the **Local Shopping** reit plc

# MAKING PROPERTY WORK

Annual Report and Accounts for the year ended 30 September 2010

# Welcome to **The Local Shopping REIT plc**



The Local Shopping REIT plc ("LSR") is a major owner of local retail property in the UK, listed on the London Stock Exchange.

Our investment objective is to provide our shareholders with an attractive and growing level of income, with additional capital growth through active asset management.

We also look to enhance shareholder returns by combining our asset management skills with the complementary interests and resources of joint venture partners.

the **Local Shopping** reit plc

London Stock Exchange
LISTED
PREMIUM

# Highlights

| Recurring Profit | Dividend per Share | Adjusted Net Asset Value |
|---|---|---|
| £2.93m | 3.6p | £66.8m |
| (2009: £2.85m) | (2009: 3.5p) | (2009: £63.9m) |

## Operational Highlights

for further details see page 7

- Joint Venture established with Pramerica Real Estate Investors after the year end, to invest £100m in the UK neighbourhood/convenience retail sector. Pramerica has committed to provide 80% of the equity (£30m) and LSR will provide the remaining 20% (£7.5m). LSR will act as asset manager and will be responsible for sourcing investments, for which it will receive related fees
- Good lettings progress made, resulting in a stable void rate at 11.3% (30 September 2009: 11.4%):
  - 107 new lettings secured generating an annual rental income of £983,534 in the year to 30 September 2010 (106 units were let at £1,127,904 per annum during the year ended 30 September 2009). Of the total, 63 were let in the second half, producing rental income of £589,770 per annum
  - 198 rent reviews generated a rental increase of £143,449 per annum, an average uplift of 5.6% (7.9% above Market Rent)
  - 45 lease renewals generated a rental increase of £16,119 per annum, an average uplift of 4.8% (5.2% above Market Rent)
  - Rental deposits increased to approximately £940,000, or 23% of our quarterly rent roll (30 September 2009: £900,000)
  - 19 recently redeveloped flats let, generating a combined annual income of £120,970
- Active acquisitions and disposals programme under way:
  - 35 properties acquired for £16.9m at an average yield of 7.89%, 20 of which were purchased during the second half for £10.8m at an average yield of 7.85%
  - Successful sale of 14 ex-growth properties for a total of £4.7m at an average yield of 6.85%, four of which were sold during the second half for £2.3m (March 2010 value: £2.2m)
- Ten change of use applications approved and planning consent secured for 50 flats, a reconfiguration of four retail units and consent for a 4,600 sq ft convenience store
- Recognised expertise in managing a diverse portfolio of smaller assets has led to ongoing progress in securing asset management opportunities with banks:
  - Appointed to manage a small mixed-use portfolio in the North West at the request of a large UK bank
  - Legal agreement signed with another UK lender to manage the properties acquired when they take back control from their borrowers
  - Discussions ongoing with a number of lenders about assisting them with distressed property situations.

## Financial Highlights

for further details see page 12

- Market value of portfolio increased 10.6% to £192.9m (30 September 2009: £174.4m). Values up 3.5% on a like-for-like basis over the full year
- Recurring profit of £2.9m or 3.6 pence per share (30 September 2009: £2.9m or 3.5 pence per share)
- IFRS profit for the year £1.8m (30 September 2009: loss of £31.0m)
- Net Asset Value (NAV) of £57.6m or 70 pence per share (30 September 2009: £58.6m or 71 pence per share)
- Adjusted NAV of £66.8m or 81 pence per share excluding liabilities arising from derivative financial instruments (30 September 2009: £63.9m or 77 pence per share)
- Annual rent roll increased 5.6% to £16.4m (30 September 2009: £15.5m)
- Prudent debt and financial management:
  - Total net debt of £131.7m, reflecting an LTV of 67.3%, with no ongoing loan to value default provisions on the fully drawn facilities and low interest cover tests across all loans
  - £44.4m of undrawn facilities as at 30 September 2010, comprising a term loan, of which £14.5m is undrawn, and a revolving credit facility, of which £29.9m is undrawn
  - Debt free properties valued at £30.1m
  - No refinancing due until 2016
- Dividend of 1.9 pence per share to be paid on 31 December 2010 as a PID to shareholders on the register on 10 December 2010. The ex dividend date was 8 December 2010

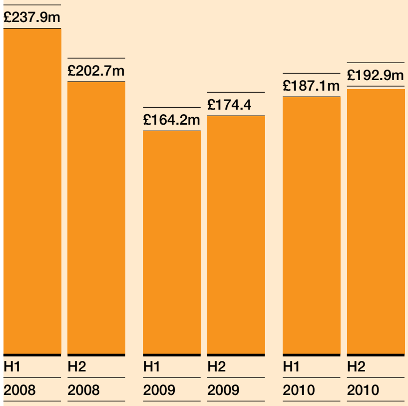
# LSR at a Glance

## Portfolio Value

£192.9m

+10.6%

(2009: £174.4m)

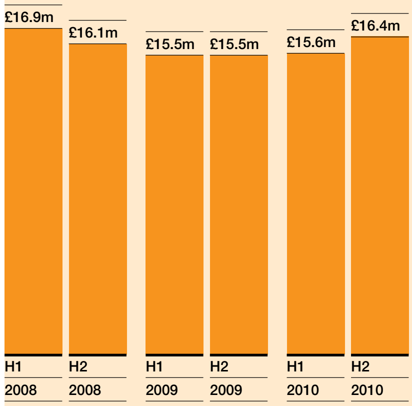



## Portfolio rent p.a.

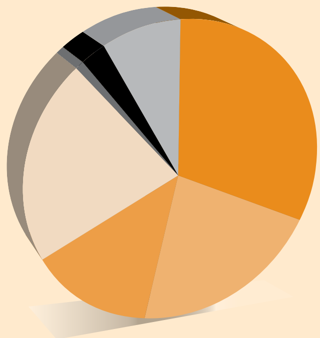
£16.4m

+5.6%

(2009: £15.5m)

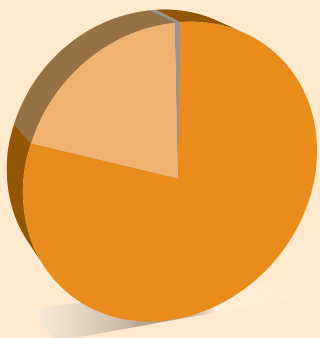



## Market Rent



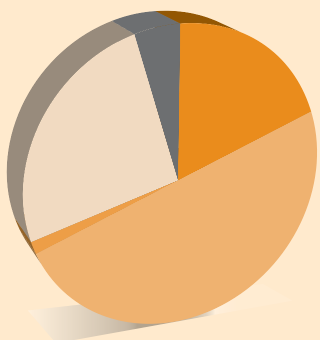
### Lease Expiry Profile

| | |
|---|---|
| 32.4% | 0-3 years |
| 21.4% | 3-6 years |
| 14.1% | 6-9 years |
| 20.8% | 9+ years |
| 0.8% | Vacant (residential) |
| 2.5% | Vacant (deliberate) |
| 8.0% | Vacant (commercial) |



### Tenure

| | |
|---|---|
| 80.8% | Freehold/virtual freehold |
| 18.8% | Leasehold |
| 0.4% | Short leasehold <50 years |



### Tenant Grade

| | |
|---|---|
| 19.2% | Local company |
| 50.2% | Individual |
| 1.4% | Government |
| 24.6% | National multiple |
| 4.6% | Regional multiple |

"The Company has established a reputation for being able to add value to smaller commercial properties located throughout the UK. We are pleased to report that we continue to achieve strong results by applying these skills to our diverse portfolio."

PROJECT

Rent Review:
**Sutherland Road, Heywood**

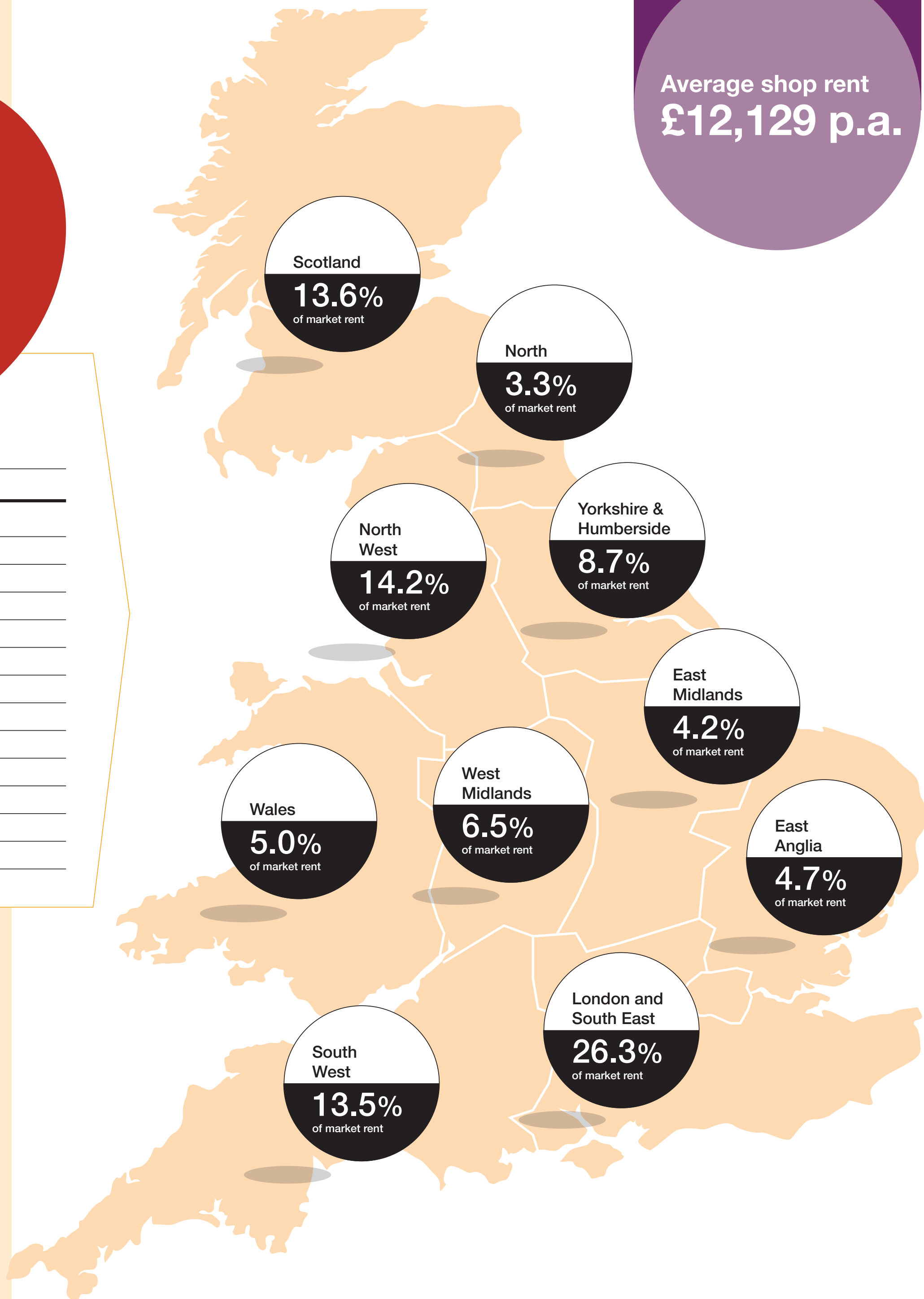

- 3,187 sq ft convenience store let to Co-op
- Passing rent £20,000 p.a. – £6.26 psf
- Tenant break and Rent Review February 2010
- Agreed May 2010 at £29,400 p.a. – £9.22 psf
- 47% uplift
- Break not exercised
- 31 March 2010 valuation £240,000
- 30 September 2010 valuation £350,000

Value before Rent Review
**£240,000**

Value after Rent Review
**£350,000**

Increase in Value
**37.5%**

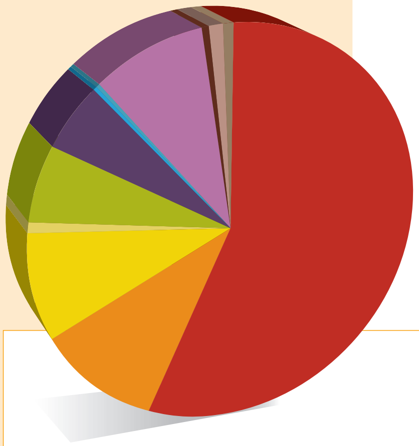
## Geographical Spread




### Did you know?

Our average shop rent is only £12,129 pa or £11.27 per sq. ft. Our rents remain affordable which is demonstrated by our continued success in letting vacant units.

**Average shop rent**
**£12,129 p.a.**



## Planning Use

| | |
|---|---|
| 57.2% | A1 Shops |
| 10.8% | A2 Financial |
| 8.9% | A3 Cafés/restaurants |
| 0.8% | A4 Pubs |
| 5.8% | A5 Takeaways |
| 5.1% | B1 Offices |
| 0.3% | B2 Industrial |
| 0.2% | B8 Storage |
| 8.6% | C3 Residential |
| 0.6% | D1 Institutional |
| 1.0% | D2 Leisure |
| 0.7% | Miscellaneous |

# Chairman's Statement

**Grahame Whateley**
Chairman

**"Despite challenging trading conditions, our business model, with its diversified tenant base, continues to perform well, with stable occupancy and a resilient lettings market."**

I am pleased to announce the Company's full year results for the 12 month period to 30 September 2010.

## Introduction

Against a difficult and uncertain economic backdrop, the Company has performed well over the year. Our programme of active asset management has delivered nearly £170,000 per annum of additional income through successful rent reviews, lease renewals and surrender and re-lettings. The conversion of redundant space above a number of our shops into 20 flats has added a further £120,000 to the annual rent roll and over the year we have secured planning consent for a further 50 such conversions. Our hands-on approach to asset management and flexible leasing policy has resulted in a stable void rate over the year. Additionally, a firm but fair approach to credit control has led to a £125,000 reduction in charges for bad debts. Through our national network of agents, we have made 35 accretive acquisitions at an average yield of 7.89% providing us with the potential for future growth. At the same time, in a difficult market, we have sold 14 ex-growth properties at an average yield of 6.85%, substantially below the prevailing yield on the portfolio.

As mentioned, however, market conditions during the period under review have continued to be challenging. Following the change of Government in May, a substantial deficit reduction programme has been put in place. The full economic impact of the cuts has yet to be felt and the ability of the economy to grow through the upcoming fiscal squeeze will have a major bearing on occupier markets in the near term. While our diverse tenant base of largely independent traders continues to perform relatively well, particularly where their trade relies on non-discretionary spend and everyday items, we are mindful that downside economic risks persist. We believe the level of interest rates is broadly supportive of current valuations, with private investors continuing to invest in smaller lot sized properties in order to satisfy their income requirements. However, there is little depth to investor demand and, with debt finance still scarce and expensive, the potential for further near term yield compression looks limited.

Our nationwide coverage, extensive network of local agents and specialist asset management skills, provide us with a unique capability to manage smaller lot sized properties throughout the UK. We see a strong business opportunity for LSR to use these skills to help other businesses manage portfolios of smaller assets, where they may not possess the relevant expertise in-house. I am pleased to report that during the year we began to manage a small, mixed portfolio of properties in the north west on behalf of a large UK bank, and have entered into an agreement with another bank to manage the smaller investment properties it will acquire as it begins to take back control of assets from distressed borrowers. We have strong relationships with many of the UK lenders and hope to build on this progress over the coming year to generate further income for the business.

Following the year end, we were also delighted to have entered a JV with Pramerica Real Estate Investors ("Pramerica"), as announced on 29 November 2010. With gearing, the JV will have around £100m to invest in the UK neighbourhood/convenience retail sector, targeting retail parades and precincts located in suburban and neighbourhood locations with values between £1.25m and £7m, lot sizes bigger than the Company's traditional asset base. Pramerica has committed to provide 80% of the equity (£30m) and LSR will provide the remaining 20% (£7.5m). LSR will act as asset manager and will be responsible for sourcing investments, for which it will receive related fees. Our partnership with Pramerica provides a strong endorsement of our asset management capabilities and the opportunities that can be found in the local shopping market. We look forward to working with Pramerica on this exciting project, which we believe will create strong returns for our shareholders and for them.

## Dividend

I am pleased to announce a dividend for the second half of 1.9 pence per share (2009: 1.8 pence per share), which is in line with our policy to pay out 100% of recurring profits earned over the year. The dividend will be paid on 31 December 2010, as a PID to shareholders on the register on 10 December 2010. This will take the total dividend paid for the year to 3.6 pence per share (2009: 3.5 pence per share).

> "As a result of our focus on maximising the value of our assets and recycling our ex-growth stock, the Company continues to maintain a sound financial position. We continue to believe that the next few years will provide opportunities to generate considerable returns from investing in distressed situations."

## Outlook

Despite challenging trading conditions, our business model, with its diversified tenant base, continues to perform well, with stable occupancy and a resilient lettings market. In the investment market, the potential for further near term yield compression looks limited. It therefore seems likely that rental growth and added value via active asset management will be the drivers of any valuation gains.

As a result of our focus on maximising the value of our assets and recycling our ex-growth stock, the Company continues to maintain a sound financial position. We continue to believe that the next few years will provide opportunities to generate considerable returns from investing in distressed situations. We have already built up strong relationships with a number of lenders and are actively managing distressed situations for two of them. In addition, our recently announced Joint Venture with Pramerica provides us with further financial firepower to exploit opportunities as they arise. This in turn will enhance our ability to deliver on our goal of creating shareholder value in the future.

**Grahame Whateley**
**Chairman**
**15 December 2010**

### Did you know?

Trading names of our shops include:

"Brief Encounters" (lingerie)
"Psychic Piglet Gifts" (Glastonbury – where else?)
"The Codfather" (fish and chips)
"Witches Brew" (health products)
"The Big Day" (wedding dresses for the larger bride)

**Portfolio comprises 2,075 letting units, producing rental income of £16.4m per annum**

# Directors' Report

**"Our nationwide coverage, extensive network of local agents and specialist asset management skills provide us with a unique capability to manage smaller properties throughout the UK. We have made encouraging progress over the year in securing mandates to assist two UK lenders with this."**

The directors present their report and audited financial statements of the Group and the Company for the year ended 30 September 2010. The Directors' Report comprises the information set out on pages 6 to 22.

## Statement of Directors' Responsibilities in Respect of the Annual Report and the Financial Statements

The directors are responsible for preparing their annual report and the Group and Company financial statements in accordance with applicable law and regulations. Company law requires that the directors prepare Group and parent company financial statements for each financial year. Under that law they are required to prepare the Group financial statements in accordance with IFRSs as adopted by the European Union and applicable law and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice).

Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Group and the parent company and of their profit or loss for the relevant period. In preparing each of the Group and parent company financial statements, the directors are required to:

- select suitable accounting policies and apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Group and the parent company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the parent company's transactions and disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the directors are also responsible for preparing a directors' report, a directors' remuneration report and a corporate governance statement, each of which conforms to the relevant law and regulations.

The directors are responsible for the maintenance and integrity of the corporate and financial information included in the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Independent Auditors' Report is set out on page 26. So far as the directors are aware, there is no information relevant to the Auditors' preparation of their report that has not been disclosed to the Company's Auditors. Each director has taken all steps required of a director to ensure that he/she is aware of any information relevant to the audit and to establish that all such information has been disclosed to the Auditors.

