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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

2018 INTERIM RESULTS ANNOUNCEMENT

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 unaudited interim results of Prosperity REIT and its subsidiaries for the six months ended 30 June 2018 (the “**Reporting Period**”) together with comparative figures for the corresponding period in 2017 as follows:

Performance Highlights

	<u>Six months ended</u> <u>30 Jun 2018</u> <u>(unaudited)</u>	<u>Six months ended</u> <u>30 Jun 2017</u> <u>(unaudited)</u>	<u>Percentage change</u> <u>Increase/(Decrease)</u>
Distribution per unit (“DPU”)	HK\$0.0920	HK\$0.0915	0.5%

<u>Key financial figures</u>	<u>As at 30 Jun 2018</u> <u>(unaudited)</u>	<u>As at 31 Dec 2017</u> <u>(audited)</u>	<u>Percentage change</u> <u>Increase/(Decrease)</u>
Net asset value per unit	HK\$5.66	HK\$5.48	3.3%
Property valuation	HK\$10,800 million	HK\$10,490 million	3.0%
Gearing ratio¹	20.8%	21.5%	(0.7%) ²

<u>Operation data</u>	<u>Six months ended</u> <u>30 Jun 2018</u> <u>(unaudited)</u>	<u>Six months ended</u> <u>30 Jun 2017</u> <u>(unaudited)</u>	<u>Percentage change</u> <u>Increase/(Decrease)</u>
Revenue	HK\$221.1 million	HK\$222.5 million	(0.6%) ³
Net property income	HK\$176.5 million	HK\$177.0 million	(0.3%) ³
Average effective unit rent	HK\$24.58 per sq. ft.	HK\$24.11 per sq. ft.	1.9%
Occupancy rate <i>(as at 30 June)</i>	96.0%	96.7%	(0.7%) ²
Cost-to-revenue ratio	20.2%	20.4%	(0.2%) ²

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

² Absolute change.

³ Decrease was mainly due to the transitory downtime from replacement tenancies in The Metropolis Tower.

MANAGEMENT DISCUSSION AND ANALYSIS

Operations Review

As at 30 June 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 30 June 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 30 June 2018, was as follows:

	Location	Gross rentable area <i>sq. ft.</i>	No. of car park spaces	Valuation <i>HK\$ million</i>	Occupancy rate
Grade A Office					
The Metropolis Tower	Hung Hom	271,418	98	3,290	88.3%
Prosperity Millennia Plaza	North Point	217,955	43	2,230	98.0%
9 Chong Yip Street	Kwun Tong	136,595	68	1,130	98.6%
Commercial					
Prosperity Place	Kwun Tong	240,000	83	1,815	99.2%
Industrial/Office					
Trendy Centre	Lai Chi Kok	173,764	79	1,080	95.6%
Prosperity Center (portion)	Kwun Tong	149,253	105	905	97.6%
Industrial					
New Treasure Centre (portion)	San Po Kong	86,168	22	350	100.0%
Total		<u>1,275,153</u>	<u>498</u>	<u>10,800</u>	<u>96.0%</u>

During the six months ended 30 June 2018, the global market has experienced robust economic growth fueled by major economies such as the U.S., China and Europe. In the U.S., GDP growth was 2.2% in the first quarter of 2018. Unemployment rate fell to 18-year low of 3.8% and inflation rate climbed to 2.8% in May. As such, U.S. Federal Reserve hiked its interest rate twice since January 2018 with a clear anticipation of another two hikes in the remaining year. In China, GDP had a stable growth of 6.8% in the first half of 2018. Despite the positive growth, the outlook of the global economy is overshadowed by financial and political risks. On one hand, the hiked interest rates have triggered capital outflow from emerging markets. For another, the political risk caused by the U.S. trade war against other major economies has casted uncertainties in the economic growth.

In spite of the U.S. interest rate hikes, Hong Kong has still maintained a low interest rate environment. Taking advantage of a stable economy and a low cost of capital, Hong Kong property market remains robust. The residential price has grown 21% since early 2017, reaching all-time high, as per the Rating and Valuation Department. The price of other property sector shared similar momentum.

