

“Bulgarian Real Estate Fund”

Annual Report 2006



March, 2007

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1 Fund's Overview

The Bulgarian Real Estate Fund /BREF/ is a real estate investment vehicle, headquartered in the capital of Bulgaria - Sofia. Incorporated in October 2004, it is among the first established Bulgarian REITs. The Fund was licensed by the FSC of Bulgaria in March 2005, and was listed on the Bulgarian Stock Exchange – Sofia (BSE) in April 2005.

As a real estate investment trust, BREF specializes in strategic property acquisitions and invests exclusively in high-performing real estates, in all property sectors across Bulgaria.

The principal investment objective of the Fund is to provide its shareholders with a combination of current income and long-term appreciation in the common stock value. To achieve the targets, its strategy is to acquire, develop, manage and lease properties that have superb potential for cash-flow growth and capital appreciation.

Stock Exchange	Ticker Symbol	Market Capitalization (31.12.2006)	Shares outstanding
Bulgarian Stock Exchange Sofia	BREF	EUR 41,725,252	60,450,000

2 Letter to the Shareholders

To the shareholders

We are pleased to report that BREF has had a very strong year of high performance and substantial growth. In 2006, the Fund considerably strengthened its position and made considerable progress across its business. It managed to increase its capital – the raised funds tripled, and it begun to develop, selectively expand and diversify its high-quality projected portfolio. The Fund finished 2006 with profit, reflecting its operational activities, part of which will be distributed to the shareholders as dividends.

Capital Increase

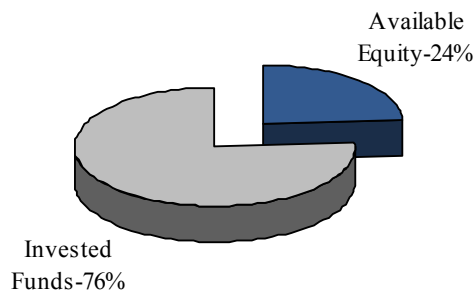
Development is the focus of our capital and the primary source of external growth. We believe our strategy of construction and value-added development will produce superior rates of return, with each new project we bring online. Since an active development program requires much capital, in 2006 we successfully raised EUR 20.61 million with the completion of a public offering. The capital increase procedure was successfully concluded in June and BREF's total raised funds reached EUR 36 million. This pulled the Fund on the top place among Bulgarian REITs, in terms of raised capital. On June 29th, shortly after the procedure completion, the Fund's shares reached a record price of EUR 0.89 (BGN 1.75). The additional capital allowed us to proceed with our investment strategy and development plans.

Portfolio Enhancement

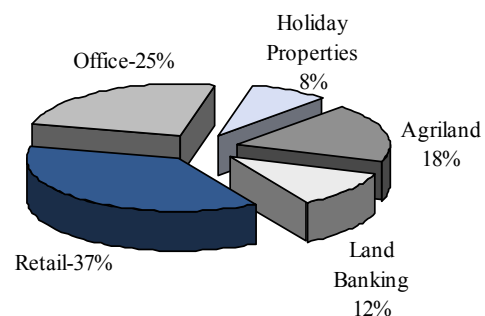
In 2006, we considerably broadened and improved our portfolio. The invested funds grew to EUR 27.5 million which is 76% of the raised capital, versus EUR 1.5 million invested as of the end of 2005. The invested amount is allocated in retail (37%) and office estate (25%), as well as in agricultural land and holiday properties, and "land-banking".

Invested Funds and Available Equity

/per 31.12.2006/



Allocation of the Invested Funds



As of 2006 end, we have had nine projects, five of which – ongoing, one in an exit stage and the other three – in the pipeline. In 2006, BREF concluded a "sale and leaseback" deal with the French DIY chain "Mr.Bricolage" for its two best performing retail outlets in the country. The lease agreement is for ten years and the project will generate sustained and stable monthly income for this period. In addition, for the purposes of efficient use of its funds, BREF refinanced the deal with a bank loan amounting to 70% of the transferred funds.

In June 2006, the Fund acquired a land plot in the capital city - Sofia and shortly after began construction of its largest development project – Kambanite Business Centre – first-class

modern mixed use building. Its construction is fast progressing, in parallel with negotiations for its pre-lease. The Fund has started another project in the office sector and this is a modern state-of-the-art office building, situated in an established office location, very close to Sofia downtown. Its construction is scheduled to start in April 2007; at the same time talks with potential tenants are also being held.

BREF made efforts in acquiring massive agricultural land plots in the most fertile regions of Bulgaria. In the short-run the land plots are leased, whereas in the long-run the Fund will capitalize from the expected appreciation of the agricultural land value. Per the end of 2006, the Fund owned 34,223 decares and 44.5 % of the acquired lands were leased. As of March 2007, the share of the leased lands increased to 52%.

Our fifth ongoing project is about development of a luxurious holiday village on the Black Sea coast. Additionally, BREF is engaged in "land-banking"; it is the owner of three accretive development land plots, suitable for construction respectively of a logistic centre, retail complex and a closed-end residential complex, the first two of which located in the country and the latter - on the outskirts of the capital.

Relative Financial Data

During the year, BREF achieved a total uplift in NAV per share of 22.57%, which is the result from the 3.6-time growth of the net assets. The immediate drivers of the NAV increase are the registered, from the new share emission, share premium reserve of over EUR 5 million and the realized profit. The net earnings grew over 7 times as compared to year 2005, reaching EUR 2.1 million. The earnings per share also increased - by 67%, to EUR 0.048 per unit. The earnings' uplift was directly driven by the revenue proceeds that grew to EUR 2.3 million, or 6.58 times compared to 2005.

The profit of the Fund, appointed for distribution to the shareholders, is EUR 227 thousands, which makes dividend per share of EUR 0.0035. The year 2007 will be the first one for BREF to distribute dividends. BREF's intention is to maintain a progressive dividend.

Future Outlook

The broadening of the equity base, as well as the expansion of the property portfolio that began in 2005/06 and has continued during the new reporting year, undoubtedly justify an optimistic view of the further development opportunities available to the Fund. BREF intends to continue to expand and diversify its property portfolio.

We remain confident that BREF is well-positioned to deliver considerable growth in its activities over the next few years and we look forward with eagerness.

We are extremely grateful for the shareholders' support in 2006 and hope to justify their confidence in 2007 and beyond.

Nikolay Skarlatov
Executive Director
Bulgarian Real Estate Fund



3 Financial Highlights

Financials for the year ended December 31 (EUR '000)	2006	2005
Rental income	286	1
Net gains from property revaluations	1,844	222
Operating Income	2,130	223
Total Revenues	2,729	415
Earnings	2,104	272
Weighted average number of ordinary shares (in thousands)	43,686	9,447
Earnings per share (EUR)	0.048	0.029
Dividends	227	0
Common shares outstanding as of 31 Dec 2006 (in thousands)	60,450	20,150
Dividends per share (EUR)	0.0035	0
Net asset value	38,011	10,517
Net asset value per share (EUR)	0.63	0.52
Property Portfolio		
Real estate assets, at cost	27,466	1,497
Real estate assets, book value	29,530	1,497
Total assets	45,486	10,566
Long-term debt	6,997	0
Debt to assets	15%	0%

4 Portfolio

4.1 Introduction

During the year, BREF made substantial progress and extended significantly its activities. Overall, it has increased its projects portfolio from EUR 1.28 million at December 31, 2005 to EUR 27.5 million at December 31, 2006 (without revaluations).

As of 2006 end, we had nine projects, of which five ongoing, three in the pipeline and one for disposal. Their total projected investment cost is over EUR 57 millions. The ongoing projects include a “sale and leaseback” deal, purchase and lease of agricultural lands, development of two office buildings and a closed-end holiday village. The three development projects are scheduled for completion in 2008, compared to the first two which are completed and have already started to generate income.

