

**EUROCASTLE INVESTMENTS LIMITED AND SUBSIDIARIES**  
**FINANCIAL RESULTS FOR HALF YEAR AND QUARTER ENDED 30 JUNE 2006**

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Eurocastle Investment Limited is a closed-ended investment company which focuses on German commercial real estate assets. The Company is Euro denominated and is listed on Euronext Amsterdam under the symbol "ECT". Eurocastle's objective is to pay out stable and growing dividends and to deliver attractive risk-adjusted returns. Eurocastle is managed by Fortress Investment Group LLC. For more information regarding Eurocastle and to be added to our email distribution list, please visit [www.eurocastleinv.com](http://www.eurocastleinv.com).

**Half Year Highlights**

- Dividends declared for the second quarter 2006 is 40 cents per share on 45.7 million shares outstanding. First quarter 2006 dividend was 30 cents per share on 45.6 million shares outstanding
- Committed to purchase or entered into exclusive negotiations to purchase an additional €840 million of real estate assets towards Eurocastle's 2006 target of €1 billion in new acquisitions. Approximately €46 million of the €840 million was funded in the second quarter 2006
- Increased real estate investment portfolio to €2.8 billion
  - Completed the acquisition of a €2 billion German property portfolio from Dresdner Bank in February 2006, via the acquisition of Dresdner Grund-Fonds
  - Funded €14.5 million in the second quarter which completes the acquisition of a €107 million retail property portfolio yielding approximately 7%, which began in the fourth quarter 2005
- Raised net proceeds of €524 million of new equity capital, helping to more than triple equity book value from year end 2005 to €935.9 million, or an increase of 66% to €20.49 on a per share basis
- Increase in net asset value includes revaluation gains of €77.3 million, which are included in operating income for the half year.
- Increased occupancy of property portfolios
  - Deutsche Bank portfolio current occupancy rate of 78.2% at quarter end, up from 74.6% at 2005 year end
  - Dresdner Bank portfolio increased occupancy to 81.4% at 30 June 2006, up from 80.7% at time of acquisition

**Key Performance Indicators**

**Second Quarter 2006**

- Net profit after tax of €13.7 million for the second quarter 2006, increased from €6.8 million for the second quarter 2005, an increase of 103%
- Earnings per ordinary share of €0.30, or €0.29 per diluted share, for the second quarter 2006 compared to €0.36 per ordinary share, or €0.35 per diluted share, for the second quarter 2005
- Funds from operations ("FFO", see Key Financial Information) increased by 189% to €18.0 million for the second quarter 2006 from €6.2 million for the second quarter 2005
- FFO of €0.40 per ordinary share, or €0.38 per diluted share
- FFO return on average invested capital\* was 8.9% for the second quarter 2006

**First Half 2006**

- Net profit after tax of €106.6 million for the first half 2006, increased from €13.2 million for the first half 2005, an increase of 707%
- Earnings per ordinary share of €2.56, or €2.46 per diluted share, for the first half 2006 compared to €0.71 per share, or €0.69 per diluted share, for the first half 2005
- Funds from operations ("FFO", see Key Financial Information) increased by 151% to €31.9 million for the first half 2006 from €12.7 million for the first half 2005
- FFO of €0.77 per ordinary share, or €0.74 per diluted share
- FFO return on average invested capital\* was 8.9% for the first half 2006

\* Invested capital represents capital and reserves less hedging reserves and net unrealised gains on available-for-sale securities, real estate fund units and investment properties (net of attributable deferred taxation).

## **Conference Call**

Management will conduct a conference call today, 23 August 2006 to review the Company's financial results for the half year and quarter ended 30 June 2006. The conference call is scheduled for 3 P.M. London time (10 A.M. New York time). All interested parties are welcome to participate on the live call. You can access the conference call by dialing +1-866-323-3742 (from within the U.S.) or +1-706-643-0550 (from outside of the U.S.) ten minutes prior to the scheduled start of the call; please reference "Eurocastle Second Quarter Earnings Call."

A webcast of the conference call will be available to the public on a listen-only basis at [www.eurocastleinv.com](http://www.eurocastleinv.com). Please allow extra time prior to the call to visit the site and download the necessary software required to listen to the internet broadcast. A replay of the webcast will be available for three months following the call.

For those who are not available to listen to the live call, a replay will be available until 11:59 P.M. New York time on Wednesday, 30 August 2006 by dialing +1-800-642-1687 (from within the U.S.) or +1-706-645-9291 (from outside of the U.S.); please reference access code "4508124."

## Key Financial Information

### FUNDS FROM OPERATIONS (“FFO”) (Unaudited)

( in €'000, except per share data)	Six Months Ended 30 June 2006	Six Months Ended 30 June 2005	Three Months Ended 30 June 2006	Three Months Ended 30 June 2005
<b>Reconciliation of FFO to net profit after taxation</b>				
Net profit after taxation	106,606	13,215	13,705	6,760
Increase in fair value of investment properties	(77,296)	(513)	(61)	(513)
Decrease in fair value of real estate fund units	2,351	-	4,374	-
Deferred tax charge on investment properties	260	-	26	-
Funds from operations (FFO)	<b>31,921</b>	12,702	<b>18,044</b>	6,247
FFO per weighted average basic share	<b>0.77</b>	0.69	<b>0.40</b>	0.34
FFO per weighted average diluted share	<b>0.74</b>	0.66	<b>0.38</b>	0.32

FFO is an appropriate measure of the underlying operating performance of real estate companies because it provides investors with information regarding our ability to service debt and make capital expenditures. Furthermore, FFO is used to compute incentive compensation to the manager. FFO, as defined by Eurocastle, represents net profit after taxation (computed in accordance with IFRS), excluding changes in the fair value of investment properties net of attributable deferred taxation and mark to market fluctuations in real estate fund units. The Group considers gains and losses on resolution of its investments to be a normal part of its recurring operations and therefore does not exclude such gains and losses when arriving at FFO. FFO does not represent cash generated from operating activities in accordance with IFRS and therefore should not be considered an alternative to cash flow as a measure of liquidity, and is not necessarily indicative of cash available to fund cash needs. Eurocastle's calculation of FFO may be different from the calculation used by other companies and, therefore, comparability may be limited.

### INCOME STATEMENT DATA (Unaudited)

( in €'000, except per share data)	Six Months Ended 30 June 2006	Six Months Ended 30 June 2005	Three Months Ended 30 June 2006	Three Months Ended 30 June 2005
Interest income	43,347	30,437	22,928	15,728
Rental income	63,108	12,655	39,300	6,306
Real estate fund unit interest income	9,595	-	4,865	-
Increase/(decrease) in fair value of investment properties and real estate fund units	74,945	513	(4,313)	513
Interest expense	62,801	25,495	36,258	13,103
Other income/(expenses)	(21,139)	(4,608)	(12,714)	(2,540)
Net profit before taxes	107,055	13,502	13,808	6,904
Net profit after taxation	106,606	13,215	13,705	6,760
Earnings per weighted average basic share	2.56	0.71	0.30	0.36
Earnings per weighted average diluted share	2.46	0.69	0.29	0.35

### BALANCE SHEET DATA

( in €'000, except per share data)	Unaudited As of 30 June 2006	As of 31 December 2005
Cash and cash equivalents	43,037	13,640
Restricted cash and short term investments	44,816	-
Asset backed securities (includes cash to be invested and securities pledged under repurchase agreements)	1,500,785	1,452,547
Real estate loans (includes loans pledged under repurchase agreements)	81,809	92,649
Real estate fund units	187,274	189,591
Investment property	2,648,478	463,540
Total assets	4,567,173	2,273,980
Debt obligations	3,631,263	1,916,189
Shareholders' equity	935,908	298,866
Book value per ordinary share	20.49	12.34

  

	Quarter Ended 30 June 2006	Quarter Ended 30 June 2005	Six Months Ended 30 June 2006	Six Months Ended 30 June 2005
<b>Weighted Average Ordinary Shares Outstanding</b>				
Basic	45,624,059	18,529,515	41,656,560	18,529,515
Diluted	47,368,788	19,253,965	43,327,351	19,253,965
<b>Ordinary Shares Outstanding</b>	<b>45,681,245</b>	24,209,670	<b>45,681,245</b>	24,209,670

## Second Quarter 2006 Dividend

Eurocastle aims to pay out substantially all of its earnings in the form of quarterly dividends to shareholders. The Board of Directors has declared a quarterly cash dividend of €0.40 per share for the quarter ended 30 June 2006. The €0.40 per share dividend is payable on 8 September 2006 to holders on record of Eurocastle's shares on 23 August 2006.

## Portfolio Review

The first half of 2006 was a very successful one for Eurocastle. The management team in Germany continued to make good progress in leasing up the Deutsche Bank portfolio and increased the occupancy from 74.6% at year end 2005 to currently 78.2%. In a short period of time, Eurocastle has successfully integrated the portfolio acquired from Dresdner Bank and has already increased the occupancy from 80.7% to 81.4%.

Eurocastle's dedicated real estate acquisition team has also been very active and the Company is well under way to achieve the acquisition target of €1 billion in 2006. Eurocastle has committed to purchase or entered into exclusive negotiations to purchase €840 million of real estate assets towards Eurocastle's 2006 target of €1 billion in new acquisitions. Approximately €46 million of the €840 million was funded in the second quarter 2006.

### Real Estate Investment Portfolio

As of 30 June 2006, Eurocastle owned an approximate €2.8 billion portfolio of real estate investments, comprising investment properties of €2.6 billion (including unrealised fair value gains of €77.3 million for the first half 2006) and real estate fund units of €187.3 million (including unrealised fair value losses of €2.4 million for the first half 2006). Real estate investments accounted for 85% of Eurocastle's total invested equity.

#### Overview Real Estate Investment Portfolio

	<b>Unaudited</b>	
	<b>As of 30 June 2006</b>	<b>As of 31 December 2005</b>
Investment properties at fair value		
<i>Thereof</i>		
Drive*	2,068,040	-
Wave*	323,943	322,352
Retail*	256,495	141,188
Real estate fund units	187,274	189,591
Total investment in real estate investments	<b>2,835,752</b>	653,131
Weighted average asset yield	<b>5.86%</b>	7.69%
Weighted average liability cost	<b>4.35%</b>	4.84%
Weighted average net spread	<b>1.51%</b>	2.85%

\*Investment property portfolios defined on page 18

### Investment Properties

#### *Drive Portfolio*

The Drive portfolio is Eurocastle's €2.1 billion German property portfolio purchased from Dresdner Bank, via the acquisition of Dresdner Grund-Fonds. The portfolio is composed of 303 German commercial real estate properties or approximately 840,000 square meters of lettable space. Dresdner Bank represents approximately 80% of rental income and the average lease is approximately 7.0 years with an average occupancy of 81.4%, up from 80.7% at the time of acquisition.

#### *Wave Portfolio*

The Wave portfolio consists of 96 properties or approximately 295,000 square meters primarily of office space, which is leased mainly to Deutsche Bank for an average remaining life of 5.0 years with occupancy of 78.2% at quarter end, up from 74.6% at 31 December 2005.

## *Retail Portfolio*

As of 30 June 2006, Eurocastle owned 103 recently developed German retail properties located throughout Germany. The properties were purchased for an aggregate purchase price of €255 million representing approximately 197,000 square meters of lettable space. The space is leased to leading German retailers with occupancy of 99.9% for an average lease term of approximately 10.0 years.

## *Acquisitions*

In the first half of 2006, Eurocastle substantially increased its real estate portfolio to €2.8 billion. In February 2006, the Company completed the acquisition of a €2 billion German property portfolio from Dresdner Bank via the acquisition of Dresdner Grund-Fonds. Furthermore, Eurocastle funded €14.5 million in the second quarter which completes the acquisition of the €107 million retail property portfolio yielding approximately 7%, which began in December 2005.