The leasing demand for office has also been supported by high GDP growth and low unemployment rate. The demand driver came from banking and financial services occupiers, PRC companies and flexible working operators. Central and its peripheral business districts office rents remain high with low vacancy, resulting in the company relocation eastward to Kowloon East newly developed high quality buildings.

During the Reporting Period, Prosperity REIT achieved a rental reversion rate of 6.6%, complemented with a stable occupancy rate of 96.0%. The average effective unit rent of Prosperity REIT's portfolio recorded a growth of 1.9% to HK\$24.58 per sq. ft.. This solid performance was attributable to our proactive leasing strategies, premium quality of our properties, as well as our attentive property management services.

Meanwhile, the REIT Manager has implemented effective measures to increase its operational efficiency, enabling Prosperity REIT to keep the cost-to-revenue ratio at a relatively low level of 20.2% for the Reporting Period.

As at 30 June 2018, Prosperity REIT's gearing ratio remained at a healthy level of 20.8% (31 December 2017: 21.5%), providing us with a strong balance sheet to take advantage of future growth opportunities.

Investment Review

The REIT Manager will continue to seek out potential acquisition opportunities. We will assess every acquisition target prudently 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

Asset enhancement has been a key growth driver for Prosperity REIT. Apart from keeping up with keen competition, upgrading our properties is another way to ensure sustainable growth in rental level and capital appreciation. During the Reporting Period, a number of asset enhancement works were carried out at Prosperity Place, Prosperity Millennium Plaza and The Metropolis Tower.

Prosperity Place and Prosperity Millennia Plaza

Prosperity Place is located in the Kwun Tong district of Kowloon East. The building is close to the Eastern Cross Harbour Tunnel, and the Kwun Tong MTR Station is just a three-minute walk away.

Prosperity Millennia Plaza stands adjacent to the Harbour Plaza North Point Hotel and across from the North Point Government Offices.

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 aging chiller sets and the upcoming increment of electricity tariff, we have further replaced another set of these two properties in order to upkeep a reliable and efficient air-conditioning provision.

The Metropolis Tower

The Metropolis Tower is located in commercial hub of Hung Hom, features a spectacular sea view of the Victoria Harbour. In order to align with the newly completed Grade A office building specification and to increase the competitiveness of our property, renovation of executive and common washrooms on selective floors have been carried out.

Outlook

Global economy is generally expected to remain on an expansion track in the remaining of 2018, notwithstanding the trade war repercussions in stock markets, investment sentiment and political tensions. As a result of the tax reforms set the pace of positive return, U.S. corporates performed stable.

China's GDP increased by 6.8% year-on-year in the first half of the year. Yet, the continued uncertainty resulted from the U.S. tariff may impact on China's economic growth. However, given the government's economic transformation and financial de-leveraging policy, it is believed that the Chinese economy will be steady and healthy in the long run.

Hong Kong's economy continued to grow solidly in the first half of 2018, supported by retail and tourism sector recovery. Barring the uncertainties affecting Hong Kong economy, such as trade protectionism and the potential interest rate hike, the property leasing and investment market is in a buoyant sentiment in Hong Kong.

Prosperity REIT has demonstrated the ability to capture market opportunities and to effectively manage the operation throughout different economic cycles. With a strong presence in the Kowloon East district, Prosperity REIT is well-positioned to gain further benefits from the Kowloon East transformation, together with the Express Rail Link completion in this year. With the diligent and professional support of Goodwell-Prosperity Property Services Limited, the property manager of Prosperity REIT, we will continue to implement effective asset management strategies.

Financial Review

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

	Turnover <i>HK\$'000</i>	Rental related income <i>HK\$'000</i>	Revenue <i>HK\$'000</i>	Net property income <i>HK\$'000</i>
Grade A Office				
The Metropolis Tower	52,570	10,230	62,800	50,414
Prosperity Millennia Plaza	39,614	7,119	46,733	38,878
9 Chong Yip Street	17,828	2,069	19,897	15,506
Commercial				
Prosperity Place	37,259	117	37,376	29,909
Industrial/Office				
Trendy Centre	22,739	3,556	26,295	21,191
Prosperity Center (portion)	18,281	1,662	19,943	14,737
Industrial				
New Treasure Centre (portion)	7,047	1,013	8,060	5,842
Total	195,338	25,766	221,104	176,477

Revenue

During the Reporting Period, revenue slightly decreased to HK\$221.1 million, being HK\$1.4 million or 0.6% lower than the last corresponding half year. The drop was mainly due to the transitory downtime from replacement tenancies in The Metropolis Tower.

