9. INVESTMENT STRATEGY

9.1 INVESTMENT STRATEGIES

9.1.1 Introduction

The Manager's principal investment strategy is to invest in a diversified portfolio of income-producing real estate which is primarily used for retail, office and hospitality purposes, with particular focus on retail and hotel properties. The primary objectives of the Manager are: (a) to provide Unitholders with stable cash distributions with potential for sustainable growth, principally from the ownership of properties; and (b) to enhance long-term Unit value. The Manager will use the operating, acquisition, capital management and financing strategies to pursue Starhill REIT's business objectives.

9.1.2 Operating Strategy

The Manager's operating strategy is to continue to enhance the performance of the Properties by increasing yields and returns from the Properties. This is to be achieved through a combination of retaining existing tenants, reducing vacancy levels, adding and/or optimising retail space at the Retail Properties and minimising interruptions in rental income and operational costs. The Manager expects to apply the following key operating and management principles in order to continue to manage the Properties efficiently, to increase the yields of the Properties and to maximise growth:

- **Improve retail rental rates**: The Manager will work with the Property Manager to manage lease renewals and new leases to minimise vacancy periods through (a) negotiations with tenants whose tenancies are about to expire and (b) identifying and increasing rents on leases which are at below market rents.

- **Establishing close relationships with tenants to optimise tenant retention**: The Manager will work closely with the Property Manager to establish closer relationships with tenants. The Manager believes that such enhanced relationship will increase the attractiveness of the Retail Properties and help maximise tenant retention.

- **Tenant base**: The Manager intends to maintain occupancy rates by actively working with the Property Manager to pursue new leasing opportunities. The Manager will also seek to diversify the tenant base to minimise over-reliance on any retail sector to reduce susceptibility to economic cycles.

- **Tenant mix and space configuration**: The Manager may review tenant mix and, if practicable, re-configure lettable space to maximise rental income. Consumer research and consultation with major tenants will allow the Manager to tailor the tenant mix to the needs of the trade areas in order to meet the retail requirements of the tenants.

- **Create more retail space**: To the extent possible and permitted by relevant laws and regulations, the Manager may convert excess common areas into retail space.

- **Continually maintaining the quality of the Properties**: The Manager will seek to achieve a high level of occupancy by maintaining the physical condition of the Properties.

- **Maximising the performance of each Property**: The Manager will seek to maximise the overall financial performance of the Properties by focusing on each individual Retail Property, using proper management systems to provide timely information to the Property Manager to support effective pricing decisions and reduce and control operating costs. The Manager will measure actual results from operations against prior years' results and planned budgets in an effort to create a focused, profit-oriented approach to the management of each Retail Property. The Manager intends to review the Retail Properties that do not achieve their targets, and will develop action plans designed to improve the operating performance of any of such Retail Properties. The Manager will also work with the Property Manager to minimise payment delinquencies and defaults by tenants.

- **Improving operating efficiencies and economies of scale**: The Manager will seek to maintain and pursue further operating efficiencies through cost control measures to achieve internal cost savings. The Manager will take advantage of centralised purchasing, construction and renovation management, information technology and accounting functions.

- **Raise the profile of the Properties**: The Manager will through its marketing, advertising and promotional efforts, help to raise the profile of the Properties.

9.1.3 Acquisition Strategy

The Manager will also seek to increase cash flow and enhance Unit value through selective acquisitions. Starhill REIT intends to pursue an acquisition strategy to increase cash flows and the potential for net asset growth.

- **Yield thresholds**: The Manager will seek to acquire properties with yields that are above Starhill REIT's cost of capital and which are expected to maintain or enhance returns to Unitholders.

- **Location**: The Manager will assess potential properties for convenient access to major roads, public transportation network and proximity to major residential areas.

- **Occupancy and tenant mix**: The Manager will seek to acquire properties with strong existing rental or with the potential for higher rental returns, relative to competing properties in the market.

- **Building and facilities specifications**: The Manager will acquire buildings with good quality specifications, with due consideration being given to the size and age of the buildings.

- **Opportunities**: The Manager may also seek to acquire properties where there is potential to increase occupancy rate and rental income through active property management (for example through selective renovations and other enhancements).

The Manager has access to a network and relationships with leading participants in the real estate and hotel industry which may assist Starhill REIT in identifying (a) acquisition opportunities to achieve favourable returns on invested capital and growth in cashflow; and (b) underperforming assets. The management of Starhill REIT believes that these deal-sourcing capabilities, combined with the deal-making capacities of the senior executives of the Manager, will be an important competitive advantage of Starhill REIT.

The Manager anticipates that any properties acquired by Starhill REIT after the Listing Date will be managed in the manner described under Section 9.1.2 above.

Starhill REIT intends to hold its Properties on a long-term basis. In the future where the Manager considers that any property has reached a stage that offers only limited scope for growth, the Manager may consider selling the property and using the proceeds for alternative investments in properties that meet its investment criteria.

9.1.4 Capital Management Strategy

The Manager aims to optimise Starhill REIT's capital structure and cost of capital within the borrowing limits prescribed by the REIT Guidelines and intends to use a combination of debt and issuance of new Units to fund future acquisitions and improvement works at the Properties. The Manager's capital management strategy involves:

(a) adopting and maintaining a conservative gearing level which will enable Starhill REIT to maintain operating flexibility when considering future acquisition opportunities and capital expenditure requirements; and

(b) adopting an active interest rate management strategy to manage risks associated with changes in interest rates while seeking to ensure that Starhill REIT's ongoing cost of debt capital remains competitive. The Manager has managed to secure

100% of Starhill REIT's borrowings on a fixed rate basis for the entire five year tenure of the Debt Facility.

9.1.5 Investment Policy and Compliance with REIT Guidelines

Starhill REIT will comply with the REIT Guidelines and other requirements as imposed by the SC from time to time, including the investment limits and restrictions set out in the REIT Guidelines. These guidelines and requirements include the following:

9.1.5.1 Permitted investments and restrictions

Under the Deed, Starhill REIT will be allowed to invest in any of the following:

(a) Real estate;

(b) Single purpose companies, which means unlisted companies whose principal assets comprise real estate;

(c) Real estate-related assets, which includes units of other real estate investment trusts, listed securities of and issued by property companies, listed or unlisted debt securities of and issued by property companies, and mortgage-backed securities;

(d) Liquid assets, which means cash, deposits with licensed institutions and/or other institutions licensed or approved to accept deposits; and any other instrument capable of being converted into cash within seven (7) days as may be approved by the trustee;

(e) Non-real estate-related assets, which means listed shares issued by non-property companies; and

(f) Asset-backed securities.

In addition, the approval of the SC has been obtained for the Manager to invest in certain non-real estate related assets which are limited to:

(a) debt securities issued by or fully guaranteed by the Government of Malaysia; and

(b) commercial paper or other debt securities issued by companies or institutions with a credit rating of not less than:

  (i) A/P-1 by Rating Agency Malaysia Berhad, or

  (ii) A/MARC-1 by Malaysia Rating Corporation Berhad,

in each case denominated and payable in Ringgit.

The Manager will ensure that the investments made by Starhill REIT will also adhere to the investment policy set out above. Whilst ensuring that Starhill REIT will strive to invest in earnings accretive investments, the Manager will also ensure that Starhill REIT will not be involved in any of the following activities for any purpose as set out in the REIT Guidelines:

(a) extending loans and any other credit facilities to any party;

(b) entering into forward purchases or forward sales in any currency or money including Malaysian Ringgit or any foreign-exchange contracts unless Starhill REIT owns foreign real estates in its portfolio and the involvement in these instruments are in compliance with the Exchange Control Act 1953 with a view to manage the risks involved in foreign exchange; and

(c) property development, except in the case where the development is made with a view of purchasing the real estate upon completion and having met the criteria spelled out under Section 10.03(8) of the REIT Guidelines.

Upon completion of the Offering, the initial investment portfolio of Starhill REIT shall only consist of the Properties.

9.1.5.2 Investment limits and restrictions

Starhill REIT's investments in real estate-related assets and non-real estate-related assets will be subject to the following limits:

(a) Spread of investments:

(i) The value of Starhill REIT's holdings of the securities of, and the securities relating to, any single issuer must not exceed 5% of the Gross Asset Value; and

(ii) The value of Starhill REIT's holdings of the securities of, and the securities relating to, any group of companies must not exceed 10% of the Gross Asset Value;

(b) Concentration of investments:

(i) Starhill REIT's holdings of any class of security of any single issuer must not exceed 10% of the security issued.

In determining compliance with any limit or restriction, the holding of an investment and/or other instrument by Starhill REIT may exclude any entitlement accruing on the investment and/or instrument held. Notwithstanding the preceding sentence, the entitlement shall not be exercised if the exercise results in the breach of any limit or restriction under this part.

9.1.5.3 Portfolio composition

The Starhill REIT's investments will be allocated in the following manner, as prescribed by the REIT Guidelines:

(a) at least 75% of the Starhill REIT's total Assets shall be invested in real estate, single-purpose companies, real estate-related assets and/or liquid assets;

(b) at least 50% of Starhill REIT's total Assets must be invested in real estate and/or single-purpose companies; and

(c) the remaining 25% of the listed fund's total assets may be invested in other assets (i.e. real estate-related assets, non-real estate-related assets or asset-backed securities).

9.2 BASIS OF VALUATION AND ITS FREQUENCY

The Manager intends to obtain a valuation of the Properties at least once every three years from the last valuation date or as the REIT Guidelines may stipulate. All valuations will be conducted on the basis and methods, which are in accordance with the Asset Valuation Guidelines issued by the SC.

The basis of valuation of the Properties, conducted by the Independent Property Valuer on 1 March 2005, was the market value. Market value is meant to be the estimated amount for which an asset 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.

In determining the market value of the Properties, the Independent Property Valuer has applied the Income (or Investment) and Comparison Approaches as defined by the Asset Valuation Guidelines issued by the SC.

Starhill REIT will not be owning any non-real estate related assets, as defined under the Deed, upon Listing. However, should Starhill REIT acquire these non-real estate assets in the future, valuation of these assets will be made at the frequency and in the manner required by the REIT Guidelines.

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An investment in the Units involves significant risks. In evaluating an investment in Starhill REIT and before deciding to invest in the Units, prospective investors should carefully consider all information contained in this Prospectus including but not limited to the general and specific risks of the following investment considerations as well as seek professional advice from their relevant advisers about their particular circumstances.

Investors should be aware that the price of the Units and the income from them, may rise or fall. Investors should note that they may not get back their original investments and that they may not receive any distributions.

10.1 RISKS RELATING TO STARHILL REIT'S ORGANISATION AND OPERATING ENVIRONMENT

Economic and political risks

Starhill REIT's operations are closely linked to the economic performance of Malaysia. Any adverse developments in the political and economic environment and uncertainties in Malaysia can materially and adversely affect the financial performance of Starhill REIT. Political and economic uncertainties include (but are not limited to) changes in general economic, business and credit conditions, government legislations and policies affecting real estate industry, inflation, interest rates, taxation, fluctuation in foreign exchange rates and political or social developments in Malaysia.

Changes to regulatory regime

Starhill REIT is subject to certain regulatory regime including the REIT Guidelines which were published by the SC on 3 January 2005. There can be no guarantee that the rules set out in the REIT Guidelines will not from time to time be amended by the SC. The regulatory regime that is currently applicable to Starhill REIT may be changed. No assurance can be given that future legislation and regulations, administrative and regulatory rulings, court decisions or changes to the REIT Guidelines will not adversely affect the financial condition and results of operations of Starhill REIT or an investment by a Unitholder.

