Derwent London plc
Report & Accounts
2007

Contents

Portobello Dock, W10

Derwent London is a real estate investment trust focused on London's West End and other emerging parts of the capital where future value has been identified.

The board's objective is to deliver an above average annualised total return to shareholders by implementing its strategy of adding value to the group's properties through creative planning, innovative design and enterprising lease management.

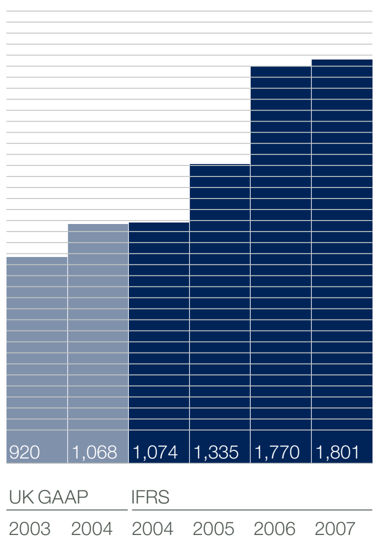
Derwent London has developed a strong reputation for anticipating the locations of tomorrow, and contributing to London's regeneration by creating quality working environments for its tenants.

Financial highlights

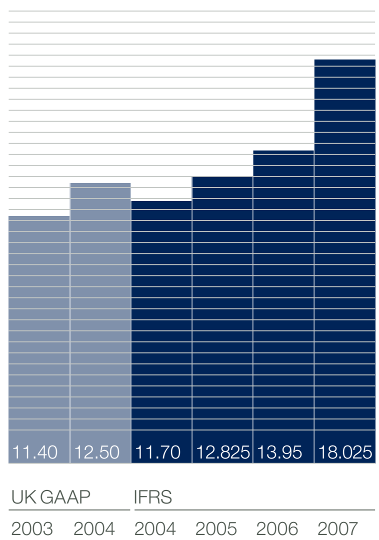
	2007	2006	Increase/ (decrease) %
Recurring net property income[1]	**£101.8m**	£46.4m	119.4
Recurring profit before taxation[2]	**£38.0m**	£16.4m	131.7
(Loss)/profit before taxation	**£(99.8)m**	£242.8m	n/a
Recurring earnings per share[3]	**35.14p**	27.44p	28.1
Earnings per share	**100.55p**	340.13p	(70.4)
Dividend per share			
Distribution of years' earnings	**22.50p**	14.75p	52.5
IFRS	**18.025p**	13.95p	29.2
Adjusted net asset value per share attributable to equity shareholders[4]	**1,801p**	1,770p	1.8
Adjusted net asset value per share[4]	**1,862p**	1,770p	5.2
Net asset value per share attributable to equity shareholders	**1,770p**	1,460p	21.2
Total return attributable to equity shareholders	**2.8%**	33.6%	
Gearing			
Balance sheet	**42.5%**	44.7%	
Profit and loss	**1.81**	1.85	

1 Excludes development income.
2 Excludes development income, exceptional items, goodwill impairment, the revaluation movement on investment properties and financial instruments and the profit on disposal of properties and investments.
3 As 2, together with the related tax effects and is stated after deduction for the minority interest share.
4 Excludes the deferred tax on the revaluation surplus, the post tax fair value of derivative financial instruments and the fair value adjustment to the secured bonds and in 2006 deferred tax in respect of capital allowances claimed.

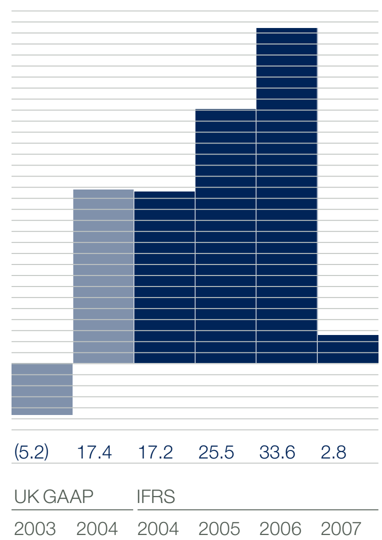
Five year review



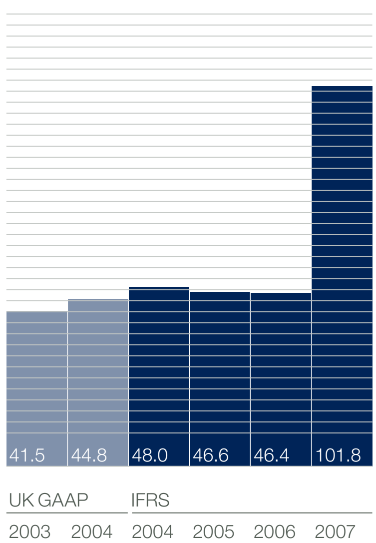
Adjusted net asset value per share (pence)*



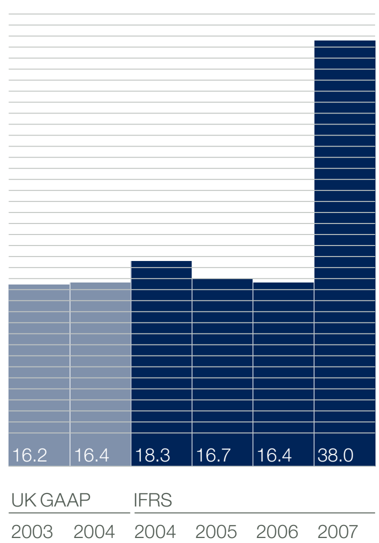
Dividend per share (pence)



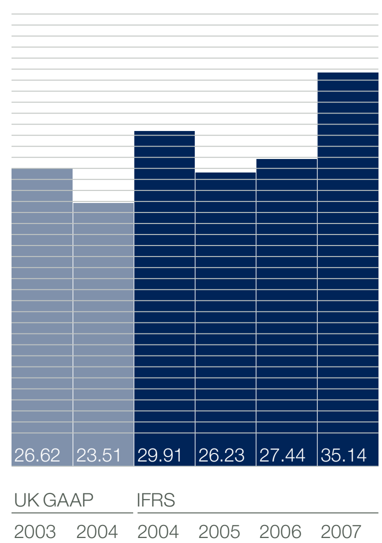
Total return (%)*



Recurring net property income (£m)



Recurring profit before tax (£m)



Recurring earnings per share (pence)*

*After deduction of minority interest share.

Chairman's statement

The Johnson Building, EC1
Art – Jason Martin

A strong set of results in a testing period for the property sector, clearly demonstrating the quality of both our portfolio and management.

Overview and results

After our first year as Derwent London following the acquisition of London Merchant Securities (LMS) in February 2007, it is extremely pleasing to be able to report a strong set of results. 2007 has been a testing period for the property sector, particularly in the latter months when the industry experienced a sharp decline in values. Against this background, the results clearly demonstrate the quality of both our portfolio and management.

Adjusted net asset value per share, based on the total net assets of the group, increased to 1,862p from the proforma figure of 1,717p at 1st February 2007, the acquisition completion date. The adjusted figure, excluding minority interests, was 1,801p, an increase of 8.4% from the comparable proforma figure of 1,662p. An increase of 12.8% in the first six months was followed by a decline of 3.9% in the second half as the impact of the credit crisis contributed to an increase in yields. At the year end, the investment portfolio was valued at £2.7 billion, producing a surplus of £94.4 million before the lease incentive adjustment of £4.1 million. The valuation reflects a true equivalent yield of 5.7%. The central London properties, which account for 93% of the total portfolio, showed a 5.8% increase for the year. Properties held throughout the period gained in value by 4.3% compared to 21.6% in 2006.

Recurring profit before tax, which includes 11 months of the results of LMS, was £38.0 million. This measure of performance has increased 132% from last year's level of £16.4 million.

REITS

The group converted to a REIT on 1st July 2007 to take advantage of the more favourable tax regime in which it is exempt from tax on both rental profits and chargeable gains. The consequent conversion charge, calculated as 2% of the value of the investment portfolio at the date of conversion, amounts to £53.6 million. This is included in the tax charge for the year and will be paid during 2008. As a REIT, the group was able to eliminate the latent capital gains tax liability on the investment property portfolio. Following conversion, the group moved decisively to take advantage of the active investment market and effect tax efficient disposals of non-core properties. This achieved outstanding results and, together with the first half sales, proceeds totalled £344 million net of costs, showing a surplus of £130 million or 63% over the proforma values. The exemption from tax on capital gains saved the group £31.3 million of tax on these disposals.

Dividend

As a REIT, the group is subject to a minimum distribution test whereby at least 90% of recurring profits from the tax-exempt business must be distributed as a Property Income Dividend (PID). Therefore, all dividends must now be allocated between PIDs and non-PIDs. The directors are recommending a final dividend of 15.0p per share of which 10.0p per share will be paid as a PID. This will be paid on 19th June 2008 to shareholders on the register on 23rd May 2008. Together with the non-PID interim dividend of 7.5p per share this gives a total dividend for the year of 22.5p per share. In accordance with the group's revised policy, this dividend includes a substantial proportion of the tax on income saved through REIT conversion and represents an increase of 52.5% on the 14.75p paid in respect of 2006.

Chairman's statement

Qube, 90 Whitfield Street, W1

Market review

After a strong first half for property values, the second half of the year was characterised by a lack of liquidity and rising yields, causing a decline in values. By contrast, tenant demand remained strong, particularly in our core area of operations, the West End. This area has a limited supply of quality office space and, as a consequence, has enjoyed growth in rental values of 14.6% over the year.

In our key London villages, we continue to focus on the middle market delivering our hallmark, design-led offices at economic rents ranging from £430–£700 per m^2 (£40–£65 per sq ft). When measured against prime rents in Mayfair and St. James's, which have exceeded £1,290 per m^2 (£120 per sq ft), we believe our buildings are an attractive proposition for tenants. The success of this approach is demonstrated by lettings totalling 21,900m^2 being completed during the year at rental levels 18% above the valuers' December 2006 estimates. These included both the highest rent achieved at Tower House, Covent Garden and a record rent for Fitzrovia at Qube. At the year end, space available for letting within the group's 533,000m^2 (5.7 million sq ft) portfolio amounted to 4.0% by floor area and 4.5% by rental value.

The planning process continues to become more complicated and lengthy. In order to minimise voids during this period, and to maintain flexibility over the timing of schemes, it is part of the group's strategy to keep properties income producing until works commence.

Despite the protracted process, three notable planning consents have recently been obtained. At North Wharf Road, Paddington, a scheme for a landmark 22,300m^2 office building and 100 residential apartments has been approved, an increase in floor area of 276% from the existing building. The property is let until a possible start date of 2010.

Secondly, we have received planning permission for the redevelopment of 40 Chancery Lane, Holborn. This involves replacing three buildings, totalling 6,600m^2, with 9,500m^2 of high quality offices. They are all multi-let on leases that expire by 2012.

Finally, at the Angel Building in Islington, planning permission has been obtained for a 23,700m^2 property, an increase of 58% from the existing building. This project also illustrates how, by working closely with our tenants, we are able to unlock additional value from within our portfolio. A restructuring of the existing lease was negotiated whereby we are able to undertake construction works immediately but the tenant continues to pay the rent of £4.2 million per annum until March 2010. With the scheme expected to be delivered for occupation in 2010, this has mitigated a substantial income void.

During the year, further investment has been made in the group's pipeline of future projects. Within the key London villages of Clerkenwell, Fitzrovia and Noho, £142 million was expended on enlarging our holdings. The average passing rent of these acquisitions is £178 per m^2 (£16.50 per sq ft) and all have the scope to substantially increase floor area. In addition, capital expenditure on projects during the year was £61 million. Principally, this was incurred on our pre-let schemes at Horseferry House and Arup Phases II and III, as well as Qube which completed towards the year end and Portobello Dock which completes in March. These projects comprise 44,800m^2.

Board

The directors are delighted to welcome David Silverman to the board. David, who has been with the group since 2002, was appointed on 2nd January 2008 with responsibility for investment acquisitions and sales.

Prospects

Our objective is to create superior shareholder return through the intensive management of our central London portfolio. This is characterised by its reversionary nature as well as the potential to create value through lease management and high quality refurbishment or re-development. These features not only underpin our future growth but also allow us to manage risk in times of uncertainty.

At present, the investment market is experiencing some instability and equilibrium will only return when there is a consistent deal flow, which requires the restoration of both confidence and liquidity to the market. Currently, demand for space in the West End remains firm for the limited available space. However, in the event of a general economic slowdown, even in this distinctive area, rental growth is likely to be affected.

While these factors lead us to have a cautious view of the market in the year ahead, our focus on properties offering mid-market rents, provides relative resilience and many of the group's most successful projects were originally acquired in similarly testing markets. At the year end, both balance sheet gearing at 42.5% and profit and loss gearing at 1.81, were at comfortable levels. Together with unused, committed, bank facilities of £370 million and long-term rental commitments from quality tenants, this shows the group to be financially well positioned not only to face, but also to capitalise, on these challenging times.

In summary, whilst we foresee a more demanding market in which the key to value creation will be hands-on property expertise, we are confident that your management's experience and proven skills will enable the group to take advantage of those opportunities which will deliver future growth.

R.A. Rayne
18th March 2008

The acquisition doubled the floor area of the portfolio to over 533,000m² and significantly strengthened our position as a leading central London office investor.

In our key London villages, we continue to focus on the middle rental market, delivering our hallmark, design-led offices.

The Johnson Building, EC1
Status: 100% let
Type: Offices/Retail
Size: 13,900m²
Value: £75–100m

1 Oliver's Yard, EC2
Status: 100% let
Type: Offices/Retail
Size: 17,300m²
Value: £75–100m

Davidson Building & Tower House, WC2
Status: 93% let
Type: Offices/Retail
Size: 8,800m²
Value: £75–100m

80 Charlotte Street & 23 Howland Street, W1
Status: 100% let
Type: Offices
Size: 18,600m²
Value: £75–100m

25 Savile Row, W1
Status: 100% let
Type: Offices
Size: 3,900m²
Value: £50–75m

Tea Building, E1
Status: 93% let
Type: Offices
Size: 21,000m²
Value: £50–75m

Qube, W1
Status: Completed October 2007
Type: Offices/Retail
Size: 10,000m²
Value: £100m+

Holden House, W1
Status: 100% let
Type: Offices/Retail
Size: 8,400m²
Value: £75–100m

1–5 Grosvenor Place, SW1
Status: 100% let
Type: Offices
Size: 15,000m²
Value: £100m+

Greencoat & Gordon House, SW1
Status: 87% let
Type: Offices
Size: 11,800m²
Value: £50–75m

The portfolio is characterised by its strong reversionary income potential and the opportunity to create value through lease management and the development process.

Over 50% of the portfolio has been identified with development potential that could result in additional floor space of over 135,000m².

16–19 Gresse Street, W1
Status: Completion March 2009
Type: Offices/Residential
Proposed size: 5,500m²

Angel Building, EC1
Status: Planning consent achieved February 2008
Type: Offices/Retail
Proposed size: 23,700m²

Arup Phases II & III, Fitzroy Street, W1
Status: 100% pre-let
Type: Offices
Proposed size: 13,200m²

Horseferry House, SW1
Status: 100% pre-let
Type: Offices
Proposed size: 15,200m²

55–65 North Wharf Road, W2
Status: Planning consent achieved January 2008
Type: Offices/Residential
Proposed size: 29,400m²

Left: Art – Richard Galpin
Gordon House, SW1

Development pipeline

The Johnson Building, EC1

Current projects

	Proposed net area m^2	Practical or expected completion	Estimated cost to complete £m	Comments
Victoria				
Horseferry House, Horseferry Road, SW1	15,200	Apr 08	11.7	Comprehensive refurbishment of this 1930s imposing office building is nearing completion. Pre-let to Burberry at £5.3 million per annum, who will take occupation at completion.
Fitzrovia				
Arup Phases II & III, Fitzroy Street and Howland Street, W1	13,200	Nov 09	32.6	An office development under phased construction. Completion is scheduled for spring 2008 for Phase II and the end of 2009 for Phase III. Both Phases are pre-let to Arup on a 25-year lease at a current rent of £2.7 million per annum, rising to £3.6 million per annum and then £6.0 million per annum upon completion of Phases II and III respectively.
Ladbroke Grove				
Portobello Dock and Kensal House, W10	6,400	Mar 08	2.6	A mixed use canal-side project to provide 19 residential units, a new office building of $2,200m^2$ and $2,400m^2$ of refurbished office suites. The residential units have been pre-sold.
Noho				
16–19 Gresse Street, W1	5,500	Mar 09	21.3	A $4,400m^2$ office building under construction with 11 residential units to be provided in an adjacent building in Rathbone Place.
	40,300		68.2	

Development pipeline

With current projects 70% pre-let, and the properties subject to planning consents and appraisal studies all income producing, the development pipeline is extremely flexible and will be managed to meet the demands of the occupier market.

Planning consents

	Net contracted rental income per annum £m	Existing floor area m²	Proposed floor area m²	Floor area uplift %	Comments
Clerkenwell/Islington					
Angel Building, 411 St. John Street, EC1	4.2	15,000	23,700	58	Planning consent was granted in February 2008 for the remodelling and extension of this landmark Islington building. Detailed scheme design is underway and a start on site is anticipated this year, with completion in 2010.
The Turnmill, 63 Clerkenwell Road, EC1	0.6	4,200	6,000	44	Planning consent obtained in December 2007 for a comprehensive refurbishment and the addition of two floors.
20–26 Rosebery Avenue, EC1	0.2	2,300	3,400	48	Planning consent for refurbishment and extension.
Paddington					
55–65 North Wharf Road, W2	1.7	7,800	29,400	276	Planning consent was granted in January 2008 for the redevelopment of these low rise 1960s buildings, which occupy a prime Paddington Basin location. This major project would provide a 22,300m² office building, a 100 unit residential block totalling 6,800m² and 270m² of retail space.
Southbank					
Wedge House, 30–40 Blackfriars Road, SE1	0.7	3,600	7,500	108	A redevelopment opportunity from June 2008 when the lease expires. Planning consent for a new 10 storey office development in this improving Southbank location.
City borders					
18–30 Leonard Street, EC2	–	Site	5,100	n/a	Planning consent for 3,200m² of residential space (47 units) and 1,900m² of offices. Works scheduled to commence in summer 2008 with completion in early 2010.
Holborn					
40 Chancery Lane, WC2	1.1	6,600	9,500	44	Planning consent obtained in February 2008 for a new office building. This would replace three buildings; two of which we have an interest in and an adjacent building of 900m², which is owned by the freeholder of part of our ownership.
	8.5	39,500	84,600	114	

Appraisal studies

	Net contracted rental income per annum £m	Existing floor area m^2	Comments
Euston			
132–142 Hampstead Road, NW1	3.2	21,500	Acquired in 2007. Offers redevelopment potential and possible planning integration with our Fitzrovia Estate. There is an existing planning permission for redevelopment to provide a new office building of 19,700m² and 4,600m² of industrial space. Our initial studies show there is the potential to substantially improve the office content and to introduce valuable residential space.
Fitzrovia			
80 Charlotte Street, W1	2.0	18,600	A substantial island block occupied by Saatchi & Saatchi with medium-term redevelopment potential. Architects appointed to consider feasibility and massing options.
Belgravia			
1–5 Grosvenor Place, SW1	5.2	15,000	Two substantial office buildings occupying a landmark location on Hyde Park Corner and offering significant redevelopment potential. Planning studies are being advanced in conjunction with our freeholders, the Grosvenor Estate.
Soho			
Astoria and 135–155 Charing Cross Road, WC2	3.6	10,000	This is the proposed location for a major Crossrail transport interchange and its implementation would unlock significant development potential. Architectural and planning studies are advancing.
City borders			
City Road Estate, EC1	1.0	9,500	Following a planning refusal in 2007 we are re-appraising a number of redevelopment options and anticipate making a revised application towards the end of this year.
Victoria			
Riverwalk House, 157–166 Millbank, SW1	2.3	6,900	A prime riverside location overlooking the River Thames. Potential to substantially increase the site density through redevelopment when the lease expires in 2011.
	17.3	81,500	

Principal properties

	Offices (O), Retail/restaurant (R), Industrial (I), Leisure (L)	Freehold (F), Leasehold (L)	Approximate net area m²
West End: Central (66%)			
Fitzrovia/Euston (25%)			
132–142 Hampstead Road, NW1	O/I	F	21,500
80 Charlotte Street and 23 Howland Street, W1	O	F	18,600
2–4 Fitzroy Street and 18–24 Howland Street, W1[1]	O	F	13,200*
Qube, 90 Whitfield Street, W1	O/R	F	10,000
13 Fitzroy Street, W1[2]	O	F	8,400
95–100 Tottenham Court Road, W1	O/R	F	6,400
Middlesex House, 34–42 Cleveland Street, W1	O	F	6,000
88–94 Tottenham Court Road, W1	O/R	F	4,900
163–170 Tottenham Court Road, WC1	O/R	F	4,400
80–85 Tottenham Court Road, W1	O/R	F	4,100
60 Whitfield Street, W1	O	F	3,400
120–134 Tottenham Court Road, W1[3]	R	F	2,700
43 and 45–51 Whitfield Street, W1	O	F	2,500
Soho/Covent Garden (10%)			
Bush House, South West Wing, Strand, WC2	O	F	10,000
Charing Cross Road, WC2:	O/R	F	10,000
Astoria and 135–155 Charing Cross Road			
The Courtyard, Sutton Row			
17 Oxford Street			
Covent Garden Estate, WC2:	O/R	F	6,700
19–26 and 19a Floral Street			
26 and 27–32 King Street			
34 Rose Street			
Tower House, 10 Southampton Street, WC2	O/R	F	4,900
Davidson Building, 5 Southampton Street, WC2	O/R	F	3,900
Jaeger House, 57 Broadwick Street, W1	O/R	F	2,300
Victoria (10%)			
Horseferry House, Horseferry Road, SW1	O	F	15,200*
Greencoat and Gordon House, Francis Street, SW1	O	F	11,800
Riverwalk House, 157–166 Millbank, SW1	O	F	6,900
Premier House, 10 Greycoat Place, SW1	O	F	5,800
6–8 Greencoat Place, SW1	O	F	3,100
Noho (6%)			
Holden and Dumbarton House, 54–68 Oxford Street, W1	O/R	F	8,400
Henry Wood House, 3–7 Langham Place, W1	O/R	L	7,400
16–19 Gresse Street and 7–8 Rathbone Place, W1	O	F/L	5,500*
Castle House, 75 Wells Street, W1	O	L	3,200
Baker Street/Marylebone (6%)			
19–35 Baker Street, W1	O/R	L	6,700
88–110 George Street, W1	O/R	L	2,400
30 Gloucester Place, W1	O	L	2,200
28 Dorset Square, NW1	O	F	2,200
16–20 Baker Street and 27–33 Robert Adam Street, W1	O/R	L	2,000
17–39 George Street, W1	O	L	2,000
Belgravia (5%)			
1–3 Grosvenor Place, SW1	O	L	7,700
4–5 Grosvenor Place, SW1	O	L	7,300
Mayfair (2%)			
25 Savile Row, W1	O/R	F	3,900
Paddington (2%)			
55–65 North Wharf Road, W2	O	L	7,800

[1] Arup Phases II & III.
[2] Arup Phase I.
[3] In addition, includes a 324-room hotel.
* Proposed areas.
( ) Percentage weighted by valuation.

Left: Art – Julian Opie
Portobello Dock, W10

Principal properties

	Offices (O), Retail/restaurant (R), Industrial (I), Leisure (L)	Freehold (F), Leasehold (L)	Approximate net area m²
West End: Outer (6%)			
Islington/Camden (5%)			
Angel Building, 411 St. John Street, EC1	O	F	15,000
Balmoral Grove Buildings, N1 and 1–9 Market Road, N7	O/I	F	4,500
Suncourt House, 18–26 Essex Road, N1	O/R	F	2,500
2–12 Pentonville Road, N1	O	F	2,400
14 Pentonville Road, N1	O	F	1,700
Ladbroke Grove (1%)			
Portobello Dock and Kensal House, W10	O	F	6,400*
City: Outer (21%)			
Clerkenwell (7%)			
88 Rosebery Avenue, EC1	O	F	9,300
Morelands Buildings, 5–27 Old Street, EC1	O/R	L	7,400
Woodbridge House, 30 Aylesbury Street, EC1	O	F	7,000
The Turnmill, 63 Clerkenwell Road, EC1	O	F	4,200
5–8 Hardwick Street and 161 Rosebery Avenue, EC1	O	F	3,300
20–26 Rosebery Avenue and 11 Warner Street, EC1	O	F	2,300
151 Rosebery Avenue, EC1	O	F	2,300
City borders (6%)			
1 Oliver's Yard, EC2	O/R	F	17,300
City Road Estate, EC1:	O/R	F	9,500
70–74 City Road			
Sophia House, 76 City Road			
Transworld House, 82–100 City Road			
36–37 Featherstone Street			
8a and 13–15 Mallow Street			
Monmouth House, 58–64 City Road, EC1	O	F	3,900
186 City Road, EC1	O	F	3,600
210 Old Street, EC1	O	F	2,100
18–30 Leonard Street, EC2	–	F	Site
Holborn (5%)			
The Johnson Building, 77 Hatton Garden, EC1	O	F	13,900
40 Chancery Lane, WC2 and 20–21 Tooks Court, EC4	O	F/L	5,700
6–7 St. Cross Street, EC1	O	F	3,100
Shoreditch (3%)			
Tea Building, Shoreditch High Street, E1	O	F	21,000
Provincial (7%)			
Scotland (4%)			
Strathkelvin Retail Park, Bishopbriggs, Glasgow	R	F	28,600
The Triangle Centre, Bishopbriggs, Glasgow	O/R	F	6,500
Land, Bishopsbriggs, Glasgow	–	F	5,500 acres
Other (3%)			
The Rotunda, Kingston-upon-Thames	L	F	15,700
Quadrant Centre and Burlington Arcade, Bournemouth	R	F	9,500

* Proposed areas.
( ) Percentage weighted by valuation.

Right: 28 Dorset Square, NW1

Directors' report

The directors present their report and the financial statements for the year ended 31st December 2007.

Results and dividend

The loss before tax was £99.8 million (2006: £242.8 million profit) and the profit for the year amounted to £100.9 million (2006: £182.2 million). The directors recommend a final dividend of 15.0p per share, which, when taken with the interim dividend of 7.5p per share paid on 9th November 2007, gives a total dividend of 22.5p per share (2006: 14.75p paid as two interim dividends) payable in respect of the results for the year ended 31st December 2007 amounting to £22.6 million (2006: £7.9 million). Ordinary dividends paid during 2007 amounted to £13.2 million (2006: £7.5 million) after which £87.7 million (2006: £174.7 million) was added to reserves.

There follows a review of the business. Further comments on the future outlook for the group can be found in the chairman's statement.

Business review

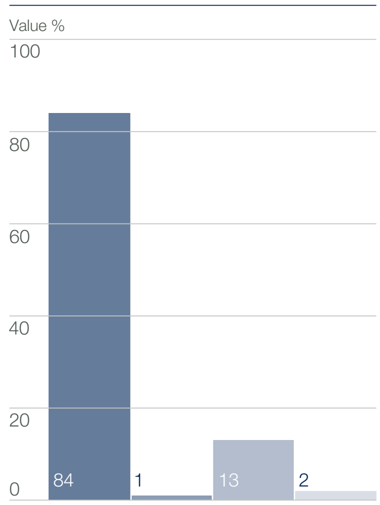
Derwent London is a property investment company focused on the central London office market. At 31st December 2007, the portfolio was valued at £2.7 billion, comprising over 533,000m^2 concentrated in the West End where 72% by value of the assets are located. The company's strategy is to deliver above average total returns from rental income and the creation of value through asset management and development. Innovative design solutions and high quality contemporary architecture play an important role in the business and the group has gained a strong reputation for delivering first class, award-winning office space that is both attractive and economical to tenants.