Net Property Income

For the Reporting Period, the net property income was HK\$176.5 million, being HK\$0.5 million or 0.3% lower than the last corresponding half year. The cost-to-revenue ratio was 20.2%.

Distributable Income

For the Reporting Period, the unaudited distributable income of Prosperity REIT to unitholders of Prosperity REIT was HK\$136.3 million, representing a DPU of HK\$0.0920. This represents an annualized distribution yield of 5.8%⁴. The distributable income for the Reporting Period is

⁴ Based on Prosperity REIT's closing unit price of HK\$3.18 as at 29 June 2018.

calculated by the REIT Manager as representing the consolidated profit after tax of Prosperity REIT and its subsidiaries for the relevant financial period, as adjusted to eliminate the effects of certain Adjustments (as defined in the Trust Deed) including a finance cost of HK\$4.0 million (equivalent to HK\$0.0027 per unit), which have been recorded in the condensed consolidated statement of profit or loss and other comprehensive income for the Reporting Period.

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. 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.

Liquidity and Financing

As at 30 June 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**").

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 30 June 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 interest rate swap and cap agreements to mitigate the impact of interest rate fluctuations. As at 30 June 2018, the interest costs for approximately 90% (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 facility origination fees, as a percentage of Prosperity REIT's gross assets was 20.8% as at 30 June 2018 (31 December 2017: 21.5%), whereas the gross liability of Prosperity REIT as a percentage of Prosperity REIT's gross assets was 25.5% as at 30 June 2018 (31 December 2017: 26.0%).

Taking into account the fair value of investment properties, currently 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 Period, Prosperity REIT's portfolio recorded an investment property revaluation gain of HK\$305.5 million, based on a professional valuation performed by an independent valuer, Colliers International (Hong Kong) Limited. The movements of fair values are tabulated below:

	<i>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
Fair value at the beginning of the period/year	10,490,000	10,183,000
Additional expenditure	4,546	11,303
Change in fair value of investment properties	305,454	295,697
Fair value at the end of the period/year	<u>10,800,000</u>	<u>10,490,000</u>

Charges on Assets

As at 30 June 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 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 Period, 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 the applicable regulations and legislation. During the Reporting Period, 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 Wednesday, 29 August 2018 to Thursday, 30 August 2018, both days inclusive, during which period no transfer of units will be effected. In order to qualify for the interim 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, Wan Chai, Hong Kong, not later than 4:30 p.m. on Tuesday, 28 August 2018. The payment date of interim distribution will be on Friday, 7 September 2018.

REVIEW OF INTERIM RESULTS

The interim results of Prosperity REIT for the Reporting Period have been reviewed by the Audit Committee and the Disclosures Committee of the REIT Manager and by Prosperity REIT’s external auditor in accordance with Hong Kong Standard on Review Engagements 2410 “Review of Interim Financial Information Performed by the Independent Auditor of the Entity” issued by the Hong Kong Institute of Certified Public Accountants.

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 30 June 2018.

ISSUANCE OF INTERIM REPORT

The Interim Report of Prosperity REIT for the Reporting Period will be published on the websites of the Stock Exchange and Prosperity REIT and will be dispatched or sent to unitholders on or before Friday, 31 August 2018.

