# EUROCASTLE INVESTMENT LIMITED

## 2013 ANNUAL REPORT

Dear Shareholders,

2013 was a transformational year for Eurocastle. Our goals for the year were ambitious: to simplify the company's capital structure, to raise equity for new investments in Italy and to continue to realize the value of our legacy businesses. Over the course of the year we made progress on all fronts. We would like to take this opportunity to highlight our key accomplishments and to share our outlook for 2014:

- Converted the Company's outstanding convertible debt into ordinary shares at €0.05 per share.
- Agreed with the Manager, FIG LLC, to reset the base on which the management fee is calculated, resulting in annualized savings of over €17.5 million.
- With the approval of majority shareholders, completed a 200:1 share consolidation resulting in 17.6 million shares outstanding.
- Issued 15 million shares at €7.25 per share generating net proceeds of €103.8 million for investment in new opportunities.
- Reinstated an annual dividend of €0.50 per share starting in the third quarter.
- Invested nearly €17 million in six performing and non-performing ("PL" and "NPL") Italian loan portfolios with an expected unlevered IRR of approximately 19%, 1.4x multiple on capital invested. These investments have performed better than anticipated, with a revised expected IRR of 38%.

## FINANCIAL RESULTS

Adjusting for the bond conversion and the capital raise in May of last year, the Company's pro forma NAV as of December 31, 2012 was €12.60 per share. The Company's adjusted NAV at the end of 2013 was €328.4 million or €10.06 per share, split between three core segments: Italian investments and corporate cash at €4.42 per share, German commercial property portfolios at €4.07 per share and debt investment portfolios at €1.57 per share. The adjusted NAV excludes the Mars Floating portfolio as well as the Bridge portfolio which was transferred to the lender in January 2014. The year-over-year decline in NAV was attributable to our two legacy businesses.

From an operating perspective, normalized FFO for the year was €15.8 million, or €0.60 per weighted average share, with €10.8 million coming from the cash-flowing portfolios. We believe that we can significantly increase this result by focusing on investments in Italy. Assuming our net corporate cash of €156 million is invested at a net 16% return, potential run rate FFO could increase annually by €25 million or €0.77 per share.

## LEGACY BUSINESS

We have made progress during the year in realizing value from our two legacy businesses: our German real estate and debt investment portfolios. Our German real estate investments comprise 9 portfolios which are non-recourse to the Company. We intend to continue to selectively sell these German assets as part of a comprehensive sales strategy aimed at harvesting the value from this portfolio in the short to medium term to generate cash for new investments in Italy. In 2013, Eurocastle sold 33 properties generating sales proceeds of €271 million and cash available for distribution of €12.2 million. As at December 31, 2013, a further 13 assets were under a binding contract with estimated sales proceeds of €94.4 million. The current value of the 9 portfolios is €1.21 billion compared to €1.22 billion at the end of 2012 on a like-for-like basis. During the year, Eurocastle received cash distributions from operations and sales of €35.5 million from its German commercial real estate business.

Distributions from the debt business in 2013 amounted to €1.5 million. As with our real estate business, our goal is to liquidate our debt portfolios in the short to medium term, maximizing returns and generating cash for investment in our Italian strategies. With this in mind, in January 2014, Eurocastle sold its remaining securities in the CDO IV portfolio, repaying all debt and realizing €22.5 million of NAV which represented a gain of €1.2 million over the third quarter's carrying values.

## NEW INVESTMENTS

As highlighted above, we have invested approximately €17 million of new capital in six pools of Italian loan portfolios comprised of both performing and non-performing loans. These investments outperformed our underwriting assumptions by nearly 134%, generating €8.8 million life to date cash flows. Furthermore, the investments are expected to generate additional €4.7 million of cash in the next 12 months, €17.2 million over the remaining life of the investment.

## OUTLOOK FOR 2014

Italy is in the midst of a significant financial crisis. Despite the turmoil, Italy remains the third largest country in the Eurozone based on the strong industrial base, moderate unemployment rates and relatively stable real estate market. We believe this creates great investment opportunities, both with respect to non-performing assets and performing assets owned by distressed sellers. Our business model is to invest in a wide range of Italian assets including NPLs, listed real estate fund units and other assets. We believe we can grow the Company through prudent asset selection and by leveraging our Manager's experience in Italy.

Our primary focus is NPLs. After several years of inactivity, Italian banks are entering a third wave of selling NPLs which we expect will be the largest. The current inventory of NPLs on banks' balance sheets is at an all-time high of over €165 billion, which is an increase of over 4 times since 2008. The political uncertainties, lack of liquidity, banks' inability to actively service the loans and the material increase in loss provisions, led by recent inspections of the Bank of Italy and the ECB, should serve as a precursor to massive deleveraging. Despite the high volume of NPLs, there are not many natural buyers, primarily due to significant barriers to entry to investing in Italian NPLs.

Italy's banks and their growing NPL problem continue to be in the top headlines with potential capital shortfalls of €10 to €15 billion presently being projected. We believe that the delay in attractive NPL deals coming to the market is due in part to the on-going ECB asset review process which started in March 2014 and is expected to be completed by the second half of 2014. We expect an increase in the NPL transactions starting in the second quarter of this year, and believe will accelerate in the third and fourth quarters.

As part of our investment strategy we have partnered with Italfondiario, the largest independent non-bank servicer in Italy, an affiliate of our Manager. Italfondiario has a proven servicing track record and strong internal infrastructure to service the NPLs. In addition to having a top servicing partner, we intend to leverage Fortress's expertise in sourcing investment opportunities through long term relationships with senior management of top Italian banks. We believe these factors give us significant competitive advantage and are key to successfully investing in Italian NPLs. We remain optimistic that NPLs will be an attractive opportunity for us in 2014 and beyond. We see a strong pipeline for new investments and we continue to focus on negotiations for near term deals.

Another area of focus is the selective purchase and tender of shares for closed-end real estate funds in Italy, which are trading at a significant discount to NAV. We see an opportunity to buy these funds and actively work them out to liquidation to recover the spread between market value and NAV. Many of these funds are reaching their final term in the next 12 months and currently trade at 50% discount to NAV and we believe can generate around a 15% return. Subsequent to the year end, Eurocastle, in an equal partnership with GWM Group, announced the launch of a €120 million tender offer, to each acquire up to 20% of the units in the Italian real estate fund UniCredito Immobiliare Uno.

In our legacy businesses, we intend to continue to realize the maximum value of the assets through liquidation, which we think can be substantially completed over the short to medium term. As noted above, we had a productive month in January, liquidating the remaining securities in the CDO IV portfolio. In connection with the liquidation of these debt assets, we will look for opportunities to increase value, such as through repurchases of debt at a discount.

The investment environment in Italy represents a tremendous opportunity for Eurocastle to grow FFO and dividends for our shareholders. We still have much hard work to do but we are excited about our business and its potential. On behalf of everyone at Eurocastle, we thank you for your continued support and look forward to updating you on our progress as the year continues to unfold.

Eurocastle Investment Limited ("Eurocastle" or the "Company") was incorporated in Guernsey, Channel Islands on 8 August 2003 and commenced its operations on 21 October 2003. Eurocastle and its consolidated subsidiaries (together with Eurocastle, the "Group") have invested primarily in Italian non-performing loans, German commercial real estate and European real estate debt. The Group is Euro denominated and currently listed on Euronext Amsterdam, under the symbol ECT. For more information regarding Eurocastle, please visit www.eurocastleinv.com.

**Strategy**

During 2013, the Company has refocused its investment strategy on Italy and is targeting a wide range of Italian real estate related products, including, but not limited to, non-performing loans ("NPLs"), closed-end real estate fund units and real estate assets. The Company may also pursue other performing and non-performing loan and receivable deals in Italy, new real estate related investments (including direct real estate investments and debt investments) in other European markets, including Germany and the United Kingdom. The Company will generally target assets that generate significant current cash flows and/or have the potential for meaningful capital appreciation. At the same time, the Group may further invest in its legacy business to preserve or harvest value from the underlying portfolio. The Group had a corporate cash balance of €139.1 million at the end of 2013 which is available for new investment.

**Capital Structure**

In the first half of 2013, the Company obtained approval from the holders of its Convertible Securities (refer note 28) to lower the conversion price from €0.30 to €0.05 per share in exchange for, inter alia, the right for the Company to require a conversion of all outstanding Convertible Securities. The terms of the Convertible Securities had obliged the Company to pay interest on those securities ahead of the payment of dividends or returns of capital to ordinary shareholders. Since the date of issue of the Convertible Securities, accrued interest had been capitalised. Therefore, the Directors considered that it was in the best interests of the Company to take action to remove the Convertible Securities from the capital structure of the Company thus giving the Company the best opportunity to grow its equity, expand its investments in the future and provide a return to all shareholders that might not otherwise exist if the interest on the securities was allowed to continue to accrue and capitalise. Conditional upon such conversion, the Company reached agreement with the Manager to reduce fees due under its Management Agreement (refer note 32) and preserve capital for future investment. The reduction in the fee amounted to €12.1 million in 2013 with an expected run rate of €6.1 million based on the Company's current paid in capital.

The Company converted all outstanding convertible securities to ordinary shares and completed a share consolidation in the ratio of 200:1 resulting in the number of shares outstanding reducing to 17,629,502 and a restated NAV per share of €17.43.

On 30 May 2013, the Company issued 15,000,000 shares at €7.25 per share. The net proceeds received from the share issue were €103.8 million after deducting share issue costs of €4.7 million and resulting in a pro-forma net asset value ("NAV") per share of €12.60.

**Dividends**

Following the corporate finance activity described above, the Company reinstated the intention to pay a quarterly dividend. During 2013, the following amounts were declared (refer note 31 for further details):

| | €'000 |
|---|---|
| Third quarter at €0.125 per share | 4,079.1 |
| Fourth quarter at €0.125 per share | 4,079.1 |
| **Total dividends declared** | 8,158.1 |

**New Business - Italian Investments**

On 22 May 2013, the Group acquired four non-performing loan portfolios and one performing loan portfolio for a total consideration of €14.0 million (refer note 13). These portfolios were acquired from a related party fund of the Manager based on an independent valuation. Since acquisition, the five portfolios have generated net collections of €8.1 million to the Group.

On 31 July 2013, the Group acquired a 50% share in a non-performing loan portfolio for €2.6 million (refer note 15). The portfolio is mainly comprised of residential first lien mortgages with a gross book value of €13.6 million. Since acquisition, the portfolio has generated net collections of €0.7 million to the Group.

| | Acquisition Date | Gross book value €'000 | Purchase price (1) €'000 | No. of Loans | Secured % |
|---|---|---|---|---|---|
| Palazzo Portfolio | May 2013 | 8,102.8 | 4,594.2 | 869 | 100.0% |
| Ieffe and BAM Portfolios | May 2013 | 3,252,804.1 | 9,412.5 | 7,290 | 11.7% |
| BNL Portfolio | July 2013 | 6,895.9 | 2,632.5 | 86 | 100.0% |
| **Total Italian Investments** | | **3,267,802.8** | **16,639.2** | **8,245** | **12.1%** |

| | | Actual | | Underwriting | |
|---|---|---|---|---|---|
| | Estimated future Cashflows €'000 | Life to date Cashflows (2) €'000 | Internal rate of return (3) % | Life to date Cashflows (2) €'000 | Internal rate of return (3) % |
| Palazzo Portfolio | 4,547.1 | 2,127.4 | 37.5% | 1,712.7 | 17.1% |
| Ieffe and BAM Portfolios | 9,463.2 | 5,977.7 | 43.5% | 1,579.8 | 19.9% |
| BNL Portfolio | 3,144.2 | 680.9 | 19.3% | 457.3 | 18.4% |
| **Total Italian Investments** | **17,154.5** | **8,786.0** | **38.0%** | **3,749.8** | **18.9%** |

(1) The amount is shown net of minority interests

(2) Cash flows received from date of acquisition

(3) Internal rate of return (IRR) represents the estimated IRR given cash flows received to date and projected cash flows based on the Servicer's 2014 Business Plan.

**Existing Business - European Real Estate Debt**

As at 31 December 2013, the NAV of the European Real Estate Debt business was €51.2 million. The value of the portfolio has declined in the year following a €54.5 million impairment charge on the Group's loan and receivable positions predominantly held within Duncannon whereby certain junior loan investments suffered potential losses as a result of work outs and restructurings. This was partially offset by a €11.4 million increase in the Group's available for sale securities (primarily in CDO IV) following positive asset level performance, asset paydowns and general improvements in the European real estate related debt markets.

During 2013, the Debt portfolio received €93.8 million of amortisation proceeds. Within Duncannon, €28.8 million of amortization proceeds was used for reinvestment in commercial mortgage backed securities with an average rating of BBB at an average price of 94% of nominal. The remaining proceeds, together with additional cash received in 2012, were used to repay €56.3 million of senior debt in Duncannon and €32.6m in CDO IV. Following the year-end, the Company sold the remaining securities in the CDO IV portfolio for an average price of 96.4% of face value, repaying the outstanding debt of €4.2m and realising €22.5 million of net asset value to Eurocastle (refer note 35). The remaining CDO IV portfolio now has a net asset value of €7.7 million and consists of two junior loan investments.

The reinvestment period for Duncannon ended on 20 June 2013 and, as a consequence, principal cash flows received on its assets are now diverted to repay senior debt.

Since June 2009, Duncannon has failed to meet certain cashflow triggers where compliance is generally a function of the market value and external credit ratings of the underlying investments. As a consequence of failing certain compliance tests, excess interest has been mandatorily diverted to amortise senior debt. In order for the test to be in compliance, the collateral value of the assets must exceed the aggregate balance of the outstanding debt senior to Eurocastle’s interest by at least 5%. As at 31 December 2013, the ratio stands at 74% against the required covenant level of 105%, which equates to a shortfall of €89.7 million or 31 per cent. The Company receives limited cashflows from Duncannon in the form of quarterly portfolio manager fees which amounted to €0.3 million for 2013 (31 December 2012: €0.4 million).

The net assets of the debt business as disclosed in note 33 is shown by portfolio in the table below:

| (Unaudited) | CDO IV (1) €'000 | Duncannon (2) €'000 | Balance Sheet (3) €'000 | Total European Debt Portfolio €'000 |
|---|---|---|---|---|
| Total assets | 34,540 | 319,774 | 1,599 | 355,913 |
| Total liabilities | (4,297) | (300,345) | (28) | (304,670) |
| **Net assets excluding non-controlling interest** | **30,243** | **19,429** | **1,571** | **51,243** |

The summarised portfolio data as at 31 December 2013 are as follows:

| (Unaudited) | CDO IV (1) | Duncannon (2) | Balance Sheet (3) | Total European Debt Portfolio |
|---|---|---|---|---|
| Weighted average Credit Rating | BB- | CCC | D | CCC |
| % Investment Grade | 56% | 18% | 0% | 20% |
| Number of securities (4) | 7 | 54 | 4 | 58 |
| Debt Maturity | Dec 2014 | Jun 2047 | - | - |

(1) CDO IV represents the net assets of CDO IV PLC

(2) Duncannon represents the net assets of Duncannon CRE CDO I PLC

(3) Balance Sheet represents the net assets of Eurocastle Funding Limited

(4) The number of securities consolidates positions where multiple classes are held. The total column eliminates positions that are held in two or more portfolios.

**Existing Business - German Commercial Real Estate (excluding the Bridge and Mars Floating portfolios)**

The Group has a number of non-recourse financing facilities which are due to reach maturity within the next 12 months at which time, the outstanding balance of the financings will become due and payable unless such financings can be extended. If proceeds from the sale of the assets which secure the relevant portfolio financing do not equal or exceed the amount outstanding under the relevant portfolio financing, the Group would be unable to repay the outstanding balance of the relevant portfolio financing when it becomes due and payable. The Group will engage in discussions with lenders in relation to the relevant portfolio financing, as they approach maturity, typically commencing such discussions three to six months prior to the relevant maturity date. Given the non-recourse nature of the financings, the Company is not obliged to utilise any additional capital to support any of the relevant portfolio financings.