# Business Review

**Mike Riley**
Joint CEO

**Nick Gregory**
Joint CEO

In the review below, as well as providing an overview of the business' activities over the last 12 months, we also make comment, where appropriate, on the progress made since the portfolio was last valued on 31 March 2010.

## Results

During the year, the Company made a recurring profit of £2.9m (3.6 pence per share), the calculation of which is provided in the Financial Review below. The recurring profit during the second half of the year was £1.5m, a small improvement on the £1.4m during the first half, but, encouragingly, substantially above the £1.1m earned during the same period in the previous financial year.

During the 12 month period, we benefitted from a rise in the value of the portfolio, mirroring the movement in the wider property market. However, the continuing fall in medium term interest rates, between 30 September 2009 and 30 September 2010, has resulted in a further loss on the fair value of our swap agreements. These factors combined have resulted in an IFRS profit of £1.8m. We have provided a breakdown of these amounts within the Income Statement to show more clearly the result from the operating business.

## Revaluation and Net Asset Value

As at 30 September 2010, the portfolio was revalued at £192.9m, a rise of £18.5m from the £174.4m portfolio valuation at 30 September 2009. On a like-for-like basis the portfolio rose in value by 3.5% over the year.

During the first half of the year, values in the Company's sector rose as private investors continued to chase income. However, as the year progressed, investors in smaller retail assets became more cautious as they tried to assess the economic impact of the new Government's debt reduction measures. As a result, the rebound in prices stalled over the summer months. This settling down of values was reflected in the valuation of our portfolio which, having risen 5.2% in the six months to 31 March 2010, recorded a small 1.6% fall in value over the second half of the year.

Our net asset value per share has fallen slightly to 70 pence per share compared to 71 pence at 30 September 2009. While values have risen over the year, the fall is largely due to the loss on our swap agreements, described above. The adjusted net asset value per share (adjusted for the fair value of the swap agreements) has risen to 81 pence per share compared to 77 pence in 2009.

## Portfolio Performance

Our portfolio was revalued at the year end at £192.9m, reflecting an equivalent yield (excluding residential element) of 8.88%. It now comprises 655 properties, with 2,075 letting units, and produces annual rental income of £16.4m.

### COMBINED PORTFOLIO

| | |
|---|---|
| Value | £192.9m |
| Initial Yield | 8.03% |
| Reversionary Yield | 8.76% |
| Equivalent Yield* | 8.88% |
| Rent per annum | £16.4m |
| Market Rent per annum | £17.9m |

| Value Range | No. of Properties | Value £m | Equivalent Yield* |
|---|---|---|---|
| £0–£100k | 148 | 11.2 | 9.38% |
| £101–£200k | 232 | 34.1 | 8.93% |
| £201–£500k | 170 | 53.1 | 8.48% |
| £501k–£1m | 77 | 50.7 | 8.96% |
| £1m–£3m | 27 | 40.7 | 8.79% |
| £3m + | 1 | 3.1 | 7.42% |
| Total | 655 | 192.9 | 8.88% |

* Excluding residential element

The table above illustrates the range of property values throughout the portfolio. The average property value is £0.294m and the median is £0.170m. The residential element of the portfolio has been valued at £17.2m, based on 85% of vacant possession value. The average value of the residential units in our portfolio remains low at just over £55,000.

On a like-for-like basis, the properties owned throughout the year recorded a rise in value of 3.5%, adjusted to make allowance for properties where LSR sold off portions of the asset, with the equivalent yield (excluding the residential element) moving in 51bps to 8.99%.

# Business Review continued

**"In addition, our cash, uncharged properties and undrawn loan facilities, together with our newly established JV with Pramerica Real Estate Investors gives us the flexibility and firepower to take advantage of any accretive buying opportunities that emerge where lenders decide to sell."**

In our Half Year Results Statement, we noted that there had been recent signs that the run-up in capital values may have been tailing off in response to a rise in supply. A mismatch between the expectations of buyers and sellers over the summer has led to a cooling in the market and, during the second half of the year, values of local shopping properties stabilised. Between 31 March 2010 and 30 September 2010, the portfolio showed a small decrease in value of 1.6%, with the equivalent yield (excluding the residential element) moving out 6bps.

**LIKE-FOR-LIKE PORTFOLIO – ADJUSTED FOR PART SALES**

| | 30 Sept 2010 | 30 Sept 2009 | Change |
|---|---|---|---|
| Value | **£175.9m** | £170.0m | +3.51% |
| Initial Yield | **8.05%** | 8.45% | -0.40bp |
| Reversionary Yield | **8.81%** | 9.36% | -0.55bp |
| Equivalent Yield* | **8.99%** | 9.50% | -0.51bp |
| Rent per annum | **£15.1m** | £15.2m | -0.98% |
| Market Rent per annum | **£16.5m** | £16.9m | -2.28% |

* Excluding residential element

Over the year as a whole, the portfolio market rent has fallen by 2.3% while the passing rent has fallen 1.0% on a like-for-like basis. Encouragingly, however, since 31 March 2010, rents have grown by 0.2% as a result of successful rent reviews and lease renewals and a reduction in the portfolio void rate following a strong letting performance in the second half of the year. Similarly, while the portfolio market rent fell 1.7% during the first half of the year, the decline in market rent reduced to only 0.6% during the second half.

## Investment Market

During the first half of the year, values continued to rise, with private investors, faced with low short term interest rates, continuing to invest in smaller lot sized properties in order to satisfy their income requirements. As the year progressed, as mentioned above, there was an increasing mismatch between the expectations of buyers and sellers, and the supply of properties for sale fell. As a consequence, sales volumes in the July round of commercial auctions were low and, while the auction rooms have been busier since the summer break, it has become clear that the rebound in prices which began in early 2009 has stalled.

PROJECT

Acquisitions:
**Trident House, Stanwell**

- Retail parade purchased in July 2010 for £1.6m
- Reversionary convenience store let off £8.40 psf
- Rent increased by £5,500 since purchase via rent reviews and new lettings
- Planning to convert 1st floor offices into 9 flats

Yield at Purchase **7.86%**

Yield at 30 September 2010 **8.12%**

Rent increased since purchase by **4%**

**Did you know?**

Of our 107 new lettings during 2009–10, the largest take-up were hairdressers (19), followed by takeaways (14).

One of our butcher tenants recently achieved local fame with his new product: Irn-Bru flavoured sausages.

**69 days:** the average **rent free** period on new lettings of our commercial units

While the banking sector needs to carry out a substantial de-leveraging over the next few years, we have seen little evidence to date of large numbers of smaller properties being placed into the market where the borrower is in default. Whilst we foresee an increase in supply from such sales over the next 12 months, we also expect the banks, constrained by their ability to make further loan write-downs, to look for longer term asset management led solutions to the distressed properties and portfolios on their books.

We believe that low interest rates are supportive of current valuation levels but, with bank debt remaining scarce, further near term yield compression in our sector seems unlikely. Increases in valuation will therefore be driven by our ability to grow rents and add value through active asset management. The prevailing low interest rate environment has also encouraged owner-occupiers to consider purchasing rather than renting. We have seen the impact of this within our own portfolio, with the sale of a number of vacant units at firm prices and increased interest from our existing tenants in acquiring their own premises.

## Acquisitions and Sales

Throughout the year we have adopted a highly selective approach to making acquisitions, concentrating on securing properties with sustainable rents and the potential for growth through fixed or RPI linked rent reviews or active asset management.

During the year, we have acquired 35 properties for a total consideration of £16.9m, at a blended yield of 7.89%. Of these, 20 were purchased since 31 March 2010 for a total consideration of £10.8m at a blended yield of 7.85%. Since the year end we have purchased four convenience store investments on long leases with fixed or RPI linked rent reviews let to Tesco and Martin McColl for £1.4m at a blended yield of 6.95%.

Throughout the year we continued to make solid progress with our stated strategy of selling ex-growth properties. During the year, we sold 14 properties, including one part disposal, for £4.7m at an average yield of 6.85%, well below the prevailing yield on the portfolio. Four of these, two vacant and two let, were sold during the second half of the year for £2.3m showing a £0.1m surplus over the 31 March 2010 valuation. We also sold a flat in Glastonbury for £85,000 against a book value of £67,000.

Since the year end, we have completed the sale of a further two properties for a total of £0.6m, in line with their September 2010 valuation, and another flat in Glastonbury for £80,000. Over the coming year we intend to sell further ex-growth properties in order to reinvest the proceeds into more interesting opportunities.

**"Trading conditions remain tough for our tenants, but their entrepreneurial drive and ability to be flexible in adapting their business plans has allowed them to react to the challenging retail environment. As a result, our diverse tenant base of smaller, independent traders continues to perform relatively well, particularly where their trade relies on non-discretionary spend."**

## Occupier Market

We remain cautious on our outlook for the occupier market, which has yet to fully feel the economic impact of the new Government's substantial deficit reduction programme. Against such a background, trading conditions for retailers remain difficult throughout the UK. However, our tenants, 69.4% of whom are local independent traders, are demonstrating they have the flexibility to deal with these challenging conditions, particularly where their businesses rely on non-discretionary spend. It is well known that the major supermarket groups are expanding rapidly into the local shopping market, with their roll-out of convenience store formats, but within our portfolio we are also seeing a number of other national multiple retailers such as Greggs leasing units in our typical neighbourhood and suburban locations. Despite the difficult economic climate, we believe that our rents remain affordable, which is demonstrated by our continuing success in letting vacant units. Our average shop rent is only £11.27 per sq ft, or £12,129 per annum (£233 per week).

As at 30 September 2010, our overall void rate was 11.3%, down from the 11.4% reported in September 2009 and down 0.6% from the 11.9% reported in March 2010.

### KEY PERFORMANCE INDICATOR – VOID RATE

| | 31 Sept 2010 | 31 July 2010 | 31 March 2010 | 31 Jan 2010 | 30 Sept 2009 |
|---|---|---|---|---|---|
| Vacant – Commercial | 8.0% | 8.0% | 8.2% | 8.0% | 8.1% |
| Vacant – Deliberate | 2.5% | 2.8% | 2.7% | 2.6% | 2.6% |
| Vacant – Residential | 0.8% | 0.9% | 1.0% | 1.3% | 0.7% |
| Total | 11.3% | 11.7% | 11.9% | 11.9% | 11.4% |

Throughout the year the void rate for our commercial properties, at 8.0% at the year end, has been broadly stable. The level of deliberate voids rose during the year as we continued to seek to convert redundant space above our shops into flats. However, towards the end of the period, the deliberate void rate fell back to 2.5% as a number of conversions were completed and the flats subsequently let. We anticipate our deliberate void rate will remain around this level as we continue to seek out opportunities for change of use and to reconfigure units to secure increased rents or improve marketability. Although fluctuating throughout the year in line with our experience in previous years, the residential void at the year end was 0.8%, in line with the 0.7% reported at 30 September 2009. Although a number of our residential tenants rely on housing benefit to pay some or all of their rent, our average residential rent is below £100 per week which will provide us with protection from cuts aimed at reducing the housing benefit budget.

# Business Review continued

Given the nature of our tenants, the majority of whom are independent traders, bad debts are inevitable. However, we are encouraged that our strong focus throughout the year on credit control has resulted in our bad debts write-offs falling by 13.6% to £918,452, compared with £1,043,247 in the previous financial year. We continue to take a robust approach to debt recovery and generally prefer to take back units where tenants are in financial difficulty so we can re-let them and improve the quality of our cash flow. However, we also recognise that there may be occasions when it is sensible to let a tenant remain in occupation at a reduced rent in order to mitigate our outgoings, particularly our liability for empty rates, if the local letting market is challenging. Similarly, we adopt a pragmatic approach to letting our more difficult vacant units in order to mitigate any increase in voids and associated costs.

When we let units to independent tenants, it is our policy to seek rent deposits of between three to six months. Over the year we have successfully increased the number and value of deposits held as we let units and deal with assignments. As at 30 September 2010, we held deposits totalling approximately £940,000 (30 September 2009: approximately £900,000) or 23% of our quarterly rent roll. This provides us with a measure of protection against tenant default, which is not generally available when letting units to national retailers.

## Asset Management

The Company has established a reputation for being able to add value to smaller commercial properties located throughout the UK. We are pleased to report that we continue to achieve strong results by applying these skills to our diverse portfolio.

Despite challenging trading conditions, demand for local shops remains resilient. During the year to 30 September 2010, the Company has let 107 vacant commercial units at a total rent of £983,584 per annum (compared to 106 units let at £1,127,904 per annum during the previous year). Encouragingly, 63 of these units were let during the second half of the year at a total rent of £589,770 per annum. Over the full year the units were let, on average, at 4.3% below Market Rent. However, 30 of these new lettings incorporated stepped rent increases, which we have ignored in our comparison. These 30 lettings were secured at an initial rent of £296,884 per annum rising to £369,454 per annum over the first three years of their leases, compared with a Market Rent of £350,750 per annum. The remaining 77 units were let at a 1.4% premium to Market Rent. With our individual tenants typically working off tighter balance sheets, we prefer to deal with letting incentives by way of these stepped rents, rather than by granting protracted rent free periods. Our average rent free period on lettings completed during the year was only 69 days.

Current market conditions make it difficult to grow rents at rent review and lease renewal. However, over the year, rent reviews on 198 units increased rental income by a total of £143,449 per annum, reflecting an average uplift of 5.6%, and 7.9% above Market Rent. This was a significant improvement on the £67,989 per annum increase secured in the previous financial year. Lease renewals on 45 units have added a further £16,119 of rental income per annum (an average uplift of 4.8%, and 5.2% above Market Rent) and two lease extensions on flats in Bishop's Stortford and London secured £13,250 in premiums from the tenants. In addition, we have surrendered and re-let seven units, which resulted in an increase in rent of £9,708 per annum (an average uplift of 13.5%, and 1.1% above Market Rent).

In line with our drive to deliver value from the under-used upper parts of our retail properties, or unused adjacent land, we have secured planning consents for 50 flats across the UK, the reconfiguration of four retail units in Bristol and consent to build a new 4,600 sq ft retail unit at Cheveley Park Shopping Centre near Durham. During the year we completed the construction of 20 flats over five separate projects, redeveloping the redundant space above shop units where we had previously secured the necessary planning consent for these conversions. 19 of these flats were subsequently let at a combined rent of £120,970 pa, while the vacant flat is under offer for sale. We plan to continue to carry out similar projects where we can achieve an acceptable rental yield following conversion.

Over the year, we also secured a number of change-of-use consents which make it easier for us to let vacant units: three units were changed from A1 (shops) to A2 (financial), two units were changed from A1 (shops) to A3 (restaurant/café) and five units to A5 (hot food take-away). In addition, we secured planning consent on a vacant retail unit in Dorking for a change-of-use from a restricted A2 consent to A1. Following the widening of the retail consent, the property was sold to an owner-occupier for £415,000, substantially ahead of its £350,000 valuation prior to the change-of-use being granted.

## Working With Banks

A key element of our strategy for growth is the management of distressed assets. During the year we were asked by a large UK bank to manage a small mixed portfolio of properties in the North-West for an asset management fee. Additionally we entered into a legal agreement with another UK lender to manage the smaller investment properties it acquires when it has to take back control of assets from its distressed borrowers. At present we are managing one property under this agreement but have identified further properties which may fall under this arrangement in due course. Our remuneration for this project is based upon an acquisition fee, management fee and profit share on ultimate disposal. We are continuing our discussions with a number of other lenders who recognise the value of our business model, encompassing nationwide coverage, an extensive network of local agents and our intensive and specialist asset management skills.

## Joint Ventures

A second key element of our strategy is to seek to grow the business through the creation of Joint Ventures. As we recently announced on 29 November 2010, we have entered into a JV agreement with Pramerica Real Estate Investors ("Pramerica") to invest in retail parades and precincts throughout the UK.

It is intended that the JV will comprise over £37m in equity which, with gearing, will provide a total of around £100m to invest in the UK neighbourhood / convenience retail sector. With Pramerica committing to provide 80% of the equity (£30m) and LSR providing the remaining 20% (£7.5m), the JV is structured so that LSR and Pramerica act as co-investors and LSR will act as Manager and be responsible for sourcing the investments. Debt finance is being provided by HSBC.

This JV provides us with substantial firepower to invest in assets with significant potential for future rental growth and the opportunity to deliver added value through active asset management. The investment size per transaction will range from £1.25m to £7m, lot sizes bigger than the Company's traditional asset base. The anticipated duration of the JV is five years, with a two year commitment period. It will focus primarily on retail parades and precincts located in suburban and neighbourhood locations where the properties are well placed to support the convenience and "top up" shopping requirements of the surrounding population.

## Business Outlook

While we believe that values in our sub-sector are supported by the current low level of interest rates, debt finance remains both scarce and expensive and equity investors only have a finite amount of money making further near term yield compression unlikely. Future growth in the value of our existing portfolio will therefore depend on our ability to grow rents, building upon our success in achieving rental uplifts of nearly £160,000 per annum from rent reviews and lease renewals over the past year, and from creating additional value by applying our active asset management skills. During the coming year we will continue to sell ex-growth properties and look to reinvest the proceeds into more interesting opportunities.

Trading conditions remain tough for our tenants, but their entrepreneurial drive and ability to be flexible in adapting their business plans has allowed them to react to the challenging retail environment. As a result, our diverse tenant base of smaller, independent traders continues to perform relatively well, particularly where their trade relies on non-discretionary spend. Our highly active approach to managing the portfolio has kept our void rate stable over the past 18 months. During the coming year it is our ambition to grow portfolio income, building upon the 0.2% increase in like-for-like rents achieved since 31 March 2010 as a result of successful rent reviews, lease renewals and a reduction in the void rate.

The banking sector needs to carry out a substantial de-leveraging over the next few years but, constrained by their ability to make further loan write-downs, in many cases banks are having to implement longer term solutions to distressed property situations. Our nationwide coverage, extensive network of local agents and specialist asset management skills provide us with a unique capability to manage smaller properties throughout the UK. We have made encouraging progress over the year in securing mandates to assist two UK lenders with this. In addition, our cash, uncharged properties and undrawn loan facilities, together with our newly established JV with Pramerica Real Estate Investors, gives us the flexibility and firepower to take advantage of any accretive buying opportunities that emerge where lenders decide to sell. We believe such distressed situations will provide LSR, whether acting as a manager or investor, with the potential to generate attractive returns for our shareholders over the coming years.

Our future success will therefore be based upon the continuing effective execution of our strategy:

- To optimise the value of and income from existing assets
- To use our unique business platform and management skills to grow revenue, which will be achieved by:
  - Sales of ex-growth properties to invest in new opportunities;
  - portfolio or corporate acquisitions;
  - the creation of further partnership vehicles aligned to our sector; and
  - distressed asset management.

## Partnerships

Our network of national, regional and local agents remains key to our business model and we are grateful to them, and to our excellent team of corporate advisers, for their continued support. We would also like to take the opportunity to thank all of our staff who have contributed to our business performance over the past year and future growth.

**Mike Riley & Nick Gregory**
**Joint Chief Executive Officers**

**"Our highly active approach to managing the portfolio has kept our void rate stable over the past 18 months. During the coming year, it is our ambition to grow portfolio income, building upon the 0.2% increase in like-for-like rents achieved since 31 March 2010 as a result of successful rent reviews, lease renewals and a reduction in the void rate."**

# Financial Review

**Victoria Whitehouse**
Finance Director

The financial statements have been prepared in accordance with International Reporting Standards (IFRS) as adopted by the EU. Several new standards have been adopted in the preparation of the Annual Report this year. The two relevant to the business are IAS 1 (revised) and IFRS 8.