**CONDENSED CONSOLIDATED STATEMENT OF PROFIT OR LOSS
AND OTHER COMPREHENSIVE INCOME**

For the six months ended 30 June 2018

		<i>Six months ended 30 June</i>	
		<i>2018</i>	<i>2017</i>
	<i>Notes</i>	<i>HK\$'000</i>	<i>HK\$'000</i>
		<i>(unaudited)</i>	<i>(unaudited)</i>
Revenue	3	221,104	222,509
Property management fees		(5,439)	(5,452)
Property operating expenses		(39,188)	(40,016)
Total property operating expenses		<u>(44,627)</u>	<u>(45,468)</u>
Net property income		176,477	177,041
Interest income		2,191	2,654
Manager's fee		(26,411)	(25,661)
Trust and other expenses	5	(4,276)	(4,520)
Gain on disposed property company	13	-	299,695
Change in fair value of investment properties		305,454	146,336
Change in fair value of derivative financial instruments		15,449	(31,487)
Finance costs	6	<u>(28,532)</u>	<u>(35,089)</u>
Profit before taxation and transactions with unitholders		440,352	528,969
Taxation	7	<u>(18,535)</u>	<u>(18,969)</u>
Profit for the period, before transactions with unitholders		421,817	510,000
Distribution to unitholders		<u>(136,263)</u>	<u>(134,096)</u>
Profit for the period, after transactions with unitholders		285,554	375,904
Total comprehensive income for the period, after transactions with unitholders		<u>285,554</u>	<u>375,904</u>
Income available for distribution to unitholders		<u>136,263</u>	<u>134,096</u>
Basic earnings per unit (HK\$)	8	<u>0.29</u>	<u>0.35</u>

DISTRIBUTION STATEMENT

For the six months ended 30 June 2018

	Six months ended 30 June	
	2018	2017
	HK\$'000	HK\$'000
	(unaudited)	(unaudited)
Profit for the period, before transactions with unitholders	421,817	510,000
Adjustments:		
Manager's fee	25,836	25,093
Gain on disposed property company	-	(299,695)
Change in fair value of investment properties	(305,454)	(146,336)
Change in fair value of derivative financial instruments	(15,449)	31,487
Finance costs	3,963	5,531
Deferred tax	5,550	8,016
Income available for distribution (note (i))	136,263	134,096
Distributions to unitholders:		
For the six months ended 30 June	136,263	134,096
Distribution per unit (HK\$) (note (ii))	0.0920	0.0915

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 stated policy of the REIT Manager 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 (the "Group") for the relevant financial period, as adjusted to eliminate the effects of certain Adjustments (as defined in the Trust Deed) which have been recorded in the condensed consolidated statement of profit or loss and other comprehensive income for the relevant financial period.

These Adjustments for the half year comprise:

- (a) manager's fee paid and payable in units of HK\$25,836,000 (2017: HK\$25,093,000) out of the total manager's fee of HK\$26,411,000 (2017: HK\$25,661,000) (the difference of HK\$575,000 (2017: HK\$568,000) is paid in cash);
- (b) change in fair value of investment properties of HK\$305,454,000 (2017: HK\$146,336,000), gain on fair value change of derivative financial instruments of HK\$15,449,000 (2017: a loss of HK\$31,487,000), and a 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\$28,532,000 (2017: HK\$35,089,000) and the cash finance costs of HK\$24,569,000 (2017: HK\$29,558,000); and
- (d) deferred tax provision of HK\$5,550,000 (2017: HK\$8,016,000).

(ii) The DPU of HK\$0.0920 (2017: HK\$0.0915) is calculated based on Prosperity REIT's income available for distribution of HK\$136,263,000 (2017: HK\$134,096,000) over 1,481,179,523 units (2017: 1,465,548,870 units), representing units in issue as at 30 June 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 second quarter of the relevant distribution period.

CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION

As at 30 June 2018

		<i>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
ASSETS AND LIABILITIES			
Non-current assets			
Investment properties	13	10,800,000	10,490,000
Derivative financial instruments		30,902	20,341
		10,830,902	10,510,341
Current assets			
Derivative financial instruments		4,877	1,528
Trade and other receivables	9	9,947	8,667
Bank balances and cash		379,510	363,451
Total current assets		394,334	373,646
Total assets		11,225,236	10,883,987
Non-current liabilities, excluding net assets attributable to unitholders			
Derivative financial instruments		-	1,539
Term loans	11	2,307,908	2,303,945
Deferred tax liabilities		192,219	186,669
Total non-current liabilities, excluding net assets attributable to unitholders		2,500,127	2,492,153
Current liabilities			
Trade and other payables	10	186,393	185,775
Amounts due to related companies		8,806	9,481
Provision for taxation		15,261	2,152
Manager's fee payable		13,274	13,246
Distribution payable		136,263	127,437
Total current liabilities		359,997	338,091
Total liabilities, excluding net assets attributable to unitholders		2,860,124	2,830,244
Net assets attributable to unitholders		8,365,112	8,053,743
Units in issue ('000)	12	1,477,126	1,469,395
Net asset value per unit (HK\$) attributable to unitholders	14	5.66	5.48