Certain regulations that apply to other securities and investments in Malaysia do not apply to the Units and Starhill REIT

Unitholders' rights differ from, and may be less protective in certain respects than, those granted to shareholders of public companies in Malaysia.

The Malaysian Code on Takeovers and Mergers, 1998 does not apply to acquisitions of units in REITs, which means (among other things) that a person may acquire any number of Units without being required to make a general offer to acquire the Units held by other Unitholders. Accordingly, Unitholders may not benefit from a possible premium price and may not receive equal prices for Units sold from an acquiree of Units.

In addition, whilst the Listing Requirements set out detailed provisions regulating transactions involving a listed issuer or its subsidiaries acquiring or disposing of business or assets and related party transactions which aim at protecting the interest of shareholders, such provisions do not apply to the Starhill REIT.

Related Party Transactions and Conflicts of Interest

As disclosed in Section 20.12 headed "*The Manager – Related Party Transactions*" of this Prospectus, there are certain related-party transactions involving the Directors and substantial shareholders and/or persons connected with the Directors or substantial shareholders of the Manager.

In addition, some of the Directors and/or substantial shareholders of YTL have interests in similar businesses as Starhill REIT which include certain hotel properties located within the same vicinity as the Properties. In this respect, the strategies and activities of Starhill REIT may be influenced by overall interest of YTL including acquisitions of properties and competition for clientele.

Furthermore, based on the monthly rent payable by the tenants as at 31 July 2005, the proportion of rent payable by the related parties attributable to the monthly rent of the Starhill Property and Lot 10 Property are 68% and 11% respectively. The entire amount payable under the Hotel Lease Agreement is also to be paid by related parties.

In mitigating the potential conflict of interest situation, the Manager will adhere strictly to its policy with respect of dealing with conflict of interest as disclosed in Section 20.13 headed "*The Manager's Policy With Respect To Dealing With Conflict of Interest Situation*" of this Prospectus.

Neither Starhill REIT nor the Manager, as new entities, has an established operating history

Starhill REIT was established on 18 November 2005 and the Manager was incorporated on 1 September, 1994 but did not commence business operations until Starhill REIT was established. As such, neither Starhill REIT nor the Manager has an operating history as a REIT or a manager of a REIT, or a track record by which its past performance may be judged. This may make it difficult for investors to assess their likely future performance. In addition, due to the change in the ownership and management of the Properties, the historical operations may not be indicative of future operations, and the historical costs may not be indicative of future costs.

Performance of Starhill REIT is subject to the success of the investment strategy and policy implemented by the Manager

Upon completion of the Listing, Starhill REIT's investment portfolio will consist only of the Properties. The Manager will need to ensure that the investment policies and strategies of the Starhill REIT will be implemented in the future to grow the investment portfolio and provide stable distribution to Unit holders with long term growth potential. Starhill REIT may change its investment policies in the future and therefore there is no assurance that the new investment policies will result in a better distribution of income to Unitholders and capital growth in such investment.

The Manager's operations are subject to regulation

No guarantee can be given that the Manager will remain the manager of Starhill REIT. In the event that the Manager ceases to be approved under the Securities Commission Act or is removed pursuant to the Deed and any other securities law, Starhill REIT may need to appoint another manager, which may materially and adversely affect the financial condition and results of operations of Starhill REIT.

There are limitations on Starhill REIT's ability to leverage

Borrowings by Starhill REIT are limited by the REIT Guidelines to no more than 35% of its Gross Asset Value at the time the borrowings are incurred.

Starhill REIT will be exposed to risks of debt financing

A first fixed charge will be granted over the Properties as security for the Debt Facility. If there is an event of default under the Debt Facility, the security over the Properties may be enforced which could result in a forced sale of the Properties. A sale of the Properties in such circumstances could adversely affect the interests of the Unitholders in Starhill REIT.

In addition, the use of leverage may increase the exposure of Starhill REIT to adverse economic factors such as rising interest rates and economic downturns. Generally, Starhill REIT is subject to general risks associated with debt financing, including the risk of: (a) there being insufficient cash flow to meet loan repayments; and (b) not being able to maintain debts at optimum levels in the future due to the lack of capacity in the lending market.

Starhill REIT's dependence on key executives of the Manager

Starhill REIT is dependent upon the efforts and abilities of the Manager's senior management team. While the Manager believes it could find replacements for these key executives, the loss of any of these individuals could adversely affect Starhill REIT's performance and continuing ability to compete effectively in the industry.

Starhill REIT is connected to the Vendor

The Vendor and/or its nominees will hold 51% of the Units upon completion of the sale of the Properties. The Manager is a subsidiary of the Vendor. The Vendor, its subsidiaries and associates are engaged in, and/or may engage in, amongst other things, investment in, and the development and management of, retail shopping malls and hotels in Malaysia and elsewhere and property management. In addition, certain Directors hold management positions or are employed by the Vendor. As a result, the strategy and activities of Starhill REIT may be influenced by the overall interests of the Vendor. There can be no assurance that conflicts of interest will not arise between Starhill REIT and the Vendor in the future, including in relation to the competition for tenants within the Malaysian market (see Sections 20.11 and 20.12 headed "*Conflicts of Interests*" and "*Related Party Transactions*" respectively).

Starhill REIT is dependent on the YTL Group for a high proportion of its revenue

Parties related to YTL who are expected to contribute to Starhill REIT's revenue include: (a) the Hotel Operator, Star Hill Hotel, (b) tenants in the Retail Properties, primarily Autodome, and (c) the car park operator, YTL Land. The total revenue contribution to Starhill REIT to be received from entities related to YTL for the forecast period 1 January 2006 to 30 June 2006 is approximately 58%.

10.2 RISKS RELATING TO INVESTMENT IN REAL ESTATE

There are general risks attached to investments in real estate

Investments in real estate are subject to various risks, including: (a) adverse changes in national or economic conditions; (b) adverse local market conditions; (c) the financial conditions of tenants, buyers and sellers of properties; (d) changes in availability of debt financing; (e) changes in interest rates and other operating expenses; (f) changes in environmental laws and regulations, zoning laws and other governmental rules and fiscal policies; (g) changes in energy prices; (h) changes in the relative popularity of property types and locations leading to an oversupply of space or a reduction in tenant demand for a particular type of property in a given market; (i) competition among property owners for tenants; (j) insufficiency of insurance coverage; (k) inability of the property manager to provide or procure the provision of adequate maintenance and other services; (l) illiquidity of real estate investments; (m) considerable dependence on cash flow for the maintenance of, and improvements to, the properties; (n) acts of God and other factors.

Many of these factors may cause fluctuations in occupancy rates, rent schedules, collection of rental income or operating expenses, causing a negative effect on the value of real estate and income derived from real estate. Increased operating costs and other expenses incurred by the owner of real estate, such as maintenance and capital expenditure, insurance premiums, property taxes and other statutory charges may also affect the value of real estate. The valuation of the Properties will reflect such factors and as a result may fluctuate upwards or downwards. The capital value of Starhill REIT's real estate assets may be significantly diminished in the event of a decrease in real estate market prices and Starhill REIT's ability to make distributions to Unitholders could also be adversely affected.

Starhill REIT is dependent on a small number of major tenants

Starhill REIT would be dependent to a significant degree on a limited number of tenants. As at 31 July 2005, the 10 largest tenants of the Retail Properties accounted for 55% of the total monthly rent due in respect of the Retail Properties. These include Autodome which is subsidiary of YTL who, as at 31 July 2005 accounted for 41.6% of the total monthly rent due in respect of the Retail Properties. In addition, as at 31 July 2005 the Hotel Operator, also a subsidiary of YTL, accounted for 27% of the total monthly rent due in respect of the Properties. Starhill REIT's financial condition, results of operations and ability to make distributions may be adversely affected by the business and financial condition of such major tenants as rent due from such tenants makes up a material proportion of the operating income of the Properties.

There may be uninsured or under-insured losses

The Property Management Agreement requires the Property Manager to obtain and maintain insurance coverage in respect of the Retail Properties usually insured in the normal course of business, with insurance companies as may be determined by the Manager and notified to the Trustee against fire and such other risks as the Manager and the Trustee may deem prudent. However, there is no assurance that insurance against some or all of these risks will in the future continue to be available, or be available in amounts that are equal to the full market value or replacement cost of the insured assets. In addition, there can be no assurance that the particular risks will continue to be insurable on an economically feasible basis or at all.

Starhill REIT may be adversely affected by the illiquidity of real estate investments

Real estate investments are relatively illiquid. Such illiquidity may affect Starhill REIT's ability to vary its investment portfolio or liquidate part of its assets in response to changes in economic, financial, real estate market or other conditions. This could have an adverse effect on Starhill REIT's financial condition and results of operations.

The Properties or part thereof may be acquired compulsorily

The Malaysian Government has the power to acquire compulsorily any land in Malaysia pursuant to the provisions of applicable legislation including the Land Acquisition Act, 1960 for certain purposes.

In the event of any compulsory acquisition of property in Malaysia, the amount of compensation to be awarded is based on the fair market value of a property and is assessed on the basis prescribed in the Land Acquisition Act, 1960 and other relevant laws. If any of the Properties were acquired compulsorily by the Malaysian Government at a point in time when the market value of the Properties has decreased, the level of compensation paid to Starhill REIT may be less than the price which Starhill REIT paid for such Properties if the fair market value of the Properties at the relevant time has fallen, which may have an adverse affect on the price of the Units.

10.3 RISKS RELATING TO STARHILL REIT'S PROPERTIES

Transfer of the Properties may not be registered

Under the Malaysian land registration system, the legal title in real property does not pass until the relevant instrument of transfer has been duly registered in the relevant land registry of title in favour of the transferee. Presently, the registration process could take a number of months to complete and the issue document of title evidencing the change in the ownership will only be received by the transferee after completion of such registration process although the date of change of ownership would be at the time of presentation of the instrument of transfer.

At the time of listing of Starhill REIT, the registration of the Properties will not have been completed. As such, there is a risk of non registration of the transfer of the Properties in favour of the Trustee on or after the Starhill REIT is listed in which event it may be necessary to terminate and wind up Starhill REIT and the relevant provisions relating to a winding up process as set out in accordance with the Deed would apply.

However, given the nature of property transactions in Malaysia, the risk of non-registration is not a risk which is unique to REITs and can be minimised by taking appropriate steps to ensure that the transfer instrument in respect of the Properties are fit for registration and that there are no restraints on dealings which could prevent the registration of the transfer of the Properties at the time of presentation of the relevant instrument of transfer for registration at the relevant land office.

The Properties are subject to the risk of non-renewal of expiring tenancies

Most of the tenancies for the Lot 10 Property and Starhill Property are for periods of 3 years or less, which reflects the general practice in the Malaysian retail property market. As a result, each of the Lot 10 Property and the Starhill Property experiences tenancy cycles within which a significant number of tenancies expire each year. This frequency of renewals makes Starhill REIT susceptible to rental market fluctuation which, in a declining market, may lead to higher vacancies and lower rents and which will in turn reduce the revenues of Starhill REIT.

The sale price for a Property may be less than its current valuation or the purchase consideration paid by Starhill REIT

The valuation of the Properties is not an indication of, and does not guarantee, a sale price either at the present time or at any time in the future (see also the investment consideration headed "*Starhill REIT may be adversely affected by the illiquidity of real estate investments*" above). Accordingly, there can be no assurance that Starhill REIT would be able to sell a Property, either at the present time or at any time in the future, or that the price realisable on such sale would not be lower than the present valuation of, or the price paid by Starhill REIT to purchase, such Property.