Key achievements in 2007 and since the year end include:

- The integration of London Merchant Securities into Derwent Valley Holdings to create Derwent London.
- Conversion to a REIT on 1st July 2007.
- £344 million of disposals, which produced a £130 million surplus.
- The acquisition of £142 million of properties, all characterised by low rental levels and offering significant planning opportunities.
- 21,900m^2 of letting activity at an annual rental income of £8.3 million and achieving 18% above the valuers' estimated rental values.
- Initial lettings made at the group's 10,000m^2 Qube office development following its completion in October.
- Substantial progress at current schemes including Horseferry House in Victoria and the Arup project in Fitzrovia, both of which are pre-let.
- Development commenced at 16–19 Gresse Street to deliver 4,400m^2 of offices in Noho in 2009.
- A significant planning permission obtained for the redevelopment of North Wharf Road, Paddington to provide 22,300m^2 of offices and 100 residential units.
- A lease restructure at the Angel Building in Islington that paved the way for a major 23,700m^2 redevelopment for which planning permission has been received in 2008.
- A total annualised property return for properties held throughout the period of 11.2%.

Overview

2007 was a groundbreaking year for the company with the creation of Derwent London – following the acquisition of LMS by Derwent Valley Holdings (DVH). Managing the merger of the businesses was an important and complex process, requiring not only the successful integration of the operations but also the continuation of the DVH ethos that has been built up over many years. With the integration fully complete, all employees are now based at our Savile Row office.



	£m
Freehold	2,249.0
Leasehold over 100 years	28.2
Leasehold 50–100 years	347.8
Leasehold under 50 years	46.7
	2,671.7

Value of portfolio by tenure

The merger doubled the floor area of the portfolio to 533,000m^2 and significantly strengthened our position as a leading central London office investor. Overall, 93% of our assets by value are located here. At the same time it reinforced our strategy of owning properties let at low average rents with important reversionary growth potential and maintaining a portfolio with substantial development potential. The average rent of the central London portfolio is £257 per m^2 and the average unexpired lease length is 8.8 years. Over 50% of this space has been identified for refurbishment/redevelopment projects at the appropriate time in the future.

Whilst substantially enlarging our property ownership, the merger also enhanced our geographical coverage within central London. In particular, DVH had a strong representation in the villages south of Oxford Street (such as Soho, Covent Garden and Victoria) which complements the LMS ownerships to the north of Oxford Street (such as Fitzrovia, Baker Street and Islington). This increased presence in these dynamic and evolving areas gives us the opportunity to provide a greater offering of West End properties to tenants at various levels of rent. With high occupational costs in the West End, this puts us in a strong position.

In the villages of central London, we have accumulated a specialist knowledge and understanding of their history and culture and how each is evolving to face the future. Through the provision of high quality working environments, we aim to be recognised as a key player in central London and to help influence the changing look of the capital. We concentrate on mid-market office rental locations, typically £430–£700 per m^2, as these are found in some of the most vibrant and improving areas in London to both work and live. For example, we identified and invested in Paddington at an early stage of its regeneration and this area has been transformed over the last five years to become an important part of the West End office market. In Fitzrovia, where we own over 100,000m^2 of property, we are reinvigorating the locality by replacing the tired 1950s properties with contemporary offices and improved retail facilities.

The London economy
With our central London focus, the health and trends of London's economy are key factors to the group, not only in the generation and growth of rental income but also in the timing and delivery of our projects.

London's economy accounts for approximately 19% of the UK's total GDP and 15% of its employment. Its growth and prosperity is strongly influenced by the vitality of the financial and business services (F&BS) sector and this has expanded rapidly over recent years. Consequently, the health of this sector is an important determinant in the demand for the capital's office space. Despite the recent turbulence in the global financial markets, economic forecasts suggest that over the next five years London's economy should be more resilient than the rest of the UK.

Total office stock in central London is estimated at 19.1 million m^2 and is subdivided into three distinct regions – the City (49%), the West End (42%) and Docklands (9%). The West End has a broad tenant base and is home to media, professional & business services and specialist fund management, whilst the City is the traditional home of banking, insurance and legal services. Since its creation in the late 1980s, Docklands has been very successful in delivering large, modern office space that has attracted tenants away from the City. The City's response was to ease planning regulations to allow taller, higher density buildings, thus increasing the development pipeline and enlarging the City office stock. By contrast, the supply of West End office space has remained extremely tight due to the restrictive planning regulations, which include the requirement for residential provision where additional office space is proposed. With conservation areas covering approximately 75% of the West End and nearly 3,900 listed buildings, development activity in the area is further constrained. As a consequence, office space in the West End has increased little since the early 1990s.

The strong UK economy in 2007, especially in the first half of the year, helped drive the central London office vacancy rate downwards, from 4.3% of total stock at 31st December 2006 to 3.0% at the year end, the lowest level since 2001. Looking at the sub-markets, the City vacancy rate dropped from 5.5% to 3.5% whilst the West End, where available space is particularly scarce, decreased from 3.5% to just 2.3%. These levels are well below the 10-year averages of 7.3% in the City and 4.8% in the West End. Strong letting activity contributed to these falling vacancy rates with take-up in central London and the West End exceeding their 10-year annual averages.

During the year, the supply-demand imbalance in the central London office market, especially in the West End, drove rents to new heights and we benefited from this in our letting activity. Tenant demand is still firm, despite the changing economic outlook in the second half of the year that began with the credit crisis, although the mood is undoubtedly more cautious. The West End market looks set to prove more resilient than that of the City due to its lower vacancy levels, more diverse tenant base and limited development pipeline.

Despite strong rental growth in 2007, the increase in yields pushed capital values downwards. According to the IPD Quarterly Property Index, the total return in 2007 for West End offices was 5.7%, outperforming both the City Office Index (–3.9%), and the All Property Index (–4.4%). Derwent London's underlying property return over the same period was 11.2%.

We monitor closely the occupational and investment trends and their subsequent impact on the office market. As the properties that form the next generation of schemes are income producing, we have the flexibility to adjust the timing of our projects to reflect anticipated market conditions. Our skills and experience in operating through different stages of the economic and property cycles enable us to produce superior returns through this careful timing of our schemes, their design and their rental competitiveness.

Portfolio statistics

	Valuation £m	Weighting %	Valuation performance* %	Floor area m²	Vacant accommodation m²
West End					
Central	1,761.3	66	6.1	279,700	24,100
Outer	160.6	6	4.2	51,800	9,200
	1,921.9	72	5.9	331,500	33,300
City					
Outer	559.6	21	5.3	128,900	9,200
Central London	2,481.5	93	5.8	460,400	42,500
Provincial					
Scotland	110.4	4	(12.3)	36,100	6,100
Other	79.8	3	(9.7)	36,600	5,200
	190.2	7	(11.2)	72,700	11,300
Total portfolio 2007	**2,671.7**	**100**	**4.3**	**533,100**	**53,800**
Total portfolio 2006	1,282.7	100	21.6	241,400	27,600

*Properties held throughout the year, with the ex-London Merchant Securities plc portfolio held from 1st February 2007.

	Net contracted rental income per annum £m	Average rental income £ per m²	Vacant accommodation rental value per annum £m	Rent review and lease reversions per annum £m	Portfolio estimated rental value per annum £m	Average unexpired lease length† Years
West End						
Central	69.5	275	12.9	29.0	111.4	10.6
Outer	8.0	188	1.8	2.4	12.2	5.3
	77.5	262	14.7	31.4	123.6	10.1
City						
Outer	29.2	245	2.1	5.5	36.8	5.4
Central London	106.7	257	16.8	36.9	160.4	8.8
Provincial						
Scotland	5.2	172	1.1	0.1	6.4	9.2
Other	5.7	184	0.5	(0.4)	5.8	13.2
	10.9	178	1.6	(0.3)	12.2	11.3
Total portfolio 2007	**117.6**	**247**	**18.4**	**36.6**	**172.6**	**9.1**
Total portfolio 2006	59.4	281	7.4	12.0	78.8	8.5

†Lease length weighted by rental income and assuming tenants break at first opportunity.

West End
Central: Belgravia, Mayfair, Soho, Covent Garden, Victoria, Fitzrovia, Noho, Paddington, Baker Street, Marylebone, Euston
Outer: Camden, Islington, Ladbroke Grove, Swiss Cottage

City
Outer: Clerkenwell, Holborn, Shoreditch, Southbank and City borders

Objectives

Derwent London's strategy is straightforward; we add value to our properties through asset management and the development process. We implement well thought out planning solutions, based on high quality architectural design and initiated by enterprising asset management which reflects our understanding of tenants' requirements. Through this process, our objective is to deliver above average annualised total return to our shareholders.

In last year's report and accounts we divided this approach into a number of key objectives. These, together with the progress that has been made during 2007, are reviewed below.

(i) Ownership of a portfolio with significant opportunities for value enhancement.
Each year a thorough property-by-property review is undertaken and incorporated into a five-year business plan. This year's review identified over 50% of the enlarged portfolio as having significant development potential, a similar proportion to a year ago prior to the merger.

(ii) Active lease management to improve rental income.
A key characteristic of the portfolio is its reversionary rental profile with low passing rents, thereby providing the opportunity for income growth and value enhancement. At the year end, our average central London office rent was £257 per m^2, compared to £281 per m^2 last year reflecting the lower average rents in the LMS portfolio. However, on a like-for-like basis, the average rent in the DVH portfolio increased to £294 per m^2.

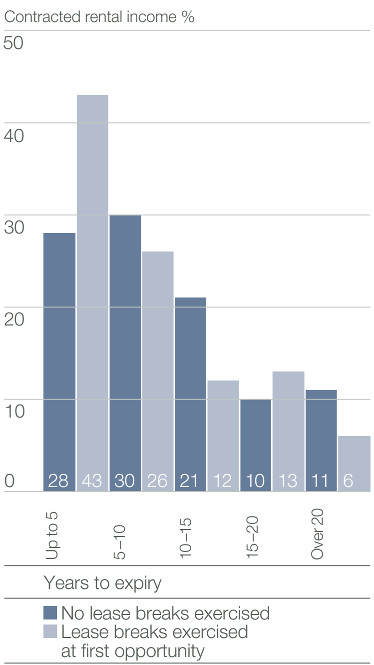
We aim to maximise rental income in all of our buildings including those earmarked for redevelopment. As an example, at the Angel Building, we secured control from the tenant in March, whilst maintaining the £4.2 million per annum rental income until 2010. Planning permission has now been obtained for a major development.

(iii) Maintain a pipeline of projects that can be delivered according to market conditions.
The planning process is complex and protracted so it is important to identify development potential and undertake appraisals at an early stage to ensure an appropriate supply of schemes for the future. With diligence and flexibility, we deliver schemes to the market at the most appropriate time. Our current major projects total 40,300m^2, of which 70% of the space has been pre-let to Arup and Burberry. Additionally, we have planning permission for over 84,600m^2 of future projects at properties which have an existing floor area of 39,500m^2 and are currently producing a rental income of £8.5 million per annum.

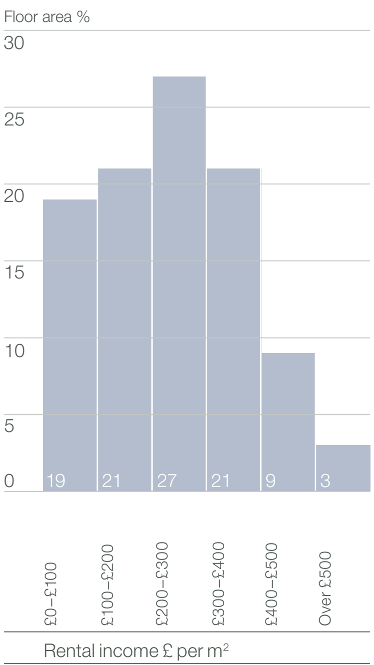
(iv) Deliver and let projects on time and to cost.
Capital expenditure during the year was approximately £61 million. Of this, £33 million was invested in Qube, Horseferry House and Arup Phase II. As planned, Qube completed towards the end of the year, and progress has been made with letting. Horseferry House and Arup Phase II, both of which are pre-let, are on course to complete this spring. Capital expenditure for 2008 is forecast to be £100 million.

(v) Apply and promote contemporary architecture and forward-thinking techniques through the Derwent London design brand.
We work with a number of architectural practices to ensure there is a constant flow of new ideas that drive the boundaries of good design. These range from established names to smaller, cutting-edge practices and enable us to nurture talent and push forward imaginative building solutions. These endeavours were recognised during the year with the winning of the 2007 Royal Institute of British Architects (RIBA) Client of the Year award.

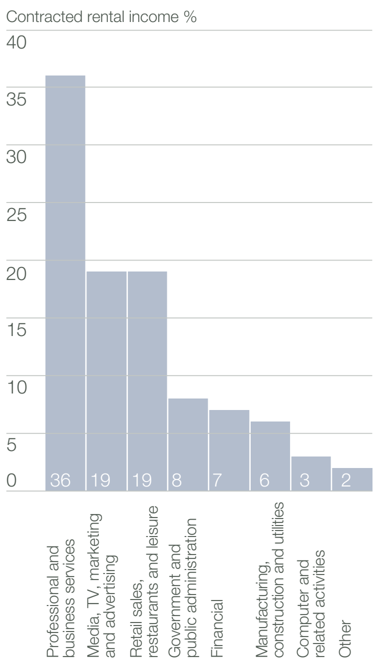
(vi) Recycle capital for reinvestment when potential is maximised.
In 2007, property disposals totalled £344 million, net of costs, and achieved outstanding prices, realising a £130 million profit. These were disposals of properties that did not conform with our post-merger strategy and included residential sites, provincial and smaller properties. Where possible they were sold post-REIT conversion, thereby improving the after tax return. We will continue to disinvest mature assets to free up capital for selective acquisitions and projects.



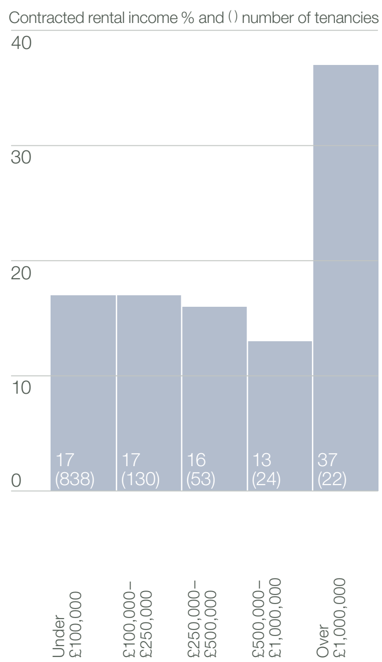
Profile of rental income expiry



Profile of occupied floor area



Profile of tenants' business sectors



Profile of rental income bands

Our strategy translated into a property return of 30.1% for 2007, compared to 26.7% in 2006. However, the figure for 2007 is distorted by the level and timing of sales during the year. The corresponding underlying figure is 11.2% with the principal drivers being rental growth and development surplus. Rental values advanced 13.0% during 2007, with the West End achieving 14.6%, albeit that the pace slowed in the second half of the year. With regards to valuations, the yield compression of the first half of the year reversed in the second half as the anticipated correction was exacerbated by the global credit problems in the financial markets. While these remain turbulent, the outlook for yields is uncertain. We are encouraged by tenant enquiries in the West End, which is relatively insulated from the impact of global financial market turmoil and expect modest rental growth here in 2008. Currently, we have no ownership in the City core.

This year, in addition to following the same six broad objectives set out above, we have also identified specific Key Performance Indicators (KPIs).

Key Performance Indicators

The following KPIs were identified for the group as a traditional property company. As more experience is gained of operating as a REIT, these may be revised to reflect the different metrics of this new environment.

Financial

(i) Total return.
This is calculated as the increase in adjusted net asset value excluding minority interests over the period plus dividends paid during the period divided by the adjusted net asset value excluding minority interests at the start of the period.

This is the return that management delivers to shareholders and for 2007 was 2.8%.

Property

(i) Total property return.
This measure combines a property's rental and capital return and is calculated by the group in accordance with the formula used by IPD. The group has adopted two targets for this KPI: to exceed the annualised IPD Quarterly Property Index for All UK Property on a three-year rolling basis and to exceed that for Central London Offices on an annual basis.

For the three-year period ending on 31st December 2007 the group's total property return was 25.6% whilst the All UK Property Index was 10.2%. Annually, the group's total property return was 30.1% whilst the Central London Index was 0.7%.

The group's figures are affected significantly by the sales undertaken to refocus the portfolio in 2007. Excluding these, the group's total property return for the year was 11.2% and for the three-year period, 19.2%.

(ii) Void management.
The group manages the level of vacant space in its portfolio to ensure an appropriate balance between value-enhancing schemes and the associated risk. The related KPI is that the expected rental value of space immediately available for letting must not exceed 10% of the portfolio's reversionary rental value.

At the year end, this figure was £7.7 million, equivalent to 4.5% of the portfolio's reversionary rental value.

Environmental

(i) Impact of developments.
A target has been adopted for the group to ensure that all developments in excess of 5,000m² are assessed against Building Research Establishment Environmental Assessment Method (BREEAM) and rated Very Good or above.

Awards

Our commitment to good design and improving the office working environment was rewarded in 2007 with Derwent London winning the RIBA Client of the Year award. The prestigious accolade was for the commissioning of both established and up-and-coming architects to deliver a mix of refurbished and new-built offices throughout London. We also won a RIBA award for 28 Dorset Square, a stylish office project in Marylebone. In April, we won the *Property Week* Deal of the Year award for the acquisition of LMS and in October, we were also awarded Property Company of the Year – London, from *Estates Gazette.*

Property review

Valuation commentary

The year under review was very much a tale of two halves. The six months to June showed modest yield compression and strong rental growth performance, delivered through healthy tenant demand and historically low vacancy rates. However, the disruptions in the world financial markets in the autumn dramatically changed the outlook for values with the investment market reacting swiftly. This contributed to an increase in yields as the availability of finance became restricted. However, letting activity remained buoyant, especially in the West End, with rents continuing to increase in the second half of the year.

Set against this background, the investment portfolio was valued at £2.7 billion at 31st December 2007.

The valuation surplus for the year was £94.4 million, before lease incentive adjustments of £4.1 million. Properties held throughout the period contributed £54.0 million, a result of strong rental growth which compensated for the increase in yields. In addition, the revaluation of our development properties added a further £50.3 million with a substantial surplus coming from the recently completed Qube development. Other properties in this category were Arup Phases II and III, Horseferry House, Portobello Dock, Gresse Street and Leonard Street. Acquisitions saw a £9.9 million deficit, principally as the associated transaction costs were written off. However, these properties contain exciting planning opportunities and offer potential for significant value enhancement in the future.

The portfolio's underlying valuation uplift was 4.3% compared to 21.6% last year. The West End properties, which represent 72% of the portfolio, achieved a 5.9% increase. Here, good uplifts came from our Belgravia and Victoria properties, which rose by 13.9% and 12.5% respectively. The remaining properties in central London, 21% of the portfolio, are located on the City borders. The value of these assets increased by 5.3% over the year with a good performance from our Holborn properties at 9.8%, principally due to a strong return at The Johnson Building. Overall, the value of the central London portfolio increased by 5.8%.

The remaining 7% of the portfolio is located in the provinces and values decreased by 11.2% as valuation yields increased and rental growth was limited. A principal factor in this return was the downgrading in value of Strathkelvin Retail Park in Scotland which comprises just over a third of the provincial portfolio by value. However, we have recently improved the planning use at this bulky goods park and are working on asset management initiatives. Further progress on the disposal of the provincial properties has been made since the year end, with the sale of our Southampton properties.

At 31st December 2007, the portfolio's initial yield, based on the annualised, contracted rental income, net of ground rents, was 4.4%, rising to 6.3% on full reversion. The portfolio's true equivalent yield was 5.7%, showing an increase from 5.4% at the start of the year and 5.3% in June 2007.

Portfolio yields

	Rental uplift per annum £m	Rental per annum £m	Yield‡ %
Annualised year end contracted rental income, net of ground rents*		117.6	4.4
Letting 21,400m² vacant accommodation available at year end	7.7		4.7
Completion and letting 32,400m² of refurbishments and developments	10.7		5.0
Anticipated rent review and lease renewal reversions	36.6		6.3
Portfolio reversion		55.0	
Potential portfolio rental value		172.6	6.3

‡Yield based upon the year end valuation and adjusted for costs to complete commenced projects.
*Includes the Horseferry House pre-letting of £5.3 million per annum.

Lettings

Managing our vacant space is an important part of the business and the appetite for high quality accommodation was evident through our letting activity. In total, we completed 21,900m^2 of lettings in 81 transactions at a combined rental income of £8.3 million per annum. These were 18% above the valuers' estimated rental values underlying the proforma valuations, highlighting the group's exceptional performance against market expectations.

Early in the year, the final floor of the 13,900m^2 Johnson Building in Holborn was let at £460 per m^2, rising to a minimum of £480 per m^2 on first review. This 1,030m^2 letting achieved a rent 26% above our initial lettings in 2006. This project was fully let in just nine months, a testament to its innovative design and flexible floorplates. Within the same complex, the 540m^2 Sweeps Studios was pre-let and 1,750m^2 was let at 6–7 St. Cross Street, the latter achieving rents of up to £375 per m^2 which was 27% above the anticipated rental values at the outset of the project.

In February 2007, we completed the 3,600m^2 refurbishment of 186 City Road in the City borders and quickly multi-let the building at a combined annual rental income of just over £1.0 million per annum. The highest rent achieved was £335 per m^2 and the overall rental income was 13% above the level initially anticipated.

At Tower House in Covent Garden, a lease paying £375 per m^2 was surrendered. The space was re-let in the second half of the year, achieving rents between £700 and £730 per m^2, exceeding the valuer's assessment at June of £540 per m^2.

In October, we completed our largest project of the year – Qube. This high specification building comprises 9,300m^2 of office space and 700m^2 of retail accommodation located on our Fitzrovia Estate, where 23% of the portfolio is held. This project is part of our long-term strategy to significantly improve this well known London village which offers attractive office space at approximately half the rents of the West End core of Mayfair. In December, advertising company Aegis Media, leased the 1,750m^2 second floor at the Qube at a rent of £1.1 million per annum, equivalent to £645 per m^2 and setting a record rent in Fitzrovia. For our retail strategy, we are targeting specific operators that improve the retail mix at this end of Tottenham Court Road. The first retail unit at Qube has been let to itsu, a fashionable sushi outlet, and again setting a new rental high for this location. The Qube, combined with the nearby Arup development, is helping to make Fitzrovia one of London's fastest improving business locations.

Principal lettings

	Approximate net area m^2	Rent per annum £m	Headline rent £ per m^2	Comments
Qube, W1	1,870	1.25	645	Letting of office floor to Aegis Media and retail unit to itsu.
186 City Road, EC1	3,600	1.05	195–335	Five lettings: Blyth & Blyth Engineers, Emprise Services, Lonely Planet Publications, Map Info and Titan Outdoor Group.
Tower House, WC2	1,430	1.02	700–730	Lettings to LG Electronics, Xstrata Services and Canamens Energy.
88–110 George Street, W1	920	0.56	645	Pre-letting to London & Newcastle.
6–7 St. Cross Street, EC1	1,750	0.51	375	Three lettings: TM Lewin, Hargreaves Associates and Giving.com.
The Johnson Building, EC1	1,030	0.47	460	Final floor let to Syzygy.
4 Grosvenor Place, SW1	465	0.34	745	Lettings to Private Advisors and Sustainable Forestry Management.
Holden House, W1	630	0.32	510	Additional space was let to existing tenant H & M Hennes.
163–170 Tottenham Court Road, WC1	690	0.25	355	Short-term letting to Unanimis Consulting.
Tea Building, E1	1,315	0.23	190–215	Various suites.

Principal rent reviews and asset management initiatives

	Approximate net area m²	Rental per annum £m	Headline rental £ per m²	Comments
Angel Building, EC1	15,000	4.2	280	Lease restructure with tenant, BT, giving us possession of the building whilst maintaining the current income until March 2010.
19–35 Baker Street, W1	4,750	2.0	420	Lease surrender with Marks & Spencer allowing offices to be leased to House of Fraser on a 10-year term.
120–134 Tottenham Court Road, W1	n/a	0.59	n/a	Grafton Hotel rent review settled to show a 12.4% increase.
4 Grosvenor Place, SW1	845	0.46	545	Various lease renewals.
80–85 Tottenham Court Road, W1	310	0.13	320	Rent review concluded to show a 30% increase.

Portfolio management

During the year, we successfully completed the amalgamation of the DVH and LMS portfolios and identified the immediate and future opportunities for asset management initiatives that the properties offered.

The integration process allowed the group's management practices to be reviewed and refined. Our asset managers have invaluable local knowledge and experience of the designated villages in which they operate. Further value is added through regular asset management meetings that enable us to identify and act upon opportunities across the villages.

In addition to new lettings, 37 rent reviews and 20 lease renewals or regears were completed during the year. As a consequence of this active management, the annualised contracted rental income, net of ground rents, was £117.6 million at the year end. The valuer's estimated rental value of the portfolio was £172.6 million, producing a 47% reversionary potential – highly significant for the future. Of the £55.0 million reversion, £18.4 million was attributable to vacant space and £36.6 million to lease renewal and rent review reversion. Of the vacant space, £7.7 million was immediately available for letting, reflecting a vacancy rate of 4.5% of the portfolio's estimated rental value. The majority of this income potential is from the recently completed Qube development (£5.2 million). The remaining £10.7 million of vacant space comprised redevelopments and refurbishments (excluding pre-lets). This includes the principal current projects, 16–19 Gresse Street and Portobello Dock, which have a combined potential annual rental income of £4.1 million. The balance is made up of smaller, yet important, refurbishments – often single floors within buildings. This activity is complemented by an average unexpired lease length of 9.1 years across the portfolio as a whole with 8.8 years in central London and 10.1 years in the West End.

As we offer a variety of office space with a wide range of pricing, we have a diverse tenant base thus balancing the portfolio's income. For instance, 36% of our contracted rental income is from professional and business services and 19% is from the media sector. Government and public administration account for 8% whilst the financial sector accounts for a further 7%.

Development programme

An integral part of our business is the management and implementation of our development programme, and we categorise this into three stages:

- Current projects
  The scheme is committed and construction is underway.
- Planning consents
  Planning permission has been granted but the project is not yet committed.
- Appraisal studies
  Planning and viability assessments are underway.

Current projects

During the year we were extremely active in Fitzrovia. We completed the striking £35 million Qube development that is now being marketed and we are well underway with the highly sustainable Arup Phases II and III development. Phase II is scheduled for completion in spring 2008 with Phase III due to be finished in late 2009, bringing the total floor area developed to 13,200m² in what is a truly enterprising design that should achieve an excellent BREEAM rating. This development is pre-let to Arup on a 25-year lease at an annual rental income of £2.7 million that rises to £3.6 million on completion of Phase II and to £6.0 million on the completion of Phase III.

In Victoria, Horseferry House will be completed this spring, allowing its new tenant, Burberry, to take possession. The entire 15,200m² building was pre-let to the company at the start of the £29 million refurbishment in 2006, and will be a stylish global headquarters for this prestigious company. The imposing 1930s building has been extensively remodelled and modernised with an imposing central atrium – a prime example of Derwent London's design-led approach to workspaces and our commitment to adding to the vitality of an area.

Continuing the theme of regeneration through high-quality design, we have recently commenced work on site at 16–19 Gresse Street, Noho. At this imaginative scheme, we are integrating a new 4,400m² office building with residential accommodation, linked by an attractive public space, and we expect to transform this area into a bustling and lively destination. Completion is due in early 2009 and rents in this locality are presently around £645 per m².

Elsewhere, we have taken an innovative approach at Portobello Dock in Ladbroke Grove. We are nearing completion in transforming a redundant group of canal-side buildings into an unusual mixed-use development. This will comprise a new office building of 2,200m², refurbished office spaces totalling 2,400m², and 19 attractive waterside apartments. These residential units were recently pre-sold in 2008 for £12.6 million.