In January 2013, the Group secured a restructuring of the Senior loan on the Drive portfolio extending the loan to 20 January 2014 with interim amortisation targets to be met through an agreed sales programme. Throughout 2013, the Group was successful in meeting all such targets reducing the debt outstanding on the Senior facility to €157.7 million as at 31 December 2013 (€369.3 million as at 31 December 2012), resulting in €7.4 million in sales fees and €2.1 million in asset management fees to the Company. On the maturity date in January 2014, a further €15.5 million was repaid and the remaining debt of €142.2 million was extended on a short term basis to 20 April 2014. In parallel, the Group has signed a binding term sheet with the lending syndicate of the Drive Junior facility to refinance the Senior loan for a term of two years with interim amortisation targets which it expects to document in advance of the April 2014 maturity. In September 2013, the Drive Junior loan maturity was extended to 31 January 2014 and for a further three months in January 2014 for an extension fee of €3.6 million (of which €2.7 million has been expensed in the Company's profit and loss at 31 December 2013). Eurocastle expects to agree a coterminous extension of the Junior facility once the Senior loan refinancing is secured.

Following the sale of an asset in Hamburg in June 2013 and an injection of a €2.0 million reserve by the Company to fund capital expenditures in July 2013, the remaining Mars Fixed 2 facility of €71.6 million was extended in September 2013 to 31 December 2014. The Group is currently marketing one of the two remaining assets in the portfolio which it expects to sell within the next six months. The sale of that asset would trigger the repayment of the €2.0 million injection and extend the facility for a further six months. The facility now bears a floating interest rate of 3 month Euribor plus a margin of 2.50%.

In May 2013, the Group secured an amendment to the Mars Floating facility with the 2012 amortisation target being extended to the December 2013 maturity, the financing was subsequently extended for a further six months in January 2014. The Company continues to benefit from running asset management and sales fees, receiving €1.0 million in 2013. Since the year end, one asset has been sold with a further two assets under binding contract. The total net proceeds of all three of these sales are expected to generate a further €30.8 million of sales proceeds and repay the facility by approximately €26.5 million leaving just over €100.3 million of debt outstanding with a remaining asset value of €64.4 million. As with all of the Group's real estate financings, the debt is non-recourse to Eurocastle.

On 15 January 2014, the Bridge facility reached its maturity. The outstanding loan balance of €372.1 million had not been repaid and the Group has been unable to negotiate an extension. As such, the Bridge facility has moved into special servicing and following the distribution of €2.6 million of cash in January 2014, the Group has no further interest in the portfolio. Please refer to note 35 for further details.

The Group has received terms on an extension for the Wave portfolio financing and is also exploring the possibility of a portfolio sale. The maturity of the financing is in April 2014.

As at 31 December 2013, the adjusted NAV of the German Real Estate business excluding the Bridge and Mars Floating portfolios was €132.9 million. Valuation adjustments, together with capital expenditure, resulted in a fair value loss of €25.4 million (excluding the Bridge and Mars Floating portfolios) with €24.8 million attributable to the Drive portfolios as a result of asset specific factors such as a decline in occupancy and shortening lease terms.

During the twelve months ended 31 December 2013, the Group signed 176 commercial leases for 159,539 square metres (sqm). Of the leases signed, 39,279 sqm relate to new leases. The renewal rate for the year ending 31 December 2013 was 62.6%. Physical occupancy was at 79.9% compared to 82.2% at the end of 2012 on a like-for-like basis primarily due to an early surrender of a major tenant's leases in the Drive portfolio for which the Group received an upfront fee of €4.2 million. In 2013, the Group sold 33 properties for total sales proceeds of €270.7 million versus a carrying value of €268.3 million with the loss after transaction costs (€5.4 million) and swap break costs (€0.6 million) reported in the decrease in fair value of investment properties.

**Property Valuation Data (by Portfolio)**

For 2013

| | Number of properties | Occupancy % | Lettable space sqm | Property valuation [1] €m | Passing Rent €m | Net operating income (NOI) [2] €m | NOI yield on valuation % |
|---|---|---|---|---|---|---|---|
| Drive | 142 | 57.9% | 308,002 | 497 | 27.6 | 18.9 | 3.8% |
| Wave | 48 | 78.4% | 126,910 | 146 | 11.3 | 9.0 | 6.2% |
| Turret | 63 | 96.2% | 141,608 | 170 | 14.6 | 12.9 | 7.6% |
| Mars Fixed 2 | 2 | 92.1% | 32,163 | 89 | 5.9 | 4.7 | 5.2% |
| Truss | 41 | 92.9% | 81,437 | 93 | 7.8 | 6.8 | 7.4% |
| Belfry | 27 | 86.7% | 52,900 | 57 | 4.6 | 3.9 | 6.7% |
| Tannenberg | 27 | 90.7% | 49,574 | 58 | 5.0 | 4.2 | 7.2% |
| Superstella | 18 | 100.0% | 38,641 | 55 | 4.4 | 4.0 | 7.3% |
| Zama | 8 | 95.2% | 30,396 | 45 | 3.7 | 3.3 | 7.4% |
| **Total portfolio excluding Bridge and Mars Floating** | **376** | **78.7%** | **861,631** | **1,210** | **84.9** | **67.7** | **5.6%** |
| Bridge | 6 | 98.4% | 191,544 | 400 | 27.8 | 25.6 | 6.4% |
| Mars Floating [3] | 7 | 59.7% | 122,500 | 95 | 7.7 | 4.3 | 4.5% |
| **Total portfolio** | **389** | **79.9%** | **1,175,675** | **1,705** | **120.4** | **97.6** | **5.7%** |

For 2012 (on a like-for-like basis):

| | Number of properties | Occupancy % | Lettable space sqm | Property valuation [1] €m | Passing Rent €m | Net operating income (NOI) [2] €m | NOI yield on valuation % |
|---|---|---|---|---|---|---|---|
| Drive | 142 | 64.7% | 307,996 | 512 | 29.5 | 22.1 | 4.3% |
| Wave | 48 | 79.2% | 127,815 | 139 | 11.0 | 8.6 | 6.2% |
| Turret | 63 | 96.9% | 141,389 | 169 | 14.9 | 12.7 | 7.5% |
| Mars Fixed 2 | 2 | 93.1% | 32,169 | 90 | 5.9 | 4.4 | 4.9% |
| Truss | 41 | 96.5% | 81,437 | 95 | 8.2 | 7.0 | 7.4% |
| Belfry | 27 | 95.1% | 52,900 | 60 | 5.1 | 4.4 | 7.3% |
| Tannenberg | 27 | 94.6% | 49,569 | 59 | 5.0 | 4.2 | 7.2% |
| Superstella | 18 | 100.0% | 38,641 | 55 | 4.4 | 4.0 | 7.2% |
| Zama | 8 | 94.3% | 30,399 | 45 | 3.6 | 3.2 | 7.1% |
| **Total portfolio excluding Bridge and Mars Floating** | **376** | **82.4%** | **862,315** | **1,225** | **87.6** | **70.6** | **5.8%** |
| Bridge | 6 | 96.5% | 191,572 | 407 | 27.1 | 25.0 | 6.1% |
| Mars Floating [3] | 7 | 58.4% | 122,637 | 105 | 7.7 | 4.9 | 4.7% |
| **Total portfolio** | **389** | **82.2%** | **1,176,524** | **1,736** | **122.4** | **100.5** | **5.8%** |

(1) Property valuation excludes the leasehold gross-ups of €23.1 million (31 December 2012: €23.2 million).

(2) Net operating income is after deducting €2.2 million (31 December 2012: €1.2 million) of free rent. It excludes the amortisation of tenant incentives and leasing commissions, the fund costs related to the Drive portfolio and other real estate related general expenses included within property operating expenses in the consolidated income statement. It is shown here as the annualised amount at the period end.

(3) The total portfolio includes 100% of the Mars Floating portfolio, in which the Group has a 50% investment.

For information regarding the risks facing the business, please refer to note 29 of the consolidated financial statements.

Lease Expiry Data (by Portfolio) for 2013:

| | Average lease term (years) | Passing rent (1) 2014 €m | 2015 €m | 2016 €m | 2017 €m | 2018 €m | 2019-2023 €m | 2023+ (2) €m |
|---|---|---|---|---|---|---|---|---|
| Drive | 3.8 | 1.5 | 1.4 | 4.1 | 12.6 | 0.4 | 6.6 | 1.0 |
| Wave | 4.5 | 0.6 | 4.0 | 0.5 | 0.2 | 0.4 | 3.4 | 2.1 |
| Turret | 6.2 | 0.8 | 2.1 | 2.7 | 0.9 | 1.7 | 2.3 | 4.2 |
| Mars Fixed 2 | 2.9 | 1.0 | 1.3 | 0.5 | 1.5 | 0.8 | 0.7 | 0.1 |
| Truss | 4.2 | 0.6 | 1.5 | 1.8 | 0.9 | 0.7 | 1.6 | 0.7 |
| Belfry | 3.9 | 0.3 | 0.6 | 0.7 | 0.7 | 0.8 | 1.4 | 0.0 |
| Tannenberg | 5.0 | 0.3 | 0.7 | 0.6 | 0.9 | 0.2 | 1.7 | 0.6 |
| Superstella | 7.8 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 4.2 | 0.0 |
| Zama | 3.1 | 0.1 | 0.4 | 0.2 | 2.7 | 0.0 | 0.3 | 0.2 |
| **Total portfolio excluding Bridge and Mars Floating** | **4.5** | **5.2** | **12.0** | **11.2** | **20.4** | **5.0** | **22.2** | **8.9** |
| Bridge | 5.2 | 1.0 | 1.3 | 1.8 | 14.3 | 1.1 | 2.7 | 5.7 |
| Mars Floating (3) | 3.8 | 0.9 | 1.0 | 1.2 | 1.0 | 0.7 | 2.1 | 0.8 |
| **Total portfolio** | **4.6** | **7.1** | **14.3** | **14.2** | **35.7** | **6.8** | **27.0** | **15.4** |

Lease Expiry Data (by Portfolio) for 2012 (on a like-for-like basis):

| | Average lease term (years) | Passing rent (1) 2014 €m | 2015 €m | 2016 €m | 2017 €m | 2018 €m | 2019-2023 €m | 2023+ (2) €m |
|---|---|---|---|---|---|---|---|---|
| Drive | 3.9 | 3.2 | 0.9 | 4.2 | 12.2 | 0.2 | 5.2 | 0.8 |
| Wave | 2.8 | 1.2 | 6.7 | 0.3 | 0.1 | 0.3 | 1.2 | 0.6 |
| Turret | 4.0 | 4.0 | 1.9 | 1.4 | 1.0 | 1.1 | 1.7 | 1.7 |
| Mars Fixed 2 | 3.4 | 1.1 | 0.9 | 0.6 | 1.6 | 0.7 | 0.4 | 0.1 |
| Truss | 4.2 | 0.7 | 1.5 | 1.8 | 0.9 | 1.0 | 1.7 | 0.0 |
| Belfry | 4.1 | 0.7 | 0.6 | 0.9 | 0.6 | 0.8 | 1.1 | 0.0 |
| Tannenberg | 5.8 | 0.5 | 0.5 | 0.6 | 0.9 | 0.0 | 1.5 | 0.8 |
| Superstella | 8.8 | 0.0 | 0.0 | 0.1 | 0.0 | 0.0 | 4.2 | 0.9 |
| Zama | 3.8 | 0.3 | 0.2 | 0.2 | 2.5 | 0.0 | 0.1 | 0.2 |
| **Total portfolio excluding Bridge and Mars Floating** | **4.1** | **11.7** | **13.2** | **10.1** | **19.8** | **4.1** | **17.1** | **5.1** |
| Bridge | 5.8 | 1.9 | 0.8 | 1.6 | 14.0 | 0.4 | 1.8 | 7.2 |
| Mars Floating (3) | 3.1 | 2.2 | 0.6 | 1.0 | 1.2 | 0.6 | 0.8 | 0.5 |
| **Total portfolio** | **4.4** | **15.8** | **14.6** | **12.7** | **35.0** | **5.1** | **19.7** | **12.8** |

(1) Passing rent is defined as the contractual annual gross rental at the period end, excluding the net effects of straight lining lease incentives. The passing rent for 2012 does not include the rent expiring in 2013.

(2) Includes open-ended leases of €2.3 million for the total portfolio (€2.4 million for 2012 on a like-for-like basis).

(3) The total portfolio includes 100% of the Mars Floating Portfolio, in which the Group has a 50% investment. The portfolio has a negative net asset value and has been separated as the financing is non-recourse to the Company and not callable as a result of any changes in the fair value of the assets.

Top 5 Tenants for 2013 (excluding Mars Floating and Bridge):

| Tenant name | Business sector | Passing rent €m | % of total portfolio (1) | Occupied square meters |
|---|---|---|---|---|
| Commerzbank AG | Banking | 22.8 | 26.8% | 128,664 |
| EDEKA | Retail | 10.3 | 12.1% | 98,499 |
| Deutsche Bank AG | Banking | 8.4 | 9.9% | 64,557 |
| REWE | Retail | 4.7 | 5.5% | 40,568 |
| Netto Marken-Discoun | Retail | 4.1 | 4.8% | 33,765 |
| **Total portfolio** | | **50.3** | **59.0%** | **366,053** |

Top 5 Tenants for 2012 (excluding Mars Floating and Bridge; and on a like-for-like basis):

| Tenant name | Business sector | Passing rent €m | % of total portfolio (1) | Occupied square meters |
|---|---|---|---|---|
| Commerzbank AG | Banking | 25.0 | 28.5% | 151,385 |
| EDEKA | Retail | 10.9 | 12.4% | 104,205 |
| Deutsche Bank AG | Banking | 8.0 | 9.1% | 64,705 |
| REWE | Retail | 4.7 | 5.4% | 40,790 |
| Netto Marken-Discoun | Retail | 2.5 | 2.9% | 21,353 |
| **Total portfolio** | | **51.1** | **58.3%** | **382,437** |

(1) Calculated as a percentage of passing rent

The tables below show the summarised performance and development of the Group:

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Income Statement | | |
| Interest income | 14,241 | 23,900 |
| Rental income | 130,121 | 139,753 |
| Service charge income | 26,131 | 27,912 |
| Decrease in fair value of investment properties | (44,759) | (94,658) |
| Impairment losses | (54,534) | (16,710) |
| Interest expense | (72,820) | (89,582) |
| Service charge and property expenses | (60,804) | (62,007) |
| Other operating expenses | (30,850) | (38,050) |
| Net loss before taxation | (86,583) | (72,446) |
| Net loss after taxation | (85,883) | (81,672) |
| Attributable to Ordinary Shareholders | (86,866) | (81,672) |
| Funds from operations ("FFO") | (40,327) | 24,719 |
| Normalised FFO | 15,842 | (4,987) |
| | | |
| Balance Sheet | | |
| Total assets | 2,317,241 | 2,655,266 |
| Total liabilities | (1,990,261) | (2,363,154) |
| **Net assets** | **326,980** | **292,112** |
| | | |
| Minority interests | (2,842) | - |
| Net (assets) / liabilities of: | | |
| Bridge [1] | (26,016) | - |
| Mars Floating [2] | 30,236 | 15,241 |
| **Adjusted net assets** | **328,358** | **307,353** |

[1] The net asset value of the Bridge portfolio (see note 35) has been excluded in 2013 as this portfolio defaulted in January 2014 and will be deconsolidated. This excludes the €2.6 million of cash that was received by the Group in January 2014.

[2] The negative net asset value of Mars Floating has also been excluded as this financing is non-recourse to the Company and not callable as a result of any changes in the value of the assets.

| | | |
|---|---|---|
| Weighted average number of ordinary shares outstanding (basic) | 26,506,716 | 484,445 |
| Dilutive effect of ordinary share options and convertible securities | 74,895 | 2,713,737 |
| **Weighted average number of ordinary shares outstanding (diluted)** | **26,581,611** | **3,198,182** |
| | | |
| Ordinary shares outstanding [1] | 32,632,502 | 637,129 |
| Fully diluted ordinary shares outstanding [1] | 32,707,397 | 3,332,351 |

[1] The prior period figures have been restated for the share consolidation (ratio of 200:1)

FFO as defined by Eurocastle as at 31 December 2013, represents net profit after taxation (computed in accordance with IFRS), excluding changes in the fair value of investment properties net of attributable deferred taxation, fair value changes of the Italian investments, changes in the fair value of interest rate swaps that are taken to the income statement, unrealised movements on currency swaps (net of translation gains/losses of related assets) and accounting losses on investments made with non-recourse financing to the extent they exceed the net amount invested. The Group considers the realisation of gains and losses on its investments to be a normal part of its recurring operations and therefore does not exclude such gains and losses when arriving at FFO. FFO does not represent cash generated from operating activities in accordance with IFRS and therefore should not be considered an alternative to cash flow as a measure of liquidity, and is not necessarily indicative of cash available to fund cash needs. Eurocastle's calculation of FFO may be different from the calculation used by other companies and, therefore, comparability may be limited.