Defects relating to the Properties may adversely affect Starhill REIT's financial condition

The Properties may be subject to structural defects or latent defects which the Vendor or Starhill REIT are not aware of. If the Properties have design, construction or other latent property or equipment defects, these may require additional capital expenditure, special repair or maintenance expenses or the payment of damages or other obligations to third parties, other than those disclosed in this Prospectus. No structural report, engineering assessment or other such due diligence investigations have been conducted with respect to the Properties prior to the acquisition thereof by the Trustee. In addition, the Vendor has not given any warranty or representation as to the state of the Properties. It is possible that defects and flaws of Properties may become apparent over time and no assurance can be given that defects and flaws in the Properties will not affect the value of the Properties. Costs or liabilities arising from such property or equipment defects may involve significant and potentially unpredictable patterns and levels of expenditure and Starhill REIT may incur additional financial or other obligations in relation to such defects and flaws. Accordingly, any defects or flaws in the Properties could have material adverse affect on the financial condition of Starhill REIT including the value of its assets, its earnings and its cash flows.

Malaysia's retail properties and hotel markets are highly competitive

New facilities built in the vicinity of the Properties may compete with the Properties for tenants. While this may enhance the establishment of Jalan Bukit Bintang as Kuala Lumpur's premier shopping street by attracting more shoppers to the area, this competition may affect Starhill REIT's ability to maintain existing occupancy and utilisation rates and rental rates in respect of the Properties. Rents and rates may need to be lowered, additional capital improvements may need to be made or additional tenant inducements may need to be offered as a result of increased competition, all of which may have a negative impact on Starhill REIT's revenues. The competitive business environment among retailers in Malaysia may also have a detrimental effect on tenants' businesses and, consequently, their ability to pay rent.

The sale of the Hotel Property is subject to the consent of the Hotel Operator

The Hotel Property is presently leased by the Vendor to the Hotel Operator for a term expiring on 31 December 2023 pursuant to the Hotel Lease Agreement. Following the Completion Date, the Hotel Lease Agreement will be novated to Starhill REIT pursuant to the Sale and Purchase Agreement.

Under the terms of the Hotel Lease Agreement, which will be novated to Starhill REIT upon the completion of the purchase of the Properties, Starhill REIT may not sell, transfer, dispose of, charge or otherwise deal with the Hotel Property without the prior written consent of the Hotel Operator which shall not be unreasonably withheld, provided that any such sale, transfer, disposal, charge or dealing with the Hotel Property must be subject to the provisions of the Hotel Lease Agreement and Starhill REIT shall ensure that any new owner of the Hotel Property undertakes to be bound by the provisions of the Hotel Lease Agreement. This restriction may impede or constrain Starhill REIT's ability to dispose of the Hotel Property, should the Manager decide that it is in the best interests of Starhill REIT to do so. See Section 8 headed "*Hotel Property*".

Starhill REIT is obliged to renew the lease if the Hotel Operator is desirous of renewing the lease for a further period of 15 years

In the event that the Hotel Operator exercises its rights to extend the lease for the Hotel Property at the expiration of the term on 31 December 2023, Starhill REIT is obliged under the Hotel Lease Agreement to extend the lease at certain fixed monthly rent if the parties cannot agree on the new rent. This may result in Starhill REIT renting the Hotel Property to the Hotel Operator at a rent which is below the then market rate. See Section 8 headed "*Hotel Property*".

10.4 RISKS RELATING TO AN INVESTMENT IN THE UNITS

The price of the Units may decline after the Offering

The Institutional Offer Price, and consequently, the Final Retail Price of the Units will be determined by agreement between the Sponsor, the Manager and the Joint Bookrunners and may not be indicative of the market price for the Units after completion of the Offering. The Units may trade at prices significantly below the Final Retail Price after the Offering and may trade at prices higher or lower than the attributable Net Asset Value per Unit. The trading price of the Units may be volatile and will depend on many factors, including but not limited to:

(a) the market value of Starhill REIT's assets;

(b) the perceived prospects of Starhill REIT's business and investments and the Malaysian real estate market;

(c) differences between Starhill REIT's actual financial and operating results and those expected by investors and analysts;

(d) changes in Starhill REIT's revenues or earnings estimates or analysts' recommendations or projections;

(e) broad market fluctuations, including weakness of the equity market and increases in interest rates;

(f) the perceived attractiveness of the Units against those of other securities, including those not related to the real estate sector;

(g) the balance of buyers and sellers of the Units; and

(h) the future size and liquidity of the Malaysian REIT market.

Distributions to Unitholders will be subject to cash flow

The Net Property Income earned from real estate investments depends on, amongst other factors, the amount of rental and other income received and the level of operating and other expenses incurred. If the Properties and any other assets held by Starhill REIT from time to time do not generate sufficient Net Property Income and Starhill REIT is unable to borrow funds from the market in a timely and cost-effective manner, Starhill REIT's income, cash flow and ability to make distributions will be adversely affected.

The Manager's intention is to distribute to Unitholders an amount equal to a stipulated percentage of Starhill REIT's DI based on its current distribution policy as more fully described in Section 14 headed "*Distribution Policy*" in this Prospectus. DI accruing to Unitholders may exceed total cash available to Starhill REIT from time to time because of items such as capital expenditure, fees and expenses. Accordingly, Starhill REIT may face periodic liquidity constraints and may be reliant on borrowings in order to pay distributions. Further, Starhill REIT may change its distribution policy.

No assurance can be given as to Starhill REIT's ability to pay or maintain distributions. Nor is there any assurance that the level of distributions will increase over time, or that there will be increases in rent under the leases of the Properties (or leases of other properties held by Starhill REIT for the time being), that vacated Properties (or other properties held by Starhill REIT for the time being) will be re-let or that the receipt of rental revenue in connection with any expansion of the Properties or future acquisitions of properties will increase Starhill REIT's income available for distribution to Unitholders.

Unitholders have no right to require the redemption of their Units

Unitholders have no right to require the redemption of their Units while the Units are listed on Bursa Securities. Accordingly, Unitholders may only be able to liquidate or dispose of their Units through a sale of such Units to third parties on the secondary market.

Substantial holdings

There is nothing in the Deed that require relevant persons to disclose to the Manager information in relation to the acquisition or disposal of interests in the Units or to, provide information in relation to substantial holdings of Units.

In addition, the Vendor and/or its nominees will hold 51% of the Units upon completion of the sale of the Properties. These Consideration Units are not required by the SC and/or any other authorities to be held under a moratorium. However, the Vendor has agreed with the Underwriters that it will not, directly or indirectly, offer, sell or contract to sell or otherwise dispose of any part of its Consideration Units or any part thereof, for a period of 180 days from and including the Listing Date. If the Vendor and/or its nominees sell or are perceived as intending to sell a substantial amount of the Units, the market price of the Units may be adversely affected.

Failure and/or delay in the Listing

The success of the listing exercise is also exposed to the risk that it may fail or be delayed should any of the following event occurs:

(a) the Underwriters of the Units fail to honour their obligations under the Underwriting Agreements;

(b) gross proceeds of less than RM461.6 million being raised;

(c) Starhill REIT is unable to meet the public spread requirements i.e. at least 25% of the total number of Units must be held by a minimum of 1,000 public holding no less than 100 Units in Starhill REIT; or

(d) the Debt Facility is not capable of being drawn down.

Changes to accounting standards may result in changes in the future as to how Starhill REIT's results and financial position are prepared and presented

The audited financial statements of Starhill REIT will be prepared in accordance with applicable approved accounting standards in Malaysia. The MASB, as part of its programme to fully converge with international financial reporting standards, has introduced a number of Malaysian Financial Reporting Standards or revised MASB Standards, collectively referred to in this Prospectus as Malaysian Financial Reporting Standards, which are effective for accounting periods beginning on or after 1 January 2006.

These new standards cover amongst others financial instruments, share-based payments, business combinations, insurance contracts and non-current assets held for sale and discontinued operations. A series of exposure drafts to revise the remaining MASB Standards have been issued and include, amongst others, proposed revisions to the accounting of investment properties.

The above changes as well as any other further changes to MASB Standards may result in significant changes in the preparation and presentation of Starhill REIT's results in the future. In Section 14 headed "*Distribution Policy*" in this Prospectus, total distribution has been defined to address the significant proposed changes so far, which may potentially impact Starhill REIT's results. However, there can be no assurance that future changes to accounting standards will not affect the ability of Starhill REIT to make distributions to Unitholders or that such distributions will be in line with those set out in Section 11 headed "*Profit Forecast and Projections*" in this Prospectus.

The actual performance of Starhill REIT and the Properties could differ materially from the forward-looking statements in this Prospectus

This Prospectus contains forward-looking statements regarding, among other things, forecast and projected distribution levels for the period from 1 January 2006 to 30 June 2008. These forward-looking statements are based on a number of assumptions which are subject to significant uncertainties and contingencies, many of which are outside of Starhill REIT's control (see Section 11 headed "*Profit Forecast and Projections*"). In addition, Starhill REIT's revenue is dependent on a number of factors, including the receipt of rent from the Properties, which may decrease for a number of reasons, such as the decline in occupancy and rental rates, insolvency of tenants or delay in rent payment by tenants. This may adversely affect Starhill REIT's ability to achieve the forecast and projected distributions as some or all of the events and circumstances assumed may not occur as expected or events and circumstances which are not currently anticipated may arise. Actual results may be materially different from the Forecast and Projections. While the Manager currently expects to meet the forecast and projected distribution levels, no assurance can be given that the assumptions will be realised and the actual distributions will be as forecast and projected.

Future dilution of the NAV of the Units

The Deed provides that the Manager shall determine the issue price of any issue of new Units based on market-based principles, subject to the approval of the Trustee and the SC. The issue price of any new Units issued after the Listing Date may be at or below the then current NAV of the existing Units. If new Units are issued at less than NAV, the NAV of existing Units will be diluted.

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Statements contained in this section that are not historical facts may be forward-looking statements. Such statements are based on the assumptions set forth in this section and are subject to certain risks and uncertainties which could cause actual results to differ materially from those forecasted and projected. Under no circumstances should the inclusion of such information herein be regarded as a representation, warranty or prediction with respect to the accuracy of the underlying assumptions by the Manager, any of the Underwriters, the Sponsor, the Trustee or any other person, nor that these results will be achieved or are likely to be achieved. See "Forward-Looking Statements" and Section 10 headed *"Risk Factors". Investors in the Units are cautioned not to place undue reliance on these forward-looking statements that speak only as of the date of this Prospectus.*

The table below sets forth Starhill REIT's profit forecast for the 6 months period from 1 January 2006 to 30 June 2006 and profit projections for the financial years ending 30 June 2007 and 30 June 2008. The financial year end of Starhill REIT is 30 June. Starhill REIT's first accounting period will be for the period from 18 November 2005, being the date of its establishment, to 30 June 2006. The profit forecast and profit projections are based on the assumptions set out below. The profit forecast and projections have been reviewed and the computations have been checked by KPMG. Their report on the Profit Forecast and Projections are set out in Appendix 3 headed "Reporting Accountants' Letters on Profit Forecast and Projections".

The Directors of the Manager have reviewed and analysed the bases and assumptions used in arriving at the Profit Forecast and Projections and are of the opinion that the Profit Forecast and Projections are fair and reasonable in light of the future plans, strategies and prospects of the Starhill REIT, and after taking into consideration the forecast gearing levels, liquidity and working capital requirements of the Starhill REIT.