Notes

(1) Principal Accounting Policies:

The condensed consolidated financial statements have been prepared on the historical cost basis, except for investment properties and certain financial instruments, which are measured at fair values.

Other than changes in accounting policies resulting from application of Hong Kong Financial Reporting Standards (“**HKFRSs**”), the accounting policies and methods of computation used in the condensed consolidated financial statements for the six months ended 30 June 2018 are the same as those followed in the preparation of the Group’s annual financial statements for the year ended 31 December 2017.

Application of new and revised HKFRSs

In the current interim period, the Group has applied, for the first time, the following new and amendments to HKFRSs issued by the HKICPA which are mandatory effective for the annual period beginning on or after 1 January 2018 for the preparation of the Group’s condensed consolidated financial statements:

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

The new and revised HKFRSs have been applied in accordance with the relevant transition provisions in the respective standards and amendments which results in changes in accounting policies, amounts reported and/or disclosures as described below.

Impacts and changes in accounting policies on application of HKFRS 15 Revenue from Contracts with Customers

The Group has applied HKFRS 15 for the first time in the current interim period. 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 within the scope of HKAS 17 *Leases*.

Key changes in accounting policies resulting from application of HKFRS 15

HKFRS 15 introduces a 5-step approach when recognising revenue:

- Step 1: Identify the contract(s) with a customer
- Step 2: Identify the performance obligations in the contract
- Step 3: Determine the transaction price
- Step 4: Allocate the transaction price to the performance obligations in the contract
- Step 5: Recognise revenue when (or as) the Group satisfies a performance obligation.

Under HKFRS 15, the Group recognises revenue when (or as) a performance obligation is satisfied, i.e. when “control” of the goods or services underlying the particular performance obligation is transferred to the customer.

A performance obligation represents a good and service (or a bundle of goods or services) that is distinct or a series of distinct goods or services that are substantially the same.

Control is transferred over time and revenue is recognised over time by reference to the progress towards complete satisfaction of the relevant performance obligation if one of the following criteria is met:

- the customer simultaneously receives and consumes the benefits provided by the Group’s performance as the Group performs;
- the Group’s performance creates and enhances an asset that the customer controls as the Group performs; or
- the Group’s performance does not create an asset with an alternative use to the Group and the Group has an enforceable right to payment for performance completed to date.

Otherwise, revenue is recognised at a point in time when the customer obtains control of the distinct good or service.

Over time revenue recognition: measurement of progress towards complete satisfaction of a performance obligation

The progress towards complete satisfaction of a performance obligation is measured based on output method, which is to recognise revenue on the basis of direct measurements of the value of the goods or services transferred to the customer to date relative to the remaining goods or services promised under the contract, that best depicts the Group’s performance in transferring

control of goods or services.

Summary of effects arising from initial application of HKFRS 15

The Group invests in a portfolio of commercial properties in Hong Kong for earning stable rental income under operating leases. It receives rental income, car park income and rental related income from tenants. HKFRS 15 does not apply to the leasing component of rental from investment properties which is under the scope of HKAS 17 *Leases*. 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 over-time as revenue only when the performance obligation is satisfied.

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

Impacts and changes in accounting policies of application on HKFRS 9 Financial Instruments and the related amendments

In the current period, 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 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) 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.

Key changes in accounting policies resulting from application of HKFRS 9

Classification and measurement of financial assets

Trade receivables arising from contracts with customers are initially measured in accordance with HKFRS 15.

All recognised financial assets that are within the scope of HKFRS 9 are subsequently measured at amortised cost or fair value.