The changes dictated by IAS 1 (revised) relate to the presentation of the primary statements. It includes the replacement of the Statement of Recognised Income and Expense with the Statement of Comprehensive Income and the introduction of a new primary statement known as the Statement of Changes in Equity.

IFRS 8 Operating Segments has also been adopted. However, this has not resulted in any additional information being disclosed in the Annual Report. The Standard requires the reporting of segmental information on the basis of internal reports presented to the Board. The Group currently carries out one operating segment and reports information to the Board on this basis. This is reviewed regularly and should the situation change, the appropriate disclosures will be made.

## Key performance indicators

In addition to the specific measures used to monitor the performance of the property portfolio, which have been described in the Business Review, the following key performance indicators are monitored by the directors to review the performance of the business and to ensure compliance with banking covenants.

| | 30 Sept 2010 £000 | 30 Sept 2009 £000 |
|---|---|---|
| Interest cover* | **211%** | 214% |
| Loan to value (LTV) ratio† | **67.3%** | 66.4% |
| Adjusted NAV per share‡ | **81p§** | 77p§ |
| Gearing (net of cash held) | **217.8%** | 188.1% |

* Based on rental income compared to interest payable
† Net of cash held on substitution to buy properties
‡ Based on 82,505,853 shares in issue at 30 September 2010 (2009: 82,505,853)
§ Adjusted to exclude the fair value of financial derivatives

## Recurring profit

The Group's results from the operating business show an improvement on the previous year and continue to demonstrate the benefits of our unique portfolio with its diversified tenant base and affordable rents.

The recurring profit for the year is £2.94m (2009: £2.85m). The calculation of recurring profit remains consistent with prior years and is as follows:

| | 30 Sept 2010 £000 | 30 Sept 2009 £000 |
|---|---|---|
| IFRS reported profit/(loss) | 1,815 | (30,997) |
| (Gain)/loss on movement in fair value of the portfolio | (2,667) | 28,275 |
| Movement in the fair value of the interest rate swaps held | 3,789 | 5,578 |
| Profit on sale of investment properties | (7) | (3) |
| Loss on disposal of fixed assets | 4 | – |
| Recurring profit | **2,934** | 2,853 |

The Group's dividend policy continues to be the payment of 100% of recurring profits. The recurring profit per share is 3.6p (2009: 3.5p). A dividend has been proposed by the directors of 1.9p (2009: 1.8p) for payment on 31 December 2010 to shareholders on the register at 10 December 2010. This dividend will be paid as a property income distribution ("PID").

An interim dividend of 1.7p per share (2009: 1.7p) was paid as a PID on 30 June 2010, as reported in the Half Year Report to 31 March 2010.

The total dividend for the year will be 3.6p per share (2009: 3.5p). As in previous years, the Employee Benefit Trust will waive its right to a dividend.

Dividends distributed by REIT's are known as PID's or non-PID's. PID's are subject to the deduction of withholding tax at the basic rate of tax (20% for 2010/11). Certain eligible shareholders can claim exemption from the withholding of tax. Should a shareholder be eligible, a form can be obtained from the Company's website (www.localshoppingreit.co.uk) which should be submitted to the Company's Registrars.

## Results

The Group has recorded an annual IFRS profit for the first time since its listing on the London Stock Exchange.

Rental income has increased during the year, following the purchase of 35 properties and the conversion of otherwise redundant commercial space to residential flats as described in the Business Review. This rental income will replace that lost from sales during 2009 and the earlier part of the 2010 financial year.

## Bank debt and facilities

The Group operates using the following facilities:

| Loan | Facility £ million | Loan outstanding £ million | Undrawn £ million | LTV convenant | Repayable in one instalment | Termination date |
|---|---|---|---|---|---|---|
| Barclays fixed rate loan | 69.2 | 69.2 | – | No | Yes | 2016 |
| HSBC fully drawn term loan | 47.7 | 47.7 | – | No | Yes | 2016 |
| HSBC term loan | 25.0 | 10.5 | 14.5 | Yes | Yes | 2016 |
| HSBC revolver facility | 35.0 | 5.1 | 29.9 | Yes | Yes | 2016 |
| | | 132.5 | 44.4 | | | |

Property operating expenses have fallen in the year, mainly as a result of reduced letting costs and lower costs incurred on vacant units. The asset management team have also been able to let more units in-house, using Law Society leases without the need to instruct third party lawyers, thereby reducing the transaction cost of these lettings. This ability to use Law Society leases and minimise the costs of re-letting is dependent on the term of the lease and annual rent, so this cost can vary depending on the mix of lettings completed. There has also been a reduction in the bad debt charge for the year.

Administrative expenses have continued to be well controlled throughout the year. The increase in these costs result from the rise in the undrawn facility fee agreed when the facility was restructured in 2009. This fee will increase further in the next financial year (as described below).

Interest payable has increased in the year, following the draw-down of debt from the available facilities to fund the purchase of properties. The Group still holds the same interest rate swaps as in the previous year. The fair value of these swaps has continued to fall, resulting in a further interest expense for the year of £3.8m (2009: £5.6m). The Group is now under hedged by £5.9m (2009: over hedged £10.5m). For further details see note 17.

## Net assets

The net assets of the Group have fallen by £1m to £57.6m (2009: £58.6m) as a result of the continued fall in the fair value of the swaps, although some of this has been mitigated by the increase in the value of the portfolio.

At 30 September 2010, the portfolio was valued at £194.1m (including the IAS 17 adjustment required in respect of leasehold properties). Over the year the portfolio rose in value by £2.7m but, at the half year, the increase recorded was £7.3m so the values have fallen back by £4.6m in the second half of the year as values have settled. The increase over the year has been recorded in the Income Statement in accordance with IFRS.

The Group's revaluation policy remains unchanged. At the half year end and year end, 25% of the portfolio, plus all properties purchased in these two six-month periods, were valued by Allsop LLP, a firm of Chartered Surveyors, acting as external valuers, who are experienced in the Group's particular type of property. The remainder of the portfolio has been valued on the basis of market value by the directors with relevant experience and professional qualifications.

As shown above, as at 30 September 2010 the total debt drawn down by the Group is £132.5m. The facilities available to the Group have remained unchanged throughout the year.

The Group has drawn down £15.6m from the available HSBC facility during the year. This facility includes an LTV covenant of 85%, together with actual and forecast interest cover tests. There was an undrawn commitment fee of 40 basis points which rises to 60 basis points in September 2010. The margin charged on the loan is variable dependent on the LTV at each of the loan's quarter dates and ranges from 80 to 120 basis points above LIBOR up to 160 basis points once the LTV exceeds 70%.

The Group continues to hold properties with a total value of £30.1m which have no debt drawn against them. These could be used in a number of ways which, together with the loan facilities available, give the Group flexibility to exploit opportunities as they arise in the future.

## Taxation

The Group has continued to operate as a REIT throughout the year. Accordingly, any profits and gains from the property investment business should be exempt from Corporation Tax provided certain conditions continue to be met. The asset management income earned in the year will form part of the "residual" business, profits from which are not exempt from Corporation Tax. However, this income was de minimis in the year and the Group has available losses to relieve any such profits arising. Therefore, no provision for Corporation Tax has been made.

**Victoria Whitehouse**
**Finance Director**

# Principal Risks and Uncertainties

The Company's approach to risk management reflects its granular business model and position in the market and also exploits the expertise of its asset managers and third party advisers. Whilst recognising that no commercial reward comes without some element of risk, the management team evaluates each investment and asset management decision on its own merits. Key decisions are considered in regular management team meetings as well as being subject to informal peer review. Higher level risks and financial exposures are subject to constant monitoring.

| Potential Risk | Impact | Mitigating Factors |
|---|---|---|
| Property Portfolio Performance | | |
| **Downturn in macro-economic environment and effect on tenants** | • Tenant defaults and reduced rental levels arising from national/local economic conditions<br>• Increased void costs<br>• Reduction in Net Asset Value | • Rental arrears are continually monitored and early discussions initiated with tenants who appear to be in difficulties<br>• Limited requirement for tenant incentives within local shopping sector<br>• Close liaison with local agents enables swift decisions on individual properties<br>• Research and experience indicates that small traders take early and sufficient action to survive tough economic conditions<br>• Early action taken to take control of units where it is in the parties' best interests to do so<br>• Diverse tenant base |
| **Failure to purchase investments at yields consistent with business model and investment strategy** | • Reduction in portfolio Net Asset Value and Total Property Return | • Defined investment criteria<br>• Independent valuations prior to purchase<br>• Internal review and sign-off by two directors<br>• Investment policy reviewed regularly by Board |
| **Failure to identify properties appropriate for sale and/or sales at under-value** | • Unsatisfactory return generated | • Regular review of individual property returns and potential income stream, with consideration at regular asset management meetings<br>• Marketing and sale prices approved by two directors<br>• Portfolio performance regularly reviewed by Board |
| **Higher than anticipated property maintenance or development costs** | • Costs not matched by future income streams and/or improvement in property value | • Future maintenance costs identified at purchase and account taken in formulating purchasing decision<br>• All material expenditure authorised by asset manager and director<br>• Investment in property development subject to rigorous criteria and reviewed at regular team meetings<br>• Capital expenditure reviewed at monthly asset management meetings |

| Potential Risk | Impact | Mitigating Factors |
|---|---|---|
| Property Portfolio Performance | | |
| **Inability to let vacant properties** | • Reduction in portfolio return | • Sustainable location and property use are prime determinants of acquisition decision<br>• Asset managers regularly review all properties for lease expiries, breaks and tenant risk. |
| **Non-exploitation of asset management opportunities** | • Failure to maximise portfolio returns | • Asset managers regularly review all properties for opportunities to improve returns through restructuring occupier terms and taking advantage of development opportunities<br>• Development projects appraised and progress reviewed at regular meetings and progress reported to Board |
| **Properties inadequately or inappropriately insured** | • Loss of portfolio value and income | • Consultant retained to ensure adequate cover is in place for all properties<br>• "Average cover" facility in place to ensure no single property is under-insured<br>• Insurance policy and selection of insurers regularly reviewed with advisers |
| **Changes to UK/EU legal environment, planning law or local planning policy** | • Adverse impact on portfolio<br>• Loss of development opportunity | • Constant monitoring of UK property environment and Government proposals<br>• Close liaison with local agents and advisers<br>• Membership of and dialogue with relevant industry bodies |
| **Failure to comply with regulatory requirements in connection with property portfolio, including health, safety and environmental** | • Claims from tenants and third parties resulting in financial loss<br>• Damage to reputation | • Managing agents and professional advisers retained to provide guidance on regulatory requirements<br>• Asset managers and agents monitor individual properties<br>• Managing agents operate formal regulatory certification process for residential accommodation<br>• Independent risk assessments carried out for key multi-tenanted sites<br>• Insurance policies cover key risks |
| **Failure to attract and retain staff of required calibre** | • Loss of skills, knowledge and business relationships<br>• Damage to reputation | • Remuneration packages regularly reviewed against market<br>• Remuneration Committee oversight<br>• Formal appraisal and informal review processes in place<br>• Individual development plans agreed with team members, with external training and qualification programmes supported |

# Principal Risks and Uncertainties

| Potential Risk | Impact | Mitigating Factors |
|---|---|---|
| Corporate Governance & Management | | |
| **Non-availability of information technology systems or failure of data security** | • Loss of applications impacts on operations<br>• Loss of data impacts on reporting ability<br>• Action against Company in relation to data protection<br>• Financial loss arising from leak of confidential information | • System security regime in place<br>• Certain systems hosted off-site<br>• Off-site data back-up programme in place<br>• Insurance policies cover various impact areas |
| **Non-compliance with UK REIT rules** | • Expulsion from REIT regime<br>• Imposition of tax charge | • Compliance with REIT rules regularly checked and reported to Board<br>• Independent advisers retained to advise on ongoing REIT compliance and issues arising from individual corporate activities<br>• Ongoing management dialogue with relevant HMRC departments<br>• Non-executive overview |
| **Financial market conditions** | • Insufficient finance available at acceptable rates to fulfil business plans<br>• Financial impact of debt interest and costs of undrawn facilities<br>• Breach of banking convenants | • Policy of hedging 60%–100% of debt<br>• Impact of interest rates on property yields constantly monitored and property purchase and sale policy adjusted accordingly |
| **Failure to manage debt levels** | • Breach of banking covenants<br>• Impact on business model<br>• Insufficient funds to fulfil business plans | • Board monitors debt management reports and forecasts against annual business plan and banking covenants |
| **Mismanagement of financial instruments** | • Financial loss | • Independent adviser retained<br>• Board regularly monitors performance of financial instruments |
| **Capital management and liquidity** | • Inadequate working capital to satisfy financial commitments as they fall due | • Management forecasts prepared and reviewed to identify requirements<br>• Sufficient debt facilities available to satisfy working capital requirements<br>• Compliance with banking covenants reviewed and agreed with banks on quarterly basis and reported to Board |

# Board of Directors

Bill Heaney Grahame Whateley

Nicholas Vetch

Mike Riley

Stephen East

Nick Gregory Victoria Whitehouse

## Grahame Whateley
**Independent Non-Executive Chairman, aged 67**

Grahame Whateley, who has chaired the Board since January 2005, has spent his working life in the property industry, for much of that time as Chairman of the Castlemore Group. He is Chairman of the Cedar Group of companies and is a non-executive director of Arden Partners Plc. He serves on the Remuneration and Nomination Committees.

## Stephen East
**Senior Independent Non-Executive Director, aged 52**

Stephen East joined the Board in September 2009, having previously served as Finance Director of Woolworth Group plc and as Finance Director of MEPC plc. He is a non-executive director of Marwyn Management Partners plc and CQS Diversified Fund Limited. He has also held non-executive appointments with Regus Group plc and Star Energy Group plc. Stephen is a Chartered Accountant and a Fellow of the Association of Corporate Treasurers. He chairs the Audit Committee and the Nomination Committee and also serves on the Remuneration Committee.

## Nicholas Gregory
**Joint Chief Executive Officer, aged 45**

Nick Gregory trained as a Chartered Surveyor with Chesterton, having previously held a commission in the Army. He subsequently joined UBS Global Asset Management (UK) Limited where he became the director responsible for acquisitions for the Triton Property Fund. Nick joined the Castlemore Group in 2002 where he was a director until 2005, when he joined the Company.

## Michael Riley
**Joint Chief Executive Officer, aged 50**

Having trained as a Chartered Surveyor with Hillier Parker, Mike Riley became Managing Director of Chesterton's property finance arm, De Groot Collis Finance Limited, in 1989. He subsequently joined HBV Real Estate Capital, becoming Managing Director. After serving as Chief Executive of Quintain Estates and Development Plc, Mike moved to Castlemore Securities Limited, where he was a director until he became a director of the Company in 2005.

## Nicholas Vetch
**Independent Non-Executive Director, aged 48**

Having trained as a Chartered Surveyor, Nick Vetch became Chief Executive of Edge Properties which he founded in 1989. In 1998 he founded Big Yellow Group PLC, of which he is Executive Chairman. He is also a non-executive director of Blue Self Storage SL, which operates in Spain. Nick Vetch serves on the Audit Committee and chairs the Remuneration Committee.

## Victoria Whitehouse
**Finance Director, aged 37**

Vickie Whitehouse qualified as a Chartered Accountant in 1997, having trained with Felton & Co. She subsequently became Senior Audit Manager at KPMG and in 2005 she joined ProLogis Developments Limited as Group Financial Controller. Vickie joined the Company in 2007.

## Company Secretary
**William Heaney**

# Statutory and Other Information

## Principal activities

During the year the Group continued its activities in investing in properties throughout the United Kingdom, principally in local shops.

## Investment Policy

The Company's investment objective is to provide our shareholders with an attractive and growing level of income, with additional capital growth through active asset management.

We also look to enhance shareholder returns by combining our asset management skills with the complementary interests and resources of joint venture partners.

Our investment policy is to acquire local shops in urban and suburban areas, investing in neighbourhood and convenience properties throughout the UK. Our portfolio typically comprises shops that are well established in their local communities, although we will invest in new developments of local shops where these are supported by existing or newly built residential property.

The shops trade across all retail planning consents and we avoid concentration of risk in a particular retail sector. Our intention is to maintain a high level of diversification.

We believe in sustaining the local trading community nationwide and dealing with all our stakeholders in a fair and open manner.

The Company currently has the power under its Articles to borrow up to an amount equal to 75% of gross assets at the time of drawdown.

## Acquisitions and Disposals

The Group made no material acquisitions or disposals during the year.

## Group Companies

The subsidiary undertakings of the Company are set out in note 21 to the financial statements.

## Corporate Social Responsibility

The principal contributors to the success of our business are:

- the talent and commitment of our employees;
- our partnerships with national and local advisers; and
- the well-being of the businesses that occupy our properties and the communities in which they operate.

These factors are fully taken into account at Board level and throughout the management of the business and are reflected in all our activities. We also recognise the importance of health and environmental considerations in relation to our workforce, partners, tenants and the local community.

## Environment and Communities

The philosophy underpinning our business – "local shops, nationwide" – is by its nature supportive of current initiatives to reduce the carbon impact of retail shopping. Typically, our shops are within easy distance of their customers' homes or workplaces. It is not our policy to construct new property assets; our development activity is focused on the refurbishment and upgrading of existing stock and the return to profitable use of space that would otherwise remain vacant. Typically, this activity produces affordable town centre residential accommodation in previously redundant commercial space, in locations where the residents are able to walk to work as well as to the shops. As well as rejuvenating central locations, this reduces the development pressure on greenfield sites. In all cases we comply with national and local requirements for carbon reduction and other potential environmental impacts.

Wherever possible we use agents and contractors from within the communities served by our properties and we take pride in the variety of partnerships we have developed throughout the country. Where practicable we extend this policy to obtain our office supplies from smaller businesses. Within our office we follow energy reduction and recycling policies. We believe that our policy of positive engagement with our tenants produces commercial benefits for the local community as well as ourselves.

## Employees

Our out-sourced business model means that considerable responsibility falls on our small group of asset managers and finance and support staff. We are happy to have maintained a focused, professional team during a period of turbulence within the property market. Our policy of employee involvement and individual training arrangements is geared towards maintaining the skills required for the future development of our business. Our recruitment procedures are demonstrably reflective of the equality and diversity policies we have in place.

## Health, Safety and Welfare

The welfare of our employees is superior to all other considerations and we recognise in particular the risks faced by our staff when visiting remote sites. Although risk levels are considered to be generally low, our employees are made fully aware of the guidelines which they are expected to adhere to for their own safety in such situations, in the knowledge that their welfare is the overriding consideration. Health and safety and environmental incidents are considered at all the Board's regular meetings.

In managing our properties, we take proper account of the welfare considerations of their occupants. Our property managers and contractors are required to ensure that all maintenance, repair and development works conform to relevant regulations. We undertake regular checks of gas and electrical installations within the residential elements of our portfolio in conformance with regulatory requirements, addressing reported items and maintaining an ongoing programme of improvement works.

## Group Result and Dividend

The profit for the Group attributable to shareholders for the year was £1.8m (2009: loss of £31.0m). An interim dividend of 1.7p per Ordinary Share was distributed on 30 June 2010 as a Property Income Distribution ("PID"). A further dividend for the year of 1.9p per Ordinary Share will be distributed as a PID on 31 December 2010 to holders of each of the Ordinary Shares in issue and entitled thereto on 10 December 2010.

## Use of financial instruments

The Company's use of financial instruments to reduce its exposure to risks arising from interest rate fluctuations is described in note 17 to the financial statements.

## Share Capital

Details of the Company's issued share capital are set out in note 14 to the financial statements on page 42.