In addition, the Company has committed to purchase or entered into exclusive negotiations to purchase €840 million of real estate assets towards Eurocastle's 2006 target of €1 billion in new acquisitions. Approximately €46 million of the €840 million was funded in the second quarter 2006.

## Real Estate Fund Units

As of 30 June 2006, Eurocastle had a total interest of €187 million (including cumulative unrealised fair value gains of €5.7 million since acquisition) in a real estate investment fund that owns a portfolio of approximately 400 Italian properties. The properties are let to Italian government agencies. The original term of the Lease Agreement is 9 years (7.5 years remaining), with an extension option for a further 9 years. The properties are 100% occupied.

## Debt Investment Portfolio

### **Overview of Real Estate and Other ABS Securities and Real Estate Loans**

	<b>Unaudited</b>	
	<b>As of 30 June 2006</b>	<b>As of 31 December 2005</b>
Total debt investments (excluding restricted cash)	<b>1,560,918</b>	1,537,945
Weighted average asset margin (above Euribor)	<b>1.87%*</b>	1.88%
Weighted average liability spread	<b>0.54%*</b>	0.53%
Weighted average net spread	<b>1.33%</b>	1.35%
Weighted average credit rating	<b>BBB</b>	BBB+
Percentage investment grade of securities portfolio	<b>81%</b>	87%
Number of securities and loans	<b>136</b>	127

\* Includes assets and liabilities referenced under total return swaps

## Portfolio

As of 30 June 2006, Eurocastle's total debt investment portfolio of approximately €1.6 billion represented 15% of the Company's total equity. The debt portfolio included €705 million of CMBS, €774 million of other asset backed securities (including €353 million of RMBS) and €82 million of loans. The debt investment portfolio is well diversified with 136 securities and loans and an average life of approximately 4.15 years; approximately 97% of the portfolio comprises floating-rate securities. The portfolio is geographically diversified with direct exposures of 45% in the UK, 19% in Italy, 15% in Germany, 8% Pan European and 5% in France. The average credit quality of the securities portfolio is BBB and approximately 81% of the securities are rated investment grade. The portfolio's weighted average credit spread was approximately 1.87% as of 30 June 2006.

Eurocastle's debt investment portfolio has continued to perform well. As of 30 June 2006, none of the Company's securities or loans had defaulted, and there have been no principal losses to date. Within Eurocastle's debt investment portfolio, the company continues to seek investments that will generate superior risk-adjusted returns with a long-term objective of capital preservation and earnings stability in varying interest rate and credit cycles.

### Acquisitions

In the first half 2006, Eurocastle purchased approximately €221.8 million of real estate related securities. The securities purchased during the first half had an average credit rating of BBB- and an average credit spread above Euribor of 1.83%.

After allowing for sales of securities and principal redemptions, the net increase in face amount of real estate related securities and real estate related loans during the first half was €27.9 million, maintaining the amount of these at approximately €1.6 billion at 30 June 2006.

### Financing

#### Debt Financing

During the first half, Eurocastle entered into €1.525 billion 7-year fixed interest term loans to finance the Dresdner Bank portfolio acquisition at an all-in cost of 4.16%. The Company also utilized a further €55 million of an €85 million 10-year fixed rate term facility to finance the purchase of the 21 additional retail properties. The amount drawn on the facility has an all-in finance cost of 4.97%. The Company raised additional financing to fund the purchase of 21 properties, utilising €35 million of a €120 million 10-year fixed rate term facility at an all-in financing cost of 4.91%.

Eurocastle continues to finance its real estate investment portfolio with fixed rate term loans, which has substantially eliminated exposure to increased interest rates. This is consistent with our objective of locking in the spread between the yield on our investments and the cost of financing those investments.

### **Forward-Looking Statements**

This release contains statements that constitute forward-looking statements. Such forward-looking statements relate to, among other things, the operating performance of our investments and financing needs. Forward-looking statements are generally identifiable by use of forward-looking terminology such as “may,” “will,” “should,” “potential,” “intend,” “expect,” “endeavour,” “seek,” “anticipate,” “estimate,” “overestimate,” “underestimate,” “believe,” “could,” “project,” “predict,” “continue” or other similar words or expressions. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain projections of results of operations or of financial condition or state other forward-looking information. Our ability to predict results or the actual effect of future plans or strategies is limited. Although we believe that the expectations reflected in such forward-looking statements are based on reasonable assumptions, our actual results and performance may differ materially from those set forth in the forward-looking statements. These forward-looking statements are subject to risks, uncertainties and other factors that may cause our actual results in future periods to differ materially from forecasted results.

# **EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES**

## **REPORT ON REVIEW OF INTERIM FINANCIAL INFORMATION**

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### **Introduction**

We have reviewed the accompanying consolidated balance sheet of Eurocastle Investment Limited and its subsidiaries, as of 30 June 2006 and the related consolidated income statement, statement of changes in equity and statement of cash flows for the six-month period then ended, and summary of significant accounting policies and other explanatory notes. Management is responsible for the preparation and presentation of this interim financial information in accordance with International Financial Reporting Standards (“IFRS”). Our responsibility is to express a conclusion on this interim financial information based on our review.

### **Scope of Review**

We conducted our review in accordance with International Standard on Review Engagements 2410, “Review of Interim Financial Information Performed by the Independent Auditor of the Entity”. A review of interim financial information consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

### **Conclusion**

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information is not prepared, in all material respects, in accordance with International Financial Reporting Standards (“IFRS”).

Ernst and Young LLP  
London  
22nd August 2006

# EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

## CONSOLIDATED INCOME STATEMENT

	Notes	Unaudited Six Months Ended 30 June 2006 €'000	Unaudited Six Months Ended 30 June 2005 €'000	Unaudited Three Months Ended 30 June 2006 €'000	Unaudited Three Months Ended 30 June 2005 €'000
<b>Operating Income</b>					
Interest income	3	43,347	30,437	22,928	15,728
Rental income	4	63,108	12,655	39,300	6,306
Real estate fund unit interest income		9,595	-	4,865	-
Realised gain on disposal of available-for-sale securities		289	1,853	8	932
Increase in fair value of investment properties		77,296	513	61	513
Decrease in fair value of real estate fund unit		(2,351)	-	(4,374)	-
Decrease in fair value of total return swap		(103)	-	(143)	-
<b>Total operating income</b>		<b>191,181</b>	<b>45,458</b>	<b>62,645</b>	<b>23,479</b>
<b>Operating Expenses</b>					
Interest expense	5	62,801	25,495	36,258	13,103
Losses on foreign currency contracts/currency translation		967	1,159	485	993
Property expenses		8,435	1,202	5,451	1,096
Other operating expenses	6	11,923	4,100	6,643	1,383
<b>Total operating expenses</b>		<b>84,126</b>	<b>31,956</b>	<b>48,837</b>	<b>16,575</b>
<b>Operating Profit before Taxation</b>		<b>107,055</b>	<b>13,502</b>	<b>13,808</b>	<b>6,904</b>
Taxation expense - current	7	189	287	77	144
Taxation expense - deferred	7	260	-	26	-
<b>Net Profit after Taxation</b>		<b>106,606</b>	<b>13,215</b>	<b>13,705</b>	<b>6,760</b>
<b>Earnings Per Ordinary Share</b>					
Basic	19	2.56	0.71	0.30	0.36
Diluted	19	2.46	0.69	0.29	0.35
<b>Weighted Average Ordinary Shares Outstanding</b>					
Basic	19	41,656,560	18,529,515	45,624,059	18,529,515
Diluted	19	43,327,351	19,253,965	47,368,788	19,253,965

See notes to the consolidated financial statements

# EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEET

	Notes	Unaudited 30 June 2006 €'000	31 December 2005 €'000
<b>Assets</b>			
Cash and cash equivalents		43,037	13,640
Restricted cash	8	4,389	-
Restricted short term investments	8	40,427	-
Asset backed securities, available-for-sale (includes cash to be invested)	9	1,450,534	1,342,638
Asset backed securities pledged under repurchase agreements	9	50,251	109,909
Real estate related loans	10	81,809	92,649
Real estate fund units	12	187,274	189,591
Investment property	13	2,648,478	463,540
Intangible assets	14	659	542
Other assets	11	60,315	61,471
<b>Total assets</b>		<b>4,567,173</b>	<b>2,273,980</b>
<b>Equity and Liabilities</b>			
<b>Capital and Reserves</b>			
Issued capital, no par value, unlimited number of shares authorised, 45,681,245 shares issued and outstanding at 30 June 2006	20	804,329	286,801
Net unrealised gain on available-for-sale securities	8,9	698	4,703
Hedging reserve	21	20,535	(12,100)
Accumulated profit		102,409	18,442
Other reserves	20	7,937	1,020
<b>Total equity</b>		<b>935,908</b>	<b>298,866</b>
<b>Minority Interests</b>		<b>2</b>	<b>2</b>
<b>Liabilities</b>			
CDO bonds payable	15	976,528	977,485
Bank borrowings	16	2,492,859	835,162
Repurchase agreements	17	46,899	103,542
Taxation payable	7	2,727	2,278
Trade and other payables	18	112,250	56,645
<b>Total liabilities</b>		<b>3,631,263</b>	<b>1,975,112</b>
<b>Total equity and liabilities</b>		<b>4,567,173</b>	<b>2,273,980</b>

See notes to the consolidated financial statements

# EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CASH FLOWS

	Unaudited Six Months Ended 30 June 2006 €'000	Unaudited Six Months Ended 30 June 2005 €'000
<b>Cash Flows From Operating Activities</b>		
Net profit before taxation	107,055	13,502
Adjustments for:		
Unrealised gain/(loss) on foreign currency contracts	967	(76)
Accretion of discounts on securities	(291)	(2,854)
Amortisation of borrowing costs	1,804	525
Realised gain on disposal of available-for-sale securities	(289)	(1,853)
Shares granted to directors	172	27
Amortisation of intangible assets	61	-
Revaluation (gain)/loss of real estate fund units	2,351	-
Revaluation (gain) of investment properties	(77,296)	(513)
Revaluation (gain) of total return swap	(40)	-
Net change in operating assets and liabilities:		
(Increase) in restricted short-term investments	(40,427)	-
(Increase)/decrease in restricted cash	(4,389)	1,043
Decrease/(increase) in other assets	15,486	(3,896)
Increase in trade and other payables	67,399	27,441
<b>Net cash flows from operating activities</b>	<b>72,563</b>	<b>33,346</b>
<b>Cash Flows From Investing Activities</b>		
Purchase of investment property	(2,107,642)	(424)
Net movement of available-for-sale securities	(114,263)	(220,898)
Net movement of securities pledged under repurchase Agreements	60,185	-
Net movement of real estate related loans	10,840	-
Additions to real estate fund units	(34)	-
Purchase of intangible assets	(178)	-
<b>Net cash flows used in investing activities</b>	<b>(2,151,092)</b>	<b>(221,322)</b>
<b>Cash Flows From Financing Activities</b>		
Proceeds of issuance of ordinary shares	535,401	99,015
Costs related to issuance of ordinary shares	(11,128)	(3,998)
Proceeds from issuance of bonds	-	445,943
Costs related to issuance of bonds	-	(4,523)
Borrowings under repurchase agreements	(56,643)	106,188
Repayments under warehouse borrowing facility	-	(350,843)
Net movement of bank borrowings	1,662,935	(14,261)
Dividends paid to shareholders	(22,639)	(12,188)
<b>Net Cash Flows from Financing Activities</b>	<b>2,107,926</b>	<b>265,333</b>
<b>Net Increase in Cash and Cash Equivalents</b>	<b>29,397</b>	<b>77,357</b>
<b>Cash and Cash Equivalents, Beginning of Period</b>	<b>13,640</b>	<b>10,293</b>
<b>Cash and Cash Equivalents, End of Period</b>	<b>43,037</b>	<b>87,650</b>

# EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

	Ordinary Shares (Adjusted for Share Consolidation)	Share Capital €'000	Other Reserves €'000	Net Unrealised Gains/ (Losses) €'000	Hedging Reserves €'000	Accumulated Profit (Loss) €'000	Total Equity €'000
<b>At 1 January 2005</b>	18,463,670	192,309	400	6,604	713	6,394	206,420
Net unrealised gain on available-for-sale securities	-	-	-	4,038	-	-	4,038
Issuance of shares – June 2005	5,740,000	99,015	-	-	-	-	99,015
Costs related to issue of shares – June 2005	-	(3,998)	-	-	-	-	(3,998)
Issuance of ordinary shares to directors	6,000	108	-	-	-	-	108
Realised gains reclassified to the income statement	-	-	-	2	-	-	2
Realised losses reclassified to the income statement	-	-	-	(1,392)	-	-	(1,392)
Net unrealised loss on hedge instruments	-	-	-	-	(6,892)	-	(6,892)
Costs related to issue of options on follow on share issue	-	(620)	620	-	-	-	-
Net gains/(losses) not recognised in the income statement	-	-	1,020	9,252	(6,179)	-	4,093
Net profit for the six months	-	-	-	-	-	13,215	13,215
<b>Total Movement for the Period</b>	-	-	-	2,648	(6,892)	13,215	8,970
Dividends paid	-	-	-	-	-	(18,652)	(18,652)
<b>At 30 June 2005 (Unaudited)</b>	24,209,670	286,814	1,020	9,252	(6,179)	957	291,864

**EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (cont'd)**

	Ordinary Shares (Adjusted for Share Consolidation)	Share Capital €'000	Other Reserves €'000	Net Unrealised Gains/ (Losses) €'000	Hedging Reserves €'000	Accumulated Profit (Loss) €'000	Total Equity €'000
<b>At 1 July 2005</b>	<b>24,209,670</b>	<b>286,814</b>	<b>1,020</b>	<b>9,252</b>	<b>(6,179)</b>	<b>957</b>	<b>291,864</b>
Net unrealised (loss) on available-for-sale securities	-	-	-	(3,827)	-	-	(3,827)
Costs related to issue of shares – June 2005	-	(13)	-	-	-	-	(13)
Realised losses reclassified to the income statement	-	-	-	(722)	-	-	(722)
Net unrealised loss on hedge instruments	-	-	-	-	(5,921)	-	(5,921)
<b>Net Gains/(Losses) Not Recognised in the Income Statement</b>	-	-	1,020	4,703	(12,100)	-	(6,377)
Net profit for the period	-	-	-	-	-	26,443	26,443
<b>Total Movement for the Year</b>	-	-	-	(4,549)	(5,921)	26,443	15,973
Dividends paid	-	-	-	-	-	(8,958)	(8,958)
<b>At 31 December 2005</b>	<b>24,209,670</b>	<b>286,801</b>	<b>1,020</b>	<b>4,703</b>	<b>(12,100)</b>	<b>18,442</b>	<b>298,866</b>

**EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES**

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY (cont'd)**

	Ordinary Shares (Adjusted for Share Consolidation)	Share Capital €'000	Other Reserves €'000	Net Unrealised Gains/ (Losses) €'000	Hedging Reserves €'000	Accumulated Profit (Loss) €'000	Total Equity €'000
<b>At 1 January 2006</b>	24,209,670	286,801	1,020	4,703	(12,100)	18,442	298,866
Net unrealised loss on available-for-sale securities	-	-	-	(4,034)	-	-	(4,034)
Issuance of shares – January 2006	21,394,429	534,690	-	-	-	-	534,690
Costs related to issue of shares – January 2006	-	(11,128)	-	-	-	-	(11,128)
Issuance of ordinary shares to directors	6,000	172	-	-	-	-	172
Share options exercised – June 2006	71,146	711	-	-	-	-	711
Realised losses reclassified to the income statement	-	-	-	29	-	-	29
Net unrealised gain on hedge instruments	-	-	-	-	32,635	-	32,635
Cost related to issue of options on follow on share issue	-	(6,917)	6,917	-	-	-	-
<b>Net Gains Not Recognised in the Income Statement</b>	-	-	7,937	698	20,535	-	29,170
Net profit for the six months	-	-	-	-	-	106,606	606,606
<b>Total Movement for the Period</b>	-	-	6,917	(4,005)	32,635	106,606	142,175
Dividends paid	-	-	-	-	-	(22,639)	(22,639)
<b>At 30 June 2006 (Unaudited)</b>	<b>45,681,245</b>	<b>804,329</b>	<b>7,937</b>	<b>698</b>	<b>20,535</b>	<b>102,409</b>	<b>935,908</b>

# **EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES**

## **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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### **1. BACKGROUND**

Eurocastle Investment Limited (the “Company”) was incorporated in Guernsey, Channel Islands on 8 August 2003 and commenced its operations on 21 October 2003. Eurocastle Investment Limited is a Euro denominated Guernsey closed-end investment company listed on Euronext Amsterdam (formerly listed on the London Stock Exchange). The activities of the Company include the investing in, financing and managing of European real estate assets and European real estate related debt.

The Company is externally managed by its manager, Fortress Investment Group LLC (the “Manager”). The Company has entered into a management agreement (the “Management Agreement”) under which the Manager advises the Company on various aspects of its business and manages its day-to-day operations, subject to the supervision of the Company’s Board of Directors. The Company has no direct employees. For its services, the Manager receives an annual management fee (which includes a reimbursement for expenses) and incentive compensation, as described in the Management Agreement. The Company has no ownership interest in the Manager.

### **2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

#### **Statement of Compliance**

The consolidated financial statements of the Company have been prepared in accordance with International Financial Reporting Standards (IFRS). The financial statements are prepared in accordance with IAS 34 “Interim Financial Statements.” The interim financial statements have been prepared under the same accounting principles and methods of computation as in the financial statements as at 31 December 2005 and for the year then ended. The consolidated financial statements are presented in euros, the functional currency of the Group, because the Group conducts its business predominantly in euros.

#### **Basis of Preparation**

The consolidated financial statements are prepared on a fair value basis for derivative financial instruments, investment property, financial assets and liabilities held for trading, and available-for-sale assets. Other financial assets and liabilities and non-financial assets and liabilities are stated at amortised or historical cost.

The preparation of these financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Although these estimates are based on management’s best knowledge of the amount, event or actions, actual results ultimately may differ from those estimates.

Where such judgements are made they are indicated within the accounting policies below.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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#### **Basis of Consolidation**

The consolidated financial statements comprise the financial statements of Eurocastle Investment Limited and its subsidiaries for the six months ended 30 June 2006. Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred from the Group.

At 30 June 2006, the Group's subsidiaries consisted of a number of subsidiaries in Ireland, Luxembourg and Germany.

Eurocastle Funding Limited ("EFL"), Eurocastle CDO I PLC ("CDO I"), Eurocastle CDO II PLC ("CDO II"), Eurocastle CDO III PLC ("CDO III") and Eurocastle CDO IV PLC ("CDO IV") are all limited companies incorporated in Ireland. The ordinary share capital of these vehicles is held by outside parties and the Company has no voting rights. In accordance with the Standing Interpretations Committee Interpretation 12 Consolidation – Special Purpose Entities, the Group consolidates EFL, CDO I, CDO II, CDO III, CDO IV as it retains control over these entities and retains the residual risks of ownership of these entities.

Eurocastle owns either directly or indirectly a 100% equity interest in a number of significant operating subsidiaries in Luxembourg, Germany and Ireland, as disclosed in Note 26, which are consolidated into these financial statements

Eurocastle's investment in real estate fund units are held by Finial Sàrl ("FIP"), a Luxembourg limited company, which is 100% owned by Luxgate Sàrl.

#### **Financial Instruments**

##### ***Classification***

*Financial assets and liabilities measured at fair value through the profit and loss account* are principally those instruments that the Group holds for the purpose of short-term profit taking. These include total return swaps, real estate fund units, interest rate swaps and forward foreign exchange contracts that are not designated as effective hedging instruments.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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*Available-for-sale assets and restricted short term investments* are financial assets that are not classified as instruments held at fair value through the profit & loss account, loans and advances, or held to maturity. Available-for-sale instruments include real estate and other asset backed securities.

#### *Recognition*

The Group recognises financial assets that are classified as held at fair value through the profit & loss account and available-for-sale assets on the date it commits to purchase the assets (trade date). From this date any gains and losses arising from changes in the fair value of the assets are recognised.

A financial liability is recognised on the date the Group becomes party to contractual provisions of the instrument.

#### *Measurement*

Financial instruments are measured initially at fair value plus, in the case of a financial asset or liability not measured at fair value through profit and loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Subsequent to initial recognition all instruments that are classified as held at fair value through the profit and loss account and available for sale assets are carried at fair value.

All financial assets other than trading instruments and available-for-sale assets are measured at amortised cost less impairment losses. Amortised cost is calculated on the effective interest rate method. Premiums and discounts, including initial transaction costs, are included in the carrying amount of the related instrument and amortised based on the effective interest rate of the instrument.

#### *Fair value measurement principles*

The fair value of financial instruments is based on their quoted market price at the balance sheet date without any deduction for transaction costs. If a quoted market price is not available, the fair value of the instrument is calculated using pricing models or discounted cash flow techniques, as applicable.

Where discounted cash flow techniques are used, expected future cash flows are based on our manager's best estimates and the discount rate is a market related rate at the balance sheet date for an instrument with similar terms and conditions. Where pricing models are used, inputs are based on market related measures at the balance sheet date.

The fair value of derivatives that are not exchange traded is calculated at the amount that the Group would receive or pay to terminate the contract at the balance sheet date taking into account current market conditions and the current creditworthiness of the counterparties.

#### *Gains and losses on subsequent measurement*

Gains and losses arising from a change in the fair value of instruments that are classified as held at fair value through the profit & loss account are recognised directly in the income statement. Gains and losses arising from a change in the fair value of available-for-sale securities are recognised directly in equity until the investment is derecognised (sold, collected, or otherwise disposed of) or impaired, at which time the cumulative gain or loss previously recognised in equity is included in the income statement for the period.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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#### *Derecognition*

A financial asset is derecognised when the Group loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished, that is when the obligation specified in the contract is discharged or cancelled, or expires.

Assets held for trading and available-for-sale assets that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Group commits to sell the assets. The Group uses the specific identification method to determine the gain or loss on derecognition.

#### *Impairment*

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the calculated future cash flows of the financial asset or group of financial assets that can be reliably measured.

In the case of financial assets classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement.

Subsequent increases in the fair values of both debt instruments classified as available-for-sale and financial assets measured at amortised cost, which can be objectively related to an event occurring after previous impairment losses have been recognised in the income statement, are recorded in the income statement. Such reversals are then taken through the income statement only to the extent previous impairment losses have been taken through the income statement.

#### *Hedge accounting*

Where there is a hedging relationship between a derivative instrument and a related item being hedged, the hedging instrument is measured at fair value.

Where a derivative financial instrument hedges the exposure to variability in the cash flows of recognised assets or liabilities, the effective part of any gain or loss on re-measurement of the hedging instrument is recognised directly in equity. The ineffective part of any gain or loss is recognised in the income statement.

The gains or losses that are recognised in equity are transferred to the income statement in the same period in which the hedged items affect the net profit and loss.

#### **Repurchase Agreements**

Securities and real estate loans subject to repurchase agreements are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liabilities have been classified as repurchase agreements.

## **EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)**

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#### **Cash and Cash Equivalents**

Cash and cash equivalents comprise cash at banks and in hand and short-term deposits with an original maturity of three months or less.