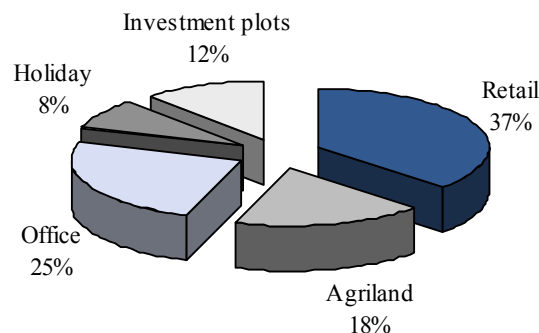
The Fund is also the owner of another 3 accretive land plots that have significant potential for development of a logistic centre, a retail area and a residential complex, respectively. However, depending on the market situation, it would also be sufficient to only capitalize from their value appreciation through disposals at much higher prices in a certain time period. The total purchase price of these land plots amounts to EUR 4 million, of which EUR 2.5 million were transferred in 2006.

Table №1: Current project portfolio of the Fund

Project	Stage	Projected Investment	Invested till 31.12.2006	Future Investment
Completed projects				
"Mr. Bricolage - sale and leaseback"	operational management	10,172	10,172	0
Agricultural land	leasing in process	5,624	4,999	626
Projects in development stage				
Kambanite Business Centre	excavation finished	20,452	5,076	15,376
Office Building - G.M.Dimitrov	excavation pending to start	7,823	1,740	6,083
Seaside Holiday Village	design approval pending	8,999	2,286	6,712
Pipeline projects				
Investment plots near Veliko Turnovo*	regulation change in process	261	261	0
Investment plots near Vidin*	purchase process in place	301	301	0
Investment plots near Sofia's Ring Road*	purchase process in place	3,399	1,950	1,449
Projects in exit stage				
Investment plots near Sofia Airport	sale process in place	681	681	0
Totals:		57,712	27,466	30,246

* Project's value will be estimated after project's design development

Allocation of Invested Funds by Sectors



4.2 Portfolio Activity and Projects' Performance

■ Project: Mr. Bricolage - Sale and Leaseback

In the second half of 2006, BREF concluded two “sale and leaseback” deals with the French “Do-It-Yourself” chain “Mr. Bricolage”. The Fund purchased two retail outlets for the total amount of EUR 10 million and leased them back to the seller – “Doverie Brico”AD. The lease contract period is ten years with a renewal option for another ten years.

The two outlets are situated in the biggest Bulgarian cities - Sofia and Varna. Each of them has merchandise area, a winter garden, warehouse and large parking area. Both of them benefit from favourable city locations. The stores offer over 50,000 types of goods for the construction, the house and the garden.

Sofia Store	
Plot area:	15,174 sq.m.
Total built-up area:	7,610 sq.m.
Purchase amount:	EUR 6 M
Acquired in:	November 2006
Monthly rent:	EUR 54,087
Rental agreement start:	November 15th, 2006

Varna Store	
Plot area:	12,184 sq.m.
Total built-up area:	5,375 sq.m.
Purchase amount:	EUR 4 M
Acquired in:	August 2006
Monthly rent:	EUR 36,060
Rental agreement start:	August 17th, 2006

The concluded “sale and leaseback” deals are low-risk ones and much suitable for the purposes of portfolio diversification. Additionally, the monthly rent for the stores, which amounts to EUR 90,147, ensures the Fund generates sustained monthly income for a ten-year period.

To efficiently use its funds, BREF refinanced the acquisition expenses in December 2006. The bank loan amounts to EUR 7 million, has a ten-year maturity and one year grace period. The dates of the interest and principal payments were optimized and matched with the rental proceeds from the stores.

Also in December 2006, we started a process for efficient energy use certification of the two stores. According to the Bulgarian legislation, buildings that are certified for efficient energy use are relieved of their obligation to pay property tax for a pre-defined period. Subsequently in February 2007, the two stores were certified and the Fund is pending to be relieved of its obligation to pay property tax for a ten-year period, starting from 2008.

Mr. Bricolage is a well-known commercial chain in Europe, specializing in the merchandise in goods for the house and the garden, as well as necessities for the construction works. It has seven outlets in Bulgaria and another four are expected to open in 2007.

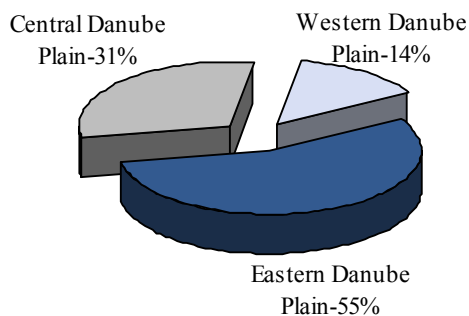
■ **Project: Agricultural Land**

Since its very inception, the acquisition of agricultural land has remained one of BREF's priorities. Our short-term aim is to generate regular current income, by leasing the land plots to farmers for cultivation. As far as our long-term aim is concerned – the land is expected to appreciate in its value in the next five to seven years - so our initial investment is much likely to bring significant capital gains.

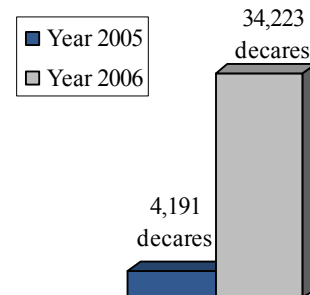
By adhering to our core objectives, we have set strict rules to invest only in high-category land plots. As a result, the purchased land plots are situated predominantly in the Danube plain (northern Bulgaria). These are top agricultural locations in a wheat-growing area, known for its rich soils and for the highly developed crop growing process. The average size of the plots is about 10-12 decares and all of them are situated in close proximity to villages with deep tradition in agriculture.

At the end of 2006, BREF owned 34,223 decares of agricultural land, compared to the 4,190 decares owned at the beginning of the year. The total amount, engaged in the land purchases for both 2005 and 2006 is EUR 5 million and equals to EUR 146 per decare on average. At the end of 2006, 44.5 % of the owned lands have been leased for an average of EUR 7.1 per decare annually.

Location of BREF's Agricultural Lands
/per the end of 2006/



Owned Agricultural Lands
/ 2006 end vs. 2005 end/



The market of the agricultural land in Bulgaria is developing and supply is still exceeding demand. The reason for its growing popularity is the EU accession of the country since January 2007. The accent is on the European subsidizing of the agricultural branch, which is expected to draw over EUR 3.2 billions into Bulgaria till year 2013. According to the common agricultural policy of the European Union, after the accession, the Bulgarian farmers will be eligible to receive direct subsidies if cultivating ten decares of agricultural land at least.

The intention of BREF in 2007 is to acquire additional lands only for the purpose of the lands' consolidation and leasing. The re-grouping of the land plots into large massifs is a big challenge in this project. The reason is that rental levels depend much on plots' size and the consolidated massifs double immediately their prices.

As of March 2007, BREF has leased to farmers additionally 2,587 decares and the total amount of the leased lands reached 52% of the owned lands.

■ **Project: Kambanite Business Centre**

As above mentioned, the office investments represent a sizeable share of the portfolio. In 2006, the Fund started two projects for building of two high-quality administrative structures in Sofia.

The first one - Kambanite Business Centre - is a large-scale development project. It envisages construction of a mixed use building, offering office and retail space.

Kambanite Business Centre	
Plot area:	8,796 sq.m
Total built-up area:	32,597 sq.m
Office space	15,636 sq.m
Retail space	14,136 sq.m
Underground parking	2,825 sq.m
Underground parking lots	180
Ground parking lots	117

Kambanite Business Centre is located at the foot of Vitosha Mountain, in the southern section of the Ring Road and is very close to Mladost IV residential area in Sofia. Its frontage is in the immediate proximity to Sofia's Ring Road and thus ensures quick and easy car accessibility through all main boulevards of the city. This area is a communicative and established office location in the outskirts of the capital.