The Company's share capital comprises one class of Ordinary Shares of 20p each. All issued shares are fully paid up and rank equally. The Company's Articles impose requirements on shareholders in relation to distributions and the size of individual holdings, in order to ensure that the Company conforms to the UK REIT regime. Subject to this, there are no restrictions on the transfer of shares or the size of holdings. The directors are not aware of any agreements between shareholders in relation to the Company's shares.

The Company's issued share capital did not alter during the year.

## Transactions in the Company's shares

The Company's previous authority to purchase its own shares was extended at the Annual General Meeting in February 2010, which authorised purchases of up to 14.99% of the Company's issued Ordinary Share capital (excluding shares held in treasury). This authority expires at the 2011 Annual General Meeting, at which a resolution will be proposed for its renewal. The directors exercise their authority to purchase the Company's shares only when they consider it in the Company's best interests to do so. No share purchases were made during the year.

## Substantial interests

As at the date of this document the Company had been notified of the following major interests (of 3% or more) in its issued share capital:

| Name | Ordinary Shares | % |
|---|---|---|
| Schroder Investment Management Limited | 13,043,889 | 15.81 |
| J G Whateley | 7,660,918 | 9.28 |
| AXA Framlington | 6,500,000 | 7.88 |
| M&G Investment Management Limited | 5,617,010 | 6.81 |
| European Investors Inc | 4,680,366 | 5.67 |
| Thames River Capital LLP | 3,258,105 | 3.95 |
| Colonial First State Investments Limited | 3,075,150 | 3.73 |
| N J Vetch | 2,873,563 | 3.48 |
| APG Algemene Pensione Groep NV | 2,477,436 | 3.00 |

## Effect of change of control on significant contracts

Funding agreements entered into by certain Group companies require the written approval of the relevant bank before any change can be made to the nature, constitution, management or ownership of the business.

The employment contracts of directors and other members of staff do not contain any provisions specifically relating to a change of control. The Company's employee share schemes contain change of control provisions which are considered to be standard for such schemes.

## Key Contracts

Certain Group companies have entered into funding arrangements with lenders. These are described in notes 11 and 17 to the Financial Statements.

## Supplier Payments

Our business model is reliant on the maintenance of good relationships with our suppliers and we therefore aim to deal with them on a fair and open basis and make payments within agreed terms. As at 30 September 2010 there were 23 suppliers' days outstanding (2009: 21).

## Directors' interests in contracts

No director has any material interest in any contract or arrangement with any company within the Group.

The interests of the directors in the issued share capital of the Company as at the date of this report, all of which were beneficial, are set out below. None of the directors has any beneficial interest in any subsidiaries of the Company.

| Director | Ordinary 20p shares 30 Sept 2010 | Ordinary 20p shares 30 Sept 2009 |
|---|---|---|
| Stephen East | 75,000 | Nil |
| Nicholas Gregory | 600,000 | 575,000 |
| Michael Riley | 600,000 | 575,000 |
| Nicholas Vetch | 2,873,563 | 2,873,563 |
| Grahame Whateley | 7,660,918 | 7,660,918 |
| Victoria Whitehouse | 1,149 | 1,149 |

Directors' interests in employee share schemes are set out in the Directors' Remuneration Report on pages 23 to 25.

## Employee Share Schemes

The Company operates the following employee share schemes:

- The Local Shopping REIT plc Company Share Option Plan ("CSOP"); and
- The Local Shopping REIT plc Long Term Incentive Plan ("LTIP").

Details of these schemes are set out in the Directors' Remuneration Report on pages 23 to 25.

The Company's Employee Benefit Trust operates to supply shares as appropriate to meet obligations arising from employee share schemes. The voting rights of shares held by the Employee Benefit Trust are identical to the remainder of the Company's issued share capital.

## REIT Regime

The Company is subject to the regulatory regime for UK Real Estate Investment Trusts.

## Charitable and Political Donations

During the year the Company made no donations to charitable organisations (2009: nil) or for political purposes (2009: nil).

## Reappointment/replacement of directors

The directors listed on page 17 held office throughout the year. Under the Company's Articles, directors appointed since the previous Annual General Meeting are subject to retirement at the next Annual General Meeting when they may offer themselves for election. All directors are, as a minimum, subject to retirement and re-election at every third Annual General Meeting following their initial election.

Stephen East and Nick Gregory retired from office at the 2010 Annual General Meeting and were reappointed at that meeting. Grahame Whateley, Nick Vetch and Victoria Whitehouse will resign and offer themselves for re-election at the 2011 Annual General Meeting.

## Amendment of Articles

The Company has no rules in place in relation to the amendment of its Articles in addition to statutory provisions.

## Auditors

KPMG Audit Plc will resign at the conclusion of the forthcoming Annual General Meeting. KPMG Audit Plc have indicated their willingness to continue as Auditors to the Company and a resolution proposing their reappointment will be put to the Annual General Meeting.

# Corporate Governance

## Compliance with the Combined Code

The Company has throughout the year complied with the provisions of the Combined Code on Corporate Governance 2008 ("the Combined Code"), as well as the Corporate Governance Rules of the Financial Services Authority. This statement summarises how the principles set out in the Combined Code have been implemented.

## Board Effectiveness

The Board is responsible for the strategy of the business and its effective control and meets regularly to review the Company's operations and the success of its strategy. Each Board meeting has a formal agenda, with key items reviewed on a regular basis. In consultation with the Board and committee Chairmen, the Company Secretary ensures that all directors receive up-to-date and accurate reports and summaries prior to each meeting. Additional meetings and discussions are arranged outside the Board's regular schedule as necessary. The executive directors, to whom day-to-day operational management is delegated, consult the non-executive directors on a regular basis outside normal Board meetings. The non-executive directors also make themselves available to provide advice to the management team. The non-executive directors also hold meetings and discussions in the absence of the executive directors. The attendance record of directors at Board meetings is set out in the table below. Of the eight Board meetings held during the year, two were held to execute business agreed at a previous meeting.

## Division of Responsibilities

There is a clear division of responsibilities between executive and non-executive directors. The Chairman's remit is clearly separate from that of the joint Chief Executives. A senior non-executive director is in place, whom shareholders may contact directly when normal communication channels may be inappropriate. Rules are in place to identify those items that should be referred to the Board as a whole. The functions of the Board's committees are set out in terms of reference approved by the Board and each non-executive director's duties and obligations are clearly set out in his letter of appointment.

## Balance and Independence

The Board's composition of three independent non-executive directors and three executive directors conforms to the requirement for balance and the need to avoid domination of decision taking. Having considered the relevant criteria and the character of each individual, the Board considers that each of its non-executive directors may be regarded as independent for the purposes of the Combined Code. All directors have access to independent advice and the services of the Company Secretary.

## Board Appointments

In appointing new directors, the Board considers advice from external professional consultants and candidates are interviewed separately by executive and non-executive directors. All director appointments are approved by the Board's Nomination Committee, which is responsible for ensuring that all appointments meet the required standards of skills, experience and stewardship ability in accordance with the principles of the Combined Code. Details of the membership of the Nomination Committee are contained in the section on Board committees set out below.

The Company's Articles of Association require any director appointed to the Board during the year to be reappointed at the next Annual General Meeting. One-third of the directors must retire at each Annual General Meeting, but may offer themselves for reappointment.

## Board Committees

The Board has established Audit, Remuneration and Nomination Committees. Each committee operates within terms of reference determined by the Board having regard to independent external guidance. The minutes of each committee meeting are circulated to the Board as a whole.

## Audit Committee

The Audit Committee's Chairman is Stephen East and its other member is Nick Vetch. Both Mr East and Mr Vetch are independent non-executive directors. The Board considers Mr East to have the requisite skills and experience to chair the Committee. The biographical details of the Committee's members are set out on page 17. The Company Secretary acts as secretary to the Committee, which has formal terms of reference approved by the Board which accord with the provisions of the Combined Code.

Committee meetings may be attended, by invitation only, by other members of the Board. Representatives of the Company's Auditors, KPMG Audit Plc, also attend the Committee's meetings and a member of the Committee also meets the Auditors in the absence of the executive directors and members of the management team. The Committee met four times during the year and each member's attendance record is set out in the table below.

## Remuneration Committee

Full details of the membership of the Remuneration Committee and the Company's remuneration policy are set out in the Directors' Remuneration Report on pages 23 to 25. The Committee met once during the year. Each member's attendance record is set out in the table below.

## Nomination Committee

The Nomination Committee comprises at least three directors, the majority of whom are independent non-executive directors. The Committee has formal terms of reference approved by the Board. The Committee is chaired by the Company's senior independent non-executive director, Stephen East. The Committee did not meet during the year.

Attendance at Board and Committee meetings during the year to 30 September 2010

| Name | Board | Audit | Remuneration | Nomination |
|---|---|---|---|---|
| Grahame Whateley | 6 | | 1 | |
| Stephen East | 6 | 4 | 1 | |
| Nick Gregory | 8 | | | |
| Mike Riley | 8 | | | |
| Nick Vetch | 6 | 4 | 1 | |
| Vickie Whitehouse | 8 | | | |
| Number of meetings during the year | 8 | 4 | 1 | – |

## Director Induction

Arrangements are made to provide new directors with an induction programme into the Company's activities. Non-executive directors visit the Company's offices between formal meetings and asset managers are pleased to make arrangements for them to inspect its investment properties.

## Performance Evaluation

The non-executive directors, through the Chairman, provide feedback to the executive directors on their performance. Similarly, the non-executive directors appraise the performance of the Chairman through the senior independent non-executive director. The executive directors are consulted as part of this process.

## Remuneration

The remuneration of all executive directors and the Chairman is determined by the Remuneration Committee. The Committee considers advice from independent consultants in determining remuneration levels and appropriate reward schemes applicable to the executive directors and senior managers. Further details are set out in the Directors' Remuneration Report on pages 23 to 25. The Board has delegated the task of setting the level of remuneration for non-executive directors to the Chairman and executive directors, who do so taking account of advice from independent consultants.

## Internal Controls

The directors acknowledge their responsibility for maintaining an appropriate system of internal controls, monitoring its effectiveness and complying with the internal control provisions of the Combined Code. The Board's approach is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide reasonable assurance against material misstatements or loss. Terms of reference are in place covering the responsibilities of the Board's committees. Whilst the Board has delegated authority to the executive directors, clear statements are in place identifying those matters which the Board has reserved to itself for decision and matters on which the executive directors are expected to consult the Board. The Board thereby retains control over corporate strategy, annual budgets, significant contracts outside the ordinary course of business and corporate acquisitions and disposals. There are prescribed limits to the executive directors' authority to commit the Company to expenditure and borrowing. The executive directors operate clear expenditure and project approval systems within the Company's management processes.

The Audit Committee monitors the Company's risk identification and internal control systems, taking into account the recommendations of the Company's Auditors and insurers, with a formal review taking place on an annual basis in addition to interim monitoring. Members of the Audit Committee also provide assistance to the Company's managers on an informal basis, bringing to bear their knowledge and experience of risk management arrangements in other businesses. Given the Company's size, the Committee does not consider the establishment of a separate internal audit function to be appropriate. The Board's approach to internal controls covers all companies within the Group and there are no associate or joint venture entities which it does not cover. A summary of the principal risks and uncertainties to which the business is exposed is contained in the Business Review section on pages 7 to 11.

## Insurance Cover

To the extent permitted by law, the Company indemnifies its directors against claims arising from their acts and omissions related to their office. The Company has put in place an insurance policy in respect of claims against directors. The Company has also arranged professional indemnity insurance in relation to its asset management advisory activities.

## Control Environment and Procedures

The Group's established internal control process comprises:

- top-level risk identification, evaluation and management framework monitored by the Audit Committee;
- written remits for executive management identifying items reserved to the Board and its committees;
- a procedures manual covering all operational activity, including limits of authority and authorisation procedures;
- effective systems for authorising capital expenditure and recording actual cost incurred;
- structured induction process for all joiners and ongoing staff development;
- a staff handbook explaining the Company's policies and procedures, including health and safety, corporate governance and professional conduct;
- regular team meetings to identify operational developments and processes to be put in place to deal with them effectively;
- regular progress meetings with the managing agents retained by the Company, including reviews of agents' systems and procedures;
- established procedures for electronic information control and security;
- regular independent audits;
- regular operational and individual performance reviews by executive management;
- monthly reporting to the Board of operational results against expectations with commentary on variances;
- regular review of operational forecasts and consideration by the Board on a quarterly basis;
- regular review of the Company's funding requirements against the status of the financial markets and the ongoing effectiveness of the Company's hedging arrangements; and
- quarterly reporting of health, safety and environmental matters.

# Corporate Governance continued

## Business Ethics

Our ability to operate successfully in our market is largely dependent on the maintenance of our straightforward approach to doing business and our reputation for integrity. We therefore require our employees and those who act on our behalf to behave and transact business in accordance with the highest professional standards. This includes complying with the regulations of any professional body to which they are affiliated. These requirements apply equally to dealings with third parties, professional advisers and tenants.

The Company has in place internal procedures enforcing the Model Code, Anti-money Laundering regulations, the Data Protection Act and the anticipated requirements of the Bribery Act, as well as customer care and external complaint guidelines. A "whistle-blowing" procedure is in place, enabling employees to notify perceived irregularities to members of the Board. Whilst such matters would ordinarily be reported through the Company Secretary, employees may also raise any concerns directly with an independent non-executive director.

## KPMG Non-Audit Work

In order to safeguard the objectivity of the Company's Auditors, strict procedures are in place for the engagement of KPMG Audit Plc in non-audit work. Careful consideration is given to whether such work might give rise to a conflict of interest and the Chairman of the Audit Committee must separately authorise any item of work that could result in fees being paid in excess of 50% of the audit fee in any year.

## Investor Relations

The directors place considerable emphasis on strong communication links with the Company's investors, maintaining a continuing programme of meetings with shareholders, subject to regulatory constraints. These usually involve the Joint Chief Executive Officers and the directors are happy to arrange additional meetings with investors on request. The Board is provided with feedback on these meetings, as well as commentary from investors and the Company's bankers and advisers. The Board provides interim management reports and other announcements in accordance with regulatory requirements. Regulatory announcements and key publications are also fed into the Company's website.

The Company's Annual General Meeting provides a further forum for investors to discuss the Company's progress. The Company complies with relevant regulatory requirements in relation to convening the meeting, its conduct and the announcement of the results of resolutions. The Annual Report and Notice of the Annual General Meeting are sent to shareholders at least 20 working days prior to the meeting and are available on the Company's website. The results of resolutions considered at the Annual General Meeting are announced to the Stock Exchange and are also published on the website.

Investors may elect to receive communications from the Company in electronic form and be advised by email of their availability on the Company's website.

## Going Concern

The directors have considered the appropriateness of preparing the financial statements on a going concern basis. The diversity of the tenant base across retail sectors and its geographical spread around the country, as shown on page 3, demonstrates no reliance on one significant tenant. The drawn and undrawn loan facilities, together with the attached covenants, are detailed on page 13. All covenants have been met throughout the year. The Group has debt free properties of £30.1m which could be applied to remedy any breach of the interest cover tests. All loans are due for repayment in one instalment in 2016. The Group has undrawn facilities in place of £44.4m. Therefore, in the absence of unforeseen circumstances, the directors consider that the Group will continue to be compliant with its banking covenants and have sufficient resources available to continue as a going concern for at least the next 12 months. Accordingly, the financial statements have been prepared on a going concern basis.

## Responsibilities Statement

The directors confirm that to the best of their knowledge:

- the report of the directors includes a fair review of the development and performance of the business and the position of the issuer and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face;
- the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company and the undertakings included in the consolidation taken as a whole.

This report was approved by the directors on 15 December 2010.

**William Heaney**
**Company Secretary**

# Directors' Remuneration Report

## Remuneration Committee

The Remuneration Committee ("the Committee") works in accordance with formal terms of reference set by the Board, within which it is responsible for:

- determining the broad policy for the remuneration and benefits of the Company's executive directors and senior managers;
- approving the design and performance targets for share-related performance plans for the Company; and
- determining the individual remuneration packages of each director, giving due regard to the provisions and recommendations of the Combined Code and the Listing Rules.

The Committee comprises independent non-executive directors. The following directors served on the Committee during the year:

Nick Vetch (Committee Chairman);
Stephen East; and
Grahame Whateley.

Biographical details of the members of the Committee are set out on page 17.

The Committee met once during the year. Other than the Company Secretary, who serves as secretary to the Committee, other directors or executives attend meetings of the Committee only by invitation. The three executive directors attended the Committee's meeting, at which no matters were discussed in which the executive directors had any personal interest.

In setting the remuneration packages of the executive directors and establishing the Company's share-related incentive plans, the Committee has access to independent advice from Hewitt New Bridge Street Associates, remuneration consultants. Hewitt New Bridge Street Associates does not provide any other services to the Group.

## Remuneration Policy

The Company's remuneration policy is based on the principles set out below:

- within a competitive market, enabling the recruitment and retention of individuals whose talent matches the entrepreneurial and leadership needs of the business, enabling the Company to fulfil its investment objectives for its shareholders; and
- placing emphasis on performance-related rewards and focusing on incentive targets that are closely aligned with the interests of shareholders.

The Committee aims to reflect these principles in the mix of basic pay, benefits, annual bonus and long-term awards contained in the remuneration packages adopted for the executive directors and senior managers. The approach adopted by the Committee is to set base pay and other fixed remuneration for executive directors at less than the median for companies in the FTSE real estate sector, with total remuneration including performance-based awards being aimed at between the median and upper quartile relative to the sector. However, rewards at this level will only be generated provided the executives achieve stretching performance targets. It is the Company's policy to use the Employee Share Option Plan, described below, to incentivise all permanent employees to contribute to the success of the business.

### Base Pay and Benefits

Basic salary and benefits are reviewed annually by the Committee against comparable market groups. In addition to their base salary, the executive directors are provided with private health insurance, death in service and disability insurance cover and critical illness cover.

The level of executive directors' base pay did not increase during the year.

### Directors' Pensions

The Company has established a Stakeholder Pension Plan and a Group Personal Pension Plan. All employees, including executive directors, are eligible to join either of these schemes. At the date of this document, no director was a member of the Stakeholder Pension Plan. Victoria Whitehouse was a member of the Group Personal Pension Plan and contribution details in respect of her membership are set out in the table on page 25. The Company made contributions to the personal pension plans of executive directors, as a percentage of base salary, as follows:

Nick Gregory 10% per annum
Mike Riley 10% per annum

### Annual Executive Bonus Plan ("the bonus plan")

The bonus plan provides for incentive payments to the participants to the extent that performance targets set by the Committee are achieved during the financial year. Under the bonus plan the Joint Chief Executives may earn annual awards of up to 100% of base salary and the Finance Director may earn bonus awards of up to 50% of salary. The maximum bonus for other participating executives will be determined by the Committee, but will not exceed 100% of base salary.

Under the plan 50% of bonus awards are dependent on the extent by which the Company's total property return exceeds that of the Investment Property Databank Index for Standard Shops during the performance period, with the remaining 50% dependent on the growth in the Company's Dividend Per Share in comparison with the growth in the Consumer Price Index during the same period.

No awards were made under the bonus plan during the year.

### Long Term Incentive Plan ("the LTIP")

Under the terms of the LTIP employees, including executive directors, may be granted awards of the Company's shares in the form of a nil cost option. The LTIP is operated by the Committee in conjunction with the Company's Employee Benefit Trust ("EBT"), which may grant awards on the Committee's recommendation. The exercise of awards granted under the LTIP is conditional on the achievement of objective performance targets set by the Committee at the time of grant. Performance is measured over a minimum period of three years and awards may not be exercised until after the expiry of the relevant performance period.