Planning consents

To ensure that we can continue to deliver, when appropriate, our individual brand of space to the market, we have significantly added to our planning consents over the last 12 months. Major consents now total 84,600m² reflecting a 114% increase over the existing floor area of 39,500m². These properties produce an annual rental income of £8.5 million and their varying lease expiries and break options offer significant flexibility for implementation.

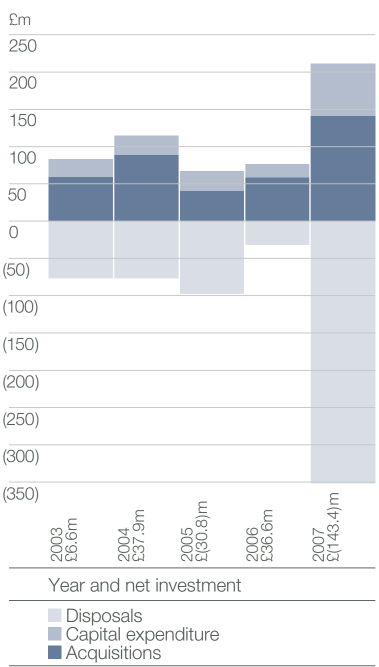
The largest planning permission is for the redevelopment of North Wharf Road in Paddington. After detailed and lengthy negotiations, permission has been obtained for a truly innovative office building of 22,300m² with 270m² of retail. This is complemented by a separate 6,800m² residential building which will provide 100 residential units, of which 16 will be designated affordable housing. The buildings will enjoy a canal-side setting thereby providing an attractive environment for both office and residential occupiers, while Paddington's excellent transport connections more than justify the area's status as a major West End location. The existing buildings, totalling 7,800m², produce an annual income of £1.7 million and, subject to detailed design and tenure restructuring, there is the potential to commence on site from 2010.

Following a lease restructure with the tenant, BT, at the Angel Building in Islington, we now have possession of the property. In February 2008, planning permission was granted for a comprehensive refurbishment and extension that will increase the size of the building by 58%, from 15,000m² to 23,700m². This will be an exceptional office building in an improving location close to King's Cross and is illustrative of Derwent London's talent for creating attractive workspaces at competitive rents in some of London's most vibrant villages.

A refined planning consent has recently been gained at Wedge House in the Southbank area. The tired, 1950s office building of 3,600m² can be replaced by a substantially larger new development of 7,500m². This is a rapidly improving location, where several other mixed-use developments promise to significantly raise the area's profile. Vacant possession can be obtained in June 2008.

At 18–30 Leonard Street we have a planning permission for a 1,900m² office development and 47 residential units totalling 3,200m². Work is scheduled to start on site later this year. The building features a refreshingly contemporary design that reflects the site's enviable position on the edge of the City, yet also close to the lively streets of Shoreditch.

At the Turnmill in Clerkenwell, planning permission has been granted to convert the former Victorian stables into 6,000m² of interesting office space, representing a 44% increase in floor area. Also, in Clerkenwell, we have permission for a 3,400m² refurbishment at 20–26 Rosebery Avenue.



Net investment

Finally, in February 2008, planning permission was obtained to replace three, multi-let properties at 40 Chancery Lane, Holborn, with a 9,500m^2 building set around a tranquil courtyard.

Appraisal studies

As part of the development process, the appraisal stage enables us to consider a number of options for a building that could lead to a planning consent and ultimately to a current project.

There are several major projects at the early stage in the appraisal process where our architectural and viability studies are being advanced. These could be some of our biggest developments over the next decade.

In partnership with the freeholder, Grosvenor, we have appointed architects to look at the redevelopment of 1–5 Grosvenor Place. This has the potential to be a unique project in Belgravia, one of London's most prestigious locations. The initial design studies envisage a building that could substantially increase the existing floor area of 15,000m^2. One option is for several floors of high quality office space set around a central atrium with residential at higher levels. These could potentially be some of the West End's most desirable addresses, enjoying an unparalleled location with unmatched views over Green Park.

At another prestigious location, our studies are evolving for the redevelopment of Riverwalk House, Millbank. Here, there is the potential for high quality residential accommodation, with exceptional views of the Thames. Massing studies show scope for a scheme in the order of 18,600m^2, a substantial uplift on the existing 6,900m^2 building. In the interim, both Riverwalk House and Grosvenor Place are fully let and produce annual rental income of £7.5 million.

Further into the future, plans are advancing for our holdings on Charing Cross Road, following the Government's recent progress on the Crossrail transport project. Together with Crossrail, we are leading the design for a major redevelopment of Tottenham Court Road underground station, which will become one of London's most strategic transport interchanges. Ultimately, we will have the option to develop this important West End commercial site. Detailed negotiations are ongoing with a wide range of organisations to take this complex project forward, and we are in an ideal position with a controlling role in the regeneration of this location.

One of the difficulties with the planning process is that even with the planning officer's recommendation for approval, consent is not always automatic. These were the circumstances in which planning permission was refused for an office and residential scheme on our City Road Estate in July 2007. However, we are now working on a revised proposal with the intention of resubmitting a planning application in 2008. The existing buildings continue to provide an annual income of £1.0 million and we are confident that we will deliver an exciting development in this prominent and improving location.

Disposals

One of the clear strategies set out at the time of the LMS acquisition was the disposal of those properties that did not adhere with the group's objectives. These fell into three categories; London development sites, provincial properties and smaller holdings. During the year, we implemented an extremely successful disposal programme that was substantially completed before the investment market became turbulent.

Disposals for the year totalled £344 million, net of costs, with the majority in the second half of the year, post-REIT conversion. These achieved an exceptional £130 million surplus above book value with an exit yield of 1.7% based on an annual rental income of £5.7 million.

The most significant disposal was of an eight acre residential site at Greenwich Reach, SE10 for £109.9 million, more than twice the book value. Much of this uplift was the result of the group reducing both the planning and commercial risks associated with the site. Other significant London transactions included the £44.3 million sale of 160–166 Brompton Road, SW3 which had residential potential and the sale of the vacant Argosy House, W1 and 3–4 South Place, EC2, which achieved £22.4 million and £18.0 million respectively.

Of the provincial assets, disposals included retail centres in Brighton (£19.5 million) and Farnham (£31.8 million), the latter being held in our joint venture with the Portman Estate.

We intend to make further disposals of our remaining provincial properties and small, management intensive assets, thereby allowing us to focus on our major central London holdings. Since the year end, we have sold all of our buildings in Southampton for £18.95 million excluding costs, in line with the December 2007 valuation.

Disposals

Properties sold for a net £343.5 million on an exit yield of 1.7%.

	Net proceeds £m	Net contracted rental income per annum £m	Floor area m^2	Comments
Central London				
Greenwich Reach, SE10	109.9	–	n/a	An eight acre cleared site on the south bank of the Thames, sold with planning consent for a major residential development.
160–166 Brompton Road, SW3	44.3	0.8	2,300	Retail and office property producing short term income.
Argory House, W1	22.4	–	2,800	Vacant office building requiring refurbishment.
3–4 South Place, EC2	18.0	–	3,500	Two adjacent vacant central city office buildings.
2–20 Winchester Road, NW3	17.9	–	n/a	Site with planning consent for residential development.
Broadmead and Westcombe House, SW1	17.5	0.3	1,500	Multi-let office and restaurant building.
70–72 and 74 Wigmore Street, W1	9.4	0.2	1,000	Two adjacent leasehold multi-let office buildings producing short term income.
37–42 Compton Street, EC1	9.1	0.2	2,700	A multi-let office building.
Other	13.5	0.3	2,700	
Provincial				
Lion and Lamb Yard, Farnham	31.8	1.6	6,500	Shopping centre held in joint venture with the Portman Estate.
Dukes Lane and Middle Street, Brighton	19.5	0.9	6,000	Shopping centre and entertainment venue.
Quadrant Arcade and South Street, Romford	15.8	1.0	5,700	Town centre retail arcade.
32–38 High Street, Dorking	6.4	0.3	2,500	Supermarket let to Sainsbury's.
Turnford Triangle, Cheshunt	4.9	–	n/a	Three acre cleared site sold with the benefit of a residential planning consent.
Other	3.1	0.1	800	
	343.5	5.7	38,000	

Acquisitions

£141.5 million, after costs, of central London acquisitions during the year.
Acquired on a net initial yield of 4.2%.

	Acquisition cost £m	Net contracted rental income per annum £m	Floor area m^2	Comments
132–142 Hampstead Road, NW1	54.9	2.0	21,500	Substantial office and warehouse buildings, together with a petrol filling station. The buildings are leased to three tenants, British Home Stores, University College Hospital and BP Oil. Occupying a 1.85 acre site there is a redevelopment opportunity upon lease expiries in 2011/12. This is an improving location, adjacent to Euston Station, one of London's main transport interchanges. Freehold.
Woodbridge House, 30 Aylesbury Street, EC1	48.7	2.5	7,000	An office building let to Pinsent Masons, solicitors, on a lease expiring in 2015 off a low rent of £350 per m^2. There is the opportunity for a future refurbishment and extension. Freehold.
Castle House, 75 Wells Street, W1	21.0	0.8	3,200	A multi-let office building located in Noho with refurbishment and lease management potential. Low average rent of £255 per m^2. Leasehold.
43 and 45–51 Whitfield Street, W1	16.9	0.7	2,500	Two adjacent office buildings, with lease expiries in June 2008. Located on our Fitzrovia Estate and offering planning and development potential. Freehold.
	141.5	6.0	34,200	

We made a number of selective acquisitions throughout the year, totalling £141.5 million after costs, where our key requirements of low passing rents with significant scope for asset management and future planning potential were all met.

The principal acquisition was 132–142 Hampstead Road, NW1 for £54.9 million in September 2007. The property comprises several fully let buildings, totalling 21,500m^2, with an annual rental income of £2.0 million, on a prominent 1.85 acre site located in what is an emerging part of the West End, adjacent to Euston Station. Being close to our Fitzrovia Estate, there is also the potential for beneficial planning synergy.

A similar planning opportunity was identified at 43 and 45–51 Whitfield Street, W1 which were acquired for £16.9 million in December. These two buildings, totalling 2,500m^2, produce an aggregate rent of £0.7 million per annum with the leases expiring in June 2008. They occupy a strategic position in the heart of our Fitzrovia holdings and represent an opportunity for redevelopment and, possibly, incorporation into our major regeneration plans for the area.

Also in the West End, Castle House, W1 was acquired for £21.0 million in May. This attractive multi-let corner office building in Noho is let at a low average passing rent of £255 per m^2 and has excellent active management potential. This is a location where the rental level for quality office refurbishments is around £650 per m^2 so there is a significant refurbishment opportunity in due course.

Finally, Woodbridge House, EC1 was acquired for £48.7 million in August. This 7,000m^2 office building is let to solicitors Pinsent Masons at a rent of £350 per m^2 and has excellent reversionary potential together with an opportunity to extend the building when the lease expires in 2015.

The group is financially well positioned to make further similar acquisitions, particularly where it sees opportunities created by the current market conditions.

Financial review

The group's results are prepared in compliance with International Financial Reporting Standards (IFRS) and the accounting policies set out in note 2 to the accounts. However, the investment community makes a number of adjustments to key IFRS figures. It is the adjusted figures that the board also uses in monitoring performance and these are included in this review.

The results for 2007 incorporate 11 months for LMS, which was acquired with effect from 1st February 2007. The acquisition was financed by the issue of 46,910,232 Derwent London ordinary shares, £32.5 million of loan notes, and a cash payment of £12.2 million. The acquired goodwill of £353.3 million has been expensed in the group income statement after the impairment tests required by IAS 36 were applied. The rationale for this can be found in the note headed Acquisition of subsidiaries.

Results commentary

The headline numbers from the results are shown below followed by a commentary which highlights the make-up of these key numbers. The figures for the prior year, as noted above, do not include any results for LMS:

	2007	2006
Net property income (£m)	**103.8**	58.0
Recurring profit before taxation (£m)	**38.0**	16.4
(Loss)/profit before taxation (£m)	**(99.8)**	242.8
Diluted recurring earnings per share (p)*	**34.99**	27.21
Adjusted net asset value per share (p)*	**1,801**	1,770

*After minority interests

Net property income

Gross property income, mainly rent receivable from tenants, rose £60.4 million to £111.7 million in 2007, with a net £54.4 million of the increase coming from properties acquired with LMS. Income from the DVH properties and 2007 acquisitions increased by £6.0 million to £57.3 million. Within this, lettings added £8.2 million, the main contributions being £3.6 million from the recently completed Johnson Building and £1.1 million from short lets at North Wharf Road, pending its redevelopment. Voids, predominantly from properties under refurbishment or redevelopment, reduced the rent roll by £3.3 million. With the exception of £1.0 million at Horseferry House, the voids were spread over a number of properties. Rent from recent acquisitions at £3.2 million exceeded that lost due to disposals by £2.0 million.

Net property expenditure on the enlarged portfolio for the year was £9.9 million, compared with £4.9 million in 2006. Void costs were £4.7 million against £2.2 million last year and transaction costs, which reflect letting and rent review activity, increased from £2.1 million to £3.6 million. Other miscellaneous property costs increased by £1.0 million.

Therefore, the net result of letting property for 2007 was an income of £101.8 million. The final component of net property income is the development profit that the group has earned from the Telstar redevelopment carried out on behalf of Prudential. The redevelopment is now complete and a further £2.0 million of profit has been earned in 2007 in addition to the £11.6 million taken to the group income statement in 2006, to give £13.6 million in total. This is a successful outcome for Telstar House, which had been sold to the Prudential in 2005 with Derwent undertaking the redevelopment and retaining a profit share valued upon practical completion. At the interim results stage, the profit earned was calculated at £6.8 million, but rising property yields by December led to a fall in the final valuation of the property and therefore a reduction in the estimated final profit.

Administrative expenses

Turning to overheads, administrative expenses excluding the goodwill write off in 2007 are £17.9 million, but this is after a credit of £1.6 million following the valuation of the LMS cash-settled share options. However, the grossed up figure of £19.5 million still shows a saving over the combined overheads of the DVH and LMS groups prior to the merger, and the second half charge of £9.1 million compares favourably with that in the first half of £10.4 million. Employment costs are the group's biggest overhead and account for £11.7 million of the total costs. With an enlarged portfolio to manage, the average number of employees during the year, excluding directors, has risen from 23 in 2006 to 56 in 2007.

Net finance costs

While little of the consideration paid for LMS was in cash, the LMS group brought with it £501 million of debt at fair value. Consequently, finance costs have shown a substantial rise from £20.4 million to £49.1 million, partially offset by a rise in finance income of £2.4 million. The company's hedging policy, and the nature of its bank loans, meant that approximately 75% of the company's debt was protected from the artificially high LIBOR interest rates in the last five months of 2007.

Recurring profit before taxation
Distilling the above into one figure, but excluding development income, the recurring profit before taxation was £38.0 million which compares with the 2006 result for DVH alone of £16.4 million, an increase of 132%.

Loss before taxation
Listed below are a number of other items in the group income statement which reconcile the recurring profit to the IFRS defined loss before taxation of £99.8 million. These are a mixture of the by now usual adjustments and those associated with the LMS acquisition.

- The group revaluation surplus for the year of £90.3 million.
- The profit on disposal of property and investments of £130.1 million, including those realised in a joint venture.
- The negative movement in the fair value of derivative financial instruments of £5.1 million.
- The Telstar development income of £2.0 million discussed above.
- The write-off of the acquired goodwill of £353.3 million following the impairment tests carried out in accordance with IFRS.
- Net exceptional finance costs of £1.8 million, being the cost of the acquisition facility less a profit on redemption of a debenture.

Tax credit
On 1st July 2007, Derwent London converted to REIT status. This generated a conversion charge of £53.6 million, which was provided for in the half year results and is payable in 2008, and also allowed most of the deferred tax liability to be credited back to the group income statement. In addition, there is a corporation tax charge for the year of £33.5 million which arises from the first half year prior to REIT conversion, and residual tax in the second half on assets outside the REIT 'ring fence'.

Earnings per share
Diluted recurring earnings per share rose to 34.99p from 27.21p in 2006, an increase of nearly 29%. This compares with the increase in the dividend of 53% from 14.75p per share to 22.5p. This has been achieved partly by distributing the major part of the tax savings arising in the second half due to the group's REIT status.

Net assets
Net assets attributable to equity shareholders at 31st December 2007 were £1,782.0 million compared with £783.4 million at the end of 2006. The group's property portfolio was valued at £2.7 billion at the year end as has been discussed earlier. The adjusted net asset value per share, excluding minority interests, has risen 139p to 1,801p per share compared with the proforma group balance sheet figure upon acquisition of LMS of 1,662p per share. The equivalent adjusted net asset value per share for DVH at December 2006 was 1,770p. The adjustments made to arrive at the above figures are shown in note 38.

Cash flow
Following the acquisition, and the board's stated intention of realising some of the acquired assets, it is not surprising that there was a cash inflow in 2007 of £84.4 million compared with an outflow of £59.4 million in 2006. However, these total figures require some interpretation. The cash inflow from operational activities was £28.4 million compared with an outflow of £5.6 million in 2006. There was also a net inflow from the group's investing activities of £85.2 million after adding back £16.0 million of LMS's pre-acquisition costs paid after 1st February. This inflow was due to the level of disposals subsequent to the LMS acquisition which, in total, realised £352.4 million, with a further £5.7 million received from the sale of a property held in a joint venture. Part of these proceeds was reinvested in the business with the acquisition of new properties totalling £140.7 million and with capital expenditure absorbing £68.3 million. The remainder has been used to reduce group debt. The only other notable figure in investing activities is the cash cost of the LMS acquisition which amounted to £38.4 million. Finally, dividends paid out to shareholders totalled £13.2 million compared with £7.5 million in 2006, the rise due to the increased number of shares in issue and the substantial increase in the 2007 interim dividend.

Debt and sources of finance

The total of net debt at the 2007 year end was £782.8 million compared with the equivalent figure for 2006 of £349.8 million, and that shown in the interim balance sheet of £947.6 million. The nominal value of this net debt was £753.9 million, the difference being the fair value less costs of the LMS bond and the leasehold liabilities. The fall in borrowings in the second half of the year was due to the disposals mentioned above with all but £34.3 million of the proceeds received in this period. The reduction in both borrowings and net assets has left balance sheet gearing at 42.5% compared with that at the half year of 49.1%. However, in terms of the group's risk profile, the more important profit and loss gearing ratio has been restored to a more normal level of 1.81 after it had fallen at the interim stage, following the acquisition, to 1.50. The figure of 1.81 compares with that in 2006, prior to the acquisition, of 1.85. To complete the debt ratios, property gearing (nominal debt divided by the fair value of investment properties) at December 2007 was 28% compared with 27% at the prior year end. This is substantially under half of what a typical conservative bank covenant would be and it demonstrates both the soundness of the Derwent London balance sheet and the potential financial resources available to the group.

The group's financing philosophy has been 'keep it simple, keep it flexible'. Both Derwent and LMS were financed in a similar manner, so the philosophy has not changed since the acquisition. LMS added a syndicated £375 million term and revolving facility, and a long-term fixed rate secured bond, to DVH's four bilateral revolving facilities. All the banks provide committed facilities and the group continues to borrow on a secured basis. Financial covenants are security specific and not corporate based. The flexibility of the revolving credit loans was demonstrated in 2007 with these absorbing disposal proceeds of approximately £350 million while remaining available to satisfy the demands of acquiring £141 million of property. At 31st December 2007, committed bank facilities totalled £918 million of which £370 million was undrawn. This level of available resources provides both comfort and opportunity in the current economic environment. Only one major facility amounting to £100 million is due for renewal in 2008 (November). Close relationships are maintained not only with existing lending banks but also a second tier to satisfy future debt requirements.

Liability risk management

Adverse movements in interest rates are one of the main risks to which the group is exposed. Therefore, in addition to fixed rate debt, interest rate derivatives are used to protect the group against such events. In a group that actively manages its portfolio with consequent swings in debt levels, flexibility is also important. Board policy reflects this in that sufficient hedging is required to be entered into such that the total of any fixed rate debt and that fixed using derivative instruments is within a range of 40% to 75% of the total nominal value of debt, excluding leasehold liabilities. The actual percentage is dependent on the perceived risk to the group. At the current time, 62% of such debt is covered to give a weighted average cost of debt of 6.05%.

The derivatives are fair valued at each reporting date and the movement in value over the year is reported in the group income statement. For 2007, this resulted in a debit of £5.1 million. Under IFRS, changes in fair value of the £175 million secured bond are not required to be reported in the group income statement unless the company has an obligation or has a present intention to redeem the bond other than at normal maturity. Neither is the case. The fair value adjustment for the bond at 31st December 2007 was £15.0 million, equivalent to 14.9p per share, compared with the £22.1 million on acquisition of LMS. The latter amount was included in the consolidated balance sheet and is being amortised over the term of the bond.

Share capital

As at 18th March 2008, the company's issued share capital comprised a single class of ordinary shares. Details of the ordinary share capital can be found in note 32 to the financial statements. Shareholder authority to buy back 10,056,672 ordinary shares was obtained at the company's 2007 AGM. No shares have been acquired in reliance on that authority.

The rights and obligations attaching to the company's ordinary shares, and provisions governing the appointment and replacement of, as well as the powers of, the company's directors, are set out in the company's articles of association, copies of which can be obtained from Companies House in the UK or by writing to the group's company secretary. There are no restrictions on the voting rights attaching to the company's ordinary shares or on the transfer of securities in the company, except, in the case of transfers of securities:

- that certain restrictions may from time to time be imposed by laws and regulations (for example, insider trading laws); and
- pursuant to the Listing Rules of the Financial Services Authority whereby certain employees of the company require the approval of the company to deal in the company's ordinary shares.

No person holds securities in the company carrying special rights with regard to control of the company. The company is not aware of any agreements between holders of securities that may result in restrictions on the transfer of securities or on voting rights. Unless expressly specified to the contrary in the articles of association of the company, the company's articles of association may be amended by a special resolution of the company's shareholders. At the 2008 AGM, a special resolution will be put to shareholders proposing amendments to the company's existing articles of association in relation to the provisions of the new Companies Act 2006.

Details of the major shareholders of the company are given in the directors' report on page 41.

Significant agreements

There are no agreements between the company and its directors or employees providing for compensation for loss of office or employment that occurs because of a takeover bid. Some of the group's banking arrangements are terminable upon a change of control of the company.

As a REIT, a tax charge may be levied on the company if it makes a distribution to another company which is beneficially entitled to 10% or more of the shares or dividends in the company or controls 10% or more of the voting rights in the company (a substantial shareholder), unless the company has taken reasonable steps to avoid such a distribution being made. The company's articles of association allow the directors to take such steps, including the power:

- to identify a substantial shareholder;
- to withhold the payment of dividends to a substantial shareholder; and
- to require the disposal of shares forming part of a substantial shareholding.

Risk management and internal control

The board recognises that risk is an inherent part of running a business and that whilst it aims to maximise returns, the associated risks must be understood and managed. Overall responsibility for this process rests with the board whilst executive management is responsible for designing, implementing and maintaining the necessary systems of control.

Key to this function is the group's risk register which is reviewed formally once a year. The register is initially prepared by the executive board which, having created the list of risks, collectively assesses the severity of the risk, the likelihood of it occurring and the strength of the controls over the risk. This approach allows the effect of any mitigating procedures to be considered, recognising that risk cannot be totally eliminated and that some activities incur inherent risk. The register is then reviewed and commented upon by the audit committee before being considered and adopted by the full board.

The risk register is divided into four parts: strategic risks, corporate risks, property risks and financial risks. During this year's review, which was conducted in November 2007, no unacceptable residual risks were identified by the board. Some of the more significant risks, together with the controls that operate over that part of the business, are set out below.

Strategic risks

- That a downturn in the property sector could result in overextended development activity.

  The group carries out an annual strategic review and, each quarter, prepares a rolling forecast for the following two years. Through monitoring key ratios derived from these documents, together with various sensitivities, the board can assess the effect of the planned development programme. The group's strategy of maintaining income from properties until a development starts, allows the programme to be adapted if necessary.

- That changes to central London planning requirements will reduce the return from development schemes.

  The board is kept appraised of proposed changes by its professional advisers. This enables the company to present its case through representative bodies and, if necessary, incorporate changes into its designs at an early stage. The effect of any delays caused by changes to the requirements is mitigated by the strategy of maintaining income at the properties that are subject to planning applications.

Corporate risks

- That the group suffers either reputational damage or financial costs through failing to comply with the regulations that govern business generally and the property sector specifically.

  The group retains a team of professional advisers to identify changes to the legislative environment and advise on compliance. Health and safety is a key concern in this area and the group employs five managers to monitor compliance with its health and safety policy.

Property risks

- That projects are delayed or the outcome adversely affected by either a contractor or sub-contractor becoming insolvent.

  The accounts of the contractors used by the group are regularly reviewed. Generally the group selects contractors from a pool of contractors that are well known to it. Specific strategies are implemented to mitigate the potential effect of an insolvency where a sub-contractor is seen to present a substantial risk to the critical path of a project.

- That projects incur cost overruns due to construction cost inflation.

  The group uses various procurement routes to manage this risk and considers the use of alternative materials/sources which are subject to less inflationary pressure.

Financial risks

- That the group may breach the REIT regulations due to the nature of the legislation and the ongoing need to interpret the new requirements.

  An adviser was retained by the group specifically to advise on the REIT regulations prior to conversion and they continue to advise the group on ongoing compliance matters. The key REIT ratios are reported in the quarterly rolling forecasts to identify any potential compliance problems at an early stage to enable them to be effectively managed.

The systems that control the risks on the risk register form the group's system of internal control. The effectiveness of this system and the operation of the key components thereof have been reviewed for the accounting year and the period to the date of approval of the financial statements.

Derwent London is committed to sustainable building design and contributing to the environment in which we operate. During 2007, we co-sponsored the Global Cities exhibition at the London Tate Modern and continued to support the Teenage Cancer Trust's initiative to set up special units for teenagers in NHS hospitals.

Environment

This is the second year of environmental reporting. This section provides a summary of the group's environmental performance for 2007 and its key objectives for 2008. The full environmental report is available on the group's website.

Working towards sustainability

Derwent London has always looked for ways to promote sustainable building design. In 2002, at the Davidson Building in Covent Garden, the group was one of the first developers of a speculative London building that used under-floor air flow and exposed thermal mass cooling as a means of reducing energy use. More recently, the Johnson Building in Hatton Garden was completed, which advanced this disbursement system and also adopted a low energy lighting technique with great commercial success. Both buildings also share an inherent sustainability in their adaptive re-use of existing structures – saving on new materials by re-using rather than demolishing. At the current project with Arup in Fitzroy Street, low energy active chilled beams will be used for air conditioning and rainwater will be re-used. The design also includes a green roof, solar water heating and a raft of other energy saving measures. These will result in a building designed to exceed the current energy regulation targets.

The group's emphasis on the refurbishment and re-use of existing buildings is by definition intrinsically sustainable, and the environmental performance of any new build properties is assessed against the Building Research Establishment Environmental Assessment Method (BREEAM) for Offices. Two of the major schemes under development during 2007 – Qube and Portobello Road – are both on track to achieve BREEAM Very Good.

In addition, the group continues to utilise 100% brownfield land and regenerate predominantly inner London sites.

Environmental management

The environmental policy was reviewed and updated in 2007 to set out the company's commitment to sound environmental management practice and to ensure that it remains compliant with relevant legislation and best practice guidance. This is available publicly on the group's website and is made available to all tenants and project teams. The policy highlights the most significant environmental impacts and an internal supporting document provides guidance to staff and contractors on how to manage and reduce these impacts. A programme of internal awareness-raising seminars is planned for 2008 to reinforce company objectives.

Environmental performance

The group is able to demonstrate a number of environmental improvements in 2007, including a decrease in energy consumption at its head office and a decrease in water usage per square metre of floor area in its managed portfolio. Carbon emissions per square metre within the landlord-controlled areas of the managed portfolio have remained fairly constant.

