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## **Prosperity Real Estate Investment Trust**

*(a Hong Kong collective investment scheme authorised under section 104 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong))*

**(Stock Code: 808)**

Managed by



**ARA Asset Management (Prosperity) Limited**

### **FINAL RESULTS ANNOUNCEMENT FOR THE YEAR ENDED 31 DECEMBER 2018**

Prosperity Real Estate Investment Trust (“**Prosperity REIT**”) is a real estate investment trust incorporated by a trust deed entered into on 29 November 2005, as amended, varied and supplemented from time to time (the “**Trust Deed**”) between ARA Asset Management (Prosperity) Limited, as the manager of Prosperity REIT (the “**REIT Manager**”), and HSBC Institutional Trust Services (Asia) Limited, as the trustee of Prosperity REIT (the “**Trustee**”). Prosperity REIT was the first private sector real estate investment trust (“**REIT**”) to list on The Stock Exchange of Hong Kong Limited (the “**Stock Exchange**”) on 16 December 2005 (the “**Listing Date**”). Prosperity REIT currently owns a diverse portfolio of seven high-quality commercial properties in Hong Kong.

The REIT Manager is pleased to announce the audited consolidated results of Prosperity REIT and its subsidiaries for the year ended 31 December 2018 (the “**Reporting Year**”) together with comparative figures for the corresponding year in 2017 as follows:

**Performance Highlights**

	<b><u>Year ended 31 Dec 2018</u></b>	<b><u>Year ended 31 Dec 2017</u></b>	<b><u>Percentage change Increase/(Decrease)</u></b>
Distribution per unit (“DPU”)	HK\$0.1810	HK\$0.1780	1.7%

<b><u>Key financial figures</u></b>	<b><u>As at 31 Dec 2018</u></b>	<b><u>As at 31 Dec 2017</u></b>	<b><u>Percentage change Increase/(Decrease)</u></b>
Net asset value per unit	HK\$5.74	HK\$5.48	4.7%
Property valuation	HK\$10,990 million	HK\$10,490 million	4.8%
Gearing ratio <sup>1</sup>	20.6%	21.5%	(0.9%) <sup>2</sup>

<b><u>Operation data</u></b>	<b><u>Year ended 31 Dec 2018</u></b>	<b><u>Year ended 31 Dec 2017</u></b>	<b><u>Percentage change Increase/(Decrease)</u></b>
Revenue	HK\$446.8 million	HK\$446.2 million	0.1%
Net property income	HK\$350.8 million	HK\$353.6 million	(0.8%)
Average effective unit rent	HK\$24.68 per sq.ft.	HK\$24.31 per sq.ft.	1.5%
Occupancy rate (as at 31 Dec)	97.6%	97.7%	(0.1%) <sup>2</sup>
Cost-to-revenue ratio	21.5%	20.8%	0.7% <sup>2</sup>

<sup>1</sup> This excludes the bank facility origination fees already paid in cash, and is calculated by dividing total borrowings over total assets.

<sup>2</sup> Absolute change.

## **Distribution**

It is the policy of the REIT Manager to distribute to unitholders of Prosperity REIT an amount equal to 100% of Prosperity REIT's annual distributable income for the financial year ended 31 December 2018. Pursuant to the Trust Deed, Prosperity REIT is required to ensure that the total amount distributed to unitholders shall be no less than 90% of Prosperity REIT's annual distributable income for each financial year.

## **Business Overview**

Despite the slowdown in the global economy, the performance of Prosperity REIT was resilient under the prevailing market conditions. We registered stable growth in both distributable income and distribution per unit (“DPU”). Net asset value per unit and property valuation grew steadily year-on-year (“YoY”) by 4.7% and 4.8% to HK\$5.74 and HK\$10,990 million respectively.

In light of these results, I am pleased to announce that our unitholders will receive a total DPU of HK\$0.1810 for the year ended 31 December 2018, representing a stable yield of 6.0%<sup>3</sup>.

## **Market Review**

Under the uncertainties in the US-China trade conflict, the Hong Kong stock market recorded a correction. GDP growth remained positive but the anticipated headwinds from the impact of trade conflict would unveil gradually.

While there was a slowdown in China economic growth, 2018 GDP continued to record a 6.6% growth. The US economic indicators were positive. The Federal Reserve raised interest rate four times in 2018. However, the Federal Open Market Committee (“FOMC”) meeting in January 2019 indicated that it would adopt a patient and wait-and-see approach in light of the global economic and financial developments. It is expected that interest rate hikes would not be as aggressive as in 2018.

## **Operations Review**

With solid domestic demand and new transportation connectivity to Mainland China with the newly-opened Express Rail Link and Hong Kong-Zhuhai-Macao Bridge, it is believed that more business opportunities would be brought to the economy. Prosperity REIT achieved stable top-line revenue and net property income at HK\$446.8 million and HK\$350.8 million respectively across the Reporting Year. Positive rental reversion attained, while occupancy rates across the portfolio remained stable amidst volatile market conditions.

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<sup>3</sup> Based on Prosperity REIT's closing unit price of HK\$3.00 as at 31 December 2018.

## **Outlook**

Looking ahead, China has strengthened its correlation with the economic growth in Hong Kong through the development of Guangdong-Hong Kong-Macao Greater Bay Area, which pushes forward the economic and infrastructure development in the area.

On the micro perspective, the Kowloon East district is continuing to grow as a mature commercial hub, serving as a priority destination for corporates looking for quality office space in decentralized districts. Decentralization trend continues, while our portfolio's strong presence in Kowloon East remains intact.

We remain cautiously optimistic regarding the challenges and unforeseen circumstances that lie ahead, mainly on the headwinds and pressure brought by the US-China trade conflict on the Hong Kong economy. Our management approach remains prudent and proactive aiming to optimize stable and sustainable returns.