Normalised FFO is a non-IFRS financial measure used to provide investors with additional information regarding the underlying performance of the Group and its ability to service debt and make capital expenditure. This measure excludes realised gains and losses, sales related costs (including realised swap losses), impairment losses, foreign exchange movements, and accounting adjustments related to the Mars refinancing.

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Key Performance Indicators [1] | | |
| Loss per weighted average basic and diluted share | (3.24) | (168.59) |
| FFO per weighted average basic share | (1.52) | 52.84 |
| Normalised FFO per weighted average basic share | 0.60 | (9.09) |
| Normalised FFO per weighted average diluted share | 0.60 | (9.09) |
| Normalised FFO per fully diluted share | 0.48 | (1.38) |
| Net assets per fully diluted share | 10.00 | 87.66 |
| Real estate net assets per fully diluted share | 4.06 | 59.28 |
| Debt investment portfolio net assets per fully diluted share | 1.56 | 30.25 |
| Adjusted net assets per fully diluted share [2] | 10.04 | 92.23 |
| Adjusted real estate net assets per fully diluted share [2] | 8.48 | 61.98 |
| Reconciliation of Funds from Operations and Normalised Funds from Operations | | |
| Net loss after taxation and minority interests | (86,866) | (81,672) |
| Decrease in fair values of investment properties | 44,759 | 94,658 |
| Net movement in fair value investments | (2,205) | - |
| Realised gain on sale of investment properties | 2,489 | 11,238 |
| Unrealised movements on currency swaps (net of translation gains on related assets) | - | (89) |
| Increase in fair value of interest rate swaps | 4 | (52) |
| Deferred tax charge on investment properties | 890 | 1,515 |
| Eliminate the Funds from Operations attributable to the Mars Floating Portfolio | 602 | (879) |
| **Funds from operations (FFO)** | **(40,327)** | **24,719** |
| Net realised losses / (gains) on investment property sales after sales costs and closure of swaps | 2,488 | (6,651) |
| (Gains) / losses on foreign currency contracts, translation and swaps | (1,424) | 1,796 |
| Impairment losses | 54,534 | 16,710 |
| Realised gain on disposal of loans and receivables | - | (592) |
| Amortisation of costs of Mars Refinancing [3] | - | (5,314) |
| Interest rate swap adjustments | 571 | 2,404 |
| Gain on repurchase of mezzanine financing | - | (885) |
| Gain on transfer of investment in Mars Fixed 1 Portfolio | - | (6,793) |
| Gain on repurchase of debt financing | - | (30,381) |
| **Normalised funds from operations** | **15,842** | **(4,987)** |

(1) The prior period figures have been restated for the share consolidation (ratio 200:1)

(2) Excludes the negative net asset value of Mars Floating as this financing is non-recourse to the Company and not callable as a result of any changes in the value of the assets and the Bridge portfolio net of the cash distribution of €2.6 million.

(3) Represents the economic (non-IFRS) impact of transferring 50% of the Group's equity in the Mars Floating Portfolio to the Lender as part of the Mars Floating restructuring.

**Business Segments**

The table below shows the summarised financial performance of the Group's business segments for the year ended 31 December 2013. This excludes the Mars Floating portfolio. The segmental analysis disclosed in note 33 is prepared according to IFRS and includes the reconciliation of the total to the Group results.

| | European Real Estate Debt [(1)] €'000 | German Real Estate [(1)] €'000 | Italian Investments [(1)] €'000 | Corporate [(1)] €'000 | Total Eurocastle €'000 |
|---|---|---|---|---|---|
| Revenue | 14,419 | 145,772 | 5 | 32 | 160,228 |
| Impairment losses | (54,534) | - | - | - | (54,534) |
| Other operating income / (loss) | 1,535 | (30,729) | 5,268 | (115) | (24,041) |
| Interest expense | (5,278) | (64,344) | (1) | - | (69,623) |
| Other operating expense | (1,968) | (66,394) | (44) | (16,226) | (84,632) |
| **Net operating (loss) / profit before taxation** | **(45,826)** | **(15,695)** | **5,228** | **(16,309)** | **(72,602)** |
| Taxation (expense) / credit | (3) | 791 | (9) | - | 779 |
| **Net operating (loss) / profit after taxation and before minority interes** | **(45,829)** | **(14,904)** | **5,219** | **(16,309)** | **(71,823)** |
| Minority interest in Italian Investments | - | - | (983) | - | (983) |
| **Net (loss) / profit** | **(45,829)** | **(14,904)** | **4,236** | **(16,309)** | **(72,806)** |
| Decrease in fair values of investment properties | - | 33,790 | - | - | 33,790 |
| Increase in fair value of interest rate swaps | 4 | - | - | - | 4 |
| FFO adjustment to Italian Investments | - | - | 2,082 | - | 2,082 |
| Unrealised fair market gains on Italian Investments (after minorities) | - | - | (4,287) | - | (4,287) |
| Deferred tax charge on investment properties | - | 890 | - | - | 890 |
| **Funds from operations (FFO)** | **(45,825)** | **19,776** | **2,031** | **(16,309)** | **(40,327)** |
| Net realised losses on investment property sales after sales costs and | - | 2,488 | | | 2,488 |
| (Gains) / losses on foreign currency contracts, translation and swaps | (1,539) | 571 | - | 115 | (853) |
| Impairment losses | 54,534 | - | - | - | 54,534 |
| Amortisation of costs of Mars Refinancing [(2)] | - | - | - | - | - |
| **Normalised funds from operations** | **7,170** | **22,835** | **2,031** | **(16,194)** | **15,842** |
| Net loss per ordinary share € | (1.40) | (0.46) | 0.16 | (0.50) | (2.20) |
| Net loss per weighted average ordinary share € | (1.73) | (0.56) | 0.20 | (0.62) | (2.71) |
| FFO per weighted average ordinary share € | (1.73) | 0.75 | 0.08 | (0.62) | (1.52) |
| Normalised FFO per weighted average ordinary share € | 0.27 | 0.86 | 0.08 | (0.61) | 0.60 |

(1) Unallocated revenue and other operating expense has been allocated between the segments based on each segment's share of net asset value.

(2) Represents the economic (non-IFRS impact) of transferring 50% of the Group's equity in the Mars Floating Portfolio to the lender as part of the Mars Floating restructuring.

The table below shows the summarised financial performance of the Group's business segments for the year ended 31 December 2013. The segmental analysis disclosed in note 33 is prepared according to IFRS and includes the reconciliation of the total to the Group results.

| | **European Real Estate Debt €'000** | **German Real Estate [(1)] €'000** | **Italian Investments [(2)] €'000** | **Corporate [(2)] €'000** | **Total Eurocastle €'000** |
|---|---|---|---|---|---|
| Investments | 346,787 | 1,228,659 | 12,138 | - | 1,587,584 |
| Other assets (including cash) | 12,384 | 60,970 | 5,846 | 140,313 | 219,513 |
| **Total assets** | **359,171** | **1,289,629** | **17,984** | **140,313** | **1,807,097** |
| Interest-bearing debt financing | (307,430) | (1,058,837) | - | - | (1,366,267) |
| Other liabilities | (495) | (88,497) | (3,882) | (10,163) | (103,037) |
| **Total liabilities** | **(307,925)** | **(1,147,334)** | **(3,882)** | **(10,163)** | **(1,469,304)** |
| **Segment net assets** | **51,246** | **142,295** | **14,102** | **130,150** | **337,793** |
| Tax liability | (1) | (9,434) | - | - | (9,435) |
| **Adjusted net assets** | **51,245** | **132,861** | **14,102** | **130,150** | **328,358** |
| Minority interest | (2) | (4) | 2,848 | - | 2,842 |
| Net assets / (liabilities) of: | | | | | |
| Bridge [(3)] | - | 26,016 | - | - | 26,016 |
| Mars Floating [(4)] | - | (30,236) | - | - | (30,236) |
| **Net assets** | **51,243** | **128,637** | **16,950** | **130,150** | **326,980** |
| Adjusted net asset value per ordinary share € | 1.57 | 4.07 | 0.43 | 3.99 | 10.06 |
| Net asset value per ordinary share € | 1.57 | 3.94 | 0.52 | 3.99 | 10.02 |
| Adjusted net asset value per diluted weighted average ordinary share € | 1.93 | 5.00 | 0.53 | 4.90 | 12.35 |
| Net asset value per diluted weighted average ordinary share € | 1.93 | 4.84 | 0.64 | 4.90 | 12.30 |

(1) The German Real Estate includes the assets and liabilities of the interim holding companies within the structure which has increased the adjusted net assets by €0.2m.

(2) Unallocated assets and liabilities have been allocated to Italian Investments as it represents the net cash available for future investments in this segment.

(3) The net asset value of Bridge has not been adjusted as the financing defaulted on 15 January 2014 and the portfolio has been deconsolidated in 2014 (refer note 35) net of the cash that has been reallocated to Corporate.

(4) The negative net asset value of Mars Floating has been adjusted as this financing is non-recourse to the Company and not callable as a result of any changes in the fair value of the assets.

**Forward-Looking Statements**

This release contains statements that constitute forward-looking statements. Such forward-looking statements may relate to, among other things, future commitments to sell real estate and achievement of disposal targets, availability of investment and divestment opportunities, timing or certainty of completion of acquisitions and disposals, the operating performance of our investments and financing needs. Forward-looking statements are generally identifiable by use of forward-looking terminology such as “may”, “will”, “should”, “potential”, “intend”, “expect”, “endeavour”, “seek”, “anticipate”, “estimate”, “overestimate”, “underestimate”, “believe”, “could”, “project”, “predict”, “continue”, “plan”, “forecast” or other similar words or expressions. Forward-looking statements are based on certain assumptions, discuss future expectations, describe future plans and strategies, contain projections of results of operations or of financial condition or state other forward-looking information. The Group’s ability to predict results or the actual effect of future plans or strategies is limited. Although the Group believes that the expectations reflected in such forward-looking statements are based on reasonable assumptions, its actual results and performance may differ materially from those set forth in the forward-looking statements. These forward-looking statements are subject to risks, uncertainties and other factors that may cause the Group’s actual results in future periods to differ materially from forecasted results or stated expectations including the risks regarding Eurocastle’s ability to declare dividends, amortise the Group’s debts, renegotiate the Group’s credit facilities, make new investments, or achieve its targets regarding asset disposals or asset performance.

**Directors**

The Directors who held office during the year and subsequently were:

Paolo Giorgio Bassi [(1)] (resigned 4 February 2013)
Keith Dorrian [(1)]
Randal A. Nardone
Udo Scheffel [(1)] (resigned 3 February 2014)
Jason Sherwill (1) (appointed 3 February 2014)
Peter Smith
Simon J. Thornton [(1)]

[(1)] Independent Directors

**Directors' Interests**

The interests of the Directors in the ordinary shares of Eurocastle are as follows:

| | As at 31 December 2013 | As at 31 December 2012 [(1)] |
|---|---|---|
| Paolo Giorgio Bassi [(2)] | - | 214 |
| Keith Dorrian | 1,045 | 45 |
| Randal A. Nardone [(3)] | 772,082 | 100 |
| Udo Scheffel | 1,030 | 30 |
| Peter Smith | - | - |
| Simon J. Thornton | 6,547 | 30 |

[(1)] The prior year comparatives have been restated for the share consolidation (ratio 200:1)
[(2)] As at 31 December 2012, Paolo Bassi held 214 shares (after taking into account the share consolidation) in the ordinary share capital of the Company. He resigned on 4 February 2013.
[(3)] Randal A. Nardone is a member of Fortress Operating Entity II LP which is the registered holder of 5,025 shares and as a result of this relationship he is interested in the shares owned by this entity or in some of such shares.

**Substantial Shareholdings**

Per the shareholder register and as at 7 March 2014, the following shareholders had an interest in 3% or more of Eurocastle's share capital:

| | % Holdings |
|---|---|
| Euroclear Nominees Limited | 80.06% |
| The Bank of New York (Nominees) Limited | 9.59% |

The shareholding above has been obtained from the share register. A number of individual shareholders have made a notification of exceeding the reporting thresholds per the Netherlands Authority for Financial Markets (AFM). These notifications can be found at the following website www.afm.nl.

**Auditors**

The Audit Committee completed an external tender process in October 2013 to assess and benchmark the audit engagement. As a result of this process, BDO LLP were appointed external auditors for the Company and Group commencing with the 2013 financial year, following the resignation of Ernst & Young LLP.

**Corporate Governance**

The Directors have applied the principles of the Guernsey Code of Corporate Governance which came into effect from the 1 January 2012.

**Management Agreement**

The Independent Directors have reviewed the continued appointment of the Manager. In carrying out the review, the Independent Directors considered the past performance of the Group and the capability and resources of the Manager to deliver satisfactory investment performance. The Independent Directors also considered the length of notice period of the Management Agreement and the fees payable to the Manager, together with the standard of the other services provided. The Independent Directors have concluded that the continued appointment of the Manager is in the best interest of the shareholders.

**Directors' Statement as to Disclosure of Information to Auditors**

The Directors who were members of the Board at the time of approving the Directors' Report are listed on page 10. Having made enquiries of fellow Directors and of Eurocastle's auditors, each of these Directors confirms that:

- to the best of each Director's knowledge and belief, there is no information (that is, information needed by the Group's auditors in connection with preparing their report) of which Eurocastle's auditors are unaware; and
- each Director has taken all the steps a Director might reasonably be expected to have taken to be aware of relevant audit information and to establish that Eurocastle's auditors are aware of that information.

**Going Concern**

The Directors have prepared the financial statements on a going concern basis which requires the Directors to have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future.

The Directors have reviewed the Group's processes to control those financial risks to which the Group is exposed, as disclosed in note 29 to the consolidated financial statements, as well as reviewing the annual budget.

As a result of this review, the Directors do have a reasonable expectation that the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the consolidated financial statements.

**Directors' Statement pursuant to the Disclosure and Transparency Rules**

Each of the Directors as at 31 December 2013 (whose names are listed on page 10) confirms that, to the best of each person's knowledge and belief:

- the financial statements, prepared in accordance with International Financial Reporting Standards, give a true and fair view of the assets, liabilities, financial position and loss of the Group and the undertakings included in the consolidation as a whole; and
- the Report of the Directors contained in the Annual Report includes a fair review of the development and performance of the business and the position of the Group and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

**Registered Office**

Regency Court
Glategny Esplanade
St. Peter Port
Guernsey
GY1 1WW

*On behalf of the Board*

Simon J. Thornton
Director and Audit Committee Chairman
Date: 12 March 2014

## STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the financial statements in accordance with applicable Guernsey law and generally accepted accounting principles.

Guernsey Company law requires the Directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Group and of the profit or loss of the Group for that period. In preparing these financial statements, the Directors should:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group will continue its business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Group and enable them to ensure that the financial statements comply with the Companies (Guernsey) Law, 2008. They are also responsible for safeguarding the assets of the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the company website. Legislation in Guernsey governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

We have audited the consolidated financial statements of Eurocastle Investment Limited for the year ended 31 December 2013 which comprise the Consolidated Income Statement, the Consolidated Statement of Comprehensive Income, the Consolidated Balance Sheet, the Consolidated Statement of Changes in Equity and the related notes 1 to 36. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards ('IFRSs') as issued by the International Accounting Standards Board.

This report is made solely to the company's members, as a body, in accordance with Section 262 of the Companies (Guernsey) Law, 2008. Our audit work is undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

**Respective responsibilities of Directors and Auditors**

As explained more fully in the Directors' Responsibilities Statement within the Directors' Report, the directors are responsible for the preparation of the consolidated financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the consolidated financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Financial Reporting Council's (FRC's) Ethical Standards for Auditors.

**Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Directors' Report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent misstatements or inconsistencies we consider the implications for our report.

**Opinion of financial statements**

In our opinion the financial statements:

- give a true and fair view of the state of the Group's affairs as at 31 December 2013 and of its loss for the year then ended;
- have been properly prepared in accordance with IFRSs; and
- have been prepared in accordance with the requirements of the Companies (Guernsey) Law, 2008.

**Matters on which we are required to report by exception**

We have nothing to report in respect of the following matters where the Companies (Guernsey) Law, 2008 requires us to report to you if, in our opinion:

- proper accounting records have not been kept; or
- the financial statements are not in agreement with the accounting records; or
- we have failed to obtain all the information and explanations, which, to the best of our knowledge and belief, are necessary for the purposes of our audit.

Michael Goldstein
For and on behalf of BDO LLP
London
Date: 12 March 2014

BDO LLP is a limited liability partnership registered in England and Wales (with registered number OC305127).

## CONSOLIDATED INCOME STATEMENT

| | Notes | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|---|
| **Operating income** | | | |
| Interest income | 3 | 14,241 | 23,900 |
| Rental income | 4 | 130,121 | 139,753 |
| Service charge income | 4 | 26,131 | 27,912 |
| Gain on disposal of loans and receivables | | - | 592 |
| Decrease in fair value of investment properties | 7,19 | (44,759) | (94,658) |
| Gain on repurchase of debt financing | 22 | - | 30,381 |
| (Decrease) / increase in fair value of interest rate swaps | 18 | (4) | 52 |
| Gains on foreign currency contracts, translation and swaps | 8 | 1,424 | - |
| Impairment losses | 9 | (54,534) | (16,710) |
| Fair value movements on Italian debt portfolio | 13 | 5,050 | - |
| Income from joint venture | 15 | 221 | - |
| Gain on repurchase of mezzanine financing | 22 | - | 885 |
| Gain on investment in Mars Fixed 1 portfolio | 14 | - | 6,793 |
| Income from associate | 14 | - | - |
| **Total operating income** | | **77,891** | **118,900** |
| **Operating expenses** | | | |
| Interest expense | 5 | 72,820 | 89,582 |
| Service charge expenses | 4 | 25,240 | 27,045 |
| Property operating expenses | 4 | 35,564 | 34,962 |
| Losses on foreign currency contracts, translation and swaps | 8 | - | 1,707 |
| Other operating expenses | 6 | 30,850 | 38,050 |
| **Total operating expenses** | | **164,474** | **191,346** |
| **Net operating loss before taxation** | | **(86,583)** | **(72,446)** |
| Taxation (credit) / expense - current | 7 | (1,590) | 7,711 |
| Taxation charge - deferred | 7 | 890 | 1,515 |
| **Total tax (credit) / expense** | | **(700)** | **9,226** |
| **Net loss after taxation** | | **(85,883)** | **(81,672)** |
| **Attributable to:** | | | |
| Ordinary equity holders of the Company | | (86,866) | (81,672) |
| Non-controlling interest | | 983 | - |
| **Net loss after taxation** | | **(85,883)** | **(81,672)** |
| **Weighted average loss per ordinary share** | | | |
| Basic and diluted | 25 | (3.24) | (168.59) |

See notes to the consolidated financial statements.

## CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

| | Notes | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|---|
| **Net loss after taxation** | | **(85,883)** | **(81,672)** |
| **Items that may or will be reclassified to profit or loss:** | | | |
| Amortisation of unrealised gains on available-for-sale securities reclassified to loans and receivables with movements released to the income statement | 12 | 8,647 | 9,752 |
| Unrealised gains reclassified to the income statement on disposal of available-for-sale securities, reclassified as loans and receivables | | - | 592 |
| Adjustment to amortisation of unrealised losses reflecting changes in expected cash flows | | (515) | (522) |
| Net unrealised gains released to the income statement on impaired available-for-sale securities reclassified to loans and receivables | 9,12 | (1,353) | (6,798) |
| Realised losses on hedge instruments reclassified to the income statement | 27 | (647) | 61 |
| Amortisation of novated swaps | 27 | (975) | (1,750) |
| | | **5,157** | **1,335** |
| **Items that will not be reclassified to profit and loss:** | | | |
| Unrealised gain on asset backed securities, available-for-sale | 11 | 11,793 | 5,213 |
| Net unrealised gain on hedge instruments | 27 | 6,259 | 4,294 |
| | | **18,052** | **9,507** |
| **Other comprehensive income** | | **23,209** | **10,842** |
| **Total comprehensive loss for the year** | | **(62,674)** | **(70,830)** |
| **Attributable to:** | | | |
| Ordinary equity holders of the Company | | (63,657) | (70,830) |
| Non-controlling interest | | 983 | - |
| **Total comprehensive loss for the year** | | **(62,674)** | **(70,830)** |

See notes to the consolidated financial statements.

There are no tax effects relating to the components disclosed in the consolidated statement of comprehensive income.

## CONSOLIDATED BALANCE SHEET

| | Notes | As at 31 December 2013 €'000 | As At 31 December 2012 (Restated) [1] €'000 | As At 1 January 2012 (Restated) [1] €'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 10 | 193,192 | 141,344 | 117,669 |
| Investment properties held for sale | 19 | 94,402 | 76,510 | 53,152 |
| Other assets | 17 | 32,896 | 24,066 | 22,875 |
| Available-for-sale securities | 11 | 26,879 | 46,098 | 45,543 |
| Loans and receivables | 12 | 316,650 | 409,965 | 448,647 |
| Fair value investments | 13 | 12,315 | - | - |
| Fixture and fittings | 21 | 4 | 55 | 133 |
| Derivative assets | 18 | 10,584 | 13,360 | 13,469 |
| Investment property | 19 | 1,628,104 | 1,943,744 | 2,162,243 |
| Investment in Joint Venture | 15 | 2,173 | - | - |
| Intangible assets | 20 | 42 | 124 | 375 |
| **Total assets** | | **2,317,241** | **2,655,266** | **2,864,106** |
| | | | | |
| **Equity and Liabilities** | | | | |
| | | | | |
| **Capital and reserves** | | | | |
| Issued capital, no par value, unlimited number of shares authorised | 26 | 1,714,425 | 1,446,624 | 1,434,370 |
| Accumulated loss | | (1,399,529) | (1,296,297) | (1,186,680) |
| Net unrealised loss on available-for-sale securities and loans and receivables | 11,12 | (11,976) | (30,548) | (38,785) |
| Hedging reserve | 27 | (870) | (5,507) | (8,112) |
| Perpetual subordinated convertible securities | 28 | - | 160,514 | 144,822 |
| Other reserves | 30 | 22,088 | 17,320 | 17,320 |
| **Total shareholders' equity** | | **324,138** | **292,106** | **362,935** |
| Non-controlling interest | | 2,842 | 6 | 6 |
| **Total equity** | | **326,980** | **292,112** | **362,941** |
| | | | | |
| **Liabilities** | | | | |
| Trade and other payables | 24 | 83,347 | 59,198 | 56,088 |
| Current taxation payable | 7 | 9,678 | 11,249 | 5,230 |
| CDO bonds payable | 22 | 299,912 | 352,905 | 431,700 |
| Bank borrowings | 23 | 1,561,858 | 1,898,045 | 1,974,226 |
| Derivative liabilities | 18 | 5,297 | 12,324 | 19,929 |
| Finance lease payable | 19 | 23,062 | 23,216 | 22,692 |
| Deferred taxation liability | 7 | 7,107 | 6,217 | 4,702 |
| **Total liabilities** | | **1,990,261** | **2,363,154** | **2,514,567** |
| | | | | |
| **Total equity and liabilities** | | **2,317,241** | **2,655,266** | **2,877,508** |

See notes to the consolidated financial statements.

[1] The prior periods have been restated for the reclassification of the Swiss Franc Derivative liability (refer note 18).

The financial statements were approved by the Board of Directors on 12 March 2014 and signed on its behalf by:

Simon J. Thornton
*Director and Audit Committee Chairman*

## CONSOLIDATED CASH FLOW STATEMENT

| | Notes | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|---|
| **Cash flows from operating activities** | | | |
| Operating loss before taxation | | (86,583) | (72,446) |
| Adjustments for non-cash items | | | |
| Interest income | | (9,010) | (15,691) |
| Interest expense | | 65,288 | 86,902 |
| Unrealised (gain) / loss on foreign exchange contracts | | (1,424) | 1,707 |
| Amortisation of discount on securities | | (6,584) | (8,210) |
| Amortisation of borrowing costs | | 7,532 | 2,680 |
| Amortisation of tenant incentives / leasing commissions | | 3,575 | 4,549 |
| Realised loss on disposal of loans and receivables | | - | 592 |
| Realised gain on repurchase of debt financing | 22 | - | (30,381) |
| Realised gain on repurchase of mezzanine financing | 22 | - | (885) |
| Impairment losses | 9 | 54,534 | 16,710 |
| Gain on investment in Mars Fixed 1 Portfolio | 14 | - | (6,793) |
| Amortisation of intangibles | 20 | 82 | 251 |
| Depreciation of fixture and fittings | 21 | 51 | 78 |
| Decrease in fair value of investment properties | 19 | 44,759 | 94,658 |
| Increase in fair value investments | | (5,050) | - |
| Income from Joint Venture | 15 | (221) | - |
| Decrease / (increase) in fair value of interest rate swaps | 18 | 4 | (52) |
| Shares issued to Directors | 26 | 1 | 1 |
| Increase in other assets | | (14,597) | (1,609) |
| Decrease / (increase) in trade and other payables | | 24,218 | (117) |
| **Cash generated from operations** | | **76,575** | **71,944** |
| Dividend paid | | (8,158) | - |
| Interest received | | 10,581 | 19,640 |
| Interest paid | | (55,911) | (87,977) |
| Taxation paid | | (3,858) | (1,692) |
| Net cash flows from operating activities | | **19,229** | **1,915** |
| **Cash flows from investing activities** | | | |
| Capital expenditures / tenant incentives | 19 | (16,524) | (17,460) |
| Proceeds from sale of investment properties | 19 | 270,679 | 112,481 |
| Proceeds from prepayment of available-for-sale securities | | 37,230 | 3,416 |
| Purchase of loans and receivables | | (28,608) | (18,983) |
| Prepayment of loans and receivables | | 51,307 | 83,677 |
| Net cash impact of acquisition in Italian Investments | | (10,038) | - |
| Investment in Joint Venture | | (2,633) | - |
| Cash collections from Fair Value Investments | | 6,080 | - |
| Cash received from Joint Venture | | 681 | - |
| Cash impact of disposal of Mars Fixed 1 Portfolio | 14 | - | 6,793 |
| Net cash flows from investing activities | | **308,174** | **169,924** |
| **Cash flows from financing activities** | | | |
| Issue of share capital net of consolidation and issuance costs | | 103,844 | - |
| Repurchase of mezzanine financing | 22 | - | (8) |
| Payments for the repurchase of bonds issued | 22 | - | (46,640) |
| Cash distributed to minority interests | | (1,458) | - |
| Repayments of bonds issued | | (56,235) | (2,674) |
| Repayments of bank borrowings | | (342,602) | (78,419) |
| Net cashflows from financing activities | | **(296,451)** | **(127,741)** |
| **Net increase in cash and cash equivalents** | | **30,952** | **44,098** |
| **Cash and cash equivalents, beginning of year** | | **141,344** | **117,669** |
| **Restricted CDO cash, beginning of year** | | **20,896** | **473** |
| **Total cash and cash equivalents, beginning of year** | | **162,240** | **118,142** |
| **Cash and cash equivalents, end of year** | 10 | **193,192** | **141,344** |
| **Restricted CDO cash, end of year** | 12 | **-** | **20,896** |
| **Total cash and cash equivalents, end of year** | | **193,192** | **162,240** |

See notes to the consolidated financial statements.

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY**

| | Attributable to equity holder of the Group | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Ordinary shares Number** | **Share capital €'000** | **Other reserves €'000** | **Perpetual subordinated convertible securities €'000** | **Net unrealised gains/(losses) €'000** | **Hedging reserves €'000** | **Accumulated loss €'000** | **Non-controlling interest €'000** | **Total equity €'000** |
| **At 1 January 2012** | **86,577,189** | **1,434,370** | **17,320** | **144,822** | **(38,785)** | **(8,112)** | **(1,186,680)** | **6** | **362,941** |
| Loss for the year | - | - | - | - | - | - | (81,672) | - | (81,672) |
| Other comprehensive income | - | - | - | - | 8,237 | 2,605 | - | - | 10,842 |
| **Total comprehensive income/(loss)** | **-** | **-** | **-** | **-** | **8,237** | **2,605** | **(81,672)** | **-** | **(70,830)** |
| Share issued to Directors (note 26) | 4,000 | 1 | - | - | - | - | - | - | 1 |
| Convertible securities converted into ordinary shares (note 23 and 25) | 40,844,591 | 12,253 | - | (12,253) | - | - | - | - | - |
| Capitalised interest on Convertible Securities issued (note 28) | - | - | - | 27,945 | - | - | (27,945) | - | - |
| **At 31 December 2012** | **127,425,780** | **1,446,624** | **17,320** | **160,514** | **(30,548)** | **(5,507)** | **(1,296,297)** | **6** | **292,112** |
| Loss for the year | - | - | - | - | - | - | (86,866) | 983 | (85,883) |
| Other comprehensive income | - | - | - | - | 18,572 | 4,637 | - | - | 23,209 |
| **Total comprehensive income/(loss)** | **-** | **-** | **-** | **-** | **18,572** | **4,637** | **(86,866)** | **983** | **(62,674)** |
| Share issued to Directors (note 26) | 3,000 | 1 | - | - | - | - | - | - | 1 |
| Capitalised interest on Convertible Securities issued (note 28) | - | - | - | 8,208 | - | - | (8,208) | - | - |
| Convertible securities converted into ordinary shares (note 23 and 25) | 3,398,474,717 | 168,722 | | (168,722) | - | - | - | - | - |
| Share consolidation of ordinary shares (note 26) | (3,508,270,995) | - | - | - | - | - | - | - | - |
| Costs in relation of consolidation of ordinary shares | - | (249) | - | - | - | - | - | - | (249) |
| Issue of ordinary shares (note 26) | 15,000,000 | 108,750 | - | - | - | - | - | - | 108,750 |
| Costs in relation of issue of ordinary shares | - | (4,655) | - | - | - | - | - | - | (4,655) |
| Costs in relation to issue of options following share issue | - | (4,968) | 4,968 | - | - | - | - | - | - |
| Acquisition of Italian Investments net of distributions | - | - | - | - | - | - | - | 1,853 | 1,853 |
| Release of option reserve for lapsed options | - | 200 | (200) | - | - | - | - | - | - |
| Dividend declared (note 31) | - | - | - | - | - | - | (8,158) | - | (8,158) |
| **At 31 December 2013** | **32,632,502** | **1,714,425** | **22,088** | **-** | **(11,976)** | **(870)** | **(1,399,529)** | **2,842** | **326,980** |

See notes to the consolidated financial statements.

## 1. BACKGROUND

Eurocastle Investment Limited ("Eurocastle") was incorporated in Guernsey, Channel Islands on 8 August 2003 and commenced its operations on 21 October 2003. Eurocastle is a Euro denominated Guernsey closed-end investment company listed on Euronext Amsterdam (formerly listed on the London Stock Exchange). On 3 November 2009, the Group ceased to maintain a secondary listing on the Frankfurt Stock Exchange. The activities of the Group include the investing in, financing and managing Italian real-estate investments (including NPLs), German real estate assets and European real estate related debt.