The group's data analysis process has indicated that some of the properties, for which whole building energy data is available, are not currently performing as designed or according to typical or best practice. Whilst this is likely to relate to tenant behaviour, which is out of the group's direct control, it will continue to investigate the results and to liaise with the tenants to determine whether any positive changes can be made.

Waste continues to be recycled in the head office, and an increased number of recycling facilities are available within the managed portfolio.

Key Objectives for 2008
- Review strategic approach to sustainability.
- Continue to achieve BREEAM Very Good for new schemes and aim to achieve BREEAM Excellent.
- Maintain 100% use of brownfield sites.
- Undertake series of awareness raising seminars for staff and key suppliers.
- Launch website for tenant engagement.
- Achieve target of 100% hardwood timber to be sourced from certified sources and work towards 100% certified sources for softwood timber.
- Continue to monitor energy consumption throughout portfolio and undertake research project to identify ways of improving performance of buildings against design criteria.
- Undertake review of waste contractors used within the managed portfolio to identify how to improve the accuracy of measurement of proportion of waste recycled.
- Achieve target of $0.55m^3/m^2$ water usage per annum for offices.

Health and safety
The group's formal health and safety policy is issued to its contractors and professional advisers and is embedded in the management regime for the group's development sites. To ensure compliance with the policy, an executive is assigned to each project to monitor the performance of the main contractor who in turn monitors the subcontractors and reports back to the executive. All sites are registered with, and inspected under, the Considerate Contractor Scheme. The board receives regular reports from each site together with notification of any accidents that require reporting under the Health and Safety regulations.

The health and safety policy is reviewed at regular intervals and revised as necessary.

To ensure continued compliance with the Disability Discrimination Act, new developments are all audited by independent access consultants.

Social policy
Derwent London's social impacts arise largely through its dealings with a range of stakeholder groups, namely: employees, customers, suppliers and the communities within which the group operates. Derwent London's social commitment is firmly aligned with its strategic business priorities, representing an important element of the company's risk management strategy and offering the potential for significant value creation. This policy is governed by a senior board executive who reports to the board on social matters regularly.

Within the group's social endeavours, it is committed to legal compliance as a minimum standard, and where practicable, strives to go beyond this. The policy is implemented through appropriate targeting, measurement, monitoring and reporting procedures to deliver continuous improvements in performance across material social impact areas. Derwent London's specific social objectives related to each of its material social impact areas are listed below together with specific examples of the group's activities in these areas:

Community
- Derwent London will consult with local communities on new development projects and will work with contractors to ensure minimum disruption and nuisance is caused during construction works.
- Derwent London will contribute to community and charitable activities through both financial and in-kind resources.

The group has strong ties with a number of influential property organisations that help mould the future of the property industry. These links help it to communicate its views to a wider audience, including national bodies and the government. On a more local level, yet equally important, it is an influential board member of the New West End Company and Westminster Property Owners Association. Both of these bodies have a vision and commitment to improve the West End as a place to work, shop, visit and live. The group is also involved with a variety of organisations that have very specific local objectives including the Paddington Waterside Partnership and the Chancery Lane Association.

During the summer the group co-sponsored the ground-breaking Global Cities exhibition at the London Tate Modern. This exhibition examined the movement towards urbanisation and the changing faces of ten dynamic international cities, including London, Los Angeles, Tokyo, Mexico City and Shanghai. The sponsorship helped to further enhance the company's profile and to ignite the debate about the role and responsibilities of developers in shaping London's future.

Throughout 2007, Derwent London continued its unique and creative partnership with the Teenage Cancer Trust (TCT) – a charity designed to improve standards of care for teenagers with cancer. The group has been supporting the work of the TCT since 2001, facilitating the Trust's ongoing initiative in setting up special units for teenagers in NHS hospitals. Acting as development and design consultants, it has introduced a variety of architects to new TCT projects which are now being developed in Cardiff and Glasgow.

Customers
- Derwent London will strive towards high quality customer service through regular contact and by being receptive to their needs.
- Derwent London will ensure that its customers are safe and secure in all managed buildings by maintaining the highest health and safety standards.

Employees
- Derwent London will provide training, support and development opportunities to all staff to help them deliver company aspirations.
- Derwent London will attract and retain high calibre employees by promoting equal opportunities and ensuring a safe working environment.

Suppliers
- Derwent London will treat its suppliers fairly and with respect.
- Derwent London will ensure that its own corporate responsibility standards are also reflected in its supply chain by encouraging responsible procurement.

Directors

The directors of the company during the year and their interests in the share capital of the company, including shares over which options have been granted, either under the Executive Share Option Scheme or the Performance Share Plan, are shown below. All of these interests are held beneficially.

	Ordinary shares of 5p each		Options	
	31st December 2007	31st December 2006	**31st December 2007**	31st December 2006
R.A. Rayne (appointed 1st February 2007)	**4,349,583**	4,333,872*	**382,746**	382,746*
J.C. Ivey	**79,072**	79,072	**–**	–
J.D. Burns	**729,614**	677,333	**149,365**	172,190
S.P. Silver	**279,689**	226,439	**69,675**	88,860
C.J. Odom	**25,141**	12,650	**120,420**	134,420
N.Q. George	**14,331**	4,153	**113,770**	123,440
P.M. Williams	**16,957**	5,622	**114,770**	126,940
S.J. Neathercoat	**3,000**	1,000	**–**	–
R.A. Farnes	**6,838**	3,066	**–**	–
S.A. Corbyn	**1,000**	–	**–**	–
J. de Moller (appointed 1st February 2007)	**2,985**	2,985*	**–**	–*
D. Newell (appointed 1st February 2007)	**1,492**	1,492*	**–**	–*

*As at date of appointment.

On 2nd January 2008, Mr D.G. Silverman was appointed to the board. At this date he owned no shares but held options over 26,250 shares.

Mr Friedlos joined the board on 1st February 2007 and resigned on 18th July 2007. Throughout this period he owned no shares and held options over 20,780 shares.

There have been no changes in any of the directors' interests between the year end and 18th March 2008.

During the year, no options were exercised by directors and no new options were granted to directors under the Executive Share Option Scheme. A conditional grant of 74,650 shares was made to directors under the Performance Share Plan whilst 119,590 shares vested to the directors from an earlier award at a zero exercise price.

In accordance with the articles of association Messrs J.C. Ivey, S.P. Silver, C.J. Odom and R.A. Farnes retire by rotation and, being eligible, offer themselves for re-election. Having served on the board for more than nine years, Mr S.J. Neathercoat retires and, being eligible, offers himself for re-election. In addition, Mr D.G. Silverman, having been appointed since the last annual general meeting and being eligible, offers himself for election. Biographies of all the directors are given on page 95.

Other than as disclosed in note 46, the directors have no interest in any material contracts of the company.

Details of the appointment and replacement of directors are given in the corporate governance report on page 82.

The business review required by s234 ZZB of the Companies Act 1985 is given on pages 22 to 39. The disclosures in respect of financial instruments, as required by Schedule 7 of the Companies Act 1985, is given on pages 71 to 74.

Fixed assets
The group's freehold and leasehold investment properties were professionally revalued at 31st December 2007, resulting in a surplus of £94.4 million, before deducting the lease incentive adjustment of £4.1 million. The freehold and leasehold investment properties are included in the group balance sheet at a carrying value of £2,654.6 million.

Charitable donations
During the year, the group made charitable donations amounting to £3,000 (2006: £67,000).

Substantial shareholders
In addition to those of the directors disclosed above, the company has been notified of the following interests in the issued ordinary share capital as at 18th March 2008.

	Number of shares	Percentage of issued share capital
Cohen & Steers Inc.	10,019,925	9.95
Michael Conn	6,483,156	6.44
Trustees of the Rayne Foundation	5,548,731	5.51
Lady Jane Rayne	4,093,838	4.07
Stichting Pensioenfonds ABP	3,920,586	3.89
ISIS Asset Management	3,352,127	3.33

Creditor payment policy
It is the group's policy to agree terms of business with suppliers prior to the supply of goods or services. In the absence of any dispute, the group pays in accordance with these agreed terms. For the year ended 31st December 2007, the average payment period for trade creditors was 24 days (2006: 19 days).

Post balance sheet events
Details of post balance sheet events are given in note 42 of the accounts.

Disclosure of information to auditors
The directors who held office at the date of approval of this directors' report confirm that, so far as they are each aware, there is no relevant audit information of which the company's auditors are unaware; and each director has taken all the steps that they ought to have taken as a director to make themselves aware of any relevant audit information.

Annual general meeting
The notice of meeting contained in the circular to shareholders dated 22nd April 2008 (the Circular), which accompanies the report and accounts, includes six resolutions to be considered as special business.

Resolution 11 renews the authority under Section 80 of the Companies Act 1985 for the directors to allot shares up to an aggregate nominal amount of £1,678,386.55 representing about one third of the issued share capital (excluding treasury shares) at the date of the notice of meeting. The directors have no present intention of issuing shares except on the exercise of options under the company's share option scheme or on the vesting of shares under the performance share plan. The authority will expire at the conclusion of the next annual general meeting after the passing of the resolution.

Resolution 12 is a special resolution, proposed annually, renewing the directors' authority under Section 95 of the Companies Act 1985. The resolution empowers the directors to allot or, now that the company may hold shares as treasury shares (as further described below), sell shares for cash in connection with pre-emptive offers with modifications to the requirements set out in Section 89 of the Companies Act 1985. The resolution further empowers the directors to allot or, in the case of treasury shares, sell shares for cash, otherwise than on a pre-emptive basis, up to an aggregate nominal value of £251,758 which is equivalent to approximately 5% of the issued share capital at 14th April 2008 (being the latest practicable date prior to the publication of this document). The authority will expire at the conclusion of the next annual general meeting after the passing of the resolution.

Resolution 13 is proposed to renew the authority enabling the company to purchase its own shares. This authority enables the directors to act quickly, if, having taken account of all major factors such as the effect on earnings and net asset value per share, gearing levels and alternative investment opportunities, such purchases are considered to be in the company's and shareholders' best interest while maintaining an efficient capital structure. The special resolution gives the directors authority to purchase up to 10% of the company's ordinary shares and specifies the maximum and minimum prices at which shares may be bought.

The Companies Act 1985 now permits the company to hold any such bought-back shares in treasury, with a view to possible re-issue at a future date, as an alternative to immediately cancelling them (as had previously been required by the legislation). Accordingly, if the company purchases any of its shares pursuant to resolution 13, the company may cancel those shares or hold them in treasury. Such a decision will be made by the directors at the time of purchase on the basis of the company's and shareholders' best interest. As at the date of the notice of meeting, the company held no shares in treasury.

The total number of options to subscribe for ordinary shares outstanding at 18th March 2008 was 1,051,612, which represented 1.044% of the issued share capital (excluding treasury shares) at that date. If the company were to purchase the maximum number of ordinary shares permitted by this resolution, the options outstanding at 18th March 2008 would represent 1.160% of the issued share capital (excluding treasury shares).

Resolution 14 proposes that new articles of association are adopted by the company. The introduction of the Companies Act 2006 required a number of changes to the company's articles and the board has taken the opportunity to review the articles and make other changes so as to incorporate the effects of other legislation that has been enacted since the current version was adopted. Details of the proposed changes are set out in appendix I of the Circular.

Resolution 15 authorises the company's remuneration committee to implement changes to the group's performance share plan which was introduced in 2004. As part of a review of the overall remuneration arrangements for senior executives, and in consultation with its advisers, New Bridge Street Consultants LLP, the remuneration committee identified a number of changes that would better align the interests of the senior executives and shareholders. Details of the changes are set out in appendix II of the Circular.

Resolution 16 seeks shareholder approval for the introduction of a new share option scheme to replace the previous scheme which expired in 2007. Details of the new scheme, under which no awards would be made to directors, are set out in appendix III of the Circular. The board see share options as an important part of remuneration policy and therefore the appropriate approval is being sought at the annual general meeting.

Auditors

BDO Stoy Hayward LLP have expressed the willingness to continue in office and accordingly, a resolution to re-appoint them and to authorise the directors to determine their remuneration will be proposed at the annual general meeting. This is resolution 10 set out in the notice of meeting.

By order of the board.
T.J. Kite ACA, Secretary
18th March 2008

Qube, 90 Whitfield Street, W1
Art – David Tremlett

Group income statement

for the year ended 31st December 2007

	Note	2007 £m	2006 £m
Gross property income	7	**111.7**	51.3
Development income	7	**2.0**	11.6
Property outgoings	8	**(9.9)**	(4.9)
Net property income		**103.8**	58.0
Administrative expenses		**(19.5)**	(10.1)
Movement in valuation of cash-settled share options		**1.6**	–
Goodwill impairment		**(353.3)**	–
Total administrative expenses		**(371.2)**	(10.1)
Revaluation surplus		**90.3**	223.3
Profit on disposal of properties and investments	9	**130.8**	2.9
(Loss)/profit from operations		**(46.3)**	274.1
Finance income	10	**2.8**	0.4
Exceptional finance income	10	**1.5**	–
Total finance income	10	**4.3**	0.4
Finance costs	10	**(49.1)**	(20.4)
Exceptional finance costs	10	**(3.3)**	(18.1)
Total finance costs	10	**(52.4)**	(38.5)
Movement in fair value of derivative financial instruments		**(5.1)**	3.2
Share of results of joint ventures	11	**(0.3)**	3.6
(Loss)/profit before tax	12	**(99.8)**	242.8
Tax credit/(expense)	17	**200.7**	(60.6)
Profit for the year		**100.9**	182.2
Attributable to:			
Equity shareholders	35	**97.0**	182.2
Minority interest		**3.9**	–
Earnings per share	18	**100.55p**	340.13p
Diluted earnings per share	18	**100.11p**	337.21p

The notes on pages 48 to 81 form part of these financial statements.

Balance sheets

as at 31st December 2007

		Group		Company	
		2007	2006	**2007**	2006
	Note	**£m**	£m	**£m**	£m
Non-current assets					
Investment property	19	**2,654.6**	1,274.0	**–**	–
Property, plant and equipment	20	**1.4**	0.3	**0.4**	0.3
Investments	21	**5.1**	5.4	**957.8**	192.5
Deferred tax asset	31	**–**	–	**1.3**	2.5
Pension scheme surplus	16	**2.8**	–	**–**	–
Derivatives	28	**1.2**	0.1	**–**	0.1
Other receivables	23	**23.3**	13.7	**–**	–
		2,688.4	1,293.5	**959.5**	195.4
Current assets					
Trading properties	24	**9.4**	–	**–**	–
Trade and other receivables	25	**61.0**	39.4	**561.5**	451.9
Corporation tax asset		**–**	1.4	**–**	1.8
Cash and cash equivalents		**10.3**	–	**–**	–
		80.7	40.8	**561.5**	453.7
Non-current assets held for sale	21	**3.4**	–	**–**	–
		84.1	40.8	**561.5**	453.7
Total assets		**2,772.5**	1,334.3	**1,521.0**	649.1
Current liabilities					
Bank overdraft and loans	28	**120.6**	2.2	**80.7**	0.7
Trade and other payables	26	**48.0**	32.5	**138.8**	89.8
Corporation tax liability		**75.4**	–	**–**	–
Provisions	27	**0.5**	0.1	**0.5**	0.1
		244.5	34.8	**220.0**	90.6
Non-current liabilities					
Borrowings	28	**672.5**	347.6	**297.4**	341.0
Provisions	27	**2.8**	1.3	**0.7**	1.3
Deferred tax liability	31	**10.8**	167.2	**–**	–
		686.1	516.1	**298.1**	342.3
Total liabilities		**930.6**	550.9	**518.1**	432.9
Total net assets		**1,841.9**	783.4	**1,002.9**	216.2
Equity					
Share capital	32	**5.0**	2.6	**5.0**	2.6
Share premium	33	**157.0**	156.1	**157.0**	156.1
Other reserves	33	**914.0**	3.8	**714.3**	3.8
Retained earnings	33	**706.0**	620.9	**126.6**	53.7
Equity shareholders' funds	34	**1,782.0**	783.4	**1,002.9**	216.2
Minority interest	33	**59.9**	–	**–**	–
Total equity		**1,841.9**	783.4	**1,002.9**	216.2

The financial statements were approved by the board of directors and authorised for issue on 18th March 2008.

J.D. Burns, Director
C.J. Odom, Director

The notes on pages 48 to 81 form part of these financial statements.

Statements of recognised income and expense

for the year ended 31st December 2007

	2007 £m	2006 £m
Group		
Profit for the year	**100.9**	182.2
Deferred tax in respect of share-based payments	**–**	0.6
Actuarial gains on defined benefit pension scheme	**1.3**	–
Foreign currency translation	**(0.6)**	–
Net gains recognised directly in equity	**0.7**	0.6
Total recognised income and expense relating to the year	**101.6**	182.8
Attributable to:		
Equity shareholders	**97.7**	182.8
Minority interest	**3.9**	–
Company		
(Loss)/profit for the year	**(114.2)**	7.1
Deferred tax in respect of share-based payments	**–**	0.6
Net gains recognised directly in equity	**–**	0.6
Total recognised income and expense relating to the year	**(114.2)**	7.7

The notes on pages 48 to 81 form part of these financial statements.

Cash flow statements

for the year ended 31st December 2007

		Group		Company	
		2007	2006	**2007**	2006
	Note	**£m**	£m	**£m**	£m
Operating activities					
Cash received from tenants		**111.9**	48.7	**–**	0.2
Direct property expenses		**(10.1)**	(5.5)	**–**	–
Cash paid to and on behalf of employees		**(10.2)**	(4.5)	**(6.3)**	(4.5)
Other administrative expenses		**(8.8)**	(3.9)	**(6.9)**	(3.9)
Interest received		**2.5**	0.4	**0.2**	0.3
Interest paid		**(53.4)**	(21.9)	**(25.2)**	(21.1)
Exceptional financing costs		**(3.3)**	(17.6)	**(3.3)**	(17.6)
Tax expense paid in respect of operating activities		**(0.2)**	(1.3)	**–**	(0.8)
Net cash from/(used in) operating activities		**28.4**	(5.6)	**(41.5)**	(47.4)
Investing activities					
Acquisition of investment properties		**(140.7)**	(48.9)	**–**	–
Capital expenditure on investment properties		**(65.1)**	(18.9)	**–**	–
Disposal of investment properties		**233.2**	31.2	**–**	–
Capital expenditure on assets under construction		**(3.2)**	–	**–**	–
Disposal of assets under construction		**110.1**	–	**–**	–
Acquisition of subsidiaries (net of cash acquired)	22	**(38.4)**	(6.6)	**(52.2)**	(6.6)
Payment of subsidiaries' pre-acquisition expenses		**(16.0)**	–	**–**	–
Purchase of property, plant and equipment		**(0.2)**	(0.2)	**(0.2)**	(0.1)
Disposal of property, plant and equipment		**0.3**	–	**–**	–
Disposal of investments		**9.1**	–	**–**	–
Distributions received from joint ventures		**5.7**	–	**–**	–
Payments in relation to joint ventures		**(0.3)**	–	**–**	–
Advances to minority interest holder		**(14.3)**	–	**–**	–
Tax expense paid in respect of investing activities		**(11.0)**	(2.9)	**(10.2)**	–
Net cash from/(used in) investing activities		**69.2**	(46.3)	**(62.6)**	(6.7)
Financing activities					
Movement in intercompany loans		**–**	–	**80.7**	5.8
Movement in bank loans		**(83.3)**	78.5	**36.5**	79.0
Movement in loan notes		**32.0**	–	**–**	–
Redemption of debenture		**(26.6)**	(35.0)	**–**	(35.0)
Net proceeds of share issues	32	**0.1**	1.0	**0.1**	1.0
Dividends paid	36	**(13.2)**	(7.5)	**(13.2)**	(7.5)
Net cash (used in)/from financing activities		**(91.0)**	37.0	**104.1**	43.3
Increase/(decrease) in cash and cash equivalents in the year		**6.6**	(14.9)	**–**	(10.8)
Cash and cash equivalents at the beginning of the year		**(2.2)**	12.7	**(0.7)**	10.1
Cash and cash equivalents at the end of the year	39	**4.4**	(2.2)	**(0.7)**	(0.7)

The notes on pages 48 to 81 form part of these financial statements.

1 Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Accounting Standards Board as adopted by the European Union and with those parts of the Companies Act 1985 applicable to companies preparing their accounts under IFRS.

The principal accounting policies are described in note 2 below. The accounting policies are consistent with those applied in the year ended 31st December 2006 as amended to reflect the adoption of the following new standards, amendments and interpretations which are mandatory for the year ended 31st December 2007.

IFRS 7/ IAS 1	IFRS 7 Financial Instruments: Disclosures and a Complementary Amendment to IAS 1 Presentation of Financial Statements – Capital Disclosures (effective from 1st January 2007)
IFRIC 7	Applying the restatement approach under IAS 29 Financial Reporting in Hyperinflationary Economies (effective from 1st March 2006)
IFRIC 8	Scope of IFRS 2 (effective from 1st May 2006)
IFRIC 9	Reassessment of embedded derivatives (effective from 1st June 2006)
IFRIC 10	Interim Financial Reporting and Impairment (effective from 1st November 2006)

IFRS 7 introduces new disclosures of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk. The amendment to IAS 1 introduces disclosures about the level of an entity's capital.

The majority of these disclosures are shown in note 4 and risk is additionally discussed in the directors' report on page 35.

At the date of authorisation of these financial statements, the following standards and interpretations applicable to the group's financial statements which have not been applied in these financial statements were in issue but not yet effective. All are deemed not relevant to the group or to have no material impact on the financial statements of the group when the relevant standards come into effect except IAS 23, which is discussed below.

IFRS 2	Share-based Payment: Vesting Conditions and Cancellations (effective from 1st January 2009)
IFRS 3	Business Combinations (revised) (effective from 1st July 2009)
IFRS 8	Operating Segments (effective from 1st January 2009)
IAS 1	Amendments to Presentation of Financial Statements (effective from 1st January 2009)
IAS 1	Amendments to Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation (effective from 1st January 2009)
IAS 23	Amendments to Borrowing Costs (effective from 1st January 2009)
IAS 27	Amendments to Consolidated and Separate Financial Statements (effective from 1st July 2009)
IAS 32	Amendments to Financial Instruments: Presentation (effective from 1st January 2009)
IFRIC 11	IFRS 2 Group and Treasury Share Transactions (effective from 1st March 2007)
IFRIC 12	Service Concession Arrangements (effective from 1st January 2008)
IFRIC 13	Customer Loyalty Programmes (effective from 1st July 2008)
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction (effective from 1st January 2008)

UK companies can only adopt IFRSs and IFRICs after they have been endorsed by the European Union. Of the standards and interpretations listed above, the following had not yet been endorsed by the European Union at the date these accounts were signed:

IFRS 2	Share-based Payment: Vesting Conditions and Cancellations
IFRS 3	Business Combinations (revised)
IAS 1	Amendments to Presentation of Financial Statements
IAS 1	Amendments to Presentation of Financial Statements – Puttable Financial Instruments and Obligations Arising on Liquidation
IAS 23	Amendments to Borrowing Costs
IAS 27	Amendments to Consolidated and Separate Financial Statements
IAS 32	Amendments to Financial Instruments: Presentation
IFRIC 12	Service Concession Arrangements
IFRIC 13	Customer Loyalty Programmes
IFRIC 14	IAS 19 – The Limit on a Defined Benefit Asset Minimum Funding Requirements and their Interaction

1 Basis of preparation (continued)

IAS 23 requires an entity to capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. In the situation, such is the case with Derwent London, when the financing activity is co-ordinated centrally the weighted average interest rate is used to allocate interest to the qualifying asset. This will be applicable to the group in relation to capital expenditure and property acquisitions. If this standard had been in effect for 2007 then the interest cost recognised in the group income statement would have been reduced by £5.0m and consequently recurring profit for the year would have been increased by the same amount. This amount would have been capitalised and the revaluation surplus would have been reduced by the same amount leaving net asset value and IFRS profit for the year unchanged.

Critical accounting estimates and judgements

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates and judgements. It also requires management to exercise judgement in the process of applying the group's accounting policies. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Although these estimates are based on management's best knowledge of the amount, event or actions, actual results may differ from those estimates.

2 Significant accounting policies

Basis of consolidation

The group financial statements incorporate the financial statements of Derwent London plc and all of its subsidiaries, together with the group's share of the results of its joint ventures.

Subsidiary undertakings are those entities controlled by the company. Control exists when the company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences and until the date control ceases.

Joint ventures are those entities over whose activities the group has joint control, established by contractual agreement. Interests in joint ventures are accounted for using the equity method of accounting as permitted by IAS 31, Interests in Joint Ventures and following the procedures for this method set out in IAS 28, Investments in Associates. The equity method requires the group's share of the joint venture's post-tax profit or loss for the period to be presented separately in the income statement and the group's share of the joint venture's net assets to be presented separately in the balance sheet.

Intra-group balances and any unrealised gains and losses arising from intra-group transactions are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with joint ventures are eliminated to the extent of the group's interest in the joint venture concerned. Unrealised losses are eliminated in the same way, but only to the extent that there is no evidence of impairment.

Gross property income

Gross property income arises from two main sources:

(i) Rental income – Rental income arises from operating leases granted to tenants. An operating lease is a lease other than a finance lease. A finance lease is one whereby substantially all the risks and rewards of ownership are passed to the lessee.

Rental income is recognised in the group income statement on a straight-line basis over the term of the lease. This includes the effect of lease incentives to tenants, which are normally in the form of rent free periods or capital contributions in lieu of rent free periods and the effect of payments received from tenants on the grant of leases.

For income from property leased out under a finance lease, a lease receivable asset is recognised in the balance sheet at an amount equal to the net investment in the lease, as defined in IAS 17, Leases. Minimum lease payments receivable, again defined in IAS 17, are apportioned between finance income and the reduction of the outstanding lease receivable so as to produce a constant periodic rate of return on the remaining net investment in the lease. Contingent rents, being the difference between the rent currently receivable and the minimum lease payments when the net investment in the lease was originally calculated, are recognised in property income in the years in which they are receivable.

(ii) Surrender premiums – Payments received from tenants to surrender their lease obligations are recognised immediately in the group income statement.

Development income

Development income is recognised in accordance with IAS 18, Revenue, and is based on the directors' assessment of the stage of completion of the project, the future costs and the expected value of the completed building.

2 Significant accounting policies (continued)

Expenses

(i) Lease payments – Where investment properties are held under operating leases, the leasehold interest is classified as if it were held under a finance lease, which is recognised at its fair value on the balance sheet, within the investment property carrying value. Upon initial recognition, a corresponding liability is included as a finance lease liability. Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability so as to produce a constant periodic rate of interest on the remaining finance lease liability. Contingent rents payable, being the difference between the rent currently payable and the minimum lease payments when the lease liability was originally calculated, are charged as expenses within property expenditure in the years in which they are payable.

(ii) Dilapidations – Dilapidations monies received from tenants in respect of their lease obligations are recognised immediately in the group income statement.

(iii) Other property expenditure – Vacant property costs and other property costs are expensed in the year to which they relate.

Employee benefits

(i) Share-based remuneration

(a) Equity-settled – The company operates a long-term incentive plan and share option scheme. The fair value of the conditional awards of shares granted under the long-term incentive plan and the options granted under the share option scheme are determined at the date of grant. This fair value is then expensed on a straight-line basis over the vesting period, based on an estimate of the number of shares that will eventually vest. At each reporting date, the non-market based performance criteria of the long-term incentive plan are reconsidered and the expense is revised as necessary. In respect of the share option scheme, the fair value of options granted is calculated using a binomial model.

Under the transitional provisions of IFRS 1, no expense is recognised for options or conditional shares granted on or before 7th November 2002.

(b) Cash-settled – For cash-settled share-based payments, a liability is recognised based on the current fair value determined at each balance sheet date. The movement in the current fair value is taken to the group income statement.

Pensions

(i) Defined contribution plans – Obligations for contributions to defined contribution pension plans are recognised as an expense in the group income statement in the period to which they relate.