#### **Restricted Cash**

Restricted cash comprises margin account balances held by derivative counterparties as collateral for forward foreign exchange contracts, as well as cash held by the trustees of CDO I, II and III securitisations as a reserve for future trustee expenses. In addition, restricted cash comprises cash held as part of the minimum liquidity requirement for the Dresdner Grund-Fonds. As such, these funds are not available for use by the Group.

#### **Investment Properties**

Investment properties comprise land and buildings. In accordance with IAS 40, property held to earn rentals and/or for capital appreciation is categorised as investment property.

Investment properties are measured initially at cost, including transaction costs. The carrying amount includes the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met; and excludes the costs of day-to-day servicing of an investment property. Subsequent to initial recognition, investment properties are stated at fair value, which reflects market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment properties are included in the income statement in the year in which they arise.

Investment properties are derecognised when either they have been disposed of or when the investment property is permanently withdrawn from use and no future economic benefit is expected from its disposal. Any gains or losses on the retirement or disposal of an investment property are recognised in the income statement in the year of retirement or disposal.

Tenant improvements and leasing commissions incurred at the commencement of the lease are capitalised, and amortised on a straight-line basis over the life of the lease.

The value of investment property incorporates 27 properties which are considered finance leases or operating leases. As the Group has assumed substantially all the risks and rewards associated with these assets, these have been treated as investment property under IAS 17 and IAS 40 respectively. These properties have been recognised at fair value in the same manner as freehold property. An associated liability representing the present value of lease payments to the freehold owner has been included in Trade and Other Payables on the balance sheet.

#### **Finance Leases**

The determination of whether an arrangement is, or contains a finance lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and whether the arrangement conveys a right to use the asset.

## **EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)**

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Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and the reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged to the income statement as they arise.

#### **Real Estate Fund Units**

Real estate fund units are recorded at fair value in the consolidated balance sheet, with any change in fair value recognised in the consolidated income statement. The interest income is recognised in the income statement as it accrues, taking into account the effective yield of the real estate fund units.

#### **Intangible Assets**

Software development costs are capitalised when they meet certain criteria relating to identifiability, it is probable that future economic benefits will flow to the enterprise, and the cost can be measured reliably. These software costs are recognised in profit and loss through amortisation of the capitalised software costs on a straight line basis over their expected useful life of 5 years.

#### **Interest-Bearing Loans and Borrowings**

All loans and borrowings, including the Group's repurchase agreements, are initially recognised at fair value, being the fair value of consideration received, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

#### **Minority Interests**

Minority interests represent interests held by outside parties in the Group's consolidated subsidiaries.

#### **Revenue Recognition**

The company considers revenue to comprise interest income and rental income as its principal business is investing in, financing and management of European real estate and other asset backed securities and other real estate related assets.

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured.

Interest income and expenses are recognised in the income statement as they accrue, taking into account the effective yield of the asset/liability or an applicable floating rate. Interest income and expense include the amortisation of any discount or premium or other differences between the initial carrying amount of an interest bearing instrument and its amount at maturity calculated on an effective interest rate basis.

Rental income on freehold and finance lease investment property is recognised on an accruals basis. Rental income arising from operating leases on investment properties is accounted for on a straight-line basis over the lease term. Incentives given to enter into lease agreements are spread evenly over the lease term as a reduction of rental expense, even if the payments are not made on such a basis.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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#### Income Tax

The Company is a Guernsey, Channel Islands limited company and is not subject to taxation. The company's subsidiaries, EFL, CDO I, CDO II, CDO III and CDO IV are Irish registered companies and are structured to qualify as securitisation companies under section 110 of the Taxes Consolidation Act 1997. It is envisaged that these companies will generate minimal net income for Irish income tax purposes and no provision for income taxes has been made for these companies.

The Group's German subsidiary companies, Longwave and Shortwave, are subject to German income tax on income arising from their investment properties, after the deduction of allowable debt financing costs and other allowable expenses. The taxation accrual for the six months ended 30 June 2006 relates to these subsidiaries.

The German subsidiaries Bastion, Belfry and Truss are also subject to German income tax on rental income net of interest and other expense deductions. No taxable income has been generated in these entities and therefore no tax accrual has been made for the period ended 30 June 2006.

The Group's investment in the underlying properties in relation to the Drive portfolio and the Real Estate Fund Units is by way of units in an open-ended real estate fund. No corporation tax is due on income generated from its investment in these units.

#### Deferred Taxation

Deferred income tax is provided in full, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements.

Deferred income tax is recognised for all temporary differences arising between the tax base of assets and liabilities and their carrying amounts in the financial statements, with the following exceptions:

- where the temporary difference arises from the initial recognition of goodwill or of an asset or liability in a transaction that is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss;
- in respect of taxable temporary differences associated with investments in subsidiaries, where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future; and
- deferred income tax assets are recognised only to the extent that it is probable that taxable profit will be available against which deductible temporary differences, carried forward tax credits or tax losses can be utilised.

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

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted at the balance sheet date.

Income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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#### Foreign Currency Translation

The functional and presentation currency of the Group and its subsidiaries is the euro. Transactions in foreign currencies are initially recorded in the functional currency rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated income statement. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

#### Share-Based Payments

Share-based payments are accounted for based on their fair value on grant date. The fair value is calculated by reference to an option pricing model. The fair value of the share options granted in relation to capital raises has been fully recognised (vested) on the date of grant as a cost relating to the issue of shares with a corresponding increase to other reserves.

Share options granted to directors is recognised in the profit & loss over the period that the services are received.

#### International Financial Reporting Standards to be adopted in 2007 and later

*IAS 1 Amendment – Presentation of Financial Statements: Capital Disclosures and IFRS 7 Financial Instruments: Disclosures*

Upon adoption of IAS 1 Amendments and IFRS 7, the Group will have to disclose additional information about its policies and processes for managing capital, as well as financial instruments, their significance and the nature and extent of risks that they give rise to. More specifically the Group will need to disclose the fair value of its financial instruments and its risk exposure in greater details. There will be no effect on reported income or net assets.

### 3. INTEREST INCOME

Interest income for the three and six months ended 30 June 2006 of €22.9 million and €43.3 million respectively (30 June 2005: €15.7 million and €30.4 million) is primarily interest income earned on the Asset backed securities available-for-sale and Asset backed securities pledged under repurchase agreements.

### 4. RENTAL INCOME

Rental income for the three and six months ended 30 June 2006 of €39.3 million and €63.1 million respectively (30 June 2005: €6.3 million and 12.7 million) represents rental income earned on investment properties.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### 5. INTEREST EXPENSES

Interest expense for the three and six months ended 30 June 2006 of €36.3 million and €62.8 million respectively (30 June 2005: €13.1 million and €25.5 million) comprises interest expense incurred on the CDO bonds payable, bank borrowings and repurchase agreements.

#### 6. OTHER OPERATING EXPENSES

	Six Months Ended 30 June 2006 €'000	Six Months Ended 30 June 2005 €'000	Three Months Ended 30 June 2006 €'000	Three Months Ended 30 June 2005 €'000
Professional fees	3,408	795	1,712	339
Management fees	5,419	1,449	3,035	(26)
Incentive fees	784	1,456	477	1,456
Amortisation	61	-	28	-
Other	2,251	400	1,391	(386)
	<b>11,923</b>	<b>4,100</b>	<b>6,643</b>	<b>1,383</b>

#### 7. TAXATION EXPENSE

	Six months ended 30 June 2006 €'000	Six months ended 30 June 2005 €'000	Three Months Ended 30 June 2006 €'000	Three Months Ended 30 June 2005 €'000
Current tax				
Germany	-	287	(21)	144
Luxembourg	189	-	98	-
<b>Total</b>	<b>189</b>	<b>287</b>	<b>77</b>	<b>144</b>
Deferred tax				
Germany	260	-	26	-
<b>Total Deferred Tax</b>	<b>260</b>	<b>-</b>	<b>26</b>	<b>-</b>
<b>Total Tax Charge</b>	<b>449</b>	<b>287</b>	<b>103</b>	<b>144</b>

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### Reconciliation of the total tax charge

The tax expense in the Income Statement for the year is higher than the standard rate of corporation tax in Guernsey of 0%. The difference is reconciled below:

	Six Months Ended 30 June 2006 €'000	Six Months Ended 30 June 2005 €'000	Three Months Ended 30 June 2006 €'000	Three Months Ended 30 June 2005 €'000
Profit on ordinary activities before taxation	107,055	13,502	13,808	6,904
Profit on ordinary activities based on Guernsey tax of 0%	-	-	-	-
Overseas taxation	189	287	77	144
<b>Total Tax Charge Reported in the Income Statement</b>	<b>189</b>	<b>287</b>	<b>77</b>	<b>144</b>

#### Analysis of Deferred Tax

	Six months ended 30 June 2006 €'000	Six months ended 30 June 2005 €'000	Three Months Ended 30 June 2006 €'000	Three Months Ended 30 June 2005 €'000
Tax losses carried forward	(204)	-	(12)	-
<b>Short term timing differences</b>				
Loan expense	(29)	-	16	-
<b>Long term timing differences</b>				
Accelerated capital allowance	488	-	(65)	-
Revaluation of investment properties	-	-	80	-
Other	5	-	7	-
<b>Deferred Tax Liability</b>	<b>260</b>	<b>-</b>	<b>26</b>	<b>-</b>

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### Movement in Taxation Payable

	30 June 2006 €'000	31 December 2005 €'000
Opening tax payable	2,278	-
Tax paid	-	-
Tax expense for the period	449	2,278
<b>Closing taxation payable</b>	<b>2,727</b>	<b>2,278</b>

The taxation expense for the 6 months ended 30 June 2006 relates to the Group's Luxembourg and German subsidiary companies as described in Note 2. The German tax charge is based on German tax on income arising from its investment properties, after the deduction of allowable debt financing costs and other allowable expenses. The Luxembourg tax charge is based on Luxembourg tax on a small amount of net interest which is attributable to shareholder loans and other debt instruments used within each of the structures supporting the different investment property portfolios.

#### 8. RESTRICTED SHORT TERM INVESTMENTS OR CASH

There is a minimum liquidity requirement of 5% of the value of Dresdner Grund-Fonds, the subsidiary through which the Drive portfolio is held, in accordance with German Investment Companies Act requirements.

	Six Months Ended 30 June 2006 €'000	Year to 31 December 2005 €'000
At 1 January 2006	-	-
Purchase of restricted short term investments	40,795	-
Unrealised losses on restricted short term investments	(368)	-
At 30 June 2006	40,427	-
Restricted cash	4,389	-

# EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

### 9. AVAILABLE-FOR-SALE SECURITIES

The following is a summary of the Group's available-for-sale securities at 30 June 2006.

