policy, including the exercise of powers to grant options under the Group's option schemes to the Executive Directors and senior management and to determine the annual bonus, awards under the Development Profit Plan and the Development Securities PLC Investment Growth Plan 2006, ad hoc bonuses for

exceptional contributions and awards under the Development Securities PLC Performance Share Plan 2006. The Remuneration report to shareholders can be found on pages 68 to 75.

- The Approvals Committee comprises M H Marx, C J Barwick and a minimum of any two Non-executive Directors. Its remit is to permit the approval of certain transactions between £2 million and £5 million, which are then reported to the Board at its next meeting. Those transactions below this level are delegated to the relevant Executive Directors responsible. The terms of reference of the Audit, Nomination and Remuneration Committees, as determined by the Board, are available upon request from the Company Secretary and are also published on the Company's website [www.developmentsecurities.com](http://www.developmentsecurities.com).

Details of the Non-executive Director service contracts are detailed in note (i) of the Remuneration report on page 72.

#### **Audit Committee**

The Audit Committee is responsible, inter alia, for recommending the appointment of the external auditors, the Group's accounting policies, and monitors the treatment of areas

of major judgement in the Group's financial statements. Furthermore, it acts as a conduit between the Board and the external auditors.

As a minimum, the Audit Committee meets three times during each financial period, of which one meeting is to determine the terms of engagement, proposed programme and fees payable to the auditors for the annual audit. The other meetings take place prior to the issue of the preliminary full-year results and interim results, in order to consider any significant issues arising from the audit and review processes.

Following a thorough market testing of three major firms of accountants, Ernst & Young LLP was selected by the Audit Committee as the new auditor in place of Deloitte & Touche LLP, which had audited the Company since 1993. The appointment of Ernst & Young LLP was subsequently ratified by the Board. A further meeting of the Audit Committee was held during the year to consider the technical issues associated with IFRS.

Apart from conducting the annual audit, Ernst & Young LLP was also engaged during the year to conduct a review of the interim results to 30th June 2006. Due to the limited scope of these additional activities, and not being

engaged in providing tax advisory, compliance or planning services, the auditors' objectivity and independence is not considered to be impaired.

In forming its opinion of the independence, objectivity and effectiveness of the external auditors, the Audit Committee takes into account the safeguards operating within Ernst & Young LLP. Regard is given to the nature of remuneration received for other services provided by Ernst & Young LLP to the Company and, inter alia, confirmation is sought from them that the fee payable for the annual audit is adequate to enable them to fulfil their obligations in accordance with the scope of the audit.

#### **Nomination Committee**

The Nomination Committee's principal role is to evaluate the structure, size and composition of the Board, preparing a succession plan for the appointment of members, both Executive and Non-executive, which is then fulfilled through an effective search, interview and evaluation process.

The Nomination Committee did not meet during the year. However, at a meeting held in February 2007, the principal issues were the appointment of David Jenkins as a Non-executive Director and acknowledgment of the stepping down of Roy Dantzig, as Chairman.

#### Relations with shareholders

The Executive Directors have regular dialogue with institutional shareholders. The Company has notified the 20 principal institutional shareholders that the Chairman, the Senior Independent Director or any of the Non-executive Directors are available at any time to meet with them. The Company's Annual General Meeting provides an opportunity to respond to shareholders' appropriate questions. Directors are introduced to shareholders at the Annual General Meeting, including the identification of Non-executives and Committee Chairmen.

#### Internal control

The Directors acknowledge their responsibility for the Group's system of internal control and for reviewing its effectiveness. The risk review process is designed to manage, rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable and not absolute assurance against material misstatement or loss.

The Board has conducted a thorough risk assessment of the business, identifying risks, their potential impact, likelihood of occurrence, controls and mitigating actions, together with early warning systems and further actions which need to be implemented.

The regular process of identifying, evaluating and managing significant risks has been delegated by the Board to a Risk Committee, consisting of M H Marx as Chairman, C J Barwick, M S Weiner and two Executives, R C McCubbine and C Christofi. R C McCubbine replaced R H Pearse on

the Committee on 20th June 2006. The Committee meets quarterly during the year to ensure that the risk control procedures are further embedded within the culture of the Company. The minutes of the Committee's deliberations are reviewed by the Board.

A 'whistleblowing policy' has been prepared and issued to all staff in the Group, outlining arrangements by which they may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters.

The Board has adopted a schedule of matters reserved for its decision, which includes the level of individual transactions which are approved by the Board and those which may be delegated. The roles and remit of the Chairman, Chief Executive and the Executive Directors are set out in writing and agreed by the Board.

The Board, following a recommendation from the Audit Committee, has considered the need for an internal audit function, but has resolved that, due to the size of the Company and the risk review process evident through the Risk Committee, this cannot be justified at present. The Board will review this decision next year.

The Board has conducted a review of the effectiveness of the system of internal control for the year ended 31st December 2006 and to the date of this report and considers that there is an ongoing process for identifying, evaluating and managing the Group's significant

risks including financial, operational and compliance controls and a risk management system, that it has been in place for the year ended 31st December 2006 and up to the date of approval of these financial statements, that it is regularly reviewed by the Board and that it accords with the Financial Reporting Council Internal Control Revised Guidance for Directors on the Combined Code dated October 2005.

#### Going concern

The Directors, having made enquiries, have a reasonable expectation that the Company and the Group have adequate resources to continue in operation for the foreseeable future, and that it is appropriate to adopt the going concern basis in preparing the financial statements. This statement also forms part of the Review of operations on pages 12 to 20.

#### Statement of Directors' responsibilities in respect of the Annual Report and the financial statements

The Directors are responsible for preparing the Annual Report, including the Directors' report, and the Group and Parent Company financial statements in accordance with applicable United Kingdom law and regulations.

The Directors are required to prepare Group financial statements for each financial year in accordance with International Financial Reporting Standards as adopted by the European Union, which present fairly the financial position of the Group and the financial performance and cash flows of the



The following table identifies the attendance of the Directors at the meetings of the Board and the Audit, Nomination and Remuneration Committees held during 2006

	Board	Audit Committee	Nomination Committee	Remuneration Committee
Number of meetings	11	5	0	5
R M Dantzic	10		0	
M H Marx	11		0	
C J Barwick	11			
P J Willis	11			
M S Weiner	11			
W Grant – resigned 11th May 2006	4			2
P V S Manduca	10	5	0	
M S Soames	11			5
V M Mitchell	10	5		4

Group for that period. In preparing those Group financial statements, the Directors are required to

- select suitable accounting policies in accordance with IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' and then apply them consistently,
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information,
- provide additional disclosures when compliance with the specific requirements of IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's financial position and financial performance, and
- state that the Company has complied with

IFRSs, subject to any material departures disclosed and explained in the financial statements

Under United Kingdom company law the Directors have elected to prepare the Parent Company financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), which are required by law to give a true and fair view of the state of affairs of the Parent Company and of the profit or loss of the Parent Company for that period. In preparing the Parent Company financial statements, the Directors are required to

- select suitable accounting policies and then apply them consistently,

- make judgements and estimates that are reasonable and prudent,
- state whether applicable United Kingdom accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements, and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Group and the Company and enable them to ensure that the financial statements comply with the Companies Act 1985 and Article 4 of the IAS regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the system of internal control and for the prevention and detection of fraud and other irregularities.

By order of the Board  
S A Lanes  
Secretary  
30th March 2007

## **Contents of the financial statements**

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## Group independent auditors' report

### Independent auditors' report to the members of Development Securities PLC

We have audited the group financial statements of Development Securities PLC for the year ended 31st December 2006 which comprise the Group Income Statement, the Group Balance Sheet, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expense and the related notes 1 to 24. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of Development Securities PLC for the year ended 31st December 2006 and on the information in the Directors' Remuneration Report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

### Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view and whether the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you whether in our opinion the information given in the Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Review of Operations and Sustainability report that is cross referred from the Business Review section of the Directors' report.

In addition we report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Director's remuneration and other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial

Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Directors' Report, the Chairman's Statement, the Review of operations and the Corporate Governance Statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

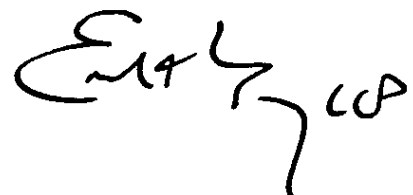
We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

### Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31st December 2006 and of its profit for the year then ended,
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation, and
- the information given in the Directors' report is consistent with the Group financial statements.

Ernst & Young LLP  
Registered Auditor  
London  
30th March 2007



**Consolidated income statement**  
For the year ended 31st December 2006

**Continuing operations**

	Notes	2006 £'000	2005 restated £'000
<b>Revenue</b>	3	<b>48,727</b>	25,468
Direct costs	3	(32,776)	(15,218)
<b>Gross profit</b>	3	<b>15,951</b>	10,250
Operating costs	3	(10,257)	(10,538)
(Loss)/gain on disposal of investment properties	3	(97)	3,728
Gain on revaluation of property portfolio	11	21,821	18,028
Deficit on revaluation of operating properties	10	(475)	(174)
<b>Operating profit</b>	4	<b>26,943</b>	21,294
Share of results of associates and joint ventures	12	151	1,453
Income from financial assets		63	149
Profit on disposal of investments	2	-	5,759
<b>Profit before interest and taxation</b>	3	<b>27,157</b>	28,655
Finance income	6	2,954	2,262
Finance costs	6	(7,321)	(7,667)
<b>Profit before taxation</b>		<b>22,790</b>	23,250
Taxation	7	769	(3,160)
<b>Profit after taxation attributable to equity shareholders of the parent</b>		<b>23,559</b>	20,090
<b>Basic earnings per share</b>	9	<b>63.4p</b>	54.8p
<b>Diluted earnings per share</b>	9	<b>63.0p</b>	54.5p

\*Refer to note 1(q)

# **Consolidated balance sheet**

As at 31st December 2006

	Notes	2006 £'000	2006 £'000	2005 restated £'000
<b>Non-current assets</b>				
Property, plant and equipment				
– Operating properties	10	8,090		9,000
– Other property, plant and equipment	10	3,618		3,776
Investment properties	11	139,461		159,568
Financial assets	12	5,881		755
Investments in joint ventures	12	20,464		–
Investments in associates	12	673		1,165
Trade and other receivables	14	1,468		1,420
Deferred tax assets	17	5,619		4,387
			<b>185,274</b>	<b>180,071</b>
<b>Investment property – held for sale</b>	11		<b>5,299</b>	<b>–</b>
<b>Current assets</b>				
Inventory - developments and trading properties	13	74,663		56,479
Trade and other receivables	14	10,014		9,677
Cash and short-term deposits		88,536		73,094
			<b>173,213</b>	<b>139,250</b>
<b>Total assets</b>			<b>363,786</b>	<b>319,321</b>
<b>Current liabilities</b>				
Trade and other payables	15	(16,747)		(15,014)
Financial liabilities	16	(15,515)		(6,204)
			<b>(32,262)</b>	<b>(21,218)</b>
<b>Non-current liabilities</b>				
Financial liabilities	16	(87,419)		(98,632)
Deferred tax liabilities	17	(11,637)		(10,434)
Provisions	15	(1,055)		(1,529)
			<b>(100,111)</b>	<b>(110,595)</b>
<b>Total liabilities</b>			<b>(132,373)</b>	<b>(131,813)</b>
<b>Net assets</b>			<b>231,413</b>	<b>187,508</b>
<b>Equity</b>				
Share capital	18	20,356		18,361
Share premium	19	108,850		87,635
Revaluation reserve	19	853		335
Other reserves	19	45,793		45,793
Retained earnings	19	55,561		35,384
<b>Equity attributable to equity shareholders of the parent</b>			<b>231,413</b>	<b>187,508</b>
Basic net assets per share	9		<b>568p</b>	<b>510p</b>
Diluted net assets per share	9		<b>565p</b>	<b>507p</b>

Approved and authorised for issue by the Board of Directors on 30th March 2007 and signed on its behalf by

M H Marx  
Director



\* Refer note 1(q)

### Consolidated statement of recognised income and expense

For the year ended 31st December 2006

	2006 £'000	2005 restated £'000
Gains on revaluation of operating properties	518	321
Deferred tax (refer note 1(q))	(992)	(2,600)
<b>Net loss recognised directly in equity</b>	<b>(474)</b>	<b>(2,279)</b>
Profit for the period	23,559	20,090
<b>Total recognised income for the period attributable to equity shareholders of the parent</b>	<b>23,085</b>	<b>17,811</b>
<b>Impact of adoption of IAS32 and IAS39 at 1st January 2005</b>	<b>-</b>	<b>15</b>

### Consolidated cash flow statement

For the year ended 31st December 2006

	Notes	2006 £'000	2005 £'000
<b>Net cash flow from operating activities</b>	20	<b>(17,977)</b>	<b>(32,261)</b>
<b>Investing activities</b>			
Interest received		3,057	2,170
Dividends received from associated undertaking		-	149
Proceeds from sale of shares in associated undertaking		-	13,396
Proceeds from redemption of preference shares held in associated undertaking		-	1,500
Proceeds on disposal of property, plant and equipment		33	-
Proceeds on disposal of investment properties		45,076	30,078
Purchase of property, plant and equipment		(1,547)	(876)
Investment in participating loan		(5,000)	-
Purchase of investment properties		(6,928)	(11,945)
Purchase of investments		(20,190)	(1,165)
<b>Net cash from investing activities</b>		<b>14,501</b>	<b>33,307</b>
<b>Financing activities</b>			
Dividends paid		(2,390)	(2,245)
Issue of new shares		23,210	245
Repayments of borrowings		(18,729)	(5,169)
New bank loans raised		11,973	25,830
Increase/(decrease) in bank overdrafts		4,854	(379)
<b>Net cash from financing activities</b>		<b>18,918</b>	<b>18,282</b>
<b>Net increase in short-term deposits</b>		<b>15,442</b>	<b>19,328</b>
Cash and short-term deposits at the beginning of the year		73,094	53,766
<b>Cash and short-term deposits at the end of the year</b>		<b>88,536</b>	<b>73,094</b>

### Cash and cash equivalents comprise

Cash and short-term deposits excluding pledged cash	81,588	48,351
Pledged cash held as security against financial liabilities	6,948	24,743
<b>Cash and short-term deposits at the end of the year</b>	<b>88,536</b>	<b>73,094</b>
Bank overdrafts	(5,929)	(1,075)
<b>Cash and cash equivalents</b>	<b>82,607</b>	<b>72,019</b>

Refer note 1(q)

## Notes to the consolidated financial statements

For the year ended 31st December 2006

### 1 ACCOUNTING POLICIES

#### a) Basis of accounting

The Group's financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the European Union as they apply to the financial statements of the Group for the year ended 31st December 2006 and applied in accordance with the Companies Act 1985. The accounting policies which follow set out those policies which apply in preparing the financial statements for the year ended 31st December 2006 and 31st December 2005.