(ii) Defined benefit plans – The group's net obligation in respect of defined benefit post-employment plans, including pension plans, is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on AA credit rated bonds that have maturity dates approximating the terms of the group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. Any actuarial gain or loss in the period is recognised in full in the statement of recognised income and expense.

Business combinations

Business combinations are accounted for under the acquisition method. Any excess of the purchase price of business combinations over the fair value of the assets, liabilities and contingent liabilities acquired and resulting deferred tax thereon is recognised as goodwill. Any discount is credited to the group income statement in the period of acquisition. Goodwill is recognised as an asset and reviewed for impairment. Any impairment is recognised immediately in the group income statement and is not subsequently reversed. Any residual goodwill is reviewed annually for impairment.

Investment properties

(i) Valuation – Investment properties are those that are held either to earn rental income or for capital appreciation or both, including those that are undergoing redevelopment. Investment properties are measured initially at cost, including related transaction costs. After initial recognition, they are carried on the group balance sheet at fair value adjusted for the carrying value of leasehold interests and lease incentive debtors. Fair value is the amount for which an investment property could be exchanged between knowledgeable and willing parties in an arm's length transaction. The valuation is undertaken by independent valuers who hold recognised and relevant professional qualifications and have recent experience in the locations and categories of properties being valued.

Surpluses or deficits resulting from changes in the fair value of investment property are reported in the group income statement in the year in which they arise.

2 Significant accounting policies (continued)

Investment properties (continued)

(ii) Capital expenditure – Capital expenditure, being costs directly attributable to the redevelopment or refurbishment of an investment property, up to the point of it being completed for its intended use, are capitalised in the carrying value of that property. Borrowing costs that are directly attributable to such expenditure are expensed in the year in which they arise.

(iii) Disposal – The disposal of investment properties is accounted for on completion of contract. On disposal, any gain or loss is calculated as the difference between the net disposal proceeds and the carrying value at the last year end plus subsequent capitalised expenditure during the year.

(iv) Development – When the group begins to redevelop an existing investment property for continued use as an investment property, the property remains an investment property and is accounted for as such. When the group begins to redevelop an existing investment property with a view to sale, the property is transferred to trading properties and held as a current asset. The property is re-measured to fair value as at the date of transfer with any gain or loss being taken to the income statement. The re-measured amount becomes the deemed cost at which the property is then carried in trading properties.

Property, plant and equipment

(i) Assets under construction – Property assets acquired with the intention of subsequent development as investment properties are included as 'Assets under construction' within property, plant and equipment, until the construction or development is completed, at which time they are reclassified as investment properties. Assets under construction are included in the balance sheet at fair value, determined by an independent valuer on the same basis as used for investment properties. If the fair value increases, this increase is credited directly to the revaluation reserve, except to the extent that it reverses a revaluation decrease of the same asset which previously had been charged to the group income statement. If the fair value decreases, this decrease is recognised in the group income statement, except to the extent that it reverses previous revaluation increases of the same asset which have been credited to the revaluation reserve, in which case it is charged against the revaluation reserve.

(ii) Other – Other property, plant and equipment, is depreciated at a rate of between 10% and 25% per annum which is calculated to write off the cost, less estimated residual value of the individual assets, over their expected useful lives.

Investments

Investments in joint ventures, being those entities over whose activities the group has joint control, as established by contractual agreement, are included in the group's balance sheet at cost together with the group's share of post acquisition reserves, on a net equity basis. Investments in subsidiaries and joint ventures are included in the company's balance sheet at the lower of cost and their net asset value. Any impairment is recognised immediately in the company income statement.

Non-current assets held for sale

Non-current assets are classified as held for sale if their carrying value will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met if the sale is highly probable, the asset is available for immediate sale in its present condition, being actively marketed and management is committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Non-current assets, including related liabilities, classified as held for sale are measured at the lower of carrying value and fair value less costs of disposal.

Trading property

Trading property includes those properties which were acquired exclusively with a view to resale or development and resale and are held at the lower of cost or transfer value and net realisable value.

Financial assets

(i) Cash and cash equivalents – Cash comprises cash in hand and on-demand deposits less overdrafts. Cash equivalents comprise short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

(ii) Trade receivables – Trade receivables are recognised and carried at the original transaction value. A provision for impairment is established where there is objective evidence that the group will not be able to collect all amounts due according to the original terms of the receivables concerned.

2 Significant accounting policies (continued)

Financial liabilities

(i) Bank loans and overdrafts – Bank loans and overdrafts are included as financial liabilities on the balance sheets at the amounts drawn on the particular facilities. Interest payable is expensed as a finance cost in the year to which it relates.

(ii) Debenture loan and bonds – The debenture loan is included as a financial liability on the balance sheet net of the unamortised discount and costs on issue. The difference between this carrying value and the redemption value is recognised in the group income statement over the life of the debenture on an effective interest basis. Interest payable to debenture holders is expensed in the year to which it relates.

On redemption, all remaining unamortised discount and costs on issue are recognised together with the premium and the costs of redemption in finance costs in the group income statement as an exceptional item in accordance with the accounting policy below.

(iii) Finance lease liabilities – Finance lease liabilities arise for those investment properties held under a leasehold interest and accounted for as investment property. The liability is initially calculated as the present value of the minimum lease payments, reducing in subsequent years by the apportionment of payments to the lessor, as described above under the heading for lease payments.

(iv) Interest rate derivatives – The group uses derivative financial instruments to manage the interest rate risk associated with the financing of the group's business. No trading in financial instruments is undertaken.

At each reporting date, these interest rate derivatives are measured at fair value, being the estimated amount that the group would receive or pay to terminate the agreement at the balance sheet date, taking into account current interest rates and the current credit rating of the counterparties. The gain or loss at each fair value remeasurement is recognised in the group income statement.

(v) Trade payables – Trade payables are recognised and carried at the original transaction value.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the tax computations, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. In respect of the deferred tax on the revaluation surplus, this is calculated on the basis of the chargeable gains that would crystallise on the sale of the investment portfolio as at the reporting date. The calculation takes account of available indexation on the historic cost of the properties and any available capital losses.

Deferred tax is calculated at the tax rates that are expected to apply in the period, based on Acts substantially enacted at the year end, when the liability is settled or the asset is realised. Deferred tax is charged or credited in the group income statement, except when it relates to items charged or credited directly to equity, in which case it is also dealt with in equity.

Dividends

Dividends payable on the ordinary share capital are recognised in the year in which they are declared.

Exceptional items

Exceptional items are material items which derive from events or transactions that fall within the ordinary activities of the group and which, individually or, if a similar type, in aggregate, need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.

3 Significant judgments, key assumptions and estimates

The group's significant accounting policies are stated in note 2 above. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. The following is intended to provide an understanding of the policies that management consider critical because of the level of complexity, judgment or estimation involved in their application and their impact on the consolidated financial statements. These judgments involve assumptions or estimates in respect of future events. Actual results may differ from these estimates.

Trading properties

Trading properties are carried at the lower of cost and net realisable value. The latter is assessed by the group having regards to suitable external advice and knowledge of recent comparable transactions.

Trade receivables

The group is required to judge when there is sufficient objective evidence to require the impairment of individual trade receivables. It does this on the basis of the age of the relevant receivables, external evidence of the credit status of the debtor entity and the status of any disputed amounts.

Exceptional items

Exceptional items are defined as those items which are sufficiently material by either their size or nature as to require separate disclosure. Deciding which items meet this definition requires the group to exercise its judgment.

Investment property valuation

The group uses the valuation performed by its independent valuers as the fair value of its investment properties. The valuation is based upon assumptions including future rental income, anticipated maintenance costs, future development costs and the appropriate discount rate. The valuers also make reference to market evidence of transaction prices for similar properties.

Unagreed rent reviews

Where the rent review date has passed, and the revised annual rent had not been agreed, rent is accrued from the date of the rent review based upon an estimate annual rent. The estimate is derived from knowledge of market rents for comparable properties.

Compliance with the real estate investment trust taxation regime

On 1st July 2007 the group converted to a REIT. In order to achieve and retain REIT status, several entrance tests had to be met and certain ongoing criteria must be maintained. The main criteria are as follows:

– At the start of each accounting period, the assets of the tax exempt business must be at least 75% of the total value of the group's assets.
– At least 75% of the group's total profits must arise from the tax exempt business.
– At least 90% of the profit of the property rental business must be distributed.

The directors intend that the group should continue as a REIT for the foreseeable future, with the result that deferred tax is no longer recognised on temporary differences relating to the property rental business which is within the REIT structure.

4 Financial instruments – risk management

The group is exposed through its operations to the following financial risks:

– credit risk;
– fair value or cash flow interest rate risk; and
– liquidity risk.

In common with all other businesses, the group is exposed to risks that arise from its use of financial instruments. This note describes the group's objectives, policies and processes for managing those risks and the methods used to measure them. Further quantitative information in respect of these risks is presented throughout these financial statements.

There have been no substantive changes in the group's exposure to financial instrument risks, its objectives, policies and processes for managing those risks or the methods used to measure them from previous periods.

The company has the same risk profile as the group (except tenant credit risk which does not exist in the company) and therefore no separate discussion has been made of the company.

4 Financial instruments – risk management (continued)

Principal financial instruments

The principal financial instruments used by the group, from which financial instrument risk arises, are as follows:

– Trade receivables
– Cash at bank
– Bank overdrafts
– Trade and other payables
– Floating rate bank loans
– Fixed rate bank loans
– Secured bonds
– Interest rate swaps
– Internal rate caps

General objectives, policies and processes

The board has overall responsibility for the determination of the group's risk management objectives and policies and, whilst retaining ultimate responsibility for them, it has delegated the authority for designing and operating processes that ensure the effective implementation of the objectives and policies to executive management.

The overall objective of the board is to set policies that seek to reduce risk as far as possible without unduly affecting the group's flexibility and its ability to maximise returns. Further details regarding these policies are set out below:

Credit risk

Credit risk is the risk of financial loss to the group if a customer or counterparty to a financial instrument fails to meet its contractual obligations. The group is mainly exposed to credit risk from its lease contracts. It is group policy to assess the credit risk of new tenants before entering contracts.

The board has established a credit committee which assesses each new tenant before a new lease is signed. The review includes the latest sets of financial statements, external ratings, when available, and in some cases forecast information and bank and trade references. The covenant strength of each tenant is determined based on this review and if appropriate a deposit or alternatively a guarantee is obtained.

Credit risk also arises from cash and cash equivalents and deposits with banks and financial institutions. For banks and financial institutions only independently rated parties with minimum rating of investment grade are accepted. This risk is reduced by the short periods that money is on deposit at any one time.

The group does not enter into derivatives to manage credit risk.

Quantitative discloses of the credit risk exposure in relation to trade and other receivables which are neither past due nor impaired, are disclosed in note 25.

Market risk

Market risk arises from the group's use of interest bearing instruments. It is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in interest rates (interest rate risk).

Fair value and cash flow interest rate risk

The group is exposed to cash flow interest rate risk from borrowings at variable rate. It is currently group policy that between 40% and 75% of external group borrowings (excluding finance lease payables) are fixed rate borrowings. Where the group wishes to vary the amount of external fixed rate debt it holds (subject to it being at least 40% and no more than 75% of expected group borrowings, as noted above), the group makes use of interest rate derivatives to achieve the desired interest rate profile. Although the board accepts that this policy neither protects the group entirely from the risk of paying rates in excess of current market rates nor eliminates fully cash flow risk associated with variability in interest payments, it considers that it achieves an appropriate balance of exposure to these risks.

During both 2007 and 2006, the group's borrowings at variable rate were denominated in sterling.

The group monitors the interest rate exposure on a regular basis. A sensitivity analysis is performed to ascertain the impact on profit or loss and net assets of a 100 basis point shift (being the maximum reasonable expectation of changes in interest rates) would be an increase of £2.9m (2006: £1.9m) or a decrease of £3.0m (2006: £2.0m).

The group manages its cash flow interest rate risk by using floating-to-fixed interest rate swaps (quantitative disclosures are given in note 28). Predominantly, the group raises long-term borrowings at floating rates and swaps them into fixed.

Liquidity risk

Liquidity risk arises from the group's management of working capital and the finance charges and principal repayments on its debt instruments. It is the risk that the group will encounter difficulty in meeting its financial obligations as they fall due.

The group's policy is to ensure that it will always have sufficient headroom in its loan facilities to allow it to meet its liabilities when they become due. To achieve this aim, it seeks to maintain committed facilities to meet the expected requirements. The group also seeks to reduce liquidity risk by fixing interest rates (and hence cash flows) on a portion of its long-term borrowings, this is further discussed in the 'Interest rate risk' section above.

The executive management receives rolling three-month cash flow projections on a monthly basis and three-year projections of loan balances on a quarterly basis as part of the group's forecasting processes. At the balance sheet date, these projections indicated that the group expected to have sufficient liquid resources to meet its obligations under all reasonably expected circumstances.

4 Financial instruments – risk management (continued)

Liquidity risk (continued)

The liquidity risk of the group is managed centrally by the finance department.

Capital disclosures

The group's capital comprises all components of equity (share capital, share premium, other reserves, retained earnings and minority interest).

The group's objectives when maintaining capital are:

- to safeguard the entity's ability to continue as a going concern, so that it can continue to provide returns for shareholders; and
- to provide an above average annualised total return to shareholders.

The group sets the amount of capital it requires in proportion to risk. The group manages its capital structure and makes adjustments to it in the light of changes in economic conditions and the risk characteristics of the underlying assets. In order to maintain or adjust the capital structure, the group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, or sell assets to reduce debt.

Consistent with others in its industry, the group monitors capital on the basis of balance sheet gearing and property gearing. Balance sheet gearing is calculated as net debt divided by net assets and property gearing is drawn facilities divided by the fair value of investment properties. Net debt is calculated as total debt (as shown in the balance sheet) less cash and cash equivalents.

During 2007, the group's strategy, which was unchanged from 2006, was to maintain the balance sheet gearing below 80% in normal circumstances. The balance sheet gearing at 31st December 2007 and at 31st December 2006 were as follows:

	2007 £m	2006 £m
Total debt	**793.1**	349.8
Less: cash and cash equivalents	**(10.3)**	–
Net debt	**782.8**	349.8
Net assets	**1,841.9**	783.4
Balance sheet gearing	**42.5%**	44.7%

The decrease in the balance sheet gearing during 2007 resulted primarily from the cash generated by the property and investment disposal programme undertaken in the second half of 2007.

The property gearing at 31st December 2007 and 31st December 2006 were as follows:

	2007 £m	2006 £m
Net debt	**782.8**	349.8
Fair value adjustment to secured bond	**(19.9)**	–
Leasehold liabilities	**(9.0)**	(6.6)
Drawn facilities	**753.9**	343.2
Fair value of investment property	**2,671.7**	1,282.7
Property gearing	**28.2%**	26.8%

5 Segmental information

During the year, the group had only one (2006: one) business activity, that being property investment, refurbishment and redevelopment. It operates only in the United Kingdom and the directors consider that all properties carry a similar risk profile.

6 Significant lease terms

The group has over 1,000 leases granted to its tenants. These vary dependent on the individual tenant and the respective property and demise but typically are let for a term of five to 15 years, at a market rent with provisions to review to market rent every five years. Standard lease provisions include service charge payments and recovery of other direct costs.

Of the leases granted during 2007, the weighted average lease length was 11.0 years (2006: 12.1 years). 46% of these leases (2006: 44%) included a rent free period at the start of the lease, the weighted average being 7.3 months (2006: 7.8 months).

7 Income

Gross property income includes surrender premiums received from tenants during 2007 of £5.7m (2006: £1.0m).

The development income of £2.0m (2006: £11.6m) is the proportion of the total profit share estimated to have been earned by the group from the construction and letting of a property on behalf of a third party.

8 Property outgoings

	2007 £m	2006 £m
Ground rents	**0.4**	0.4
Other property costs	**9.5**	4.5
	9.9	4.9

Property outgoings include £1.4m (2006: £nil) of costs relating to properties which produced no property income during the year.

9 Profit on disposal of properties and investments

	2007 £m	2006 £m
Investment property		
Disposal proceeds	**233.6**	31.2
Carrying value	**(157.4)**	(30.7)
Leasehold liabilities	**–**	2.4
	76.2	2.9
Assets under construction		
Disposal proceeds	**109.9**	–
Carrying value	**(56.3)**	–
	53.6	–
Investments		
Disposal proceeds	**9.1**	–
Carrying value	**(8.1)**	–
	1.0	–
Total		
Disposal proceeds	**352.6**	31.2
Carrying value	**(221.8)**	(30.7)
Leasehold liabilities	**–**	2.4
	130.8	2.9

The profit of £130.8m (2006: £2.9m) contains £112.6m (2006: £nil) which relates to properties acquired as part of the acquisition of London Merchant Securities (see note 22). A description of these profits is discussed in the business review on page 31.

10 Finance income and costs

	2007 £m	2006 £m
Finance income		
Interest on development funding	1.1	–
Return on pension plan assets	0.6	–
Foreign exchange gain	0.4	–
Bank interest received	0.1	0.4
Other	0.6	–
	2.8	0.4
Exceptional finance income		
Profit on redemption of debentures	1.5	–
Total finance income	4.3	0.4
Finance costs		
Bank loans and overdraft wholly repayable within five years	27.0	12.7
Bank loans not wholly repayable within five years	9.4	3.7
Loan notes	1.5	–
Secured bond and debenture	9.9	3.1
Mortgages	0.1	–
Finance leases	0.6	0.9
Pension interest costs	0.5	–
Other	0.1	–
	49.1	20.4
Exceptional finance costs		
Cost of unused acquisition facility	3.3	–
Loss on redemption of debentures	–	18.1
	3.3	18.1
Total finance costs	52.4	38.5

The exceptional profit of £1.5m arose following the payment of a £6.6m premium on the redemption of a debenture. The debenture was fair valued at £8.1m on the acquisition of London Merchant Securities plc. The year to 31st December 2007 also contained exceptional finance costs of £3.3m which is the cost of acquisition finance. In 2006, exceptional finance costs arose from the redemption of the 10⅛% First Mortgage Debenture Stock 2019.

11 Share of results of joint ventures

	2007 £m	2006 £m
Loss from disposals of investment properties	(0.7)	–
Revaluation surplus	–	3.5
Other profit from operations after tax	0.4	0.1
	(0.3)	3.6

12 (Loss)/profit before tax

	2007 £m	2006 £m
This is arrived at after charging:		
Depreciation and amortisation	0.2	0.1
Rent payable under property leases	0.4	0.4
Auditor's remuneration		
Audit – group	0.2	0.1
Audit – subsidiaries	0.1	–
Tax compliance services	0.2	0.1

In addition, auditor's remuneration included £nil (2006: £0.5m) for corporate finance services which was capitalised in the balance sheet.

13 Directors' emoluments

	2007 £m	2006 £m
Remuneration for management services	3.1	2.8
Adjustment in respect of prior years' incentive schemes	0.1	–
Non-executive directors' remuneration	0.4	0.2
Gain on exercise of share options	1.7	1.7
Pension contributions	0.4	0.4
	5.7	5.1

Included within the figures shown in note 14 below are amounts recognised in the group income statement in accordance with IFRS 2, Share-based payment relating to the directors. These are an expense of £0.9m (2006: £0.7m) and a credit of £1.6m (2006: £nil) relating to equity-settled and cash-settled share options respectively.

Details of the directors' remuneration, awards under the long-term incentive plan and options held by the directors under the group share option schemes are given in the report on directors' remuneration on pages 86 to 94. The only key management personnel are the directors. An amount of £0.5m was paid during the year to a director as a compensation payment under the terms of his original contract with LMS, and was accrued in the fair value acquisition balance sheet (see note 22). This is discussed further in the directors' remuneration report on page 88.

14 Employees

	Group		Company	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Staff costs, including those of directors:				
Wages and salaries	**7.2**	4.4	**5.9**	4.4
Social security costs	**1.1**	1.0	**0.8**	1.0
Pension costs	**0.9**	0.6	**0.7**	0.6
Share-based payments expense relating to equity-settled schemes	**1.1**	0.9	**1.1**	0.9
Share-based payments credit relating to cash-settled schemes	**(1.6)**	–	**–**	–
	8.7	6.9	**8.5**	6.9

The average number of employees in the group during the year, excluding directors, was 56 (2006: 23). The average number of employees in the company during the year, excluding directors, was 38 (2006: 23). All were employed in administrative roles.

15 Share-based payments

Details of the options held by directors and employees under the group's share option schemes are given in the report on directors' remuneration on pages 86 to 94.

Equity-settled option scheme

The following information is relevant in the determination of the fair value of options granted during the year under the equity-settled option scheme operated by the group. No options were granted during 2007.

	2007	2006
Option pricing model used	**–**	Binomial lattice
Share price at date of grant	**–**	£15.120
Exercise price	**–**	£15.120
Number granted	**–**	14,250
Contractual life	**–**	10 years
Risk free interest rate	**–**	4.8%
Volatility	**–**	20%
Dividend yield	**–**	0.9%

For the 2006 grant, additional assumptions have been made that there is no employee turnover before vesting and 4% after vesting, and 50% of employees exercise early when the share options are 20% in the money.

The volatility assumption, measured at the standard deviation of expected share price returns, is based on a statistical analysis of daily prices over the last five years.

Cash-settled option scheme

All options relating to the cash-settled option scheme arose as a result of the acquisition of London Merchant Securities (see note 22).

A binomial lattice pricing model was used to value the cash-settled options. The closing share price at 31st December 2007 of £14.14 and a dividend yield of 3% were used together with risk free interest rates of between 4.4% and 4.8% depending on the term of the options.

Due to the small number of individuals who have been granted these options, an assumption of zero employee turnover has been made. Additionally, volatilities of 37% p.a., 27% p.a. and 25% p.a. respectively have been used for options with lives of one year, three years and five years (and over).

In general, the value of an option is affected by how quickly employees are assumed to exercise their awards after vesting. In this case, however, given the other assumptions, the share price at the 31st December 2007, and the fact that the expected lives of the options are relatively short, the fair values are not sensitive to this assumption. It has been assumed that employees try to maximise their returns and therefore do not exercise their options immediately, but tend to exercise their options later at the financially optimal date.

16 Pension costs

The group operates a defined contribution scheme and a defined benefit scheme. The latter was acquired as part of the acquisition of LMS and is closed to new members. All new employees will join the defined contribution scheme. The assets of the pension schemes are held separately from those of the group companies.

Defined benefit plan

The defined benefit scheme, which is contributory for members, provides benefits based on final pensionable salary and contributions are invested in a Managed Fund Policy with Sun Alliance and London Insurance Company Limited plus annuity policies held in the name of the Trustees.

The pension charge for the defined benefit scheme is assessed in accordance with the advice of a qualified actuary. The most important assumptions made in connection with the establishment of this charge were that the return on the fund will be 7.3% per annum and that salaries with be increased at 4.7% per annum. The market value of assets of the scheme at 31st December 2007 was £11.6m and the actuarial value of those assets on an ongoing basis represented 132% of the benefit of £8.8m that had accrued to members allowing for expected future increases in earnings. The pension surplus is £2.8m (2006: £nil).

Defined benefit obligations

	2007 £m	2006 £m
Present value of funded obligations	(8.8)	–
Fair value of plan assets	11.6	–
Recognised surplus for defined benefit obligations	2.8	–

Movements in present value of the defined benefit obligations recognised in the balance sheet

	2007 £m	2006 £m
Net surplus for defined benefit obligation at 1st January	–	–
Arising on acquisition of subsidiary	1.4	–
Contributions by employer	0.1	–
Actuarial gains recognised in reserves	1.3	–
Net surplus for defined benefit obligations at 31st December	2.8	–

Expense recognised in the income statement

	2007 £m	2006 £m
Current service costs	(0.1)	–
Interest on obligation	(0.5)	–
Expected return on plan assets	0.6	–
	–	–

The expense is recognised in the following line items in the income statement.

	2007 £m	2006 £m
Administrative expenses	(0.1)	–
Other finance costs	(0.5)	–
Finance income	0.6	–
	–	–

The group does not expect to contribute to its defined benefit plan in the next financial year.

16 Pension costs (continued)
Change in the fair value of plan assets

	2007 £m	2006 £m
At 1st January	–	–
Arising on acquisition of subsidiary	10.8	–
Expected return	0.6	–
Total contributions	0.1	–
Benefits paid	(0.1)	–
Actuarial gains and losses	0.2	–
At 31st December	11.6	–

The actual return on the plan assets for the year was £0.8m (2006: £nil).

Changes in the present value of defined benefit obligations

	2007 £m	2006 £m
At 1st January	–	–
Arising on acquisition of subsidiary	9.4	–
Service cost	0.1	–
Interest cost	0.5	–
Member contributions	–	–
Benefits	(0.1)	–
Actuarial gains	(1.1)	–
At 31st December	8.8	–

Experience gains and losses

	2007 £m	2006 £m
Experience gains on plan assets	0.2	–
Experience gains on plan liabilities	(1.1)	–

Analysis of plan assets

	2007 £m	2006 £m
Equities	9.7	–
Bonds	0.8	–
Property	0.1	–
Cash	1.0	–
Total	11.6	–

Principal actuarial assumptions

	2007 % per annum	2006 % per annum
Discount rate at 31st December	5.9	–
Expected return on plan assets at 31st December	7.3	–
Future salary increases	4.7	–
Inflation	3.2	–
Future pension increases	5.0	–

Defined contribution plan
The group operates a defined contribution pension plan. The total expense relating to this plan in the current year was £0.7m (2006: £0.6m).

17 Tax (credit)/expense

	2007 £m	2006 £m
Corporation tax expense		
UK corporation tax and income tax on profit for the year	**33.5**	0.7
REIT conversion charge	**53.6**	–
Adjustment for under/(over) provision in prior years	**0.3**	(1.0)
	87.4	(0.3)
Deferred tax expense		
Origination and reversal of temporary differences	**(287.4)**	60.6
Change in tax rates	**(0.7)**	–
Adjustment for under provision in prior years	**–**	0.3
	(288.1)	60.9
	(200.7)	60.6

The tax charge for both 2007 and 2006 is lower than the standard rate of corporation tax in the UK. The differences are explained below:

	2007 £m	2006 £m
(Loss)/profit before tax	**(99.8)**	242.8
Expected tax (credit)/expense based on the standard rate of corporation tax		
in the UK of 30% (2006: 30%)	**(29.9)**	72.8
Indexation relief on investment properties	**–**	(11.1)
Difference between tax and accounting profit on disposals	**(9.4)**	0.2
Goodwill impairment	**106.0**	–
REIT conversion charge	**53.6**	–
Revaluation gain attributable to REIT properties	**(24.1)**	–
Deferred tax released as a result of REIT conversion	**(288.7)**	–
Other differences	**(8.5)**	(0.6)
Tax (credit)/expense on current year's profit	**(201.0)**	61.3
Adjustments in respect of prior years' tax	**0.3**	(0.7)
	(200.7)	60.6
Tax credited directly to reserves		
Deferred tax on share-based payments	–	(0.6)

18 Earnings per share

	Profit for the year £m	Weighted average number of shares '000	Earnings per share p
Year ended 31st December 2007	97.0	96,473	**100.55**
Adjustment for dilutive share-based payments	–	418	**(0.44)**
Diluted	97.0	96,891	**100.11**
Year ended 31st December 2006	182.2	53,567	340.13
Adjustment for dilutive share-based payments	–	464	(2.92)
Diluted	182.2	54,031	337.21
Year ended 31st December 2007	97.0	96,473	**100.55**
Adjustment for:			
Disposal of properties and investments	(98.2)	–	**(101.79)**
Disposal of joint venture property	0.7	–	**0.72**
Group revaluation surplus	(89.0)	–	**(92.26)**
Fair value movement in derivative financial instruments	5.1	–	**5.28**
Deferred tax released as a result of REIT conversion	(288.7)	–	**(299.25)**
REIT conversion charge	53.6	–	**55.56**
Goodwill impairment	353.3	–	**366.22**
Development income	(1.4)	–	**(1.45)**
Exceptional finance income and costs	(1.2)	–	**(1.24)**
Minority interests in respect of the above	2.7	–	**2.80**
Recurring	33.9	96,473	**35.14**
Adjustment for dilutive share-based payments	–	418	**(0.15)**
Diluted recurring	33.9	96,891	**34.99**
Year ended 31st December 2006	182.2	53,567	340.13
Adjustment for:			
Deferred tax on capital allowances	2.7	–	5.04
Disposal of investment properties	(1.7)	–	(3.17)
Group revaluation surplus	(167.0)	–	(311.76)
Share of joint venture's revaluation surplus	(2.9)	–	(5.41)
Exceptional finance costs	12.7	–	23.71
Development income	(8.1)	–	(15.12)
Fair value movement in derivative financial instruments	(3.2)	–	(5.98)
Recurring	14.7	53,567	27.44
Adjustment for dilutive share-based payments	–	464	(0.23)
Diluted recurring	14.7	54,031	27.21

The recurring earnings per share excludes the after tax effect of fair value adjustments to the carrying value of assets and liabilities, the profit or loss after tax arising from the disposal of properties and investments, the development income, and any exceptional costs and income in order to show the underlying trend. In addition, the conversion charge and the release of deferred tax related to the transfer to REIT status, and the impairment of goodwill resulting from the acquisition of London Merchant Securities plc have also been excluded. For the 2006 figures, the recurring earnings per share figure also excludes the deferred tax charge provided in respect of capital allowances claimed, on the basis that it is unlikely that a liability will ever crystallise.