11.1 Profit Forecast and Projections

	Forecast	Projections	
	1 January 2006 to 30 June 2006	**1 July 2006 to 30 June 2007**	**1 July 2007 to 30 June 2008**
	RM'000	*RM'000*	*RM'000*
Gross Receipts			
Rental Revenue	40,760	84,006	86,989
Service Charge	4,540	9,081	9,081
Car Park Income	2,500	5,000	5,125
Other Income	250	500	500
Total Gross Receipts	**48,050**	**98,587**	**101,695**
Allowance for Bad Debts	(650)	(1,337)	(1,385)
Net Revenue	**47,400**	**97,250**	**100,310**
Property Operating Expenses			
Service Charge and Operating Costs[1]	(5,283)	(10,565)	(10,565)
Property Management Fees	(743)	(1,536)	(1,586)
Property Costs			
Assessment	(2,260)	(4,521)	(4,521)
Quit rent	(40)	(79)	(79)
Insurance	(176)	(353)	(353)
Property maintenance	(87)	(52)	(981)
Total Property Costs	(2,563)	(5,005)	(5,934)
Total Property Operating Expenses	**(8,589)**	**(17,106)**	**(18,085)**

	Forecast	Projections	
	1 January 2006 to 30 June 2006	1 July 2006 to 30 June 2007	1 July 2007 to 30 June 2008
	RM'000	*RM'000*	*RM'000*
Net Property Income	**38,811**	**80,144**	**82,225**
Interest Income	292	487	511
Trust Expenses			
Trustee Fee	(182)	(364)	(364)
Base Fee	(636)	(1,272)	(1,272)
Performance Fee	(831)	(1,715)	(1,760)
Administration Expenses	(200)	(200)	(200)
Arranger's Fee	(630)	-	-
Finance Charges	(4,320)	(8,640)	(8,640)
Total Trust Expenses	**(6,799)**	**(12,191)**	**(12,236)**
Net Income Before Tax	**32,304**	**68,440**	**70,500**
DI	**32,304**	**68,440**	**70,500**
Distribution to Unitholders	**(32,304)**	**(68,440)**	**(66,975)**
Net Income Retained	**-**	**-**	**3,525**
Number of Units in Issue ('000)	1,040,000	1,040,000	1,040,000
Gross Distribution per Unit (sen)	3.11	6.58	6.44
Annualised gross distribution yield based on the Retail Price of RM0.98 per Unit (%)[(2)]	6.43%	6.71%	6.57%
Annualised gross distribution yield based on the illustrative Institutional Offer price of RM1.03[(2)]	6.12%	6.39%	6.25%
Distribution Rate	100%	100%	95%
Distributable Amount	32,304	68,440	66,975
Distribution Cover [(3)]	100%	100%	105%

Notes:

(1) This comprises service charge payable by Starhill REIT for the maintenance of Lot 10 Common Property as well as fixed cost payable to the Property Manager for the operation and maintenance of Starhill Property. Please refer to Section 11.1(II) headed "*Property Operating Expenses*" for further information.

(2) Starhill REIT, the Manager, the Underwriters, the Sponsor and the Trustee do not guarantee the performance of Starhill REIT, the repayment of capital or the payment of any distributions, or any particular return on the Units. The forecast and projected yields stated in the table above are calculated based on the Retail Offer Price and the illustrative Institutional Offer Price. Such yields will vary accordingly for investors who purchase Units in the secondary market at a market price that differs from the Retail Offer Price and the illustrative Institutional Offer Price.

Annualised distribution yield has been computed by extrapolating on a monthly basis the revenue and expenses of Starhill REIT for the 6 months from 1 January 2006 and 30 June 2006, except that certain expenses, such as property maintenance, administration expenses and arranger's fee have not been extrapolated as such expenses are expected to remain unchanged regardless of the length of the financial period under review.

(3) Defined as the amount available for distribution to Unitholders over the actual amount distributed, expressed as a percentage.

Net Revenue and Net Property Income of Each Property

The forecast and projected contributions of Starhill Property, Lot 10 Property and Hotel Property to Net Revenue are as follows:

Property	Contribution to Net Revenue forecast for Forecast Period 2006		Contribution to Net Revenue forecast for Projection Period 2007		Contribution to Net Revenue forecast for Projection Period 2008	
	(RM'000)	(%)	*(RM'000)*	(%)	*(RM'000)*	(%)
Starhill Property	21,258	44.9	44,351	45.6	45,550	45.4
Lot 10 Property	15,882	33.5	32,379	33.3	33,641	33.5
Hotel Property	10,260	21.6	20,520	21.1	21,119	21.1
Net Revenue	**47,400**	**100.0**	**97,250**	**100.0**	**100,310**	**100.0**

The forecast and projected contributions of Starhill Property, Lot 10 Property and Hotel Property to Net Property Income are as follows:

Property	Contribution to Net Property Income forecast for Forecast Period 2006		Contribution to Net Property Income forecast for Projection Period 2007		Contribution to Net Property Income forecast for Projection Period 2008	
	(RM'000)	(%)	*(RM'000)*	(%)	*(RM'000)*	(%)
Starhill Property	17,596	44.5	37,026	45.3	38,225	45.6
Lot 10 Property	12,454	31.5	25,646	31.4	25,979	31.0
Hotel Property	9,504	24.0	19,008	23.3	19,607	23.4
Net Property Income (excluding Property Management Fees)	**39,554**	**100.0**	**81,680**	**100.0**	**83,811**	**100.0**
Property Management Fees	(743)		(1,536)		(1,586)	
Net Property Income	**38,811**		**80,144**		**82,225**	

Directors' Commentary and Analysis

The Directors confirm that the Forecast and Projections of the Starhill REIT and the underlying bases and assumptions stated herein have been reviewed by the Directors after due and careful inquiries, and that the Directors, having taken into account the future prospects of the industry, the future direction of Starhill REIT and its level of gearing, liquidity and working capital requirements, are of the opinion that the Forecast and Projections of Starhill REIT are achievable and the assumptions made are reasonable, barring unforeseen circumstances.

Nevertheless, in the light of the current economic environment in Malaysia, regionally and globally, certain assumptions, including interest and exchange rates, may differ significantly from the date of this Prospectus and this may have a material impact on Starhill REIT's Forecast and Projections.

Assumptions

The Manager has prepared the Forecast and Projections based on the assumptions listed below. The Manager considers these assumptions to be appropriate and reasonable as at the date of this Prospectus. However, investors should consider these assumptions as well as the Forecast and make their own assessment of the future performance of Starhill REIT.

(I) Net Revenue

Net revenue comprises rental revenue, service charges, car park income and other income receivable from the operation and/or maintenance of the Properties, net of allowance for doubtful debts. A summary of the assumptions which have been used in calculating the net revenue is set out below:

(a) Rental Revenue

Rental revenue consists of (i) hotel lease revenue and (ii) base rental revenue and turnover rent of the Retail Properties.

The Hotel Operator will pay to Starhill REIT an initial annual rent of RM20,520,000 per annum, payable monthly in advance. The monthly rental shall be increased by 5% of the then prevailing monthly rental after the expiry of 3 years from 1 December 2004 and thereafter at 5 yearly intervals.

The percentage of forecast rental revenue (excluding turnover rent) attributable to Committed Tenancies of Retail Properties is as follows:

	Forecast Period		Projection Year 2007		Projection Year 2008	
	Lot 10 Property	**Starhill Property**	**Lot 10 Property**	**Starhill Property**	**Lot 10 Property**	**Starhill Property**
Percentage of rental revenue attributable to Committed Tenancies of Retail Properties (%)	82	94	65	82	35	37

(i) *Base rental revenue*

The base rental revenue is the rent payable by tenants based on the Net Lettable Area occupied by the respective tenants. In order to forecast and project the base rental revenue, the Manager has, in the first instance, used rental payable under the Committed Tenancies. The Manager has used the following process to forecast and project the base rental revenue for the Forecast and Projections following the expiry of the tenancies committed by the existing tenants:

- The Manager has assessed the market rent for each lettable area at the Retail Properties as at 31 July 2005. The market rent is the rent which the Manager believes it could be achieved if each tenancy were renegotiated at that time and is estimated with reference to rental revenue payable pursuant to comparable tenancies that have recently been negotiated, the effect of competing retail and office properties, assumed tenant retention rates upon tenancy expiries, likely market conditions, inflation levels and tenant demand levels.

The Manager has forecast base rental revenue of RM30.1 million for the Forecast Period, and projected RM62.6 million and RM64.9 million for 2007 and 2008 Projection Periods, respectively.

(ii) *Turnover rent*

Certain tenants have provision in their tenancy agreements for the payment of turnover rent, in addition to base rental revenue. Turnover rent is payable by the tenants based on their monthly sales achieved. As at 31 July 2005, only about 8.2% or 20 numbers of committed tenancy agreements contain provisions for the payment of turnover rent.

The Manager has analysed the historical collection of turnover rent and, based on the analysis, assumed the turnover rent component of the Starhill Property and the Lot 10 Property to be RM0.286 million and RM0.12 million respectively for the Forecast period and 10% higher for the Projection periods.

Turnover rent represents 1.3% of rental revenue for the Forecast and 1.4% and 1.5% for the projection year 2007 and 2008 respectively.

(iii) *Renewal rate*

In preparing the Forecast and Projections, it has been assumed that all of Starhill Property and Lot 10 Property's existing tenancies with a renewable option will be fully renewed. Such tenancies represent 93% and 86% of Starhill Property and Lot 10 Property respectively based on Net Lettable Area as at 31 July 2005.

(iv) *Occupancy rate*

The occupancy rate of the Starhill Property and Lot 10 Property as at 31 July 2005 was 100% and 98% respectively. All existing vacant storage space in the Retail Properties are not expected to be leased during the Forecast Period and Projection Periods. The vacant storage space represents approximately 1.1% and 0.1% of the NLA of Lot 10 Property and Starhill Property as at 31 July 2005 respectively. Save for the aforementioned, the NLA of the Retail Properties is expected to be fully leased throughout the period of the Forecast and Projections, except for those lots without a renewal term where one (1) month rent free period was assumed.

(b) Service charge

The service charge is a contribution payable by tenants towards the maintenance of the Starhill Property and Lot 10 Property area and for provision of certain services and facilities.

Tenants who are subjected to service charges are generally charged with a rate that ranges from RM0.77 per sq ft to RM2.00 per sq ft for the Lot 10 Property, and from RM1.50 per sq ft to RM2.50 per sq ft for the Starhill Property as at 31 July 2005. The service charge is expected to remain at this rate throughout the period of the Forecast and Projections. A minority of retail tenants in Lot 10 Property and tenants occupying the office space in the Starhill Property do not pay service charge as the flat rental rate payable by these tenants include such service charge amount. Tenants occupying the NLA for the use as storage and kiosks are not required to pay any service charge.

(c) Car park income

The car park income is the fixed amount payable by YTL Land to the Starhill REIT pursuant to the Car Park Agreement.

The car park income is fixed at RM5.0 million per annum during the period of the Forecast and projection year 2007 and is increased by 5% during the projection year 2008. The car park income attributable to each of the car parks of Lot 10 Property and Starhill Property is RM2.5 million per annum.

(d) Other income

Other income represents income receivable from tenants for the provision of maintenance services of their respective lettable areas in relation to the Lot 10 Property and Starhill Property.