	Current Face Amount €'000	Amortised Cost Basis €'000	Gross Unrealised		Carrying Value €'000	Weighted Average			Maturity (Years)
			Gains €'000	Losses €'000		S&P Rating	Coupon	Margin	
<b>Portfolio I</b>									
CMBS	151,009	150,827	1,010	(8)	151,829	BBB	4.57%	1.75%	3.42
Other ABS	250,557	251,284	1,589	(469)	252,404	BBB	4.79%	1.92%	4.02
	<b>401,566</b>	<b>402,111</b>	<b>2,599</b>	<b>(477)</b>	<b>404,233</b>	<b>BBB</b>	<b>4.71%</b>	<b>1.85%</b>	<b>3.79</b>
<b>Portfolio II</b>									
CMBS	131,839	132,242	-	(392)	131,850	BBB	4.42%	1.51%	4.81
Other ABS	143,937	144,274	388	(528)	144,134	BBB	4.30%	1.33%	4.28
	<b>275,776</b>	<b>276,516</b>	<b>388</b>	<b>(920)</b>	<b>275,984</b>	<b>BBB</b>	<b>4.36%</b>	<b>1.42%</b>	<b>4.54</b>
<b>Portfolio III</b>									
CMBS	176,102	176,485	570	(235)	176,820	BBB-	4.85%	1.93%	4.83
Other ABS	204,601	204,812	499	(183)	205,128	BBB	4.43%	1.50%	3.83
	<b>380,703</b>	<b>381,297</b>	<b>1,069</b>	<b>(418)</b>	<b>381,948</b>	<b>BBB</b>	<b>4.62%</b>	<b>1.70%</b>	<b>4.29</b>
<b>Portfolio IV</b>									
CMBS	240,602	239,654	312	(1,297)	238,669	BBB	4.59%	1.96%	5.70
Other ABS	128,700	128,746	88	(811)	128,023	BBB-	4.49%	1.60%	5.12
	<b>369,302</b>	<b>368,400</b>	<b>400</b>	<b>(2,108)</b>	<b>366,692</b>	<b>BBB</b>	<b>4.55%</b>	<b>1.83%</b>	<b>5.50</b>
<b>Total Portfolio</b>	<b>1,427,347</b>	<b>1,428,324</b>	<b>4,456</b>	<b>(3,923)</b>	<b>1,428,857</b>	<b>BBB</b>	<b>4.58%</b>	<b>1.72%</b>	<b>4.51</b>
<b>Other Securities</b>									
CMBS	5,780	5,486	294	(29)	5,751	BBB	4.47%	1.50%	6.47
Other ABS	44,500	44,232	268	-	44,500	AAA	4.14%	0.90%	1.24
	<b>50,280</b>	<b>49,718</b>	<b>562</b>	<b>(29)</b>	<b>50,251</b>	<b>AA+</b>	<b>4.18%</b>	<b>0.97%</b>	<b>1.84</b>
	<b>1,477,627</b>	<b>1,478,042</b>	<b>5,018</b>	<b>(3,952)</b>	<b>1,479,108</b>	<b>BBB</b>	<b>4.56%</b>	<b>1.70%</b>	<b>4.42</b>
<b>Restricted Cash – Cash to be Invested</b>					<b>21,677</b>				
<b>Total Asset Backed Securities (Including Cash to be Invested)</b>					<b>1,500,785</b>				

CMBS – Commercial Mortgage Backed Securities  
Other ABS – Other Asset Backed Securities

The securities within Portfolio I, II and III are encumbered by CDO securitisations (Note 15).

# EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

The following is a summary of the Group's available-for-sale securities at 31 December 2005.

	Current Face Amount €'000	Amortised Cost Basis €'000	Gross Unrealised		Carrying Value €'000	Weighted Average			Maturity (Years)
			Gains €'000	Losses €'000		S&P Rating	Coupon	Margin	
<b>Portfolio I</b>									
CMBS	152,096	151,956	1,592	(43)	153,505	BBB	4.13%	1.86%	3.16
Other ABS	248,300	248,813	2,258	(159)	250,912	BBB+	4.28%	1.95%	3.74
	400,396	400,769	3,850	(202)	404,417	BBB	4.23%	1.91%	3.52
<b>Portfolio II</b>									
CMBS	130,013	129,898	434	(527)	129,805	BBB	3.89%	1.67%	5.02
Other ABS	143,945	144,266	588	(350)	144,504	BBB	3.82%	1.40%	4.84
	273,958	274,164	1,022	(877)	274,309	BBB	3.85%	1.53%	4.93
<b>Portfolio III</b>									
CMBS	169,452	169,646	1,016	(254)	170,408	BBB-	4.26%	1.94%	4.81
Other ABS	211,768	212,038	628	(810)	211,856	BBB	3.87%	1.61%	3.56
	381,220	381,684	1,644	(1,064)	382,264	BBB	4.04%	1.75%	4.11
<b>Portfolio IV</b>									
CMBS	207,063	206,254	308	(139)	206,423	BBB+	4.00%	1.81%	5.30
Other ABS	67,952	68,025	137	(188)	67,974	A-	4.06%	1.82%	4.70
	275,015	274,279	445	(327)	274,397	BBB+	4.01%	1.81%	5.15
<b>Total Portfolio</b>	<b>1,330,589</b>	<b>1,330,896</b>	<b>6,961</b>	<b>(2,470)</b>	<b>1,335,387</b>	<b>BBB</b>	<b>4.05%</b>	<b>1.77%</b>	<b>4.32</b>
<b>Other Securities</b>									
CMBS	65,617	65,543	73	(207)	65,409	AA-	2.89%	0.58%	0.72
Other ABS	44,500	44,154	346	-	44,500	AAA	3.54%	0.90%	1.76
	<b>110,117</b>	<b>109,697</b>	<b>419</b>	<b>(207)</b>	<b>109,909</b>	<b>AA</b>	<b>3.15%</b>	<b>0.71%</b>	<b>1.14</b>
	<b>1,440,706</b>	<b>1,440,593</b>	<b>7,380</b>	<b>(2,677)</b>	<b>1,445,296</b>	<b>BBB+</b>	<b>3.98%</b>	<b>1.69%</b>	<b>4.07</b>

Restricted Cash – Cash to be Invested

7,251

**Total Asset Backed Securities (Including Cash to be Invested)**

**1,452,547**

Asset backed securities, available for sale at fair value of €50.3 million (31 December: €109.9 million) have been pledged to third parties in sale and repurchase agreements. In accordance with the revisions to IAS 39 Financial Instruments: Recognition and Measurement, effective 1 January 2005, these securities have been reclassified as pledged securities as follows:

	30 June 2006 €'000	31 December 2005 €'000
Asset backed securities, available for sale (includes cash to be invested)	1,450,534	1,342,638
Asset backed securities pledged under repurchase agreements	50,251	109,909
<b>Total Asset Backed Securities</b>	<b>1,500,785</b>	<b>1,452,547</b>

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

Cumulative net unrealised gains on available-for-sale securities and hedge instruments recognised in the statement of changes in equity were as follows:

	<b>30 June 2006</b>	<b>31 December 2005</b>
	<b>€'000</b>	<b>€'000</b>
Unrealised gains on available-for-sale securities	5,018	7,380
Unrealised losses on available-for-sale securities	(3,952)	(2,677)
Unrealised losses on restricted short term investments	(368)	-
Net unrealised gains on available-for-sale securities	698	4,703
Unrealised gain/(loss) on hedge instruments (note 21)	20,535	(12,100)
	<b>21,233</b>	<b>(7,397)</b>

### 10. REAL ESTATE LOANS

The following is a summary of the Group's real estate loans at 30 June 2006.

	<b>Current Face Amount</b>	<b>Amortised Cost Basis</b>	<b>Gross Unrealised</b>		<b>Carrying Value</b>	<b>S&amp;P Rating</b>	<b>Weighted Average</b>		<b>Maturity (Years)</b>
			<b>Gains</b>	<b>Losses</b>			<b>Coupon</b>	<b>Margin</b>	
	€'000	€'000	€'000	€'000	€'000				
Real estate loans	82,175	81,809	-	-	81,809	*	5.88%	3.25%	4.78

\* Included in real estate loans are loans with a total current face amount of €47.0 million and with an average rating of BB from Standard and Poors.

As at 31 December 2005:

	<b>Current Face Amount</b>	<b>Amortised Cost Basis</b>	<b>Gross Unrealised</b>		<b>Carrying Value</b>	<b>S&amp;P Rating</b>	<b>Weighted Average</b>		<b>Maturity (Years)</b>
			<b>Gains</b>	<b>Losses</b>			<b>Coupon</b>	<b>Margin</b>	
	€'000	€'000	€'000	€'000	€'000				
Real estate loans	93,120	92,649	-	-	92,649	*	5.49%	3.48%	3.88

### 11. OTHER ASSETS

	<b>30 June 2006</b>	<b>31 December 2005</b>
	<b>€'000</b>	<b>€'000</b>
Unsettled security transactions	-	26,178
Interest receivable	21,512	18,963
Rent receivable	4,228	4,222
Prepaid expenses	515	638
Derivative assets (see note 11.1)	25,778	11,470
Other accounts receivable	8,282	-
	<b>60,315</b>	<b>61,471</b>

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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#### 11.1 Total Return Swap

Included in the Derivative Assets are two total return swaps, the fair value of which as at 30 June 2006 is €289,034 and the collateral deposit posted is €11.2 million. These total return swaps have been recorded as Derivative Assets and are treated as trading assets that are not designated as Effective Hedging Instruments for accounting purposes and any gain or loss arising from the change in fair value of the asset is recognized through profit and loss.

In August 2005, a subsidiary entered into a total return swap with a major investment bank, whereby it receives the sum of all interest (at an average of Sterling LIBOR + 5.50%) and any positive change in value from a referenced term loan with an initial notional amount of £15 million, and pays interest (at Sterling Overnight Interbank Average - "SONIA") on the notional amount plus any negative change in value amounts from such loan. Under the contract, the subsidiary is required to post an initial collateral deposit equivalent to 36.7% of the notional amount and additional margin may be payable in the event of a decline in the value of the referenced term loan.

In December 2005, a subsidiary entered into a total return swap with a major investment bank, whereby it receives the sum of all interest (at EURIBOR + 4.00%) and any positive change in value from a referenced term loan with an initial notional amount of €25.85 million, and pays interest (at EURIBOR + 0.40%) on the notional amount plus any negative change in value amounts from such loan. In May 2006, the subsidiary increased its holdings in the existing total return swap by €6.6 million. Under the contract, the subsidiary is required to post an initial collateral deposit equivalent to 10.0% of the notional amount and additional margin may be payable in the event of a decline in the value of the referenced term loan.

#### 12. REAL ESTATE FUND UNITS

Between July and October 2005, the Group purchased an interest in 1,500 Class A real estate fund units backed by a portfolio of 394 properties in Italy. The original term of the Lease Agreement is 9 years, automatically renewable for a further 9 years, unless terminated by the Agenzia del Demanio (a public entity established by the Italian Ministry of Finance), with 12 months prior notice. The properties have a total occupancy of 100%.

	<b>30 June 2006</b>	<b>31 December 2005</b>
	<b>€ '000</b>	<b>€'000</b>
At 1 January	189,591	-
Purchase of real estate fund units	-	181,493
Additional acquisition costs	34	-
(Decrease) / increase in fair value	(2,351)	8,098
	<u>187,274</u>	<u>189,591</u>

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### 13. INVESTMENT PROPERTIES

The table below shows the items aggregated under investment property in the consolidated balance sheet:

	<b>Freehold Land &amp; Buildings €'000</b>	<b>Leasehold Property €'000</b>	<b>30 June 2006 Total €'000</b>	<b>31 December 2005 Total €'000</b>
At 1 January	448,060	15,480	463,540	318,514
Additions	2,012,279	95,363	2,107,642	143,524
Disposals	-	-	-	(459)
Increase in fair value	74,658	2,638	77,296	1,961
<b>Total</b>	<b>2,534,997</b>	<b>113,481</b>	<b>2,648,478</b>	<b>463,540</b>

The value of investment properties incorporates 27 properties which are held by the Company under finance or operating leases. An associated liability is recognised at an amount equal to the fair value of the leased property, or if lower, the present value of the minimum lease payments, determined at the inception of the lease.

Lease arrangements over the land on which the 27 investment properties are built have unexpired terms ranging from 8 years to 86 years.

A reconciliation of investment property valuations to the balance sheet carrying value of property is shown below:

	<b>30 June 2006 €'000</b>	<b>31 December 2005 €'000</b>
Investment property at market value as determined by external valuers *	<b>2,622,580</b>	460,588
Add minimum payments under head leases separately included in trade and other payables on the balance sheet.	25,898	2,952
Balance sheet carrying value of investment property	<b>2,648,478</b>	<b>463,540</b>

\* Market values include the Drive portfolio valuation of €2,049 million based on the independent valuation from CB Richard Ellis GmbH dated 17 January 2006, resulting in a €77.9 million increase in fair value.