19 Investment property

	Freehold £m	Leasehold £m	Total £m
Group			
Carrying value			
At 1st January 2007	1,025.2	248.8	1,274.0
Arising on acquisition of subsidiary	1,104.6	141.0	1,245.6
Acquisitions	120.5	21.0	141.5
Capital expenditure	57.1	3.9	61.0
Additions	1,282.2	165.9	1,448.1
Disposals	(151.2)	(6.2)	(157.4)
Revaluation	67.9	22.4	90.3
Movement in grossing up of headlease liabilities	–	(0.4)	(0.4)
At 31st December 2007	**2,224.1**	**430.5**	**2,654.6**
At 1st January 2006	724.2	291.4	1,015.6
Transfer	38.5	(38.5)	–
Acquisitions	58.3	–	58.3
Capital expenditure	17.8	0.9	18.7
Additions	76.1	0.9	77.0
Disposals	(10.3)	(20.4)	(30.7)
Revaluation	196.7	26.6	223.3
Movement in grossing up of headlease liabilities	–	(11.2)	(11.2)
At 31st December 2006	1,025.2	248.8	1,274.0
Adjustments from fair value to carrying value			
At 31st December 2007			
Fair value	2,249.0	422.7	2,671.7
Adjustment for rents recognised in advance	(24.9)	(1.2)	(26.1)
Adjustment for grossing up of headlease liabilities	–	9.0	9.0
Carrying value	2,224.1	430.5	2,654.6
At 31st December 2006			
Fair value	1,039.7	243.0	1,282.7
Adjustment for rents recognised in advance	(14.5)	(0.8)	(15.3)
Adjustment for grossing up of headlease liabilities	–	6.6	6.6
Carrying value	1,025.2	248.8	1,274.0

The investment properties were revalued at 31st December 2007 by external valuers, on the basis of market value as defined by the Appraisal and Valuation Standards published by The Royal Institution of Chartered Surveyors. CB Richard Ellis Limited valued properties to a value of £2,647.9m (2006: CB Richard Ellis, £1,040.9m; Keith Cardale Groves (Commercial) Limited, £241.8m); other valuers, £23.8m (2006: £nil).

At 31st December 2007, the historical cost of investment property owned by the group was £1,990.7m (2006: £688.9m).

20 Property, plant and equipment

	Assets under construction £m	Plant and equipment £m	Total £m
Group			
Net book value			
At 1st January 2006	–	0.4	0.4
Additions	–	0.2	0.2
Disposals	–	(0.2)	(0.2)
Depreciation	–	(0.1)	(0.1)
At 31st December 2006	–	0.3	0.3
Arising on acquisition of subsidiary	53.1	1.6	54.7
Capital expenditure	3.3	0.2	3.5
Additions	56.4	1.8	58.2
Disposals	(56.4)	(0.5)	(56.9)
Depreciation	–	(0.2)	(0.2)
At 31st December 2007	**–**	**1.4**	**1.4**
Net book value at 31st December 2007			
Cost or valuation	–	3.1	3.1
Accumulated depreciation	–	(1.7)	(1.7)
	–	1.4	1.4
Net book value at 31st December 2006			
Cost or valuation	–	1.2	1.2
Accumulated depreciation	–	(0.9)	(0.9)
	–	0.3	0.3

	Plant and equipment £m
Company	
Net book value	
At 1st January 2006	0.4
Additions	0.2
Disposals	(0.2)
Depreciation	(0.1)
At 31st December 2006	0.3
Additions	0.2
Depreciation	(0.1)
At 31st December 2007	**0.4**
Net book value at 31st December 2007	
Cost or valuation	1.4
Accumulated depreciation	(1.0)
	0.4
Net book value at 31st December 2006	
Cost or valuation	1.2
Accumulated depreciation	(0.9)
	0.3

21 Investments

Group

The group has 50% interests in the joint ventures Primister Ltd, Dorrington Derwent Holdings Ltd and Miller Swinton Limited, which have been accounted for by the equity method. In addition, the group has a 25% interest in the joint venture Euro Mall Sterboholy, which is held for resale at 31st December 2007 and has not been accounted for by the equity method in accordance with IFRS 5, Non-current assets held for sale. This is expected to be disposed of in the first half of 2008. The following amounts have been recognised in the group's balance sheet relating to these joint ventures.

	2007 £m	2006 £m
Non-current assets	**8.0**	8.0
Current assets	**1.8**	0.4
Current liabilities	**(1.2)**	(0.2)
Non-current liabilities	**(3.5)**	(2.8)
Net assets	**5.1**	5.4
Assets held for sale	**3.4**	–
Total net assets	**8.5**	5.4
Income	**19.0**	3.9
Expenses	**(19.3)**	(0.3)
Profit for the year	**(0.3)**	3.6

	Subsidiaries £m	Joint ventures £m	Total £m
Company			
Shares in subsidiaries:			
At 1st January 2006	185.4	–	185.4
Acquisition of subsidiary	6.2	–	6.2
At 31st December 2006	191.6	–	191.6
Acquisition of subsidiary	965.6	–	965.6
Impairment	(200.3)	–	(200.3)
At 31st December 2007	956.9	–	956.9
Loans:			
At 1st January 2006, 31st December 2006 and 31st December 2007	–	0.9	0.9
At 31st December 2007	**956.9**	**0.9**	**957.8**
At 31st December 2006	191.6	0.9	192.5

At 31st December 2007 the carrying value of the investment in LMS was reviewed in accordance with IAS 36, Impairment of Assets and the resulting impairment has been taken to the company income statement.

22 Acquisition of subsidiaries

The whole of the issued share capital of London Merchant Securities plc, a property investment company, was acquired on 1st February 2007 for a total cost of £965.6m.

	£m
Cost of acquisition:	
Equity	912.9
Loan notes	32.5
Cash	12.2
Directly attributable acquisition costs	8.0
	965.6

22 Acquisition of subsidiaries (continued)

The equity consideration was satisfied by Derwent London plc issuing 46,910,232 ordinary shares at a price of £19.46 on 1st February 2007. This was the closing market price of the company's 5p ordinary shares on 31st January 2007. This issue price consists of the nominal value of the ordinary shares of £0.05 and a share premium of £19.41.

Directly attributable acquisition costs are those charged by the company's advisers in performing due diligence activities and producing the acquisition documents.

The net assets acquired at 1st February 2007 were:

	Book value of net assets acquired £m	Fair value of net assets acquired £m
Non-current assets		
Investment property	1,245.6	1,245.6
Property, plant and equipment	53.9	54.7
Investments	18.0	17.5
Pension scheme surplus	1.4	1.4
Deferred tax asset	12.0	12.0
Derivatives	6.1	6.1
Other receivables	6.2	6.2
	1,343.2	1,343.5
Current assets		
Trading property	1.3	9.4
Trade and other receivables	9.4	8.8
Cash and cash equivalents	13.9	13.9
	24.6	32.1
Total assets	1,367.8	1,375.6
Current liabilities		
Bank loans	(4.6)	(4.6)
Trade and other payables	(39.8)	(40.9)
	(44.4)	(45.5)
Non-current liabilities		
Borrowings	(480.4)	(510.6)
Deferred tax liability	(148.8)	(144.4)
Other	(6.8)	(6.8)
	(636.0)	(661.8)
Total liabilities	(680.4)	(707.3)
Net assets acquired	687.4	668.3
Minority interests	(56.0)	(56.0)
Group's interest in the total net assets acquired	631.4	612.3
Goodwill on acquisition		353.3
Cost of acquisition		965.6

The goodwill on acquisition disclosed above differs from that in the interim results of £297.3m due to an amendment to the treatment of minority interests on consolidation.

Adjustments from book value to fair value include those arising from the fair value adjustments to property, plant and equipment, trading property and debt. Adjustments arising from the application of Derwent London's accounting policies have been made to the book value figures.

22 Acquisition of subsidiaries (continued)
At the date of publishing the 2006 year end report and accounts, work was still outstanding on the fair value verification exercise. This has now been completed and a number of amendments were identified to both book and fair value.

A detailed review of the existence of intangible assets, other than goodwill, has already been concluded, and none were found to have any material value. An impairment test has been carried out on the goodwill arising on the acquisition.

The properties acquired on the acquisition of LMS complement the existing portfolio of properties held by the group. It is anticipated that, in future, the group will be capable of deriving significantly enhanced cashflows from the acquired portfolio due to future lease management, refurbishment and redevelopment, which are proposed to be made to the acquired property portfolio. While the amount that the group has paid for LMS is justified by these anticipated enhancements and benefits that will be brought to the group, IAS 36, Impairment of Assets does not permit such enhancements to be included in the cashflows used in estimating value in use for the purposes of impairment testing, and instead requires the cashflows to be based on the assets in their current condition.

In addition, the benefits arising from the acquired portfolio are specific to the group and, consequently, the fair value, less costs to sell, of the acquired business does not support the carrying amount of the goodwill associated with the acquisition.

As a consequence, the goodwill associated with this transaction is deemed to be fully impaired and has been written off to the group income statement.

If the date for this acquisition had been 1st January 2007, then the group property income would have increased by £4.6m. As the fair value adjustments and adjustments arising from the application of Derwent London's accounting policies made above have not been made to the results of London Merchant Securities for 31st December 2006 it is impractical to assess the impact on the profit for the year arising from a 1st January 2007 acquisition date. The profit for the year ended 31st December 2007 of £100.9m, which is after recognising the £353.3m of goodwill impairment, includes post acquisition profits of £203.0m for London Merchant Securities.

Year ended 31st December 2006
The whole of the issued share capital of Bramley Road Limited, a property investment company, was acquired on 4th October 2006 for a total cost of £6.2m.

The net assets acquired on 4th October 2006 were:

	Book value of net assets acquired £m	Fair value of net assets acquired £m
Non-current assets		
Investment property	8.6	8.6
Current assets		
Cash and cash equivalents	0.2	0.2
Current liabilities		
Trade payables	(0.1)	(0.1)
Non-current liabilities		
Financial liabilities	(0.7)	(0.7)
Deferred tax liabilities	(1.8)	(1.8)
Net assets acquired	6.2	6.2
Goodwill on acquisition		–
Cost of acquisition		6.2

The cost of this acquisition was settled 100% in cash, paid from the company's existing bank facilities.

In relation to the acquisition of Bramley Road Limited, post acquisition profit of £0.2m was recognised in the profit for the year ended 31st December 2006. If the acquisition date for this business combination had been 1st January 2006, the property income of the combined entity would have increased by £0.4m to £51.7m. As the investment property owned by Bramley Road Limited was not professionally valued at 31st December 2005 it is impracticable to state the potential effect on the profit for the year.

23 Other receivables (non-current)

	Group 2007 £m	Group 2006 £m	Company 2007 £m	Company 2006 £m
Accrued income	**23.3**	13.7	**–**	–

24 Trading properties

The fair value of trading properties at 31st December 2007 is the same as their book value.

25 Trade and other receivables

	Group 2007 £m	Group 2006 £m	Company 2007 £m	Company 2006 £m
Trade receivables	**16.5**	11.2	**–**	–
Amounts owed by subsidiaries	**–**	–	**559.9**	439.5
Other receivables	**21.9**	12.0	**0.6**	11.4
Prepayments	**4.9**	1.3	**1.0**	0.7
Amounts recoverable under contract	**13.6**	11.6	**–**	–
Accrued income	**4.1**	3.3	**–**	0.3
	61.0	39.4	**561.5**	451.9

	2007 £m	2006 £m
Group trade receivables are split as follows:		
less than three months due	**11.8**	7.5
between three and six months due	**4.1**	1.2
between six and twelve months due	**0.6**	2.5
	16.5	11.2

Group trade receivables includes a provision for bad debts as follows:

	2007 £m	2006 £m
At 1st January	**–**	–
Arising on acquisition of subsidiary	**1.0**	–
Additions	**0.9**	–
Released	**(0.7)**	–
At 31st December	**1.2**	–
The provision for bad debts is split as follows:		
between six and twelve months due	**0.7**	–
over twelve months	**0.5**	–
	1.2	–

26 Trade and other payables

	Group 2007 £m	Group 2006 £m	Company 2007 £m	Company 2006 £m
Trade payables	**5.8**	4.6	**0.4**	2.5
Amounts owed to subsidiaries	**–**	–	**131.4**	72.7
Other payables	**0.2**	0.2	**–**	–
Sales and social security taxes	**3.2**	0.7	**0.9**	–
Accruals and deferred income	**38.8**	27.0	**6.1**	14.6
	48.0	32.5	**138.8**	89.8

27 Provisions

	Share option liability £m	Onerous contract £m	National insurance on share-based payments £m	2007 Total £m	Onerous contract £m	National insurance on share-based payments £m	2006 Total £m
Group							
At 1st January	–	0.7	0.7	**1.4**	0.8	0.5	1.3
Arising on acquisition	3.9	–	–	**3.9**	–	–	–
Charged to the income statement	(1.6)	–	–	**(1.6)**	–	0.2	0.2
Utilised in year	(0.2)	–	(0.2)	**(0.4)**	(0.1)	–	(0.1)
At 31st December	2.1	0.7	0.5	**3.3**	0.7	0.7	1.4
Due within one year	–	0.1	0.4	**0.5**	0.1	–	0.1
Due after one year	2.1	0.6	0.1	**2.8**	0.6	0.7	1.3
	2.1	0.7	0.5	**3.3**	0.7	0.7	1.4
Company							
At 1st January		0.7	0.7	**1.4**	0.8	0.5	1.3
Charged to the income statement		–	–	**–**	–	0.2	0.2
Utilised in year		–	(0.2)	**(0.2)**	(0.1)	–	(0.1)
At 31st December		0.7	0.5	**1.2**	0.7	0.7	1.4
Due within one year		0.1	0.4	**0.5**	0.1	–	0.1
Due after one year		0.6	0.1	**0.7**	0.6	0.7	1.3
		0.7	0.5	**1.2**	0.7	0.7	1.4

The onerous contract relates to the excess of rents payable over rents receivable on a lease which expires in 2014 and reflects the discounted present value of future net payments under that lease.

National insurance is payable on gains made by employees on the exercise of share-based payments granted to them. The eventual liability to national insurance is dependent on:

– the market price of the company's shares at the date of exercise;
– the number of equity instruments that will be exercised; and
– the prevailing rate of national insurance at the date of exercise.

A provision is made for the potential liability for cash-settled share options based on the valuation carried out at each balance sheet date (see note 15).

28 Derivatives and borrowings

	Group		Company	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Non-current assets				
Derivative financial instruments	**(1.2)**	(0.1)	**–**	(0.1)
Current liabilities				
Bank loans	**113.4**	–	**80.0**	–
Unsecured loans	**1.3**	–	**–**	–
Overdraft	**5.9**	2.2	**0.7**	0.7
	120.6	2.2	**80.7**	0.7
Non-current liabilities				
6.5% Secured Bonds 2026	**194.9**	–	**–**	–
Loan notes	**32.0**	–	**32.0**	–
Bank loans	**434.0**	341.0	**265.0**	341.0
Mortgages	**2.2**	–	**–**	–
Unsecured loans	**0.4**	–	**0.4**	–
Leasehold liabilities	**9.0**	6.6	**–**	–
	672.5	347.6	**297.4**	341.0
Total	**791.9**	349.7	**378.1**	341.6

Undrawn committed bank facilities

	Group		Company	
	2007	2006	**2007**	2006
	£m	£m	**£m**	£m
Maturity dates:				
less than 1 year	**24.1**	2.8	**24.1**	2.8
between 1–2 years	**17.0**	15.0	**17.0**	15.0
between 2–3 years	**–**	31.0	**–**	31.0
between 3–4 years	**125.0**	–	**125.0**	–
between 4–5 years	**–**	–	**–**	–
more than 5 years	**208.0**	38.0	**18.0**	38.0
	374.1	86.8	**184.1**	86.8

28 Derivatives and borrowings (continued)

	Group 2007 £m	Group 2006 £m	Company 2007 £m	Company 2006 £m
Secured				
Bank loans wholly repayable:				
in less than 1 year	**113.4**	–	**80.0**	–
between 1–2 years	**108.0**	85.0	**108.0**	85.0
between 2–3 years	**–**	94.0	**–**	94.0
between 3–4 years	**75.0**	–	**75.0**	–
between 4–5 years	**–**	100.0	**–**	100.0
more than 5 years	**251.0**	62.0	**82.0**	62.0
6.5% Secured Bonds 2026	**194.9**	–	**–**	–
Mortgages	**2.2**	–	**–**	–
	744.5	341.0	**345.0**	341.0
Unsecured				
Loan notes	**32.0**	–	**32.0**	–
Unsecured loans	**1.7**	–	**0.4**	–
Overdrafts repayable in less than 1 year	**5.9**	2.2	**0.7**	0.7
Gross debt	**784.1**	343.2	**378.1**	341.7
Leasehold liabilities repayable in more than 5 years	**9.0**	6.6	**–**	–
Total debt	**793.1**	349.8	**378.1**	341.7
Cash and cash equivalents	**(10.3)**	–	**–**	–
Net debt	**782.8**	349.8	**378.1**	341.7

At 31st December 2007, £1,648.2m (2006: £802.4m) of the group's properties are subject to a fixed charge to secure the bank loans and mortgages. In addition, the bonds are secured by a floating charge over certain of the group's companies, which contain £370.6m (2006: £nil) of the group's properties.

Fixed interest rate and hedged debt

The group's and company's fixed rate debt comprised the Secured Bonds 2026 and Mortgages together with the instruments used to hedge its floating rate debt. Additionally, it also comprised the Debenture Stock 2019 until its redemption in November 2006. Details are summarised below:

	Principal £m	Weighted average interest rate %	Weighted average life Years	Fair value £m	Fair value adjustment to carrying value £m
Secured Bonds 2026	175.0	6.500	18.22	190.0	4.9
Mortgages	2.2	6.985	6.04	2.2	–
Interest rate swaps	280.0	4.979	4.14	(1.2)	1.2
Interest rate cap	10.0	6.010	3.46	–	–
At 31st December 2007				**191.0**	**6.1**
Interest rate swaps	140.0	5.384	1.63	(0.1)	0.1
Interest rate cap	10.0	6.010	4.46	–	–
At 31st December 2006				(0.1)	0.1

In both 2007 and 2006, there was no difference between the book value and the fair value of all other financial assets and liabilities.

28 Derivatives and borrowings (continued)

Fixed interest rate and hedged debt (continued)

Secured Bonds 2026

On acquisition of LMS on 1st February 2007 (see note 22), the Secured Bonds 2026 were included at fair value less acquisition costs. This difference from its principal value is being amortised through the income statement. The fair value shown above was determined by the mid-price of 108.58 as at 31st December 2007. The carrying value at 31st December 2007 was £194.9m.

Interest rate swaps

The fair value represents the net present value of the difference between the contracted fixed rates and the fixed rates payable if the swaps were to be replaced on 31st December 2007 for the period to the contracted expiry dates.

Interest rate cap

The fair value represents the net cost of replacement on identical terms at prices prevailing on 31st December 2007.

Interest rate exposure

After taking into account the various interest rate hedging instruments entered into by the company, the interest rate exposure of the group's and company's gross debt was:

	Floating rate £m	Hedged £m	Fixed rate £m	Gross debt £m	Weighted average cost of debt %	Weighted average life Years
Group						
At 31st December 2007	**297.0**	**290.0**	**197.1**	**784.1**	**6.34**	**6.85**
At 31st December 2006	193.2	150.0	–	343.2	6.00	3.95
Company						
At 31st December 2007	**88.1**	**290.0**	**–**	**378.1**	**6.50**	**2.96**
At 31st December 2006	191.7	150.0	–	341.7	6.00	3.97

Further information on risk as required by IFRS 7, Financial Instruments: Disclosure is given in note 4 and in the business review on pages 36 and 37.

29 Gearing

Balance sheet gearing is 42.5% (2006: 44.7%). This is defined as net debt divided by net assets.

Profit and loss gearing is 1.81 (2006: 1.85). This is defined as recurring net property income less administrative costs divided by net interest payable, having reversed the reallocation of ground rent payable on leasehold investment properties to interest payable of £0.7m (2006: £0.9m). For 2007 and 2006, the only adjustment to net property income to arrive at recurring net property income is to exclude development income.

30 Financial assets and liabilities

	Fair value through profit and loss £m	Loans and receivables £m	Amortised cost £m	Total carrying value £m	Fair value £m
Group					
Cash and cash equivalents	–	10.3	–	10.3	10.3
Bank overdrafts	–	–	(5.9)	(5.9)	(5.9)
Borrowings due within one year	–	–	(114.7)	(114.7)	(114.7)
Borrowings due after one year	–	–	(672.5)	(672.5)	(666.0)
Derivative assets	1.2	–	–	1.2	1.2
Other assets – current	–	56.1	–	56.1	56.1
Other liabilities	–	–	(93.5)	(93.5)	(93.5)
At 31st December 2007	**1.2**	**66.4**	**(886.6)**	**(819.0)**	**(812.5)**
Bank overdrafts	–	–	(2.2)	(2.2)	(2.2)
Borrowings due within one year	–	–	–	–	–
Borrowings due after one year	–	–	(340.9)	(340.9)	(340.9)
Derivative assets	0.1	–	–	0.1	0.1
Other assets – current	–	39.5	–	39.5	39.5
Other liabilities	–	–	(18.3)	(18.3)	(18.3)
At 31st December 2006	0.1	39.5	(361.4)	(321.8)	(321.8)
Company					
Bank overdrafts	–	–	(0.7)	(0.7)	(0.7)
Borrowings due within one year	–	–	(80.0)	(80.0)	(80.0)
Borrowings due after one year	–	–	(297.4)	(297.4)	(297.4)
Derivative assets	–	–	–	1.2	1.2
Other assets – current	–	560.5	–	560.5	560.5
Other liabilities	–	(131.4)	(7.4)	(138.8)	(138.8)
At 31st December 2007	**–**	**429.1**	**(385.5)**	**44.8**	**44.8**
Bank overdrafts	–	–	(0.7)	(0.7)	(0.7)
Borrowings due after one year	–	–	(341.0)	(341.0)	(341.0)
Derivative assets	0.1	–	–	0.1	0.1
Other assets – current	–	450.9	–	450.9	450.9
Other liabilities	–	(72.7)	(17.1)	(89.8)	(89.8)
At 31st December 2006	0.1	378.2	(358.8)	19.5	19.5

31 Deferred tax

	Revaluation surplus £m	Capital allowances £m	Other £m	Total £m
Group				
Deferred tax liability				
At 1st January 2007	150.2	16.3	0.7	167.2
Acquired on acquisition of subsidiary	135.9	7.8	(11.3)	132.4
Transfer to investment in joint ventures	(0.7)	–	–	(0.7)
Provided during the year in income statement	1.3	–	–	1.3
Released during the year in income statement	(272.7)	(24.1)	8.1	(288.7)
Change in tax rates	(0.9)	–	0.2	(0.7)
At 31st December 2007	**13.1**	**–**	**(2.3)**	**10.8**
Deferred tax liability				
At 1st January 2006	91.6	13.6	–	105.2
Adjustment to reserves in respect of deferred tax				
on share-based payments	–	–	(0.6)	(0.6)
Acquired on acquisition of subsidiary	1.7	–	–	1.7
Provided during the year in income statement	56.9	2.7	1.3	60.9
At 31st December 2006	150.2	16.3	0.7	167.2
Company				
Deferred tax asset				
At 1st January 2007			2.5	2.5
Provided during the year in income statement			(1.2)	(1.2)
At 31st December 2007			**1.3**	**1.3**
Deferred tax asset				
At 1st January 2006			2.5	2.5
Adjustment to reserves in respect of deferred tax				
on share-based payments			0.6	0.6
Provided during the year in income statement			(0.6)	(0.6)
At 31st December 2006			2.5	2.5

Deferred tax on the revaluation surplus is calculated on the basis of the chargeable gains that would crystallise on the sale of the investment property portfolio as at 31st December 2007. The calculation takes account of available indexation on the historic cost of the properties and any available capital losses. Due to the group's conversion to REIT status on 1st July 2007, deferred tax is only provided at 31st December 2007 on properties outside the REIT regime.

32 Share capital

	Authorised £m	Issued and fully paid £m
At 1st January 2006 and 31st December 2006	3.55	2.6
Increase in authorised share capital	2.49	–
Issues of shares on acquisition of subsidiaries	–	2.4
At 31st December 2007	**6.04**	**5.0**

The number of 5p ordinary shares in issue at the year end was 100,703,194 (2006: 53,656,492). During the year, 7,077 shares (2006: 184,000 shares) were issued as a result of the exercise of share options and 129,393 shares (2006: nil) were issued as a result of the 2004 long-term investment plan grant vesting, which realised proceeds of £0.1m (2006: £1.0m). The number of outstanding share options and other share awards granted are disclosed in the report on directors' remuneration on pages 86 to 94.

33 Reserves

	Share premium £m	Other reserves £m	Retained earnings £m	Minority interest £m
Group				
At 1st January 2007	156.1	3.8	620.9	–
Arising on acquisition of subsidiary	–	–	–	56.0
Premium on issue of shares	0.9	910.5	–	–
Share-based payments expense transferred to reserves	–	0.3	–	–
Actuarial pension gains	–	–	1.3	–
Foreign exchange translation differences	–	(0.6)	–	–
Profit for the year	–	–	97.0	3.9
Dividends paid	–	–	(13.2)	–
At 31st December 2007	**157.0**	**914.0**	**706.0**	**59.9**
At 1st January 2006	155.1	2.3	446.2	–
Premium on issue of shares	1.0	–	–	–
Share-based payments expense transferred to reserves	–	0.9	–	–
Deferred tax in respect of share-based payments	–	0.6	–	–
Profit for the year	–	–	182.2	–
Dividends paid	–	–	(7.5)	–
At 31st December 2006	156.1	3.8	620.9	–
Company				
At 1st January 2007	156.1	3.8	53.7	–
Premium on issue of shares	0.9	910.5	–	–
Share-based payments expense transferred to reserves	–	0.3	–	–
Loss for the year	–	–	(114.2)	–
Transfer between reserves	–	(200.3)	200.3	–
Dividends paid	–	–	(13.2)	–
At 31st December 2007	**157.0**	**714.3**	**126.6**	**–**
At 1st January 2006	155.1	2.3	54.1	–
Premium on issue of shares	1.0	–	–	–
Share-based payments expense transferred to reserves	–	0.9	–	–
Deferred tax in respect of share-based payments	–	0.6	–	–
Profit for the year	–	–	7.1	–
Dividends paid	–	–	(7.5)	–
At 31st December 2006	156.1	3.8	53.7	–

The following describes the nature and purpose of each reserve within owners' equity:

Reserve	**Description and purpose**
Share premium	Amount subscribed for share capital in excess of nominal value less directly attributable issue costs.
Other	Premium on the issue of shares as equity consideration for the acquisition of London Merchant Securities plc (see note 22). Fair value and related deferred tax of equity instruments granted but not yet exercised under share-based payments.
Retained earnings	Cumulative net gains and losses recognised in the group income statement.