The accounts were approved by the Directors for issue on 30th March 2007. The preparation of financial statements in accordance with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

The key areas where such judgements are made are in the valuation of the investment, development and trading property portfolios and the recognition of development revenues and profits. The recognition of development revenues is described in note 1(c) below. In making its judgement, management has considered the detailed criteria set out in IAS 11 'Construction contracts' and IAS 18 'Revenue'. Determining development revenues and profits requires an estimate of development costs, construction progress and letting activity. The accounting policies in respect of the valuation of the property portfolio are set out in note 1(e) and 1(f) below. Key judgements relating to such valuations include estimates of future rental income and yields.

The Group financial statements are presented in Sterling and all values are rounded to the nearest thousand pounds (£'000) except when otherwise stated.

IASB and IFRIC have issued new standards and interpretations with an effective date after the date of these financial statements. The standards and interpretations considered to be relevant by the Directors are:

International Accounting Standards (IAS/IFRSs)		Effective date
IFRS 7	Financial Instruments: Disclosures	1 January 2007
IFRS 8	Operating Segments	1 January 2009
IAS 1	Amendment – Presentation of Financial Statements: Capital Disclosures	1 January 2007

International Financial Reporting Interpretations Committee (IFRIC)

IFRIC 8	Scope of IFRS 2	1 May 2006
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The Directors do not anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

Upon adoption of IFRS 7, the Group will have to disclose additional information about its financial instruments, their significance and the nature and extent of risks that they give rise to, including the fair value of its financial instruments and its risk exposure in greater detail. There will be no effect on reported income or net assets.

#### b) Basis of consolidation

- i) The consolidated financial statements of the Group include the financial statements of Development Securities PLC ('the Company'), its subsidiaries and the Group's share of profits and losses and net assets of jointly controlled entities and associated undertakings.

Where necessary, adjustments have been made to the financial statements of subsidiaries, associates and jointly controlled entities to bring the accounting policies used and accounting periods into line with those used by the Group.

Intra-group balances and any unrealised gains and losses arising from intra-group transactions are eliminated in preparing the consolidated financial statements.

- ii) The results of subsidiaries acquired during the year are included from the effective date of acquisition, being the date on which the Group obtains control. Business combinations are accounted for under the acquisition method. Any excess of the purchase price of the business combination over the fair value of the assets and liabilities acquired is recognised as goodwill. Any discount received is credited to the income statement in the period of acquisition.

## 1 ACCOUNTING POLICIES continued

### c) Revenue

Revenue, which excludes value added tax, represents

- i) the sales proceeds of trading properties, undeveloped land and building units held as inventory and sold during the year, which are recognised on completion,
- ii) rental income is calculated on a straight line basis, and excludes sales of investment properties. Any incentives for lessees to enter into lease agreements are spread evenly over the periods to the earlier of lease expiry and any tenant option to break, where that option is expected to be exercised,
- iii) trading income from operating properties is calculated on a straight line basis and comprises licence fee income and revenue from other services provided,
- iv) development revenue and profits are recognised in accordance with the terms of development agreements where applicable and in accordance with IAS 11 'Construction contracts' and IAS 18 'Revenue' so as to match the proportion of development work completed. Profits are only recognised where the development is sufficiently complete and the outcome can be determined with reasonable certainty. Full provision is made for foreseeable losses as soon as such losses are identified,
- v) project management fee income is recognised on a straight line basis over the term for which project management services are provided as the Group's fair estimate of the value of work completed,
- vi) finance income is recognised by reference to the principal outstanding and prevailing interest rate applicable, and
- vii) dividend income from investments is recognised when the Group's right to receive income has been established

### d) Associates and jointly controlled entities

An associated company is defined as an undertaking other than a subsidiary or jointly controlled entity in which the Group holds a long-term interest and has the power to exercise significant influence. The Group's investments in associates are accounted for in the consolidated financial statements using the equity method. The Group's share of the profits and losses of associated undertakings are shown in the consolidated income statement while the Group's share of the net assets of associated undertakings is shown in the consolidated balance sheet. The Group does not equity account for further losses from investments in associated companies where the investment is held at nil value after provisions for impairment.

A jointly controlled entity is defined as an undertaking other than a subsidiary or associated undertaking in which the Group has the power to exercise significant influence and which is jointly controlled by two or more venturers under a contractual arrangement. The Group's share of the post-acquisition results of jointly controlled entities is shown in the consolidated income statement. Investments in jointly controlled entities are included in the consolidated balance sheet at cost plus the appropriate share of post-acquisition results and reserves less provisions for any impairment.

### e) Investment properties

- i) Investment properties are those properties that are held either to earn rental income or for capital appreciation or both. Investment properties may be freehold or leasehold properties. For leasehold properties that are classified as investment properties, the associated leasehold obligations are accounted for as finance lease obligations.
- ii) Investment properties are revalued each year on the basis of Market Value, unless the market value cannot be reliably estimated, in which case the assets are carried at cost. Surpluses and deficits arising are recognised in the consolidated income statement for the period.
- iii) Profits and losses on disposal of investment properties are calculated by reference to book value and recognised on completion.
- iv) Investment properties in the course of development are accounted for as investment properties, where these properties have previously been classified as investment assets.
- v) Investment property held for sale is carried at fair value less selling costs.

### f) Property, plant and equipment

#### i) Operating properties

Operating properties are those properties classified as owner-occupied and held for business purposes rather than for investment, generating revenue by way of licence fees and ancillary services. These properties are revalued each year by independent, professional valuers on the basis of Existing Use Value. Surpluses and deficits in the period are included in a Revaluation reserve, except where carrying value is below depreciated cost, in which case surpluses and deficits are included in the Consolidated income statement. Depreciation is provided so as to write off the value of the properties, excluding land, over their expected useful lives.

#### ii) Other property, plant and equipment

Other non-current assets are held at cost less accumulated depreciation and any provision for impairment. Depreciation is provided so as to write off the cost less estimated residual value of the assets over their expected useful lives. The principal annual rates used for this purpose are as follows:

Fixtures and fittings	– 10% to 33%
Motor vehicles	– 20%

### g) Leases

Rental payments under operating leases are charged on a straight-line basis over the term of the lease even if the payments are not made on such a basis.



#### **h) Inventory – developments in progress and trading properties**

Developments and properties held as trading assets, are valued at the lower of cost and estimated net realisable value. The cost of property developments including net outgoings and attributable interest are accumulated in Inventory, up to the date of completion. Costs arising from development activity are capitalised from commencement of active development until cessation of such activity.

#### **i) Taxation**

Current tax is the expected tax payable on the taxable income for the year, using tax rates applicable at the balance sheet date, together with any adjustment in respect of previous years.

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

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted at the balance sheet date. Income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

#### **j) Financial assets and financial liabilities**

Financial assets and Financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual terms of the instrument.

- i) Trade and other receivables are recognised initially at fair value and subsequently at amortised cost. A provision for estimated irrecoverable amounts of trade receivables is established where there is evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables concerned,
- ii) Trade and other payables are recognised initially at fair value and thereafter at amortised cost,
- iii) cash and cash equivalents comprise cash balances, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less and no significant risk of changes in value. Bank overdrafts that are repayable on demand and which form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows,
- iv) interest bearing loans and borrowings are initially recognised at fair value, net of directly attributable arrangement costs, and subsequently remeasured at amortised cost. Such directly attributable costs are realised in the Income statement at a constant rate on carrying value,
- v) the Group recognises the fair value of its derivative financial instruments including interest rate swaps on the Balance sheet and movements on those values within the Income statement, and
- vi) where an asset is impaired, an appropriate impairment provision is recognised.

#### **k) Borrowing costs**

Gross borrowing costs relating to direct expenditure on investment properties and inventories under development or undergoing major refurbishment are capitalised. The interest capitalised is calculated using the Group's weighted average cost of borrowings over the period from commencement of the development work until the date of practical completion. The capitalisation of Finance costs is suspended if there are prolonged periods when development activity is interrupted.

All other borrowing costs are recognised in the Group's Income statement in the period in which they are incurred.

#### **l) Pension schemes**

The Group operates a defined contribution scheme. The charge to the Consolidated income statement in the period represents the actual amount paid or payable to the scheme in the period. Differences between contributions payable in the year and contributions paid are shown as either accruals or prepayments in the Consolidated balance sheet.

#### **m) Foreign currencies**

Transactions denominated in foreign currencies are translated into Sterling at the rates of exchange ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates ruling at that date. Exchange movements are dealt with in the Consolidated income statement.

#### **n) Share-based payments**

The cost of granting share options and other share-based remuneration to employees and Directors is recognised through the Consolidated income statement. The Group has used a Black-Scholes option valuation model and the resulting fair value is amortised on a straight-line basis through the Consolidated income statement over the vesting period of the options.

#### **o) Dividend distribution**

Dividend distributions to the Company's shareholders are recognised as a liability in the Group's financial statements in the period in which the dividends are declared.

## 1 ACCOUNTING POLICIES continued

### p) Definitions

Operating profit stated after profit on disposal of investment properties and the revaluation of the property portfolio and before the results of associates, jointly controlled entities, finance income and costs

IPD Index and Total Portfolio Return total return from the investment property portfolio, comprising net rental income or expenditure and capital gains or losses from disposals and revaluation surpluses or deficits, divided by the average capital employed during the financial period, as defined and measured by Investment Property Databank Limited, a company that produces independent benchmarks of property returns

IPD Initial Yield annualised current passing rent expressed as a percentage of the property valuation

Total Shareholder Return dividends plus annual growth in net assets

Gearing expressed as a percentage, is measured as net debt divided by total shareholders' funds

### (q) Prior year restatement

The Directors have made the following revisions to the prior year financial statements in respect of the following items

#### Operating properties

Comparative figures for the year-ended 31st December 2005 have been restated to more accurately adopt IFRS requirements in respect of certain leasehold properties. The financial effect at 1st January 2005 is a reduction in the net asset value of Operating properties of £1,348,000, a reduction in Revaluation reserve of £1,659,000 and a revaluation gain of £347,000. For the year ended 31st December 2005, the depreciation charge in respect of Operating properties was reduced by £44,000 and the Revaluation gain reduced by £80,000.

#### Deferred tax

The Directors have corrected an error in the computation of deferred tax in respect of the revaluation gain of an Operating property. Accordingly, at 31st December 2005, Deferred tax liabilities have been restated and increased by £2,900,000 and Deferred tax assets have been restated and increased by £300,000, with a corresponding net reduction in Retained reserves of £2,600,000. The impact on the deferred tax charge for the year ended 31st December 2005 was a decrease of £300,000.

#### Other reclassifications

Certain balances have been reclassified at 31st December 2005 to more fully comply with IFRS requirements.

Lease incentives, previously included within Investment property balances, are now separately identified within Prepayments and accrued income. The financial effect is a reduction in Investment properties of £678,000 and an increase in Prepayments and accrued income of £678,000, as set out in notes 11 and 14.

An investment in the loan notes of an associate, amounting to £755,000, previously classified as part of an Investment in the joint venture, was reclassified at 31st December 2005 to Financial assets, as disclosed in note 12(c).

Certain receivables, amounting to £939,000 (2005 £798,000), were reclassified as Non-current assets from Current assets, increasing Non-current receivables and decreasing Current receivables by the same amount.

The presentation of the Cash flow statement at 31st December 2005 has been reviewed to conform with the presentation adopted for 31st December 2006.

## 2 DISPOSAL OF ASSOCIATED UNDERTAKING

On 23rd December 2005, the Group disposed of its investment in Stead & Simpson Group Limited. The profit on disposal is presented in the Consolidated income statement and is calculated by reference to the book value of the investment at the date of disposal, after accounting for the Group's share of the associate's results and the net asset value at 23rd December 2005.

## 3 SEGMENTAL ANALYSIS

For management purposes, the Group is currently organised into three operating divisions:

- |                         |   |
|-------------------------|---|
| Investment              | – management of the Group's investment property portfolio, generating rental income and valuation surpluses from property management, |
| Trading and development | – managing the Group's development projects. Revenue is received from project management fees and development profits, and            |
| Operating               | – serviced office operations and retail activities. Revenue is principally received from short-term licence fee income.               |

These divisions are the basis on which the Group reports its primary segmental information. All operations occur and all assets are located in the United Kingdom, except assets of £1,394,000 (2005 £1,727,000), which are located in France and The Netherlands. Accordingly no secondary segmental information is shown. All revenue arises from continuing operations.