#### Schedule of Minimum Lease Payments Under Finance and Operating Leases

	<b>Total Value 30 June 2006 €'000</b>	<b>Present Value 30 June 2006 €'000</b>	<b>Total Value 31 December 2005 €'000</b>	<b>Present Value 31 December 2005 €'000</b>
Under 1 year	1,300	1,256	239	227
From 2 to 5 years	5,420	4,564	1,013	778
More than 5 years	94,250	20,078	27,710	1,947
<b>Total</b>	<b>100,970</b>	<b>25,898</b>	<b>28,962</b>	<b>2,952</b>

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### Additional Information

The tables below provide additional information for the Wave and Drive portfolios and the Retail portfolio which includes the Bastion, Belfry, Truss and Turret portfolios.

Portfolio	Passing Rent	Net Rental Income	Lettable Area	Vacancy	Property Valuation	Property Cost	Net Rental Yield (Cost)
	€'000	€'000	Sq Metre	%	€'000	€'000	%
Wave	25,548	21,859	294,720	21.8%	323,943	317,490	6.9%
Drive	111,043	99,898	841,682	18.6%	2,068,040	1,971,163	5.1%
Retail	19,873	18,195	196,617	0.1%	256,495	254,521	7.1%
<b>Total</b>	<b>156,464</b>	<b>139,952</b>	<b>1,333,019</b>		<b>2,648,478</b>	<b>2,543,174</b>	

Portfolio	Rent on Expiring Leases Yr 0-1	Rent on Expiring Leases Yr 2-3	Rent on Expiring Leases Yr 4-6	Rent on Expiring Leases Yr 7-10	Rent on Expiring Leases Yr 10+	Average Lease Length	Number of Properties
	€'000	€'000	€'000	€'000	€'000	Years	
Wave	642	8,036	1,610	14,386	874	5.0	96
Drive	2,413	6,913	33,955	27,696	40,066	7.0	303
Retail	30	576	4,497	6,470	8,300	10.0	103
<b>Total</b>	<b>3,085</b>	<b>15,525</b>	<b>40,062</b>	<b>48,552</b>	<b>49,240</b>		<b>502</b>

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### 14. INTANGIBLE ASSET

Intangible Assets comprise software development costs with a book value as at 30 June 2006 of €0.66 million (31 December 2005: €0.54 million), after an amortisation charge of €0.06 million (31 December 2005: €0.01 million).

#### 15. BONDS PAYABLE

##### CDO Bonds

As at 30 June 2006

	Class	Rating	Current Face Amount €'000	Carrying Amount €'000	Weighted Average Cost of Financing	Weighted Average Margin	Weighted Average Maturity (in years)
CDO I	A and B Notes	AAA/AA	351,000	348,471	3.57%	0.60%	5.9
CDO II	A, B and C Notes	AAA/AA/ A	263,727	261,324	3.51%	0.49%	9.0
CDO III	A, B and C Notes	AAA/AA/ A	370,000	366,733	3.45%	0.49%	9.0
<b>Total</b>			<b>984,727</b>	<b>976,528</b>	<b>3.51%</b>	<b>0.53%</b>	<b>7.9</b>

As at 31 December 2005

	Class	Rating	Current Face Amount €'000	Carrying Amount €'000	Weighted Average Cost of Financing	Weighted Average Margin	Weighted Average Maturity (in years)
CDO I	A and B Notes	AAA/AA	351,000	348,271	3.08%	0.60%	6.3
CDO II	A, B and C Notes	AAA/AA/ A	265,362	262,783	3.02%	0.53%	9.5
CDO III	A, B and C Notes	AAA/AA/ A	370,000	366,431	2.97%	0.49%	9.5
<b>Total</b>			<b>986,362</b>	<b>977,485</b>	<b>3.02%</b>	<b>0.54%</b>	<b>8.4</b>

None of the CDO bonds are due to be repaid within one year of the balance sheet date.

# EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

### 16. BANK BORROWINGS

The bank borrowings comprises of:

		30 June 2006 €'000	31 December 2005 €'000
Term finance	(Note 16.1)	2,441,584	782,031
Revolving credit facility	(Note 16.2)	17,387	18,578
Other short term financing	(Note 16.3)	33,888	34,553
		<b>2,492,859</b>	<b>835,162</b>

#### 16.1 Term Financing

Real Estate Debt	Month Raised	Current Face Amount €'000		Carrying Amount €'000		Hedged Weighted Average Funding Cost	Maturity
		30 June 2006	31 December 2005	30 June 2006	31 December 2005		
CDO IV	Jul-2005	368,935	308,321	368,608	307,917	3.52%	Jul 2008
<b>Investment Property</b>							
Wave Portfolio	Dec-2004	245,268	245,900	242,668	242,762	4.57%	Apr 2013
Belfry Portfolio	Aug-2005	56,240	56,240	55,421	55,363	4.81%	Oct 2015
Bastion Portfolio	Sep-2005	26,500	26,500	26,224	26,202	4.42%	Sep 2012
Truss Portfolio	Dec-2005	84,929	30,163	84,361	29,607	4.97%	Feb 2016
Turret Portfolio	May-2006	34,603	-	33,883	-	4.91% <sup>(1)</sup>	May 2016
Drive Portfolio	Feb-2006	1,525,000	-	1,510,046	-	4.16% <sup>(2)</sup>	Jan 2013
<b>Real Estate Fund Units</b>							
FIP Units	Jul-2005	121,875	121,875	120,373	120,180	5.42%	Jul 2018
<b>Total</b>		<b>2,463,350</b>	<b>788,999</b>	<b>2,441,584</b>	<b>782,031</b>		

<sup>(1)</sup> This is the fixed rate of the loan that is effective as from the 29 September 2006 until maturity. The effective interest rate that applied during the second quarter is 3.97%.

<sup>(2)</sup> This is the fixed rate of the loan that is effective as from the 20 July 2006 until maturity. The effective interest rate that applied during the second quarter is 3.51%.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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#### Real Estate Debt

On 14 July 2005, the Group through Eurocastle CDO IV PLC entered into a €400 million 3 year extendable warehouse facility with a major UK bank. This facility was previously used to refinance a significant part of the portfolio previously financed under short-term repurchase agreements, and is currently being used to build and finance a portfolio of asset backed securities and real estate related loans. The lender uses a rating agency CDO model to determine the level of equity contribution the Group is required to make to support the portfolio from time to time. The facility is secured over, inter alia, the collateral making up the portfolio. The margin payable to the lender depends on the deemed rating levels of the portfolio as determined by the rating agency model.

#### Investment Properties

In order to finance the Investment Property portfolios, the Group entered into non-recourse loan facilities as described in the table above. These facilities are secured in the customary manner for German real estate lending, granting security over, inter alia, the real estate purchased as well as rent receivables, bank accounts and shares in the Borrower. Interest in respect of these facilities is payable quarterly.

The committed Truss facility is €85 million, of which €84.9 million has been drawn at 30 June 2006.

The committed Drive facility is €1,525 million, the full amount of which has been drawn at 30 June 2006. The loan is divided into a Senior and Junior loan of €841.3m (carrying value: €831.2m) and €683.7m respectively (carrying value: €678.8m). €50m of the Junior loan incurs interest at floating rate Euribor whereas the remaining portion is fixed. Interest charges on both loans are currently based on Euribor fixing as at the start of the loan. As from 20 July 2006, the Senior loan will have a weighted average funding cost of 3.83%. As from 31 July 2006, the Junior loan will have a weighted average funding cost of 4.57%.

The committed Turret facility is €120 million, of which €34.6 million has been drawn at 30 June 2006.

#### Real Estate Fund Units

On 22 July 2005, the Group entered into a non-recourse 13 year loan facility to finance its acquisition of 1,450 Class A Units in Fondo Immobili Pubblici. The facility is secured over, inter alia, the 1,450 Class A Units, an assignment of receivables under the units, a pledge over bank accounts and over shares in the Borrower. The interest rate on the loan is Euribor + 1.95%, payable semi-annually. On 21 October 2005, the Group acquired a further 50 Class A Units through the same facility.

#### 16.2 Revolving Credit Facility

In December 2004, the Group entered into a revolving €35 million credit facility with Deutsche Bank as a means of securing access to temporary working capital. The facility is secured by receivables flowing from CDO I, CDO II, CDO III and EFL and with security assignments of the Group's rights under its management agreement with Fortress Investment Group LLC. The facility contains a number of financial covenants including a maximum leverage ratio and a minimum interest cover ratio. The interest rate on drawn amounts is Euribor + 1.5% p.a., while on undrawn amounts it is 0.4% p.a. The facility was increased to €50 million on 26 May 2005. On 15 May 2006, the facility was further increased to €150 million.

As at 30 June 2006 there was €17.4 million drawn on this facility (31 December 2005: €18.6 million)

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### 16.3 Other Short Term Financing

In May 2005, in order to finance the participation in a loan made to SC Karanis in connection with the Coeur Defense development in Paris, the Group entered into a full recourse €10 million one year loan facility. The facility is backed by a security assignment over the financed asset. It also contains an obligation to ensure that loan to value remains below 75%. The loan bears a rate of Euribor + 1.85%. In May 2006, this loan facility matured. The investment was funded via the Revolving Credit Facility as at 30 June 2006.

In August 2005, in order to finance the participation in a loan that had previously been made to Mapeley Columbus Limited in connection with certain properties leased to Abbey National PLC in the United Kingdom, the Group entered into a full recourse €24.5 million one year loan facility. The participation has been transferred to the Lender as security for the facility. It also contains an obligation to ensure that loan to value remains below 75%. The loan bears a rate of Libor + 1.00%.

#### 17. REPURCHASE AGREEMENTS

The Company's consolidated subsidiary EFL has entered into master repurchase agreements with certain major investment banks to finance the purchase of available-for-sale securities. The obligations under those agreements are guaranteed by the Company. The terms of the repurchase agreements provide for interest to be calculated with reference to floating rate benchmarks (i.e. Euribor or Sterling Libor) which reset or roll monthly or quarterly, with the corresponding security coupon payment dates, plus an applicable spread.

As at 30 June 2006, the Group's carrying amount and weighted average financing cost of these repurchase agreements was approximately €46.9 million (31 December 2005: €103.5 million) and 3.37% (31 December 2005: 2.61%) respectively.

#### 18. TRADE AND OTHER PAYABLES

	30 June 2006 €'000	31 December 2005 €'000
Security deposit	5,287	5,221
Unsettled security purchases	26,905	17,604
Interest payable	17,369	6,953
Due to manager (note 24)	784	4,555
Derivative liabilities	-	12,297
Finance lease payable	25,898	2,952
Accrued expenses & other payables*	36,007	7,063
	<b>112,250</b>	<b>56,645</b>

\* Included within the Accrued Expenses and Other Payables, is an amount of €18.5 million which is an amount of capital expenditure that was agreed to be undertaken as part of the Drive acquisition.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### 19. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net profit available to ordinary shareholders by the weighted average number of shares of ordinary stock outstanding during the period.

Diluted earnings per share is calculated by dividing net profit available to ordinary shareholders by the weighted average number of ordinary shares outstanding plus the additional dilutive effect of potential ordinary shares during the period.

The Group's potential ordinary shares during the period were the stock options issued under its share option plan.

There have been no other transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of the financial statements.

The following is a reconciliation of the weighted average number of ordinary shares outstanding on a diluted basis.

	<b>Six Months Ended 30 June 2006</b>	<b>Six Months Ended 30 June 2005</b>	<b>Year Ended 31 December 2005</b>
Weighted average number of ordinary shares, outstanding basic	41,656,560	18,529,515	21,392,936
Dilutive effect of ordinary share options	1,670,791	724,450	772,928
Weighted average number of ordinary shares outstanding, diluted	<b>43,327,351</b>	<b>19,253,965</b>	<b>22,165,864</b>

#### 20. SHARE CAPITAL AND RESERVES

As at the 31 December 2005 there were 24,209,670 shares issued and outstanding.