(e) **Allowance for bad debts**

An allowance for bad debts has been provided for the Forecast and Projections on the rental revenue and service charges at the rate of 3% and 1% for the Lot 10 Property and the Starhill Property respectively.

(II) **Property Operating Expenses**

The property operating expenses consist of (i) service charge and operating cost payable, (ii) Property Management Fees, and (iii) Property Costs.

A summary of the assumptions which have been used in arriving at the property operating expenses is set out below:

(a) **Service charge and operating cost**

A service charge will be payable on a monthly basis at the rate of RM1.00 per sq ft based on the total area of Lot 10 Property as stated in the strata titles for the maintenance of Lot 10 Common Property by the Lot 10 MC (or such other person appointed by the Lot 10 MC). Service charge payable by Starhill REIT is expected to be RM5.2 million per annum for the period covered by the Forecast and Projections. Please refer to Section 7.2 headed "*Lot 10 Common Property*" for further details.

Pursuant to the Property Management Agreement, the operation and maintenance of the Starhill Property will be undertaken by the Property Manager at a fixed sum of RM5.4 million per annum for the period of Forecast and Projections which shall be payable in equal installments on a monthly basis. Please refer to Section 22.7 headed "*Fixed Operating Cost*" for further details.

(b) **Property management fees**

The operations and maintenance of the Managed Properties will be undertaken by the Property Manager pursuant to the Property Management Agreement.

Starhill REIT shall pay to the Property Manager a property management fee calculated based on the following fee scale:

- 5% per annum of the first RM30,000 of the annual Gross Receipts relating to the Managed Properties;
- 3% per annum of the next RM30,001 to RM100,000 of the annual Gross Receipts relating to the Managed Properties; and
- 2% per annum of over the amounts above RM100,000 of the annual Gross Receipts relating to the Managed Properties.

The property management fees is subject to 5% government service tax and shall be payable on a monthly basis in arrears.

(c) **Property costs**

Property costs consist of (i) assessment, (ii) quit rent, (iii) insurance and (iv) property maintenance cost.

Assessment is a rate imposed by the local authority on land. Quit rent is a rent imposed by the state authority on alienated land located within the jurisdiction of such state authority. As the assessment and quit rent amount is determined annually by the local authorities, it has been assumed that the amounts for the period of Forecast and Projections is expected to remain the same as the amount for the FY 2005 which is approximately RM4.5 million per annum.

The insurance premium is expected to be RM0.35 million per annum for the period covered by the Forecast and Projections, which remains the same as the premium for FY 2005.

Property maintenance cost relates to revenue expenditure items incurred including non routine repairs and external painting and lighting which do not form part of the services provided under the Property Management Agreement or which falls within the responsibility of Starhill REIT under the Car Park Agreement.

(d) Interest income

It has been assumed that surplus funds will be placed in the fixed deposit to earn interest income at the prevailing rate of 2.7% per annum.

(III) Trust Expenses

Trust expenses comprise Starhill REIT's recurring operating expenses such as the trustee's fee, base fee and performance fee payable to the Manager, other administration expenses, arranger's fee and finance charges.

(a) Trustee fee

The trustee fee is payable to the Trustee at the rate of 0.03% per annum of the Gross Asset Value of the Starhill REIT. The fee is accrued daily and paid half-yearly in arrears in accordance with the Deed.

(b) Base fee and performance fee

The base fee and performance fee are payable to the Manager in accordance to the Deed. The base fee is charged on the basis of 0.1% per annum of the Gross Asset Value of the Starhill REIT whilst the performance fee is charged on the basis of 2% per annum of the net property income, but before deduction of Property Management Fees. The base fee and performance fee are subject to a 5% government service tax.

(c) Administration expenses

Administration expenses include expenses such as annual listing fees, registration fees, accounting, audit and tax advisory fees, valuation fees, costs associated with the preparation and distribution of reports to Unitholders, investor communication costs, annual facility and security agent fees in respect of the Debt Facility and other miscellaneous expenses.

(d) Arranger's fee

Arranger's fee is a one-off payment to be made in relation to the arrangement of the Debt Facility, charged on the basis of 0.35% flat on the amount of the Debt Facility.

(e) Finance charges

Finance charges in relation to the Debt Facility is calculated based on the fixed interest rate of 4.80% per annum on the full amount to be drawndown from the Debt Facility.

(IV) Unit Issue Expenses

The costs associated with the issue of the Units will be paid for by Starhill REIT. These costs are charged against Unitholders' funds in the balance sheet and have no impact on the Profit Forecast or distributions.

(V) Capital Expenditure

The Manager is not expecting any material capital expenditure to be incurred on the Properties for the period of the Forecast and Projections.

Total capital expenditure requirement for the Lot 10 Property for the Forecast is estimated to be approximately RM0.03 million, and RM0.11 million and RM0.03 million for projection year 2007 and 2008 respectively.

Capital expenditure requirements for the period of the Forecast and Projections are expected to be funded internally.

(VI) Debt Facility

Upon drawdown of the Debt Facility granted by the Lender to part finance the acquisition of the Properties, Starhill REIT will have outstanding borrowings of RM180 million, which is repayable five years after the date of the first drawdown.

(VII) Properties

The Properties will be revalued at least once in every three (3) years and it is assumed that the next valuation will be carried out in FY2008. For the purposes of the profit Forecast and Projections, the Manager has assumed that the value of the Properties remain unchanged at the Appraised Value taking into consideration the capital expenditure to be incurred to maintain the valuation of the Properties.

(VIII) Accounting Standards

The Manager has assumed no change in the applicable approved accounting standards or other financial reporting requirements in Malaysia that may have a material effect on the Forecast and Projections.

Significant accounting policies adopted by the Manager in the preparation of the Forecast and Projections are set out in Section 13.9.

(IX) Other Assumptions

The Manager has made the following additional assumptions in preparing the Forecast and Projections:

- that the property portfolio remains unchanged throughout the period of the Forecast and Projections;
- that no further capital will be raised during the period of the Forecast and Projections;
- that there will be no change in taxation legislation or other applicable legislation;
- that all tenancies and licences are enforceable and will be performed in accordance with their terms (with allowances for bad and doubtful debts); and
- that 100% of DI will be distributed for the Forecast and projection year 2007 to the Unitholders and as such no tax will be payable under the ITA.
- that 95% of total DI will be distributed for the projection year 2008 to the Unitholders. The Manager assumes no tax is payable as there will be sufficient unutilised capital allowance to set off against the net income for projection year 2008.

11.2 Sensitivity Analysis

The forecast and projected distributions included in this Prospectus are based on a number of assumptions that have been outlined above including no material changes in existing political, legal, fiscal, market or economic conditions in Malaysia. The forecast and projected distributions are also subject to a number of risks as outlined in Section 10 headed "*Risk Factors*".

Investors should be aware that future events cannot be predicted with any certainty and that deviations from the figures forecast or projected in this Prospectus are to be expected. To assist investors in assessing the impact of these assumptions on the profit forecast and profit projection, a series of tables demonstrating the sensitivity of the distribution per Unit to changes in the principal assumptions are set out below.

The sensitivity analysis is intended to provide a guide only and variations in actual performance could exceed the ranges shown. Movement in other variables may offset or compound the effect of a change in any variable beyond the extent shown.

Rental revenue

Changes in the rental revenue will impact the Net Property Income of Starhill REIT and, consequently, the gross distribution yield. The assumptions for rental revenue have been set out earlier in this section. The effect of variations in the rental revenue on the gross distribution yield is set out below:

	Annualised gross distribution yield (%) pursuant to changes in Rental Revenue[1]		
	Forecast Period 2006	Projection Year 2007	Projection Year 2008
Retail Offer Price	**RM0.98**	**RM0.98**	**RM0.98**
5.0% above base case	6.71	7.01	6.87
Base Case	6.43	6.71	6.57
5.0% below base case	6.15	6.42	6.28
Institutional Offer Price	**RM1.03**	**RM1.03**	**RM1.03**
5.0% above base case	6.39	6.67	6.53
Base Case	6.12	6.39	6.25
5.0% below base case	5.85	6.11	5.97

Note:

(1) Starhill Property and Lot 10 Property

Past performance is not an indication of future performance

The following table presents the proforma income statements for Starhill REIT for FY2001, FY2002, FY2003, FY2004 and FY2005. Such proforma income statements should be read in conjunction with Section 13 headed "*Management's Discussion and Analysis of Financial Conditions and Results of Operations* ".

Starhill REIT's Reporting Accountant, KPMG, have reported on the proforma income statements and the report is included in Appendix 4 headed "*Reporting Accountants' Letters on Proforma Historical Financial Information*" of the Malaysian Prospectus. The proforma income statement of Starhill REIT has been prepared on the bases set out in Appendix 4 headed "*Reporting Accountants' Letters on Proforma Historical Financial Information*" of the Malaysian Prospectus.

The objective of the proforma income statements is to show what the financial position of the Properties might have been if Starhill REIT existed at an earlier date. However, the proforma income statements do not include Trust Expenses (as defined in Section 11.1(III) in this Prospectus) as the purpose of this proforma is to illustrate the operating performance of the Properties. The proforma income statement of Starhill REIT is not indicative of the total income that would have been attained had Starhill REIT actually existed earlier.

Proforma Income statement

	FY 2001 *RM'000*	**FY 2002** *RM'000*	**FY 2003** *RM'000*	**FY 2004** *RM'000*	**FY 2005** *RM'000*
Net Revenue					
Rental revenue	37,778	43,510	49,209	57,098	65,239
Service charge....................	5,090	5,770	6,609	5,053	4,687
Car park income	2,955	3,125	3,615	3,375	3,225
Other income	417	365	617	468	546
	46,240	52,770	60,050	65,994	73,697
Less: Property Operating Expenses					
Property cost					
Assessment	4,074	4,222	4,273	4,522	4,522
Quit rent............................	74	74	75	79	79
Insurance	497	484	437	322	353
	4,645	4,780	4,785	4,923	4,954
Operating Cost................	9,478	9,330	9,772	9,723	9,705
Total Property Operating Expenses..........................	14,123	14,110	14,557	14,646	14,659
Net Property Income........	**32,117**	**38,660**	**45,493**	**51,348**	**59,038**

The following discussion and the selected financial and operating information set forth below should be read in conjunction with Section 12 headed "Proforma Historical Financial Information" and the assumptions set out in this Prospectus and the Reporting Accountants' Letter set forth in Appendix 4 to this Prospectus, which have been prepared in accordance with applicable approved accounting standards in Malaysia. Statements contained in this section that are not historical facts may be forward looking statements. Such forward looking statements are subject to certain risks, uncertainties and assumptions which could cause actual results to differ materially from those forecasted and projected. Under no circumstances should the inclusion of such information herein be regarded as a representation, warranty or prediction with respect to the accuracy of the underlying assumptions by the Manager, the Trustee, the Underwriters or any other person. Investors are cautioned not to place undue reliance on these forward looking statements that speak only as of the date hereof.

13.1 INTRODUCTION

Starhill REIT is a real estate investment trust established in Malaysia as a real estate investment trust pursuant to the Deed. As Starhill REIT was only established on 18 November 2005 and will only acquire the Properties on the Completion Date (expected to be 16 December 2005), Starhill REIT has no historical operating results and financial information based on which prospective investors in the Retail Offer Units and/or the Institutional Offer Units may evaluate the Starhill REIT. Starhill REIT's first accounting period will be from 18 November 2005 to 30 June 2006.

Starhill REIT was established to own and invest in real estate and real estate-related assets whether directly or indirectly through the ownership of single-purpose companies whose principal assets comprise real estate.