### 3 SEGMENTAL ANALYSIS continued

Year ended 31st December 2006				
	Investment £'000	Trading and development £'000	Operating £'000	Total £'000
<b>Segment revenue</b>	8,995	34,675	5,057	48,727
Direct costs	(1,601)	(26,195)	(4,980)	(32,776)
<b>Segment result</b>	7,394	8,480	77	15,951
Unallocated operating costs				(10,257)
Loss on disposal of investment properties	(97)	-	-	(97)
Net gain/(loss) on revaluation of property portfolio	21,821	-	(475)	21,346
<b>Operating profit</b>				26,943
Share of results of associates and joint ventures accounted for using the equity method				151
Income from financial assets				63
<b>Profit before interest and taxation</b>				27,157
Finance income				2,954
Finance costs				(7,321)
<b>Profit before taxation</b>				22,790
Taxation				769
<b>Profit after taxation attributable to equity shareholders of the parent</b>				23,559
<b>Assets and liabilities</b>				
Segment assets	205,723	100,006	13,911	319,640
Unallocated assets				44,146
<b>Total assets</b>				<b>363,786</b>
Segment liabilities	(83,771)	(31,104)	(2,593)	(117,468)
Unallocated liabilities				(14,905)
<b>Total liabilities</b>				<b>(132,373)</b>
<b>Other segment information</b>				
Capital expenditure	7,047		1,305	8,352
Unallocated capital expenditure				242
Depreciation			982	982
Unallocated depreciation				146

Year ended 31st December 2006				
	Investment £'000	Trading and development £'000	Operating £'000	Total £'000
<b>Revenue</b>				
Rental income	8,700	124	-	8,824
Operating property income	-	-	5,057	5,057
Project management fees	-	587	-	587
Trading property sales	-	25,800	-	25,800
Development profits	-	8,164	-	8,164
Other income	295	-	-	295
	8,995	34,675	5,057	48,727

### 3 SEGMENTAL ANALYSIS continued

	Year ended 31st December 2005 restated			
	Investment £'000	Trading and development £'000	Operating £'000	Total £'000
<b>Segment revenue</b>	10,626	9,687	5,155	25,468
Direct costs	(1,994)	(8,446)	(4,778)	(15,218)
<b>Segment result</b>	8,632	1,241	377	10,250
Unallocated operating costs				(10,538)
Profit on disposal of investment properties	3,728	–	–	3,728
Net gain/(loss) on revaluation of property portfolio	18,028	–	(174)	17,854
<b>Operating profit</b>				21,294
Share of results of associates and joint ventures accounted for using the equity method				1,453
Income from other fixed asset investments				149
Profit on disposal of investments				5,759
<b>Profit before interest and taxation</b>				28,655
Finance income				2,262
Finance costs				(7,667)
<b>Profit before taxation</b>				23,250
Taxation				(3,160)
<b>Profit after taxation attributable to equity shareholders of the parent</b>				20,090
<b>Assets and liabilities</b>				
Segment assets	226,002	59,568	11,681	297,251
Unallocated assets				22,070
<b>Total assets</b>				319,321
Segment liabilities	(88,715)	(27,268)	(2,439)	(118,422)
Unallocated liabilities				(13,391)
<b>Total liabilities</b>				(131,813)
<b>Other segment information</b>				
Capital expenditure	11,845		6	11,851
Unallocated capital expenditure				870
Depreciation			(909)	(909)
Unallocated depreciation				(181)

	Year ended 31st December 2005 restated			
	Investment £'000	Trading and development £'000	Operating £'000	Total £'000
<b>Revenue</b>				
Rental income	10,585	111	–	10,696
Operating property income	–	–	5,155	5,155
Project management fees	–	266	–	266
Trading property sales	–	9,135	–	9,135
Development profits	–	175	–	175
Other income	41	–	–	41
	10,626	9,687	5,155	25,468

#### 4 OPERATING PROFIT

	2006 £'000	2005 restated £'000
The profit from operations is stated after charging		
Share-based payments expense	142	110
Depreciation – Operating property	330	307
Depreciation – Other property, plant and equipment	798	783
Auditors' remuneration – audit of the financial statements	145	132
– audit related reporting	20	65

#### 5 STAFF COSTS

	2006 £'000	2005 £'000
Wages and salaries	4,887	5,462
Social security	541	633
Pension costs	425	416
	<b>5,853</b>	<b>6,511</b>

Included in wages and salaries is a total expense of share-based payments of £142,000 (2005 £110,000) all of which arises from transactions accounted for as equity settled share-based payment transactions

#### Average weekly number of employees, including Directors, during the year

	2006 Number	2005 Number
Property development and investment	33	34
Operating property activities	56	41
	<b>89</b>	<b>75</b>

The Directors are considered to be the only key management personnel. Their remuneration is shown in the Remuneration report on pages 68 to 75.

#### 6 FINANCE INCOME AND COSTS

	2006 £'000	2005 £'000
<b>Finance costs</b>		
Interest on bank loans and other borrowings	5,622	5,693
Interest on Debenture	2,200	2,200
Amortisation of arrangement costs	230	232
Capitalised interest	(731)	(458)
	<b>7,321</b>	<b>7,667</b>
<b>Finance income</b>		
Interest receivable	(2,954)	(2,262)
	<b>4,367</b>	<b>5,405</b>

Interest has been capitalised at a rate of 6.33% (2005 6.50%). Capitalised interest in the amount of £1,145,000 (2005 £181,000) was written off in the year against gross profit.

## 7 TAXATION

	2006 £'000	2005 restated £'000
Corporation tax on income at 30% (2005 30%)	2	–
Adjustment in respect of prior years	250	–
Total current tax charge	252	–
Deferred taxation (credit)/charge	(1,021)	3,160
	(769)	3,160

Deferred taxation expense for 2005 has been restated as set out in note 1(q)

	2006 £'000	2005 restated £'000
Analysis of (credit)/charge in the period		
Current tax	252	–
Deferred tax	503	3,160
Deferred tax (sale of investment property)	(1,524)	–
	(769)	3,160

	2006 £'000	2005 restated £'000
Tax on items charged to equity		
Deferred tax credit in respect of share-based payments	(240)	(13)
Deferred tax on property revaluations	1,232	–
	992	(13)

The differences between the total current tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax are as follows

	2006 £'000	2005 restated £'000
<b>Profit before taxation</b>	<b>22,790</b>	<b>23,250</b>
Tax on profit on ordinary activities at 30% (2005 30%)	6,837	6,975
Permanent differences	773	396
Prior year movements	(3,278)	(4,196)
Indexation allowance	(2,501)	(1,464)
Other deferred tax movements	(2,600)	1,449
	(769)	3,160

## 8 DIVIDENDS

	2006 £'000	2005 £'000
Declared and paid during the year		
Equity dividends on Ordinary shares		
Final dividend for 2005 4.25 pence per share (2004 4.00 pence per share)	1,562	1,467
Interim dividend for 2006 2.25 pence per share (2005 2.12 pence per share)	828	778
	<b>2,390</b>	<b>2,245</b>
Proposed for approval by shareholders at the Annual General Meeting		
Final dividend for 2006 4.50 pence per share (2005 4.25 pence per share)	1,832	1,562

The final dividend was approved by the Board on 27th March 2007 and has not been included as a liability or deducted from retained profits as at 31st December 2006. The final dividend is payable on 6th July 2007 to Ordinary shareholders on the register at the close of business on 8th June 2007 and will be recognised in 2007.

## 9 EARNINGS PER SHARE AND NET ASSETS PER SHARE

Basic earnings per share amounts are calculated by dividing profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the profit attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The calculation of the basic and diluted earnings per share is based on the following data:

	2006 £'000	2005 restated £'000
<b>Earnings</b>		
Earnings for the purposes of basic and diluted earnings per share	<b>23,559</b>	<b>20,090</b>
	<b>2006 £'000</b>	<b>2005 £'000</b>
<b>Number of shares</b>		
Weighted average number of Ordinary shares for the purposes of basic earnings per share	<b>37,151</b>	<b>36,675</b>
Effect of dilutive potential Ordinary shares		
Share options	<b>252</b>	<b>208</b>
Weighted average number of Ordinary shares for the purpose of diluted earnings per share	<b>37,403</b>	<b>36,883</b>
<b>Basic earnings per share (pence)</b>	<b>63.4</b>	<b>54.8</b>
<b>Diluted earnings per share (pence)</b>	<b>63.0</b>	<b>54.5</b>

Net assets per share and diluted net assets per share have been calculated as follows:

	2006			2005 restated		
	Net assets £'000	No. of shares '000	Net assets per share pence	Net assets £'000	No. of shares '000	Net assets per share pence
<b>Basic net assets per share</b>	<b>231,413</b>	<b>40,712</b>	<b>568</b>	187,508	36,722	510
Effect of dilutive potential Ordinary shares	2,086	547	(3)	2,647	779	(3)
<b>Diluted net assets per share</b>	<b>233,499</b>	<b>41,259</b>	<b>565</b>	190,155	37,501	507

## 10 PROPERTY, PLANT AND EQUIPMENT

### a) Operating properties

	Freehold £'000	Long leasehold £'000	Short leasehold £'000	Total £'000
At valuation 1st January 2005	8,154	1,597	1,535	11,286
Prior year restatement in respect of operating leases (see note 1 (q))	-	-	(1,535)	(1,535)
<b>As restated at 1st January 2005</b>	<b>8,154</b>	<b>1,597</b>	<b>-</b>	<b>9,751</b>
Additions	6	-	-	6
Disposals	(71)	-	-	(71)
(Deficit)/surplus on revaluation	(174)	321	-	147
<b>At valuation 31st December 2005 (restated)</b>	<b>7,915</b>	<b>1,918</b>	<b>-</b>	<b>9,833</b>
Additions	874	-	-	874
Transfer of asset to investment properties	(1,652)	-	-	(1,652)
(Deficit)/surplus on revaluation	(475)	518	-	43
<b>At valuation 31st December 2006</b>	<b>6,662</b>	<b>2,436</b>	<b>-</b>	<b>9,098</b>
Depreciation				
At 1st January 2005	404	122	187	713
Prior year restatement in respect of operating leases (refer note 1(q))	-	-	(187)	(187)
<b>As restated at 1st January 2005</b>	<b>404</b>	<b>122</b>	<b>-</b>	<b>526</b>
Charge for the year	261	46	-	307
<b>At 31st December 2005 (restated)</b>	<b>665</b>	<b>168</b>	<b>-</b>	<b>833</b>
Charge for the year	262	68	-	330
Transfer of accumulated depreciation to investment properties	(155)	-	-	(155)
<b>At 31st December 2006</b>	<b>772</b>	<b>236</b>	<b>-</b>	<b>1,008</b>
<b>Net book value 31st December 2006</b>	<b>5,890</b>	<b>2,200</b>	<b>-</b>	<b>8,090</b>
Net book value 31st December 2005	7,250	1,750	-	9,000
<b>Original cost of operating properties at 31st December 2006</b>	<b>5,727</b>	<b>1,583</b>	<b>-</b>	<b>7,310</b>
Original cost of operating properties at 31st December 2005	8,367	1,583	-	9,950

Operating properties with a net book value of £8,090,000 (2005 £9,000,000) are charged as security against the Group's borrowings (refer note 16)

The surplus on revaluation of £518,000 for the year ended 31st December 2006 is credited to property revaluation reserve. The revaluation deficit of £475,000 is debited to the income statement. If the operating properties were measured using the cost model, the carrying value would be £6,302,000 (2005 £9,117,000)

The Group's operating properties have been valued at market value as at 31st December 2006 by independent professional valuers DTZ Debenham Tie Leung, Chartered Surveyors, on the basis of Existing Use Value in accordance with the Appraisal and Valuation Manual of the Royal Institution of Chartered Surveyors and without any special assumptions. The values disclosed above are as stated by the valuer in their valuation report to the Directors. The valuer has consented to the use of its name in this report. A definition of market value is set out in note 11



## 10 PROPERTY, PLANT AND EQUIPMENT continued

### b) Other property, plant and equipment

	Fixtures and fittings £'000	Motor vehicles and other tangible assets £'000	Total £'000
<b>Cost</b>			
At 1st January 2005	6,244	547	6,791
Additions	763	107	870
Disposals	(752)	(91)	(843)
<b>At 31st December 2005</b>	<b>6,255</b>	<b>563</b>	<b>6,818</b>
Additions	503	170	673
Disposals	(304)	(64)	(368)
<b>At 31st December 2006</b>	<b>6,454</b>	<b>669</b>	<b>7,123</b>
<b>Depreciation</b>			
At 1st January 2005	2,807	191	2,998
Charge for the year	717	66	783
Disposals	(690)	(49)	(739)
<b>At 31st December 2005</b>	<b>2,834</b>	<b>208</b>	<b>3,042</b>
Charge for the year	716	82	798
Disposals	(293)	(42)	(335)
<b>At 31st December 2006</b>	<b>3,257</b>	<b>248</b>	<b>3,505</b>
<b>Net book value 31st December 2006</b>	<b>3,197</b>	<b>421</b>	<b>3,618</b>
Net book value 31st December 2005	3,421	355	3,776

## 11 INVESTMENT PROPERTIES

### a) Summary of investment properties

	Freehold £'000	Long leasehold £'000	Total £'000
At valuation 1st January 2005	151,764	4,808	156,572
Prior year restatement in respect of lease incentives (refer note 1(q))	(678)	-	(678)
<b>As restated at 1st January 2005</b>	<b>151,086</b>	<b>4,808</b>	<b>155,894</b>
Additions			
- acquisitions	7,110	-	7,110
- capital expenditure	4,735	-	4,735
Disposals	(24,314)	(1,885)	(26,199)
Surplus on revaluation	18,028	-	18,028
<b>At valuation 31st December 2005 (restated)</b>	<b>156,645</b>	<b>2,923</b>	<b>159,568</b>
Additions			
- acquisitions	3,248	2,209	5,457
- capital expenditure	1,585	5	1,590
Transfer from operating properties	1,497	-	1,497
Transfer to investment property - held for sale	(5,299)	-	(5,299)
Disposals	(42,423)	(2,750)	(45,173)
Surplus on revaluation	21,790	31	21,821
<b>At valuation 31st December 2006</b>	<b>137,043</b>	<b>2,418</b>	<b>139,461</b>

## 11 INVESTMENT PROPERTIES continued

### b) Reconciliation of net book value of investment properties to the market value

The following table reconciles the net book value of investment properties to their market value. The components of the reconciliation are included within their relevant balance sheet heading.