Eurocastle is externally managed by its investment manager, FIG LLC (the "Manager"). Eurocastle has entered into a management agreement (the "Management Agreement") under which the Manager advises the Group on various aspects of its business and manages its day-to-day operations, subject to the supervision of the Group's Board of Directors. For its services, the Manager receives an annual management fee and incentive compensation (as well as reimbursement for expenses, including expenses of certain employees providing property / asset management and finance services), as described in note 32. The Group has no ownership interest in the Manager.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### Statement of compliance

The consolidated financial statements of the Group have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB") and under the historical cost basis except for investment properties, available-for-sale securities and derivative financial investments which are measured at fair value. The financial statements have been prepared under the same accounting principles and methods of computation as in the financial statements as at 31 December 2012 and for the year then ended, except that the Group has adopted the following new and amended IFRS and IAS interpretations as of 1 January 2013:

- IFRS 10 *Consolidated Financial Statements*
- IFRS11 *Joint Arrangements*
- IFRS12 *Disclosure of Interest in Other Entities*
- IFRS13 *Fair Value Measurement*
- IAS 1 *Presentation of Other Comprehensive Income - Amendment to IAS 1*

The adoption of the statements is described below:

### IFRS 10 *Consolidated Financial Statements*

The application of IFRS 10 has not impacted the reported financial position or performance of the Group. However, the assessment of control has changed, but the result is similar to prior conclusions. The Group assessed that its control of undertakings is based on the factors set out in the standard including the Group's power over the investees and the Group's exposure to variable returns.

### IFRS 11 *Joint Arrangements*

The application of IFRS 11 has not impacted the reported financial position or performance of the Group.

### IFRS 12 *Disclosure of Interests in Other Entities*

IFRS 12 sets out the requirements for disclosures relating to an entity's interests in subsidiaries, joint arrangements, associates and structured entities. The additional disclosure requirements in IFRS 12 are set out in these financial statements.

### IFRS 13 *Fair Value Measurement*

IFRS 13 establishes a single source of guidance for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS when fair value is required or permitted. The Group has considered the specific requirements relating to highest and best use, valuation premise, and principal (or most advantageous) market. The methods, assumptions, processes and procedures for determining fair value were revisited and adjusted where applicable. The resulting calculations under IFRS 13 did not affect the principles that the Group uses to assess the fair value, and the assessment of fair value under IFRS 13 has not materially changed the fair values recognised or disclosed. IFRS 13 mainly impacts the disclosures of the Group. It requires specific disclosures about fair value measurements and disclosures of fair values, some of which replace existing disclosure requirements in other standards, including IFRS 7 Financial Instruments: Disclosures. The disclosure requirements of IFRS 13 apply prospectively and need not be provided for comparative periods before initial application. Consequently, comparatives of these disclosures have not been provided.

### IAS 1 *Presentation of Items of Other Comprehensive Income - Amendments to IAS 1*

The amendments to IAS 1 became effective 1 July 2012 and were first applied by the Group on 1 January 2013. The amendments introduce a grouping of items presented in other comprehensive income (OCI). Items that will be reclassified ('recycled') to profit or loss at a future point in time (e.g., net loss or gain on available-for-sale financial assets) have to be presented separately from items that will not be reclassified (e.g., revaluation reserve). The amendment affected presentation only and had no impact on the Group's financial position or performance.

**Basis of consolidation**

The consolidated financial statements comprise the financial statements of Eurocastle Investment Limited and its subsidiaries for the year ended 31 December 2013. Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred from the Group.

At 31 December 2013, the Group's subsidiaries consisted of a number of subsidiaries in Ireland, Italy, Luxembourg and Germany (refer to note 34).

As a result of the Group's investment in the performing and non-performing loan portfolios in Italy (refer notes 13 and 16), it has acquired subsidiaries in Italy, Luxembourg and the United States of America. The Group holds 80.66% of the member's interest in NPL Top Tier Holding LLC ("Ieffe and Palazzo") and 100% of the outstanding notes in FMIL S.r.l. ("BAM"). The investments in the underlying loan portfolios are held through Law 130 securitisation notes.

The Group's investment in the BNL portfolio of non-performing loans is through a joint investment entity in Italy called Quintino Securitisation S.r.l. The financial and operating decisions of this entity require joint agreement and hence is subject to joint control. The results, assets and liabilities of the joint investment entity are incorporated in these financial statements using the equity method. Refer note 15.

Eurocastle Funding Limited ("EFL"), Eurocastle CDO IV PLC ("CDO IV"), Duncannon CRE CDO 1 PLC ("Duncannon") and FECO SUB SPV PLC ("Feco") are all limited companies incorporated in Ireland. The ordinary share capital of these vehicles is held by outside parties and the Group has no voting rights. The Group consolidates EFL, CDO IV, Duncannon and FECO as it retains control over these entities and retains the residual risks of ownership of these entities.

Following the Mars Floating financing restructuring in May 2009, the Group recognised an external liability of 50% of the adjusted amortised cost of the Mars Floating and Mars Fixed 1 portfolio company Loan Notes and Shareholder's loans invested by Eurocastle Investment Limited (EIL), while EIL's transfer of its interest in the loan notes and shareholder's loans on behalf of its Mars subsidiaries is considered to be a cost of refinancing the Mars facility and is hence capitalised and amortised over the life of the new loan facility.

As a result of the Group's transfer in May 2011 of a further 50% of its remaining interest in the shareholder's loans and equity to the Mars Fixed 1 junior lender in respect of the Mars Fixed 1 portfolio refinancing, the Group has deconsolidated its investment in the Mars Fixed 1 portfolio, and values its remaining 25% investment in the loan notes and shareholder loans using the equity method as described under IAS 28 - Investments in Associates. Under the equity method, the investment is carried in the balance sheet at cost plus post-transfer changes in the Group's share of net assets of the associate, less distributions received and less any impairment in value of the individual investments. In 2012, the Group completed the sale of the remaining 25% interest in the Mars Fixed 1 portfolio.

Financial statements of the Mars Fixed 1 portfolio are prepared for the same reporting period as the Group. Where necessary, adjustments are made to bring the accounting policies in line with those used by the Group. Adjustments are also made to the Group's financial statements to eliminate the Group's share of unrealised gains and losses on transactions between the Group and its associates.

**Critical accounting judgements and estimates**

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

The critical accounting judgements and estimates and significant accounting policies are the same as those disclosed in the financial statements for the year ended 31 December 2012 except for the fair value treatment of financial assets detailed in (vi).

**(i) Impairment of available-for-sale investments and loans and receivables**

The Group assesses on a regular basis whether there is any objective evidence of impairment in respect of the available-for-sale investments and loans and receivables portfolios. In determining whether objective evidence of impairment exists, the Group makes judgements as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows. This evidence may include observable significant financial difficulty of the issuer or obligor, defaults or breaches of contract, the probability of the borrower entering bankruptcy or other financial reorganisation, adverse changes in the payment status of the borrowers in a group or external events that would imply a high probability of default and loss.

**(ii) Valuation of available-for-sale investments**

Available-for-sale investments are stated at fair value. The determination of the fair value of available-for-sale investments requires considerable judgement and the consideration of factors such as the nature of the securities, credit rating, quality of collateral, extent of active market and the reputation of the issuers. The fair value is based on indicative dealer price quotations.

**(iii) Valuation of investment properties**

Investment properties are stated at fair value. The determination of fair values requires considerable judgement, and includes certain assumptions, which include passing rent, void periods, yield, relettability, marketability of properties, terms of lease and comparison with similar properties in the real estate market. The fair values are determined based on valuations by external valuers, which are carried out in accordance with the Valuation Standards of the Royal Institution of Chartered Surveyors. Accordingly, the values reflect the physical, economical, legal and regulatory status of the properties based on the information available at the date of valuation. Refer to note 19.

**(iv) Fair value of derivatives**

The fair values of derivatives are determined by using valuation techniques. Where valuation techniques including models are used to determine fair values, they are validated and periodically reviewed by qualified personnel. All models are calibrated to ensure that outputs reflect actual data and comparative market prices. To the extent practical models use only observable data, however, areas such as credit risk (both own and counterparty) and volatilities require management to make estimates. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

**(v) Refinancing of bank borrowings and CDO bonds payable**

Refinancing of bank loans and CDO bonds payable are reviewed to determine if the terms of the new facility are substantially different to the existing terms. The Group makes this determination using the net present value of the cash flows under the new terms discounted at the original effective interest rate compared to the discounted present value of the remaining cash flows under the existing terms. If the comparison exceeds a 10% threshold, the refinancing is considered to be substantially different. The Group also reviews the qualitative changes to the financings (e.g. nature and amount of security, counterparties or change in type of financing) to make their assessment. The Group renegotiated the Drive and Mars Floating term financing and the Duncannon Revolver note assumed the same terms and conditions of the existing Class A note. Both are considered to be a continuance of existing facilities. Refer to note 22 and 23.

**(vi) Financial assets at fair value through profit and loss**

The underlying loan portfolio investments held by the Italian Investment entities are held at fair value through profit and loss on initial recognition. The fair value and changes therein are based on future expected cash flows based on the assumptions of the latest business plan discounted at the internal rate of return at the initial acquisition.

**Financial Instruments**

***Classification***

Financial assets and liabilities classified at fair value through profit or loss include those designated as such in initial recognition, including interest rate swaps, foreign currency swaps and forward foreign exchange contracts that are not designated as effective hedging instruments.

Available-for-sale assets, including restricted cash balances, are financial assets that are not classified as instruments held at fair value through the income statement, loans and advances, or held to maturity.

***Recognition***

All financial assets and liabilities are initially recognised on the trade date, i.e., the date that the Group becomes a party to the contractual provisions of the instrument. This includes regular way trades: purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

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

***Measurement***

Financial instruments are measured initially at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets or liabilities that are not measured at fair value through profit or loss are included in the carrying amount.

Subsequent to initial recognition all instruments that are classified as held at fair value through the consolidated income statement and available-for-sale assets are carried at fair value.

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

***Loans and receivables***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, do not qualify as trading assets and have not been designated as either fair value through profit and loss or available-for-sale. Gains and losses are recognised in income when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

***Reclassification of asset backed securities, available for sale loans and receivables***
Following the amendments to IAS 39 and IFRS 7, "Reclassification of Financial Assets," the Group reclassified all available-for-sale securities within Duncannon to loans and receivables. The Group identified assets, eligible under the amendments, for which at 1 July 2008 it had the intention and the ability to hold to maturity or the foreseeable future. Under IAS 39 as amended, the reclassifications were made with effect from 1 July 2008 at fair value at that date.

For an asset reclassified out of the 'available-for-sale' category, any previous gain or loss on that asset that has been recognised in equity is amortised to profit or loss over the remaining life of the investment. Any difference between the new amortised cost and the expected cash flows is also amortised over the remaining life of the asset using the new effective interest rate. If the asset is subsequently determined to be impaired then the amount recorded in equity is recycled in the income statement.

An analysis of reclassified assets is disclosed in note 12.

***Interest-bearing loans and borrowings (financial liabilities measured at amortised cost)***
Financial assets and liabilities classified at fair value through profit or loss include those designated as such in initial recognition, including interest rate swaps, foreign currency swaps and forward foreign exchange contracts that are not designated as effective hedging instruments.

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

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

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

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

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

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

***Loans and receivables investments***

Loans and receivables investments are carried at amortised cost less provision for impairment. The Group assesses individually each loan and receivable asset to ascertain whether objective evidence of impairment as described above exists.

If there is objective evidence that an impairment loss has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not yet been incurred). The carrying amount of the assets is reduced by the amount of the loss which is recognised in the income statement. Interest income continues to be accrued on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the carrying amount of the asset is amended and the increase or decrease is recognised in the income statement.

The present value of the estimated future cash flows is discounted at the financial asset's original Effective Interest Rate ('EIR'). If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current EIR. If the Group has reclassified available-for-sale assets to loans and receivables, the discount rate for measuring any impairment loss is the new EIR determined at the reclassification date.

***Available-for-sale investments***

Available-for-sale investments are carried at fair value. The Group assesses individually each available-for-sale asset whether objective evidence of impairment as described above exists.

If there is evidence of impairment, the cumulative unrealised loss previously recognised in equity, in net unrealised gains and losses, is removed from equity and recognised in the income statement for the period, reported in net gains / losses on financial assets available-for-sale. This amount is determined as the difference between the acquisition cost (net of any principal repayments and amortisation) and current fair value of the asset less any impairment loss on that investment previously recognised in the income statement.

If, in a subsequent period, the fair value of a debt instrument classified increases and the increase can be objectively related to a credit event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

Future interest income is based on the reduced carrying amount and is accrued using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. The interest income is recorded as part of "Interest Income".

Refer to notes 9, 11 and 12 for details of impairment losses on available-for-sale and loans and receivables investments.

***Hedge accounting***

Hedge accounting is only used where, at the inception of the hedge, there is formal designation and documentation of the hedging relationship and it meets the Group's risk management objective strategy for undertaking the hedge. Where there is a hedging relationship between a derivative instrument and a related item being hedged, the hedging instrument is measured at fair value.

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

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

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

***Joint Ventures***

Jointly controlled entities are those entities over whose activities the Group has joint control established by contractual agreement and requiring unanimous consent for strategic financial and operating decisions. The Group's interest in these entities is consolidated using the equity method in accordance with IFRS 11 - *Joint Arrangements.* The fair value of the investment is based on the underlying investment.

**Derecognition of financial assets and liabilities**

***Financial assets***
A financial asset is derecognised when:

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

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

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

***Financial liabilities***
A financial liability is derecognised when the obligation under the liability is discharged, cancelled or expires.

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

**Cash and cash equivalents**

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

**Restricted cash**

Restricted cash comprises margin account balances held by derivative counterparties as collateral for forward foreign exchange contracts, cash held by the trustees of securitisation vehicles as a reserve for future trustee expenses and cash held as part of the minimum liquidity requirement by property funds. As such, these funds are not available for use by the Group.

**Investment property**

Investment property comprises land and buildings. In accordance with IAS 40, property held to earn rentals and/or for capital appreciation is categorised as investment property. Investment property is measured initially at cost, including transaction costs, and recognised when the customary conditions precedent under the relevant purchase agreement have been satisfied and the purchase price is paid to the vendor. The cost of replacing part of an existing investment property is included in the carrying amount when the cost is incurred, if the recognition criteria are met. Subsequent to initial recognition, investment property is stated at fair value, which reflects market conditions at the balance sheet date. Gains or losses arising from changes in the fair values of investment property is included in the income statement in the year in which they arise. Tenant incentives and leasing commissions are held as other assets and are amortised over the life of the lease.

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

Properties that meet the definition of investment property held under operating leases are accounted for as investment property. In such cases the operating leases are accounted for as if they were finance leases with an associated liability representing the present value of future minimum lease payments included in finance lease liabilities on the balance sheet.

**Leases**

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

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

Other leases are classified as operating leases and the expenses are taken on a straight line basis over the lease term, unless they relate to properties that meet the definition of investment property (please refer to previous page).

Rental income arising from operating leases on investment properties is recognised on a straight-line basis over the lease term. Incentives given to enter into lease agreements are spread evenly over the shorter of the lease term and 5 years as a reduction of rental expense, even if the payments are not made on such a basis.

**Intangible assets**

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

**Fixtures and fittings**

Fixtures and fittings are stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Fixtures and fittings are depreciated on a straight line basis over their expected useful life of 5 years.

**Non-controlling interests**

Non-controlling interests represent interests held by outside parties in the Group’s consolidated subsidiaries.

**Revenue**

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

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

**Service charges**

The Group acts as a principal bearing the risk of under recovering of service costs from its tenants. The service charge income earned from the tenants and the service costs incurred are shown separately in the consolidated income statement.

**Service income**

Service income represents service costs recoverable from tenants and is recognised on the basis of services being provided.

**Service costs**

Service costs represent service contracts entered into for the operation of the property, relating to lettable space for which it has been agreed with tenants to recover these amounts and are recognised on an accruals basis.

**Property expenses**

Property expenses are expenses that are incurred on the property portfolio that are not able to be recovered from tenants or relate to vacant space. Property expenses are recognised on an accruals basis in the consolidated income statement.

**Deferred taxation**

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

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

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

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

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

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

**Foreign currency translation**

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

**Share-based payments**

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

Shares granted to Directors are recognised in the income statement over the period that the services are received.

**Perpetual subordinated convertible securities**

Perpetual subordinated convertible securities comprise the issuance of convertible securities, which are convertible into fully paid ordinary shares. The convertible securities and accrued interest are accounted for in equity under the guidance of IAS 32 as Eurocastle as the Issuer holds the option to redeem the securities (principal and interest), and does not have a present obligation to transfer financial assets to the shareholder. The redemption of the securities is solely at the discretion of Eurocastle.

**Standards and interpretations that have been issued with an effective date after the date of these financial statements:**

The IASB and International Financial Reporting Interpretations Committee ("IFRIC") have issued a number of standards and interpretations with an effective date after the date of these financial statements. The Directors have set out below only those which may have a material impact on the financial statements in future periods.