## **Acknowledgements**

I would like to take this opportunity to once again sincerely thank all those who have contributed to our success over the past year. Our staff members, tenants, service providers and business partners have also all played significant roles taking us forward in often challenging times. In particular, my thanks go to my fellow Board members and the management team for their dedication and efforts.

I would like to finish by acknowledging and thanking all our unitholders. Your continuing support and confidence in Prosperity REIT is critical for our sustainable growth.

**Chiu Kwok Hung, Justin**  
*Chairman*  
**ARA Asset Management (Prosperity) Limited**  
**as manager of Prosperity REIT**

Hong Kong, 22 March 2019

## MANAGEMENT DISCUSSION AND ANALYSIS

### Operations Review

As at 31 December 2018, Prosperity REIT owned a diverse portfolio of seven properties in the decentralized business districts of Hong Kong, comprising all, or a portion of, three Grade A office buildings, one commercial building, two industrial/office buildings and one industrial building. As at 31 December 2018, the total gross rentable area was 1,275,153 sq. ft., with a total of 498 car park spaces.

Information about the properties in the portfolio, as at 31 December 2018, was as follows:

	<b>Location</b>	<b>Gross rentable area <i>sq. ft.</i></b>	<b>No. of car park spaces</b>	<b>Valuation <i>HK\$ million</i></b>	<b>Occupancy rate</b>
<b>Grade A Office</b>					
The Metropolis Tower	Hung Hom	271,418	98	3,330	99.2%
Prosperity Millennia Plaza	North Point	217,955	43	2,250	97.6%
9 Chong Yip Street	Kwun Tong	136,595	68	1,150	92.4%
<b>Commercial</b>					
Prosperity Place	Kwun Tong	240,000	83	1,860	99.2%
<b>Industrial/Office</b>					
Trendy Centre	Lai Chi Kok	173,764	79	1,110	96.0%
Prosperity Center (portion)	Kwun Tong	149,253	105	930	97.1%
<b>Industrial</b>					
New Treasure Centre (portion)	San Po Kong	86,168	22	360	100.0%
<b>Total</b>		<b>1,275,153</b>	<b>498</b>	<b>10,990</b>	<b>97.6%</b>

With the REIT Manager's professional management expertise, Prosperity REIT was able to attain a stable occupancy rate of 97.6% as at 31 December 2018, reflecting the effectiveness of the leasing strategies deployed. With efficient streamlining of operations, the cost-to-revenue ratio was maintained at a relatively low level of 21.5%.

### **Investment Review**

The REIT Manager will continue to implement its investment strategy prudently. We shall assess every acquisition target in accordance with our established investment criteria, including the enhancement potential of asset value, organic growth prospects and synergies with existing properties in the portfolio.

### **Asset Enhancement**

It is an established strategy of the REIT Manager to provide premium rentable space in order to achieve sustainable rental growth. To this end, asset enhancement initiatives have been planned and executed on a continuous basis. During the Reporting Year, a number of asset enhancement works were completed at The Metropolis Tower, Prosperity Place and Prosperity Millennia Plaza. Asset enhancement initiatives will continue in 2019 across the portfolio, with prudently planned payback periods.

### **The Metropolis Tower**

The typical floor sanitary facilities were reviewed. The executive and common washrooms on all typical floors were renovated. A pantry was built. These initiatives enhanced the workplace environment for our tenants and increased the competitiveness of the building.

### **Prosperity Place and Prosperity Millennia Plaza**

We have replaced one of the chiller sets by a more energy-efficient model in 2014 and 2015 for Prosperity Place and Prosperity Millennia Plaza respectively, and achieved notable energy cost savings. Considering higher maintenance costs for the remaining ageing chiller sets and to offset portion of the increment of electricity tariff, we have further replaced another chiller set in these two properties in order to upkeep a reliable and efficient air-conditioning provision.

## **Financial Review**

The revenue and net property income of each property in Prosperity REIT's portfolio for the Reporting Year are summarized as follows:

	<b>Turnover</b>	<b>Rental related income</b>	<b>Revenue</b>	<b>Net property income</b>
	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
<b>Grade A Office</b>				
The Metropolis Tower	106,140	20,184	126,324	97,986
Prosperity Millennia Plaza	80,333	14,321	94,654	77,641
9 Chong Yip Street	36,355	4,117	40,472	30,727
<b>Commercial</b>				
Prosperity Place	75,425	267	75,692	60,804
<b>Industrial/Office</b>				
Trendy Centre	45,331	7,068	52,399	40,679
Prosperity Center (portion)	37,268	3,412	40,680	30,714
<b>Industrial</b>				
New Treasure Centre (portion)	14,536	2,057	16,593	12,260
<b>Total</b>	<b>395,388</b>	<b>51,426</b>	<b>446,814</b>	<b>350,811</b>

## **Revenue**

During the Reporting Year, revenue slightly increased to HK\$446.8 million, being HK\$0.6 million or 0.1% higher than that of 2017. The increase was mainly due to the positive rental reversion and stable occupancy rates.

### Net Property Income

For the Reporting Year, the net property income was HK\$350.8 million, being HK\$2.8 million or 0.8% lower than that of 2017. The cost-to-revenue ratio was 21.5%.

### Distributable Income

The annual distributable income of Prosperity REIT to unitholders for the Reporting Year, amounted to HK\$268.9 million, representing a total DPU of HK\$0.1810. The distributable income for the Reporting Year is calculated by the REIT Manager as representing the consolidated profit after tax of Prosperity REIT and its subsidiaries for the relevant financial year, as adjusted to eliminate the effects of certain Adjustments (as defined in the Trust Deed) including a finance cost of HK\$8.0 million (equivalent to HK\$0.0054 per unit), which have been recorded in the consolidated statement of profit or loss and other comprehensive income for the Reporting Year.