	2006 £'000	2005 restated £'000
Market value at 31st December assessed by the independent valuers or Directors	146,560	160,246
Amount included in prepayments and accrued income in respect of lease incentives	(1,800)	(678)
Less amounts reported as investment property held for sale	(5,299)	–
Book value of investment property at 31st December	139,461	159,568

The Group's investment properties have been valued at 31st December 2006 by independent, professional valuers, DTZ Debenham Tie Leung, Chartered Surveyors or Colliers CRE, Chartered Surveyors, except for those investment properties valued by the Directors. Investment properties have been valued on the basis of market value in accordance with the Appraisal and Valuation Standards of the Royal Institution of Chartered Surveyors.

Included within the Group's investment properties are freehold land, buildings and investment properties under development of £60,243,000 (2005: £52,915,000). These properties are held at Directors' valuation and include finance charges capitalised of £2,641,000 (2005: £2,678,000). Included within investment properties held at Directors' valuation are certain assets that have also been valued by the Group's independent valuers at £42,709,000 (2005: £34,213,000).

Market value has been assessed as the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. A deduction is made to reflect purchaser's acquisition costs and no special assumptions have been made except in the case of those properties held at Directors' valuation where it is the Directors' opinion that the valuation of an investment property under development should also reflect its future development potential in order to reflect its true fair value.

£112,327,000 (2005: £121,635,000) of investment properties are charged as security against the Group's borrowings (refer note 16).

### c) Investment property – held for sale

The asset available for sale represents an investment property for which a sale contract was exchanged prior to 31st December 2006. The sale was completed on 8th February 2007.

## 12 INVESTMENTS

	2006 £'000	2005 £'000
Investments in joint ventures	20,464	–
Investments in associates	673	1,165
Investments accounted for using the equity method	21,137	1,165

### a) Investment in associates

The Group holds a 29 per cent interest in Continental Estates Corporation BV, a company incorporated and registered in The Netherlands, whose principal activity is the holding of investments. The Directors consider that the Group's share of the assets and liabilities of that company is not material and the equity investment of £256,000 has been provided against in full in previous years.

**a) Investment in associates (continued)**

The Group holds 50 per cent of the Ordinary shares and 10 per cent of the preference shares of Peacock Place Limited, a company incorporated and registered in Jersey, whose principal activity is property development. The rights granted under the shareholder agreement for this company reflect the status of this investment as an associate

C M Heritage Park Limited and Luneside East Limited, previously classified as associates, have been reclassified as subsidiary undertakings and joint ventures respectively

The Group's share of assets of its associates is set out below. These companies have no trading activity and no reported liabilities

	2006				2005
	Peacock Place Limited £'000	CM Heritage Park Limited £'000	Luneside East Limited £'000	Peacock Place Limited £'000	Total restated £'000
Summarised balance sheets					
Current assets	673	218	236	711	1,165
Share of gross assets	673	218	236	711	1,165

The associate profit of £1,453,000 in 2005 represents the Group's share of the result of Stead & Simpson Group Limited. The investment was disposed of during 2005.

**b) Investment in joint ventures**

The Group has the following interests in joint ventures

	% of share capital	Country of incorporation	Principal Activity	Joint venture partner
Wimbledon Phoenix Limited	50	United Kingdom	Property development	Foinavon Limited
Curzon Park Limited	50	United Kingdom	Property development	Grainger PLC
Luneside East Limited	50	United Kingdom	Property development	CTP Limited

The Group's share of the assets, liabilities, income and expenses of its joint ventures are as follows

	Curzon Park Limited £'000	Wimbledon Phoenix Limited £'000	Luneside East Limited £'000	2006 Total £'000
<b>Summarised income statements</b>				
Administrative expenses	—	(6)	—	(6)
Finance costs	54	—	—	54
Finance income	103	—	—	103
<b>Profit/(loss) before and after taxation</b>	157	(6)	—	151
<b>Summarised balance sheets</b>				
Non-current assets	20,020	222	241	20,483
Share of gross assets	20,020	222	241	20,483
Current liabilities	(1)	(18)	—	(19)
<b>Share of net assets</b>	20,019	204	241	20,464

**c) Financial assets**

	2006	2005
	£'000	restated £'000
Participating development loan	5,000	—
Interest rate swap	126	—
Loan notes	755	755
	<b>5,881</b>	<b>755</b>

The participating development loan relates to a development project. The asset entitles the Group to a share of development profits based on the internal rate of return of the project.

The fair value of interest rate swaps is calculated by discounting future cash flows (refer note 16)

Loan notes are held in Continental Estates Corporation BV (refer note 12(a)) Interest is earned at a fixed rate of 60%

**d) Principal subsidiaries**

The following were principal subsidiaries at 31st December 2006

	% holding in ordinary shares at 31st December 2006	Principal activity
DS Property Developments Limited*	100	Property Development
Development Securities Estates PLC	100	Management and Investment Company
Development Securities (Investments) PLC	100	Property Investment
DS Jersey (No 1) Limited	100	Investment
DS Jersey (No 7) Limited	100	Investment

indirectly held

**13 INVENTORY – DEVELOPMENTS AND TRADING PROPERTIES**

	2006 £'000	2005 restated £'000
Developments in progress	18,673	15,086
Trading properties	55,990	41,393
	<b>74,663</b>	<b>56,479</b>

Developments in progress and trading properties are stated at the lower of cost and estimated net realisable value

**14 TRADE AND OTHER RECEIVABLES**

**a) Non-current**

	2006 £'000	2005 restated £'000
Other receivables	939	798
Prepayments and accrued income	529	622
	<b>1,468</b>	<b>1,420</b>

**b) Current**

	2006 £'000	2005 restated £'000
Trade receivables	2,065	2,838
Other receivables	5,215	5,093
Other taxation recoverable	–	362
Prepayments and accrued income	2,734	1,384
	<b>10,014</b>	<b>9,677</b>

The provision for bad debts was £48,000 (2005 £7,000)

Transactions and balances with related parties are disclosed in note 24

## 15 TRADE AND OTHER PAYABLES

### a) Current

	2006 £'000	2005 restated £'000
Trade payables	185	97
Other payables	2,440	2,737
Other tax and social security	1,412	671
Accruals and deferred income	12,710	11,509
	<b>16,747</b>	<b>15,014</b>

### b) Non-current

	2006 £'000	2005 £'000
Provisions	<b>1,055</b>	<b>1,529</b>

Provisions of £896,000 (2005 £1,152,000) relate to properties and £159,000 (2005 £377,000) to onerous leases

## 16 FINANCIAL LIABILITIES

### a) Current

	2006 £'000	2006 £'000	2005 £'000	2005 £'000
Bank overdrafts		<b>5,929</b>		1,075
Current instalments due on bank loans	<b>9,785</b>		5,325	
Unamortised arrangement costs	<b>(199)</b>		(196)	
		<b>9,586</b>		5,129
		<b>15,515</b>		<b>6,204</b>

### b) Non-current

	2006 £'000	2005 £'000
First mortgage debenture 11% due 2016	<b>20,000</b>	20,000
Bank loans	<b>67,692</b>	79,075
Deferred revenue expenditure	<b>(273)</b>	(443)
	<b>87,419</b>	<b>98,632</b>

All bank loans and overdrafts are denominated in Sterling. Bank loans and the Debenture are supported by way of mortgages and legal charges on certain properties and cash deposits held by the Group.

Bank loans and overdrafts in the sum of £48,406,000 (2005 £56,602,000), included in notes 15 and 16, attract variable rates of interest based on LIBOR/base rate in the range +1.0625 per cent to +1.075 per cent and loans in the sum of £55,000,000 (2005 48,873,000) attract fixed rates of interest of between 5.88 per cent and 11 per cent.

## 16 FINANCIAL LIABILITIES (continued)

### Maturity table

	Effective interest rate %	Total £'000	2006 Maturity			
			Less than one year £'000	One to two years £'000	Two to five years £'000	More than five years £'000
Fixed rate debenture	11.0	20,000	–	–	–	20,000
Sterling bank loans						
Fixed rate loans	8.3	35,000	458	527	1,852	32,163
Variable rate loans	6.2	42,477	9,327	33,150	–	–
Bank overdrafts	–	5,929	5,929	–	–	–
Deferred revenue expenditure	–	(472)	(199)	(133)	(130)	(10)
		<b>102,934</b>	<b>15,515</b>	<b>33,544</b>	<b>1,722</b>	<b>52,153</b>

	Effective interest rate %	Total £'000	2005 Maturity			
			Less than one year £'000	One to two years £'000	Two to five years £'000	More than five years £'000
Fixed rate debenture	11.0	20,000	–	–	–	20,000
Sterling bank loans						
Fixed rate loans	8.8	28,873	309	337	1,204	27,023
Variable rate loans	6.2	55,527	5,016	22,011	28,500	–
Bank overdrafts	–	1,075	1,075	–	–	–
Deferred revenue expenditure	–	(639)	(196)	(178)	(216)	(49)
		<b>104,836</b>	<b>6,204</b>	<b>22,170</b>	<b>29,488</b>	<b>46,974</b>

Cash in the amount of £6,948,000 (2005 £24,743,000) is held on deposit as security against the above borrowings and facilities.  
Borrowings due for repayment after five years include £6,738,000 (2005 £5,467,000) repayable by instalments.

## FINANCE REVIEW

The Group's financial instruments, other than trade receivables and payables arising from its operations, comprise borrowings, cash resources and equity investments. Monetary assets and liabilities, other than certain equity investments, amounting to £1,394,000 (2005 £1,727,000), are denominated in pounds Sterling.

The Group had net borrowings of £14,398,000 at 31st December 2006 (2005 £31,742,000). Cash balances were £88,536,000 (2005 £73,094,000), of which £6,948,000 (2005 £24,743,000) was pledged as security against borrowings. Undrawn, committed revolving credit facilities were £42,790,000 (2005 £24,738,000).

The decrease in net financial liabilities largely reflects net cash inflows from investment and trading property disposals and proceeds from a share placing during the year.

### Financing and interest rate strategy

The Group's investment portfolio is mainly financed with fixed-rate debt facilities, matching debt service costs with cash flow from rental income. Where appropriate, interest rate swaps have been used to commercially hedge the Group's exposure to short-term fluctuations in interest rates on floating rate debt. The Group holds £27,500,000 (2005 £27,500,000) of interest rate swaps. The Group does not hedge account its interest rate swaps and states them at fair value, with changes to fair value included in the income statement. The fair value of such swaps at 31st December 2006 was £126,000 (2005 £nil), (refer note 12(c)).

The Group seeks to pre-fund and pre-let appropriate projects in line with its risk-averse development strategy. The Group's own development project finance is arranged by way of internally generated cash resources and medium-term, revolving credit facilities which provide the necessary flexibility to draw down funds when required.

Fixed and floating rate liabilities and financial assets as at 31st December 2006 are analysed as

	2006 £ million	Weighted average interest rate %	Weighted average debt maturity Years	2005 £ million	Weighted average interest rate %	Weighted average debt maturity Years
Fixed rate debt	54.7	9.3	10.1	48.5	9.7	11.1
Floating rate debt	48.2	6.2	1.1	56.3	5.9	2.0
Gross debt	102.9	7.9	6.3	104.8	7.7	6.3
Cash balances	(88.5)	5.1	-	(73.1)	4.4	-
Net debt	14.4	-	-	31.7	-	-
Undrawn facilities	42.8	6.3	1.4	24.7	5.9	2.7

Floating rate debt is generally re-priced quarterly based on prevailing LIBOR rates.

### Valuation of financial assets and liabilities

A valuation was carried out as at 31st December 2006 by J C Rathbone Associates Limited, to calculate the market value of the Group's fixed rate debt on a replacement basis, taking into account the difference between fixed interest rates for the Group's borrowings and the market value and prevailing interest rate of appropriate debt instruments as a fair value adjustment. Whilst the replacement basis provides a consistent method for valuation of fixed rate debt, such financing facilities are in place to provide continuing funding for the Group's activities. The valuation is therefore only an indication of a notional effect on the net asset value of the Group as at 31st December 2006 and may be subject to daily fluctuations in line with money market movements.