IFRS 9, as issued in 2010, reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January 2013. In November 2013, Chapter 6 of IFRS 9 on hedge accounting was published. At the same time, Chapter 7 containing the effective date and transition provisions was amended to remove the mandatory effective date of IFRS 9. This was intended to provide sufficient time for preparers to make the transition to the new requirements. Entities may still choose to apply IFRS 9 immediately, but are not required to do so. In subsequent phases, the IASB is addressing impairment of financial assets. The adoption of the first phase of IFRS 9 will have an effect on the classification and measurement of the Group's financial assets, but will not have an impact on classification and measurements of financial liabilities. The Group will quantify the effect in conjunction with the other phases, when the final standard including all phases is issued.

The amendments to IFRS 10, IFRS 12 and IAS 27 provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries at fair value through profit or loss. These amendments are effective for annual periods beginning on or after 1 January 2014. It is not expected that this amendment would be relevant to the Group, since none of the entities in the Group would qualify to be an investment entity under IFRS 10.

The amendments to IAS 32 clarify the meaning of "currently has a legally enforceable right to set-off". The amendments also clarify the application of the IAS 32 offsetting criteria to settlement systems (such as central clearing house systems) which apply gross settlement mechanisms that are not simultaneous. These amendments are not expected to impact the Group's financial position or performance and will become effective for annual periods beginning on or after 1 January 2014.

**Amendment to presentation of derivative assets and liabilities**

The foreign currency swap contract contains a Pound Sterling and Swiss Franc leg which is underwritten by individual positions in either currency. The facility does not allow the set-off of individual positions against each other. As such, the separate currency legs should be disclosed on a gross basis. There is no impact to the profit and loss in prior periods. The derivative asset and liability has been restated by €3.6 million in 2012 and €6.7 million in 2011. Refer note 18. The segmental analysis (refer note 33) for 2012 has also been restated.

## 3. INTEREST INCOME

Included in interest income for the year ended 31 December 2013 is €14.2 million (31 December 2012: €23.9 million) of interest income earned on the available-for-sale securities and loans and receivables. Interest income for the year ended 31 December 2013 includes interest calculated using the EIR method of €12.7 million (31 December 2012: €23.8 million). Coupon interest earned of €7.4 million (31 December 2012: €14.3 million) is split between available-for-sale securities (€0.8 million), loans and receivables (€4.0 million), and real estate related loans (€2.6 million) (31 December 2012: €1.6 million, €6.3 million, and €6.4 million respectively).

Interest earned using the EIR method on impaired assets for the year ended 31 December 2013 of €2.2 million (31 December 2012: €2.5 million) includes €nil interest on available-for-sale securities, interest on loans and receivables of €1.0 million, and interest on real estate related loans of €1.2 million (31 December 2012: €nil million, €1.8 million, and €0.7 million respectively).

Interest income includes the effect of amortisation of the available-for-sale securities reserve amounting to €8.6 million (31 December 2012: €9.2 million) as a result of reclassification of available-for-sale securities to loans and receivables. This amortisation is offset by the accretion of the carrying value of the reclassified loans and receivables, resulting in a net nil impact on the income statement. The amortisation and accretion have been adjusted to reflect changes in the anticipated cash flows.

## 4. RENTAL INCOME / PROPERTY OPERATING EXPENSE / SERVICE CHARGE INCOME AND EXPENSE

### 4.1 Rental income

Rental income for the year ended 31 December 2013 of €130.1 million (31 December 2012: €139.8 million) represents rental income earned on investment properties.

### 4.2 Property operating expense

Property operating expenses (including repairs and maintenance) arising from investment properties that generated rental income for the year ended 31 December 2013 were €35.6 million (31 December 2012: €35.0 million). Included within property operating expenses is the amortisation of leasing commissions and tenant incentives for the year of €3.6 million (31 December 2012: €4.5 million) and fund costs relating to the Drive portfolio of €3.7 million (31 December 2012: €2.0 million).

### 4.3 Service charge income and expense

Service charge income for the year ended 31 December 2013 of €26.1 million (31 December 2012: €27.9 million) represents the service costs recoverable from tenants.

Service charge expense for the year ended 31 December 2013 of €25.2 million (31 December 2012: €27.0 million) represents the costs of operating the properties that are recoverable from tenants.

## 5. INTEREST EXPENSE

Interest expense for the year ended 31 December 2013 of €72.8 million (31 December 2012: €89.6 million) comprises interest expense incurred on the CDO bonds payable and bank borrowings amounting to €3.6 million and €68.6 million (31 December 2012: €6.1 million and €83.5 million) respectively. Interest expense is calculated using the EIR method.

Included within the interest expense for the year are losses on the termination of interest rate swaps of €0.6 million (31 December 2012: €2.4 million) and capitalised financing costs written off of €0.4 million (31 December 2012: €nil million) relating to the sale of investment property.

Interest expense also includes a €nil credit (31 December 2012: €5.3 million credit) relating to the release of a portion of the amortisation charge with respect to the Mars Floating portfolios (refer to note 23.1).

## 6. OTHER OPERATING EXPENSES

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Professional fees | 1,140 | 944 |
| Sale related costs | 5,431 | 4,233 |
| Management fees (note 32) | 9,727 | 21,819 |
| Net Manager Recharge (1) | 5,372 | 6,752 |
| Amortisation of financing costs | 6,416 | 2,680 |
| Amortisation of discount/premium | 1,116 | 599 |
| Depreciation of fixtures and fittings | 51 | 78 |
| Amortisation of intangible assets | 82 | 251 |
| General and administrative expenses | 1,515 | 694 |
| **Total other operating expenses** | **30,850** | **38,050** |

(1) Included within the Net Manager recharge for the year ended 31 December 2012 is a €1.0 million termination fee for the Mars Fixed 1 portfolio.

## 7. TAXATION (CREDIT) / EXPENSE

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Current tax (credit) / expense | | |
| Germany | (602) | 6,104 |
| Luxembourg | (988) | 1,607 |
| **Total current tax** | **(1,590)** | **7,711** |
| Deferred tax charge | | |
| Germany | 890 | 1,515 |
| Luxembourg | - | - |
| **Total deferred tax** | **890** | **1,515** |
| **Total tax (credit) /expense** | **(700)** | **9,226** |

There are currently no tax expenses in Italy.

**Reconciliation of total tax expense**

The Group is exempt from Guernsey income tax. The tax expense in the consolidated income statement for the year ended is higher than the Group's Guernsey income tax rate of 0%. The difference is reconciled below:

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Net loss before taxation | (86,583) | (72,446) |
| Tax on ordinary activities based on Guernsey tax of 0% (31 December 2012: 0%) | - | - |
| Overseas taxation expense - Germany | 288 | 7,619 |
| Overseas taxation expense - Luxembourg | (988) | 1,607 |
| **Total tax (credit) /expense** | **(700)** | **9,226** |

**Analysis of deferred tax:**

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Tax losses carried forward / (utilised) | 1,881 | (544) |
| **Temporary differences** | | |
| Loan expense | 5 | (80) |
| Tenant improvements and leasing commissions | 34 | (95) |
| Accelerated capital allowance | 5,508 | 660 |
| Revaluation of investment properties [1] | (5,164) | 5 |
| Capital expenditure | 358 | (5) |
| Disposal of investment properties | - | 1,599 |
| Other | (1,732) | (25) |
| **Deferred tax charge** | **890** | **1,515** |

(1) This represents deferred tax on the difference between the fair value and the German tax book value of the investment properties, except the Drive portfolio as the Group’s investment in the underlying properties in relation to the Drive portfolio is by way of units in an open ended real estate fund. No corporation tax is due on income generated or revaluation gains from its investment in the Drive portfolio.

**Deferred tax on revaluation of investment properties**

| Portfolio | Year ended 31 December 2013 (decrease) / increase in fair values €'000 | Year ended 31 December 2013 deferred tax asset / (liability) €'000 | Year ended 31 December 2012 (decrease) / increase in fair values €'000 | Year ended 31 December 2012 deferred tax asset / (liability) €'000 |
|---|---|---|---|---|
| Mars [1] | (15,653) | - | (24,863) | - |
| Drive | (22,099) | - | (51,472) | - |
| Wave | 7,343 | 273 | 12,227 | 610 |
| Zama | 21 | - | 286 | - |
| Bridge | (8,420) | - | (19,389) | - |
| Retail | (5,951) | (5,437) | (11,447) | (605) |
| **Total** | **(44,759)** | **(5,164)** | **(94,658)** | **5** |

(1) The Mars portfolio consists of 23 entities, of which 8 hold investment properties. Deferred tax represents the tax on the valuation losses / gains at the individual entity level.

**Breakdown of taxation liability:**

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Split between: | | |
| Current tax | 9,678 | 11,249 |
| Deferred tax | 7,107 | 6,217 |
| **Closing taxation payable** | **16,785** | **17,466** |

**Reconciliation of total tax charge:**

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| **Loss before tax** | (86,583) | (72,446) |
| **Tax at domestic tax rates applicable to profits in the respective countries** | - | - |
| Tax effect of revaluation of investment properties | (5,164) | 5 |
| Tax effect on timing differences | 5,905 | 480 |
| Tax effect of tax losses | 1,881 | (544) |
| Other [1] | (3,322) | 9,285 |
| **Total tax expense** | **(700)** | **9,226** |

(1) Includes current taxes credits relating to Germany and Luxembourg of €0.6 million and €1.0 million (31 December 2012 current tax charges of €6.1 million and €1.6 million) respectively.

**Deferred tax liabilities are attributed to the following:**

| | 2013 | | | 2012 | | |
|---|---|---|---|---|---|---|
| | **Assets** | **Liabilities** | **Net** | **Assets** | **Liabilities** | **Net** |
| | **€'000** | **€'000** | **€'000** | **€'000** | **€'000** | **€'000** |
| Loan expense | 9 | (145) | (136) | 30 | (161) | (131) |
| Tenant improvement and leasing commissions | - | (112) | (112) | - | (78) | (78) |
| Accelerated capital allowance | - | (12,779) | (12,779) | - | (7,271) | (7,271) |
| Revaluation of investment properties | 8,560 | (2,038) | 6,522 | 3,123 | (1,765) | 1,358 |
| Capital expenditure | - | (1,980) | (1,980) | - | (1,622) | (1,622) |
| Tax value of recognised losses | 1,385 | - | 1,385 | 3,266 | - | 3,266 |
| Short-term temporary differences | 212 | (219) | (7) | 15 | (1,754) | (1,739) |
| **Net deferred tax asset / (liability)** | **10,166** | **(17,273)** | **(7,107)** | **6,434** | **(12,651)** | **(6,217)** |

Deferred tax liabilities are presented net of deferred tax assets where the legal right of offset exists.

**Unrecognised tax losses**

The Group has tax losses which arose in Germany of €113.1 million (31 December 2012: €254.9 million) that are available indefinitely for offset against future taxable profits of the companies in which the losses arose. Included in this amount for 2013, is €41.1 million with respect to the Bridge Portfolio (please refer to note 35). A deferred tax asset of €27.0 million (31 December 2012: €18.7 million) has not been recognised in respect of those losses as they may not be used to offset taxable profits elsewhere in the Group and they have arisen in subsidiaries that have been loss-making for some time.

The taxation expense for the year ended 31 December 2013 relates to the Group’s Luxembourg and German subsidiary companies. The Company is a Guernsey, Channel Islands limited company and is not subject to taxation. The Company’s subsidiaries, EFL, CDO IV, Duncannon and Feco, are Irish registered companies and are structured to qualify as securitisation companies under section 110 of the Taxes Consolidation Act 1997. It is envisaged that these companies will generate minimal net income for Irish income tax purposes and no provision for income taxes has been made for these companies.

The Group’s German subsidiary companies, Longwave and Shortwave, are subject to German corporate income tax ("CIT") plus Solidarity Surcharge and German trade tax (TT) on income arising from their investment properties, after the deduction of allowable debt financing costs and other allowable expenses. The taxation accrual for the year ended 31 December 2013 includes a provision relating to these subsidiaries.

The Group’s subsidiaries Bridge, Turret, Mars, Zama (Huk), Tannenberg and Superstella are also subject to CIT on rental income net of interest and other expense deductions on an accruals basis.

The Group’s subsidiaries Belfry and Truss are transparent entities for tax purposes. The partners are subject to CIT on rental income net of interest and other expense deductions on an accruals basis. Foreign corporations with rental income have to compute the taxable income on an accruals basis.

The Group’s investment in the underlying properties in relation to the Drive portfolio and the Real Estate Fund Units is by way of units in an open-ended real estate fund. No corporation tax is due on income generated or revaluation gains from its investment in these units before 30 September 2011. Due to an amendment of the tax law foreign corporations, partners of an open-ended real estate fund are now liable for CIT which will be held by the underlying fund.

The Group’s Luxembourg subsidiaries are subject to Luxembourg tax on the net income earned within these subsidiaries.

The Group's Italian subsidiaries are not subject to Italian tax. The Group's investment in the Law 130 notes are also not subject to Italian tax .

## 8. GAINS / (LOSSES) ON FOREIGN CURRENCY CONTRACTS, TRANSLATION AND SWAPS

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Fair value movements in currency swaps[1] | (2,776) | (10,378) |
| Foreign currency translation gains on assets subject to currency swaps [1] | 715 | 8,937 |
| **Sub-total** | **(2,061)** | **(1,441)** |
| Other currency gains / (losses) | 3,485 | (266) |
| **Total currency gains / (losses)** | **1,424** | **(1,707)** |

[1] The foreign currency swaps are disclosed in note 18.

## 9. IMPAIRMENT LOSSES

| | Year ended 31 December 2013 €'000 | Year ended 31 December 2012 €'000 |
|---|---|---|
| Impairment losses on loans and receivables | 20,373 | 11,060 |
| Impairment losses on real estate related loans | 35,514 | 12,448 |
| Realisation of previously unrealised losses on impaired loans and receivables previously held as available for sale | (1,353) | (6,798) |
| **Total impairment losses** | **54,534** | **16,710** |

During the year ended 31 December 2013, the Group has recognised impairment losses on 24 securities (31 December 2012: 21 securities). As at 31 December 2013, 29 securities have recognised impairment losses (31 December 2012: 25 securities).

The carrying value of the impaired securities or loans as at 31 December 2013 after the impairment losses was €109.6 million (31 December 2012: €82.8 million).

## 10. CASH AND CASH EQUIVALENTS

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Corporate cash | 139,086 | 38,838 |
| Cash within Italian Investments | 6,745 | - |
| Cash within the real estate operating companies | 43,255 | 98,366 |
| Cash within the CDO vehicles | 4,106 | 4,140 |
| **Total cash and cash equivalents** | **193,192** | **141,344** |

Cash within the real estate operating companies is held to cover interest obligations, operating expenses and other working capital. It also includes any proceeds from the disposal of investment property that has not been distributed or used to amortise bank borrowings. The amount excludes the €2.6 million of cash within the Bridge Portfolio which was released to the Group in 2014 following the default of the facility (refer note 35). This amount has been recorded as Corporate cash.

The cash within the CDO vehicles is restricted to repaying CDO interest as it falls due or for repayment of debt within the CDO. The reinvestment period for Duncannon ended on 20 June 2013 and, as a consequence, principal cash flows received on its assets are now diverted to repay senior debt.

Cash within Italian Investments is held to cover distributions, operating expenses and other working capital. It includes €2.5 million which is to be distributed to the minority interests in 2014.