The distributable income for the half year from 1 July 2018 to 31 December 2018 is HK\$132.6 million, equivalent to a DPU of HK\$0.0890. The interim DPU from 1 January 2018 to 30 June 2018 was HK\$0.0920. The total DPU for the Reporting Year is HK\$0.1810, which represents a distribution yield of 6.0%<sup>4</sup>. The DPU increased by 1.7% YoY.

The distribution for the half year from 1 July 2018 to 31 December 2018 will be paid on Thursday, 18 April 2019.

### Liquidity and Financing

As at 31 December 2018, Prosperity REIT had facilities in aggregate of HK\$2,770 million, comprising:

- (i) A term loan and revolving credit facility of up to an aggregate principal amount of HK\$1,970 million (the “**HK\$1,970 Million Facilities**”) comprising a HK\$1,540 million unsecured term loan facility and a HK\$430 million unsecured revolving credit facility, which bear interest at a margin of 0.82% per annum over HIBOR. The term loan facility will mature and become repayable 5 years from 30 November 2017, and the revolving credit facility will be repaid on each maturity date and can be redrawn upon maturity; and
- (ii) A HK\$800 million unsecured term loan bears interest at floating interest rate of 1.05% per annum over HIBOR, and will mature and become repayable 5 years from 31 August 2016 (the “**HK\$800 Million Facility**”).

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<sup>4</sup> Based on Prosperity REIT's closing unit price of HK\$3.00 as at 31 December 2018.

In relation to the HK\$1,970 Million Facilities, the term loan facility of HK\$1,540 million was fully drawn on 30 November 2017. None of the revolving credit facility was drawn as at 31 December 2018.

The HK\$800 Million Facility was fully drawn on 31 August 2016.

As all facilities bear interests at a variable rate, Prosperity REIT has entered into plain vanilla interest rate swap and cap agreements to mitigate the impact of interest rate fluctuations. As at 31 December 2018, the interest costs for approximately 50% (31 December 2017: 90%) of Prosperity REIT's outstanding term loans have been hedged through interest rate swaps and cap.

The total borrowings of Prosperity REIT, excluding the bank facilities origination fees, as a percentage of Prosperity REIT's gross assets was 20.6% as at 31 December 2018, whereas the gross liability of Prosperity REIT as a percentage of Prosperity REIT's gross assets was 25.1% as at 31 December 2018.

Taking into account the fair value of investment properties, presently available banking facilities and internal financial resources of Prosperity REIT, Prosperity REIT has sufficient financial resources to satisfy its commitments and working capital requirements.

### Investment Properties and Property Valuation

For the Reporting Year, Prosperity REIT's portfolio recorded an investment property revaluation gain of HK\$487.9 million, based on a professional valuation performed by an independent qualified external valuer, Colliers International (Hong Kong) Limited. The movements of fair values are tabulated below:

	<b>31 December 2018</b> <i>HK\$'000</i>	31 December 2017 <i>HK\$'000</i>
Fair value at the beginning of the year	<b>10,490,000</b>	10,183,000
Additional expenditure	<b>12,118</b>	11,303
Change in fair value of investment properties	<b>487,882</b>	295,697
Fair value at the end of the year	<b>10,990,000</b>	10,490,000

### Charges on Assets

As at 31 December 2018, all bank loan facilities of Prosperity REIT are unsecured. None of the investment properties of Prosperity REIT were pledged to secure bank loan facilities of Prosperity REIT's finance companies.

Prosperity REIT has provided guarantees for the HK\$1,970 Million Facilities and the HK\$800 Million Facility.

### **EMPLOYEES**

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

### **REPURCHASE, SALE OR REDEMPTION OF UNITS**

During the Reporting Year, other than the disposal of 3,742,000 units of Prosperity REIT by the REIT Manager which the REIT Manager had received as payment of its management fee, there was no repurchase, sale or redemption of the units of Prosperity REIT by Prosperity REIT or its subsidiaries.

### **CORPORATE GOVERNANCE**

The REIT Manager was established for the purpose of managing Prosperity REIT. The REIT Manager is committed to the establishment of good corporate governance practices and procedures. The corporate governance principles of the REIT Manager emphasize a quality board of directors, sound internal control, transparency and accountability to all unitholders. The REIT Manager has adopted its compliance manual (the "**Compliance Manual**") for use in relation to the management and operation of Prosperity REIT, which sets out the key

processes, systems and measures, and certain corporate governance policies and procedures to be applied for compliance with all applicable regulations and legislation. A summary of the key components of the corporate governance policies that have been adopted and complied with by the REIT Manager and Prosperity REIT will be set out in the Annual Report of Prosperity REIT for the Reporting Year. During the Reporting Year, both the REIT Manager and Prosperity REIT have in material terms complied with the provisions of the Compliance Manual.

#### **CLOSURE OF REGISTER OF UNITHOLDERS**

The register of unitholders will be closed from Tuesday, 9 April 2019 to Wednesday, 10 April 2019, both days inclusive, during which period no transfer of units will be effected. In order to qualify for the distribution, all unit certificates with completed transfer forms must be lodged with Prosperity REIT's unit registrar, Computershare Hong Kong Investor Services Limited at Shops 1712–16, 17/F., Hopewell Centre, 183 Queen's Road East, Wanchai, Hong Kong, not later than 4:30 p.m. on Monday, 8 April 2019. The payment date of the final distribution will be on Thursday, 18 April 2019.

#### **REVIEW OF FINAL RESULTS**

The final results of Prosperity REIT for the Reporting Year have been reviewed by the Audit Committee and the Disclosures Committee of the REIT Manager.