LTIP awards made since the adoption of the scheme in May 2007 reward participants for the achievement of improvements in Total Shareholder Return ("TSR"). Fifty per cent of the shares comprising an award are subject to the satisfaction of an Absolute TSR target. The remaining 50% of an award are subject to a Comparator TSR target, by which the Company's TSR is compared with a comparator group of publicly quoted real estate investment companies.

# Directors' Remuneration Report continued

Under the Absolute TSR target:

- no award may be exercised in respect of the shares subject to the Absolute TSR target if the average annual percentage growth in the Company's TSR over the performance period is less than 8%;
- an award may be exercised as to 20% of the shares subject to the Absolute TSR target if the average annual percentage growth in the Company's TSR over the performance period is equal to or greater than 8%;
- an award may be exercised as to 100% of the shares subject to the Absolute TSR target if the average annual percentage growth in the Company's TSR over the performance period is equal to or greater than 16%; and
- where the Company achieves a TSR over the performance period of between 8% and 16%, the award may be exercised on a pro rata basis between 20% and 100% of the shares subject to the Absolute TSR target.

Under the Comparator TSR target:

- no award may be exercised in respect of the shares subject to the Comparator TSR target unless the Company is ranked equal to or above the 50th percentile by reference to its TSR relative to that of the comparator group over the performance period;
- an award may be exercised as to 25% of the shares subject to the Comparator TSR target if the Company is ranked equal to the 50th percentile by reference to its TSR relative to that of the comparator group over the performance period; and
- an award may be exercised as to a further 3% of the shares subject to the Comparator TSR target for each percentile by which the Company is ranked above the 50th percentile, so that the award subject to the Comparator TSR target may be capable of exercise in full if the Company is ranked equal to or above the 75th percentile.

The LTIP is subject to an overriding exercise requirement, under which no award may be exercised unless the Company has complied with the REIT regulations in relation to dividend distribution throughout the performance period. Awards to directors made under the LTIP are set out in the table opposite.

No LTIP awards were made during the year and no awards made in prior years vested.

### Future Awards

As stated in the 2009 Remuneration Report, the Committee has been considering altering the operation of both the bonus plan and the LTIP so they are aligned more closely with the Company's investment objectives. It is likely that future awards under both schemes will be linked to the achievement of recurring profit targets, which the Committee believes is an appropriate benchmark given the Company's stated intention to distribute 100% of recurring profit in dividend.

### Employee Share Option Plan ("the CSOP")

Under the terms of the CSOP, employees of the Company, including executive directors, are eligible to be granted options over the Company's shares at the discretion of the Remuneration Committee. The exercise price of options granted under the CSOP will ordinarily be equal to the market value of the Company's shares at the date of grant and the exercise of options will not normally be subject to a separate performance target. Options will ordinarily be exercised between the third and tenth anniversary of their grant. The CSOP has been approved by HM Revenue & Customs.

No awards have been made to executive directors under the CSOP.

### Internal Relativity

The Committee is sensitive to the need to set directors' remuneration having regard to pay and conditions generally within the Company and for the Company to remain competitive as an employer within the sector. The Committee therefore monitors internal and external relativities in line with the Company's growth and the evolving market.

### Non-Executive Directors

The level of fees paid to non-executive directors was set at the time of the Company's admission to the Official List of the London Stock Exchange having regard to market levels at that time. The level of non-executive pay will be reviewed at least every three years by the Chairman and the executive directors, to whom the Board has delegated this task.

## Directors' Contracts & Terms of Appointment

One-third of the directors are subject to retirement at each Annual General Meeting.

For non-executive directors, the Company's policy is for initial appointments to be for a term of 12 months, subject to extension by periods of 12 months thereafter and also subject at any time to termination on notice by the Company or the director. This policy is reflected in the terms of the formal appointment document which is in place for each non-executive director, which also sets out the expected time commitment of the non-executive directors to the Company's affairs.

Grahame Whateley has an appointment document dated 30 March 2007, subject to annual extensions.

Nick Vetch has an appointment document dated 30 March 2007, subject to annual extensions.

Stephen East has an appointment document dated 9 September 2009, subject to annual extensions.

For executive directors, the Company's policy is that service contracts should be capable of termination by the Company at not more than one year's notice. The Company has the right to terminate the service contracts without full notice on the payment of compensation in lieu of the period of notice forgone.

Nick Gregory, Mike Riley and Victoria Whitehouse all have service contracts dated 30 March 2007, all of which provide for 12 months' notice.

## External Appointments

The non-executive directors consider it beneficial in principle for the Company for the executive directors to hold a limited number of outside directorships or other appointments. The executive directors have not as yet taken up any such appointment.

Save as indicated below, the remainder of this report has been audited.

## Directors' Total Emoluments

| Director | Salary £ | Bonus £ | Pension contributions £ | Benefits in kind £ | Total 2010 £ | Total 2009 £ |
|---|---|---|---|---|---|---|
| **Non-executive Directors** | | | | | | |
| Andrew Cunningham† | – | – | – | – | – | 28,423 |
| Stephen East* | 30,000 | – | – | – | 30,000 | 1,731 |
| Nick Vetch | 30,000 | – | – | – | 30,000 | 30,000 |
| Grahame Whateley | 50,000 | – | – | – | 50,000 | 50,000 |
| **Executive Directors** | | | | | | |
| Nick Gregory | 285,000 | – | 26,000 | 5,289 | 316,289 | 315,732 |
| Mike Riley | 285,000 | – | 26,000 | 4,466 | 315,466 | 315,400 |
| Victoria Whitehouse | 125,000 | – | 2,820 | 1,460 | 129,280 | 126,088 |
| **Total** | 805,000 | – | 54,820 | 11,215 | 871,035 | 867,374 |

* Appointed 10 September 2009.
† Resigned 10 September 2009.

## Directors' LTIP Awards

| Director | Shares subject to award at 1 October 2009 | Granted during year | Exercised during year | Lapsed during year | Shares subject to award at 30 September 2010 | Market value per share at award date | Exercise date from | Exercise date to |
|---|---|---|---|---|---|---|---|---|
| Nick Gregory | 298,850 | – | – | 298,850 | – | £1.74 | 3 May 2010 | 3 May 2017 |
| Mike Riley | 298,850 | – | – | 298,850 | – | £1.74 | 3 May 2010 | 3 May 2017 |
| Victoria Whitehouse | 16,522 | – | – | 16,522 | – | £1.74 | 3 May 2010 | 3 May 2017 |
| **Total** | 614,222 | – | – | 614,222 | – | | | |

## Directors' Service Contracts

### Non-executive directors

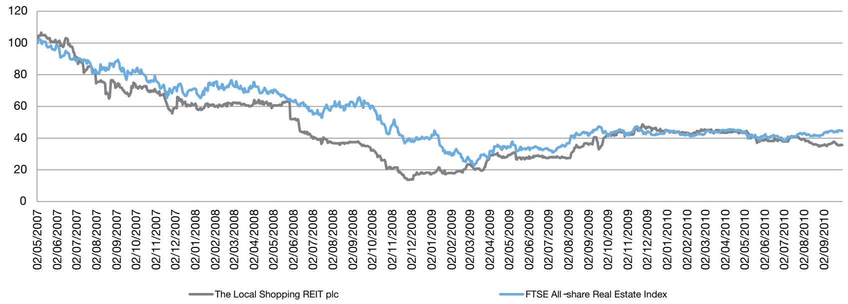
| Director | Date of appointment as director | Date of current appointment letter | Expiry of term |
|---|---|---|---|
| Stephen East | 10 September 2009 | 9 September 2010 | 9 September 2011 |
| Nick Vetch | 30 March 2007 | 30 March 2010 | 29 March 2011 |
| Grahame Whateley | 20 September 2004 | 30 March 2010 | 29 March 2011 |

### Executive directors

| Director | Date of contract | Notice period |
|---|---|---|
| Nick Gregory | 30 March 2007 | 12 months from either party |
| Mike Riley | 30 March 2007 | 12 months from either party |
| Victoria Whitehouse | 30 March 2007 | 12 months from either party |

## TSR Performance Graph (Not Audited)

TSR PERFORMANCE FROM IPO ON 2 MAY 2007 TO 30 SEPTEMBER 2010




The TSR performance graph above sets out the comparison of the Company's TSR against the Real Estate Sector. This comparison has been chosen as it is considered the most appropriate benchmark against which to assess relative performance of the Company.

This report has been approved by the Board of directors.

**Nicholas Vetch**
**Remuneration Committee Chairman**
**15 December 2010**

# Independent Auditors' Report to the Members of The Local Shopping REIT plc

We have audited the financial statements of The Local Shopping REIT plc for the year ended 30 September 2010 set out on pages 27 to 56. The financial reporting framework that has been applied in the preparation of the Group financial statements is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU. The financial reporting framework that has been applied in the preparation of the parent company financial statements is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice).

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an Auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members, as a body, for our audit work, for this report, or for the opinions we have formed.

## Respective Responsibilities of Directors and Auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 22, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's (APB's) Ethical Standards for Auditors.

## Scope of the Audit of the Financial Statements

A description of the scope of an audit of financial statements is provided on the APB's website at www.frc.org.uk/apb/scope/UKP.

## Opinion on Financial Statements

In our opinion:

- the financial statements give a true and fair view of the state of the Group's and of the parent company's affairs as at 30 September 2010 and of the Group's profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with IFRSs as adopted by the EU;
- the parent company financial statements have been properly prepared in accordance with UK Generally Accepted Accounting Practice;
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006; and, as regards the Group financial statements, Article 4 of the IAS Regulation.

## Opinion on Other Matters Prescribed by the Companies Act 2006

In our opinion:

- the part of the Directors' Remuneration Report to be audited has been properly prepared in accordance with the Companies Act 2006; and
- the information given in the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Matters on which we are required to Report by Exception

We have nothing to report in respect of the following:

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements and the part of the Directors' Remuneration Report to be audited are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit; or
- a Corporate Governance Statement has not been prepared by the Company.

Under the Listing Rules we are required to review:

- the directors' statement, set out on page 22, in relation to going concern; and
- the part of the Corporate Governance Statement on pages 20 to 22 relating to the Company's compliance with the nine provisions of the June 2008 Combined Code specified for our review.

**Darren K Turner (Senior Statutory Auditor)**
**for and on behalf of KPMG Audit Plc, Statutory Auditor**
**Chartered Accountants**
**One Snowhill**
**Snow Hill Queensway**
**Birmingham B4 6GH**
**15 December 2010**

# Consolidated Income Statement

**for the year ended 30 September 2010**

| | Note | 2010 £000 | 2009 £000 |
|---|---|---|---|
| Gross rental income | | 15,539 | 15,319 |
| Property operating expenses | | (2,646) | (2,891) |
| Net rental income | | 12,893 | 12,428 |
| Profit on disposal of investment properties | | 7 | 3 |
| Gain/(loss) from change in fair value of investment properties | 8 | 2,667 | (28,275) |
| Loss on disposal of fixed assets | | (4) | – |
| Administrative expenses | 3 | (2,573) | (2,491) |
| Net other (expense)/income | 4 | (40) | 5 |
| Operating profit/(loss) before net financing costs | | 12,950 | (18,330) |
| Financing income* | 5 | 7 | 58 |
| Financing expenses* | 5 | (7,353) | (7,147) |
| Movement in fair value of financial derivatives | 16 | (3,789) | (5,578) |
| Profit/(loss) before tax | | 1,815 | (30,997) |
| Taxation | 6 | – | – |
| Profit/(loss) for the year attributable to equity holders of the Company | | 1,815 | (30,997) |
| Basic and diluted profit/(loss) per share | 15 | 2.2p | (37.5)p |

* Excluding movement in the fair value of financial derivatives.

# Consolidated Statement of Comprehensive Income

**for the year ended 30 September 2010**

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Profit/(loss) for the year | 1,815 | (30,997) |
| Total comprehensive income for the year | 1,815 | (30,997) |
| Attributable to: | | |
| Equity holders of the parent company | 1,815 | (30,997) |

# Consolidated Balance Sheet

as at 30 September 2010

| | Note | 2010 £000 | 2009 £000 |
|---|---|---|---|
| **Non-current assets** | | | |
| Property, plant and equipment | 7 | 189 | 180 |
| Investment properties | 8 | 194,079 | 174,156 |
| **Total non-current assets** | | 194,268 | 174,336 |
| **Current assets** | | | |
| Trade and other receivables | 9 | 4,337 | 4,646 |
| Investment properties held for sale | 8 | – | 1,300 |
| Cash | 10 | 6,120 | 5,949 |
| **Total current assets** | | 10,457 | 11,895 |
| **Total assets** | | 204,725 | 186,231 |
| **Non-current liabilities** | | | |
| Interest bearing loans and borrowings | 11 | (131,691) | (116,133) |
| Finance lease liabilities | 13 | (1,206) | (1,024) |
| Derivative financial instruments | 16 | (6,746) | (2,976) |
| **Total non-current liabilities** | | (139,643) | (120,133) |
| **Current liabilities** | | | |
| Interest bearing loans and borrowings | 11 | – | – |
| Trade and other payables | 12 | (5,061) | (5,170) |
| Derivative financial instruments | 16 | (2,381) | (2,362) |
| **Total current liabilities** | | (7,442) | (7,532) |
| **Total liabilities** | | (147,085) | (127,665) |
| **Net assets** | | 57,640 | 58,566 |
| **Equity** | | | |
| Issued capital | 14 | 18,334 | 18,334 |
| Reserves | 14 | 3,773 | 3,773 |
| Capital redemption reserve | 14 | 1,764 | 1,764 |
| Retained earnings | | 33,769 | 34,695 |
| **Total attributable to equity holders of the Company** | | 57,640 | 58,566 |

The financial statements were approved by the Board of directors and authorised for issue on 15 December 2010. They were signed on its behalf by:

**M E Riley**
Joint CEO

**N J Gregory**
Joint CEO

The registered number of the Company is 5304743.

# Consolidated Statement of Cash Flows

**for the year ended 30 September 2010**

| | Note | 2010 £000 | Restated 2009 £000 |
|---|---|---|---|
| **Operating activities** | | | |
| Profit/(loss) for the year | | 1,815 | (30,997) |
| Adjustments for: | | | |
| Gain/(loss) from change in fair value of investment properties | 8 | (2,667) | 28,275 |
| Net financing costs | 5 | 11,135 | 12,667 |
| Profit on disposal of investment properties | | (7) | (3) |
| Loss on disposal of fixed assets | | 4 | – |
| Payment of finance leases | | 116 | 116 |
| Depreciation | 7 | 38 | 41 |
| Employee share options | 3 | 107 | 176 |
| | | 10,541 | 10,275 |
| Decrease/(increase) in trade and other receivables | | 310 | (100) |
| Decrease in trade and other payables | | (174) | (257) |
| | | 10,677 | 9,918 |
| Interest paid | | (7,331) | (6,874) |
| Interest received | | 7 | 58 |
| Corporation tax paid | | – | (253) |
| **Net cash from operating activities** | | 3,353 | 2,849 |
| **Investing activities** | | | |
| Proceeds from sale of investment properties | | 4,589 | 6,922 |
| Acquisition and improvements to investment properties | | (20,356) | (7,277) |
| Acquisition of property, plant and equipment | | (51) | (5) |
| **Cash flows from investing activities** | | (15,818) | (360) |
| **Net cash flows from operating activities and investing activities** | | (12,465) | 2,489 |
| **Financing activities** | | | |
| Costs of own shares acquired | | – | (210) |
| Repayment of borrowings | | – | – |
| New borrowings | | 15,600 | – |
| Dividends paid | | (2,848) | (3,741) |
| Payment of finance lease liabilities | | (116) | (116) |
| **Cash flows from financing activities** | | 12,636 | (4,067) |
| Net increase/(decrease) in cash | | 171 | (1,578) |
| Cash at 1 October 2009 | | 5,949 | 7,527 |
| **Cash at 30 September 2010** | 10 | 6,120 | 5,949 |

# Consolidated Statement of Changes in Equity

**for the year ended 30 September 2010**

| | Share capital £000 | Reserves £000 | Capital redemption reserve £000 | Retained earnings £000 | Total £000 |
|---|---|---|---|---|---|
| Balance at 1 October 2008 | 18,469 | 3,773 | 1,629 | 69,467 | 93,338 |
| **Total comprehensive income for the year** | | | | | |
| Loss for the year | – | – | – | (30,997) | (30,997) |
| **Transactions with owners, recorded directly in equity** | | | | | |
| Cancellation of shares | (135) | – | 135 | – | – |
| Own shares acquired | – | – | – | (210) | (210) |
| Dividends | – | – | – | (3,741) | (3,741) |
| Share-based payments | – | – | – | 176 | 176 |
| **Total contributions by and distributions to owners** | (135) | – | 135 | (3,775) | (3,775) |
| **Balance at 30 September 2009** | 18,334 | 3,773 | 1,764 | 34,695 | 58,566 |
| **Total comprehensive income for the year** | | | | | |
| Profit for the year | – | – | – | 1,815 | 1,815 |
| **Transactions with owners, recorded directly in equity** | | | | | |
| Dividends | – | – | – | (2,848) | (2,848) |
| Share-based payments | – | – | – | 107 | 107 |
| **Total contributions by and distributions to owners** | – | – | – | (2,741) | (2,741) |
| **Balance at 30 September 2010** | **18,334** | **3,773** | **1,764** | **33,769** | **57,640** |

# Notes to the Financial Statements

for the year ended 30 September 2010

## 1 Accounting Policies

### Basis of Preparation

The Local Shopping REIT plc ("the Company") is a company incorporated and domiciled in the UK. The Group's financial statements have been prepared in accordance with International Financial Reporting Standards as adopted by the EU (adopted "IFRS") and in accordance with the provisions of the Companies Act 2006.

The financial statements are prepared in pounds sterling, rounded to the nearest thousand. They have been prepared under the historical cost convention except for the following assets which are measured on the basis of fair value: investment properties, financial derivatives and investment properties held for sale. They have been prepared on a going concern basis as explained on page 22.

The 2009 comparative figures for the Cash Flow Statement only have been restated by £190,000 as finance lease payments had been incorrectly classified.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

### Basis of Consolidation

The consolidated financial statements include the financial statements of the Company and all its subsidiary undertakings up to 30 September 2010. Subsidiaries are consolidated from the date on which the Group obtains control, being the power to govern the financial and operating policies of the entity so as to obtain benefit from its activities. They continue to be consolidated until the date that such control ceases. The financial statements of subsidiaries are prepared using consistent accounting policies. Inter-company transactions and balances are eliminated.

### Investment Property

Investment properties are those properties owned by the Group that are held to earn rental income or for capital appreciation or both and are not occupied by the Company or any of its subsidiaries.

The fair value of investment properties are based on market values being an estimated amount for which a property could be exchanged on the date of valuation under an arm's length transaction between a willing buyer and seller after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion. Professional external valuers have valued a sample selected by themselves of 25% of the existing portfolio at the half year and year end and all new purchases since the previous valuation to the half year and to the year end. The remainder of the portfolio has been valued on the basis of market value at the year end by the directors who have appropriate recognised professional qualifications and recent experience of the location and category of the property being valued.

Investment properties are treated as acquired at the point the Group assumes the significant risks and returns of ownership. Subsequent expenditure is charged to the asset's carrying value only when it is probable that future economic benefits associated with the expenditure will flow to the Group and the cost of each item can be reliably measured. All other repairs and maintenance costs are charged to the Income Statement during the period in which they are incurred.