Financial assets at fair value through profit or loss (“FVTPL”)

Financial assets that do not meet the criteria for being measured at amortised cost or fair value through other comprehensive income (“FVTOCI”) or designated as FVTOCI are measured at FVTPL.

Financial assets at FVTPL are measured at fair value at the end of each reporting period, with any fair value gains or losses recognised in profit or loss. The net gain or loss recognised in profit or loss excludes any dividend or interest earned on the financial asset and is separately disclosed in the condensed statement of profit or loss and other comprehensive income.

The REIT Manager reviewed and assessed the Group’s financial assets as at 1 January 2018 based on the facts and circumstances that existed at that date. There would be no impact on initial application of HKFRS 9 as all other financial assets and financial liabilities will continue to be measured on the same bases as are currently measured under HKAS 39.

Impairment under ECL model

The Group recognises a loss allowance for ECL on financial assets which are subject to impairment under HKFRS 9 (including trade and other receivables and bank balances and cash). The amount of ECL is updated at each reporting date to reflect changes in credit risk since initial recognition.

Lifetime ECL represents the ECL that will result from all possible default events over the expected life of the relevant instrument. In contrast, 12-month ECL (“**12m ECL**”) represents the portion of lifetime ECL that is expected to result from default events that are possible within 12 months after the reporting date. Assessment are done based on the Group’s historical credit loss experience, adjusted for factors that are specific to the debtors, general economic conditions and an assessment of both the current conditions at the reporting date as well as the forecast of future conditions.

The Group always recognises lifetime ECL for trade receivables. The ECL on these assets are assessed individually for debtors with significant balances and collectively using a provision matrix with appropriate groupings.

For all other instruments, the Group measures the loss allowance equal to 12m ECL, unless when there has been a significant increase in credit risk since initial recognition, the Group recognises lifetime ECL. The assessment of whether lifetime ECL should be recognised is based on significant increases in the likelihood or risk of a default occurring since initial recognition.

Significant increase in credit risk

In assessing whether the credit risk has increased significantly since initial recognition, the Group compares the risk of a default occurring on the financial instrument as at the reporting date with the risk of a default occurring on the financial instrument as at the date of initial recognition. In making this assessment, the Group considers both quantitative and qualitative information that is reasonable and supportable, including historical experience and forward-looking information that is available without undue cost or effort.

In particular, the following information is taken into account when assessing whether credit risk has increased significantly:

- an actual or expected significant deterioration in the financial instrument's external (if available) or internal credit rating;
- significant deterioration in external market indicators of credit risk, e.g. a significant increase in the credit spread, the credit default swap prices for the debtor;
- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor's ability to meet its debt obligations;
- an actual or expected significant deterioration in the operating results of the debtor;
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the debtor that results in a significant decrease in the debtor's ability to meet its debt obligations.

Irrespective of the outcome of the above assessment, the Group presumes that the credit risk has increased significantly since initial recognition when contractual payments are more than 30 days past due, unless the Group has reasonable and supportable information that demonstrates otherwise.

The Group considers that default has occurred when the instrument is more than 90 days past due unless the Group has reasonable and supportable information to demonstrate that a more lagging default criterion is more appropriate.

Measurement and recognition of ECL

The measurement of ECL is a function of the probability of default, loss given default (i.e. the magnitude of the loss if there is a default) and the exposure at default. The assessment of the probability of default and loss given default is based on historical data adjusted by forward-looking information.

Generally, the ECL is estimated as the difference between all contractual cash flows that are due to the Group in accordance with the contract and all the cash flows that the Group expects to receive, discounted at the effective interest rate determined at initial recognition.

Interest income is calculated based on the gross carrying amount of the financial asset unless the financial asset is credit impaired, in which case interest income is calculated based on amortised cost of the financial asset.

As at 1 January 2018, the REIT Manager reviewed and assessed the Group's existing financial assets for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of HKFRS 9. No material impact on impairment was noted at the date of initial application, 1 January 2018.

Except as disclosed above, the application of other revised HKFRSs in the current interim period has had no material effect on the amounts reported and/or disclosures set out in these condensed consolidated financial statements.