Starhill REIT's key objective is to provide Unitholders with stable distributions per Unit with the potential for sustainable long term growth of such distributions and the Net Asset Value per Unit.

The Starhill REIT's strategy is, *inter alia*, to acquire properties that meet Starhill REIT's investment criteria.

The retail, office and hotel property sectors in Malaysia remain highly competitive and are affected by amongst other factors, the demand for, and the supply of, space which are in turn, affected by economic conditions of Malaysia in general. The principal competitive factors include rental rates, quality and location of properties, supply of comparable space and changing needs of business users. Trade mix and accessibility of a retail mall are also major factors in attracting traffic and tenants.

13.2 STARHILL REIT'S RESULTS OF OPERATIONS

13.2.1 Revenue

13.2.1.1 Net Revenue

Starhill REIT's Net Revenue during each relevant period comprised primarily of its rental revenue, service charge, car park income, and other income paid in respect of the Properties, net of allowance for doubtful debts, if any.

13.2.1.2 Rental Revenue

Rental revenue consists of base rental revenue and turnover rent. The base rental revenue is based on the rents payable by the tenants under their tenancies (based on the Net Lettable Area). The payment of turnover rent is in addition to base rental revenue and only certain tenants have provision in their tenancy agreements for the payment of turnover rent.

13.2.1.3 Service Charge

The service charge is a contribution paid by tenants (based on the net lettable area) towards the maintenance of the Starhill Property and Lot 10 Property common area and for the provision of certain services and facilities. See Section 5 headed "*The Properties*" for a detailed list of service charges payable.

13.2.1.4 Car Park Income

Car park income is revenue received from car park operations net of car park operating cost during the relevant period. The car park operating cost comprises equipment maintenance cost, car park stationeries, license fee, staff cost and any other costs directly related to car park operation.

13.2.1.5 Other Income

Other income relates mainly to income from tenants for utility charges, repair and maintenance and property manager's costs in liaising with tenants on renovations.

13.2.2 Total Property Operating Expenses

13.2.2.1 Property Costs

Property costs consist of (a) assessments, (b) quit rent, (c) insurance and (d) property maintenance costs.

Assessment is a rate imposed by the local authority on land. Quit rent is a rent imposed by the state authority on alienated land located within the jurisdiction of such state authority. The assessment is payable on a semi-annual basis and quit rent amount is payable on an annual basis.

The insurance policies have been taken out in respect of the Retail Properties by YTL Land, in its capacity as owner of the Properties. The Hotel Operator will be responsible for payment of the insurance premiums relating to the Hotel Property.

13.2.2.2 Operating Costs

Operating Costs comprise the following:

(a) Utilities Expenses;

Utilities expenses refers to charges for supply of water, gas, electricity, and disposal of sewerage and all other utility services supplied to or consumed under each of the common area of Retail Properties.

(b) Contractual Maintenance Expenses;

Contractual maintenance expenses refer to cost of engaging contractors for the provision of maintenance of air-conditioning, building automated system, lift, escalator, generator set, public address system and cleaning for each the Properties.

(c) Repair and Maintenance Expenses;

Repair and maintenance expenses refer to the normal cost of repairing and maintaining the air-conditioning, fire fighting system, sanitary, lighting, lifts, escalators, public address system, building automated system, generators, roller shutters, closed circuit television, and any other systems installed to each of the Properties.

(d) Other Direct Expenses; and

Other direct expenses refer to the cost of repairing and maintaining each of the properties other than classified above.

(e) Staff Expenses

Staff expenses refer to personnel costs and benefits directly attributable to the operation of each of the Properties such as leasing and marketing, technical and security.

In arriving at the operating cost under the proforma income statement, rental revenue and other income generated from the Lot 10 Common Property were used to defray the abovementioned operating cost, to reflect actual operating cost for Lot 10 Property.

13.3 RECENT DEVELOPMENTS

13.3.1 Occupancy Trends

The table below sets out information on the average occupancy rates of the Lot 10 Property and the Starhill Property for FY2002, FY2003, FY2004 and FY2005:

	Lot 10 Property Average Occupancy Rate	Starhill Property Average Occupancy Rate
FY2002	94%	83%
FY2003	93%	91%[1]/90%[2]
FY2004	94%	82% [1]/ 89%[2]
FY2005	96%	77% [1]/ 93%[2

Notes:

[1] Including the Tangs Area previously leased to Tangs from April 2003 to March 2004 that was vacant during the relevant period.

[2] Excluding the Tangs Area which was being renovated and not available for occupation.

The average occupancy rate for the Lot 10 Property remained stable from FY2002 to FY2005, despite the global economic slowdown, acts of terrorism and the outbound of severe acute respiratory syndrome ("SARS") during this period.

The average occupancy for the Starhill Property improved from FY2002 to FY2003. In FY2004 there was a decrease in the average occupancy rate because the tenancy of the main tenant, Tangs, expired in March 2004, which resulted in a decrease in the average occupancy rate to 82% for FY2004. The occupancy rate excluding the Tangs's Area remained relatively stable within a range of 83% to 93% from FY2002 to FY2005.

13.3.2 Starhill Re-branding and Re-positioning

Since Tangs vacated the Tangs Area in April 2004, YTL Land commenced the physical transformation of Starhill Property to become a leading expression of taste and style in food, fashion, living beauty and art in Kuala Lumpur. The renovation works which have been designed by international architect David Rockwell of New York were completed in July 2005.

Starhill Property was officially launched on 30 July 2005 as "Starhill Gallery".

13.4 COMPARISON OF FY2005 WITH FY2004

13.4.1 Revenue

13.4.1.1 Net Revenue

Net Revenue increased by 11.67% to RM73.697 million for FY2005 from RM65.994 million for FY2004.

13.4.1.2 Rental Revenue

Rental revenue increased by 14.26% to RM65.239 million for FY2005 from RM57.098 million for FY2004.

Lot 10 Property:

Rental revenue increased by 4.86% to RM22.277 million for FY2005 from RM21.244 million for FY2004.

The increase in rental revenue was mainly attributable to the conversion of the trade mix of certain floors and this has resulted an increase in occupancy rates as well as rental rates. Further, rental rates of the office block have been revised upwards during the year.

During FY2005, a total of 39 tenancies with net lettable area of 70,055 sq. ft. expired, of which 36% of the tenancies or 61% of net lettable area were renewed at an average rental rate of RM7.09 from RM5.11 per square foot. Tenancies which expired and not renewed were subsequently replaced by new tenants with an average rental rate of RM12.43 from RM11.88 per square foot.

The average rental rates per sq. ft. of Lot 10 Property for FY2005 and FY2004 were RM10.67 and RM10.17 respectively, an increase of 4.92%.

Starhill Property:

Rental revenue increased by 16.11% to RM25.037 million for FY2005 from RM21.563 million for FY2004.

The increase was mainly attributable to Autodome's agreement to rent a substantial area vacated by Tangs.

During FY2005, a total of 45 tenancies with net lettable area of 113,720 sq. ft. expired, of which 24% of the tenancies or 30% of net lettable area were renewed at an average rental rate of RM8.57 from RM6.04 per square foot. Tenancies which expired and not renewed were subsequently replaced by new tenants with an average rental rate of RM7.74 from RM4.65 per square foot.

The average rental rates per sq. ft. of Starhill Property for FY2005 and FY2004 were RM8.71 and RM7.23 respectively, an increase of 20.47%.

Hotel Property:

Rental revenue increased by 25.43% to RM17.925 million for FY2005 from RM14.291million for FY2004.

The increase was due to the increase in lease rental which commenced in December 2004.

13.4.1.3 Service Charge

Service charge decreased by 7.24% to RM4.687 million for FY2005 from RM5.053 million for FY2004.

Lot 10 Property:

Service charge increased by 10.38% to RM2.883 million for FY2005 from RM2.612 million for FY2004.

Starhill Property:

Service charge decreased by 26.10% to RM1.804 million for FY2005 from RM2.441 million for FY2004.

The decrease was mainly attributable to a waiver of service charges for a period of eight months since July 2004 for all tenants of Starhill Property during the period where renovation was undertaken to reposition the Starhill Property.

13.4.1.4 Car Park Income

Car park income decreased by 4.44% to RM3.225 million for FY2005 from RM3.375 million for FY2004.

Lot 10 Property:

Car park income decreased by 3.25% to RM1.724 million for FY2005 from RM1.782 million for FY2004.

This decrease was a result of reduced shopping traffic.

Starhill Property:

Car park income decreased by 5.78% to RM1.501 million for FY2005 from RM1.593 million for FY2004.

This decrease resulted from reduced shopping traffic (including car park activity) resulting from major renovations that was undertaken on Starhill Property following the closure of the Tangs Area for renovation.

13.4.1.5 Other Income

Other income increased by 16.67% to RM0.546 million for FY2005 from RM0.468 million for FY2004.

Lot 10 Property:

Other income increased by 32.10% to RM0.321 million for FY2005 from RM0.243 million for FY2004.

This increase was mainly attributable to higher repair and maintenance work done by tenants.

Starhill Property:

Other income remained unchanged at RM0.225 million for both FY2005 and FY2004.

13.4.2 Total Property Operating Expenses

13.4.2.1. Property Costs

Property Costs comprised three main components:

(a) Assessment

Assessment costs remained the same at RM4.522 million for both FY2005 and FY2004.

(b) Quit Rent

The quit rent cost remained the same at RM0.079 million for both FY2005 and FY2004.

(c) Insurance

The Insurance cost for Retail Properties increased by 9.63% to RM0.353 million for FY2005 from RM0.322 million for FY2004.

13.4.2.2 Operating Costs

Operating costs include utilities, contractual maintenance, repair & maintenance, other direct expenses and staff expenses.

Operating costs decreased by 0.19% to RM9.705 million for FY2005 from RM9.723 million for FY2004.

The operating costs remained relatively unchanged.

13.4.3 Net Property Income

As a result of the above factors, YTL Land's Net Property Income increased by 14.98% to RM59.038 million in FY2005 from RM51.348 million in FY2004.

13.5 COMPARISON OF FY2004 WITH FY2003

13.5.1 Revenue

13.5.1.1 Net Revenue

Net revenue increased by 9.90% to RM65.994 million for FY2004 from RM60.050 million for FY2003.

13.5.1.2 Rental Revenue

Rental revenue increased by 16.03% to RM57.098 million for FY2004 from RM49.209 million for FY2003.

Lot 10 Property:

Rental revenue increased by 3.25% to RM21.244 million for FY2004 from RM20.575 million for FY2003.

This increase was attributable to various rental renewals and new tenancies that commenced in FY2003 and FY2004 which increased the average rental rates payable for FY2004, even though occupancy rates remained stable. During FY2004, a total of 22 tenancies with net lettable area of 30,767 sq. ft. expired, of which 36% of the tenancies or 66% of net lettable area were renewed at average rental rate of RM13.17 from RM13.02 per square foot. Tenancies which had expired and not renewed were subsequently replaced by new tenants with average rental rate of RM12.50 from RM14.04 per square foot.

The average rental rate for Lot 10 Property for FY2004 and FY2003 were RM10.17 and RM9.85 respectively, an increase of 3.25%.

Starhill Property:

Rental revenue increased by 24.33% to RM21.563 million for FY2004 from RM17.343 million for FY2003.