The development of the project is progressing. BREF acquired the land plot along with the construction permission in June 2006. It signed project management agreement shortly after, and in August the excavation works commenced. At the end of 2006 the excavation works were fully completed and the foundations were pending to be laid. Till the beginning of 2007, the invested funds in this project were over EUR 5 million.

The inauguration of Kambanite Business Centre is scheduled for August 2008. Its projected cost, including the land plot, is estimated at EUR 20.45 million.

■ **Project: Office Building – G.M.Dimitrov**

Our next project for construction of an administrative building is also located in Sofia, but in the outskirts of the central parts of the city. It envisages development of a luxurious class A office building that will have two underground and ten above ground floors.

The structure will offer retail space on the ground floor and underground parking, as well.

The project is located relatively close to the city centre, between two main boulevards, providing quick access to Sofia downtown and Sofia Airport. The site also enjoys great access to the public transport.

Till 2006 end, the already invested funds were EUR 1.7 million. At 2006 end, the architectural design was completed and construction permission was pending to be granted. The excavation works are scheduled to start in April 2007, after the construction permission is obtained.

The total investment cost will amount to EUR 7.8 million including the land acquisition and the planned leverage is 70%. The building is expected to be tenant-ready by September 2008.

Office Building - G.M.Dimitrov	
Plot area	1,520 sq.m
Total built-up area	13,627 sq.m
Office space	9,668 sq.m
Retail space	999 sq.m
Underground parking	2,960 sq.m
Underground parking lots	72
Ground parking lots	5

■ **Project: Seaside Holiday Village**

With our fifth ongoing project we have entered the holiday-homes sector of the real estate market. The project is about the development of a second-home type holiday village on the southern Black Sea coast. The complex will include 291 apartments with a selection of studio, 2-bedroom and 3-bedroom luxury apartments and one-family houses, all for sale. The wealth of the on-site

Seaside Holiday Village	
Plot area	28,758 sq.m
Total built-up area	17,963 sq.m
- Apartments	11,112 sq.m
- Studios	4,574 sq.m
- One-family houses	1,279 sq.m
- Retail space	998 sq.m

facilities will include two spacious swimming pools, situated amidst professionally landscaped grounds, two restaurants, as well as retail and entertainment area. BREF is having the ambition to deliver better, high-grade features of the new project, in response to the growing refined attitude of the potential buyers. BREF intends to sell the holiday properties “off-plan”, which means that the Fund will begin to receive sale proceeds shortly after the construction start.

The land plot was acquired in June 2006. In September 2006, a preliminary design has been delivered and submitted for approval to the local authorities. After approval is obtained, final architectural plans will be prepared and submitted for final approval. Besides, extensive research on potential real estate agencies, which could sell the projected holiday apartments, has already been undertaken.

The total investment is projected to be EUR 9 million and the invested funds as per the end of 2006 were EUR 2.3 million.

4.3 Pipeline Projects

The development and completion of the contracted projects will not, by any means, put an end to the Fund’s expansion. BREF has been proactively investing in “land-banking”, i.e. acquiring land plots that are highly potential for development of further projects.

The significant flow of local and foreign funds to real estate projects in Bulgaria has supported steady increase in the prices of the land plots for future construction and they jumped by over 30% during the last two years. BREF’s management intends to cash its good knowledge of the local market and extensive network of relationships with real estate agencies, through acquiring high-potential plots, in order either to generate capital gains or for own developments.

■ Project: Investment Plots near Veliko Turnovo

In November 2006, BREF acquired a 203-decare non-regulated land plot, through tender participation. The acquisition price was EUR 261 thousands equalling to EUR 1.19 per sq.m. on average. The property is located near the town of Veliko Turnovo that is in the central part of northern Bulgaria. More precisely, the plot is situated on the high-way from Sofia to Varna, at a 5-km distance from the centre of Veliko Turnovo. The District is a region with leading role as an industrial, transport-logistical, tourist, cultural and educational centre. The property is well- situated to take the advantage of the strong growth prospects in the region.

Investment Plots near Veliko Turnovo	
Total plots' area	203,248 sq.m
Purchase price	EUR 261 thousands
Status	rezoning procedure in process

We believe the exclusive location of the land plot makes it quite suitable for development of hypermarket stores. It would be a highly profitable enterprise, having also that consumer preferences are gradually shifting in favour of large shopping outlets offering a wide choice of brands, lower prices and quality control.

However, since the land plot is not regulated and its statute is “agricultural land”, any future development on it requires, first and foremost, the land regulation. That is why in 2006, BREF started preparation for the rezoning procedure, which takes usually six months, at least.

■ Project: Investment Plots near Vidin

In October 2006, BREF won a tender for acquisition of an 86-decare non-regulated land plot, located near the town of Vidin. The acquisition price was EUR 301 thousands or EUR 3.49 per sq.m., on average. Vidin is an important transportation centre in north-western Bulgaria. Its district is bounded by the state borders - Danube River to the north and by Serbia state border to the west.

Investment Plots near Vidin	
Total plots area	86,008 sq.m
Purchase price	EUR 301 thousands
Status	purchase in process

The land plot has a very strategic location. It is situated within 4 km from Vidin, on the road leading to the ferry port, which connects originally Western Europe with Bulgaria and Aegean Sea. Right across the plot is located Customs Office that services the Danube cargos. In addition, the second Danube Bridge connecting Bulgaria and Romania is planned to be built in immediate proximity to the subject property.

With the mentioned features, we believe that the land plot is well-positioned to serve the needs of logistic and trade companies. The development of a logistic centre seems to be much perspective, having also that the Pan European Transport Corridor №4 is passing by. In this regard, BREF has started discussions and negotiations with several logistic companies that are willing to rent warehousing space in the region.

■ **Project: Investment Plots near Sofia's Ring Road**

In November and December 2006, BREF acquired three neighbouring, not regulated land plots with total size of 10,337 sq.m., located on the outskirts of Sofia. In addition, an extra 6,900 sq.m, neighbouring plots were already agreed to be purchased for the amount of EUR 1.5 million.

Investment Plots near Sofia's Ring Road	
Acquired plots	10,337 sq.m
Purchase price	EUR 1,950 thousands
Status	purchase in process
Additional plots to be acquired	6,900 sq.m
Purchase price	EUR 1,449 thousands

The land plots are located right behind the other BREF's property – Kambanite Busines Centre site, near the Sofia's Ring Road. The area is featured by good transport infrastructure of the Ring Road, proximity to the developing "Residential Park Sofia" and "Business Park Sofia" and majority of commercial sites. All these make the land plots very suitable for development of a one-end residential complex, offering cosiness and high living standards.

In the short run, after the purchase process has been finished, the Fund will start the rezoning procedure.

4.4 Projects for disposal

■ **Investment Plots near Sofia Airport**

In June 2005, BREF acquired 7 arable and non-regulated neighbouring land plots, with total area of 14,552 sq.m. The plots are situated close to the Sofia Airport and the Fund's original intentions were to develop a logistic centre, supplying quality office and warehousing space for rent.

In September 2006, however, BREF received an offer to sell the land plots at a price as high as 3 times the purchase price. Having discussed extensively and considered carefully the dynamic market conditions and the possible scenarios, the Board of Directors decided to accept the offer.

In October 2006, the pre-sale agreement was signed and a 10%-deposit was transferred by the contracting party to the notary's bank account. The sale was practically accomplished in March 2007. The transaction parameters and the financial impact are summarized in the table.