The Group has not applied any new and revised HKFRSs that are not yet effective for the current accounting period.

(2) Basis of preparation:

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

The condensed consolidated financial statements have been prepared in accordance with Hong Kong Accounting Standard 34 (HKAS 34) "Interim Financial Reporting" issued by the Hong Kong Institute of Certified Public Accountants as well as with the applicable disclosure requirements of Appendix 16 to the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited and the relevant disclosure requirements set out in Appendix C of the REIT Code.

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 Reporting Period. Hence, the condensed consolidated financial statements have been prepared on a going concern basis.

(3) Revenue:

	<i>Six months ended 30 June</i>	
	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
	<i>(unaudited)</i>	<i>(unaudited)</i>
Gross rental from investment properties		
Rental income	180,503	182,389
Car park income	14,835	13,717
	<hr/>	<hr/>
	195,338	196,106
Rental related income (note)	25,766	26,403
	<hr/>	<hr/>
	221,104	222,509
	<hr/> <hr/>	<hr/> <hr/>

Note: Rental related income, which consist of payments in respect of the operation of the properties in Hong Kong which are payable by the tenants, are recognised over time as income when the services and facilities are provided. The Group billed a fixed amount for each month according to the term of the relevant lease.

(4) Segment information:

During the Reporting Period, 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, portion of Prosperity Center and 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.

Six months ended 30 June 2018 (unaudited)

	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
Segment revenue in Hong Kong	62,800	46,733	19,897	37,376	26,295	19,943	8,060	221,104
Segment profit	50,414	38,878	15,506	29,909	21,191	14,737	5,842	176,477
Interest income								2,191
Manager's fee								(26,411)
Trust and other expenses								(4,276)
Change in fair value of investment properties								305,454
Change in fair value of derivative financial instruments								15,449
Finance costs								(28,532)
Profit before taxation and transactions with unitholders								440,352

Six months ended 30 June 2017 (unaudited)

	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	66,769	44,687	19,569	5,756	34,086	24,300	19,669	7,673	222,509
Segment profit	55,339	37,002	15,560	4,880	25,513	17,837	15,176	5,734	177,041
Interest income									2,654
Manager's fee									(25,661)
Trust and other expenses									(4,520)
Gain on disposed property company									299,695
Change in fair value of investment properties									146,336
Change in fair value of derivative financial instruments									(31,487)
Finance costs									(35,089)
Profit before taxation and transactions with unitholders									528,969

* The Harbourfront Landmark Property was disposed on 3 March 2017 as set out in note 13.

(5) Trust and other expenses:

	<i>Six months ended 30 June</i>	
	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
	<i>(unaudited)</i>	<i>(unaudited)</i>
Audit fee	120	130
Back-office support service fee	29	27
Bank charges	694	852
Legal and professional fees	287	435
Public relations and related expenses	115	162
Registrar fee	300	300
Trust administrative expenses	1,164	1,066
Trustee's fee	1,567	1,548
	<hr/>	<hr/>
	4,276	4,520
	<hr/> <hr/>	<hr/> <hr/>

(6) Finance costs:

	<i>Six months ended 30 June</i>	
	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
	<i>(unaudited)</i>	<i>(unaudited)</i>
Interest expense on:		
Secured term loan	-	23,150
Unsecured term loans	26,492	7,405
Equalisation of interest expense through interest rate swaps	2,040	4,522
	<hr/>	<hr/>
	28,532	35,077
Secured revolving loan	-	12
	<hr/>	<hr/>
	28,532	35,089
	<hr/> <hr/>	<hr/> <hr/>

(7) Taxation:

	<i>Six months ended 30 June</i>	
	<i>2018</i>	<i>2017</i>
	<i>HK\$'000</i>	<i>HK\$'000</i>
	<i>(unaudited)</i>	<i>(unaudited)</i>
Current tax	12,985	10,953
Deferred tax	5,550	8,016
	<hr/>	<hr/>
	18,535	18,969
	<hr/> <hr/>	<hr/> <hr/>

The estimated tax rate used is 16.5% for the period under review. No provision for Hong Kong Profits Tax is required for certain subsidiaries as these subsidiaries did not have any assessable profits for the period or the assessable profit is wholly absorbed by tax losses brought forward.