On 27 January 2006, the Company made a further public offering and issued 11,667,000 ordinary shares at a price of €30 each. On 1 February 2006, the over-allotment option relating to the January offering was exercised resulting in 1,156,000 ordinary shares being issued at €30 each.

On February 15, 2006, immediately prior to completion of the Dresdner Portfolio acquisition, 8,571,429 shares with aggregate nominal value of €8,571,429 were issued to certain funds managed by Fortress Investment Group LLC (the "Fortress Funds") at €17.50 each raising gross proceeds of €150 million. The principal terms of the Fortress Funds investment were agreed on 22 December 2005 and were, in relevant part, as follows:

- The Fortress Funds would invest up to €300 million by subscribing for Shares at €17.50 per Share (representing an approximately 2.75% discount to the weighted average share price for the Company's shares over the 10 day period up to 21 December 2005), provided that the Company could reduce the amount of such subscription down to €150 million were it able to raise funds prior to completion of the Dresdner acquisition; as the Company was successful in raising additional capital prior to completion of the Dresdner portfolio acquisition in the offering described above, the Fortress Funds' subscription was reduced to €150 million.

## **EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES**

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)**

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The total number of shares issued in January and February 2006 was 21,394,429 ordinary shares, with net proceeds of €523.5 million being raised for the Company.

In May 2006, the Company issued 5,000 shares to Paolo Bassi and 1,000 to Keith Dorrian in their capacity as Directors of the Company. The shares issued to the Directors were non-cash shares, and were issued with nil proceeds.

As at 30 June 2006, there were 45,681,245 shares issued and outstanding.

Under the Company's Articles of Association, the Directors have the authority to affect the issuance of additional ordinary shares or to create new classes of shares as they deem necessary.

#### **Other Reserves**

Other reserves represent the fair value of share options at the grant date, granted to the Manager in December 2003, June 2004, June 2005 and February 2006.

#### **21. HEDGE ACCOUNTING – CASH FLOW HEDGES OF INTEREST RATE RISK**

The Group's policy is to hedge its exposure to interest rates and foreign currencies on a case-by-case basis. Hedge accounting is only applied to cash flow hedges of interest rate risk exposures. Interest rate swaps under which the Group pays a fixed rate and receives a floating rate have been used to hedge the interest rate risk on floating rate long-term bank borrowing.

The gain or loss on measurement of the fair value of the interest rate swaps has been recognised in the statement of changes in equity to the extent that the swaps are effective.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

The details of interest rate swaps entered into by the Group in respect of certain of the term financing agreements are as follows:

	<b>Wave</b>	<b>Bastion</b>	<b>Drive *</b>	<b>FIP</b>	<b>Truss**</b>	<b>Turret</b>	<b>Pre-Hedge***</b>
<b>30 June 2006</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	<b>€'000</b>
Nominal amount	210,000	26,500	-	121,875	71	130,000	200,000
Pay rate	3.47%	3.04%	-	3.34%	3.78%	3.91%	4.07%
Receive rate	3 Month Euribor	3 month Euribor	-	6 Month Euribor	3 Month Euribor	3 Month Euribor	3 Month Euribor
Remaining life	6.8	6.0	-	11.3	-	9.9	7.3
Fair value of swaps assets	6,606	1,331	-	3,463	2	2,834	153
	<b>Wave</b>	<b>Bastion</b>	<b>Drive</b>	<b>FIP</b>	<b>Truss</b>	<b>Turret</b>	
<b>31 December 2005</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	<b>€000</b>	
Nominal amount	210,000	26,500	1,300,000	121,875	-	-	
Pay rate	3.47%	3.04%	3.37%	3.34%	-	-	
Receive rate	3 Month Euribor	3 Month Euribor	3 Month Euribor	6 Month Euribor	-	-	
Remaining life	7.3	6.5	7.1	11.8	-	-	
Fair value of swaps (liabilities)/assets	(3,831)	197	(7,214)	(1,252)	-	-	

\* As at 31 March 2006 the Interest Rate Swap agreement related to the Drive portfolio was novated to Deutsche Bank AG in conjunction with the loan agreement. The positive fair value of €6.4m as at the date of novating the swap has been recorded within the hedging reserve and will be recycled through the Income Statement in the same periods during which the interest expense on the loan is recognised. A corresponding amount has been included in the carrying value of the Drive loan within term financing (refer to Note 16.1).

\*\* From the period of 3 April 2006 to 22 May 2006 the Interest Rate Swap agreement relating to the Truss portfolio was novated to Morgan Stanley Bank International Limited in conjunction with the loan agreement. The positive fair value of €0.3 million as at the dates of novating the swap has been recorded within the hedging reserve and will be recycled through the Income Statement. As at 30 June 2006, there was an amount of €70,000 still to be novated. This amount was novated on 3 July 2006.

\*\*\* Pre-hedge represents interest rate swaps undertaken to hedge the interest rate risk on a forecasted transaction. The fair value of €152,000 on the revaluation of the €100 million Interest Rate Swap has been recorded within the hedging reserve.

**22. FINANCIAL INSTRUMENTS**

**Risk Management**

This section provides details of the Group's exposure to risk and describes the methods used by management to control risk. The most important types of financial risk to which the Group is exposed are market risk, credit, liquidity, interest rate and foreign currency risk.

**Market Risk**

The Group's exposure to market risk is comprised mainly of movements in the value of its debt securities, property investments and real estate fund units.

The Group's securities are predominantly floating rate and as such are valued based on a market credit spread over Euribor and Libor benchmarks for euro and sterling denominated assets respectively. Increases in the credit spreads above such benchmarks may affect the Group's net equity, net income or cash flow directly through their impact on unrealised gains or losses on available-for-sale securities, and therefore its ability to realise gains on such securities, or indirectly through their impact on its ability to borrow and access capital.

Under the terms of the securities contract the Group was exposed to market risk on the underlying securities as, should the intended securitisation of such assets not be consummated, the Group would be required to either purchase the securities or pay the loss realised on the disposal up to the amount of any deposits made by the Group under the contract, less any interest earned on the deposits.

The Group's investment property assets are based in Germany and Italy and are subject to general property market risks. These risks are assessed by management at the point of acquisition as well as on an ongoing basis. In addition, external valuations of the property assets are obtained during each financial year.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### Credit Risk

The Group is subject to credit risk with respect to its investments in real estate and other asset backed securities and loans.

The securities the Group invests in are generally junior in right of payment of interest and principal to one or more senior classes, but benefit from the support of one or more subordinate classes of securities or other form of credit support within a securitisation transaction. While the expected yield on these securities is sensitive to the performance of the underlying assets, the more subordinated securities are designed to bear the first risk of default and loss.

The Group further minimises credit risk by actively monitoring its securities portfolios and the underlying credit quality of its holdings and, where appropriate, repositioning its investments to upgrade the credit quality and yield on the investments.

The Group's securities portfolio is diversified by asset type, industry, location and issuer. This diversification minimises the risk of capital loss. At June 30, 2006, the Group's securities, which serve as collateral for its CDO financings and other borrowings, had an overall weighted average credit rating of approximately BBB.

The Group's available for sale asset backed securities and real estate loans portfolio was split between countries within Europe as follows:

	30 June 2006			31 December 2005		
	Number of Securities	Face Value of Securities €'000	Location Split	Number of Securities	Face Value of Securities €'000	Location Split
United Kingdom	61	700,308	44.9%	60	764,958	49.9%
Italy	16	290,460	18.6%	14	247,947	16.2%
Germany	22	234,234	15.0%	18	183,470	12.0%
Pan European	10	129,504	8.3%	10	141,622	9.1%
France	9	77,663	5.0%	9	79,525	5.2%
Other	18	126,436	8.2%	16	116,304	7.6%
	<b>136</b>	<b>1,558,605</b>	<b>100%</b>	<b>127</b>	<b>1,533,826</b>	<b>100%</b>

The Group's hedging transactions using derivative instruments also involve certain additional risks such as counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. The counterparties to the Group's derivative arrangements are major financial institutions with investment grade credit ratings with which the Group and its affiliates may also have other financial relationships. As a result, it is not anticipated that any of these counterparties will fail to meet their obligations.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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The Group's German real estate portfolio consists of a Dresdner Bank office portfolio (the Drive portfolio), the Deutsche Bank office portfolio (the Wave portfolio) and a German retail property portfolio (the Bastion, Belfry and Truss portfolios). The Drive portfolio derives over 79% of its rental income from Dresdner Bank, the Wave portfolio derives over 69% of its rental income from Deutsche Bank, whilst the German retail portfolios in aggregate derive over 87% of their retail income from German national retailers, including prominent national retailers such as the Edeka Group, the Rewe Group, the Tengelmann Group, the Schwarz Group and Tegut.

The Group's Italian real estate assets comprise an investment in a real estate investment fund that owns a portfolio of 394 properties in Italy that are let to Italian government agencies.

#### Liquidity Risk

The Group's ability to execute its business strategy, particularly the growth of its investment portfolio, depends to a significant degree on the Group's ability to obtain additional capital.

The Group's primary source of funds for liquidity consist of net cash provided by operating activities, borrowings under loans and the issuance of debt and equity securities. The Group's loans and debt securities are generally secured directly over its assets. The Group expects that its cash on hand and cash flow provided by operations will satisfy its liquidity needs with respect to its current investment portfolio over the next twelve months. The Group expects to meet its long-term liquidity requirements, specifically the repayment of its debt obligations, through additional borrowings and the liquidation, refinancing or repayment of its assets at maturity.

A significant portion of the Group's investments are financed with collateralised debt obligations, known as CDOs. If spreads for CDO liabilities widen or if demand for such liabilities ceases to exist, then the ability to execute future CDO financings will be restricted. Proceeds from the sale of real estate and other asset backed securities which serve as collateral for the Group's CDO financings, including gains thereon, are required to be retained in the CDO structure until the related bonds are retired and are therefore not available to fund current cash needs.

The Group's real estate securities are financed long-term and their credit status is continuously monitored; therefore, these investments are expected to generate a generally stable current return, subject to interest rate fluctuations. The Group's operating real estate is also financed long-term and primarily leased to credit tenants with long-term leases and is therefore also expected to generate generally stable current cash flows.

As described in Note 16, the Group has access to temporary working capital through a revolving €150 million credit facility.

#### Interest Rate Risk

The Group's primary interest rate exposures relate to its real estate and other asset backed securities, loans and floating rate debt obligations, as well as its interest rate swaps. Changes in the level of interest rates also can affect the Group's ability to acquire securities and loans and its ability to realise gains from the settlement of such assets.