#### **PUBLIC FLOAT**

As far as the REIT Manager is aware, more than 25% of the issued units of Prosperity REIT were held in public hands as at 31 December 2018.

#### **ISSUANCE OF ANNUAL REPORT**

The Annual Report of Prosperity REIT for the Reporting Year will be dispatched or sent to unitholders on or before Tuesday, 30 April 2019.

#### **ANNUAL GENERAL MEETING**

It is proposed that the annual general meeting of Prosperity REIT will be held on Friday, 17 May 2019. Notice of the annual general meeting will be published and issued to unitholders in due course.

**Consolidated Statement of Profit or Loss and Other Comprehensive Income**  
*For the year ended 31 December 2018*

	<i>Notes</i>	<i>2018</i> <i>HK\$'000</i>	<i>2017</i> <i>HK\$'000</i>
Revenue	3	446,814	446,242
Property management fees		(10,994)	(10,965)
Property operating expenses		(85,009)	(81,677)
Total property operating expenses		<u>(96,003)</u>	<u>(92,642)</u>
<b>Net property income</b>		350,811	353,600
Interest income		4,790	5,225
Manager's fee		(53,610)	(51,954)
Trust and other expenses	5	(8,603)	(9,276)
Gain on disposed property company	13	-	299,695
Change in fair value of investment properties		487,882	295,697
Change in fair value of derivative financial instruments		1,941	(18,050)
Finance costs	6	<u>(57,691)</u>	<u>(86,775)</u>
<b>Profit before taxation and transactions with unitholders</b>		725,520	788,162
Taxation	7	<u>(37,940)</u>	<u>(39,737)</u>
<b>Profit for the year, before transactions with unitholders</b>		687,580	748,425
Distribution to unitholders		<u>(268,899)</u>	<u>(261,533)</u>
<b>Profit for the year, after transactions with unitholders</b>		418,681	486,892
<b>Total comprehensive income for the year, after transactions with unitholders</b>		<u>418,681</u>	<u>486,892</u>
<b>Income available for distribution to unitholders</b>		<u>268,899</u>	<u>261,533</u>
<b>Basic earnings per unit (HK\$)</b>	8	<u>0.46</u>	<u>0.51</u>

## Distribution Statement

For the year ended 31 December 2018

	2018 HK\$'000	2017 HK\$'000
<b>Profit for the year, before transactions with unitholders</b>	<b>687,580</b>	<b>748,425</b>
Adjustments:		
Manager's fee	52,441	50,815
Gain on disposed property company	-	(299,695)
Change in fair value of investment properties	(487,882)	(295,697)
Change in fair value of derivative financial instruments	(1,941)	18,050
Finance costs	7,991	26,411
Deferred tax	10,710	13,224
<b>Income available for distribution (note (i))</b>	<b>268,899</b>	<b>261,533</b>
<b>Distributions to unitholders:</b>		
HK\$0.0920 (2017: HK\$0.0915) per unit for the six months ended 30 June (note (ii))	136,263	134,096
HK\$0.0890 (2017: HK\$0.0865) per unit for the six months ended 31 December (note (iii))	132,636	127,437
	<b>268,899</b>	<b>261,533</b>
<b>Total distribution per unit (HK\$)</b>	<b>0.1810</b>	<b>0.1780</b>

Notes:

- (i) In accordance with the Trust Deed, Prosperity REIT is required to distribute to unitholders not less than 90% of its distributable income for each financial period and it is the REIT Manager's stated policy to distribute 100% of the distributable income. Pursuant to the Trust Deed, distributable income is defined as the amount calculated by the REIT Manager as representing the consolidated profit after tax of Prosperity REIT and its subsidiaries for the relevant financial year, as adjusted to eliminate the effects of certain Adjustments (as defined in the Trust Deed) which have been recorded in the consolidated statement of profit or loss and other comprehensive income for the relevant financial year.

These adjustments for the current year comprise:

- (a) manager's fees paid/payable in units of HK\$52,441,000 (2017: HK\$50,815,000) out of the total manager's fee of HK\$53,610,000 (2017: HK\$51,954,000) (the differences of HK\$1,169,000 (2017: HK\$1,139,000) are paid in cash);

- (b) change in fair value of investment properties of HK\$487,882,000 (2017: HK\$295,697,000), gain on fair value change of derivative financial instruments of HK\$1,941,000 (2017: a loss of HK\$18,050,000) and gain on disposed property company of nil (2017: HK\$299,695,000);
  - (c) adjustment in respect of the difference between the accounting finance costs of HK\$57,691,000 (2017: HK\$86,775,000) less cash finance costs of HK\$49,700,000 (2017: HK\$60,364,000); and
  - (d) deferred tax provision of HK\$10,710,000 (2017: HK\$13,224,000).
- (ii) The distribution per unit of HK\$0.0920 for the six months ended 30 June 2018 (six months ended 30 June 2017: HK\$0.0915) is calculated based on Prosperity REIT's income available for distribution of HK\$136,263,000 (six months ended 30 June 2017: HK\$134,096,000) over 1,481,179,523 units (30 June 2017: 1,465,548,870 units), representing units in issue as at 30 June 2018 plus the number of units issued after the distribution period to the REIT Manager as payment of base fee and variable fee in the second quarter of 2018. The distribution was paid to unitholders on 7 September 2018.
- (iii) The distribution per unit of HK\$0.0890 for the six months ended 31 December 2018 (six months ended 31 December 2017: HK\$0.0865) is calculated based on Prosperity REIT's income available for distribution of HK\$132,636,000 (six months ended 31 December 2017: HK\$127,437,000) over 1,490,179,376 units (31 December 2017: 1,473,137,260 units), representing units in issue as at 31 December 2018 plus the number of units to be issued after the distribution period to the REIT Manager as payment of base fee and variable fee in the last quarter of the relevant distribution year.