Transaction details	
Total plots' area	14,552 sq.m
Purchase price	EUR 681 thousands
Sale price	EUR 2,110 thousands
Average IRR for the holding period	112.5 %

5 Management Discussion and Analysis

5.1 Strategy

The core objectives of the Fund are to provide shareholders with stable and growing dividend distributions and to maximize the long-term unit value. Our investment approach is to seek for a combination of income and uplift in the net asset value. We invest in all types of real estate properties that have potential for cash-flow growth and capital appreciation, as well as in the development of projects, able to provide exceptional returns.

We apply a rigorous property-picking approach, focusing on the financial characteristics to identify assets and special situations, where we can use our skills to create value. We focus on increasing long-term growth in funds from operations and funds available for distribution per share, as well as on increasing the value of our portfolio through effective management, growth, financing and investment strategies.

This strategy, combined with development activities and proactive property portfolio management, forms the foundation for the long-term success of BREF and the sustained growth of shareholder equity.

5.2 Financial results per share

The net financial result per share in 2006, totalled to EUR 0.1104 per share, which comprises an increase in NAV per share of EUR 0.1069 and of EUR 0.0035 – dividend per share appointed for distribution.

Results per share (EUR)	2006	2005
Earnings (EUR '000)	2,104	272
Earnings per share	0.048	0.029
NAV (EUR '000)	38,011	10,517
NAV per share	0.629	0.522
NAV per share increase	0.1069	0.0106
Dividends (EUR '000)	227	0
Dividends per share	0.0035	0

The realized earnings are EUR 2,104 thousands and divided by the weighted average number of shares, make earnings per share of EUR 0.048 or an increase by 67%. The uplift in the financial result is due to the increased operating income and mainly on the gains from revaluations.

During the year, the Fund achieved a total uplift in NAV per share of EUR 0.1069, which results from the growth of the net assets that multiplied 3.6 times. The immediate drivers of the NAV increase are the registered, from the new share emission, share premium reserve of EUR 5,016 thousands and the realized profit. The management expects NAV per share and the net gains from revaluations to increase in the future, as driven by the operating income expansion.

According to the Act on Special Investment Purpose Companies, the Fund is obliged to distribute at least 90% of its annual net profits as adjusted by the effects of all transactions with investment properties carried out throughout the year and exclusive of the fair value adjustments for investment properties. Accordingly, the recognized provision for distribution is EUR 227 thousands, which amounts to dividend per share of EUR 0.0035. The year 2007 will be the first time for BREF to distribute dividends and the intention of the Fund is to maintain a progressive dividend.

5.3 Results from Operations

■ Revenues

Total revenues multiplied over 6.5 times and reached EUR 2,729 thousands in 2006. The main drivers of the result are the net gains from revaluations, as well as the interest and the rental income.

Revenues (EUR '000)	2006	2005
Net gains from revaluations	1,844	222
- investment properties	1,042	222
- development properties	802	0
Interest Income	499	192
Rental Income	286	1
Net gains on available for sale investments	100	0
Total Revenues	2,729	415

○ Gains from Revaluations

The surplus of property revaluation amounted to EUR 1,844 thousands and made the most significant contribution to the profit increase. The most accretive properties, according to the Auditor's report, are the investment properties, which comprise the agricultural land, the investment land plots in Vidin and Veliko Turnovo, and the two retail stores in Varna and Sofia. In the next year, the revaluation gains are expected to increase additionally, due to the progress in the development projects and the agricultural lands prices' rise.

○ Interest Income

The interest income recorded an over 2.5-time increase in 2006. It is the result of depositing the proceeds from the capital increase. The free cash resource was left at fixed deposits with terms up to three months and interest rate in the range of 2.75% and 7 %. Since the available funds on the bank accounts nearly tripled, interest income was one-way reflected. In 2007, the available cash on bank accounts is expected to significantly decrease, in accordance to the investment activities' advance. Consequently, the interest income is going to considerably decrease.

○ Rental Income

The rental income is EUR 286 thousands and has two sources – the operating lease and the agricultural lands' lease. The rental income from leasing the two “Mr. Bricolage” retail outlets amounted to EUR 245 thousands and is for the August-December period. In the next year, it will increase to EUR 1,081,764 and remain at the same level for the following 9-year period /the lease instalments were pre-fixed/.

The rental income from leasing agricultural lands was EUR 41 thousands. However, 87% of the owned lands were acquired in 2006 and not all of them have been leased in 2006. The average rental level was EUR 7.15 per decare. The annual rental income from the agricultural lands is going to rise sharply in the next year as all the owned lands are expected to be leased out. As per March 2007, about 52% of the agricultural lands, owned by BREF have been leased.

■ Expenses

The total expenses for the year multiplied 4.37 times and amounted to EUR 625 thousands, of which 65% are related to fees, paid to the Management Company.

Expenses (EUR '000)	2006	2005
Management Fees	411	97
Interest Expenses	3	9
Directors' fees and Employee benefit costs	15	6
Net loss on derivative financial instrument	10	0
Other Expenses	186	31
Total Expenses	625	143

○ Management Fees

Management fees hold the highest share of the Fund's expenses, based annually on an aggregate of 2% of the Net Assets Value of the Fund. As of June 2006, this aggregate fee was decreased to 1.5% of NAV, as per signed annex from February 2006. Our expectations are that these expenses will remain relatively stable within the next year. However, possible deviations are likely to occur in relation to the annual financial result and the increase in the Net Assets.

○ Interest Expenses

The interest expenses, reported in 2006, hold an inessential share among the total expenses of the Fund. They are entirely related to the refinancing loan that was utilized in December 2006. For the next years the interest expenses will significantly increase, and are expected to be in the range of EUR 350-400 thousands.

○ Other Expenses

These expenses comprise property taxes and other expenses, related to the real estate transactions. They mark an increase of EUR 170 thousands, following the investment expansion of the Fund, and are likely to keep the same tendency.

■ Net Earnings

The net earnings from the Fund's activity totalled EUR 2,104 thousands in 2006, compared to EUR 272 thousands in 2005. The drivers of the uplift were the quickly growing revenues and the improvement of the profit margin ratio that reached 0.771 in 2006. This enhancement is due to the increased share of the rental revenue, compared to the other revenues. We are reasonably confident that the realized profit in the next year will keep the upward trend at a much more intensive pace. Our assurance is based on the fast increasing rental revenues and also considers the proceeds from the accomplished sale in the beginning of 2007.

Financial Result (EUR '000)	2006	2005
Revenues	2,729	415
Expenses	625	143
Profit	2,104	272
Profit Margin	0.771	0.655

5.4 Capital Resources and Liquidity

■ Investments (acquisitions)

Invested Amount and Needed Cash (EUR '000)	2006
Total Projected Investments	57,712
Invested Amount till December 2006	27,466
Future Investment	30,246
Cash available at 2006 end	14,310
Cash needed	15,936

BREF's current investment portfolio comprises of projects which total projected investment cost is EUR 57.7 million. Per the end of 2006, from the aforementioned amount, the Fund has already invested EUR 27.5 million and the remaining EUR 30.2 million are planned to be invested in the next two years. Since the available cash on December 31st, 2007 was EUR 14.3 million, the needed cash in order to finish the projects amounts to EUR 15.9 million. It should be emphasized that these amounts do not include the future investments related to the pipeline projects in Vidin, Veliko Turnovo and Sofia's Ring Road (the acquired plots that are about to be put under regulation), because there were no approved design projects till the end of the reported period. In case the Fund starts development of any of the three, the required amounts will have to be utilized additionally. The projected needed funds will be obtained either through external financing (loans or bonds issuance) or capital increase, depending on the particular situation and conditions.