34 Changes in shareholders' equity

	Group		Company	
	2007	2006	2007	2006
	£m	£m	£m	£m
Total recognised income and expense relating to the year	**97.7**	182.8	**(114.2)**	7.7
Dividends paid	**(13.2)**	(7.5)	**(13.2)**	(7.5)
Share-based payments transferred to reserves	**0.3**	0.9	**0.3**	0.9
Issue of shares	**2.4**	–	**2.4**	–
Premium on issue of shares	**911.4**	1.0	**911.4**	1.0
	998.6	177.2	**786.7**	2.1
Equity attributable to equity holders of the parent company at 1st January	**783.4**	606.2	**216.2**	214.1
Equity attributable to equity holders of the parent company at 31st December	**1,782.0**	783.4	**1,002.9**	216.2

35 Profit for the year attributable to members of Derwent London plc

The company has taken advantage of the exemption allowed under section 230 of the Companies Act 1985 and has not presented its own income statement in these financial stateme ts. Profit for the year includes a loss of £114.2m (2006: £7.1m profit) which has been dealt with in the accounts of the company.

36 Dividend

	2007	2006
	£m	£m
Second interim dividend of 10.525p (2006 final: 9.725p) per ordinary share declared during the year relating to the previous year's results	**5.7**	5.2
Interim dividend of 7.5p (2006: 4.225p) per ordinary share declared during the year	**7.5**	2.3
	13.2	7.5

The directors are proposing the payment of a final dividend in respect of the current year's results of 15p (2006 second interim: 10.525p) per ordinary share which would total £15.1m (2006 second interim: £5.6m). This dividend has not been accrued at the balance sheet date.

37 Total return

	2007	2006
	%	%
Total return	**2.8**	33.6

Total return is the movement in adjusted net asset value per share as derived in note 38 plus the dividend per share paid during the year, expressed as percentage of the adjusted net asset value per share at the beginning of the year.

38 Net asset value per share

	Net assets £m	Deferred tax on revaluation surplus £m	Fair value of derivative financial instruments £m	Fair value adjustment to secured bonds £m	Adjusted £m
At 31st December 2007					
Net assets	1,841.9	13.1	(1.2)	21.6	1,875.4
Minority interest	(59.9)	(1.7)	–	–	(61.6)
Net assets attributable to equity shareholders	1,782.0	11.4	(1.2)	21.6	1,813.8
Net asset value per share (p)	**1,829**	**13**	**(1)**	**21**	**1,862**
Net asset value per share attributable to equity shareholders (p)	**1,770**	**11**	**(1)**	**21**	**1,801**

	Net assets £m	Deferred tax on revaluation surplus £m	Deferred tax on capital allowances £m	Fair value of derivative financial instruments £m	Adjusted £m
At 31st December 2006					
Net assets attributable to equity shareholders	783.4	150.2	16.3	(0.1)	949.8
Net asset value per share (p)	1,460	280	30	–	1,770
Net asset value per share attributable to equity shareholders (p)	1,460	280	30	–	1,770

The number of shares at 31st December 2007 was 100,703,194 (2006: 53,656,492).

The net asset values per share are shown in the table both for the assets under control by the group and of its interest in these assets, i.e. after deduction for the minority interest share. Adjustments are made for the deferred tax on the revaluation surplus and the post tax fair value of derivative financial instruments and the adjustment to the secured bond are excluded, on the basis that these amounts are not relevant when considering the group as an ongoing business. Additionally, at 31st December 2006, adjusted net assets also excluded the deferred tax provided in respect of capital allowances claimed, on the basis that it was unlikely that this liability would ever crystallise.

39 Cash and cash equivalents

	Group 2007 £m	Group 2006 £m	Company 2007 £m	Company 2006 £m
Overdrafts	**(5.9)**	(2.2)	**(0.7)**	(0.7)
Short-term deposits	**10.3**	–	**–**	–
	4.4	(2.2)	**(0.7)**	(0.7)

40 Exceptional cash flows

The cash flow for the year to 31st December 2007 contained exceptional administrative expenses of £16.0m (2006: £nil) which relate to costs incurred by London Merchant Securities prior to the acquisition and accrued to 31st January 2007 in the fair value balance sheet shown in note 22.

The year to 31st December 2007 also contained exceptional finance costs of £3.3m (2006: £17.6m), which is the cost of acquisition finance (see note 10).

41 Capital commitments

Contracts for capital expenditure entered into by the group at 31st December 2007 and not provided for in the accounts amounted to £78.3m (2006: £48.3m).

42 Post balance sheet events

Subsequent to the balance sheet date and before approval of these financial statements the group completed the sale of 11 properties for £28.6m, before costs, and exchanged contracts for the disposal of a further four properties for a total of £10.9m, before costs. The estimated profit on these disposals is £0.1m.

43 Leases

	2007 £m	2006 £m
Operating lease receipts		
Minimum lease receipts under non-cancellable operating leases to be received:		
not later than one year	110.2	56.6
later than one year and not later than five years	338.7	164.7
later than five years	602.8	277.5
	1,051.7	498.8

	2007 £m	2006 £m
Finance lease obligations		
Minimum lease payments under finance leases fall due:		
not later than one year	0.6	0.5
later than one year and not later than five years	2.6	1.6
later than five years	45.9	25.2
	49.1	27.3
Future finance charges on finance leases	(40.1)	(20.7)
Present value of finance lease liabilities	9.0	6.6
Present value of minimum finance lease obligations:		
later than one year and not later than five years	0.1	0.1
later than five years	8.9	6.5
	9.0	6.6

44 Contingent liabilities

The company and its subsidiaries are party to cross guarantees securing the overdraft and certain bank loans. At 31st December 2007 the maximum liability that could arise for the company from the cross guarantees amounted to £5.1m (2006: £1.5m). The company has guaranteed its share of a loan to Primister Limited, the contingent liability for which at 31st December 2007 amounted to £2.8m (2006: £2.8m). In addition, the company guarantees its share of interest payable on this loan which amounts to £0.3m per annum (2006: £0.3m). Where the company enters into financial guarantee contracts and guarantees the indebtedness of other companies within the group, the company considers these to be insurance arrangements, and accounts for them as such. In this respect, the company treats the guarantee contract as a contingent liability until such time that it becomes probable that the company will be required to make a payment under the guarantee.

45 Principal operating companies

The principal operating companies within the group at 31st December 2007 are:

	Ownership	Principal activity
Subsidiaries		
British Commercial Property Investment Trust Limited	100%	Property investment
Caledonian Property Investments Limited	100%	Property investment
Central London Commercial Estates Limited	100%	Property investment
City Commercial Real Estate Investments Limited	100%	Property investment
Derwent Valley Central Limited*	100%	Property investment
Derwent Valley London Limited*	100%	Property investment
Derwent Valley Property Developments Limited*	100%	Property investment
Derwent Valley Property Investments Limited*	100%	Property investment
Goodge Street Properties Limited	100%	Property investment
Kensington Commercial Property Investments Limited	100%	Property investment
LMS (City Road) Limited	100%	Property investment
LMS (Goodge Street) Limited	100%	Property investment
LMS Properties Limited	100%	Property investment
LMS Shops Limited	100%	Property investment
LMS Offices Limited	100%	Property investment
LMS (Kingston) Limited	100%	Property investment
Palaville Limited	100%	Property investment
Rainram Investments Limited	100%	Property investment
The New River Company Limited	100%	Property investment
Urbanfirst Limited	100%	Property investment
West London & Suburban Property Investments Limited	100%	Property investment
Bargate Quarter Limited	58.5%	Property investment
Portman Investments (Baker Street) Limited	55%	Property investment
Caledonian Properties Limited	100%	Property trading
Corinium Estates Limited	100%	Property trading
LMS Residential Limited	100%	Property trading
City Shops Limited	90%	Property trading
Derwent Valley Finance Limited	100%	Finance company
LMS Finance Limited	100%	Finance company
LMS Industrial Finance Limited	100%	Finance company
LMS Limited*	100%	Holding company

* Indicates subsidiary undertakings held directly.

All holdings are of ordinary shares with the exception of £6.3m of preference shares in Urbanfirst Limited.

Joint ventures		
Miller (Swinton) Limited	50%	Property investment
Primister Limited	50%	Property investment
Dorrington Derwent Holdings Limited	50%	Holding company
Euro Mall Sterboholy	25%	Property investment

The company controls 50% of the voting rights of each of the joint ventures. All are accounted for and disclosed in accordance with IAS 31, Interests in Joint Ventures, except Euro Mall Sterboholy which is accounted for and disclosed in accordance with IFRS 5, Non-current assets held for sale.

All of the above companies are registered and operate in England and Wales.

46 Related party transactions

Details of directors' remuneration are given in the report on directors' remuneration on pages 86 to 94 and note 13. Other related party transactions are as follows:

Group

Messrs J.D. Burns and S.P. Silver are partners in The Pilcher Hershman Partnership (PHP), estate agents. The partnership occupies offices owned by the group for which they paid a commercial rent in the year of £0.1m (2006: £0.1m). In addition, it received fees at a commercial rate in respect of the letting, acquisition and disposal of certain properties owned by the group of £0.9m (2006: £0.5m), during the year. Procedures have been established whereby the audit committee are able to verify that neither of Messrs Burns and Silver derive any direct benefit from these fees. The 2006 figure was previously reported as £1.2m and has been adjusted to exclude management fees as, following a restructuring of arrangements during 2006, PHP no longer have any interest in these fees.

The Hon. R.A. Rayne is a director of LMS Capital plc, an investment company, which occupies offices owned by the group for which they paid a commercial rent of £0.4m (2006: £nil).

During the year, the group paid fees at a commercial rate in respect of the acquisition of certain properties of £0.6m (2006: £0.2m) to Everton Philips LLP, a firm in which the son of Mr J.D. Burns is a partner.

On 29th June 2007, the group sold investments with a book value of £6.9m (2006: £nil) to LMS Capital plc for £7.9m, an amount which would have been commanded in an arm's length transaction. This yielded a profit of £1.0m (2006: £nil) which is shown in note 9. There are no outstanding balances owed to the group with respect to this transaction.

During the year, the group made a payment of £1.0m to the Rayne Foundation, a charitable organisation of which The Hon. R.A. Rayne is chairman, in order to discharge the obligations acquired as part of the acquisition of LMS. This amount was accrued in the acquisition fair value balance sheet (see note 22).

At 31st December 2007, included within other receivables in note 25 is an amount owed by the Portman Estate, the minority owner of two of the group's subsidiaries, of £16.3m. The majority of this amount is an amount of £14.3m paid during the year following the disposal of the jointly owned properties. This debt will be discharged by a distribution to shareholders.

Company

The company received dividends from some of its subsidiaries during the year. These transactions are summarised below:

	Dividend received		Interest received/(paid)		Balance owed/(owing)	
	2007	2006	2007	2006	2007	2006
	£m	£m	£m	£m	£m	£m
Related party						
Bramley Road Ltd	–	–	–	–	0.6	0.5
Derwent Valley Central Ltd	55.0	19.0	–	10.0	206.5	225.6
Derwent Valley London Ltd	12.5	10.0	–	6.7	144.6	123.2
Derwent Valley Property Developments Ltd	8.5	3.0	–	3.4	65.8	61.8
Derwent Valley Property Investments Ltd	2.5	2.5	–	(2.3)	0.7	(44.2)
Derwent Valley Property Trading Ltd*	–	–	–	–	–	(0.2)
Derwent Valley Railway Company*	–	–	–	–	(0.2)	(0.2)
Derwent Valley Properties Ltd*	–	–	–	–	–	(1.1)
Derwent Valley West End Ltd	–	–	–	–	–	0.1
Itkin Properties (London) Ltd*	–	–	–	–	–	1.3
LMS Ltd	50.0	–	–	–	10.5	–
	128.5	34.5	–	17.8	428.5	366.8

* Dormant companies.

The group has not made any provision for bad or doubtful debts in respect of related party debtors. Inter-company balances are repayable on demand.

Compliance

The board supports the principles of good governance and believes that the company has, except as noted, complied with the main and supporting principle of the Combined Code on Corporate Governance published by the Financial Reporting Council and which is appended to the Listing Rules of the Financial Services Authority. The company has not complied with code provision A.2.2, concerning the independence of the chairman on appointment. The company's position is described in the following section. A number of other code provisions were not applicable in the current year.

The board

At the start of the year, the board comprised Mr Ivey, the non-executive chairman, five executive directors, Messrs Burns, Silver, Odom, George and Williams and three non-executive directors, Messrs Neathercoat, Farnes and Corbyn. On 1st February 2007, when the company acquired London Merchant Securities plc, Mr Friedlos joined the board as an executive director, Mr Rayne was appointed as non-executive chairman and Mrs de Moller and Mr Newell joined as non-executive directors. Mr Friedlos resigned on 18th July 2007.

The board assesses the independence of the non-executive directors with regard to the guidance on independence contained in code provision A.3.1, and notes that Messrs Rayne, Ivey and Neathercoat cannot automatically be deemed independent. The board is also aware that code provision A.2.2 requires a new chairman to be independent on appointment. In accordance with principle A.6 of the code, the board has reviewed the roles and performance of all directors and, amongst other matters, reconsidered the independence of the non-executive directors.

Having served in an executive capacity at London Merchant Securities plc prior to the merger Mr Rayne cannot be deemed independent. However, the board continues to consider that the contribution Mr Rayne makes as chairman of the enlarged board justifies his position.

Mr Ivey is not deemed independent, having served on the board for more than nine years. Again, the board considered his expertise and the manner in which he carried out his duties during the year and concluded that shareholders should have no concern that his independent judgement is in any way impaired.

Mr Neathercoat has also served as a non-executive director for more than nine years. The board has therefore reviewed his independence and is of the view that he continues to show strong independence in both judgement and in the performance of his duties as a director. This, together with the fact that he has no association with management that might compromise his independence, causes the board to conclude that he remains independent.

As required under the 2006 Combined Code, the board has decided that all non executive directors who have served on the board for more than nine years will be subject to re-election annually. Mr Ivey is due for re-election under the rotation provisions in the company's articles of association and Mr Neathercoat will stand for re-election under this new requirement.

The directors considered the composition of the board and, taking into account the balance between independent non-executive directors and executive directors, continue to believe that it is suitably structured to satisfy the requirements of good corporate governance.

A formal schedule, which has been approved by the board, sets out the division of responsibilities between the chairman, who is responsible for the effectiveness of the board, and the chief executive officer, who is responsible for the day-to-day operations of the business. Mr Neathercoat is the senior independent director. Biographies of the directors are given on page 97.

The board is responsible for setting the company's strategic aims, ensuring that adequate resources are available to meet its objectives and reviewing management performance. The formal list of matters reserved for the full board's approval is maintained and reviewed periodically. The full board met six times during the year and six meetings are scheduled for 2008. Extra meetings will be arranged if necessary. Additionally, the executive board, which consists of the executive directors met 10 times in 2007. The board is provided with comprehensive papers in a timely manner to ensure that the directors are fully briefed on matters to be discussed at these meetings.

Since 1993, the board has maintained a number of board committees. The terms of reference of each committee are available on the group's website. Set out below are details of the membership and duties of the three principal committees.

Remuneration committee

The committee comprises of Mr Neathercoat, Mr Corbyn, Mrs de Moller and Mr Newell under the chairmanship of Mr Farnes. It is responsible for establishing the company's remuneration policy and individual remuneration packages for the executive directors. There were five meetings of the committee in 2007. The report on directors' remuneration is set out on pages 86 to 94.

Audit committee

Mr Neathercoat is chairman of the committee, which is served by Mr Corbyn, Mr Farnes, Mrs de Moller and Mr Newell. The committee is responsible for considering the application of financial reporting and internal control principles and for maintaining an appropriate relationship with the group's auditors. The committee met four times during 2007. The report of the audit committee is on page 96.

Nominations committee

Mr Ivey is chairman of this committee which consisted of all of the non-executive directors, except the chairman. The committee's responsibilities include identifying external candidates for appointment as directors and, subsequently, recommending their appointment to the board and, if requested, making a recommendation concerning an appointment to the board from within the company. The committee also carries out the annual appraisal of the performance and effectiveness of the board and its three committees. The committee met only once during the period under review. The nominations committee report is on page 97.

Directors' attendance at board and committee meetings during the year was as follows:

	Full board	Executive board	Remuneration committee	Audit committee	Nominations committee
Number of meetings	6	10	5	4	1
Executive directors					
J.D. Burns	6	10	–	–	–
S.P. Silver	6	8	–	–	–
C.J. Odom	6	9	–	–	–
P.M. Williams	6	10	–	–	–
N.Q. George	6	9	–	–	–
N.R. Friedlos*	2	5	–	–	–
Non-executive directors					
R.A. Rayne	6	–	–	–	–
J.C. Ivey	6	–	–	–	1
S.J. Neathercoat	6	–	3	4	1
R.A. Farnes	6	–	5	4	1
S.A. Corbyn	6	–	4	2	1
D. Newell	6	–	5	4	1
J. de Moller	5	–	5	4	1

*For the period 1st February 2007 to 18th July 2007.

Performance evaluation

During 2007, the nomination committee carried out a formal appraisal of the performance of the board and its committees. The remuneration committee performed appraisals of each of the executive directors, as part of the salary review process. The performance of the chairman was evaluated by the non-executive directors under the chairmanship of the senior independent director. All of the appraisals were conducted internally using questionnaires based on the guidance contained in the Higgs Report.

Directors

Appointment of a director from outside the company is on the recommendation of the nominations committee, whilst internal promotion is a matter decided by the board unless it is considered appropriate for a recommendation to be requested from the nominations committee. All new directors must stand for election at the first annual general meeting following their appointment. Existing directors must submit themselves for re-election at least once every three years.

If considered appropriate, new directors are sent on an external training course addressing their role and duties as a director of a quoted public company. Existing directors monitor their own continued professional development and are encouraged to attend those courses that keep their market and regulatory knowledge current.

All directors have access to the services of the company secretary and any director may instigate an agreed procedure whereby independent professional advice may be sought at the company's expense. Directors and officers liability insurance is maintained by the company.

Communication with shareholders

The company has always recognised the importance of clear communication with shareholders. Regular contact with institutional shareholders and fund managers is maintained, principally by the executive directors, through the giving of presentations and organising visits to the group's property assets. The board receives regular reports of these meetings. The annual report, which is sent to all shareholders, reinforces this communication. The annual general meeting provides an opportunity for shareholders to question the directors and, in particular, the chairman of each of the board committees. An alternative channel of communication to the board is available through the senior independent director.

Internal control

The directors recognise that they have overall responsibility for ensuring that the group maintains a sound system of internal control that provides the board with reasonable assurance regarding the effective and efficient operations, internal financial control and compliance with laws and regulations. Such a system can only manage business risk, not eliminate it, and cannot provide absolute assurance against material misstatement or loss. Accordingly, the system is designed to provide reasonable assurance that material risks and problems are identified and appropriate remedial measures taken on a timely basis.

A more detailed description of the group risk management and internal control is included in the business review.

The board has considered the need for an internal audit function but continues to believe that this is unnecessary given the size and complexity of the group.

Going concern

Having made due enquiries, the directors have reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Therefore, the board continues to adopt the going concern basis in preparing the accounts.

Statement of directors' responsibilities

Directors' responsibilities

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company, for safeguarding the assets of the company, for taking reasonable steps for the prevention and detection of fraud and other irregularities and for the preparation of a directors' report and directors' remuneration report which comply with the requirements of the Companies Act 1985.

The directors are responsible for preparing the annual report and the financial statements in accordance with the Companies Act 1985. The directors are also required to prepare financial statements for the group in accordance with International Financial Reporting Standards as adopted by the European Union (IFRSs) and Article 4 of the IAS Regulation. The directors have chosen to prepare financial statements for the company in accordance with IFRSs

International Accounting Standard 1 requires that financial statements present fairly for each financial year the company's financial position, financial performance and cash flows. This requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the International Accounting Standards Board's 'Framework for the preparation and presentation of financial statements'. In virtually all circumstances, a fair presentation will be achieved by compliance with all applicable IFRSs. A fair presentation also requires the directors to:

- consistently select and apply appropriate accounting policies;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance.

Financial statements are published on the group's website in accordance with legislation in the United Kingdom governing the preparation and dissemination of financial statements, which may vary from legislation in other jurisdictions. The maintenance and integrity of the group's website is the responsibility of the directors. The directors' responsibility also extends to the ongoing integrity of the financial statements contained therein.

Remuneration committee

The remuneration committee (the 'committee') is chaired by Mr Farnes and Messrs Neathercoat and Corbyn served throughout the year. On 1st February 2007 the company acquired London Merchant Securities plc and Mrs de Moller and Mr Newell joined the committee. None of the members who have served during the year had any personal interest in the matters decided by the committee, or any day to day involvement in the running of the business and, therefore, are considered to be independent.

The committee's responsibilities include determining remuneration packages for the executive directors. It also oversees the operation of the group's performance share plan. The terms of reference of the committee are available on the group's website.

During the year the committee undertook a review, discussed below, of its remuneration arrangements for senior executives. Hewitt New Bridge Street LLP (HNBS) were retained to assist with this review. HNBS also provided independent assistance to the committee in relation to its determination of the extent of vesting of outstanding share awards. No director had any involvement in determining his own remuneration although some of the matters considered by the committee were discussed with Mr Burns. The company secretary acted as secretary to the committee.

Remuneration policy

The key aims of the committee's remuneration policy for senior executives are:

- to ensure that the company attracts, employs and motivates executives that have the skills and experience necessary to make a significant contribution to the delivery of the group's objectives;
- to incentivise key executives by use of a remuneration package that is appropriately competitive with other real estate companies taking into account the significantly enhanced size and complexity of the roles following the acquisition of London Merchant Securities plc and the experience and importance to the business of the individuals involved, whilst also having broad regard to levels of remuneration in similar sized FTSE 350 companies;
- to align, as far as possible, the interests of the senior executives with those of shareholders by providing a significant proportion of the directors' total remuneration potential through a balanced mix of short- and long-term performance related elements; and
- to ensure that incentive schemes are subject to appropriately stretching performance conditions and designed so as to be consistent with best practice.

Review of remuneration arrangements

The company has operated with an essentially unchanged remuneration structure for its senior executive team since 2004. Following the acquisition of London Merchant Securities plc, the committee felt it was an appropriate time to assess whether these arrangements remain appropriate and consistent with its remuneration policy and accordingly commissioned an independent review by HNBS. Following this review, the committee has decided that a number of changes should be made to the senior executives' remuneration structure as outlined in the report below. The committee believes that the changes will enable the company to provide a remuneration package that is competitive, challenging and, by rewarding executives for significant financial and share price out-performance, aligned with the interests of its shareholders.

One of the key findings of the review was that the total value of the executive directors' existing remuneration packages was generally significantly below market levels. The committee is very keen to retain its current executive team to continue the excellent growth of recent years and accordingly recognises that it needs to offer an appropriately competitive remuneration package. Variable rather than fixed pay will be the primary basis of the potential increase in remuneration and that is only payable in the event of the company performing strongly.

Elements of remuneration package

a) Base salary and benefits

Base salaries for executive directors are reviewed annually by the committee with changes being effective from 1st January. Salaries effective from 1st January 2008, adjusted following the review, are John Burns £500,000, Simon Silver £425,000, Chris Odom £315,000, Nigel George £300,000, Paul Williams £300,000 and David Silverman £220,000.

The executive directors receive a pension contribution worth 20% of base salary to a defined contribution scheme or a salary supplement in lieu of this contribution. The principal benefits in kind comprise a company car and medical insurance.

b) Annual bonus

Since 2004, the annual bonus scheme has allowed executive directors to earn up to 100% of salary in cash each year, two thirds based on Adjusted Net Asset Value ('NAV') growth and one third at the discretion of the committee.

Following the review, the committee has decided that the maximum bonus potential should be increased in 2008 to 150% of salary for John Burns and Simon Silver and to 125% of salary for the other executive directors.

Any bonus worth up to 100% of salary will continue to be paid in cash. However, any bonus earned above 100% of salary will be compulsorily deferred in shares with half released 12 months after award and the remainder released 24 months after award. These shares will be potentially forfeitable if the executive leaves prior to the share release date.

Annual bonus measures for 2008 will be based 75% on two financial measures, namely NAV growth and Total Return (being NAV growth plus dividends) and 25% at the committee's discretion (linked to the achievement of pre-set personal and strategic targets). The committee felt that it was appropriate for a greater proportion of bonus to be determined by financial measures than previously (hence the increase to a 75% weighting). It also felt that, as a REIT, dividend performance should determine part of the bonus, hence the inclusion of Total Return as a measure for the first time.

c) Long-term incentives

Under the existing performance share plan (PSP), approved by shareholders at the 2004 AGM, selected individuals may receive a conditional award of shares worth up to 100% of salary. This award will normally be released after three years subject to continued employment with half being subject to a Total Shareholder Return (TSR) performance measure and the other half being subject to a NAV performance measure. This mix of measures is felt by the committee to be appropriate as it rewards executives for achieving above market levels of growth in asset value and above market returns to shareholders. Details of outstanding share entitlements under the scheme, along with associated performance conditions, are set out below in Table 2.

Following the independent review, a number of changes are proposed to the PSP which, subject to the changes receiving shareholder approval, would apply to grants following the 2008 AGM. Full details of the proposed changes, and the rationale underlying them, are outlined in the chairman's letter in the circular to shareholders dated 22nd April 2008 which accompanies the report and accounts but, in summary, it is proposed that for future awards:

- The maximum permitted annual award level of shares will be increased from 100% of salary to 200% of salary (with a higher limit of 300% of salary for use in the event of exceptional circumstances such as recruitment). Award policy within this limit will be limited initially to annual awards worth no more than 175% of salary for John Burns and Simon Silver and 150% of salary for other directors.
- The TSR performance condition will compare performance with a comparator group comprising a selected group of real estate companies rather than the constituents of the FTSE All-Share Real Estate sector as at present.
- The NAV performance condition will reward executives for the extent of out-performance of the total return of the median performing property in the IPD Central London Offices Total Return Index rather than the median to upper quartile vesting scale currently employed.

Vesting of future awards under the PSP will, therefore, normally occur provided that the executive is still employed at the end of the three-year vesting period and to the extent that pre-set performance targets have been satisfied. Performance targets for the initial awards will be as follows:

- 50% of an award will be determined by the company's TSR compared to that of the companies listed below:
  Land Securities Group plc
  British Land Company plc
  Liberty International plc
  Hammerson plc
  Segro plc
  Great Portland Estates plc
  Brixton plc
  Shaftesbury plc
  Quintain Estates and Development plc
  Workspace Group plc
  Big Yellow Group plc
  St Modwen Properties plc
  Mapeley Estates Ltd
  Capital & Regional plc
  Minerva plc

  TSR will be measured over a single three-year performance period from the date of grant and will be calculated by comparing average performance over three months prior to the start and end of the performance period.
- 50% of an award will be determined by the company's NAV growth compared to the return from properties in the IPD Central London Offices Total Return Index over the performance period. Performance will be measured over a single three-year period from the start of the financial year in which the award is granted.
- Vesting will be on the basis outlined below:

TSR performance	NAV growth performance	Vesting percentage
Below median	Below median	0%
Median	Median	25%
Upper quartile	Out-perform median by 5% p.a.	100%
Intermediate performance		Pro rata between 25% and 100%

  The committee will have discretion to reduce the extent of vesting in the event that it feels that performance against the relevant measure of performance (whether TSR or NAV growth) is inconsistent with underlying financial performance.
- Awards will be satisfied by either newly issued shares or shares purchased in the market. Any use of newly issued shares will be limited to corporate governance compliant dilution limits contained in the scheme rules.