## Consolidated Statement of Financial Position

As at 31 December 2018

	Notes	2018 HK\$'000	2017 HK\$'000
<b>ASSETS AND LIABILITIES</b>			
<b>Non-current assets</b>			
Investment properties	13	10,990,000	10,490,000
Derivative financial instruments		21,065	20,341
		<u>11,011,065</u>	<u>10,510,341</u>
<b>Current assets</b>			
Derivative financial instruments		1,206	1,528
Trade and other receivables	9	15,016	8,667
Bank balances and cash		358,736	363,451
Total current assets		<u>374,958</u>	<u>373,646</u>
<b>Total assets</b>		<u><u>11,386,023</u></u>	<u><u>10,883,987</u></u>
<b>Non-current liabilities, excluding net assets attributable to unitholders</b>			
Derivative financial instruments		-	1,539
Term loans	11	2,311,936	2,303,945
Deferred tax liabilities		197,379	186,669
Total non-current liabilities, excluding net assets attributable to unitholders		<u>2,509,315</u>	<u>2,492,153</u>
<b>Current liabilities</b>			
Trade and other payables	10	192,941	185,775
Amounts due to related companies		11,460	9,481
Provision for taxation		1,550	2,152
Manager's fee payable		13,710	13,246
Distribution payable		132,636	127,437
Total current liabilities		<u>352,297</u>	<u>338,091</u>
<b>Total liabilities, excluding net assets attributable to unitholders</b>		<u><u>2,861,612</u></u>	<u><u>2,830,244</u></u>
<b>Net assets attributable to unitholders</b>		<u><u>8,524,411</u></u>	<u><u>8,053,743</u></u>
<b>Units in issue ('000)</b>	12	<u><u>1,485,861</u></u>	<u><u>1,469,395</u></u>
<b>Net asset value per unit (HK\$) attributable to unitholders</b>	14	<u><u>5.74</u></u>	<u><u>5.48</u></u>

## Notes

### (1) General:

Prosperity REIT is a Hong Kong collective investment scheme authorised under section 104 of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and its units have been listed on the Stock Exchange since 16 December 2005. Prosperity REIT is governed by the Trust Deed made between the REIT Manager and the Trustee, and the Code on Real Estate Investment Trusts (the “**REIT Code**”) issued by the Securities and Futures Commission of Hong Kong.

The principal activity of Prosperity REIT and its subsidiaries (the “**Group**”) is to own and invest in a portfolio of commercial properties, comprising office, commercial, industrial/office and industrial buildings located in Hong Kong with the objective of producing stable and sustainable distributions to unitholders and to achieve long term growth in the net asset value per unit.

#### Application of new and revised Hong Kong Financial Reporting Standards (“**HKFRSs**”)

New and amendments to HKFRSs that are mandatorily effective for the current year.

The Group has applied the following new and amendments to HKFRSs and an interpretation issued by the Hong Kong Institute of Certified Public Accountants (“**HKICPA**”) for the first time in the current year:

HKFRS 9	Financial Instruments
HKFRS 15	Revenue from Contracts with Customers and the related Amendments
HK(IFRIC)-Int 22	Foreign Currency Transactions and Advance Consideration
Amendments to HKFRS 2	Classification and Measurement of Share-based Payment Transactions
Amendments to HKFRS 4	Applying HKFRS 9 Financial Instruments with HKFRS 4 Insurance Contracts
Amendments to HKAS 28	As part of the Annual Improvements to HKFRSs 2014-2016 Cycle
Amendments to HKAS 40	Transfers of Investment Property

Except as described below, the application of the amendments to HKFRSs and the interpretation in the current year has had no material impact on the Group's financial performance and positions for the current and prior years and/or on the disclosures set out in these consolidated financial statements.

### **HKFRS 9 Financial Instruments**

In the current year, the Group has applied HKFRS 9 *Financial Instruments* and the related consequential amendments to other HKFRSs. HKFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) expected credit losses ("ECL") for financial assets and other items (for example, lease receivables) and 3) general hedge accounting.

The Group has applied HKFRS 9 in accordance with the transition provisions set out in HKFRS 9, i.e. applied the classification and measurement requirements (including impairment under ECL model) retrospectively to instruments that have not been derecognised as at 1 January 2018 (date of initial application) and has not applied the requirements to instruments that have already been derecognised as at 1 January 2018. The difference between carrying amounts as at 31 December 2017 and the carrying amounts as at 1 January 2018, if any, is recognised in the opening retained profits and other components of equity, without restating comparative information.

The REIT Manager reviewed and assessed the Group's financial assets and liabilities as at 1 January 2018 based on the facts and circumstances that existed on that date. There was no material impact on initial application of HKFRS 9 as all financial assets and financial liabilities continue to be measured on the same bases as were previously measured under HKAS 39 *Financial Instruments: Recognition and Measurement* and no impairment was recognised at the initial date of application, 1 January 2018.

### **HKFRS 15 Revenue from Contracts with Customers**

The Group has applied HKFRS 15 for the first time in the current year. HKFRS 15 superseded HKAS 18 *Revenue*, HKAS 11 *Construction Contracts* and the related interpretations. HKFRS 15 applies to all contracts with customers except for leases which are within the scope of HKAS 17 *Leases*.

The Group has applied HKFRS 15 retrospectively with the cumulative effect of initially applying this standard recognised on the date of initial application, 1 January 2018. Any difference as at the date of initial application is recognised in the opening retained profits (or other components of equity, as appropriate) and comparative information has not been restated. Furthermore, in accordance with the transition provisions in HKFRS 15, the Group has elected to apply the standard retrospectively only to contracts that have not been completed at 1 January 2018.