The debt valuation as at 31st December 2006 is analysed as

	Book value 31 December 2006 £'million	Fair value 31 December 2006 £'million	Fair value adjustment 31 December 2006 £'million	Fair value adjustment 28 February 2007 £'million
Fixed rate mortgage facilities	34.7	40.8	(6.1)	(5.8)
First Mortgage debenture 11% due 2016	20.0	25.8	(5.8)	(5.6)
<b>Total fixed rate financial liabilities</b>	<b>54.7</b>	<b>66.6</b>	<b>(11.9)</b>	<b>(11.4)</b>

The fair value adjustment of £11,900,000 at 31st December 2006 (2005 £15,100,000) represents approximately 21.8 per cent of gross, fixed rate borrowings (2005 31.1 per cent). The effect on net assets per share after tax of this adjustment would be a decrease of 20.5 pence (2005 28.8 pence). As at 28th February 2007, the fair value adjustment had decreased to £11,400,000 equivalent to a decrease of 19.6 pence per share after tax. The Directors consider that the fair value of other remaining financial assets and liabilities is not materially different to their book values as at 31st December 2006.

#### Debt maturity

The maturity profile of the Group's borrowings is set out above in this note. Of the total of £42,800,000 of currently undrawn revolving credit facilities, £16,200,000 expire in 2007, with the remaining £26,600,000 in 2008.

#### Gearing

Gearing, measured as net debt to total shareholders' funds, has decreased to 6.2 per cent (2005 16.5 per cent) as at 31st December 2006.

#### Currency risk

The Group does not undertake significant trade overseas, but does hold certain assets, amounting to £1,394,000 (2004 £1,727,000) denominated in foreign currencies. The currency exposure arising from these investments is not considered to materially affect the Group's operations and is not subject to hedging arrangements.

#### Credit risk

The Group's principal financial assets are bank balances and cash, trade and other receivables and investments. The Group's credit risk is primarily attributable to its trade and other receivables. The amounts shown in the balance sheet are net of any provision for bad debts. Such provisions are made where there is an identified event which provides evidence of a reduction in the recoverability of debts. The credit risk on liquid funds and derivative financial instruments is limited because the counterparties are banks and financial institutions with high credit-ratings. The Group has no significant concentration of credit risk, with exposure spread over a large number of tenants and counterparties.

#### Price and liquidity risk

Details of price and liquidity risk are set out in the Review of operations and the Property portfolio review on pages 12 to 20.



## 17 DEFERRED TAX

The following are the major deferred tax liabilities and assets and movements thereon recognised by the Group during the current and previous financial year. Deferred tax is calculated in full on the temporary differences under the liability method using a tax rate of 30% (2005 30%)

	2006 £'000	2005 restated £'000
At 1st January	6,047	–
Prior year restatement (refer note 1(q))	–	2,900
<b>At 1st January as restated</b>	<b>6,047</b>	<b>2,900</b>
(Credit)/charge for the year	(1,021)	3,460
Prior year restatement (refer note 1(q))	–	(300)
Debited/(credited) directly to equity	992	(13)
<b>At 31st December</b>	<b>6,018</b>	<b>6,047</b>
	2006 £'000	2005 restated £'000
<b>Tax on items charged to equity</b>		
Deferred tax in respect of share-based payments	(240)	(13)
Deferred tax on property revaluations	1,232	–
	992	(13)

	Accelerated tax depreciation £'000	Revaluation of property £'000	Total £'000
<b>Deferred tax liabilities recognised</b>			
At 1st January 2006	394	7,140	7,534
Prior year restatement (refer note 1 (q))	–	2,900	2,900
<b>At 1st January 2006 as restated</b>	<b>394</b>	<b>10,040</b>	<b>10,434</b>
Charged to the income statement	(990)	961	(29)
Other property revaluation reserve	–	1,232	1,232
<b>At 31st December 2006 due in more than one year</b>	<b>(596)</b>	<b>12,233</b>	<b>11,637</b>

	Provisions £'000	Tax losses £'000	Other £'000	Total £'000
<b>Deferred tax assets recognised</b>				
At 1st January 2006	(54)	(4,020)	(13)	(4,087)
Prior year restatement (refer note 1(q))	–	(300)	–	(300)
<b>At 1st January 2006 as restated</b>	<b>(54)</b>	<b>(4,320)</b>	<b>(13)</b>	<b>(4,387)</b>
Charged to income statement	–	(992)	–	(992)
Other reserve	–	–	(240)	(240)
<b>At 31st December 2006 due in more than one year</b>	<b>(54)</b>	<b>(5,312)</b>	<b>(253)</b>	<b>(5,619)</b>

	2006 £'000
Net deferred tax liability	
Net liabilities due in more than one year	6,018
<b>At 31st December 2006</b>	<b>6,018</b>

Deferred tax assets and liabilities are only offset where there is a legally enforceable right of offset and there is an intention to settle the balances net. Deferred tax assets arising from the Group's trading and capital losses are recognised on the basis that there will be sufficient profits in the foreseeable future to utilise such losses.

Movements in deferred tax assets and liabilities (prior to the offsetting of balances) are shown above.

## 18 SHARE CAPITAL

	2006 £'000	2005 £'000
<b>Authorised</b>		
50,000,000 Ordinary shares of 50 pence (2005 50,000,000 Ordinary shares of 50 pence)	25,000	25,000
<b>Issued, called up and fully paid</b>		
40,711,652 Ordinary shares of 50 pence (2005 36,722,286 Ordinary shares of 50 pence)	20,356	18,361

	Number of shares
<b>Shares in issue at the date of this report</b>	<b>40,711,652</b>

On 29th November 2006, 3,700,000 Ordinary shares were allotted following a Placing at 625 pence per share, raising £23,125,000 principally to fund the Company's share of the consideration payable for the purchase of a 1.4 million sq ft site at Curzon Park, Birmingham in an equal joint venture with Grainger PLC

In addition, during the year, £913,224 cash consideration was also received following the allotment of 289,366 Ordinary shares as a consequence of the exercise of share options

The Company has one class of Ordinary shares which carry no right to fixed income

### Share option schemes

As at 31st December 2006 and at the date of this report, the options outstanding under the Company's share option schemes were exercisable as follows (price stated in pence per share)

#### Executive share option scheme 1995

Date of grant	31 12.06	Number 30 03 07	Number Exercise Dates	Price
19th May 1997	20,189	20,189	19th May 2000 to 18th May 2007	248.0
21st May 1998	20,190	20,190	21st May 2001 to 20th May 2008	325.5
27th March 2001	50,327	50,327	27th March 2004 to 26th March 2011	338.0
30th April 2001	55,518	55,518	30th April 2004 to 29th April 2011	397.0
19th April 2004	66,979	66,979	19th April 2007 to 18th April 2014	360.0
30th April 2004	151,424	151,424	30th April 2007 to 29th April 2014	361.0
9th November 2004	50,000	50,000	9th November 2007 to 8th November 2014	392.5
	414,627	414,627		

#### Executive share option plan 2005

Date of grant	31 12.06	Number 30 03 07	Number Exercise Dates	Price
27th October 2005	40,000	40,000	27th October 2008 to 26th October 2015	445.75
28th April 2006	40,000	40,000	28th April 2009 to 27th April 2016	580.0
	80,000	80,000		

#### Savings related share option scheme 1995

Date of grant	31 12.06	Number 30 03 07	Number Exercise Dates	Price
20th May 2004	28,259	28,259	1st July 2007 to 31st December 2007	289.0

#### Save as you earn option plan 2005

Date of grant	31 12.06	Number 30 03 07	Number Exercise Dates	Price
22nd May 2006	24,562	24,562	1st July 2009 to 31st December 2009	464.0

## 18 SHARE CAPITAL continued

### Share-based payments – Group and Company

The expense recognised for equity-settled share-based payments in respect of employee services received during the year is £142,000 (2005 £110,000)

The following table illustrated the number and weighted average exercise prices of, and movements in, share options during the year

	Number	2006 Weighted average exercise price (pence)	Number	2005 Weighted average exercise price (pence)
At 1st January	779,122	339 7	796,496	329 6
Options granted	65,368	534 9	40,000	445 8
Options exercised	(289,366)	315 6	(54,978)	297 5
Options expired/lapsed	(7,676)	307 3	(2,396)	289 0
<b>At 31st December</b>	<b>547,448</b>	<b>382 9</b>	<b>779,122</b>	<b>339 7</b>

All of the options exercised during the year were not recognised in accordance with IFRS 2 as these options were granted on or before 7th November 2002. These options have not been subsequently modified and therefore do not need to be accounted for in accordance with IFRS 2

The weighted average fair value of options granted during the year was £1 32 (2005 £1 04). The weighted average share price during the year was 575 6 pence (2005 481 9 pence). Of the 547,448 (2005 779,122) outstanding options at 31st December 2006, 146,224 were exercisable (2005 434,634)

The options outstanding at 31st December 2006 were exercisable between 248 0 pence and 580 0 pence per share and have a weighted average remaining contractual life of 6 0 years (2005 4 6 years)

The fair value of grants is measured at the grant date using a Black-Scholes pricing model, taking into account the terms and conditions upon which the instruments were granted. The services received and a liability to pay for those services are recognised over the expected vesting period. The main assumptions of the Black-Scholes pricing model are as follows

Grant date	22 05 06	28 04 06
Exercise price (p)	580 0	464 0
Term (years)	7	7
Expected volatility	22	28
Expected dividend yield p a.	1 5%	1 5%
Risk free rate	4 5%	4 5%
Expected forfeiture p a.	Nil	Nil

Expected volatility was determined by calculating the historical volatility of the Development Securities PLC share price over multiple time periods. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may not necessarily be the actual outcome

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur

## 19 RESERVES AND MOVEMENTS IN EQUITY

	Share capital £'000	Share premium £'000	Property revaluation reserve £'000	Share-based payments reserve £'000	Capital redemption reserve £'000	Capital reserve £'000
At 1st January 2005	18,334	87,417	1,673	64	1,431	44,188
Prior year restatement in respect of operating leases (refer note 1(q))	-	-	(1,659)	-	-	-
<b>At 1st January 2005 (restated)</b>	<b>18,334</b>	<b>87,417</b>	<b>14</b>	<b>64</b>	<b>1,431</b>	<b>44,188</b>
Net proceeds of issue of new shares	27	134	-	-	-	-
VAT recovered on share issue costs	-	84	-	-	-	-
Net surplus on revaluation of operating properties (restated)	-	-	321	-	-	-
Share-based payments cost	-	-	-	110	-	-
<b>At 31st December 2005 (restated)</b>	<b>18,361</b>	<b>87,635</b>	<b>335</b>	<b>174</b>	<b>1,431</b>	<b>44,188</b>
Net proceeds of issue of new shares	1,995	21,215	-	-	-	-
Net surplus on revaluation of operating properties	-	-	518	-	-	-
<b>At 31st December 2006</b>	<b>20,356</b>	<b>108,850</b>	<b>853</b>	<b>174</b>	<b>1,431</b>	<b>44,188</b>

The capital reserve and capital redemption reserve arose from business combinations in prior financial periods. Neither of these reserves are distributable.

### Retained earnings

	Retained earnings £'000
At 1st January 2005	20,079
Prior year restatement in respect of operating leases (refer note 1(q))	347
<b>At 1st January 2005 (restated)</b>	<b>20,426</b>
Retained profit for the year	20,090
Prior year restatement in respect of tax (refer note 1 (q))	(2,900)
Adjustment to tax in respect of share-based payments	13
Final dividend 2004	(1,467)
Interim dividend 2005	(778)
<b>At 31st December 2005 (restated)</b>	<b>35,384</b>
Retained profit for the year	23,559
Deferred tax	(992)
Final dividend 2005	(1,562)
Interim dividend 2006	(828)
<b>At 31st December 2006</b>	<b>55,561</b>

Retained profit for the year ended 31st December 2005 includes a prior year restatement of £300,000 in respect of the taxation charge for the year (refer note 1(q)).

## 20 NOTE TO THE CASH FLOW STATEMENT

	2006 £'000	2005 £'000
<b>Operating profit</b>	<b>26,943</b>	<b>21,294</b>
<b>Adjustments for</b>		
Loss/(gain) on disposal of investment properties	97	(3,728)
Net gain on revaluation of property portfolio and operating properties	(21,346)	(17,854)
Share-based payments	142	110
Depreciation of property, plant and equipment	1,128	1,149
<b>Operating cash flows before movements in working capital</b>	<b>6,964</b>	<b>971</b>
Increase in developments	(3,587)	(996)
Increase in trading properties	(14,975)	(34,248)
(Increase)/decrease in receivables	(182)	7,702
Increase/(decrease) in payables	1,727	(20)
(Decrease)/increase in provisions	(474)	1,529
<b>Cash outflow from operations</b>	<b>(10,527)</b>	<b>(25,062)</b>
Capitalised interest charged to direct costs	1,145	181
Income taxes paid	(473)	(906)
Interest paid	(8,122)	(6,474)
<b>Net cash outflow from operating activities</b>	<b>(17,977)</b>	<b>(32,261)</b>

## 21 FINANCIAL COMMITMENTS AND OPERATING LEASE ARRANGEMENTS

Financial commitments authorised and commitments not provided for in these financial statements are estimated at

	2006 £'000	2005 £'000
<b>Financial commitments</b>	<b>11,657</b>	<b>4,240</b>
Group share of the financial commitments of joint ventures	3,257	—

### Operating lease arrangements

#### The Group as lessee

	2006 £'000	2005 £'000
Minimum lease payments under operating leases recognised for the year	2,094	2,254

At the balance sheet date, the Group had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows

	2006 £'000	2005 £'000
Within one year	2,094	2,254
In the second to fifth years inclusive	7,236	8,142
After five years	10,579	13,615
	<b>19,909</b>	<b>24,011</b>

Operating lease payments represent rentals payable by the Group for certain of its office properties. Leases were negotiated for an average term of 14.9 years (2005: 13.8 years).