The Group's general financing strategy focuses on the use of match-funded structures, meaning that it seeks to match the maturities of its debt obligations with the maturities of its investments to minimise the risk that the Group will have to refinance its liabilities prior to the maturities of its assets, reducing the impact of changing interest rates on its earnings. In addition, the Group match funds interest rates on its investments with like-kind debt directly or through the use of interest rate swaps. However, based on a variety of factors, the Manager finances certain assets on a short term basis, including the use of repurchase agreements.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

The interest rate profile of the Group at 30 June 2006 and 31 December 2005 was as follows:

Assets  Type	Total Per Consolidated Balance Sheet €'000	Non- Interest Bearing Assets €'000	Within 1 year		1 to 5 years		Over 5 years	
			Fixed %	Variable %	Fixed %	Variable %	Fixed %	Variable %
<b>30 June 2006</b>								
Cash and cash equivalents	43,037			43,037				
Restricted cash	4,389			4,389				
Restricted short term investments	40,427			40,427				
Asset backed securities, available for sale (includes cash to be invested)	1,450,534		55,870	94,576	19,004	706,189		574,895
Asset backed securities, pledged under repurchase agreements	50,251					44,500		5,751
Real estate related loans	81,809			12,762		22,015		47,032
Real estate fund units	187,274		187,274					
Investment property	2,648,478	2,648,478						
Intangible assets	659	659						
Other assets	60,315	22,252	743	23,084			14,236	
	<b>4,567,173</b>	<b>2,671,389</b>	<b>243,887</b>	<b>218,275</b>	<b>19,004</b>	<b>772,704</b>	<b>14,236</b>	<b>627,678</b>
<b>31 December 2005</b>								
Cash and cash equivalents	13,640	-	-	13,640	-	-	-	-
Asset backed securities, available for sale (includes cash to be invested)	1,342,638	-	8,203	99,452	39,985	716,625	-	478,373
Asset backed securities, pledged under repurchase agreements	109,909	-	-	59,593	-	44,500	-	5,816
Real estate related loans	92,649	-	-	13,478	-	79,171	-	-
Real estate fund units	189,591	-	189,591	-	-	-	-	-
Investment property	463,540	463,540	-	-	-	-	-	-
Intangible assets	542	542	-	-	-	-	-	-
Other assets	61,471	31,586	568	29,120	-	-	197*	-
	<b>2,273,980</b>	<b>495,668</b>	<b>198,362</b>	<b>215,283</b>	<b>39,985</b>	<b>840,296</b>	<b>197</b>	<b>484,189</b>

\* Net interest rate swap receivable related to the cash flow hedges as described in Note 21

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

Liabilities  Type	Total Per Consolidated Balance Sheet €'000	Non Interest Bearing Liabilities €'000	Within 1 year		1 to 5 years		Over 5 years	
			Fixed %	Variable %	Fixed %	Variable %	Fixed %	Variable %
<b>30 June 2006</b>								
CDO bonds payable	976,528							976,528
Bank loans	2,492,859			33,888		368,608	1,987,708	102,655
Repurchase agreements	46,899			46,899				
Taxation payable	2,727	2,727						
Trade and other payables	112,250	94,881		17,369				
	<b>3,631,263</b>	<b>97,608</b>		<b>98,156</b>		<b>368,608</b>	<b>1,987,708</b>	<b>1,079,183</b>
<b>31 December 2005</b>								
CDO bonds payable	977,485	-	-	-	-	-	-	977,485
Bank loans	835,162	-	-	53,131	-	307,917	441,352	32,762
Repurchase agreements	103,542	-	-	103,542	-	-	-	-
Taxation payable	2,278	2,278	-	-	-	-	-	-
Trade and other payables	56,645	37,395	-	6,953	-	-	12,297*	-
	<b>1,975,112</b>	<b>39,673</b>	-	<b>163,626</b>	-	<b>307,917</b>	<b>453,649</b>	<b>1,010,247</b>

\* Net interest rate swap payable related to the cash flow hedges as described in Note 21

#### Foreign Currency Risk

The Group's primary foreign currency exchange rate exposures relate to its sterling denominated portfolio of securities and loans. Changes in the currency rates can adversely impact the fair values and earnings streams of the Group's non euro denominated assets and liabilities. The Group has mitigated this impact through a combination of (i) sterling denominated financing and (ii) rolling forward foreign exchange contracts to hedge its net sterling equity investment.

In connection with the Group's purchase of its available-for-sale real estate and other asset backed securities and real estate loans, the foreign currency risk is covered through forward foreign currency exchange contracts.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

#### Fair values of financial assets and financial liabilities

Set out below is a comparison by category of carrying amounts and fair values of all of the Company's financial instruments that are carried in the financial statements.

	30 June 2006 €'000 Carrying Value	31 December 2005 €'000 Carrying Value	30 June 2006 €'000 Fair Value	31 December 2005 €'000 Fair Value
<i>Financial Assets</i>				
Cash and cash equivalents	43,037	13,640	43,037	13,640
Restricted cash	4,389	-	4,389	-
Restricted short term investments	40,427	-	40,427	-
Asset backed securities, available for sale (includes cash to be invested)	1,450,534	1,342,638	1,450,534	1,342,638
Asset backed securities, pledged under repurchase agreements	50,251	109,909	50,251	109,909
Real estate related loans	81,809	92,649	81,809	92,649
Real estate fund units	187,274	189,591	187,274	189,591
Investment property	2,648,478	463,540	2,648,478	463,540
<i>Financial Liabilities</i>				
CDO bonds payable	976,528	977,485	976,528	977,485
Bank loans	2,492,859	835,162	2,496,535	836,393
Repurchase agreements	46,899	103,542	46,899	103,542

#### 23. SHARE OPTION PLAN

In December 2003, the Company (with the approval of the Board of Directors and pursuant to the confidential information memorandum dated August 2003) adopted a nonqualified share option plan (the "Company Option Plan") for officers, Directors, employees, consultants and advisors, including the Manager. In December 2003, for the purpose of compensating the Manager for its successful efforts in raising capital for the Company, the Manager was granted options representing the right to acquire 1,185,767 ordinary shares at an exercise price of €10 per share (number of shares and exercise price adjusted for share consolidation). The fair value of the options at the date of grant was €0.2 million and was calculated by reference to an option pricing model.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

In June 2004 following the IPO, the Manager was granted an additional 660,000 options at an exercise price of €12 per share. The fair value of the additional options at the date of grant was €0.2 million and was also calculated by reference to an option pricing model. In June 2005 following the secondary public offering, the Manager was granted an additional 574,000 options at an exercise price of €17.25 per share. The fair value of the additional options at the date of grant was €0.6 million. The Manager's options represent an amount equal to 10% of the ordinary shares issued by the Company. The options granted to the Manager were fully vested on the date of grant and expire ten years from the date of issuance.

In February 2006, following the third public offering, the Manager was granted 1,282,300 options at €30.00 per share and, pursuant to December 2005 board action, an additional 857,142 options at an exercise price of €18.00 per share. The fair value of the additional options at the date of grant was €2.1m and €4.8m respectively. The Manager's options represent an amount equal to 10% of the ordinary shares issued by the Company in respect of the public and private offerings that preceded the Drive acquisition. The options granted to the Manager were fully vested on the date of grant and expire ten years from the date of issuance.

The fair value at the date of grant of options granted to the Manager has been offset against the proceeds from issuance of ordinary shares as the grant of options is a cost of capital.

On 8 June 2006, 71,146 Share Options were exercised at a strike price of €10 per share.

#### 24. DIVIDENDS PAID & DECLARED

	Six Months Ended 30 June 2006 €000	Six Months Ended 30 June 2005 €000
Paid during the 6 months ended 30 June:	22,639	12,188
Equity dividends on ordinary shares:		
Fourth quarter dividend for 2005: €0.37 (2004: €0.30)	8,958	6,093
First quarter dividend for 2006: €0.30 (2005: €0.33)	13,681	6,095
	22,639	12,188
Second quarter dividend declared on 22 August 2006: €0.40 (2005: €0.33)	18,272	6,464

#### 25. MANAGEMENT AGREEMENT & RELATED PARTY TRANSACTIONS

The Company entered into the Management Agreement with the Manager in August 2003, which provides for an initial term of ten years with automatic three year extensions, subject to certain termination rights. The Management Agreement may be terminated by the Company by payment of a termination fee, as defined in the Management Agreement, equal to the amount of management fees earned by the Manager during the twelve consecutive calendar months immediately preceding the termination, upon the vote of a majority of the holders of the outstanding ordinary shares. Pursuant to the Management Agreement, the Manager, under the supervision of the Company's board of directors, will formulate investment strategies, arrange for the acquisition of assets, arrange for financing, monitor the performance of the Group's assets and provide certain advisory, administrative and managerial services in connection with the operations of the Group. For performing these services, the Company will pay the Manager an annual fee (payable monthly in arrears) of 1.5% of the gross equity of the Company, as described in the Management Agreement.

The Management Agreement provides that the Company will reimburse the Manager for various expenses incurred by the Manager or its officers, employees and agents on the Company's behalf, including the cost of

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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legal, accounting, tax, auditing, administrative, asset management, property management and other similar services rendered for the Company by providers retained by the Manager or, if provided by the Manager's or its affiliates' employees, in amounts which are no greater than those that would be payable to external professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arms-length basis. Such expenses have been included in the Consolidated Income Statement.

To provide an incentive for the Manager to enhance the value of the Company's ordinary stock, the Manager is entitled to receive incentive compensation on a cumulative, but not compounding, basis in an amount equal to the product of (A) 25% of the euro amount by which (1) funds from operations ("FFO") of the Company before the incentive compensation per ordinary share, exceeds (2) an amount equal to (a) the weighted average of the price per ordinary share in any offerings by the Company (adjusted for any prior capital dividends or distributions) multiplied by (b) a simple interest rate of eight percent (8%) per annum multiplied by (B) the weighted average number of ordinary shares outstanding during such period.

FFO is used to compute the Company's incentive compensation to the Manager. FFO, for these purposes, represents net income (computed in accordance with International Financial Reporting Standards), plus depreciation and amortisation on real estate property (and excluding accumulated depreciation and amortisation from the computation of gain or loss on sold real estate property), after adjustments for unconsolidated partnerships and joint ventures (calculated to reflect FFO on the same basis).

At 30 June 2006 management fees, incentive fees and expense reimbursements of approximately €3.2 million (31 December 2005: €4.5 million) were due to the Manager. For the six months ended 30 June 2006 management fees of €5.4 million (30 June 2005: €1.5 million), incentive fees of €0.8 million (30 June 2005: €1.5 million) and expense reimbursements of €1.8 million (30 June 2005: €0.1 million) were charged to the income statement.

Keith Dorrian and Paolo Bassi each currently receive €30,000 per annum payable semi-annually in equal instalments. Wesley R. Edens does not receive any remuneration from the Company.

As stated in Note 20, the Company issued 5,000 shares to Paolo Bassi and 1,000 to Keith Dorrian in their capacity as Directors of the Company. The shares issued to the Directors were non-cash shares, and were issued with nil proceeds.

## EUROCASTLE INVESTMENT LIMITED AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) (cont'd)

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#### 26. INVESTMENT IN SUBSIDIARIES

The legal entity group structure of Eurocastle is designed to support the Group's businesses within an efficient legal, tax, regulatory and funding framework.

The significant operating subsidiaries, in which the Company owns directly or indirectly a 100% equity interest, which are listed by jurisdiction below:

##### *Luxemburg:*

Luxgate s.a.r.l.  
Turret LP s.a.r.l  
Drive s.ar.l.  
Eurobarbican s.a.r.l.  
Bastion Participation s.a.r.l  
Belfry Participation s.a.r.l  
Truss Participation s.a.r.l  
Finial s.a.r.l  
Turret Participation s.a.r.l  
Undercroft s.a.r.l

##### *Germany:*

Dresdner Grund-Fonds  
Shortwave Acquisition GmbH  
Longwave Acquisition GmbH  
Bastion GmbH & Co.KG  
Belfry GmbH & Co.KG  
Truss GmbH & Co.KG

Additionally, the Company has investments in Eurocastle Funding Limited, Eurocastle CDO I PLC, Eurocastle CDO II PLC, Eurocastle CDO III PLC and Eurocastle CDO IV PLC that it consolidates in accordance with SIC 12.

#### 27. SUBSEQUENT EVENTS

##### **Second Quarter 2006 Dividend**

On 22 August 2006, the directors declared a second quarter 2006 dividend of €0.40 per share to all holders of shares on 23 August 2006, the record date. The total dividend to be paid on 8 September 2006 is €18,272,498.

#### 28. COMMITMENTS

As at 30 June 2006, amounts contracted for but not provided in the financial statements for the acquisition of Investment property amounted to:

- Entered into agreements to acquire a further € 24.3 million representing 14 retail properties within the Turret portfolio