■ Sales

In 2006 there were no sales of investment properties that could influence the capital resources of the Fund. However, as already mentioned, one of the BREF's land properties, comprising seven land plots, located close to the Sofia Airport was negotiated to be sold and a pre-sale agreement has been signed in November 2006. It was practically sold on March 6th, 2007 for the amount of EUR 2.1 million. This amount will secure a part of the Fund's needed cash for fulfilment of its investment intentions

■ Refinancing

In the late December 2006, BREF utilized a loan for refinancing the acquisition expenses related to the "sale and leaseback" deals. Its amount is EUR 7 million and its characteristics are enclosed in the below table.

Loan Characteristics	
Amount utilized (EUR)	7,000,000
Term	10 years
Principal's grace period	1 year
Maturity date	December 14th, 2016
Monthly Interest	1(3) M Euribor +1.6%

The interest rate is floating – bound to the 1M EURIBOR for the period July 2007 – December 2016, and to the 3M EURIBOR for December 2006 – June 2007. The EURIBOR has been following an upward tendency recently. Because of the rising-rates surrounding, BREF has concluded an interest rate swap agreement, in order to minimize the increase of its interest rate exposure. Through the agreement a fixed interest payment of 4.04% on behalf of BREF is exchanged for a 1M EURIBOR on behalf of the bank.

The drawn funds amount to 15.55 % of the total long-term capital of the Fund. This leverage ratio is relatively low, so that it allows for additional funds to be borrowed at favourable interest levels.

■ Equity

In 2006, BREF's equity increased by EUR 27.49 million and reached EUR 38.01 million. The main driver of the significant equity change is the raised capital of EUR 20.61 million, which was carried out by issuance of new 40,300,000 ordinary shares. Besides, the emission price of the new shares exceeded by EUR

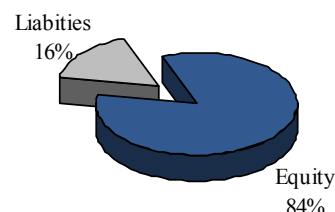
0.13 their face value, amounting to EUR 0.64 per unit and thus a share premium reserve of EUR 5,016 thousands was formed. This share premium reserve comprises the spread between the emission and face value of the shares less the emission expenses. The retained earnings have also increased and reached EUR 2.1 million; they comprise the year 2005's retained earning and the year 2006's profit less the recognized provision for dividends.

Equity (EUR '000)	2006	2005
Share Capital	30,907	10,303
Share Premium	5,016	0
Net unrealized gains reserve	-3	0
Retained Earnings	2,091	214
Total Equity	38,011	10,517

■ Capital Structure

The Fund's capital structure is dominated by the internal sources of capital. At the end of 2006 the equity and liabilities totalled EUR 45.5 million, of which 84% is the equity. The relatively low leverage ratio amounting to 16% indicates that BREF is exposed to insignificant credit risk and has good potential to utilize additional non-equity funds at favourable interest levels. In addition, the equity capital covers 1.37 times the non-current assets indicating that long-term assets are fully financed with comparable long-term funds, which minimizes the exposure to liquidity risk.

BREF's Capital Structure



■ Cash Flow and Liquidity

Net cash provided by the Fund's activities in 2006 was EUR 5.5 million. The biggest part of the out-coming cash flows are related to the investment activities of the Fund - EUR 25.6 million and from the operating activities EUR

1.5 million. The biggest source of the in-coming cash flows is the proceeds from the equity rise. The Fund's liquidity has decreased compared to 2005, but still remains relatively high. Following the investment policy of the Fund, we expect the liquidity ratios to decrease and thus to increase the efficiency of the raised funds.

Liquidity Ratios	2006	2005
Current Ratio	37	185
Quick Ratio	33.37	184.76
Cash Ratio	29.97	179.75
Operating Cash Flow Ratio	(1.66)	(1.06)

Additionally, the management believe that net cash provided by operations, especially from rents, will continue to be adequate to meet the operating requirements of the Fund in both the short-term and the long-term period. We anticipate funding our future acquisition activities primarily by using internal funds or long-term credit facilities.

5.5 Significant accounting judgments, estimates and assumptions

(The following are according to the Auditor's Report.)

■ Judgments

In the process of applying the Fund's accounting policies, management has made the following judgments, apart from those involving estimations, which has the most significant effect on the amounts recognised in the financial statements:

○ Operating Lease Commitments – Fund as Lessor

The Fund has entered into commercial property leases on two of its investment properties. The Fund has determined that it retains all the significant risks and rewards of ownership of these properties and so accounts for them as operating leases.

■ Estimates and assumptions

In preparing the financial statements, management is required to make estimates and assumptions that affect reported income, expenses, assets, liabilities and disclosure of contingent assets and liabilities. Use of available information and application of judgment are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may be material to the financial statements. These estimates are reviewed on a regular basis and if a change is needed, it is accounted in the period the changes become known.

5.6 Risks

The income, the profit and the value of the assets owned by the Fund might be unfavourably affected by various factors, specific for the investments in real estate: changes in the regulation, development exposure, market oversupply, increase in construction costs and interest rates, etc. The mentioned risks could lead to the Fund's inability to generate sufficient income to cover its expenses. This would have a negative impact upon the Fund's profit and respectively upon the dividends paid out to its stockholders, as well as upon the market price of the Fund shares.

The Fund has investment guidelines that set out its overall business strategies, its tolerance for risk and its general risk management philosophy and has established processes to monitor and control investment transactions in a timely and accurate manner. These guidelines are reviewed annually by the Board of Directors and weekly reviews are undertaken to ensure that the Fund's guidelines are adhered to.

■ Changes in legislation

Keeping the current tax regime for the activities of the special purpose investment companies like BREF, in particular the exemption of the profit from corporate income tax, is of key importance for the financial result of the Fund and the income distributed to its shareholders. There is no guarantee whether or for how long the Fund and its shareholders will benefit from favourable tax treatment. Moreover, both the activity of the Company and the real estate itself are subject to a detailed and multi-aspect legal regulation. There is no warranty that the legislation, related to the activity of the Fund, will not be changed in an unfavourable direction, involving considerable unforeseen expenses, which would negatively affect the Fund's profit. However, it should be noted that the trend for harmonization of Bulgarian legislation with the European regulatory framework, in the part concerning special purpose investment companies, supports the opinion that the favourable regulatory model applicable to these companies will be preserved also in the future

■ Risks related to the projects' development

The Fund investment strategy envisages that a considerable part of the raised equity and external financing is invested in real estate construction. Therefore, it runs a risk, related to the ability of the hired construction companies to complete the projects on time and within the set budget, also in compliance with the architectural plans, construction blueprints and regulations. Whether the delay in the execution is due to the contractor's fault or not, this could lead to abrogation of preliminary contracts for sale or rent and/or payment of damages. In order to minimize this risk BREF's management thoroughly investigates the construction companies considered as potential contractors and concludes contracts only with companies that are able to perform the assignment properly, on time and on budget. In addition, the Fund constantly monitors the ongoing construction and completion works.

■ Market risk

The Fund's investment properties are susceptible to market price risk arising from uncertainties about future prices and rental levels.

○ Reduction in market prices

The Fund is expected to realize part of its profits through re-sale of the acquired real estate. Therefore the market prices of real estate would have a considerable impact on the profitability of the Fund. It is possible that a reduction in real estate prices might decrease the capital gain of the Fund, to negatively affect the cash dividend paid out to the investors and the Fund's shares price. The analysis we have carried out on the real estate market and its prospects gives us grounds to anticipate stable upward tendency in real estate prices in the medium-term, while the risk of significant decline in the prices over the long-term is comparatively low.