Shareholder approval will also be sought at the AGM for a new share option scheme to replace the 1997 Executive Share Option Scheme which expired last year. Executive directors are not eligible to participate in this scheme. Full details of the scheme are outlined in the circular to shareholders dated 22nd April 2008 which accompanies the report and accounts.

Shareholding guideline
Following the independent review, and in line with best practice, a share ownership guideline has been introduced for executive directors requiring them to retain at least half of any share awards vesting from 1st January 2009 as shares (after paying any tax due on the shares) until they have a shareholding worth at least 100% of their salary (200% of salary for the CEO).

Service contracts
The service contracts of Messrs. Burns, Silver and Odom are dated 20th May 1997 whilst those of Messrs. George and Williams are dated 31st March 1999 and that of Mr Silverman 2nd January 2008. The contracts have no stated termination date but require 12 months' notice of termination by the company or six months' notice by the executive. A provision is included whereby the company will pay, by way of liquidated damages, a cash amount equivalent to 12 months' salary and benefits in kind plus a pension contribution or salary supplement of at least 20% of basic salary. The remuneration committee reviews its policy in relation to executive service contracts periodically and a review is scheduled for 2008.

Details of directors' remuneration are given in Table 1 below:

Table 1

	Salary and fees £'000	Estimated bonus £'000	Benefits in kind £'000	Gains from equity settled schemes £'000	**2007 Total £'000**	**2007 Pension and life assurance £'000**
Executive						
J.D. Burns	450	337	40	461	**1,288**	**99**
S.P. Silver	375	281	25	386	**1,067**	**96**
C.J. Odom	290	218	12	290	**810**	**76**
N.Q. George	275	206	16	236	**733**	**67**
P.M. Williams	275	206	19	263	**763**	**67**
N.R. Friedlos**	115	–	8	27	**150**	**26**
Non-executive						
R.A. Rayne*	137	–	28	–	**165**	**–**
J.C. Ivey	50	40	–	–	**90**	**–**
S.J. Neathercoat	38	–	–	–	**38**	**–**
R.A. Farnes	38	–	–	–	**38**	**–**
S.A. Corbyn	35	–	–	–	**35**	**–**
J. de Moller*	32	–	–	–	**32**	**–**
D. Newell*	32	–	–	–	**32**	**–**
	2,142	1,288	148	1,663	**5,241**	**431**

*From 1st February 2007.
**For the period 1st February 2007 to 18th July 2007.

In addition to the above, Mr Friedlos received a predetermined compensation payment of £536,758 when he resigned from the company. This was in accordance with a clause in his service agreement which had been preserved from his service contract with LMS Services Limited.

The bonus paid to Mr Ivey in 2007 was in recognition of the extra duties undertaken during the acquisition and integration of London Merchant Securities plc.

Table 1 (continued)

	Salary and fees £'000	Estimated bonus £'000	Benefits in kind £'000	Gain on exercise of share options £'000	2006 Total £'000	Under provision of 2006 bonus £'000	Revised 2006 Total £'000	2006 Pension and life assurance £'000
Executive								
J.D. Burns	420	315	38	457	1,230	23	1,253	96
S.P. Silver	350	263	24	826	1,463	19	1,482	95
C.J. Odom	270	203	12	350	835	14	849	73
N.Q. George	250	187	15	–	452	14	466	61
P.M. Williams	250	187	14	103	554	14	568	62
Non-executive								
J.C. Ivey	50	–	–	–	50	–	50	–
I. Yeatman*	17	–	–	–	17	–	17	–
S.J. Neathercoat	38	–	–	–	38	–	38	–
R.A. Farnes	38	–	–	–	38	–	38	–
S.A. Corbyn**	21	–	–	–	21	–	21	–
	1,704	1,155	103	1,736	4,698	84	4,782	387

*To 23rd May 2006.
**From 23rd May 2006.

The under provision of the 2006 bonus, which has been recognised in the 2007 results, is the amount by which the final award under the bonus scheme exceeded the estimated amount included in the 2006 results. The result could only be ascertained once the results of all the comparator companies had been announced. The total remuneration for 2006, which was previously disclosed as £4,698,000, has been revised to allow a correct comparison to be made between the two years.

Mr Burns received fees of £40,000 (2006: £37,500) in respect of his position as a non-executive director of The Davis Service Group. In accordance with the committee's policy, the fees are retained by Mr Burns.

Chairman and non-executive directors

The remuneration for the chairman is set by the full board. The remuneration for non-executive directors, which consists of fees for their services in connection with board and board committee meetings and, where relevant, for additional services such as chairing a board committee, is set by the whole board. Neither the chairman nor non-executive directors are eligible for pension scheme membership and do not participate in the company's bonus or equity based incentive schemes.

The non-executive directors do not have service contracts and are appointed for three year terms which expire as follows: Mr Ivey, 12th December 2008, Mr Farnes, 31st March 2009, Mr Corbyn, 23rd May 2009, Mrs de Moller and Mr Newell, 31st January 2010 and Mr Neathercoat, 28th February 2011. Mr Rayne has a letter of appointment, which runs for three years, expiring on 31st January 2010. In addition to his fee as chairman, it provides for a car, driver and secretary, together with a contribution to his office running costs. His letter of appointment also contains provisions relating to payment in lieu of notice, which are similar to those for the executive directors.

Performance Share Plan

Details of the conditional share awards held by directors and employees under the group's performance share plan at 31st December 2007 are given in Table 2 below:

Table 2

Market price at award date £	Earliest vesting date	Directors J.D. Burns	S.P. Silver	C.J. Odom	N.Q. George	P.M. Williams	Employees	Total
8.74	15/06/07	43,000	36,000	27,000	22,000	24,500	12,500	165,000
10.70	21/03/08	37,250	31,250	23,250	20,000	21,250	11,500	144,500
Interest at 1st January 2006		80,250	67,250	50,250	42,000	45,750	24,000	309,500
Shares conditionally awarded during the year:								
16.19	06/04/09	25,940	21,610	16,670	15,440	15,440	8,640	103,740
Interest at 31st December 2006		106,190	88,860	66,920	57,440	61,190	32,640	413,240
Shares conditionally awarded during the year:								
22.30	03/04/10	20,175	16,815	13,000	12,330	12,330	7,395	82,045
Shares vested or lapsed during the year:								
Market price at award date £	Market price at date of vesting							
8.74	13.68	(33,721)	(28,231)	(21,173)	(17,252)	(19,213)	(9,803)	(129,393)
8.74	Lapsed	(9,279)	(7,769)	(5,827)	(4,748)	(5,287)	(2,697)	(35,607)
Interest at 31st December 2007		**83,365**	**69,675**	**52,920**	**47,770**	**49,020**	**27,535**	**330,285**

The performance criteria in respect of the 2004 award were measured on 14th June 2007 and resulted in a vesting percentage of 78.42%. The balance of the award lapsed. At the same time the committee considered whether the group's total shareholder return reflected its underlying financial performance. Having taken into account the growth in net assets and profits over the period, the committee concluded that this was the case. The participants had six months in which to exercise the vested option and the shares were allotted on 21st November 2007.

For awards granted in 2004-2007, half of the shares vest according to TSR performance compared to the constituents, as at the date of grant, of the FTSE All-Share Real Estate Index. At a median level of performance, 25% will vest. At or above an upper quartile level of performance, 100% will vest. Between these two points, vesting will accrue on a straight-line basis. This element will only vest if the committee is also satisfied that the TSR performance reflects underlying financial performance.

The other half of the award will vest according to NAV growth compared to properties in the IPD Central London Offices Total Return Index for the same period. If the growth in NAV is less than the return from the median performing property in the IPD Index, no shares will vest. If growth in NAV is equal to the return from the median performing property in the IPD index, 25% will vest and the entitlement will then increase on a sliding scale up to 100% which is achieved if NAV growth equals the return from the upper quartile performing property in the IPD Index.

Share option schemes

Details of the options held by directors and employees under the group's share option schemes at 31st December 2007 are given in Table 3 below:

Table 3

Year ended 31st December 2007

Exercise price £	Date from which exercisable	Expiry date	Directors J.D. Burns	S.P. Silver	C.J. Odom	N.Q. George	P.M. Williams	Employees	Total number of shares
5.530	16/04/02	15/04/09	–	–	–	8,750	–	–	8,750
5.015	14/04/03	13/04/10	–	–	–	11,000	13,000	–	24,000
7.235	12/04/04	11/04/11	42,000	–	26,500	15,000	18,000	–	101,500
6.725	15/04/05	14/04/12	24,000	–	15,000	10,750	12,250	6,500	68,500
4.265	22/04/06	21/04/13	–	–	26,000	20,500	22,500	16,500	85,500
8.590	05/07/07	04/07/14	–	–	–	–	–	20,000	20,000
10.710	26/04/08	25/04/15	–	–	–	–	–	20,000	20,000
13.630	08/06/09	07/06/16	–	–	–	–	–	14,250	14,250
Outstanding at 1st January 2007			66,000	–	67,500	66,000	65,750	77,250	342,500
Options exercised during the year:									
Exercise price £		Market price at date of exercise £							
4.265		20.87	–	–	–	–	–	(5,000)	(5,000)
Outstanding at 31st December 2007			**66,000**	**–**	**67,500**	**66,000**	**65,750**	**72,250**	**337,500**
Number not exercisable									34,250
Number exercisable									303,250

In respect of options exercised during the year, the weighted average exercise price was £4.265 (2006: £5.454) and the weighted average market price at date of exercise was £20.87 (2006: £15.12). No options were granted during 2007 and no options lapsed during 2007 or 2006.

Table 3 (continued)
Year ended 31st December 2006

Exercise price £	Date from which exercisable	Expiry date	J.D. Burns	S.P. Silver	Directors C.J. Odom	N.Q. George	P.M. Williams	Employees	Total number of shares
5.530	16/04/02	15/04/09	–	–	16,500	8,750	10,750	–	36,000
5.015	14/04/03	13/04/10	–	–	19,000	11,000	13,000	–	43,000
7.235	12/04/04	11/04/11	42,000	35,000	26,500	15,000	18,000	5,500	142,000
6.725	15/04/05	14/04/12	24,000	20,250	15,000	10,750	12,250	6,500	88,750
4.265	22/04/06	21/04/13	42,000	35,000	26,000	20,500	22,500	16,500	162,500
8.590	05/07/07	04/07/14	–	–	–	–	–	20,000	20,000
10.710	26/04/08	25/04/15	–	–	–	–	–	20,000	20,000
Outstanding at 1st January 2006			108,000	90,250	103,000	66,000	76,500	68,500	512,250
Options granted during the year:									
13.630	08/06/09	07/06/16	–	–	–	–	–	14,250	14,250
Options exercised during the year:									

Exercise price £		Market price at date of exercise £	J.D. Burns	S.P. Silver	C.J. Odom	N.Q. George	P.M. Williams	Employees	Total number of shares
5.530		15.12	–	–	(16,500)	–	(10,750)	–	(27,250)
5.015		15.12	–	–	(19,000)	–	–	–	(19,000)
7.235		15.12	–	(35,000)	–	–	–	(5,500)	(40,500)
6.725		15.12	–	(20,250)	–	–	–	–	(20,250)
4.265		15.12	–	(35,000)	–	–	–	–	(35,000)
4.265		15.15	(42,000)	–	–	–	–	–	(42,000)
			(42,000)	(90,250)	(35,500)	–	(10,750)	(5,500)	(184,000)
Outstanding at 31st December 2006			66,000	–	67,500	66,000	65,750	77,250	342,500
Number not exercisable									54,250
Number exercisable									288,250

	31st December 2007	31st December 2006	1st January 2006
Weighted average exercise price of share options:			
Exercisable	**£6.20**	£6.00	£6.58
Not exercisable	**£11.92**	£10.70	£5.53
Weighted average remaining contracted life of share options:			
Exercisable	**4.12 years**	4.98 years	5.20 years
Not exercisable	**7.79 years**	8.32 years	7.62 years

The exercise of options granted under the 1997 executive share option scheme is subject to a three-year performance criteria. This states that a year's options can only be exercised once the growth of the group's net asset value per share over a subsequent three-year period exceeds the increase of the IPD Central London Office Capital Growth Index over the same period by 6% or more. Those exercisable on 16th April 2002, 14th April 2003, 12th April 2004, 15th April 2005, 22nd April 2006 and 5th July 2007 have met this criteria. Subsequent options have yet to be tested. No options lapsed during the year.

As a result of the acquisition, options that had already vested under LMS's Executive Share Option Scheme were converted to options over Derwent London shares. Details of these options, all of which are exercisable, are given in Table 4 below:

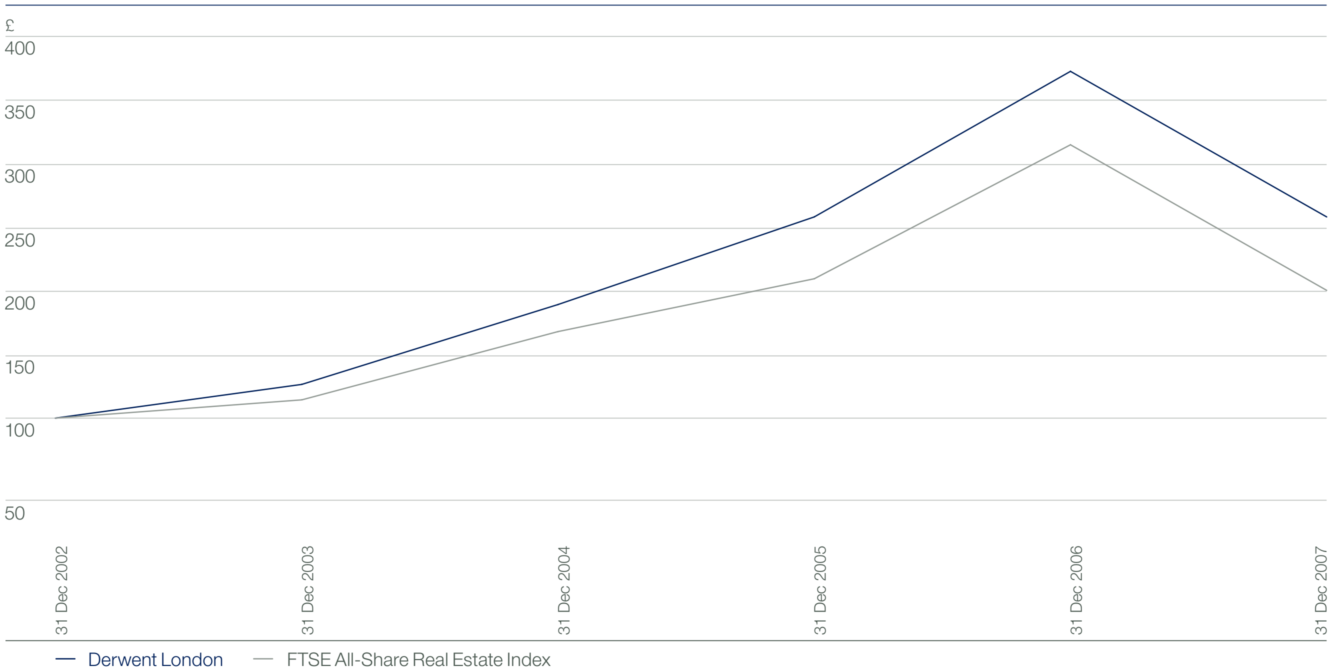
Table 4

Exercise price £	Expiry date	R.A. Rayne	N.R. Friedlos	Employees	Total
Outstanding at 1st January 2006 and 31st December 2006		–	–	–	–
Options arising as a result of the acquisition of LMS plc:					
9.54	05/01/11	225,401	–	–	225,401
7.54	29/08/13	65,615	–	–	65,615
9.92	01/03/08	–	–	7,163	7,163
9.92	01/09/14	50,274	–	–	50,274
12.03	28/12/08	–	20,780	1,081	21,861
12.03	28/06/15	41,456	–	–	41,456
14.44	29/07/08	–	–	7,548	7,548
		382,746	20,780	15,792	419,318
Options exercised during the year:					
Exercise price £	Market price at date of exercise £				
14.44	22.68	–	–	(4,640)	(4,640)
14.44	22.70	–	–	(831)	(831)
14.44	22.79	–	–	(2,077)	(2,077)
12.03	15.46	–	(8,000)	–	(8,000)
		–	(8,000)	(7,548)	(15,548)
Outstanding at 31st December 2007		**382,746**	**12,780**	**8,244**	**403,770**

In respect of the options shown in Table 4 exercised during the year the weighted average exercise price was £13.20 and the weighted average exercise price was £18.98. The weighted average exercise price of the options outstanding at 31st December 2007 was £9.74 and the weighted average remaining contracted life was 4.1 years. No options lapsed during 2007

The market price of the 5p ordinary shares at 31st December 2007 was £14.14. During the year, they traded in a range between £13.09 and £22.80.

Performance graph
Total shareholder return compared to the FTSE All-Share Real Estate Index.



Net investment
2002–2007

This graph shows the value, by the end of 2007, of £100 invested in Derwent Valley Holdings/Derwent London compared to that of £100 invested in the FTSE All-Share Real Estate Index. This index has been chosen by the committee as it is considered the most appropriate benchmark against which to assess the relative performance of the company for this purpose. To produce a 'fair value', each point is a 30 day average of the return.

The disclosure on directors' remuneration in Tables 1 to 4 above has been audited as required by Part 3 of Schedule 7A of the Companies Act 1985.

On behalf of the board

R.A. Farnes
Chairman of the remuneration committee
18th March 2008

Directors

R.A. Rayne, 58 Non-executive chairman
The Hon R A Rayne joined the board following the merger with London Merchant Securities plc where he had been chief executive since 2001. He has been on the boards of a number of public companies, including First Leisure Corporation plc and Crown Sports plc and is currently chief executive officer of LMS Capital plc, a company listed on AIM. He is also a non-executive director of Weatherford International Inc., an international oil services company quoted on the New York Stock Exchange, and chairman of Energy Cranes International Limited.

J.C. Ivey, 66 Non-executive deputy chairman
A chartered accountant, Mr Ivey is a director of RWS Holdings plc and was formerly chief executive of The Davis Service Group plc. He has served on the board since 1984 and chairs the nominations committee.

J.D. Burns, 63 Chief executive officer
Mr Burns has been a director of the company since 1984 and has overall responsibility for group strategy, business development and day-to-day operations. He is a non-executive director of The Davis Service Group plc and a partner in The Pilcher Hershman Partnership, estate agents.

S.P. Silver, 57
Mr Silver has overall responsibility for acquisitions, design and development projects. He became a director in 1986 and is a partner in The Pilcher Hershman Partnership.

C.J. Odom, 57
Mr Odom joined the board in 1988. He is a chartered accountant and has overall responsibility for financial strategy, treasury, taxation and financial reporting.

N.Q. George, 44
A chartered surveyor, Mr George was appointed to the board in 1998. He has responsibility for acquisitions and investment analysis.

P.M. Williams, 48
Mr Williams is a chartered surveyor and was appointed to the board in 1998. His responsibilities include asset management and supervision of refurbishment and development projects.

D.G. Silverman, 38
Mr Silverman joined the board in January 2008. He is a chartered surveyor and plays an important role in investment acquisitions and disposals.

S.J. Neathercoat, 59 Senior independent director
Mr Neathercoat is a chartered accountant. He joined the board in March 1999 and chairs the audit committee whilst serving on the remuneration and nominations committees. He was previously a managing director of Dresdner Kleinwort Wasserstein.

R.A. Farnes, 62 Non-executive director
Mr Farnes is a chartered surveyor. He was previously the chairman of CB Hillier Parker and joined the board on 1st April 2003. He chairs the remuneration committee and is a member of the audit and nominations committees.

S.A. Corbyn, 63 Non-executive director
Mr Corbyn was appointed to the board in May 2006. He is also chief executive of Cadogan Estates, one of the principal private estates in London, and a former president of the British Property Federation.

J. de Moller, 60 Non-executive director
Mrs de Moller joined the board following the merger with London Merchant Securities plc, where she had been a non-executive director since 2002. She is a non-executive director of Temple Bar Investment Trust plc and Archant Limited. Previously, she was managing director of Carlton Communications Plc and a non-executive director of Cookson Group plc, BT plc, AWG plc and J Sainsbury plc.

D. Newell, 65 Non-executive director
Mr Newell joined the board following the merger with London Merchant Securities plc, where he had been a non-executive director since 1998. Mr Newell was senior partner of Hillier Parker May & Rowden until 1998, co-chairman of the Europe, Middle East and Africa division of CB Richard Ellis Services Inc until December 2000 and a past president of the British Council of Offices.

Report of the audit committee

Membership

Mr Neathercoat was chairman of the committee with Messrs Corbyn and Farnes serving throughout 2007. Following the acquisition of London Merchant Securities plc on 1st February 2007 Mrs de Moller and Mr Newell joined the committee. All members are considered independent by the company having no day-to-day involvement with the company. Mr Neathercoat is a member of the Institute of Chartered Accountants of England and Wales and considered to have appropriate recent and relevant financial experience. The committee has access to further financial expertise at the company's expense, if required.

Roles and responsibilities

The terms of reference for the committee are available on the group's website.

Meetings

The committee meets at least three times a year to discharge its responsibilities. Meetings are attended by the group's external auditors and the group's finance director when invited. During 2007, four meetings were held.

Work of the committee

During the year, the committee has carried out the following:

- reviewed the interim and annual financial statements and considered the appropriateness of the accounting policies used, assumptions adopted and estimates made;
- held meetings with the group's external valuers;
- reviewed the scope of the annual audit and the level of associated fees; and
- considered the adequacy of the auditor's statement of independence and monitored the operation of the group's policy regarding the use of the external auditor for non-audit work which helps to protect the auditor's independence and objectivity.

A major source of non-audit work each year for the group's auditor is tax compliance work. The committee has considered this arrangement and continues to be of the opinion that this is an efficient arrangement that does not compromise the auditor's independence:

- recommended the re-appointment of the group's external auditors after due consideration of the conduct of the audit and the matters raised in the management letter;
- commissioned a review of the operation of the group's systems and controls;
- considered the need for an internal audit function; and
- reviewed, commented upon and approved the preparation of the group's risk register.

S.J. Neathercoat
Chairman of the audit committee
18th March 2008

Report of the nominations committee

Membership

At the start of the year, the nominations committee comprised the three independent, non-executive directors, Messrs Neathercoat, Corbyn and Farnes, under the chairmanship of Mr Ivey. Following the acquisition of London Merchant Securities plc, Mrs de Moller and Mr Newell joined the committee.

Roles and responsibilities

The terms of reference for the committee are available on the group's website.

Meetings

The committee will meet at least once a year to carry out the annual appraisal of the board and its committees. Further meetings are arranged, as required, to discharge the committee's responsibilities in connection with identifying and nominating to the board suitable candidates to fill vacancies for non-executive directors and, if requested, executive directors.

Work of the committee

During the year, the committee has carried out the following:

- appraised the board and its committees;
- discussed the composition of the post-merger board with institutional investors; and
- considered the proposed appointment of Mr Silverman to the board.

J.C. Ivey
Chairman of the nominations committee
18th March 2008

Independent auditor's report to the shareholders of Derwent London plc

We have audited the group and parent company financial statements (the 'financial statements') of Derwent London plc for the year ended 31st December 2007 which comprise the consolidated income statement, the consolidated and parent company balance sheets, the consolidated and parent company cash flow statements, the consolidated and parent company statements of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the directors' remuneration report that is described as having been audited.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report, the directors' remuneration report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the statement of directors' responsibilities.

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

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and whether, in addition, the group financial statements have been properly prepared in accordance with Article 4 of the IAS Regulation. We also report to you whether, in our opinion, the information given in the directors' report is consistent with the financial statements. In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the company's compliance with the nine provisions of the 2006 Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the group's corporate governance procedures or its risk and control procedures.

We read other information contained in the annual report and consider whether it is consistent with the audited financial statements. This other information comprises only the directors' report, the unaudited part of the directors' remuneration report, the chairman's statement, the business review and the corporate governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Our report has been prepared pursuant to the requirements of the Companies Act 1985 and for no other purpose. No person is entitled to rely on this report unless such a person is a person entitled to rely upon this report by virtue of and for the purpose of the Companies Act 1985 or has been expressly authorised to do so by our prior written consent. Save as above, we do not accept responsibility for this report to any other person or for any other purpose and we hereby expressly disclaim any and all such liability.

Basis of audit opinion

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

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

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the group's affairs as at 31st December 2007 and of its profit for the year then ended;
- the group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the parent company financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, of the state of the parent company's affairs as at 31st December 2007;
- the parent company financial statements and the part of the directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the directors' report is consistent with the financial statements.

BDO Stoy Hayward LLP
Chartered Accountants and Registered Auditors
London
18th March 2008

Five year summary

	IFRS*				UK GAAP	
	2007	2006	2005	2004	2004	2003
	£m	£m	£m	£m	£m	£m
Gross property income	**111.7**	51.3	49.5	52.1	49.9	47.9
Net property income	**103.8**	58.0	46.6	48.0	44.8	41.5
Recurring profit before tax†	**38.0**	16.4	16.7	18.3	16.4	16.2
Profit on disposal of properties and investments	**130.8**	2.9	9.6	24.9	6.4	1.6
(Loss)/profit before tax	**(99.8)**	242.8	150.4	91.1	22.8	17.1
Net assets	**1,841.9**	783.4	606.2	495.5	554.7	477.6
Investment property valuation	**2,671.7**	1,282	1,009.8	906.2	924.8	812.1
Revaluation surplus/(deficit)	**90.3**	223.2	124.1	46.4	66.9	(39.6)
Net debt	**782.8**	349.8	303.9	341.5	319.3	301.8
Cash flow	**84.4**	(59.4)	34.5	(17.9)	(17.9)	(5.0)
Net cash inflow/(outflow) from operating activities	**28.4**	(5.6)	13.7	12.9	12.9	11.7
Acquisitions	**140.7**	48.9	40.3	88.7	88.7	59.1
Capital expenditure on properties	**68.3**	18.9	26.7	26.1	26.1	24.0
Disposals	**352.4**	31.2	97.8	76.9	76.9	76.5
Recurring earnings per share (p)†	**35.14**	27.44	26.23	29.91	23.51	26.62
Dividend per share (p)	**18.025**	13.95	12.83	11.70	12.50	11.40
Adjusted net asset value per share (p)†	**1,801**	1,770	1,335	1,074	1,068	920
Net asset value per share (p)	**1,770**	1,460	1,134	930	1,041	898
Total return (%)	**2.8**	33.6	25.5	17.2	17.4	(5.2)
Gearing						
Balance sheet (%)	**42.5**	44.7	50.1	68.9	57.6	63.2
Profit and loss	**1.81**	1.85	1.85	1.76	1.87	1.96

* The figures for 2004 to 2007 above have been prepared under IFRS and therefore are not directly comparable with the prior year UK GAAP figures for 2003 and 2004.
† As defined in financial highlights on page 6.

Financial calendar

Issue of first quarter 2008 management statement	May 2008
Annual general meeting	5th June 2008
Announcement of 2008 interim results	August 2008
Issue of third quarter 2008 management statement	November 2008
Payment of 2008 interim dividend	November 2008
Announcement of 2008 preliminary results	March 2009

Advisers

Auditor
BDO Stoy Hayward LLP

Solicitor
Slaughter and May

Brokers
UBS
JP Morgan Cazenove

Clearing banker
HSBC Bank plc

Registrar
Equiniti

The paper used in this annual report is 100% chlorine free woodpulp from sustainable forests, using thinnings and waste from the timber industry and is totally recyclable and biodegradable.

Designed and produced by CDT Design
www.cdt-design.co.uk

Printed in England by Fulmar Colour Printing

DERWENT LONDON

Derwent London plc

Registered office:
25 Savile Row
London W1S 2ER

t 020 7659 3000
f 020 7659 3100
www.derwentlondon.com

Registered No. 1819699