Deferred tax is provided on temporary differences relating to accelerated tax depreciation and tax losses using the estimated tax rate. The investment property is not held within a business model whose objective is to consume substantially all of the economic benefits embodied in the investment property over time and hence the presumption that the carrying amounts are recovered entirely through sale is not rebutted.

(8) Basic earnings per unit:

The basic earnings per unit is calculated by dividing the profit for the period, before transactions with unitholders of HK\$421,817,000 (2017: HK\$510,000,000) by the weighted average of 1,477,097,755 (2017: 1,461,739,065) units in issue during the period, taking into account the units issuable as manager's fee for its service in the last quarter of the relevant distribution period.

(9) Trade and other receivables:

	<i>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
Trade receivables	427	561
Less: allowance for doubtful debts	(42)	(129)
	<hr/> 385	<hr/> 432
Deposits, prepayments and other receivables	9,562	8,235
	<hr/> 9,947	<hr/> 8,667
	<hr/> <hr/>	<hr/> <hr/>

Ageing analysis of the Group's trade receivables presented based on the invoice date at the end of the Reporting Period is as follows:

	<i>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
0 day – 1 month	142	178
2 – 3 months	223	254
Over 3 months	20	-
	<hr/> 385	<hr/> 432
	<hr/> <hr/>	<hr/> <hr/>

(10) Trade and other payables:

	<i>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
Trade payables	1,700	1,495
Tenants' deposits		
- Outside parties	134,077	138,356
- Related parties	3,442	779
Rental received in advance		
- Outside parties	4,885	3,589
Other payables	42,289	41,556
	<hr/>	<hr/>
	186,393	185,775
	<hr/> <hr/>	<hr/> <hr/>

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>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
0 day – 1 month	751	473
2 – 3 months	505	357
Over 3 months	444	665
	<hr/>	<hr/>
	1,700	1,495
	<hr/> <hr/>	<hr/> <hr/>

Tenants' deposits represent the deposits refundable to tenants upon termination or cancellation of operating lease arrangements and amounts outstanding for ongoing costs. 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 end of the Reporting Period based on the lease terms amounted to HK\$85,683,721 as at 30 June 2018 (31 December 2017: HK\$83,245,000).

(11) Borrowings:

	<i>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
Unsecured term loans	2,340,000	2,340,000
Bank facility origination fees	(32,092)	(36,055)
	<u>2,307,908</u>	<u>2,303,945</u>
Carrying amount repayable:		
Within a period of more than one year but not exceeding five years	2,307,908	2,303,945
	<u>2,307,908</u>	<u>2,303,945</u>

(12) Units in issue:

	Number of units	HK\$'000
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	15,726,217	51,130
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 period	7,730,715	25,815
Balance as at 30 June 2018	<u>1,477,126,162</u>	<u>3,168,358</u>

(13) Investment properties:

	<i>30 Jun 2018</i> <i>HK\$'000</i> <i>(unaudited)</i>	<i>31 Dec 2017</i> <i>HK\$'000</i> <i>(audited)</i>
Fair value at the beginning of the period/year	10,490,000	10,183,000
Additional expenditure	4,546	11,303
Change in fair value of investment properties	305,454	295,697
Fair value at the end of the period/year	<u>10,800,000</u>	<u>10,490,000</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 period ended 30 June 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 1,477,126,162 units in issue as at 30 June 2018 (31 December 2017: 1,469,395,447 units).
- (15) At the end of the Reporting Period, the Group's net current assets, defined as current assets less current liabilities, amounted to HK\$34,337,000 (31 December 2017: HK\$35,555,000) and the Group's total assets less current liabilities amounted to HK\$10,865,239,000 (31 December 2017: HK\$10,545,896,000).
- (16) The results have been reviewed by the Audit Committee and the Disclosures Committee of the REIT Manager, and by Prosperity REIT's external auditor in accordance with Hong Kong Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity" issued by the HKICPA.

Hong Kong, 14 August 2018

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.