Disposals of investment properties are recognised on completion; profits and losses arising are recognised through the Income Statement, the profit is determined as the difference between the sales proceeds and the carrying amount of the asset at the last valuation date plus any additional expenditure incurred since that date.

Interest on loans associated with acquiring investment properties is expensed on an effective interest basis.

Rental income from investment properties is accounted for as described below.

### Investment Properties Held for Sale

Investment properties held for sale are included in the Balance Sheet at their fair value. In determining whether assets no longer meet the investment criteria of the Group, consideration has been given to the conditions required under IFRS 5.

### Head Leases

Where a property is held under a head lease and is classified as an investment property, it is initially recognised as an asset based on the sum of the premium paid on acquisition and if the remaining life of the lease at date of acquisition is considered to be material, the net present value of the minimum ground rent payments. The corresponding rent liability to the leaseholder is included in the Balance Sheet as a finance obligation in current and non-current liabilities.

The payment of head rent reduces the gross liability and the interest element of the finance lease is charged to the Income Statement. Head leases considered not to have a material life remaining at the date of acquisition are accounted for as operating leases with the head rent paid being expensed through the Income Statement.

# Notes to the Financial Statements continued
for the year ended 30 September 2010

## 1 Accounting Policies continued

### Property, Plant and Equipment

All property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure which is directly attributable to the acquisition of the asset.

Depreciation is charged to the Income Statement on the following basis:

- Fixtures and fittings – 15% reducing balance;
- Computer equipment – straight-line basis over three years; and
- Leasehold improvements – straight-line basis over the shorter of the length of lease or the useful economic life.

### Trade and Other Receivables

Trade and other receivables are initially recognised at fair value and subsequently held at amortised cost less impairment. Impairment is made where it is established that there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivable. The impairment is recorded in the Income Statement.

### Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances and deposits held on call. Cash equivalents are short-term, highly liquid investments with original maturities of three months or less.

### Derivative Financial Instruments and Hedging

The Group uses derivative financial instruments such as interest rate swaps to economically hedge risks associated with interest rate fluctuations. The Group does not hold or issue derivatives for trading purposes.

Such instruments are initially measured at fair value on the date on which a contract is entered into and are subsequently re-measured at fair value. Financial derivatives are recognised as current and non-current based on the maturity profile of the associated cash flows.

The Group has determined that the derivative financial instruments held did not qualify as effective for hedge accounting under the criteria set out in IAS 39 and consequently any gains or losses arising from changes in their fair value are taken to the Income Statement. In the future and on an ongoing basis as new derivative financial instruments are entered into, the directors will review the derivative contracts to consider whether they qualify for hedge accounting.

### Financial Assets

Financial assets are impaired when there is objective evidence that the cash flows from the financial asset are reduced.

### Trade and Other Payables

Trade and other payables are initially recognised at fair value and subsequently held at amortised cost less impairment.

### Ordinary Share Capital

External costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

Shares which have been repurchased are classified as Treasury shares and shown in retained earnings. They are recognised at the trade date for the amount of consideration paid, together with directly attributable costs. This is presented as a deduction from total equity. Shares held by the Employee Benefit Trust are treated as being those of the Group.

The nominal value of shares cancelled has been taken to a capital redemption reserve.

### Rental Income

Rental income from investment properties leased out under operating leases is recognised in the Income Statement on a straight-line basis over the term of the lease. When the Group provides lease incentives to its tenants the cost of incentives are recognised over the lease term, on a straight-line basis, as a reduction to income.

## 1 Accounting Policies continued

### Other Income

Other income includes lease variation fees which are recognised in the Income Statement as received.

### Taxation

Corporation tax on the profit or loss for the year comprises current and deferred tax. Corporation tax is recognised in the Income Statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

As a REIT, the Group will be exempt from corporation tax on the profits and gains from its property investment business, provided it continues to meet certain conditions. Non-qualifying profits and gains of the Group (the residual business) continue to be subject to corporation tax. Therefore, current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date and any adjustment to tax payable in respect of previous years. The REIT entry charge is expensed on the date of entry to the REIT regime.

Deferred tax is provided using the balance sheet liability method. Provision is made for temporary differences between the carrying amounts of assets and liabilities in the financial statements for financial reporting purposes and the amounts used for taxation purposes. Deferred income tax is calculated after taking into account any indexation allowances and capital losses on an undiscounted basis. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities using tax rates enacted or substantially enacted at the balance sheet date. Deferred tax assets are recognised only to the extent that it is probable that future profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised. Deferred tax assets and liabilities are only offset if there is a legally enforceable right of set off.

### Pensions

The Group operates a defined contribution pension plan. Contributions payable by the Group in respect of defined contribution plans are charged to administrative expenses as incurred.

### Share-Based Payments

The Group operates equity settled, share-based compensation plans comprising awards under a Long Term Incentive Plan ("LTIP") and a Company Share Option Plan ("CSOP") for certain employees. The fair values of these schemes are measured at their fair value at the date of grant. The fair value is then recognised as an employee cost, with a corresponding increase in equity, on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest.

The fair value of each scheme is measured using an option pricing model. The awards under the LTIP scheme are measured using a Monte Carlo simulation model and the awards under the CSOP scheme are measured using a Black–Scholes model.

### Employee Benefit Trust

The Group operates an Employee Benefit Trust in order to hedge its obligations under the CSOP and LTIP schemes. The Group either purchases own shares directly or it funds the trust to acquire shares in the Company. Transactions of the Employee Benefit Trust are treated as being those of the Company and are therefore reflected in the Group financial statements.

### Use of Estimates and Judgements

To be able to prepare accounts according to generally accepted accounting principles, management must make estimates and assumptions that affect the asset and liability items and revenue and expense amounts recorded in the financial statements. These estimates are based on historical experience and various other assumptions that management and the Board of directors believe are reasonable under the circumstances. The results of these considerations form the basis for making judgements about the carrying value of assets and liabilities that are not readily available from other sources.

The areas requiring the use of estimates and judgements that may significantly impact the Group's earnings and financial position include the estimation of: the fair value of investment properties, derivative financial instruments and trade receivables.

The valuation of the Group's investment properties is the main area of judgement exercised by the Board in respect of the Group's results. The Board have obtained an external valuation of the portfolio carried out by professionally qualified valuers in accordance with the Appraisal and Valuation Standards of the Royal Institute of Chartered Surveyors in respect of all properties purchased since 1 October 2009 and a further 25% of the portfolio at the half year and year end as selected by the valuers. This valuation has been used by the directors to value the remainder of the portfolio. The assumptions underlying the valuation include future rental income and an appropriate discount rate. The valuers were acting as independent valuers and have good information and experience of the current market prices for properties similar to those owned by the Group.

# Notes to the Financial Statements continued

for the year ended 30 September 2010

## 1 Accounting Policies continued

### Use of Estimates and Judgements continued

The valuation of derivative financial instruments and the fixed rate loan are also areas where judgement has been exercised by the Board. These assets and liabilities have been valued by JC Rathbone Associates Limited and this valuation has been relied upon by the Board.

The Group is required to assess whether there is sufficient objective evidence to require the impairment of individual trade receivables. It does this through a regular review of arrears with consideration given to any specific circumstances relating to the receivable.

### New Standards and Interpretations Not Yet Adopted

There are a number of new standards, amendments to standards and interpretations of standards which are not yet effective for the year ended 30 September 2010 and have not been applied in preparing these consolidated financial statements. These are as follows:

- IFRS 9 – Financial Instruments relates to the classification and measurement of financial instruments. This standard is not expected to have a material impact on the Group's financial statements once the standard becomes effective.
- Amendments to IFRS 7 – Financial instruments: disclosures

International Financial Reporting Interpretations Committee (IFRIC) interpretations:

- IFRIC 15 – Agreements for construction of real estate
- IFRIC 17 – Distributions of non cash assets to owners
- IFRIC 18 – Transfer of assets from customers
- Amendment to IFRIC 14 – Prepayment of a minimum funding requirement
- IFRIC 19 – Extinguishing financial liabilities with equity instruments

Amendments to existing standards

- Annual improvements 2010
- Amendment to IFRS 2 – Share-based payments – Group cash settled share-based payment transactions
- Amendments to IFRS 1 for additional exemptions
- Amendments to IAS 24 – Related Party disclosures
- Amendment to IAS 39 – Financial Instruments: Recognition and Measurement

All of the above IFRS's and amendments to existing standards are endorsed by the European Union (EU) at the date of approval of these financial statements.

At the date of approval of these financial statements, the following interpretations and amendments to standards were issued, endorsed by the EU and are mandatory for the Group for the first time for the financial year beginning on 1 October 2009:

- IFRIC 9 and IAS 39 – Embedded derivatives
- IFRIC 13 – Customer loyalty programmes relating to IAS 18 – Revenue
- IAS 1 (revised) – Presentation of financial statements
- Amendment to IFRS 1 – First time adoption of IFRS and IAS 27 – Consolidated and separate financial statements
- IFRS 3 – Business combinations

## 2 Segmental Reporting

IFRS 8 requires operating segments to be identified on the basis of internal reports that are regularly reported to the chief operating decision maker to allocate resources to the segments and to assess their performance.

The Group is organised as a single operating and reportable segment. All management information is produced quarterly on a Group basis and presented to the Board of Directors. No data is provided below portfolio level. The Board of Directors are considered to be the chief operating decision makers. All of the Group's revenues are derived from the ownership of investment properties. The Group has a large and diverse tenant base, there is no significant reliance on any one tenant. The Group's investment properties are located across the country, as shown by the geographical analysis provided on page 3.

The financial information presented quarterly to the Board is recurring profit. The following reconciles profit stated in the Income Statement to the recurring profit presented to the Board.

| | 2010 | 2009 |
|---|---|---|
| IFRS reported profit/(loss) | 1,815 | (30,997) |
| (Gain)/loss on the movement in fair value of the portfolio | (2,667) | 28,275 |
| Movement in the fair value of the interest rate swaps held | 3,789 | 5,578 |
| Profit on disposal of investment properties | (7) | (3) |
| Loss on disposal of fixed assets | 4 | – |
| **Recurring profit** | 2,934 | 2,853 |

## 3 Administrative Expenses

a) The following fees have been paid to the Group's Auditors:

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Auditors' remuneration for audit services: | | |
| Audit of parent company | 32 | 30 |
| Auditors' remuneration for non-audit services: | | |
| Statutory audit of subsidiaries | 48 | 45 |
| Tax services | 34 | 38 |
| Other services supplied | 18 | 20 |

The other services supplied relate to the review report issued in respect of the Half Year Review.

b) Included in administrative expenses are staff costs and directors' remuneration.

The average number of persons employed by the Group, including directors, was as follows:

| | 2010 Number of Employees | 2009 Number of Employees |
|---|---|---|
| Administration | 16 | 15 |

The aggregate payroll costs of these people were as follows:

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Wages and salaries | 1,275 | 1,241 |
| Social security costs | 154 | 148 |
| Other pension costs | 64 | 53 |
| Equity settled share-based payments | 107 | 176 |
| | 1,600 | 1,618 |

Directors' emoluments are disclosed separately in the Directors' Remuneration Report on pages 23 to 25.

# Notes to the Financial Statements continued
for the year ended 30 September 2010

## 3 Administrative Expenses continued

### Share Award Schemes

The Company operates two share award schemes for certain employees: a Company Share Option Plan and a Long Term Incentive Plan. Both plans were adopted by the Company with effect from 2 May 2007.

During the year further shares were awarded to employees under the Company Share Option Plan. Details of the exercise price and the periods in which they may be exercised are given below.

| Company Share Option Plan | Exercise Price p | Exercisable Between | 2010 Number 000 | 2009 Number 000 |
|---|---|---|---|---|
| | | 11 Dec 2012– | | |
| 10 December 2009 | 63.0 | 1 Dec 2019– | 40 | – |
| | | 12 Feb 2012– | | |
| 11 February 2009 | 28.5 | 1 Feb 2019 | – | 61 |
| | | 12 Jan 2011– | | |
| 11 January 2008 | 102.0 | 1 Jan 2018 | – | – |
| | | 3 May 2010– | | |
| 2 May 2007 | 175.5 | 1 May 2017 | – | – |

| | Number of Shares 000 | Fair Value £000 |
|---|---|---|
| At 1 October 2008 | 62 | 14 |
| Granted | 61 | 2 |
| Expensed | – | (6) |
| Expired | (2) | – |
| At 30 September 2009 | 121 | 10 |
| Granted | 40 | 4 |
| Expensed | – | (8) |
| Expired | – | – |
| **At 30 September 2010** | **161** | **6** |

The estimated fair value of the share options granted during the year have been calculated using the Black Scholes model. Inputs to the model are summarised below:

| | 2010 | 2009 |
|---|---|---|
| Expected volatility | 35.12% | 35.12% |
| Risk free interest rate | 2.95% | 2.55% |
| Expected life of options | 5 years | 5 years |
| Expected dividend yield | 5.75% | 5.75% |
| Weighted average share price | 63p | 28.5p |

## 3 Administrative Expenses continued

The expected life of the options is based on historical data and the Company's expectations. It is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumptions that the historical volatility is indicative of future trends which may also not necessarily be the actual outcome. The volatility was calculated according to comparable data of companies with a similar activity.

| Long Term Incentive Plan | Exercise Price p | Exercisable Between | 2010 Number 000 | 2009 Number 000 |
|---|---|---|---|---|
| 11 January 2008 | – | 12 Jan 2011– 1 Jan 2018 | – | – |
| 2 May 2007 | – | 3 May 2010– 1 May 2017 | – | – |

| | Number of Shares 000 | Fair Value £000 |
|---|---|---|
| At 1 October 2008 | 667 | 269 |
| Granted | – | – |
| Expensed | – | (170) |
| At 30 September 2009 | 667 | 99 |
| Granted | – | – |
| Expensed | – | (99) |
| Expired | (642) | – |
| **At 30 September 2010** | **25** | **–** |

The Monte Carlo model was used to determine the fair value of the shares awarded under the Long Term Incentive Plan in 2008. The assumptions used in the model were as follows:

| | 2008 |
|---|---|
| Expected volatility | 31.6% |
| Risk free interest rate | 4.20% |
| Expected life of options | 3 years |
| Expected dividend yield | 4.75% |
| Weighted average share price | 102.0p |

The scheme and its performance criteria are fully explained in the Directors' Remuneration Report on pages 23 and 25.

The expected volatility rate used is the average of a selection of companies which have a similar profile to the Company, as the Company does not have sufficient trading history to use its own share price. The expected volatility is based on historical share prices of these companies over a period equal to the expected term of the awards. The companies used for these purposes are not members of the comparator group of companies for the total shareholder return performance condition.

No options or share awards were exercised as of the balance sheet date.

The fair value of the options and share awards were valued by the directors.

## 4 Net Other (Expense)/Income

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Other income | **48** | 4 |
| Other expenses | **(88)** | 1 |
| | **(40)** | 5 |

Other income relates to sundry amounts charged to tenants in connection with variations to leases and income from property management services. Other expenses relate to fees incurred on aborted property purchases, aborted property sales and costs incurred in connection with property management services.

# Notes to the Financial Statements continued

for the year ended 30 September 2010

## 5 Net Financing Costs

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Interest receivable | 7 | 58 |
| Financing income excluding fair value movements | 7 | 58 |
| Fair value gains on derivative financial instruments (note 16) | – | – |
| Financing income | 7 | 58 |
| Bank loan interest | (7,167) | (6,825) |
| Amortisation of loan arrangement fees | (130) | (248) |
| Head rents treated as finance leases | (56) | (74) |
| Financing expenses excluding fair value movements | (7,353) | (7,147) |
| Fair value losses on derivative financial instruments (note 16) | (3,789) | (5,578) |
| Financing expenses | (11,142) | (12,725) |
| Net financing costs | (11,135) | (12,667) |

## 6 Taxation

| | 2010 £000 | 2009 £000 |
|---|---|---|
| **Current tax** | | |
| Corporation tax charged at 28% (2009: 28%) | – | – |
| Total current tax | – | – |
| | | |
| **Deferred tax charge** | | |
| Origination and reversal of temporary differences | – | – |
| Total tax charge in the Income Statement | – | – |

### Reconciliation of Effective Tax Rate

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Profit/(loss) before tax | 1,815 | (30,997) |
| Corporation tax in the UK of 28% (2009: 28%) | 508 | (8,679) |
| Tax relief available from REIT status | (1,326) | (1,302) |
| Effects of: | | |
| Revaluation deficit and other non-deductible items | 314 | 9,479 |
| Deferred tax asset not recognised | 504 | 502 |
| | – | – |

The Emergency Budget on 22 June 2010 announced that the UK corporation tax rate will reduce from 28% to 24% over a period of 4 years from 2011. The first reduction in the UK corporation tax rate from 28% to 27% was substantially enacted on 20 July 2010 and will be effective from 1 April 2011. This will reduce the company's future current tax charge accordingly.

From 11 May 2007, the Group elected to join the UK REIT regime. As a result, the Group will be exempt from corporation tax on the profits and gains from its property investment business from this date, provided it continues to meet certain conditions. Non-qualifying profits and gains of the Group (the residual business) continue to be subject to corporation tax. The directors consider that all the rental income post 11 May 2007 originates from the Group's tax exempt business. Due to the availability of losses, no provision for corporation tax has been made in these accounts.

On entering the UK REIT regime, a conversion charge equal to 2% of the gross market value of properties involved in the property rental business, at that date, became due which has now been paid in full.

The deferred tax asset not recognised relates to losses which can be carried forward indefinitely in respect of the residual business. It is not anticipated that these will be utilised in the foreseeable future.

## 7 Property, Plant and Equipment

| | Leasehold Improvements £000 | Fixtures and Fittings £000 | Computer Equipment £000 | Total £000 |
|---|---|---|---|---|
| **Cost** | | | | |
| At 1 October 2008 | 163 | 35 | 61 | 259 |
| Additions | 3 | – | 2 | 5 |
| At 30 September 2009 | 166 | 35 | 63 | 264 |
| Additions | – | 3 | 48 | 51 |
| Disposals | – | – | (50) | (50) |
| **At 30 September 2010** | **166** | **38** | **61** | **265** |
| **Depreciation** | | | | |
| At 1 October 2008 | 9 | 7 | 27 | 43 |
| Charge for year | 16 | 4 | 21 | 41 |
| At 30 September 2009 | 25 | 11 | 48 | 84 |
| Charge for year | 17 | 4 | 17 | 38 |
| Disposals | – | – | (46) | (46) |
| **At 30 September 2010** | **42** | **15** | **19** | **76** |
| **Net book value** | | | | |
| **At 30 September 2010** | **124** | **23** | **42** | **189** |
| At 30 September 2009 | 141 | 24 | 15 | 180 |
| At 30 September 2008 | 154 | 28 | 34 | 216 |

## 8 Investment Properties

| | Leasehold Investment Properties £000 | Freehold Investment Properties £000 | Total £000 |
|---|---|---|---|
| At 1 October 2008 | 39,481 | 164,224 | 203,705 |
| Additions | 2,335 | 4,942 | 7,277 |
| Disposals | (2,926) | (4,325) | (7,251) |
| Fair value adjustments | (3,785) | (24,490) | (28,275) |
| Investment properties held for sale | – | (1,300) | (1,300) |
| At 30 September 2009 | 35,105 | 139,051 | 174,156 |
| Additions | 1,182 | 19,359 | 20,541 |
| Disposals | (594) | (2,691) | (3,285) |
| Fair value adjustments | 878 | 1,789 | 2,667 |
| **At 30 September 2010** | **36,571** | **157,508** | **194,079** |

# Notes to the Financial Statements continued

**for the year ended 30 September 2010**

## 8 Investment Properties continued

No investment properties have been identified that meet the criteria of assets held for resale at 30 September 2010.