○ Reduction in rental levels

The profits of the Fund from lease of real estate depend on the rental rates in the respective real estate market sub-sectors. Any reduction in rental rates would negatively impact the profits of the Fund and respectively, rise in the rental rates would boost profits. This would affect negatively, respectively positively, the cash dividend paid by the Fund, all other things being equal. The Fund aims at decreasing the risk of potential rental rates reduction by entering into long-term lease agreements, as well as through investment diversification in various market sub-sectors.

■ Construction cost increase

As far as considerable part of the Fund's assets have to be invested in the construction of the new buildings, an increase in the prices of design, construction and installation works and construction materials will negatively affect the Fund's profitability. The Fund will try to minimize these expenses by holding procurement tenders for designers and main project contractors, as well as by consolidating a number of smaller orders into one larger order, also by entering into long-term frame agreements, turn-key construction contracts at pre-determined fixed prices, with the purpose of negotiating the most attractive prices while at the same time observing certain quality assurance criteria.

■ Financing resources

Since the amount required by the investment intentions of the Fund, exceeds its available capital, an additional amount of non-equity funds would have to be borrowed. The respective risk is related to the uncertainty whether the Fund would be able to draw the needed amount, either through bank loans, or through bond issuance. Presently, however, the Fund is financially stable and has a very good reputation among the Bulgarian banks, which are interested in cooperating with BREF.

■ **Interest rates**

The Fund is exposed to risks associated with the effects of fluctuations in the prevailing levels of market interest rates on its financial position and cash flows. The management of the Fund believes that the fair value of the cash and long term interest bearing loan does not differ significantly from their current carrying amounts. The Fund’s exposure to the risk of changes in market interest relates primarily to the Fund’s long term debt obligation, which is with floating interest rates. To manage this, the Fund enters into interest rate swap agreement, in which agrees to exchange monthly, the difference between fixed and variable rate interest amounts calculated by reference to an agreed-upon notional principal amount.

5.7 Share Performance

As a result from the capital increase, concluded in June 2006, the number of shares grew from 20,150,000 up to 60,450,000. The shares are traded on the unofficial segment of the Bulgarian Stock Exchange. Overall, the trading volume rose, resulting in improvement of the Fund’s shares’ liquidity.

Summarized trading details for the period January 1st, 2006 – December 31st, 2006:

- Opening Price – BGN 1.30 (January 3rd, 2006)
- Closing Price – BGN 1.35 (December 22nd, 2006)
- Highest Price – BGN 1.75 (June 29th, 2006)
- Lowest Price – BGN 1.29 (April 27th, 2006)
- Total Trading Volume – 5,308,711 shares
- Turnover for the period – BGN 7,740,096 (EUR 3,957,448)
- Weighed-Average Price – BGN 1.46
- Market Capitalisation (31.12.2006r.) – BGN 81,607,500 (EUR 41,725,252)

**Share Price Performance
(01.01.2006 – 31.12.2006)**



Apart from increase of the traded volume, the weighted-average price also recorded rise in 2006. It increased by 23.7%, from BGN 1.18 per share in 2005 to BGN 1.46 per share in 2006. The main impact on the weighted-average price, made the sharp increase of the traded shares volume on June 29th, 2006. The weighted-average price on that day was BGN 1.61, but the highest reached BGN 1.75. The lowest price was recorded on April 29th, 2006; that is in the

period of the capital increase and it is just after the stop of the trade with shares eligible to participate in the capital increase procedure.

After the capital increase procedure was concluded till the year end, the share prices moved in smaller intervals – BGN 1.35 – 1.45 per share.

6 Financial Statements and Auditor's Report

INDEPENDENT AUDITORS' REPORT

TO THE SHAREHOLDERS OF BULGARIAN REAL ESTATE FUND

We have audited the accompanying financial statements of **BULGARIAN REAL ESTATE FUND**, which comprise the balance sheet as of 31 December 2006, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, as endorsed by the European Union (EU). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of **BULGARIAN REAL ESTATE FUND** as of 31 December 2006, and of its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards, as endorsed by the EU.



23 March 2007
Sofia, Bulgaria

**BULGARIAN REAL ESTATE FUND
INCOME STATEMENT**

For the year ended 31 December 2006

(All amounts in EUR thousand unless otherwise stated)

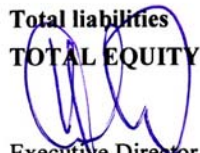
	Notes	2006	2005
Revenue			
Interest income		499	192
Net gains from fair value adjustments to investment and development properties	4	1,844	222
Rental income	3.1	286	1
Net gain on available for sale investments	3.2	100	-
Total revenue		2,729	415
Expenses			
Interest expenses		(3)	(9)
Management fees	16.1	(411)	(97)
Directors' fees and Board expenses	16.2	(9)	(5)
Employee benefit costs		(6)	(1)
Other expenses	3.3	(186)	(31)
Net loss on derivative financial instrument	13.2	(10)	-
Total expenses		(625)	(143)
Profit for the year		2,104	272
Earnings per share – basic and diluted	17	€ 0.048	€ 0.029

Executive Director
Nikolay Skarlatov

BULGARIAN REAL ESTATE FUND
BALANCE SHEET
As of 31 December 2006

(All amounts in EUR thousand unless otherwise stated)

	Notes	2006	2005
ASSETS			
Non-current assets			
Investment property	4.1	15,943	1,497
Development property	4.2	11,854	-
Furniture and fixtures	5	5	-
Intangible assets	6	1	-
Available for sale investments	7	15	-
		<u>27,818</u>	<u>1,497</u>
Current assets			
Investment property held for sale	4.3	1,733	-
Value added tax receivable		909	-
Amounts due from brokers	8.1	467	16
Accrued interest and rental income	9	47	64
Prepayments	10	202	166
Cash and short-term deposits	11	14,310	8,823
		<u>17,668</u>	<u>9,069</u>
TOTAL ASSETS		<u>45,486</u>	<u>10,566</u>
EQUITY AND LIABILITIES			
Equity			
Share capital	12.1	30,907	10,303
Share premium	12.2	5,016	-
Net unrealized gains reserve	3.2	(3)	-
Retained earnings		2,091	214
Total equity		<u>38,011</u>	<u>10,517</u>
Non-current liabilities			
Interest bearing loan	13.1	6,987	-
Derivative financial instrument	13.2	10	-
		<u>6,997</u>	<u>-</u>
Current liabilities			
Payables to Management Company	16.1	122	42
Amounts due to brokers	8.2	20	-
Provision for dividends due	15	227	-
Other payables	14	109	7
		<u>478</u>	<u>49</u>
Total liabilities		<u>7,475</u>	<u>49</u>
TOTAL EQUITY AND LIABILITIES		<u>45,486</u>	<u>10,566</u>


Executive Director
Nikolay Skarlatov

BULGARIAN REAL ESTATE FUND
STATEMENT OF CHANGES IN EQUITY
For the year ended 31 December 2006

(All amounts in EUR thousand unless otherwise stated)

	Share capital (Note 12.1)	Share premium (Note 12.2)	Net unrealized gains reserve (Note 3.2)	Retained earnings	Total
At 1 January 2005	256	-	-	-	256
Payment of capital	10,047	-	-	-	10,047
Transaction costs for capital increase	-	-	-	(58)	(58)
Profit for the year	-	-	-	272	272
At 31 December 2005	10,303	-	-	214	10,517
At 1 January 2006	10,303	-	-	214	10,517
Payment of capital	20,604	5,151	-	-	25,755
Transaction costs for capital increase	-	(135)	-	-	(135)
Net loss on available for sale investments (Note 3.2)	-	-	(3)	-	(3)
Profit for the year	-	-	-	2,104	2,104
Equity dividends (Note 15)	-	-	-	(227)	(227)
At 31 December 2006	30,907	5,016	(3)	2,091	38,011

Executive Director
Nikolay Skarlatov

BULGARIAN REAL ESTATE FUND
CASH FLOW STATEMENT
For the year ended 31 December 2006