The Group currently invests in a portfolio of commercial properties, comprising office, commercial, industrial/office and industrial buildings located in Hong Kong for earning stable rental income under operating leases. It receives leasing rental income, car park income and rental related income from tenants. HKFRS 15 does not apply to the leasing component of base rental and other rental which are under the scope of HKAS 17. Rental related income (e.g. management fee income and air conditioning income) are non-lease components which fall within HKFRS 15. Each of these incomes has a stand-alone selling price for the services which are observable under the lease contracts and they are recognised as revenue only when the performance obligation is satisfied.

The REIT Manager reviewed and assessed the Group's revenue as at 1 January 2018 based on the facts and circumstances that existed on that date. There was no material impact from the initial application of HKFRS 15.

#### **New and amendments to HKFRSs that have been issued but not effective**

The Group has not early applied the following new and amendments to HKFRSs and an interpretation that have been issued but are not yet effective.

HKFRS 16	Leases <sup>1</sup>
HKFRS 17	Insurance Contracts <sup>3</sup>
HK(IFRIC) - Int 23	Uncertainty over Income Tax Treatments <sup>1</sup>
Amendments to HKFRS 3	Definition of a Business <sup>4</sup>
Amendments to HKFRS 9	Prepayment Features with Negative Compensation <sup>1</sup>
Amendments to HKFRS 10 and HKAS 28	Sale or Contribution of Assets between an Investor and its Associate or Joint Venture <sup>2</sup>
Amendments to HKAS 1 and HKAS 8	Definition of Material <sup>5</sup>
Amendments to HKAS 19	Plan Amendment, Curtailment or Settlement <sup>1</sup>
Amendments to HKAS 28	Long-term Interests in Associates and Joint Ventures <sup>1</sup>

<sup>1</sup> *Effective for annual periods beginning on or after 1 January 2019*

<sup>2</sup> *Effective for annual periods beginning on or after a date to be determined*

<sup>3</sup> *Effective for annual periods beginning on or after 1 January 2021*

<sup>4</sup> *Effective for business combinations and asset acquisitions for which the acquisition date is on or after the beginning of the first annual period beginning on or after 1 January 2020*

<sup>5</sup> *Effective for annual periods beginning on or after 1 January 2020*

## **HKFRS 16 Leases**

HKFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. HKFRS 16 will supersede HKAS 17 and the related interpretations when it becomes effective.

Other than certain requirements which are also applicable to lessor, HKFRS 16 substantially carries forward the lessor accounting requirements in HKAS 17, and continues to require a lessor to classify a lease either as an operating lease or a finance lease.

The Group currently considers refundable rental deposits received of HK\$144,051,000 as rights and obligations under leases to which HKAS 17 applies. Based on the definition of lease payments under HKFRS 16, such deposits are not rental payments relating to the right to use the underlying assets. Accordingly, the carrying amounts of such deposits may be adjusted to amortised cost and such adjustments are considered as additional lease payments. Adjustments to refundable rental deposits received would be considered as advance lease payments.

The application of new requirements may result in changes in measurement, presentation and disclosure as indicated above. The Group intends to elect the practical expedient to apply HKFRS 16 to contracts that were previously identified as leases under HKAS 17 and HK(IFRIC)-Int 4 *Determining whether an Arrangement contains a Lease* and not apply this standard to contracts that were not previously identified as containing a lease under HKAS 17 and HK(IFRIC)-Int 4. Therefore, the Group will not reassess whether the contracts are, or contain leases which already existed prior to the date of initial application.

## **HK(IFRIC)-Int 23 Uncertainty over Income Tax Treatments**

HK(IFRIC)-Int 23 sets out how to determine the accounting tax position when there is uncertainty over income tax treatments. The interpretation requires an entity to determine whether uncertain tax positions are assessed separately or as a group; and assess whether it is probable that a tax authority will accept an uncertain tax treatment used, or proposed to be used, by an entity in its income tax filings.

The REIT Manager anticipates that the application of other new and amendments to HKFRSs and the interpretation in the future will not have a material effect on the Group's consolidated financial statements.

### (2) Significant Accounting Policies:

#### Basis of preparation of financial statements

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

The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA. In addition, the consolidated financial statements are drawn up in accordance with the relevant provisions of the Trust Deed and include the relevant disclosure requirements set out in Appendix C of the REIT Code.

The consolidated financial statements have been prepared on the historical cost basis, except for investment properties and certain financial instruments that are measured at fair values at the end of each reporting period, as explained in the accounting policies set out below.

Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Group takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these consolidated financial statements is determined on such a basis, except for share-based payment

transactions that are within the scope of HKFRS 2 *Share-based Payment*, leasing transactions that are within the scope of HKFRS 17 *Leases*, and the measurements that have some similarities to fair value but are not fair value, such as net realisable value in HKAS 2 *Inventories* or value in use in HKAS 36 *Impairment of Assets*.

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

For financial instruments and investment properties which are transacted at fair value and a valuation technique that unobservable inputs is to be used to measure fair value in subsequent periods, the valuation technique is calibrated so that the results of the valuation technique equals the transaction price.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2, or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The REIT Manager is of the opinion that, taking into account the fair value of investment properties, presently available banking facilities and internal financial resources, Prosperity REIT has sufficient working capital for its present requirements within one year from the end of the reporting period. Hence, the consolidated financial statements have been prepared on a going concern basis.

The principal accounting policies are set out below:

#### Basis of consolidation

The consolidated financial statements incorporate the financial statements of Prosperity REIT and entities controlled by Prosperity REIT and its subsidiaries. Control is achieved when Prosperity REIT:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee;  
and
- has the ability to use its power to affect its returns.