Investment properties held for sale at the prior year balance sheet date were shown separately as current assets as required by IFRS 5. These assets no longer met the investment criteria of the Group. In determining whether assets no longer meet the investment criteria of the Group, consideration has been given to the conditions required under IFRS 5.

The investment properties have all been revalued to their fair value at 30 September 2010.

All properties acquired since October 2009, together with a sample selected by the valuers of 25% of the portfolio, at the half year and year end have been valued by Allsop LLP, a firm of independent Chartered Surveyors. The valuations were undertaken in accordance with the Royal Institute of Chartered Surveyors Appraisal and Valuation Standards on the basis of market value. Market value is defined as the estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

The remainder of the portfolio has been valued on the basis of market value by the directors who have an appropriate recognised professional qualification and recent experience in the location and category of the property being valued.

All rental income recognised in the Income Statement is generated by the investment properties held and all direct operating expenses incurred resulted from investment properties that generated rental income.

A reconciliation of the portfolio valuation to the total value given in the Balance Sheet for investment properties is as follows:

| | 2010<br>£000 | 2009<br>£000 |
|---|---|---|
| Portfolio valuation | **192,873** | 174,432 |
| Investment properties held for sale | **–** | (1,300) |
| Head leases treated as investment properties held under finance leases per IAS 17 | **1,206** | 1,024 |
| Total per Balance Sheet | **194,079** | 174,156 |

## 9 Trade and Other Receivables

| | 2010<br>£000 | 2009<br>£000 |
|---|---|---|
| Trade receivables | **2,883** | 3,355 |
| Other receivables | **696** | 963 |
| Prepayments | **758** | 328 |
| | **4,337** | 4,646 |

## 10 Cash

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Bank balances | **6,120** | 5,949 |
| Cash in the Statement of Cash Flows | **6,120** | 5,949 |

Included in bank balances are amounts held pending the next interest payment due in October 2010. Until the interest payment has been deducted from these balances the cash is not available for use by the Group. At the year end the amount held on such account was £3,366,604 (2009: £1,621,302) with accruals for interest due of £1,385,773 (2009: £1,332,097).

## 11 Interest Bearing Loans and Borrowings

| | 2010 £000 | 2009 £000 |
|---|---|---|
| **Non-current liabilities** | | |
| Secured bank loans | **132,529** | 116,929 |
| Loan arrangement fees | **(838)** | (796) |
| | **131,691** | 116,133 |
| **Current liabilities** | | |
| Current portion of secured bank loans | **–** | – |

All bank borrowings are secured by fixed charges over certain of the Group's property assets and floating charges over the companies which own the assets charged. All loans are repayable in one instalment in 2016.

For more information about the Group's exposure to interest rate risk, see note 17.

## 12 Trade and Other Payables

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Trade payables | **433** | 541 |
| Other taxation and social security | **292** | 403 |
| Other payables | **1,006** | 1,060 |
| Accruals and deferred income | **3,330** | 3,166 |
| | **5,061** | 5,170 |

Other payables include rent deposits held in respect of commercial tenants of £854,000 (2009: £825,000).

# Notes to the Financial Statements continued

for the year ended 30 September 2010

## 13 Leasing

### Obligations Under Finance leases

Finance lease liabilities on head rents are payable as follows:

| | Principal £000 | Interest £000 | Minimum Lease Payment £000 |
|---|---|---|---|
| At 1 October 2008 | 8,834 | (7,478) | 1,356 |
| Additions | – | – | – |
| Disposals | (1,546) | 1,214 | (332) |
| (Payments)/charge | (74) | 74 | – |
| At 30 September 2009 | 7,214 | (6,190) | 1,024 |
| Additions | 1,489 | (1,306) | 183 |
| Disposals | (101) | 100 | (1) |
| (Payments)/charge | (56) | 56 | – |
| **At 30 September 2010** | **8,546** | **(7,340)** | **1,206** |

In the above table, interest represents the difference between the carrying amount (minimum lease payment) and the contractual liability/cash flow (principal).

All leases expire in more than five years.

## 14 Capital and Reserves

### Share Capital

| | 2010 Ordinary 20p Shares | | 2009 Ordinary 20p Shares | |
|---|---|---|---|---|
| | Number 000 | Amount £000 | Number 000 | Amount £000 |
| Allotted, called up and fully paid | **91,670** | **18,334** | 91,670 | 18,334 |

### Investment in Own Shares

In the prior year the Company purchased 630,000 shares, 675,000 shares were cancelled and 25,000 shares were transferred to the Company's Employee Benefit Trust, LSR Trustee Limited ("EBT"). At the year end, 9,164,017 shares were held in treasury (2009: 9,164,017). The number of shares held by the EBT at the year end was 1,123,339 (2009: 1,123,339).

### Reserves

The value of shares issued to purchase Gilfin Property Holdings Limited in excess of their nominal value has been shown as a separate reserve in accordance with the Companies Act 2006.

### Capital Redemption Reserve

The capital redemption reserve arose in the prior year on the cancellation of 675,000 Ordinary 20p Shares.

### Dividends

A dividend of 1.7p per share (total: £1.38m) was paid on 30 June 2010. Under the REIT legislation the Company's dividends are divided into two components, known as PID and non-PID. This dividend was wholly classified as a PID.

On 31 December 2009 a dividend of 1.8p per share (total: £1.46m) was paid. This dividend was wholly classified as a non-PID.

On 30 June 2009 dividend was paid of 1.7p per share (total: £1.38m). This dividend was wholly classified as a PID.

On 31 December 2008 a dividend was paid of 2.875p per share (total: £2.36m). This dividend was wholly classified as a non-PID.

## 14 Capital and Reserves continued

### Calculation of Net Asset Value Per Share (NAV)

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Net assets | 57,640 | 58,566 |
| Fair value of derivative financial instruments (see note 16) | 9,127 | 5,338 |
| Adjusted net assets | 66,767 | 63,904 |

| | 2010 Number 000 | 2009 Number 000 |
|---|---|---|
| Allotted, called up and fully paid shares | 91,670 | 91,670 |
| Treasury shares | (9,164) | (9,164) |
| Number of shares | 82,506 | 82,506 |
| | | |
| NAV per share | 70p | 71p |
| Adjusted NAV per share | 81p | 77p |

## 15 Earnings Per Share

### Basic Earnings Per Share

The calculation of basic earnings per share was based on the profit/(loss) attributable to Ordinary Shareholders and a weighted average number of Ordinary Shares outstanding, calculated as follows:

### Profit/(Loss) Attributable to Ordinary Shares

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Profit/(loss) for the year | 1,815 | (30,997) |

### Weighted Average Number of Ordinary Shares

| | 2010 Number 000 | 2009 Number 000 |
|---|---|---|
| Issued Ordinary Shares at 1 October 2009 | 91,670 | 92,275 |
| Effect of own shares held | – | (429) |
| Shares held by EBT | (1,123) | (1,123) |
| Treasury shares | (9,164) | (9,164) |
| Weighted average number of Ordinary Shares at 30 September 2010 | 81,383 | 81,559 |

### Diluted Earnings Per Share

There is no difference between basic and diluted earnings per share.

# Notes to the Financial Statements continued

for the year ended 30 September 2010

## 16 Derivative Financial Instruments

Derivative financial instruments held by the Group are interest rate swaps used to manage the Group's interest rate exposure. These are shown in the Balance Sheet as follows:

| | Fair Value 2008 £000 | Movements in Income Statement £000 | Fair Value 2009 £000 | Movements in Income Statement £000 | Fair Value 2010 £000 |
|---|---|---|---|---|---|
| Non-current assets | 37 | (37) | – | – | – |
| Current assets | 203 | (203) | – | – | – |
| Non-current liabilities | – | (2,976) | (2,976) | (3,770) | (6,746) |
| Current liabilities | – | (2,362) | (2,362) | (19) | (2,381) |
| Fair value | 240 | | (5,338) | | (9,127) |
| Amount charged to Income Statement | | (5,578) | | (3,789) | |

At 30 September 2010 and 30 September 2009 these derivative financial instruments did not qualify as effective swaps for hedge accounting under the criteria set out in IAS 39.

A summary of the swaps and their maturity dates are as follows:

| Maturity Date | Amount £000 | Rate Payable on Fixed Leg of Swap % | Fair Value 2009 £000 | Movements in Income Statement £000 | Fair Value 2010 £000 |
|---|---|---|---|---|---|
| 30 April 2016 | 33,000 | 5.06–5.29 | (3,315) | (864) | (4,179) |
| 31 January 2017 | 24,578 | 5.4476 | (1,975) | (2,973) | (4,948) |
| Swaps in place at 30 September 2010 | 57,378 | | (5,290) | (3,837) | (9,127) |
| Amortising swap with a maturity date of 31 January 2017 | 800 | 5.4476 | (48) | 48 | – |
| 30 September 2009 | 58,178 | | (5,338) | (3,789) | (9,127) |

The interest rate receivable on each swap is LIBOR.

The derivative financial instruments included in the above tables were valued by JC Rathbone Associates Limited, independent financial risk management consultants, using a discounted cash flow model and published market information.

More details of the Group's policy regarding the management of interest rate risk is given in note 17.

## 17 Financial Instruments and Risk Management

The Board of directors has overall responsibility for the establishment and oversight of the Group's risk management framework. As described in the Corporate Governance report on pages 20 to 22, this responsibility has been assigned to the executive directors with support and feedback from the Audit Committee. The Audit Committee oversees how management monitors compliance with the Group's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by the Group.

The Group has identified exposure to the following financial risks from its use of financial instruments: capital management risk, market risk, credit risk and liquidity risk.

### Capital Management Risk

The Group's capital consists of long-term borrowings, cash and equity attributable to the shareholders. The Board's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain the future development of the business. The Board regularly reviews the Group's capital structure, cost of capital, gearing levels and other specific measures. From time to time, the Company purchases its own shares when the Board considers that this course of action would enhance the value of the Group for shareholders. There were no changes in the Group's approach to capital management during the year.

### Market Risk

Market risk is the risk that changes in market conditions, such as interest rates, foreign exchange rates and equity prices, will affect the Group's profit or loss and cash flows. The Group's exposure to market risks is restricted to interest rate risk only. The Group borrows at fixed and floating rates of interest and uses financial instruments to fix the floating rates of interest in accordance with its policy.

The Group does not speculate in financial instruments, it only uses these to limit its exposure to interest rate fluctuations. The Group's policy is to hedge between 60% and 100% of its interest rate exposure. At 30 September 2010, 95% (2009: 100%) of the Group's debt was fixed or protected, as shown below.

| | At 30 September 2010 | | | | At 30 September 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Interest bearing loans £000 | Fixed rate loans £000 | Notional value of swaps £000 | Loans not protected by swaps £000 | Interest bearing loans £000 | Fixed rate loans £000 | Notional value of swaps £000 | Excess swaps held £000 |
| Fixed rate loan | **69,229** | **69,229** | **–** | **–** | 69,229 | 69,229 | – | – |
| Variable rate loan | **63,300** | **–** | **57,378** | **5,922** | 47,700 | – | 58,178 | (10,478) |
| | **132,529** | **69,229** | **57,378** | **5,922** | 116,929 | 69,229 | 58,178 | (10,478) |

The variable rate loan is protected by interest rate swaps which are carried at fair value, by valuation method. These have been identified as Level 2 in the fair value hierarchy. Level 2 is defined as inputs other than quoted prices included within Level 1 that are observable for the liability either directly (ie as prices) or indirectly (as derived from prices).

### Sensitivity Analysis

IFRS 7 requires an illustration of the impact on the Group's financial performance of changes in interest rates. The following sensitivity analysis has been prepared in accordance with the Group's existing accounting policies and considers the impact on the Income Statement and on equity of an increase of 100 basis points (1%) in interest rates. As interest rates were below 1% in the current and previous year, it has not been possible to consider the impact of a decrease of 100 basis points on interest income and expense as it would result in a negative rate of interest. Therefore, the impact of a fall in interest rates has been restricted to 0%, a fall of 0.7452% (2009: 0.8875%). It has been possible to consider the impact of a 1% change in rates on the fair value of derivatives as the contracted rates are greater than 1%. All other variables remain the same and any consequential tax impact is excluded. The analysis assumes that changes in market interest rates affect the interest income and interest expense of derivative financial instruments. Changes in the fair value of derivative financial instruments have been estimated by discounting future cash flows at appropriate market rates prevailing at each year end.

Actual results in the future may differ materially from these assumptions and as such, these tables should not be considered as a projection of likely future gains and losses.

| | 2010 | | | | 2009 | | | |
|---|---|---|---|---|---|---|---|---|
| | Impact on income | | Impact on equity | | Impact on income | | Impact on equity | |
| | + £000 | - £000 | + £000 | - £000 | + £000 | - £000 | + £000 | - £000 |
| Impact on interest income and expense | **39** | **9** | **39** | **9** | 28 | 31 | 28 | 31 |
| Impact on fair value of derivatives | **3,138** | **3,138** | **3,138** | **3,138** | 3,497 | 3,497 | 3,497 | 3,497 |

# Notes to the Financial Statements continued

for the year ended 30 September 2010

## 17 Financial Instruments and Risk Management continued

### Credit Risk

Credit risk is the risk of financial loss to the Group if a tenant, bank or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Group's receivables from tenants, cash and cash equivalents held by the Group's banks and derivative financial instruments entered into with the Group's banks.

### Trade and Other Receivables

The Group's exposure to credit risk is influenced mainly by the individual characteristics of each tenant. The Group has over 2,000 tenants in over 650 properties. There is no significant concentration of credit risk due to the large number of small balances owed by a wide range of tenants who operate across all retail sectors. Geographically there is no concentration of credit risk in any one area of the UK. An analysis of the business by region, user type and tenant grade is given on page 3 of the Annual Report. The level of arrears is monitored monthly by the Group and more frequently on a tenant by tenant basis by the asset managers.

### Cash, Cash Equivalents and Derivative Financial Instruments

Three major UK banks provide the majority of the banking services used by the Group. Financial derivatives are only entered into with these core banks.

The Group's financial assets which are exposed to credit risk are classified as follows and are shown with their fair value:

### 30 September 2010

| | At Fair Value £000 | Available For Sale £000 | At Amortised Cost £000 | Total Carrying Amount £000 | Fair Value £000 |
|---|---|---|---|---|---|
| Cash and cash equivalents | – | 6,120 | – | 6,120 | 6,120 |
| Trade receivables | – | – | 2,883 | 2,883 | 2,883 |
| Other receivables | – | – | 696 | 696 | 696 |
| | – | 6,120 | 3,579 | 9,699 | 9,699 |

### 30 September 2009

| | At Fair Value £000 | Available For Sale £000 | At Amortised Cost £000 | Total Carrying Amount £000 | Fair Value £000 |
|---|---|---|---|---|---|
| Cash and cash equivalents | – | 5,949 | – | 5,949 | 5,949 |
| Trade receivables | – | – | 3,355 | 3,355 | 3,355 |
| Other receivables | – | – | 963 | 963 | 963 |
| | – | 5,949 | 4,318 | 10,267 | 10,267 |

For all classes of financial assets, the carrying amount is a reasonable approximation of fair value.

The ageing of trade receivables are as follows:

| | 2010 | | | 2009 | | |
|---|---|---|---|---|---|---|
| | Total £000 | Impairment £000 | After Impairment £000 | Total £000 | Impairment £000 | After Impairment £000 |
| Not yet due | 790 | – | 790 | 1,177 | – | 1,177 |
| Past due by one to 30 days | 1,330 | (11) | 1,319 | 1,402 | (14) | 1,388 |
| Past due by 30-60 days | 221 | (5) | 216 | 229 | (19) | 210 |
| Past due by 60-90 days | 108 | (3) | 105 | 69 | (5) | 64 |
| Past due by 90 days | 927 | (474) | 453 | 875 | (359) | 516 |
| | 3,376 | (493) | 2,883 | 3,752 | (397) | 3,355 |

Trade receivables that are not impaired are expected to be recovered.

Other receivables at 30 September 2010 and 30 September 2009 were not past due.

## 17 Financial Instruments and Risk Management continued

The movement in the trade receivables' impairment allowance during the year was as follows:

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Balance at 1 October 2009 | **397** | 292 |
| Impairment loss recognised | **918** | 1,043 |
| Trade receivables written off | **(822)** | (938) |
| Balance at 30 September 2010 | **493** | 397 |

The impairment loss recognised relates to the movement in the Group's assessment of the recoverability of outstanding trade receivables.

### Liquidity Risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity risk is to ensure, as far as possible, that it will always have adequate resources to meet its liabilities when they fall due for both the operational needs of the business and to meet planned future investments. This position is formally reviewed on a quarterly basis or more frequently should events require it.

The Group's financial liabilities are classified and are shown with their fair value as follows:

### 30 September 2010

| | At Fair Value £000 | At Amortised Cost £000 | Total Carrying Amount £000 | Fair Value £000 |
|---|---|---|---|---|
| Interest bearing loans and liabilities | **–** | **131,691** | **131,691** | **142,779** |
| Finance lease liabilities | **–** | **1,206** | **1,206** | **1,206** |
| Derivative financial instruments | **9,127** | **–** | **9,127** | **9,127** |
| Trade payables | **–** | **433** | **433** | **433** |
| Other payables | **–** | **948** | **948** | **948** |
| Accruals | **–** | **1,988** | **1,988** | **1,988** |
| | **9,127** | **136,266** | **145,393** | **156,481** |

### 30 September 2009

| | At Fair Value £000 | At Amortised Cost £000 | Total Carrying Amount £000 | Fair Value £000 |
|---|---|---|---|---|
| Interest bearing loans and liabilities | – | 116,133 | 116,133 | 122,056 |
| Finance lease liabilities | – | 1,024 | 1,024 | 1,024 |
| Derivative financial instruments | 5,338 | – | 5,338 | 5,338 |
| Trade payables | – | 541 | 541 | 541 |
| Other payables | – | 992 | 992 | 992 |
| Accruals | – | 1,719 | 1,719 | 1,719 |
| | 5,338 | 120,409 | 125,747 | 131,670 |

For all classes of financial liabilities, other than the fixed rate loan, the carrying amount is a reasonable approximation of fair value.

The fair value of the fixed rate element of the interest bearing loan disclosed above has been valued by JC Rathbone Associates Limited, financial risk consultants, using a discounted cash flow model and published market information.