This increase was due to the acquisition by YTL Land of Tangs Area which was completed on 31 March 2003. Simultaneous with the completion of the aforesaid acquisition, Tangs then entered into a tenancy agreement with YTL Land for a tenancy of the Tangs Area for a tenure of one year which commenced on 1st April 2003 at a fixed rental for the same area Tangs disposed to YTL Land. For FY2003, it recorded a rental income for 3 months in respect of the Tangs Area, whereas 9 months rental income was recorded for FY2004, accounting for a substantial part of the increase in rental revenue for FY2004.

Apart from the expiry of the tenancy for the Tangs Area in April 2004, a total of 30 tenancies with net lettable area of 30,674 sq. ft. expired, of which 27% of the tenancies or 36% of net lettable area were renewed at average rental rate of RM10.19 from RM9.37 per square foot. Tenancies which expired and not renewed were subsequently leased at an average rental rate of RM6.13 from RM3.11 per square foot.

The average rental rate for Starhill Property, excluding area occupied by Tangs for FY2004 and FY2003 were RM7.23 and RM7.07 respectively, an increase of 2.25%.

Hotel Property:

Rental revenue increased by 26.57% to RM14.291 million for FY2004 from RM11.291 million for FY2003.

The increase was due to the increase in lease rental which commenced in July 2003 after the refurbishment of 32 hotel rooms on the top four floors, which were structurally completed but remained unfurnished by the previous owner.

13.5.1.3 Service Charge

Service charge decreased by 23.54% to RM5.053 million for FY2004 from RM6.609 million for FY2003.

Lot 10 Property:

Services charge decreased by 2.36% to RM2.612 million for FY2004 from RM2.675 million for FY2003.

This decrease was attributable primarily to a small number of units becoming untenanted resulting in lower service charge being received.

Starhill Property:

Services charge decreased by 37.95% to RM2.441 million for FY2004 from RM3.934 million for FY2003.

This decrease is attributable primarily to the completion of the acquisition of the Tangs Area on 31 March 2003, where the service charge of RM1.00 oer sq. ft previously imposed on Tangs prior to the acquisition was no longer imposed. As a consequence of this acquisition, Starhill Property received 9 months of service charge from Tangs in FY2003 whereas no service charges were received in FY2004 in respect of the Tangs Area.

13.5.1.4 Car Park Income

Car park income decreased by 6.64% to RM3.375 million for FY2004 from RM3.615 million for FY2003.

Lot 10 Property:

Car park income decreased by 5.11% to RM1.782 million for FY2004 from RM1.878 million for FY2003. This decrease resulted from a decrease in car park utilisation and also the introduction of a flat rate charge during weekends and public holidays and after certain hours of a weekday. Prior to the revised car park flat charge, the car park rate was charged on an hourly basis at all times.

Starhill Property:

Car park income decreased by 8.29% to RM1.593 million for FY2004 from RM1.737 million for FY2003.

This decrease resulted from reduced shopping traffic (including car park activity) resulting from major renovations taking place to the Starhill Property following the closure of the Tangs Area for renovation.

13.5.1.5 Other Income

Other income decreased by 24.15% to RM0.468 million for FY2004 from RM0.617 million for FY2003.

Lot 10 Property:

Other income decreased by 10.99% to RM0.243 million for FY2004 from RM0.273 million for FY2003.

This decrease is substantially due to lower number of tenancies which had expired in FY2004 i.e. 22 tenancies as opposed to 77 tenancies in FY2003, resulting in lower renovation charges generated.

Starhill Property:

Other income decreased by 34.59% to RM0.225 million for FY2004 from RM0.344 million for FY2003.

The decrease is substantially due to lower consumption of utilities by tenants and lower provision of repair and maintenance work to tenants' premises.

13.5.2 Total Property Operating Expenses

13.5.2.1 Property Costs

As described above, property costs are composed of three main components: assessments, quit rent and insurance costs.

(a) **Assessment**

Assessment costs increased by 5.83% to RM4.522 million for FY2004 from RM4.273 million for FY2003.

This increase in assessments was a result of the acquisition by YTL Land of the Tangs Area in 2002, which account for the increase in the estimated rateable annual value for FY2004 and, as a consequence, the increased assessment in respect of the Starhill Property.

(b) **Quit Rent**

Quit rent increased by 5.33% to RM0.079 million for FY2004 from RM0.075 million for FY2003.

The increase is due to the acquisition of Tangs Area by YTL Land, in respect of which quit rent was paid in FY2004.

(c) **Insurance**

Insurance costs referred to insurance premium paid for the Retail Properties, it decreased by 26.32% to RM0.322 million for FY2004 from RM0.437 million for FY2003.

This decrease was due primarily to a change of insurance cover for all retail properties in May 2003. Following an analysis of insurance requirements, YTL Land decided not to insure for foundation and basement structures of the Retail Properties and insured the Retail Properties based on replacement cost of the Retail Properties, which accounted for the decrease in the insurance cost.

13.5.2.2 Operating Costs

Operating costs decreased by 0.5% to RM9.723 million in FY2004 from RM9.772 million in FY2003.

13.5.3 Net Property Income

As a result of the above factors, YTL Land's Net Property Income increased by 12.87% to RM51.348 million in FY2004 from RM45.493 million in FY2003.

13.6 COMPARISON OF FY2003 WITH FY2002

13.6.1 Revenue

13.6.1.1 Net Revenue

Net revenue increased by 13.80% to RM60.050 million for FY2003 from RM52.770 million for FY2002.

13.6.1.2 Rental Revenue

Rental revenue increased by 13.10% to RM49.209 million for FY2003 from RM43.510 million for FY2002.

Lot 10 Property:

Rental revenue increased by 6.12% to RM20.575 million for FY2003 from RM19.389 million for FY2002.

This increase is attributable to substantial rental renewals early FY2003 which increased the average rental rates payable for FY2003. During FY2003, a total of 77 tenancies with net lettable area of 92,390 sq. ft. expired, of which 56% of the tenancies or 61% of net lettable area were renewed at average rental rate of RM12.01 per square foot from RM11.81 per square foot for FY2002. The tenancies which expired and were not renewed were subsequently replaced by new tenants at average rental rate of RM15.23 from RM13.32 per square foot.

The average rental rate of Lot 10 Property for FY2003 and FY2002 were RM9.85 and RM9.34 respectively, an increase of 5.46%.

Starhill Property:

Rental revenue increased by 35.18% to RM17.343 million for FY2003 from RM12.830 million for FY2002.

This increase was primarily due to two factors. Firstly, YTL Land acquired the Tangs Area on 31 March 2003 and leased the same to Tangs immediately. As a result, for FY2003, 3 months rent was received from Tangs, whereas no rent was received in respect of the Tangs Area for FY2002. This accounted for approximately 15% of the increase in the rental revenue. Secondly, when the

Starhill Property was acquired by YTL Land in FY1999 many of the tenancies provided for relatively low rental rates. Many of these leases were renewed at higher rates from the FY2002 to FY2003. As a result, these higher rental rates contributed relatively more to rental revenue for FY2003 than for FY2002.

In FY2003, a total of 37 number of tenancies with total net lettable area of 72,934 sq. ft. expired , of which 54% of the tenancies or 62% of net lettable area were renewed at average rental rates of RM7.71 per square foot from RM6.95 per square foot for FY2002. The tenancies which had expired and were not renewed were subsequently replaced by new tenants at average rental rate of RM6.38 from RM6.09 per square foot.

The average rental rate for Starhill Property for FY2003 and FY2002 were RM7.07 and RM5.73 respectively, an increase of 23.34%.

Hotel Property:

The rental revenue for the hotel property was fixed at RM11.291 million as a result of which the rental revenue of the Hotel Property had no impact on the overall increase in rental revenue.

13.6.1.3 Service Charge

Service charge increased by 14.54% to RM6.609 million for FY2003 from RM5.770 million for FY2002.

Lot 10 Property:

Service charge receivable increased by 16.35% to RM2.675 million for FY2003 from RM2.299 million for FY2002.

This increase was attributable primarily to an increase in the rate of the service charge in March 2002 to RM2.00 per square foot from RM1.50 per square foot generally. Because this increase became effective from March 2002, it was collected only for 3 months of FY2002 compared to the full 12 months for FY2003.

Starhill Property:

Service charge increased by 13.34% to RM3.934 million for FY2003 from RM3.471 million for FY2002.

This increase was attributable primarily to an increase in the rate of the Tenant Service Charge Receivable fee in March 2002 to RM 2.00 per square foot from RM 1.50 per square foot generally. Because this increase became effective from March 2002, it was collected for 3 months of FY2002 compared to the full 12 months of FY2003.

The increase mentioned above was partially set off by the acquisition of the Tangs Area by YTL Land on 31 March 2003 where upon Tangs entered into a fixed rent tenancy agreement with YTL Land and service charge previously imposed on Tangs prior to the acquisition was not imposed.

13.6.1.4 Car Park Income

Car park income increased by 15.68% to RM3.615 million for FY2003 from RM3.125 million for FY2002.

Lot 10 Property:

Car park income increased by 11.79% to RM1.878 million for FY2003 from RM1.680 million for FY2002.

This increase resulted from a strengthening in the retail business in FY2003 following a slowdown in the retail industry caused in part by the New York terrorist attacks of 11 September 2001.

Starhill Property:

Revenue from car park income increased by 20.21% to RM1.737 million for FY2003 from RM1.445 million for FY2002.

This increase is attributable to increased car park utilisation resulting from:

(a) the conversion of retail space into meeting rooms, which resulted in increased traffic to the Starhill Property;

(b) a general increase in hotel occupancy after the terrorist attacks in New York on 11 September 2001 which had the effect of causing more Asians to travel within Asia; and

(c) the success of retail sales campaigns organised by Tourism Malaysia, a campaign organized by the Government following the terrorist attacks in New York on 11 September 2001.

13.6.1.5 Other Income

Other income increased by 69.04% to RM0.617 million for FY2003 from RM0.365 million for FY2002.

Lot 10 Property:

Other income increased by 66.46% to RM0.273 million for FY2003 from RM0.164 million for FY2002.

This increase is mainly due to the revision of tenants utilities charges at the end of FY2002 and the substantial number of new tenancies which commenced in FY2003 resulting in higher tenant renovation charges. The increase in tenant's utilities charges reflected the to increase in utilities rate by the local authorities.

Starhill Property:

Other income increased by 71.14 % to RM0.344 million for FY2003 from RM0.201 million for FY2002.

This increase is mainly due to revision of tenant's utilities charges at the end of FY2002. The increase in tenant's utilities charges is with accordance to increase in utilities rate by local authority.

13.6.2 Total Property Operating Expenses

13.6.2.1. Property Costs

Property Costs are composed of three main components:

(a) Assessment

Assessment costs increased by 1.2% to RM4.273 million for FY2003 from RM4.222 million for FY2002.

(b) Quit Rent

The quit rent cost increased by 1.35% to RM0.075 million for FY2003 from RM0.074 million for FY2002.

This is a fixed cost charged by the State of Wilayah Persekutuan Kuala Lumpur.

(c) Insurance

The insurance cost for the Retail Properties decreased by 9.71% to RM0.437 million for FY2003 from RM0.484 million for FY2002.

Since the change of insurance cover took place in May 2003, it reflected only 2 months reduction in FY2003.

13.6.2.2 Operating Costs

Operating costs include utilities, contractual maintenance, repair & maintenance, other direct expenses and staff expenses.

Operating costs increased by 4.74% to RM9.772 million in FY2003 from RM9.330 million in FY2002.

The increase in operating cost is substantially due to the increase in electricity consumption.

13.6.3 Net Property Income

As a result of the above factors, YTL Land's Net Property Income increased by 17.67% to RM45.493 million in FY2003 from RM38.660 million in FY2002.