## 11. ASSET BACKED SECURITIES AVAILABLE-FOR-SALE

The following is a summary of the Group's available-for-sale securities at 31 December 2013:

| | | | Gross unrealised | | | Weighted average | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Current face amount €'000** | **Amortised cost base €'000** | **Gains €'000** | **Losses €'000** | **Carrying value €'000** | **Average rating [1]** | **Coupon %** | **Margin %** | **Maturity (years)** |
| **Portfolio IV** | | | | | | | | | |
| CMBS | 26,385 | 26,286 | - | (676) | 25,609 | BBB | 0.96% | 0.53% | 2.18 |
| Other ABS | 1,205 | 1,205 | - | (74) | 1,131 | BBB- | 2.25% | 2.05% | 14.01 |
| | 27,590 | 27,491 | - | (750) | 26,740 | BBB | 1.01% | 0.59% | 2.43 |
| **Other securities** | | | | | | | | | |
| CMBS | 6,930 | 673 | - | (534) | 139 | D | 2.92% | 2.70% | - |
| | 6,930 | 673 | - | (534) | 139 | D | 2.92% | 2.70% | - |
| **Total portfolio** | **34,520** | **28,164** | **-** | **(1,284)** | **26,879** | **BB+** | **1.40%** | **1.02%** | **1.94** |

The following is a summary of the Group's available-for-sale securities at 31 December 2012:

| | | | Gross unrealised | | | Weighted average | | | |
|---|---|---|---|---|---|---|---|---|---|
| | **Current face amount €'000** | **Amortised cost base €'000** | **Gains €'000** | **Losses €'000** | **Carrying value €'000** | **Average rating [1]** | **Coupon %** | **Margin %** | **Maturity (years)** |
| **Portfolio IV** | | | | | | | | | |
| CMBS | 57,940 | 57,625 | - | (12,383) | 45,242 | BB+ | 0.75% | 0.71% | 2.45 |
| Other ABS | 1,232 | 1,232 | - | (514) | 718 | BBB- | 2.21% | 2.05% | 13.01 |
| | 59,172 | 58,857 | - | (12,897) | 45,960 | BB+ | 0.78% | 0.74% | 2.66 |
| **Other securities** | | | | | | | | | |
| CMBS | 6,930 | 318 | - | (180) | 138 | D | 2.89% | 2.70% | 3.33 |
| | 6,930 | 318 | - | (180) | 138 | D | 2.89% | 2.70% | 3.33 |
| **Total portfolio** | **66,102** | **59,175** | **-** | **(13,077)** | **46,098** | **BB** | **1.00%** | **0.95%** | **2.73** |

[1] Average ratings are calculated by reference to the lowest rating currently assigned to each loan or security by any of Moody's Investor Services, Standard & Poor's, and Derivative Fitch and an arithmetic mean weighted by the current face amount of each loan or security.

## 12. LOANS AND RECEIVABLES

The following is a summary of the Group's loans and receivables as at 31 December 2013:

| | Current face amount €'000 | Amortised cost basis €'000 | Impairment losses €'000 | Carrying value €'000 | Weighted average: Average rating [1] | Coupon % [2] | Margin % | Maturity (years) |
|---|---|---|---|---|---|---|---|---|
| **Portfolio IV** | | | | | | | | |
| Real estate related loans | 11,425 | 11,428 | (3,801) | 7,627 | D | 0.63% | 2.30% | 3.01 |
| | 11,425 | 11,428 | (3,801) | 7,627 | D | 0.63% | 2.30% | 3.01 |
| **Portfolio V [3]** | | | | | | | | |
| CMBS | 225,457 | 193,684 | (35,691) | 157,993 | B- | 1.10% | 0.88% | 3.40 |
| Other ABS | 44,171 | 40,744 | - | 40,744 | BB | 2.52% | 1.84% | 6.49 |
| Real estate related loans | 204,105 | 204,020 | (94,568) | 109,452 | C | 0.70% | 2.72% | 1.63 |
| | 473,733 | 438,448 | (130,259) | 308,189 | CCC | 1.06% | 1.76% | 2.93 |
| **Other securities** | | | | | | | | |
| Real estate related loans | 17,486 | 3,311 | (2,477) | 834 | D | 1.24% | 2.47% | 0.84 |
| | 17,486 | 3,311 | (2,477) | 834 | D | 1.24% | 2.47% | 0.84 |
| **Total portfolio** | **502,644** | **453,187** | **(136,537)** | **316,650** | **CCC** | **1.06%** | **1.80%** | **2.86** |

| | |
|---|---|
| Restricted cash - cash to be invested | - |
| **Total loans and receivables (including cash to be invested)** | **316,650** |

**As at 31 December 2012:**

| | Current face amount €'000 | Amortised cost basis €'000 | Impairment losses €'000 | Carrying value €'000 | Weighted average: Average rating [1] | Coupon % [2] | Margin % | Maturity (years) |
|---|---|---|---|---|---|---|---|---|
| **Portfolio IV** | | | | | | | | |
| Real estate related loans | 13,185 | 13,188 | (3,474) | 9,714 | CC | 2.16% | 2.30% | 1.42 |
| | 13,185 | 13,188 | (3,474) | 9,714 | CC | 2.16% | 2.30% | 1.42 |
| **Portfolio V [2]** | | | | | | | | |
| CMBS | 246,823 | 204,570 | (15,391) | 189,179 | B | 1.10% | 4.45% | 3.45 |
| Other ABS | 41,419 | 36,731 | (4,776) | 31,955 | B+ | 1.91% | 1.17% | 5.60 |
| Real estate related loans | 240,573 | 240,922 | (83,987) | 156,935 | CCC- | 2.67% | 2.69% | 2.11 |
| | 528,815 | 482,223 | (104,154) | 378,069 | B- | 1.88% | 3.39% | 3.01 |
| **Other securities** | | | | | | | | |
| Real estate related loans | 23,413 | 8,433 | (7,147) | 1,286 | CCC- | 1.84% | 2.92% | 1.24 |
| | 23,413 | 8,433 | (7,147) | 1,286 | CCC- | 1.84% | 2.92% | 1.24 |
| **Total portfolio** | **565,413** | **503,844** | **(114,775)** | **389,069** | **B-** | **1.88%** | **3.35%** | **2.90** |

| | |
|---|---|
| Restricted cash - cash to be invested | 20,896 |
| **Total loans and receivables (including cash to be invested)** | **409,965** |

(1) Average Ratings are calculated by reference to the lowest rating currently assigned to each loan or security by any of Moody's Investor Services, Standard & Poor's, and Derivative Fitch and an arithmetic mean weighted by the current face amount of each loan or security.

(2) Weighted average coupon rates exclude any coupon for assets that are impaired for which the Group does not accrue coupon interest income. The Group recognises any coupon interest received on impaired assets on a cash-received basis.

(3) The securities within Portfolio V are encumbered by CDO securitisations (note 22).

Following the amendments to IAS 39, “Reclassification of Financial Assets”, the Group reclassified all available-for-sale securities within Duncannon to loans and receivables. The Group identified assets, eligible under the amendments, for which at 1 July 2008 it had the intention and the ability to hold for maturity or the foreseeable future. Under IAS 39 as amended, the reclassifications were made with effect from 1 July 2008 at fair value at that date which amounted to €1.1 billion. The disclosures below detail the impact of the reclassifications to the Group.

The following table shows carrying values and fair values of the reclassified assets:

| | At 01 July 2008 Carrying Value €'000 | At 31 December 2013 Carrying Value €'000 | At 31 December 2012 Carrying Value €'000 | At 31 December 2013 Fair Value €'000 | At 31 December 2012 Fair Value €'000 |
|---|---|---|---|---|---|
| Available-for-sale securities, reclassified to loans and receivables | 1,077,560 | 115,328 | 143,401 | 78,996 | 82,340 |

As of the reclassification date, the effective interest rate on the reclassified available-for-sale securities was approximately 12%, with expected recoverable cash flows of €1.3 billion. The effective interest rate was determined on an asset-by-asset basis.

If the reclassification had not been made, Eurocastle’s income statement for 2013 would have included €15.3 million on the reclassified available-for-sale securities of impairment losses, compared with impairment reversals of €11.1 million after the reclassification. During 2013, shareholders' equity (net losses not recognised in the income statement) would have included €13.3 million of changes in unrealised fair value gains in respect of reclassified available-for-sale securities which were not impaired between 1 July 2008 and 31 December 2012.

After reclassification, the reclassified financial assets contributed the following amounts to income for the year ended 31 December 2013:

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Net interest income | 2,742 | 4,705 |
| Impairment losses on securities classified as loans and receivables | (54,534) | (16,710) |
| **Losses on available-for-sale securities reclassified to loans and receivables** | **(51,792)** | **(12,005)** |

As of the reclassification dates, unrealised fair value losses recorded directly in shareholders’ equity amounted to €283.3 million. This amount will be released from shareholders’ equity to the income statement on an effective interest rate basis.

After the reclassification, if the asset subsequently becomes impaired the amount recorded in shareholders’ equity relating to the impaired asset is released to the income statement at the impairment date. During 2013, €1.4 million of unrealised fair value gains have been released to the income statement for impaired reclassified financial assets available-for-sale (31 December 2012: €6.8 million of losses). Additionally, €8.6 million (31 December 2012: €9.2 million) of amortisation of the available-for-sale securities reserve has been released from shareholders equity as a result of the reclassification of available-for-sale securities to loans and receivables. This amortisation has been adjusted by €0.5 million to reflect changes in the expected cash flows (31 December 2012: €0.5 million).

At 31 December 2013, the net unrealised loss on loans and receivables was €10.7 million (31 December 2012: €13.1 million).

The movement in the impairment losses is shown below:

| | 2013 €'000 | 2012 €'000 |
|---|---|---|
| Balance as at 1 January | (114,775) | (112,652) |
| Reversals due to paydowns and sales in the year | 30,681 | 19,901 |
| Losses for the year | (55,943) | (46,227) |
| Reversals for the year | 3,500 | 24,203 |
| **Balance at 31 December** | **(136,537)** | **(114,775)** |

## 13. FAIR VALUE INVESTMENTS

| | Gross book value €'000 | Cost €'000 | Fair value €'000 | No. of borrowers | Weighted average life [(1)] (years) | Effective rate [(2)] % |
|---|---|---|---|---|---|---|
| **Non-performing loans** | | | | | | |
| Ieffe | 3,279,865 | 3,945 | 2,324 | 5,476 | 1.78 | 81.8% |
| Ieffe Due | 88,033 | 1,825 | 1,079 | 297 | 1.85 | 21.9% |
| Ieffe Tre | 649,438 | 5,648 | 4,038 | 1,498 | 2.21 | 25.1% |
| BAM | 12,422 | 203 | 165 | 19 | 2.78 | 12.4% |
| **Total non-performing loans** | **4,029,758** | **11,621** | **7,606** | **7,290** | **1.80** | **41.5%** |
| | | | | | | |
| **Performing loans** | | | | | | |
| Palazzo | 10,046 | 5,696 | 4,709 | 869 | 1.33 | 37.5% |
| **Total performing loans** | **10,046** | **5,696** | **4,709** | **869** | **1.33** | **37.5%** |
| | | | | | | |
| **Total portfolio** | **4,039,804** | **17,317** | **12,315** | **8,159** | **1.88** | **38.0%** |

(1) At the acquisition date

(2) Effective rate represents current estimated internal rate of return given cash flows received to date and projected cash flows based on the original underwriting assumptions.

The movement in fair value investments is as follows:

| | 2013 | | | | |
|---|---|---|---|---|---|
| | **Group** | **Minority interest** | **Total Ieffe and Palazzo** | **BAM** | **Total Portfolio** |
| Balance as at 1 January | - | - | - | - | - |
| Acquisition of portfolios | 13,804 | 3,310 | 17,114 | 203 | 17,317 |
| Cash received within portfolios | (8,109) | (1,943) | (10,052) | - | (10,052) |
| Increase in fair value | 4,104 | 983 | 5,087 | (37) | 5,050 |
| **Balance as at 31 December** | **9,799** | **2,350** | **12,149** | **166** | **12,315** |

On 22 May 2013, the Group acquired the Ieffe and Palazzo portfolios for €13.8 million. On the same date, the Group acquired the BAM portfolio for a total consideration of €0.2 million (refer note 16). These portfolios were acquired from a related party fund of the Manager and subject to an independent valuation to determine the purchase price. The Group acquired the BNL portfolio on 31 July 2013 for €2.6 million through a joint venture entity; please refer to note 15.

The non-performing loan portfolios are partly secured by residential and commercial properties, judicial mortgages and personal guarantees in Italy.

The performing loan portfolio is secured by residential and commercial properties in Italy.

All portfolios are serviced by Italfondiario S.p.A. a related party to the Manager (refer note 32).

The minority interest in the fair value of the portfolios is €2.9. million.

The fair value of the investments is based on internal valuation models. The assumptions used in the models are based on cash flows (actual and projected) provided by the Servicer of the portfolios as per the latest business plan. The Servicer uses market knowledge and historical performance as a basis for the projections. These projections are reviewed and updated on a quarterly basis. The cashflows are discounted at the internal rate of return at the initial acquisition.

Gains and losses recorded in profit or loss for recurring fair value measurements categorised within Level 3 of the fair value hierarchy amount to €5.1 million (31 December 2012: €nil million) and are presented in the Group income statement in the line item "Fair value movements on Italian debt portfolio".

The major inputs to the external valuation process are verified by senior management who also assess the individual property valuation changes from the prior period valuation report and hold discussions with the external valuers. When this process is complete, the valuation report is recommended to the Audit Committee, which considers it as part of its overall responsibilities.

The significant assumptions made relating to the valuations are set out below:

| | Non-performing loans | Performing loans |
|---|---|---|
| Total projected cashflows (€'000) | 9.5 | 4.5 |
| Weighted average life (years) | 2.0 | 1.3 |
| Internal rate of return | 19.9% | 17.1% |

**Sensitivity analysis**

The table below presents the sensitivity of the valuation to changes in the most significant assumptions underlying the valuation of fair value investments:

| | Non-performing loans €'000 | Performing loans €'000 | Total €'000 |
|---|---|---|---|
| Fair value | 7,606 | 4,709 | 12,315 |
| Increase in internal rate of return by 25bps | 7,570 | 4,699 | 12,269 |
| **Value sensitivity** | **(36)** | **(10)** | **(46)** |

### 14. INVESTMENT IN ASSOCIATE

On 4 April 2012, the Group sold its remaining 25% interest in the Mars Fixed 1 portfolio. The profit on disposal was €6.8 million. The Associate reported an unaudited loss of €21.8 million for the period ending 4 April 2012 of which the Group recognised €nil as the investment was carried at €nil value.

### 15. INVESTMENT IN JOINT VENTURE

On 31 July 2013, the Group acquired a 50% share in a non-performing loan portfolio. The Group's share of the investment was €2.6 million. The portfolio is mainly comprised of residential first lien mortgages with a gross book value of €13.6 million. The Group's investment was made through a joint investment entity in Italy called Quintino Securitisation S.r.l. ("BNL"). This entity is a securitisation vehicle which has issued Italian Law 130 securitisation notes. The joint venture partner is a credit fund managed by an affiliate of the Manager.

The following table summarises the consideration paid and the amounts of the share of net assets acquired recognised at 31 July 2013:

| | BNL €'000 |
|---|---|
| Total cash consideration paid | 2,633 |
| Proportional share of net assets acquired | 2,633 |

The Group's share of the joint venture's profits are as follows:

| | Year ended 31 December 2013 €'000 |
|---|---|
| Fair value movements on Italian debt portfolio | 221 |
| Profit before tax | 221 |
| Taxation | - |
| **Profit after tax** | **221** |

The Group's share of the joint venture's assets and liabilities are as follows:

| | **As at 31 December 2013 €'000** |
|---|---|
| Fair value investments | 2,173 |
| Cash | 460 |
| **Total Assets** | **2,633** |
| | |
| **Total Liabilities** | **(460)** |

The movement in the investment venture is as follows:

| | **2013 €'000** |
|---|---|
| 1 January | - |
| Acquisition | 2,633 |
| Cash distributions received | (681) |
| Share of current year's profits | 221 |
| **31 December** | **2,173** |

The amounts above represent the Group's 50% share of the entire assets, liabilities and net income of the joint venture. These are based on the accounts made up to 31 December 2013.

## 16. ACQUISITION OF SUBSIDIARIES

On 22 May 2013, the Group acquired one performing and three non-performing loan portfolios (refer note 13) through its acquisition of the controlling share (80.66%) of the Member’s interest in NPL Top Tier Holding LLC (“Ieffe and Palazzo”). NPL Top Tier Holding LLC is domiciled in Delaware. The acquisition was made as part of the Group’s new investment strategy. Within this structure, there are a number of holding and interim holding companies; as well as four special purpose securitisation vehicles which have invested in the underlying loan portfolios. The Group's holding in the securitisation vehicles is held through shares and Italian Law 130 securitisation notes.