## 21 FINANCIAL COMMITMENTS AND OPERATING LEASE ARRANGEMENTS continued

### The Group as lessor

Property investment income earned during the year was £8,995,000 (2005 £10,626,000). Certain of the Group's properties held for rental purposes, with a carrying amount of £6,519,000, have been disposed of since the balance sheet date.

At the balance sheet date, the Group had contracted with tenants for the following future minimum payments

	2006 £'000	2005 £'000
Within one year	7,396	12,008
In the second to fifth years inclusive	21,994	41,155
After five years	44,600	90,863
	<b>73,990</b>	<b>144,026</b>

## 22 CONTINGENT LIABILITIES

Performance bonds given on behalf of Group companies are guaranteed by banks in favour of third parties for a total of £151,185 (2005 £161,185). The due performance of obligations under various leases entered into by Group companies, expiring subsequent to 2014, amount to £1,341,000 per annum (2005 £1,593,000). The net present value after tax of the maximum net cash outflow over the term of certain leases to Stead & Simpson Limited is £2,100,000 at 31st December 2006 (2005 £2,221,000). The Directors do not expect this contingent liability to become payable.

## 23 PENSION SCHEME

The Company operates a defined contribution scheme for Directors and employees. Monthly premia are invested in an independent insured fund. The amounts charged to the profit and loss account during the year are set out in note 5.

## 24 RELATED PARTIES

During the year, the Group entered into transactions, in the ordinary course of business, with related parties.

Transactions entered into and balances outstanding at 31st December with related parties are set out below. There were no transactions with Directors other than remuneration set out in the Remuneration report on pages 68 to 75.

	Sales to Related parties £'000	Purchases from related parties £'000	Amounts owed by related parties £'000	Amounts owed to related parties £'000
<b>Joint ventures</b>				
2006	—	—	20,008	—
2005	—	—	—	—
<b>Associates</b>				
2006	—	—	172	—
2005	—	—	78	—

## Company independent auditors' report

### INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF DEVELOPMENT SECURITIES PLC

We have audited the parent company financial statements of Development Securities PLC for the year ended 31st December 2006 which comprise the Balance Sheet and the related notes 25 to 34. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration report that is described as having been audited.

We have reported separately on the Group financial statements of Development Securities PLC for the year ended 31st December 2006.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

#### Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration report and the parent company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Directors' Remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view and whether the parent company financial statements and the part of the Directors' Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the parent company Directors' report is consistent with the financial statements. The information given in the Directors' report includes that specific information presented in the Review of Operations and Sustainability report that is cross referred from the Business Review section of the Directors' report.

In addition we report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the Directors' report, the unaudited part of the Directors' Remuneration report, the Chairman's Statement and the Review of Operations. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company

financial statements. Our responsibilities do not extend to any other information.

#### Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Directors' Remuneration report to be audited. It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements and the part of the Directors' Remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements and the part of the Directors' Remuneration report to be audited.

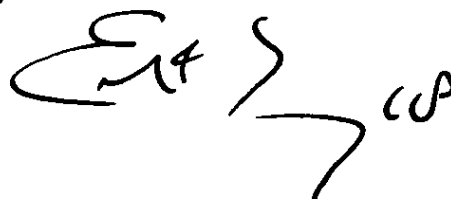
#### Opinion

In our opinion:

- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31st December 2006,
- the parent company financial statements and the part of the Directors' Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' report is consistent with the parent company financial statements.

#### Ernst & Young LLP

Registered Auditor  
London  
30th March 2007



**Company balance sheet**  
As at 31st December 2006

	Notes	2006 £'000	2006 £'000	2005 restated £'000
<b>Fixed assets</b>				
Tangible fixed assets	29	773		704
Investments	30	80,957		78,743
			<b>81,730</b>	<b>79,447</b>
<b>Current assets</b>				
Debtors	31	319,191		272,407
Cash in hand and at bank		29,750		9,422
		<b>348,941</b>		<b>281,829</b>
<b>Creditors</b>				
Amounts falling due within one year	32	(286,390)		(226,301)
<b>Net current assets</b>			<b>62,551</b>	<b>55,528</b>
<b>Net assets</b>			<b>144,281</b>	<b>134,975</b>
<b>Financed by</b>				
<b>Capital and reserves</b>				
Called up share capital	33	20,356		18,361
Share premium	34	108,850		87,635
Share-based payments reserve	34	174		174
Capital redemption reserve	34	1,431		1,431
Retained earnings	34	13,470		27,374
<b>Total equity shareholders' funds</b>	.	<b>144,281</b>		<b>134,975</b>

Approved by the Board of Directors on 30th March 2007 and signed on its behalf by

M H Marx  
Director





## Notes to the company financial statements

For the year ended 31st December 2006

### 25 ACCOUNTING POLICIES

#### a) Basis of accounting

The Company's financial statements have been prepared in accordance with applicable United Kingdom accounting standards and under the historical cost convention. The accounting policies adopted are consistent with the previous year and are set out below.

The Company has not presented its own profit and loss account, as permitted by s230 of the Companies Act 1985. The loss after tax for the year was £11,514,000 (2005 £6,662,000 profit).

The accounts were approved by the Directors for issue on 30th March 2007.

#### b) Subsidiaries, associates and joint ventures

The Company's investments in subsidiaries, associates and joint ventures are accounted for in the financial statements at cost less any provision for impairment.

#### c) Operating leases

Rental payments under operating leases are charged on a straight-line basis over the lease term even if the payments are not made on such a basis.

#### d) Tangible fixed assets

Tangible fixed assets are held at cost less accumulated depreciation and any provision for impairment. Depreciation is provided so as to write off the cost less estimated residual value of such assets over their expected useful lives.

The principal annual rates used for this purpose are as follows:

Fixtures and fittings	- 10% to 33%
Motor vehicles	- 20%

#### e) Taxation

Current tax, including UK corporation tax and foreign tax where applicable, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred taxation is provided in full on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law. Timing differences arise from the inclusion of items of income and expenditure in taxation computations in periods different from those in which they are included in financial statements. Deferred tax assets are recognised to the extent that it is regarded as more likely than not that they will be recovered. Deferred tax assets and liabilities are not discounted.

#### f) Pension schemes

The Company operates a defined contribution scheme on behalf of the Development Securities PLC group. The charge to the profit and loss account in the period represents the actual amount payable to the scheme in the year. Differences between contributions payable in the year and contributions paid are shown as either accruals or prepayments in the balance sheet.

#### g) Foreign currencies

Transactions denominated in foreign currencies are translated into Sterling at the rates ruling at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the rates ruling at that date. Exchange movements are dealt with in the profit and loss account.

#### h) Share-based payments

The cost of granting share options and other share-based remuneration to employees and Directors is recognised through the profit and loss account. The Company has used a Black-Scholes pricing model and the resulting fair value is amortised on a straight-line basis through the profit and loss account over the vesting periods of the options.

#### i) Prior year restatement

An investment in the loan notes of an associate, amounting to £755,000, previously classified as part of an investment in the joint venture, was reclassified at 31st December 2005 to Financial assets, as disclosed in note 12(c).

A provision previously classified as part of Other creditors is now classified as a provision against Amounts owed by subsidiary companies. The financial effect is a reduction in Other creditors of £15,953,000 and a reduction in Amounts owed by subsidiary companies of the corresponding amount.

### 26 AUDITORS' REMUNERATION

Auditors' remuneration in respect of the audit for the Company was £30,000 (2005 £88,000).

## 27 EMPLOYEE INFORMATION

### Staff costs including Directors

	2006 £'000	2005 £'000
Wages and salaries	4,133	4,785
Social security	506	592
Pension costs	410	401
	<b>5,049</b>	<b>5,778</b>

### Average weekly number of employees, including Directors, during the year

	2006 Number	2005 Number
Property development and investment	33	34

## 28 OPERATING LEASE ARRANGEMENTS

### The Company as lessee

	2006 £'000	2005 £'000
Minimum lease payments under operating leases recognised for the year	494	500

At the balance sheet date, the Company had outstanding commitments for future minimum lease payments under non-cancellable operating leases, which fall due as follows

	2006 £'000	2005 £'000
Within one year	494	500
In the second to fifth years inclusive	1,868	1,868
After five years	1,518	1,985
	<b>3,880</b>	<b>4,353</b>

Operating lease payments represent rentals payable by the Company for its office property. The lease was negotiated for an average term of 8.3 years (2005: 9.3 years).

## 29 TANGIBLE FIXED ASSETS

	Fixtures and fittings £'000	Motor vehicles and other tangible assets £'000	Total £'000
Cost			
At 1st January 2006	733	307	1,040
Additions	101	141	242
Disposals	(20)	(64)	(84)
<b>At 31st December 2006</b>	<b>814</b>	<b>384</b>	<b>1,198</b>
Depreciation			
At 1st January 2006	238	98	336
Charge for the year	74	72	146
Disposals	(15)	(42)	(57)
<b>At 31st December 2006</b>	<b>297</b>	<b>128</b>	<b>425</b>
<b>Net book value 31st December 2006</b>	<b>517</b>	<b>256</b>	<b>773</b>
Net book value 31st December 2005	495	209	704

### 30 INVESTMENTS

	Shares in subsidiary undertakings £'000	Interest in associated undertakings £'000	Interest in loan notes £'000	Interest in joint ventures £'000	Total restated £'000
Cost					
At 1st January 2006	110,246	236	–	755	111,237
Restatement in respect of investment loan notes (refer note 1 (q))	–	–	755	(755)	–
<b>As restated 1st January 2006</b>	<b>110,246</b>	<b>236</b>	<b>755</b>	<b>–</b>	<b>111,237</b>
Transfer to joint ventures	–	(236)	–	236	–
Investment in joint ventures	–	–	–	214	214
Acquisition of shares	19,591	–	–	–	19,591
Disposal of shares	(17,591)	–	–	–	(17,591)
<b>At 31st December 2006</b>	<b>112,246</b>	<b>–</b>	<b>755</b>	<b>450</b>	<b>113,451</b>
Amounts provided					
At 1st January and 31st December 2006	(32,494)	–	–	–	(32,494)
<b>Net book value at 31st December 2006</b>	<b>79,752</b>	<b>–</b>	<b>755</b>	<b>450</b>	<b>80,957</b>
Net book value at 31st December 2005	77,752	236	–	755	78,743

Interest in loan notes represents £755,000 (2005 £755,000) invested in loan stock of Continental Estates Corporation BV. Continental Estates Corporation BV is incorporated and registered in The Netherlands. The company's principal activity is currently as an investment holding company. Details of the Company's equity investment in Continental Estates Corporation BV is set out in note 12(a) of the Group financial statements.

The interest in joint ventures, representing the Company's investment in Luneside East Limited and Wimbledon Phoenix Limited, is set out in note 12(b) of the Group financial statements.

The principal subsidiaries of the Company are set out in note 12 (d) of the Group financial statements.

### 31 DEBTORS

	2006 £'000	2005 £'000
Trade debtors	22	54
Amounts owed by subsidiary companies	315,951	269,591
Other debtors	2,395	1,459
Other taxation recoverable	–	635
Deferred tax	400	400
Prepayments	423	268
	<b>319,191</b>	<b>272,407</b>

Deferred tax assets arising from the Company's trading and capital losses are recognised on the basis that there will be sufficient future profits to utilise such losses.