(All amounts in EUR thousand unless otherwise stated)

	Notes	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES			
Profit for the year		2,104	272
Adjustments to reconcile profit for the year to net cash flows			
Non-cash:			
Net gains from fair value adjustments to investment and development properties	4	(1,844)	(222)
Interest income		(499)	(192)
Interest expense		3	9
Net gain on available for sale investments	3.2	(100)	-
Net loss on derivative financial instrument	13.2	10	-
Loss on disposal of investment property	3.3	1	-
Amortisation expense	6	1	-
Working capital adjustments:			
Increase in accrued rental income		(43)	(1)
Increase in amounts due from brokers		(451)	(16)
Increase in payables		202	49
Increase in prepayments		(23)	(1)
Increase in value added tax receivable		(909)	-
Net cash flows used in operating activities		(1,548)	(102)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of investment properties		(14,721)	(1,275)
Advances paid for purchases of investment properties		(178)	(165)
Purchase of development properties		(11,052)	-
Purchase of furniture and fixtures		(5)	-
Purchase of intangible assets		(2)	-
Purchase of available for sale investments	7	(173)	-
Proceeds from sale of investment properties		3	-
Interest received		559	129
Net cash flows used in investing activities		(25,569)	(1,311)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from borrowings		7,000	360
Interest paid		(16)	(9)
Repayment of borrowings		-	(360)
Proceeds from share capital		25,620	9,989
Net cash flows from financing activities		32,604	9,980
Net increase in cash and cash equivalents		5,487	8,567
Cash and cash equivalents at 1 January		8,823	256
Cash and cash equivalents at 31 December	11	14,310	8,823

Executive Director
Nikolay Skarlatov

6.1 Basis of preparation

The financial statements have been prepared on a historical cost basis, except for investment properties, derivative financial instruments and available for sale investments that have been measured at fair value.

The financial statements are presented in Euro (EUR or €) and all values are rounded to the nearest thousand (EUR thousand) except when otherwise indicated.

■ Statement of compliance

The financial statements of Bulgarian Real Estate Fund have been prepared in accordance with the International Financial Reporting Standards, as endorsed by the European Union (IFRS, as endorsed by the EU).

6.2 First time adoption of IFRS, as endorsed by the EU

The financial statements of BREF for the year ended 31 December 2005 were prepared in accordance with the Bulgarian National Accounting

Legislation (BNAL). BNAL applicable for 2005 includes International Accounting Standards (IAS) from 2002, as officially translated into the Bulgarian language, approved by the Council of Ministers and published in the State Gazette.

BREF adopts IFRS, as endorsed by the EU, for the first time in 2006 with the date of transition 1 January 2005. The transition from BNAL to IFRS, as endorsed by the EU is performed following IFRS 1 First-time Adoption of International Financial Reporting Standards.

The Fund has applied retrospectively all accounting policies chosen under the IFRS. As a result, no adjustments and/or reclassifications have been made in the equity as of 1 January 2005 and the comparative figures for the year ended 31 December 2005.

6.3 Summary of significant accounting policies

■ Foreign currency translation

The financial statements are presented in Euros while the functional currency of the Fund is Bulgarian Lev (BGN). The Fund uses the Euro as a presentation currency due to the wide range of users of the financial statements.

As at the reporting date, the assets, liabilities, equity, revenue and expenses of the Fund are translated into the presentation currency at the fixed rate of BGN/EUR of 1.95583 or EUR/BGN of 0.51129 quoted by the Bulgarian National Bank. BGN is pegged to the EUR at the exchange rate of 1.95583 as from 1 January 2002 (BGN was pegged to the DEM as from 1 July 1997, with the introduction of the Currency Board in Bulgaria).

Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated on a monthly basis by applying the exchange rate published by the Bulgarian National Bank for the last working day of the respective month. All differences are taken to profit or loss. Non monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the dates of initial transactions.

■ Investment properties

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

from changes in the fair values of investment properties are included in the income statement in the year in which they arise.

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

■ **Investment properties (continued)**

For a transfer from investment property to inventories, the deemed cost of property for subsequent accounting is its fair value at the date of change in use. For a transfer from inventories to investment property, any difference between the fair value of the property at that date and its previous carrying amount is recognised in the income statement. When the Fund completes the construction or development of a self constructed investment property, any difference between the fair value of the property at that date and its previous carrying amount is recognised in the income statement.

■ **Furniture and fixtures**

Furniture and fixtures are stated at cost, excluding the costs of day to day servicing, less accumulated depreciation and accumulated impairment in value. Such cost includes the cost of replacing part of the furniture and fittings when that cost is incurred, if the recognition criteria are met.

Depreciation is calculated on a straight line basis over the useful life of the assets.

An item of furniture and fittings is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year the asset is derecognised.

The asset's residual values, useful lives and methods of depreciation are reviewed, and adjusted if appropriate, at each financial year end.

■ **Borrowing costs**

Borrowing costs are recognised as an expense when incurred.

■ **Intangible assets**

Intangible assets are measured on initial recognition at cost. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses.

The useful lives of intangible assets are assessed to be finite.

Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset with a finite useful life is reviewed at least at each financial year end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset is accounted for by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates. The amortisation expense on intangible assets with finite lives is recognised in the income statement in the expense category consistent with the function of the intangible asset.

Gains or losses arising from derecognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is derecognised.

■ Impairment of non-financial assets

The Fund assesses at each reporting date whether there is an indication that an asset may be impaired. If any such indication exists, or when annual impairment testing for an asset is required, the Fund makes an estimate of the asset's recoverable amount. An asset's recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. In determining fair value less costs to sell, an appropriate valuation model is used. These calculations are corroborated by valuation multiples or available fair value indicators.

Impairment losses of continuing operations are recognised in the income statement in those expense categories consistent with the function of the impaired asset.

For non-financial assets, an assessment is made at each reporting date as to whether there is any indication that previously recognised impairment losses may no longer exist or may have decreased. If such indication exists, the Fund makes an estimate of recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognised. If that is the case the carrying amount of the asset is increased to its recoverable amount. That increased amount cannot exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in the income statement.

■ Investments and other financial assets

Financial assets within the scope of IAS 39 are classified as either financial assets at fair value through profit or loss, loans and receivables, held to maturity investments, and available for sale financial assets, as appropriate. When financial assets are recognised initially, they are measured at fair value, plus, in the case of investments not at fair value through profit or loss, directly attributable transaction costs. The Fund considers whether a contract contains an embedded derivative when the entity first becomes a party to it. The embedded derivatives are separated from the host contract which is not measured at fair value through profit or loss when the analysis shows that the economic characteristics and risks of embedded derivatives are not closely related to those of the host contract.

The Fund determines the classification of its financial assets after initial recognition and, where allowed and appropriate, re-evaluates this designation at each financial year end.

All regular way purchases and sales of financial assets are recognised on the trade date, which is the date that the Fund commits to purchase the asset. Regular way purchases or sales are purchases or sales of financial assets that require delivery of assets within the period generally established by regulation or convention in the marketplace.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement loans and receivables are subsequently carried at amortised cost using the effective interest method less any allowance for impairment. Amortised cost is calculated taking into account any discount or premium on acquisition and includes fees that are an integral part of the effective interest rate and transaction costs. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

■ Investments and other financial assets (continued)

Available-for-sale financial investments

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale or are not classified in any of the three preceding categories. After initial measurement, available for sale financial assets are measured at fair value with unrealised gains or losses being recognised directly in equity in the net unrealised gains reserve. When the investment is disposed of, the cumulative gain or loss previously recorded in equity is recognised in the income statement. Interest earned or paid on the investments is reported as interest income or expense using the effective interest rate. Dividends earned on investments are recognised in the income statement as 'Dividends received' when the right of payment has been established.