13.7 COMPARISON OF FY2002 WITH FY2001

13.7.1 Revenue

13.7.1.1 Net Revenue

Net revenue increased by 14.12% to RM52.770 million for FY2002 from RM46.240 million for FY2001.

13.7.1.2 Rental Revenue

Rental revenue increased by 15.17% to RM43.510 million for FY2002 from RM37.778 million for FY2001.

Lot 10 Property:

Rental revenue increased by 14.40% to RM19.389 million for FY2002 from RM16.949 million for FY2001.

During FY2002, a total of 19 tenancies with net lettable area of 34,736 sq. ft. expired, of which 58% of the tenancies or 77% of net lettable area were renewed at average rental rate of RM6.40 from RM5.17 per square foot. Tenancies which expired and not renewed were subsequently replaced by new tenants with an average rental rate of RM13.80 from RM9.30 per square foot.

The average rental rate per square foot for Lot 10 Property for FY2002 and FY2001 were RM9.34 and RM8.18 respectively, an increase of 14.18%.

Starhill Property:

Rental revenue increased by 30.25% to RM12.830 million for FY2002 from RM9.850 million for FY2001.

During FY2002, a total of 33 tenancies with a net lettable area of 45,701 sq. ft. expired, of which 15% of the tenancies or 21% of net lettable area were renewed at average rental rate of RM11.31 from RM7.12 per square foot. Tenancies which expired and not renewed were subsequently leased at average rental rates of RM11.15 from RM6.29 per square foot.

The average rental rate per square foot for Starhill Property for FY2002 and FY2001 were RM5.73 and RM4.22 respectively, an increase of 35.78%.,

Hotel Property:

Rental revenue increased by 2.84% to RM11.291 million for FY2002 from RM10.979 million for FY2001.

Included in the rental income for FY2001 of RM10.979 million was a set off of rental of RM0.312 million being over billing to the hotel operator for FY2000. Therefore, the actual revenue for FY2001 was RM11.291 million resulting in no increase in revenue when comparing FY2002 with FY2001.

13.7.1.3 Service Charge

Service charge increased by 13.36% to RM5.770 million for FY2002 from RM5.090 million for FY2001.

Lot 10 Property:

Service charge increased by 13.20% to RM2.299 million for FY2002 from RM2.031 million for FY2001.

This increase was attributable primarily to an increase in the service charge in March 2002 to RM2.00 per square foot from RM1.50 per square foot.

Starhill Property:

Service charge increased by 13.47% to RM3.471 million for FY2002 from RM3.059 million for FY2001.

This increase was attributable primarily to an increase in the service charge in March 2002 to RM2.00 per square foot from RM1.50 per square foot.

13.7.1.4 Car Park Income

Car park income increased by 5.75% to RM3.125 million for FY2002 from RM2.955 million for FY2001.

Lot 10 Property:

Car park income decreased by 6.93% to RM1.680 million for FY2002 from RM1.805 million for FY2001.

Prior to FY2001, the management of car park was outsourced to a third party operator on a fixed cost arrangement. YTL Land took over the management of car park operations in July 2001 and it undertook measures which resulted in the reduction of car park operating costs. However, the low utilisation of car park offset the savings in operating cost thus resulted in a decrease in car park income.

Starhill Property:

Car park income increased by 25.65% to RM1.445 million for FY2002 from RM1.150 million for FY2001.

This increase was attributable to the conversion of retail space into meeting rooms, which resulted in increased traffic to the Starhill Property. In addition, YTL Land took over the management of the car park in Nov 2000 and undertook measures which resulted in the reduction of car park operating cost. Prior to this, the management of car park operators was outsourced to a third party on a fixed cost arrangement.

13.7.1.5 Other Income

Other income decreased by 12.47% to RM0.365 million for FY2002 from RM0.417 million for FY2001.

Lot 10 Property:

Other Income decreased by 7.34% to RM0.164 million for FY2002 from RM0.177 million for FY2001.

Starhill Property:

Other income decreased by 16.25% to RM0.201 million for FY2002 from RM0.240 million for FY2003.

The decrease is substantially due to lower consumption of utilities by tenants.

13.7.2 Total Property Operating Expenses

13.7.2.1 Property Costs

As described above, property costs comprised three main components: assessments, quit rent and insurance costs.

(a) **Assessment**

Assessment increased by 3.63% to RM4.222 million for FY2002 from RM4.074 million for FY2001.

Lower assessment cost was reported in FY2001 due to the delay in allocating the apportioned assessment cost to the previous owner in respect of Hotel Property which should have been allocated in FY1999 instead of FY2001. Thus, as a result of the allocation in FY2001, the assessment cost decreased.

(b) **Quit Rent**

Quit rent has remained stable at RM0.074 million in FY2002 and FY2001 respectively.

(c) **Insurance**

Insurance costs referred to insurance premium paid for the Retail Properties, it decreased by 2.62% to RM0.484 million for FY2002 from RM0.497 million for FY2001.

The insurance expense has been relatively stable.

13.7.2.2 Operating Costs

Operating costs decreased by 1.56% to RM9.330 million in FY2002 from RM9.478 million in FY2001.

The operating costs remained relatively constant.

13.7.3 Net Property Income

As a result of the above factors, YTL Land's Net Property Income increased by 20.37% to RM38.660 million in FY2002 from RM32.117 million in FY2001.

13.8 LIQUIDITY AND CAPITAL RESOURCES, INDEBTEDNESS AND CAPITAL EXPENDITURE

13.8.1 Liquidity and Capital Resources

Funding for improvement works for the Properties has historically been from cash flow from operations as well as parent company advances.

For funding of distributions, servicing of interest on the loan, payment of non-property expenses and other future capital expenditure, the primary source will be from net cash from operations.

The Manager is of the opinion that Starhill REIT's working capital would be sufficient for its present requirements as rental income is received in advance and generally, tenants are required to provide a deposit of four months of the monthly rental payable.

Starhill REIT is expected to distribute 100% of its DI for the period from Listing Date to 30 June 2007. Thereafter, Starhill REIT is expected to distribute at least 90% of its DI available for distributions. Consequentially, Starhill REIT will not be able to meet all its obligations to repay the principal of its debt obligations from its cash flow generated from operations. As such, Starhill REIT will be required to refinance the principal of its debt obligations on maturity in the market or repay from equity financing or both. There can be no assurance that such financing will be available on terms similar to its present debt obligations.

13.8.2 Indebtedness

A Debt Facility of RM180 million with a fixed rate of 4.8% per annum for a term of five (5) years would be made available to Starhill REIT to part finance the purchase consideration of the Properties. The aforesaid Debt Facility is expected to be drawn on Completion Date.

As the Debt Facility carries a fixed interest rate of 4.8% per annum, Starhill REIT's financing costs will not be subject to fluctuations in the interest rate in the financial markets. Starhill REIT will be required to pay a one-off arrangement fee, calculated on the principal amount of the Debt Facility in the amount of RM180 million. A first fixed charge over the Properties will be created for the benefit of the Lender as security for the Debt Facility.

13.8.3 Capital Expenditure

As the strata titles for the individual parcels within the Lot 10 Shopping Centre (including the Lot 10 Property) have been issued, the Lot 10 MC (which comprises all the individual parcel proprietors of the Lot 10 Shopping Centre) has come into existence. The responsibility for the repair, maintenance and operation of the Lot 10 Common Property, including replacement and upgrading of plant and equipment will rest with the Lot 10 MC. The individual parcel proprietors are required to pay maintenance contributions to the Lot 10 MC (or such other person authorised by the Lot 10 MC) based on their respective share units to fund these capital expenditures.

Accordingly, the parcel proprietors of Lot 10 Shopping Centre are responsible only for the upkeep and repair of fixtures and fittings within their individual parcels and will pay a service charge to the Lot 10 MC (or such person authorised by Lot 10 MC) as contribution for the costs of maintenance of the Lot 10 Common Property. Lot 10 MC has appointed YTL Land to manage the Lot 10 Common Property for a period from 18 November 2005 until 31 December 2006 and has authorised YTL Land to collect service charges at the rate of RM1.00 per sq ft and subject to the agreement of Starhill REIT, Lot 10 MC and YTL Land, this arrangements is expected to continue for a further period mutually agreed upon.

For Starhill Property, the capital expenditures will be borne by Starhill REIT and will entail repair, maintenance, upgrading of plant and equipment. As Starhill Property was only completed in September 1995, the Manager does not anticipate major capital expenditure in the forecast and projection period/years.

Under the Hotel Lease Agreement for the Hotel Property, the repair and maintenance of the property rests with the Hotel Operator. As this property was only completed in July 1997, the Manager does not anticipate major capital expenditure in the forecast and projection period/years.

13.9 ACCOUNTING POLICIES

The following accounting policies will be adopted by Starhill REIT.

(a) Basis of accounting

The financial statements of the REIT will be prepared in compliance with the provisions of applicable approved accounting standards in Malaysia, applicable provisions of the Deed and the REIT Guidelines.

(b) Investment properties

Investment properties consist of leasehold and freehold land and buildings held for their investment potential and rental income. Investment properties are accounted for as non-current assets and are stated at valuation. Valuations are performed annually.

Any increase or decrease in valuation on revaluation is credited or charged directly to the income statement as a net appreciation or depreciation in the value of the investment properties.

When an investment property is disposed of, the resulting gain or loss recognised in the income statement is the difference between net disposal proceeds and the carrying amount of the property.

(c) Plant and equipment

Investment properties are not depreciated. Other plant and equipment are stated at cost less accumulated depreciation and accumulated impairment losses. The policy for recognition and measurement of impairment losses is in accordance with paragraph (g).

Plant and equipment retired from active use and held for disposal are stated at the carrying amount at the date when the asset is retired from active use, less impairment losses, if any.

Depreciation

The straight line method is used to write off the cost of plant and equipment over the term of their estimated useful lives at the principal annual rates of 10%.

(d) Trade and other receivables

Trade and other receivables are stated at cost less allowance for doubtful debts.

(e) Liabilities

Borrowings and trade and other payables are stated at cost.

(f) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances and deposits with banks and highly liquid investments which have an insignificant risk of changes in value. For the purpose of the cash flow statement, cash and cash equivalents are presented net of bank overdrafts and pledged deposits.

(g) Impairment

The carrying amount of assets, other than deferred tax assets and financial assets, are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset or the cash-generating unit to which it belongs exceeds its recoverable amount. Impairment losses are recognised in the income statement.

The recoverable amount is the greater of the asset's net selling price and its value in use. In assessing value in use, 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. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount and it is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. The reversal is recognised in the income statement.

(h) Unit issue costs

Unit issue costs represent expenses incurred in connection with the initial public offering of Starhill REIT on the Main Board of the Bursa Securities. All such expenses are deducted directly against Unitholders' funds.

(i) Income tax

Tax on the profit or loss for the year comprises current and deferred tax. Income 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.

Current tax expense is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Temporary differences are not recognised for the initial recognition of assets or liabilities that at the time of the transaction affects neither accounting nor taxable profit. 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.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

(j) Revenue

i) Rental income

Rental income is recognised in the income statement as it accrues over the period of the rental and such revenue include services charges and other maintenance income on general maintenance services rendered to the tenants.

ii) Carpark income

Carpark income is recognised in the income statement on accrued basis.

iii) Interest income

Interest income is recognised in the income statement as it accrues, taking into account the effective yield on the asset.

(k) Financing costs

All interest and other costs incurred in connection with borrowings, are expensed as incurred.