### 32 CREDITORS amounts falling due within one year

	2006 £'000	2005 restated £'000
Bank loans and overdrafts	40	16
Trade creditors	11	–
Amounts owed to subsidiary undertakings	282,283	221,664
Other creditors	–	5
Corporation tax	1,685	1,685
Other tax and social security	580	511
Accruals and deferred income	1,791	2,420
	<b>286,390</b>	<b>226,301</b>

### 33 SHARE CAPITAL

	2006 £'000	2005 £'000
<b>Authorised</b>		
50,000,000 Ordinary shares of 50 pence (2005 50,000,000 Ordinary shares of 50 pence)	25,000	25,000
<b>Issued, called up and fully paid</b>		
40,711,652 Ordinary shares of 50 pence (2005 36,722,286 Ordinary shares of 50 pence)	20,356	18,361
	<b>Number of shares</b>	
<b>Shares in issue at the date of this report</b>	<b>40,711,652</b>	

On 29th November 2006, 3,700,000 Ordinary shares were allotted following a Placing at 625 pence per share, raising £23,125,000, before costs of issue, principally to fund the Company's share of the consideration payable for the purchase of a 1.4 million sq. ft. site at Curzon Park, Birmingham in an equal joint venture with Grainger PLC

In addition, during the year, £913,224 cash consideration was also received following the allotment of 289,366 Ordinary shares as a consequence of the exercise of share options

#### Share option schemes

As at 31st December 2006 and at the date of this Report the options outstanding under the Company's share option schemes were exercisable as follows (price stated in pence per share)

#### Executive share option scheme 1995

Date of grant	Number 31.12.06	Number 30.03.07	Number Exercise Dates	Price
19th May 1997	20,189	20,189	19th May 2000 to 18th May 2007	248.0
21st May 1998	20,190	20,190	21st May 2001 to 20th May 2008	325.5
27th March 2001	50,327	50,327	27th March 2004 to 26th March 2011	338.0
30th April 2001	55,518	55,518	30th April 2004 to 29th April 2011	397.0
19th April 2004	66,979	66,979	19th April 2007 to 18th April 2014	360.0
30th April 2004	151,424	151,424	30th April 2007 to 29th April 2014	361.0
9th November 2004	50,000	50,000	9th November 2007 to 8th November 2014	392.5
	414,627	414,627		

#### Executive share option plan 2005

Date of grant	Number 31.12.06	Number 30.03.07	Number Exercise Dates	Price
27th October 2005	40,000	40,000	27th October 2008 to 26th October 2015	445.75
28th April 2006	40,000	40,000	28th April 2009 to 27th April 2016	580.00
	80,000	80,000		

#### Savings related share option scheme 1995

Date of grant	Number 31.12.06	Number 30.03.07	Number Exercise Dates	Price
20th May 2004	28,259	28,259	1st July 2007 to 31st December 2007	289.0

#### Save as you earn option plan 2005

Date of grant	Number 31.12.06	Number 30.03.07	Number Exercise Dates	Price
22nd May 2006	24,562	24,562	1st July 2009 to 31st December 2009	464.0

Information on the Company share-based payments is identical to that set out for the Group in note 18

### 34 RESERVES

Information in respect of share-based payments is set out in note 18 of the Group financial statements

	Share capital £'000	Share premium £'000	Share based payments £'000	Capital redemption reserve £'000
At 1st January 2006	18,361	87,635	174	1,431
Net proceeds of issue of new shares	1,995	21,215	–	–
<b>At 31st December 2006</b>	<b>20,356</b>	<b>108,850</b>	<b>174</b>	<b>1,431</b>

	Retained earnings £'000
As previously reported	27,374
Retained loss for the year	(13,904)
<b>As at 31st December 2006</b>	<b>13,470</b>

The loss after tax of the Company was £11,514,000 (2005 £6,662,000 profit)

## **Remuneration report**

The Remuneration Committee, as constituted by the Board, is responsible for the determination of the remuneration policy for the Development Securities' Executive Directors and for ensuring that the remuneration of senior managers and other employees is consistent with the Company's remuneration philosophy. The Committee, which met five times during the year, comprises M S Soames as Chairman and V M Mitchell W Grant retired as Chairman on 11th May 2006 following his resignation as a Director of the Company. All members of the Committee are considered independent Non-executive Directors of the Company. No member has any personal financial interest in the matters to be decided.

The Committee's principal role is to determine the total remuneration of the Executive Directors and to ensure that senior management remuneration is consistent with corporate policy. In addition to the support of the Executive Director, M H Marx and the Company Secretary, S A Lanes, the Committee sought professional advice from external consultants Towers Perrin and legal support from Linklaters. Towers Perrin, who currently do no other work for the Group, were appointed by the Remuneration Committee. Linklaters are also the Group's principal legal advisor.

During the previous year, the Committee carried out a thorough review of all elements of the Group's remuneration package, assisted by the Committee's professional advisors, with the Development Securities PLC Performance Share Plan 2006 and Investment Growth Plan 2006 approved by shareholders at the Annual General Meeting held on 11th May 2006. The emphasis by the Remuneration Committee in considering remuneration policy is to provide a balanced remuneration package for both Executive Directors and senior managers, requiring attention to both short- and long-term performance.

This report sets out the Committee's existing policy and disclosures on Executive Directors' and senior managers' pay and also outlines the several incentive plans and option schemes in operation by the Company. The Company has complied throughout the period with the FRC Combined Code on Corporate Governance June 2006 in relation to Directors' remuneration. In addition, the report has been prepared in accordance with the Directors' Remuneration Report Regulations 2002. As part of the Regulation requirements, sections 2 and 3 of this report have been audited.

### **1 EXECUTIVE REMUNERATION POLICY**

The objective of the Development Securities' remuneration policy is to ensure that Executive Directors and senior managers are rewarded in a way that attracts, retains, motivates and rewards management of the highest quality. The Development Securities PLC Performance Share Plan 2006, together with the various option schemes are designed to encourage Executive Directors and senior managers to align their long-term career aspirations with the long-term interests of the Group, promoting the attainment of both individual and corporate achievements measured against specific performance criteria. They are also designed to ensure a significant proportion of the total remuneration package for those individuals is performance related, thereby correlating with the interests of shareholders through either the attainment of growth in net asset value per share or total shareholder return.

#### **a) Salary**

The salaries of the Executive Directors are reviewed each year and are determined by reference to individual performance and in relation to comparable companies of similar size in the same business sector.

#### **b) Annual bonus**

The non-pensionable annual bonus is based on the performance of the Company during the year, team achievements and the specific contribution of the individuals concerned.

With the exception of M H Marx, Executive Directors are set a target bonus of 37.5 per cent of salary and an above target maximum of 75 per cent. As M H Marx does not normally qualify for awards under the Development Profit Plan below, his target bonus is 75 per cent of salary, with a maximum of 150 per cent. The annual bonus in respect of the Executive Directors is determined principally by the three main drivers for the creation of shareholder value in our business, namely, accurate reading of the economic and market cycles in which we operate, the pipeline of future development projects and the maintenance of the standards of excellence that are embedded within the Company's corporate culture. In addition, the Remuneration Committee measures the Company's relative performance against its peer group companies during the year.

### c) Development Profit Plan

The Remuneration Committee reserves the right to make awards under the Development Profit Plan to Executive Directors and other senior managers who have been instrumental in securing development opportunities for the Company

Awards are eligible on projects where the first phase is likely to produce profits in excess of £20 million. No more than 10 per cent of the profits of the development project is awarded in total. When any particular development project becomes unconditional, the Remuneration Committee determines which individuals should receive awards under the Plan and the amount of the award. The bonus is dependent principally upon the amount of profit actually realised upon completion. 20 per cent of the award will be retained until such time as the profit is actually realised whereupon it will be re-evaluated to determine if any additional Executive Directors or senior managers have been instrumental in making a significant and material contribution in progressing the scheme through to completion and if not, this retention would revert back to the original participants.

In awarding annual bonuses and awards under the Development Profit Plan there is no 'double-counting'. The contribution of any team and individual performance, which leads to awards under the Development Profit Plan are disregarded in assessing the annual bonus.

During the year, the following awards were made to the Executive Directors under the Development Profit Plan

Project	C J Barwick % award	M S Weiner % award
Paddington Central Phase II	7	—
CityPark, Manchester	4	4
Colindale, London NW	4	4
Cavendish Walk Shopping Centre, Huyton	—	9
Luneside, Lancaster	—	10
Hartfield Road, Wimbledon	4	4

Subsequent to the year-end, the only award in respect of Frimley, Surrey and Globeside Business Park, Marlow was three per cent awarded to M S Weiner, both projects having come to a successful conclusion during 2006. A bonus of £87,096 under the Development Profit Plan has consequently been made.

Cavendish Walk Shopping Centre, Huyton achieved practical completion in December 2006 and was subsequently disposed of, realising £240 million of proceeds. Accordingly, M S Weiner has received a Development Profit Plan payment of £631,775.

In addition to making awards under the Development Profit Plan in securing development opportunities, the Remuneration Committee retains the discretion to award bonuses to Executive Directors and other executives at any time for making an exceptional contribution towards the Company. Such awards will not be applied in securing any corporate acquisitions. No such awards were made during the year.

### d) Investment Growth Plan

The Remuneration Committee reserves the right to award bonuses under the Investment Growth Plan. The performance condition of the award is that the total investment portfolio return must exceed 120 per cent of the All-Fund Universe Index as published by Investment Property Databank if the index is greater than zero, or at least 0.1 per cent if the index is less than or equal to zero and, in addition, represents at least one percentage point above the total return under the index. The total investment portfolio return represents the sum of income return, net of irrecoverable property expenses, together with capital growth.

The Initial Bonus represents a bonus pool of five per cent of the value determined by the excess of the total investment portfolio return over the benchmark index up to a cap of £1 million unless otherwise determined. The award is remitted following the end of the financial year when the award is then determined, with an equivalent amount representing a Deferred Bonus assessed two years thereafter, provided that during the intervening period the total investment portfolio return exceeds a specified proportion of the index.

The performance condition for the 2006 financial year was not satisfied, giving rise to a nil bonus pool. The Deferred Bonus from 2004 has satisfied the additional condition, giving rise to a remittance of £160,622. The amount deferred from 2005 of £211,260 will be retested next year.

**e) Long-Term Incentive Plan and Performance Share Plan**

The Long-Term Incentive Plan was approved by shareholders at an Extraordinary General Meeting of the Company on 15th December 1999. The Plan, which first became operative in respect of the financial year ended 31st December 2000, permits the Remuneration Committee to award performance-related deferred bonuses. The deferred bonuses vest over a three-year period. The award will be paid in cash, all of which will be used to buy shares in the Company, except where participants are subject to tax and social security in respect of the award, they will, to that extent receive cash only. At the end of each year, the Group's net asset value per share will be calculated. If the increase in the Group's net asset value per share is at least equal to that of the median of a group of 17 listed property companies, then the deferred bonus will vest as to one-sixth of the maximum amount which can be awarded. If growth reaches the upper quartile level, the deferred bonus will vest as to one-third of the maximum amount which can be awarded. Between these criteria, the deferred bonus will vest pro rata. If the Group's net asset value per Ordinary share is below the median for any year, the deferred bonus will not vest at all in respect of that year. The 17 listed property companies comprise The British Land Company PLC, Brixton PLC, CLS Holdings PLC, Capital & Regional PLC, Daejan Holdings PLC, Derwent Valley Holdings PLC, Great Portland Estates PLC, Hammerson PLC, Helical Bar PLC, Land Securities Group PLC, Liberty International PLC, London Merchant Securities PLC, McKay Securities PLC, Quintain Estates and Development PLC, Rugby Estates PLC, Slough Estates PLC and Warner Estate Holdings PLC. Furthermore, there is an underpin that the increase in the Group's net asset value per share must also have at least equalled the increase in the retail price index plus 2 per cent for the first performance year, 4 per cent over the first two years for the second year and 6 per cent over all three years for the third year. The primary performance condition is considered appropriate as it measures the Company's added value against a representative peer group of companies. Normally, once the three years of vestings have been determined by the Remuneration Committee, the deferred bonus is capable of exercise during the period of 42 days from the announcement of the Company's results.

Development Securities PLC ranked seventeenth against the comparator group of companies in respect of the third year of vesting for the deferred bonus granted under the long-term incentive plan on 7th May 2003, the second vesting of the deferred bonus granted on 30th April 2004 and the first vesting of the deferred bonus granted on 29th April 2005. The value of each of these vestings was £nil.

The deferred bonus award granted on 7th May 2003 matured during the year and had a total vesting to date of £nil.

The Remuneration Committee considered the Long-Term Incentive Plan to be complicated and unmotivational. Accordingly shareholder approval was obtained at the Annual General Meeting held on 11th May 2006 for its replacement by the Development Securities PLC Performance Share Plan 2006.

Awards under the Performance Share Plan will be made on the basis that shares will be acquired subject to the satisfaction of performance conditions over a three-year performance period, with no retesting. The performance is measured by comparing the total shareholder return ('TSR') achieved by the Company with the individual constituent members of the FTSE Real Estate Index. There is a sliding scale of vesting as follows:

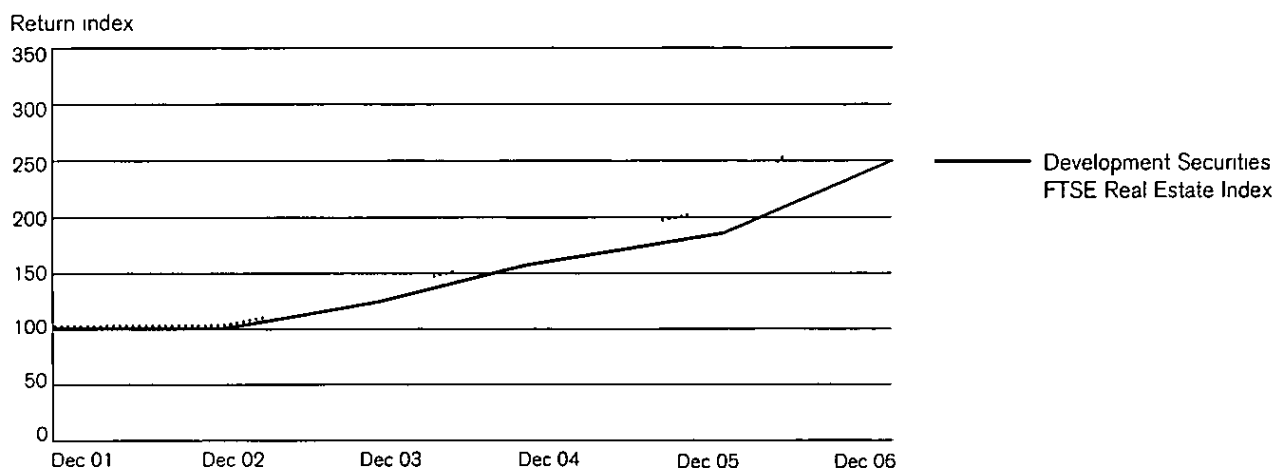
- i) 25 per cent of the award will vest if the Company's TSR equals the median TSR of the comparator group,
- ii) 100 per cent of the award will vest if the Company's TSR equals or exceeds the 85th percentile TSR of the comparator group,
- iii) pro rata vesting will apply in between the above points.

In addition, the Remuneration Committee must be satisfied that there has been a sustained improvement in the Company's underlying financial performance over the performance period.