# Notes to the Financial Statements continued

**for the year ended 30 September 2010**

## 17 Financial Instruments and Risk Management continued

The Group has undrawn committed borrowing facilities available at 30 September as follows:

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Expiring after more than five years | | |
| Bank loans – term loan facility | 14,500 | 25,000 |
| Bank loans – revolving credit facility | 29,900 | 35,000 |
| | 44,400 | 60,000 |

The maturity profile of the Group's financial liabilities are as follows:

### 30 September 2010

| | Carrying Value £000 | Contractual Cash Flows £000 | Within One Year £000 | One to Two Years £000 | Two to Three Years £000 | Three to Four Years £000 | Four to Five Years £000 | Over Five Years £000 |
|---|---|---|---|---|---|---|---|---|
| Interest bearing loans and borrowings | 131,691 | 174,895 | 7,270 | 7,270 | 7,270 | 7,270 | 7,270 | 138,545 |
| Finance lease liabilities | 1,206 | 8,545 | 61 | 61 | 61 | 61 | 61 | 8,240 |
| Derivative financial instruments | 9,127 | 9,127 | 2,381 | 2,113 | 1,660 | 1,282 | 966 | 725 |
| Trade payables | 433 | 433 | 433 | – | – | – | – | – |
| Other payables | 948 | 948 | 948 | – | – | – | – | – |
| Accruals | 1,988 | 1,988 | 1,988 | – | – | – | – | – |
| | 145,393 | 195,936 | 13,081 | 9,444 | 8,991 | 8,613 | 8,297 | 147,510 |

### 30 September 2009

| | Carrying Value £000 | Contractual Cash Flows £000 | Within One Year £000 | One to Two Years £000 | Two to Three Years £000 | Three to Four Years £000 | Four to Five Years £000 | Over Five Years £000 |
|---|---|---|---|---|---|---|---|---|
| Interest bearing loans and borrowings | 116,133 | 164,897 | 7,300 | 6,773 | 6,834 | 6,913 | 7,270 | 129,807 |
| Finance lease liabilities | 1,024 | 7,213 | 74 | 74 | 74 | 74 | 74 | 6,843 |
| Derivative financial instruments | 5,338 | 5,571 | 2,372 | 1,390 | 667 | 386 | 309 | 447 |
| Trade payables | 541 | 541 | 541 | – | – | – | – | – |
| Other payables | 992 | 992 | 992 | – | – | – | – | – |
| Accruals | 1,719 | 1,719 | 1,719 | – | – | – | – | – |
| | 125,747 | 180,933 | 12,998 | 8,237 | 7,575 | 7,373 | 7,653 | 137,097 |

Contractual cash flows include the undiscounted committed interest cash flows and, where the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the year end.

## 18 Operating Lease Arrangements

a) As Lessee

Future minimum lease payments payable by the Group under non-cancellable operating leases were as follows:

| | Land and Buildings | | Plant and Equipment | |
|---|---|---|---|---|
| | 2010 £000 | 2009 £000 | 2010 £000 | 2009 £000 |
| Operating leases which expire: | | | | |
| Within one year | **96** | 96 | **6** | 14 |
| One to two years | **96** | 96 | **–** | 6 |
| Two to five years | **96** | 96 | **–** | – |
| Over five years | **408** | 504 | **–** | – |
| | **696** | 792 | **6** | 20 |

b) As Lessor

Future minimum lease payments receivable by the Group under non-cancellable operating leases were as follows:

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Operating leases which expire: | | |
| Within one year | **2,495** | 2,364 |
| One to two years | **1,530** | 815 |
| Two to five years | **4,300** | 4,020 |
| Over five years | **8,087** | 8,467 |
| | **16,412** | 15,666 |

## 19 Capital Commitments

At 30 September 2010 the Group had contracted capital expenditure for which no provision has been made in these financial statements of £1,202,000 (2009: £735,000).

## 20 Related Parties

### Identity of Related Parties

The Group has related party relationships with its subsidiaries (see note 21), and with its key management personnel.

### Transactions with Key Management Personnel

The only transactions with key management personnel relate to remuneration which is set out in the Directors' Remuneration Report on pages 23 to 25.

The key management personnel of the Group for the purposes of related party disclosures under IAS 24 comprise all executive and non-executive directors.

During the current and previous years there were no transactions or outstanding balances with any related parties.

# Notes to the Financial Statements continued

for the year ended 30 September 2010

## 21 Group Entities

### Subsidiaries

| | Country of Incorporation | Ownership Interest* 2010 | Ownership Interest* 2009 |
|---|---|---|---|
| NOS Limited | United Kingdom | **100%** | 100% |
| NOS 2 Limited | United Kingdom | **100%** | 100% |
| NOS 3 Limited | United Kingdom | **100%** | 100% |
| NOS 4 Limited | United Kingdom | **100%** | 100% |
| NOS 5 Limited | United Kingdom | **100%** | 100% |
| NOS 6 Limited | United Kingdom | **100%** | 100% |
| NOS 7 Limited | United Kingdom | **100%** | 100% |
| NOS 8 Limited | United Kingdom | **100%** | 100% |
| Gilfin Property Holdings Limited | United Kingdom | **100%** | 100% |
| LSR Asset Management Limited | United Kingdom | **100%** | 100% |
| NOS Residential Limited | United Kingdom | **100%** | 100% |

* All interests are in Ordinary Shares.

## 22 Subsequent Event

On 29 November 2010 the Group entered into an agreement, with Pramerica Real Estate, to invest up to £7.5m in an arrangement to buy up to £100m of property in the UK neighbourhood/convenience retail sector. The duration of the arrangement is anticipated to be five years. The Group will act as manager and be responsible for sourcing the investments, for which it will receive related fees.

# Company Balance Sheet

**as at 30 September 2010**

| | Note | 2010 £000 | 2010 £000 | 2009 £000 | 2009 £000 |
|---|---|---|---|---|---|
| **Fixed assets** | | | | | |
| Property, plant and equipment | C5 | | 189 | | 180 |
| Investments | C6 | | 134,829 | | 152,843 |
| | | | 135,018 | | 153,023 |
| **Current assets** | | | | | |
| Debtors | C7 | 5,138 | | 2,282 | |
| Cash | | 30 | | 1,965 | |
| | | 5,168 | | 4,247 | |
| Creditors: Amounts falling due within one year | C8 | (34,058) | | (28,598) | |
| Net current liabilities | | | (28,890) | | (24,351) |
| Total assets less current liabilities | | | 106,128 | | 128,672 |
| Creditors: Amounts falling due after one year | | | – | | – |
| Net assets | | | 106,128 | | 128,672 |
| | | | | | |
| **Capital and reserves** | | | | | |
| Share capital | C9 | | 18,334 | | 18,334 |
| Reserves | C9 | | 3,742 | | 3,742 |
| Capital redemption reserve | C9 | | 1,764 | | 1,764 |
| Profit and loss account | C9 | | 82,288 | | 104,832 |
| Shareholders' funds | | | 106,128 | | 128,672 |

These financial statements were approved by the Board of directors on 15 December 2010 and were signed on its behalf by:

**M E Riley**
Joint CEO

**N J Gregory**
Joint CEO

**The registered number of the Company is 5304743.**

# Notes to the Company Financial Statements

**for the year ended 30 September 2010**

## C1 Accounting Policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

### Basis of Preparation

The financial statements have been prepared in accordance with applicable UK Accounting Standards and under the historical cost accounting rules.

### Cash Flow Statement

Under FRS 1, the Company is exempt from the requirement to prepare a cash flow statement on the grounds that the Company is included in its own published consolidated financial statements.

### Related Party Transactions

The Company has taken advantage of the exemption in FRS 8 – Related Party Transactions and has not disclosed transactions or balances with entities which form part of the Group as these consolidated financial statements include the results of these entities.

### Financial Instruments

The Company has adopted the requirements of FRS 29 – Financial Instruments Disclosures and has taken the exemption under that standard from disclosure on the grounds that the Group financial statements contain disclosures in compliance with IFRS 7.

### Investments

Investments in subsidiary undertakings are stated at historic cost less provisions for impairment.

### Tangible Fixed Assets

All fixed assets are stated at historical cost less depreciation. Historical cost includes expenditure which is directly attributable to the acquisition of the asset.

Depreciation is charged to the profit and loss account on the following basis:

- Fixtures and fittings – 15% reducing balance;
- Computer equipment – straight-line basis over three years; and
- Leasehold improvements – straight-line basis over the life of the lease.

### Taxation

The charge for taxation is based on the result for the period and takes into account taxation deferred because of timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes, which have arisen, but not reversed by the balance sheet date, except as otherwise required by FRS 19.

### Pensions

The Company operates a defined contribution pension plan. Contributions payable by the Company in respect of defined contribution pension plans are charged to administrative expenses as incurred.

### Share-Based Payments

The Company operates equity settled, share-based compensation plans comprising awards under a Long Term Incentive Plan ("LTIP") and a Company Share Option Plan ("CSOP") for certain employees. The fair values of these schemes are measured at their fair value at the date of grant. The fair value is then recognised as an employee cost, with a corresponding increase in equity, on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest.

The fair value of each scheme is measured using an option pricing model. The awards under the LTIP scheme are measured using a Monte Carlo simulation model and the awards under the CSOP scheme are measured using a Black–Scholes model.

## C1 Accounting Policies continued

### Employee Benefit Trust

The Company operates an Employee Benefit Trust in order to hedge its obligations under the CSOP and LTIP schemes. The Company either purchases own shares directly or it funds the trust to acquire shares in the Company. Transactions of the Employee Benefit Trust are treated as being those of the Company and are reflected in the Company's financial statements.

### Ordinary Share Capital

External costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds.

Shares which have been repurchased are classified as Treasury shares and shown in retained earnings. They are recognised at the trade date for the amount of consideration paid, together with directly attributable costs. This is presented as a deduction from total equity. Shares held by the Employee Benefit Trust are treated as being those of the Company.

The nominal value of shares cancelled has been taken to a capital redemption reserve.

### Loss for the Financial Year

The Company has taken advantage of Section 408 of the Companies Act 2006 and has not included its own profit and loss account in these financial statements. The Company's loss for the year was £19,803,000 (2009: loss £4,336,000).

## C2 Remuneration of Directors

The detailed information concerning directors' emoluments, shareholdings and share options is shown in the Remuneration Report on pages 23 to 25.

All directors of the Company are directors of the Group.

## C3 Remuneration of Auditors

The detailed information concerning Auditors' remuneration is shown in note 3 to the Group financial statements.

## C4 Staff Numbers, Costs and Share Option Schemes

The detailed information concerning staff numbers, costs and share option schemes is shown in note 3 to the Group financial statements.

## C5 Tangible Fixed Assets

| | Leasehold Improvements £000 | Fixtures and Fittings £000 | Computer Equipment £000 | Total £000 |
|---|---|---|---|---|
| **Cost** | | | | |
| At 30 September 2009 | 166 | 35 | 63 | 264 |
| Additions | – | 3 | 48 | 51 |
| Disposals | – | – | (50) | (50) |
| **At 30 September 2010** | **166** | **38** | **61** | **265** |
| **Accumulated depreciation** | | | | |
| At 30 September 2009 | 25 | 11 | 48 | 84 |
| Charge for year | 17 | 4 | 17 | 38 |
| Disposals | – | – | (46) | (46) |
| **At 30 September 2010** | **42** | **15** | **19** | **76** |
| **Net book value** | | | | |
| **At 30 September 2010** | **124** | **23** | **42** | **189** |
| At 30 September 2009 | 141 | 24 | 15 | 180 |

# Notes to the Company Financial Statements continued

**for the year ended 30 September 2010**

## C6 Fixed Asset Investments

| | Shares in Group Undertakings £000 | Total £000 |
|---|---|---|
| **Cost** | | |
| At 1 October 2009 | 155,355 | 155,355 |
| Additions | – | – |
| **At 30 September 2010** | **155,355** | **155,355** |
| **Provisions** | | |
| At 1 October 2009 | 2,512 | 2,512 |
| Impairment charge for year | 18,014 | 18,014 |
| **At 30 September 2010** | **20,526** | **20,526** |
| **Net book value** | | |
| **At 30 September 2010** | **134,829** | **134,829** |
| At 30 September 2009 | 152,843 | 152,843 |

In the prior year the Company subscribed for a further 1,150,000 Ordinary £1 Shares in its 100% owned subsidiary, NOS 3 Limited and 5,250,000 Ordinary £1 Shares in its 100% owned subsidiary, NOS 6 Limited.

An impairment review of the carrying value of the Company's investments in its subsidiary undertakings has been performed. In carrying out this review, the directors had due regard to the long-term nature of the property investments held, which is commensurate with the long-term funding arrangements in place. On the basis of this review which included a review of the underlying assets of the individual subsidiaries the directors have written down the value of investments in subsidiary undertakings to their estimated realisable value in the medium term.

The companies in which the Company's interests at the year end are more than 20% are as follows:

| Subsidiary undertaking | Nature of Business | Ownership Interest* |
|---|---|---|
| NOS Limited | Property trading | 100% |
| NOS 2 Limited | Property investment | 100% |
| NOS 3 Limited | Property investment | 100% |
| NOS 4 Limited | Property investment | 100% |
| NOS 5 Limited | Property investment | 100% |
| NOS 6 Limited | Property investment | 100% |
| NOS 7 Limited | Property investment | 100% |
| NOS 8 Limited | Property investment | 100% |
| Gilfin Property Holdings Limited | Property investment | 100% |
| LSR Asset Management Limited | Property management | 100% |
| NOS Residential Limited | Property investment | 100% |

* All interests are in Ordinary Shares.

All of the above companies are incorporated in Great Britain.

## C7 Debtors

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Amounts owed by Group undertakings | 5,060 | 2,216 |
| Other debtors | 6 | 13 |
| Prepayments | 72 | 53 |
| | 5,138 | 2,282 |

## C8 Creditors: Amounts Falling Due Within One Year

| | 2010 £000 | 2009 £000 |
|---|---|---|
| Trade creditors | 20 | 45 |
| Amounts owed to Group undertakings | 33,491 | 28,130 |
| Other taxation and social security | 147 | 48 |
| Other creditors | 60 | 61 |
| Accruals | 340 | 314 |
| | 34,058 | 28,598 |

## C9 Reconciliation of Shareholders' Funds

### Share Capital

| | 2010 Ordinary 20p Shares | | 2009 Ordinary 20p Shares | |
|---|---|---|---|---|
| | Number 000 | Amount £000 | Number 000 | Amount £000 |
| Allotted, called up and fully paid | 91,670 | 18,334 | 91,670 | 18,334 |

### Reserves

| | Reserves £000 | Capital Redemption Reserve £000 | Profit and Loss Account £000 | Total £000 |
|---|---|---|---|---|
| At 1 October 2008 | 3,742 | 1,629 | 112,943 | 118,314 |
| Cancellation of shares | – | 135 | – | 135 |
| Own shares acquired | – | – | (210) | (210) |
| Dividend | – | – | (3,741) | (3,741) |
| Share-based payments | – | – | 176 | 176 |
| Loss for the financial year | – | – | (4,336) | (4,336) |
| At 1 October 2009 | 3,742 | 1,764 | 104,832 | 110,338 |
| Dividend | – | – | (2,848) | (2,848) |
| Share-based payments | – | – | 107 | 107 |
| Loss for the financial year | – | – | (19,803) | (19,803) |
| At 30 September 2010 | 3,742 | 1,764 | 82,288 | 87,794 |

# Notes to the Company Financial Statements continued

**for the year ended 30 September 2010**

## C9 Called Up Share Capital and Reserves continued

### Investment in Own Shares

In the prior year the Company purchased 630,000 shares, of these 605,000 were cancelled together with a further 70,000 shares which were held in Treasury. There were no such share transactions completed in the current year.

At 30 September 2010, 9,234,017 shares were held in Treasury (2009: 9,234,017).

### Reserves

The value of shares issued to purchase Gilfin Property Holdings Limited in excess of their nominal value has been shown as a separate reserve in accordance with the Companies Act 2006.

### Capital Redemption Reserve

The capital redemption reserve arose in the prior year on the cancellation of 675,000 Ordinary 20p Shares.

### Dividends

A dividend of 1.7p per share (total: £1.38m) was paid on 30 June 2010. Under the REIT legislation the Company's dividends are divided into two components, known as PID and non-PID. This dividend was wholly classified as a PID.

On 31 December 2009 a dividend of 1.8p per share (total: £1.46m) was paid. This dividend was wholly classified as a non-PID.

On 30 June 2009 a dividend of 1.8p per share (total: £1.38m) was paid. This dividend was wholly classified as a PID.

On 31 December 2008 a dividend was paid of 2.875p per share (total: £2.36m). This dividend was wholly classified as a non-PID.

## C11 Post Balance Sheet Event

On 29 November 2010 the Group entered into an agreement with Pramerica Real Estate to invest up to £7.5m in an arrangement to buy up to £100m of property in the UK neighbourhood/convenience retail sector. The duration of the arrangement is anticipated to be five years. The Group will act as manager and be responsible for sourcing the investments, for which it will receive related fees.

# Glossary of Terms

### Adjusted net asset value ("Adjusted NAV") per share

Adjusted NAV is calculated as shareholders' funds, plus the mark-to-market adjustment of the fixed rate loan, divided by the number of shares in issue at the year end, excluding Treasury shares.

### Earnings per share ("EPS")

EPS is calculated as profit attributable to shareholders divided by the weighted average number of shares in issue in the year.

### Equivalent yield

Equivalent yield is a weighted average of the initial yield and reversionary yield and represents the return a property will produce based upon the timing of the income received. In accordance with usual practice, the equivalent yields (as determined by the Group's external valuers) assume rent received annually in arrears and on gross values including prospective purchasers' costs (including stamp duty, agents and legal fees.

### Funds from operations ("FFO")

FFO is a term adopted by the National Association of Real Estate Investment Trusts. It is calculated as net income adjusted for depreciation of investment properties and gains/losses on sales of investment properties.

### Head lease

A head lease is a lease under which the Group holds an investment property.

### Initial yield

Initial yield is the annualised net rent generated by a property expressed as a percentage of the property valuation. In accordance with usual practice the property value is grossed up to include prospective purchasers' costs.

### Interest cover

Interest cover is the number of times financial expenses less the head rents treated as finance leases adjustment, is covered by underlying profit before net financing costs, taxation, revaluation adjustments and other income.

### Interest rate swap

An interest rate swap is a financial instrument where two parties agree to exchange an interest rate obligation for a predetermined amount of time. These are used by the Group to convert floating rate debt to fixed rates.

### Investment Property Databank Ltd ("IPD")

IPD produces an independent benchmark of property returns.

### Initial Public Offering ("IPO")

An IPO is the first sale of shares by a privately owned company on a Stock Exchange. LSR issued its shares for sale on 2 May 2007.

### London Interbank Offered Rate ("LIBOR")

LIBOR is the interest rate charged by one bank to another bank for lending money.

### Loan-to-value ("LTV")

Loan-to-value is the ratio of debt, excluding any mark-to-market adjustments, to the value of investment properties.

### Market value

Market value is the estimated amount for which a property should exchange on the date of valuation between a willing buyer and willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

### Market rent

Market rent is the estimated amount for which a property should lease on the date of valuation between a willing lessor and a willing lessee on appropriate lease terms, in an arm's length transaction, after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

### Net asset value ("NAV") per share

NAV per share is calculated as shareholders' funds divided by the number of shares in issue at the year end excluding Treasury shares.

### Real Estate Investment Trust ("REIT")

A REIT is a listed property company which qualifies for and has elected into a tax regime, which exempts qualifying UK property rental income and gains on investment property disposals from corporation tax. LSR converted to REIT status on 11 May 2007.

### Rent roll

The total contractual annualised rent receivable from the portfolio net of any head rent payments.

### Reversionary yield

Reversionary yield is the annualised net rent that would be generated by a property if it were fully let at market rent expressed as a percentage of the property valuation. In accordance with usual practice the property value is grossed up to include prospective purchasers' costs.

# Shareholder Information

## Registered Office

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Website: www.localshoppingreit.co.uk

## Directors

Stephen East
Nicholas Gregory
Michael Riley
Nicholas Vetch
Grahame Whateley
Victoria Whitehouse

## Company Secretary

William Heaney

## Finance Advisers and Broker

**JP Morgan Cazenove**
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## Solicitors

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**Olswang LLP**
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**Biggart Baillie LLP**
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## Valuers

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## Registrar

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## Principal Bankers

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**HSBC Bank plc**
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**The Royal Bank of Scotland plc**
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Key dates and other important information are available on our website: www.localshoppingreit.co.uk

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