Prosperity REIT reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

Consolidation of a subsidiary begins when Prosperity REIT obtains control over the subsidiary and ceases when Prosperity REIT loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the date Prosperity REIT gains control until the date when Prosperity REIT ceases to control the subsidiary.

Where necessary, adjustments are made to the financial statements of the subsidiaries to bring their accounting policies in line with those used by the Group.

All intra-group assets and liabilities, income, expenses and cashflow are eliminated in full on consolidation.

When Prosperity REIT loses control of a subsidiary, the assets and liabilities of that subsidiary and non-controlling interests (if any) are derecognised. A gain or loss is recognised in profit or loss and is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the carrying amount of the assets (including goodwill), and liabilities of the subsidiary attributable to the owners of the Company. All amounts previously recognised in other comprehensive income in relation to that subsidiary are accounted for as if the Group had directly disposed of the related assets or liabilities of the subsidiary (i.e. reclassified to profit or loss or transferred to another category of equity as specified/permitted by applicable HKFRSs).

(3) Revenue:

	2018 HK\$'000	2017 HK\$'000
Gross rental from investment properties:		
Rental income	365,154	365,644
Car park income	30,234	28,261
	<u>395,388</u>	<u>393,905</u>
Rental related income (note)	51,426	52,337
	<u>446,814</u>	<u>446,242</u>

*Note: Rental related income, which mainly consists of management fee income and air conditioning income which are payable by the tenants, are recognised over time as income when the services and facilities are provided. The Group applied the practical expedient in HKFRS by recognising revenue in the amount to which the Group has right to invoice, since the Group billed a fixed amount for each month according to the term of the relevant lease. As permitted under HKFRS 15, the aggregate amount of the transaction price allocated to the unsatisfied contracts is not disclosed.*

(4) Segment information:

During the Reporting Year, Prosperity REIT invested in seven (2017: eight) office, commercial, industrial/office and industrial buildings located in Hong Kong, namely The Metropolis Tower, Prosperity Millennia Plaza, 9 Chong Yip Street, Prosperity Place, Trendy Centre, a portion of Prosperity Center and a portion of New Treasure Centre. These properties are the basis on which the REIT Manager, being the chief operating decision maker, reports Prosperity REIT's segment information for the purpose of resource allocation and performance assessment.

For the year ended 31 December 2018

	The Metropolis Tower	Prosperity Millennia Plaza	9 Chong Yip street	Prosperity Place	Trendy Centre	Prosperity Center (portion)	New Treasure Centre (portion)	Consolidated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Rental income	106,140	80,333	36,355	75,425	45,331	37,268	14,536	395,388
Rental related income	20,184	14,321	4,117	267	7,068	3,412	2,057	51,426
Segment revenue in Hong Kong	126,324	94,654	40,472	75,692	52,399	40,680	16,593	446,814
Segment profit	97,986	77,641	30,727	60,804	40,679	30,714	12,260	350,811
Interest income								4,790
Manager's fee								(53,610)
Trust and other expenses								(8,603)
Change in fair value of investment properties								487,882
Change in fair value of derivative financial instruments								1,941
Finance costs								(57,691)
Profit before taxation and transactions with unitholders								725,520

For the year ended 31 December 2017

	The Metropolis Tower	Prosperity Millennia Plaza	9 Chong Yip street	Harbourfront Landmark (portion)	Prosperity Place	Trendy Centre	Prosperity Center (portion)	New Treasure Centre (portion)	Consolidated
	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000	HK\$'000
Segment revenue in Hong Kong	135,326	91,116	38,964	5,756	70,182	49,650	39,853	15,395	446,242
Segment profit	112,226	75,058	30,316	4,880	53,145	36,316	30,717	10,942	353,600
Interest income									5,225
Manager's fee									(51,954)
Trust and other expenses									(9,276)
Gain on disposed property company									299,695
Change in fair value of investment properties									295,697
Change in fair value of derivative financial instruments									(18,050)
Finance costs									(86,775)
Profit before taxation and transactions with unitholders									788,162

(5) Trust and other expenses:

	<i>2018</i> <i>HK\$'000</i>	<i>2017</i> <i>HK\$'000</i>
Audit fee	239	272
Back-office support service fee	35	64
Bank charges	1,382	1,700
Legal and professional fees	802	805
Public relations-related expenses	203	397
Registrar fee	600	600
Trust administrative expenses	2,136	2,323
Trustee's fee	3,206	3,115
	<u>8,603</u>	<u>9,276</u>

(6) Finance costs:

	<i>2018</i> <i>HK\$'000</i>	<i>2017</i> <i>HK\$'000</i>
Interest expense on:		
Secured term loan	-	58,546
Unsecured term loans	60,739	18,416
Equalisation of interest (income) expense through interest rate swaps	<u>(3,048)</u>	<u>9,801</u>
	57,691	86,763
Secured revolving loan	<u>-</u>	<u>12</u>
	<u>57,691</u>	<u>86,775</u>

(7) Taxation:

	<i>2018</i> <i>HK\$'000</i>	<i>2017</i> <i>HK\$'000</i>
Current tax	27,796	26,910
Over-provision in prior year	(566)	(397)
Deferred tax	<u>10,710</u>	<u>13,224</u>
	<u>37,940</u>	<u>39,737</u>

Hong Kong Profits Tax is calculated at 16.5% of the estimated assessable profit for both years. No provision for Hong Kong profits tax are required for certain subsidiaries as these subsidiaries did not have any assessable profits or have tax losses brought forward to set off their assessable profits for the year. Deferred tax is provided on temporary differences using the current applicable rates.

- (8) The basic earnings per unit is calculated by dividing the profit for the year, before transactions with unitholders of HK\$687,580,000 (2017: HK\$748,425,000) by the weighted average of 1,481,458,516 (2017: 1,465,575,357) units in issue during the year, taking into account the units issuable as manager's fee for its service in the last quarter of the relevant distribution year.