On 20th June 2006, awards were made under the Performance Share Plan to M H Marx of 83,293 shares representing 150 per cent of salary, and to C J Barwick of 49,784 shares, P J Willis of 49,784 shares and M S Weiner 44,040 shares each representing 100 per cent of salary. In total, 329,807 shares were, at the discretion of the Remuneration Committee, awarded to 28 employees and four Executive Directors.



The graph below demonstrates Development Securities PLC's total shareholder return as represented by share price growth plus reinvested dividends, against the FTSE Real Estate Index also measured by total shareholder return over the past five financial years. The FTSE Real Estate Index is considered the most appropriate index for comparison of the Company's business performance against that of its competitors.



#### f) Option scheme 1993

The option scheme 1993 is a share-based bonus scheme approved by shareholders in that year. It allows individuals to benefit from movements in the price of the Company's shares over the period between the third and tenth year following grant. The Directors may at the date of grant limit the aggregate notional bonus which may become payable.

No new grants have been made during the year and none are currently outstanding.

#### g) Share option schemes

The Executive Share Option Scheme 1995 was approved by shareholders in that year. This was replaced by the Executive Share Option Plan 2005 which was approved by the shareholders at the 2005 Annual General Meeting on 12th May 2005. The options under both schemes were granted on the basis that they may only be exercised if a performance condition is satisfied.

Options over 40,000 shares were granted on 28th April 2006 to M S Weiner at 580 pence per share under the Executive Share Option Plan 2005. The performance condition is to measure the average net asset growth of the Company over three consecutive financial years against the growth in the Investment Property Databank Index (All Property). The options will vest on a sliding scale with 50 per cent if average net asset growth is at least equal to that of the Index, 100 per cent if in excess of the Index by 4 per cent per annum and pro rata vesting in-between. The performance condition will not be retested after the end of the performance period. The performance condition is considered appropriate as the Index measures against the Company's added value.

It is the intention of the Remuneration Committee that no further grants be made to Executive Directors except under exceptional circumstances, for example a new appointment or an acute retention requirement. Grants to senior managers may continue in the future as appropriate.

Following the declaration of a 28.5 pence special dividend on 19th February 2003, the Remuneration Committee have resolved that option holders may receive a cash bonus upon exercise of those options then outstanding, equivalent to the special dividend as equitable compensation.

#### h) Savings related option scheme

The Savings Related Option Plan 1995 was replaced by the Save As You Earn Option Plan 2005 at the 2005 Annual General Meeting held on 12th May 2005, following the expiry of the earlier scheme's 10-year life. The first grant under the Save As You Earn Option Plan 2005 was made on 22nd May 2006 for a total of 25,368 options over shares at 464 pence per share to 23 members of staff, including C J Barwick for 2,015 and M S Weiner for 1,410 options over shares. The Option Plan was open to all employees who had been employed by the Group in excess of three months. The options may be exercised after three years at a price not less than 80 per cent of the market value of the shares at the time of invitation. The options granted on 20th May 2004 at 289 pence per share may also be exercised after three years.

#### **i) Directors' contracts**

The contracts of employment in relation to M H Marx dated 24th June 1994, of C J Barwick dated 12th May 1998, and M S Weiner dated 17th March 2004 may all be terminated upon 12 months' notice by either party. The contracts do not specify an expiry date. Severance payments are based upon the service contract terms, whilst bearing in mind a duty to mitigate, where appropriate. In the event of early termination, the contractual entitlement includes salary, pension, benefits in kind and any awards outstanding under the sections described above, subject to the rules of the individual schemes and plans. P V S Manduca, V M Mitchell and M S Soames serve for fixed terms expiring at the date of the Annual General Meetings to be held in 2008, 2009 and 2009 respectively. D S Jenkins will be standing for election at the 2007 Annual General Meeting and if elected will then stand for re-election at the Annual General Meeting to be held in 2010. D S Jenkins' letter of appointment may be terminated with 12 months' notice by either party and those for P V S Manduca, V M Mitchell and M S Soames may be terminated with six months' notice by either party. R M Dantzie will be standing down at the 2007 Annual General Meeting which coincides with the end of his fixed term.

Following the departure of M R Landau as an Executive Director of the Company as at 31st December 2002, a consultancy service agreement was executed with Executive Services Overseas Inc for the provision by M R Landau, of services on a non-exclusive basis. This includes in broad terms the payment by the Company of 10 per cent of the development profits on completed projects, with a deduction of £675,000 from any profit entitlement in respect of future development at Broughton Park, near Chester. The agreement has been extended for a further period to 31st December 2007.

The fees of the Non-executive Directors are determined by the Board within the aggregate limit set by the Articles of Association. No Director participates in any discussion about their own particular remuneration. The fees of the Non-executive Directors were reviewed with effect from 1st July 2006 based on advice received from Towers Perrin. The basic fee of a Non-executive Director was increased from £25,000 to £30,000 per annum, with £7,500 per annum for chairmanship of the Audit and Remuneration Committees and £2,500 per annum for membership of those two Committees and with £2,500 per annum awarded to the Senior Independent Director.

The fees of the Chairman were reviewed at the same date by the Remuneration Committee, being increased from £50,000 to £60,000 per annum. The Chairman's fees had previously been reviewed in 1999.

Executive Directors may accept appointment to an external Non-executive Directorship to gain experience, provided this does not create any conflict of interest and for which they may retain any attributable fees. The only Executive Directors to have received any external Non-executive Directorship fees during the year were M H Marx, who received £9,200 from FIBI Bank (UK) PLC and £15,000 from Nationwide Accident Repair Services PLC and C J Barwick, who received £45,000 from London & Continental Railways Limited.

#### **j) Retirement benefits**

Qualifying members of staff are invited to join the Development Securities PLC retirement benefits scheme, which is a contracted-in money purchase scheme, including appropriate life assurance. Since the Company's policy is to render pension payments on a defined contribution basis, this avoids the uncertainty of pension liabilities to the Company, which would be the case had a defined benefit scheme been adopted. M H Marx has a separate personal pension arrangement, whilst C J Barwick and M S Weiner are members of the Company scheme. Funded unapproved retirement benefits schemes (FURBS) have been established for both M H Marx and C J Barwick. The maximum contributions by the Company towards the approved Company scheme, or personal pension arrangements, together with the FURBS, may not exceed a total of 17.5 per cent of salary.

#### **k) Executive Directors' shareholding requirement**

During 2003, it was determined that Executive Directors should align themselves with shareholders' interests, with any new Executive Director obliged to establish a beneficial shareholding to the value of one-half of their basic salary within two years of appointment, rising to an amount equivalent to basic salary after four years. M H Marx and C J Barwick, the two Executive Directors then in position at the time of resolution, were required to secure and maintain a beneficial shareholding to an amount equivalent to basic salary by 1st April 2006. Both Directors have met this objective. The Remuneration Committee retains the discretion to reduce this requirement in the event of corporate or personal constraints.

## 2 DIRECTORS' EMOLUMENTS (AUDITED)

The total Directors' remuneration was as follows

	2006 £'000	2005 restated £'000
Emoluments	2,858	2,827
Long-term incentive plan	-	232
Company contributions to money purchase pension schemes	175	167
Gain on exercise of share options	745	13
	<b>3,778</b>	<b>3,239</b>

The remuneration of the individual Directors who held office during the year is set out below

	Salaries and Fees £'000	Bonus £'000	Benefits in kind £'000	Total 2006 £'000	Total 2005 £'000	Long-term incentive plan 2006 £'000	Long-term incentive plan 2005 £'000	Pension Contributions 2006 £'000	Pension Contributions 2005 £'000
<b>Chairman</b>									
R M Dantzic	55	-	-	55	50	-	-	-	-
<b>Executive Directors</b>									
M H Marx	290	283	18	591	1,248	-	101	52	53
C J Barwick	260	186	17	463	367	-	101	43	42
P J Willis	260	125	19	404	370	-	-	40	39
M S Weiner (highest paid Director)	230	991	15	1,236	685	-	30	40	33
<b>Non-executive Directors</b>									
W Grant	11	-	-	11	32	-	-	-	-
P V S Manduca	36	-	-	36	25	-	-	-	-
M S Soames	32	-	-	32	25	-	-	-	-
V M Mitchell	30	-	-	30	25	-	-	-	-
	1,204	1,585	69	2,858	2,827	-	232	175	167

Benefits in kind received during the year comprise motor vehicles, cash in lieu of a motor vehicle, fuel and medical insurance

### 3 DIRECTORS' SHARE INTERESTS (AUDITED)

The interests of the Directors, all of which were beneficial in the share capital of the Company, were

#### Ordinary Shares

	2006 Number	2005 Number
R M Dantzie	5,739	5,739
M H Marx	277,895	277,895
C J Barwick	131,749	69,643
P J Willis	23,315	4,635
M S Weiner	15,059	6,179
V M Mitchell	1,549	1,549
M S Soames	5,739	5,739
	<b>461,045</b>	<b>371,379</b>

#### Options

	1st January 2006 Number	Granted	Exercised	31st December 2006 Number	Exercise price Pence	Market price at exercise Pence	Gain on exercise £'000	Date from which exercisable	Expiry date
<b>M H Marx</b>									
Savings related scheme	3,261	—	—	3,261	2890	—	—	01/07/07	31/12/07
<b>C J Barwick</b>									
Executive option scheme 1995	216,431	—	216,431	—	323.5	660.3	728	26/05/01	25/05/08
Savings related scheme	—	2,015	—	2,015	4640	—	—	01/07/09	31/12/09
<b>P J Willis</b>									
Executive option scheme 1995	151,424	—	—	151,424	3610	—	—	30/04/07	29/04/14
Executive option scheme 1995	50,000	—	—	50,000	3925	—	—	09/11/07	08/11/14
<b>M S Weiner</b>									
Executive option scheme 1995	59,207	—	8,880	50,327	3380	5360	17	27/03/04	26/03/11
Executive option scheme 1995	66,979	—	—	66,979	3600	—	—	19/04/07	18/04/14
Savings related scheme	978	—	—	978	2890	—	—	01/07/07	31/12/07
Executive option scheme 2005	40,000	—	—	40,000	445.75	—	—	27/10/08	26/10/15
Executive option scheme 2005	—	40,000	—	40,000	5800	—	—	28/04/09	27/04/16
Savings related scheme	—	1,410	—	1,410	4640	—	—	01/07/09	31/12/09
							<b>745</b>		

### Long-Term Incentive Plan

	Date of grant	1st January 2006 maximum award £'000	Awarded during year maximum award £'000	Lapsed during year maximum award £'000	31st December 2006 maximum award £'000	Vested during year £'000	Vested to date £'000	Final vesting date
M H Marx	07 05 03	345	—	345	—	—	—	31 12 05
	30 04 04	180	—	—	180	—	—	31 12 06
	29 04 05	220	—	—	220	—	—	31 12 07
C J Barwick	07 05 03	345	—	345	—	—	—	31 12 05
	30 04 04	180	—	—	180	—	—	31 12 06
	29 04 05	220	—	—	220	—	—	31 12 07
P J Willis	29 04 05	150	—	—	150	—	—	31 12 07
M S Weiner	07 05 03	120	—	120	—	—	—	31 12 05
	30 04 04	120	—	—	120	—	—	31 12 06
	29 04 05	150	—	—	150	—	—	31 12 07

a) The final vesting dates represent the dates at which the Group's net assets are compared against the 17 listed property companies as outlined in section 1(e). In practice, however, it is several months thereafter that the relevant annual report and accounts are published, in order that the final vesting can be determined.

### Performance Share Plan

	Date of grant	Market price at date of grant Pence	1st January 2006 Number	Granted	Exercised	31st December 2006 Number	Final vesting date
M H Marx	20/06/06	522.25	—	83,293	—	83,293	31/12/08
C J Barwick	20/06/06	522.25	—	49,784	—	49,784	31/12/08
P J Willis	20/06/06	522.25	—	49,784	—	49,784	31/12/08
M S Weiner	20/06/06	522.25	—	44,040	—	44,040	31/12/08

a) None of the Directors had a beneficial interest in the shares of any subsidiary company.

b) The mid-market price of the shares at the close of business on 29th December 2006, the last trading day in the financial year, was 695 pence and the range during 2006 was 475 pence to 695 pence.

c) No options lapsed or were exercised during the year, except as disclosed above.

d) There were no transactions between 31st December 2006 and the date of this report.

Approved by the Board and signed on its behalf by

M S Soames  
Chairman of the Remuneration Committee  
30th March 2007

## **Financial calendar and advisors**

### **Financial calendar**

Annual General Meeting	15th May 2007
Payment of Ordinary Dividend	6th July 2007
Announcement of Interim Results to 30th June 2007	September 2007

### **Secretary**

S A Lanes FCA

### **Registered office**

Portland House  
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London SW1E 5DS  
Telephone 020 7828 4777  
Facsimile 020 7828 4999

### **Website address**

[www.developmentsecurities.com](http://www.developmentsecurities.com)

### **Registered number**

1528784

### **Incorporation**

Development Securities PLC is incorporated in Great Britain  
and registered in England and Wales

### **Auditors**

Ernst & Young LLP  
Chartered Accountants

### **Principal bankers**

Barclays Bank PLC  
HSBC Property Finance  
Bank of Scotland  
Norwich Union Mortgage Finance Limited

### **Corporate solicitors**

Linklaters

### **Financial advisor and corporate stockbroker**

Collins Stewart Limited

### **Registrars and Transfer office**

Capita Registrars  
Northern House  
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