- Fair value

The fair value of investments that are actively traded in organised financial markets is determined by reference to quoted market bid prices at the close of business on the balance sheet date. For investments where there is no active market, fair value is determined using valuation techniques. Such techniques include using recent arm's length market transactions; reference to the current market value of another instrument, which is substantially the same; discounted cash flow analysis or other valuation models.

■ Impairment of financial assets

The Fund assesses at each balance sheet date whether a financial asset or group of financial assets is impaired.

- Assets carried at amortised cost

If there is objective evidence that an impairment loss on loans and receivables carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e. the effective interest rate computed at initial recognition). The carrying amount of the asset is reduced through use of an allowance account. The amount of the loss shall be recognised in profit or loss.

The Fund first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant. If it is determined that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and that group of financial assets is collectively assessed for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss is reversed. Any subsequent reversal of an impairment loss is recognised in profit or loss, to the extent that the carrying value of the asset does not exceed its amortised cost at the reversal date.

- Available-for-sale financial investments

If an available-for-sale asset is impaired, an amount comprising the difference between its cost (net of any principal payment and amortisation) and its current fair value, less any impairment loss previously recognised in the income statement, is transferred from equity to the income statement. Reversals in respect of equity instruments classified as available for sale are not

recognised in the income statement. Reversals of impairment losses on debt instruments are reversed through the income statement; if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in the income statement.

■ **Cash and cash equivalents**

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

For the purpose of the cash flow statement, cash and cash equivalents consist of cash and short-term deposits as defined above.

■ **Interest bearing loans and borrowings**

All loans and borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs.

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method.

Gains and losses are recognised in the income statement when the liabilities are derecognised as well as through the amortisation process.

- Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss includes financial liabilities held for trading and financial liabilities designated upon initial recognition as at fair value through profit and loss.

Financial liabilities are classified as held for trading if they are acquired for the purpose of selling in the near term. Derivatives, including separated embedded derivatives are also classified as held for trading unless they are designated as effective hedging instruments. Gains or losses on liabilities held for trading are recognised in profit and loss.

Where a contract contains one or more embedded derivatives, the entire hybrid contract may be designated as a financial liability at fair value through profit or loss, except where the embedded derivative does not significantly modify the cash flows or it is clear that separation of the embedded derivative is prohibited.

Financial liabilities may be designated at initial recognition as at fair value through profit or loss if the following criteria are met: (i) the designation eliminates or significantly reduces the inconsistent treatment that would otherwise arise from measuring the liabilities or recognising gains or losses on them on a different basis; (ii) or the liabilities are part of a group of financial liabilities which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy; (iii) or the financial liability contains an embedded derivative that would need to be separately recorded. As at 31 December 2006, no financial liabilities have been designated as at fair value through profit and loss (2005: Nil).

■ **Derivative financial instruments**

The Fund uses derivative financial instruments such as interest rate swaps to hedge its risks associated with interest rate. Such derivative financial instruments are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative.

Any gains or losses arising from changes in fair value on derivatives during the are taken directly to the income statement.

The fair value of interest rate swap contracts is determined by reference to market values for similar instruments.

■ Derecognition of financial assets and liabilities

○ Financial assets

A financial asset (or, where applicable a part of a financial asset or part of a group of similar financial assets) is derecognised when:

- the rights to receive cash flows from the asset have expired;
- the Fund retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or
- the Fund has transferred its rights to receive cash flows from the asset and either (a) has transferred substantially all the risks and rewards of the asset, or (b) has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Where the Fund has transferred its rights to receive cash flows from an asset and has neither transferred nor retained substantially all the risks and rewards of the asset nor transferred control of the asset, the asset is recognised to the extent of the Fund's continuing involvement in the asset. Continuing involvement that takes the form of a guarantee over the transferred asset is measured at the lower of the original carrying amount of the asset and the maximum amount of consideration that the Fund could be required to repay.

Where continuing involvement takes the form of a written and/or purchased option (including a cash settled option or similar provision) on the transferred asset, the extent of the Fund's continuing involvement is the amount of the transferred asset that the Fund may repurchase, except that in the case of a written put option (including a cash settled option or similar provision) on an asset measured at fair value, the extent of the Fund's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price.

○ Financial liabilities

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Where an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in the respective carrying amounts is recognised in the income statement.

■ Provisions

○ General

Provisions are recognised when the Fund has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Fund expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted using a current pre tax rate that reflects, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as a finance cost.

- Provision for dividends due

According to the Act on Special Investment Purpose Companies, the Fund is obliged to distribute at least 90% of its annual net profits as adjusted by the effects of all transactions with investment properties carried out throughout the year. Such effects inclusive of fair value adjustments for investment properties are restricted in relation to distribution to shareholders. Based on the Fund's financial performance for the reporting year, consideration has been given to dividend distribution based on operational and legal considerations. As a result the Fund recognised provision for dividends due for its present legal obligation to distribute dividends at the balance sheet date.

■ Leases

The determination of whether an arrangement is, or contains a lease is based on the substance of the arrangement at inception date of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset. A reassessment is made after inception of the lease only if one of the following applies:

- a) There is a change in contractual terms, other than a renewal or extension of the arrangement;
- b) A renewal option is exercised or extension granted, unless the term of the renewal or extension was initially included in the lease term;
- c) There is a change in the determination of whether fulfilment is dependant on a specified asset; or
- d) There is a substantial change to the asset.

Where a reassessment is made, lease accounting shall commence or cease from the date when the change in circumstances gave rise to the reassessment for scenarios a), c) or d) and at the date of renewal or extension period for scenario b).

For arrangements entered into prior to 1 January 2005, the date of inception is deemed to be 1 January 2005 in accordance with the transitional requirements of IFRIC 4.

- Fund as a lessee

Operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

- Fund as a lessor

Leases where the Fund does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Initial direct costs incurred in negotiating an operating lease are added to the carrying amount of the leased asset and recognised over the lease term on the same bases as rental income. Contingent rents are recognised as revenue in the period in which they are earned.

■ Revenue recognition

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Fund and the revenue can be reliably measured. Revenue is measured at the fair value of the consideration received, excluding discounts, rebates, and other sales taxes or duty. The following specific recognition criteria must also be met before revenue is recognised:

- Interest income

Revenue is recognised as interest accrues (using the effective interest method that is the rate that exactly discounts estimated future cash receipts through the expected life of the financial instrument to the net carrying amount of the financial asset).

- Rental income

Rental income arising from operating leases on investment properties is accounted for on a straight line basis over the lease terms.

■ **Expenses**

Expenses are accounted for on an accrual basis. Expenses are charged to the income statement except for expenses incurred on the acquisition of an investment and other properties that are included in the cost of that property and transaction costs for share capital increase which are deducted directly from equity.

■ **Earnings per share**

Basic earnings per share are calculated by dividing the net profit or loss for the year attributable to the shareholders by the weighted average number of shares outstanding during the period.

■ **Share capital**

Share capital represents the par value of shares issued and paid by the shareholders. Any proceeds in excess of par value are recorded in share premium.

■ **Taxes**

- Income tax

The Fund being a Real Estate Investment Trust is not subject to corporate income tax in accordance with the Bulgarian Corporate Income Tax Act.

- Value Added Tax

Revenues, expenses and assets are recognized net of the amount of Value Added Tax (VAT) except :

- where the VAT incurred on a purchase of assets or services is not recoverable from the taxation authority, in which case the VAT is recognized as part of the cost of acquisition of the asset or other operating expense; and
- receivables and payables that are stated with the amount of VAT included.

The net amount of VAT recoverable from, or payable to, the taxation authority is included as part of the receivables or payables in the balance sheet.