No diluted earnings per unit has been presented as there were no potential units in issue.

- (9) Trade and other receivables:

	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Trade receivables	1,283	561
Less: allowance for doubtful debts	(54)	(129)
	<u>1,229</u>	<u>432</u>
Deposit and prepayments and other receivables	13,787	8,235
	<u>15,016</u>	<u>8,667</u>

Ageing analysis of the Group's trade receivables presented based on the invoice date, net of allowance of doubtful debts, at the end of the reporting period is as follows:

	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Current – 1 month	86	178
2 – 3 months	1,143	254
	<u>1,229</u>	<u>432</u>

(10) Trade and other payables:

	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Trade payables	3,425	1,495
Tenants' deposits		
- Outside parties	140,870	138,356
- Related parties	3,181	779
Rental received in advance		
- Outside parties	5,086	3,589
Other payables	40,379	41,556
	<u>192,941</u>	<u>185,775</u>

Ageing analysis of the Group's trade payables presented based on the invoice date at the end of the reporting period is as follows:

	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Current – 1 month	763	473
2 – 3 months	2,049	357
Over 3 months	613	665
	<u>3,425</u>	<u>1,495</u>

Tenants' deposits represent the deposits refundable to tenants upon termination or cancellation of operating lease arrangements. The tenants' deposits are refundable to tenants within 45 days upon the termination of the tenancy agreement. The tenants' deposits to be settled after twelve months from the reporting period based on the lease terms amounted to HK\$95,343,000 (2017: HK\$83,245,000).

(11) Borrowings:

	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
Unsecured term loans	2,340,000	2,340,000
Bank facility origination fees	(28,064)	(36,055)
	<u>2,311,936</u>	<u>2,303,945</u>
Carrying amount repayable:		
Within a period of more than one year but not exceeding five years	2,311,936	2,303,945
	<u>2,311,936</u>	<u>2,303,945</u>

(12) Units in issue:		
	Number of units	<i>HK\$'000</i>
Balance as at 1 January 2017	1,453,669,230	3,091,413
Payment of manager's base fee and variable fee through issuance of new units during the year	<u>15,726,217</u>	<u>51,130</u>
Balance as at 31 December 2017	1,469,395,447	3,142,543
Payment of manager's base fee and variable fee through issuance of new units during the year	<u>16,465,518</u>	<u>51,987</u>
Balance as at 31 December 2018	<u><u>1,485,860,965</u></u>	<u><u>3,194,530</u></u>

(13) Investment properties:		
	<i>31 Dec 2018</i> <i>HK\$'000</i>	<i>31 Dec 2017</i> <i>HK\$'000</i>
<b>Fair value</b>		
At the beginning of the year	10,490,000	10,183,000
Additional expenditure	12,118	11,303
Change in fair value of investment properties	<u>487,882</u>	<u>295,697</u>
At the end of the year	<u><u>10,990,000</u></u>	<u><u>10,490,000</u></u>

On 20 January 2017, the Trustee (in its capacity as trustee of Prosperity REIT) as vendor and the REIT Manager (in its capacity as manager of Prosperity REIT) entered into a share purchase agreement with an independent third party in respect of the sale of the Harbourfront Landmark Property and the disposal was completed on 3 March 2017 for a cash consideration of HK\$877,378,000 (representing to the gross consideration of HK\$885,741,000 minus the adjusted net asset value of Harbour Champ Limited of HK\$8,363,000) as at completion date of the disposal. The disposal resulted in a gain of approximately HK\$299,695,000, mainly representing fair value change of investment property as a result of such transaction.

Analysis of assets and liabilities over which control was lost:

	<i>Upon disposal</i>
	<i>HK\$'000</i>
Investment properties	594,000
Trade and other receivables	240
Trade and other payables	(10,141)
Deferred tax liabilities	(12,443)
Net assets disposed	<u>571,656</u>

Gain on fair value change of investment property through the disposal of a property company is determined as follows:

	<i>HK\$'000</i>
Consideration received	877,378
Less: Transaction cost incurred	(1,598)
Less: Divestment fee	(4,429)
Less: Net assets disposal	(571,656)
	<u>299,695</u>

Net cash inflow arising on disposal is as follows:

	<i>HK\$'000</i>
Net proceeds from disposal	<u>871,351</u>

During the year ended 31 December 2017, HK\$5,756,000 out of the Group's revenue and HK\$2,690,000 out of the Group's profit were attributable to the subsidiary disposed.

- (14) The net asset value per unit is calculated based on the net assets attributable to unitholders and the total number of 1,485,860,965 units in issue as at 31 December 2018 (1,469,395,447 units in issue as at 31 December 2017).
- (15) At the end of the Reporting Year, the Group's net current assets, defined as current assets less current liabilities, amounted to HK\$22,661,000 (2017: net current assets of HK\$35,555,000) and the Group's total assets less current liabilities amounted to HK\$11,033,726,000 (2017: HK\$10,545,896,000).
- (16) The consolidated financial statements have been prepared in accordance with HKFRSs issued by the HKICPA.

(17) The results have been reviewed by the Disclosures Committee and the Audit Committee of the REIT Manager.

*The directors of the REIT Manager as at the date of this announcement are Dr. Chiu Kwok Hung, Justin (Chairman), Mr. Lim Hwee Chiang and Mr. Ma Lai Chee, Gerald as Non-executive Directors; Ms. Wong Lai Hung as Executive Director; Dr. Lan Hong Tsung, David, Mrs. Sng Sow-Mei (alias Poon Sow Mei) and Mr. Wong Kwai Lam as Independent Non-executive Directors.*