On 22 May 2013, the Group acquired one non-performing loan portfolio (refer note 13) through its acquisition of the controlling interest (100%) of the outstanding equity and notes in FMIL S.r.l. (“BAM”). The acquisition was made as part of the Group’s new investment strategy. Within this structure, there is one special purpose vehicle which has invested in the underlying loan portfolio. The Group's holding in this securitisation vehicle is held through shares and Italian Law 130 securitisation notes.

The following table summarises the consideration paid and the amounts of the assets acquired and liabilities assumed recognised at 22 May 2013:

| | **Ieffe and Palazzo acquisition €'000** | **BAM acquisition €'000** | **Total €'000** |
|---|---|---|---|
| Total cash consideration paid | 13,804 | 203 | 14,007 |
| | | | |
| Acquisition-related costs included in other operating expenses in the profit and loss | - | - | - |
| | | | |
| **Recognised amounts of identifiable assets acquired and liabilities assumed** | | | |
| Fair valued investments | 17,114 | 203 | 17,317 |
| Cash | 2,928 | 602 | 3,530 |
| Other liabilities | (2,928) | (602) | (3,530) |
| **Total identifiable net assets** | **17,114** | **203** | **17,317** |
| Less the minority interest thereon | (3,310) | - | (3,310) |
| **Total Group identifiable net assets** | **13,804** | **203** | **14,007** |
| | | | |
| Cash consideration | 13,804 | 203 | 14,007 |
| Less: Cash acquired at date of acquisition | (2,928) | (602) | (3,530) |
| **Net cash outflow on acquisition** | **10,876** | **(399)** | **10,477** |

## 17. OTHER ASSETS

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Tenant incentives and leasing commissions | 5,598 | 10,493 |
| Service charge receivable | 3,766 | 5,509 |
| Investment Property disposal proceeds to be received | 15,284 | 2,804 |
| Interest receivable | 848 | 1,720 |
| Rent receivable | 1,654 | 1,839 |
| Prepaid expenses | 517 | 699 |
| Other accounts receivable | 5,229 | 1,002 |
| **Total other assets** | **32,896** | **24,066** |

Service charge and rent receivables are net of a provision for doubtful debts of €4.6 million (31 December 2012: €7.6 million).

All the other assets are expected to mature in less than one year.

## 18. DERIVATIVE ASSETS AND LIABILITIES

**Derivative Assets**

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Foreign currency swaps [(1)] - Pound Sterling | 10,584 | 13,360 |
| **Total derivative assets** | **10,584** | **13,360** |

**Derivative Liabilities**

| | As at 31 €'000 | As at 31 €'000 |
|---|---|---|
| Foreign currency swaps [(1)] - Swiss Franc | 3,258 | 3,568 |
| Interest rate swaps | 2,039 | 8,756 |
| **Total derivative liabilities** | **5,297** | **12,324** |

(1) The foreign currency swap contract contains a Pound Sterling and Swiss Franc leg which is underwritten by individual positions in either currency. The facility does not allow the set-off of individual positions against each other. As such, the separate currency legs are disclosed on a gross basis. The derivative asset and liability has been restated by €3.6 million in 2012 and €6.7 million in 2011.

**Derivative Assets and Liabilities**

Derivative assets and liabilities represent the fair value of interest rate swaps, foreign exchange forward contracts and foreign currency swaps. Interest rate swaps, which are used to hedge the Group's interest rate exposures, represent cash flow hedges and fair value hedges. The Wave cash flow hedge and the fair value hedges are deemed effective for hedge accounting purposes.

**Foreign Currency Swaps**

During 2007, a subsidiary entered into a series of foreign currency swaps with a major investment bank to cover the foreign exchange risk in relation to its Pound Sterling / Swiss Franc denominated assets. As per the arrangement, the subsidiary pays any Pound Sterling and / or Swiss Franc interest or principal it receives (through prepayments, repayments, or recoveries) on assets held and receives the Euro equivalent of such principal sums converted at a fixed foreign exchange rate and with regards to interest Euribor plus a spread. The fair value loss of €2.8 million (31 December 2012: €10.4 million) is recorded in the income statement (refer to note 8).

**Interest Rate Swaps**
Please refer to note 27 for details of the swap.

## 19. INVESTMENT PROPERTY

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Investment property held for sale | 94,402 | 76,510 |
| Investment property | 1,628,104 | 1,943,744 |
| Total investment property net of tenant incentives and leasing commissions | 1,722,506 | 2,020,254 |
| Tenant incentives and leasing commissions (included in other assets - note 17) | 5,598 | 10,493 |
| **Total investment property** | **1,728,104** | **2,030,747** |

As at 31 December 2013, the investment property held for sale is financed by approximately €86.6 million of bank borrowings (31 December 2012: approximately €72.8 million). During the Year ended 31 December 2013, the Group has sold 33 (31 December 2012: 41) properties and no land parcels (31 December 2012: 1) for €270.7 million (31 December 2012: €112.5 million) versus a carrying value of €268.3 million (31 December 2012: €101.2 million).

The table below shows the items classified under investment property in the consolidated balance sheet (including capitalised tenant incentives and leasing commissions included within other assets) as at 31 December 2013:

| | Freehold land and buildings €'000 | Leasehold property €'000 | Total €'000 |
|---|---|---|---|
| Balance at 1 January 2013 | 1,953,804 | 76,943 | 2,030,747 |
| Capital expenditures | 16,498 | - | 16,498 |
| Tenant incentives and leasing commissions | (3,567) | (8) | (3,575) |
| Free rent amortisation | 26 | - | 26 |
| Disposals | (270,679) | - | (270,679) |
| Increase in minimum payments under head lease | - | (154) | (154) |
| Decrease in fair value | (42,307) | (2,452) | (44,759) |
| **Balance at 31 December 2013** | **1,653,775** | **74,329** | **1,728,104** |

**As at 31 December 2012**

| | Freehold land and buildings €'000 | Leasehold property €'000 | Total €'000 |
|---|---|---|---|
| Balance at 1 January 2012 | 2,144,403 | 80,048 | 2,224,451 |
| Capital expenditures | 16,429 | - | 16,429 |
| Tenant incentives and leasing commissions | (4,541) | (8) | (4,549) |
| Free rent amortisation | 1,031 | - | 1,031 |
| Disposals | (112,481) | - | (112,481) |
| Increase in minimum payments under head lease | - | 524 | 524 |
| Decrease in fair value | (91,037) | (3,621) | (94,658) |
| **Balance at 31 December 2012** | **1,953,804** | **76,943** | **2,030,747** |

Investment properties are stated at fair value, which has been determined based on valuations performed by external valuers who hold a recognised and relevant professional qualification and have recent experience in the location and category of investment being valued. In arriving at their estimates of market values, the valuers have used their market knowledge and professional judgment and not only rely on historical transactional comparables. The main factors the valuers consider when determining a fair valuation are the following: passing rent, void periods, yield, relettability and marketability of properties. The fair value represents the amount at which the asset could be exchanged between a knowledgeable, willing buyer and a knowledgeable, willing seller in an arm's-length transaction at the date of valuation, in accordance with international valuation standards.

These techniques are consistent with the principles in IFRS 13 - *Fair Value Measurement* and use significant unobservable inputs such that the fair value measurement of each property within the portfolio has been classified as Level 3 in the fair value hierarchy.

Gains and losses recorded in profit or loss for recurring fair value measurements categorised within Level 3 of the fair value hierarchy amount to €44.8 million (31 December 2012: €94.7 million) and are presented in the Group income statement in the line item "Decrease in fair value of investment properties".

The major inputs to the external valuation process are verified by senior management who also assess the individual property valuation changes from the prior year valuation report and hold discussions with the external valuers. When this process is complete, the valuation report is recommended to the Audit Committee, which considers it as part of its overall responsibilities.

The external valuers hold meetings with the Auditor to discuss the valuation process and outcome at each year end. The total fees, including the fee for the assignment earned by valuer from the Group is less than 5.0% of the total rental income.

Investment properties held for sale are stated at fair value, and are those properties that have been notarised for sale as at 31 December 2013. The gain or loss on the sale of investment property is reported in the fair value movements in the income statement.

A reconciliation of investment property valuations to the balance sheet carrying value of property (including tenant incentives and leasing commissions within other assets) is shown below:

| | **As at 31 December 2013 €'000** | **As at 31 December 2012 €'000** |
|---|---|---|
| Investment property at market value | 1,705,042 | 2,007,531 |
| Minimum payments under head leases separately included in liabilities on the balance sheet | 23,062 | 23,216 |
| **Balance sheet carrying value of investment property** | **1,728,104** | **2,030,747** |

The significant assumptions made relating to the valuations are set out below:

| **Year ending 31 December 2013** | **Office** | **Retail** | **Average** |
|---|---|---|---|
| Passing rent per sqm per month (€) | 10.61 | 8.13 | 9.69 |
| Market rent per sqm per month (€) | 13.12 | 8.51 | 11.40 |
| Average net initial yield | 5.6% | 6.8% | 2.9% |
| Vacancy rate | 27.3% | 3.8% | 20.1% |

| **Year ending 31 December 2012** | **Office** | **Retail** | **Average** |
|---|---|---|---|
| Passing rent per sqm per month (€) | 10.09 | 8.68 | 9.64 |
| Market rent per sqm per month (€) | 12.79 | 8.58 | 11.44 |
| Average net initial yield | 5.5% | 7.1% | 5.8% |
| Vacancy rate | 24.3% | 3.1% | 18.6% |

The Group acquired certain leasehold property that it classifies as investment property. The leases are accounted for as finance leases. Lease arrangements over the land on which the 22 investment properties are built have unexpired terms ranging from 8 years to 86 years. Most are at a fixed rental, but some contain an obligation to pay a contingent rental calculated by reference to a retail price index. The amount recognised as an expense in the year in respect of contingent rental is €1.0 million (31 December 2012: €1.2 million).

**Schedule of Minimum Lease Payments under Finance Leases**

| | **Total value 31 December 2013 €000** | **Present value 31 December 2013 €000** | **Total value 31 December 2012 €000** | **Present value 31 December 2012 €000** |
|---|---|---|---|---|
| Under 1 year | 1,058 | 1,030 | 1,068 | 1,040 |
| From 2 to 5 years | 4,452 | 3,897 | 4,401 | 3,858 |
| More than 5 years | 47,316 | 18,135 | 48,243 | 18,318 |
| **Total** | **52,826** | **23,062** | **53,712** | **23,216** |

The carrying value of investment properties held under finance leases is approximately €50.5 million (31 December 2012: €53.0 million).

**Sensitivity analysis**

The table below presents the sensitivity of the valuation to changes in the most significant assumptions underlying the valuation of investment property.

| **2013 (€'million)** | **Office** | **Retail** | **Total** |
|---|---|---|---|
| Market value | 1,271 | 434 | 1,705 |
| Increase in yield of 25 bps | 1,107 | 407 | 1,514 |
| **Value sensitivity** | **(164)** | **(27)** | **(191)** |

| **2012 (€'million)** | **Office** | **Retail** | **Total** |
|---|---|---|---|
| Market value | 1,569 | 439 | 2,008 |
| Increase in yield of 25 bps | 1,399 | 426 | 1,825 |
| **Value sensitivity** | **(170)** | **(13)** | **(183)** |

**Additional information**

The table below provides additional information for various portfolios within the Group at 31 December 2013:

| Portfolio | Property valuation (1) €'000 | Term financing (face amount) €'000 | Other (liabilities)/ assets (2) €'000 | Net assets / (liabilities) (3) €'000 | Net operating income (NOI) (4) €'000 | NOI yield on valuation % | Occupancy % | Capitalised expenditures / (accrual releases) (5) €'000 |
|---|---|---|---|---|---|---|---|---|
| Drive | 497,209 | 450,732 | (18,680) | 40,024 | 18,925 | 3.8% | 57.9% | 10,112 |
| Wave | 145,597 | 131,494 | (14,010) | 25,215 | 9,031 | 6.2% | 78.4% | 905 |
| Turret | 170,005 | 147,556 | (2,467) | 23,149 | 12,879 | 7.6% | 96.2% | 432 |
| Mars Fixed 2 | 89,290 | 71,603 | 1,997 | 19,654 | 4,685 | 5.2% | 92.1% | 1,844 |
| Truss | 92,700 | 84,430 | (1,946) | 8,345 | 6,825 | 7.4% | 92.9% | 51 |
| Belfry | 57,320 | 54,092 | 1,016 | 4,423 | 3,868 | 6.7% | 86.7% | 199 |
| Tannenberg | 58,520 | 54,500 | (3,260) | 5,666 | 4,205 | 7.2% | 90.7% | 18 |
| Superstella | 55,140 | 52,960 | 240 | 1,582 | 4,027 | 7.3% | 100.0% | (2) |
| Zama | 44,590 | 39,896 | 272 | 4,926 | 3,303 | 7.4% | 95.2% | 13 |
| **Total portfolio excluding Bridge and Mars Floating** | **1,210,371** | **1,087,263** | **(36,838)** | **132,984** | **67,748** | **5.6%** | **78.7%** | **13,572** |
| Bridge | 399,539 | 372,090 | 1,957 | 28,628 | 25,578 | 6.4% | 98.4% | 1,024 |
| Mars Floating (6) | 95,132 | 126,704 | 1,349 | (30,236) | 4,324 | 4.5% | 59.7% | 1,902 |
| **Total portfolio** | **1,705,042** | **1,586,057** | **(33,532)** | **131,376** | **97,650** | **5.7%** | **79.9%** | **16,498** |

The table below provides additional information for various portfolios within the Group at 31 December 2012:

| Portfolio | Property valuation (1) €'000 | Term financing (face amount) €'000 | Other (liabilities)/ assets (2) €'000 | Net assets / (liabilities) (3) €'000 | Net operating income (NOI) (4) €'000 | NOI yield on valuation % | Occupancy % | Capitalised expenditures / (accrual releases) (5) €'000 |
|---|---|---|---|---|---|---|---|---|
| Drive | 709,882 | 677,813 | 32,832 | 72,616 | 30,200 | 4.3% | 66.9% | 8,263 |
| Wave | 181,778 | 153,534 | (21,654) | 17,720 | 11,146 | 6.1% | 81.4% | 439 |
| Turret | 169,295 | 147,556 | (2,524) | 22,958 | 12,673 | 7.5% | 96.9% | 1,000 |
| Mars Fixed 2 | 96,410 | 78,303 | 2,076 | 19,853 | 4,745 | 4.9% | 89.8% | 819 |
| Truss | 94,940 | 85,280 | (2,839) | 9,035 | 7,044 | 7.4% | 96.5% | 102 |
| Belfry | 60,210 | 54,770 | (851) | 4,876 | 4,390 | 7.3% | 95.1% | 383 |
| Tannenberg | 59,150 | 54,500 | (3,246) | 6,594 | 4,230 | 7.2% | 94.6% | 122 |
| Superstella | 55,460 | 52,960 | 186 | 2,027 | 3,972 | 7.2% | 100.0% | 55 |
| Zama | 44,650 | 39,896 | 710 | 5,257 | 3,174 | 7.1% | 94.3% | 60 |
| **Total portfolio excluding Bridge and Mars Floating** | **1,471,775** | **1,344,612** | **4,690** | **160,936** | **81,574** | **5.6%** | **79.9%** | **11,243** |
| Bridge | 406,971 | 372,090 | 180 | 35,017 | 25,023 | 6.1% | 96.5% | 2,070 |
| Mars Floating (6) | 128,785 | 147,872 | 4,237 | (15,241) | 6,280 | 4.9% | 59.3% | 3,116 |
| **Total portfolio** | **2,007,531** | **1,864,574** | **9,107** | **180,712** | **112,877** | **5.6%** | **81.2%** | **16,429** |

(1) Property valuation excludes the leasehold gross-ups of €23.1 million (31 December 2012: €23.2 million).

(2) Other assets / liabilities do not include unallocated assets and liabilities per note 33 and include cash.

(3) Net assets / (liabilities) exclude holding companies within the real estate structure with net liabilities of €0.1 million (31 December 2012: €0.2 million)

(4) Net operating income is after deducting €2.2 million (31 December 2012: €1.2 million) of free rent. It excludes the amortisation of tenant incentives and leasing commissions, the fund costs related to the Drive portfolio and other real estate related general expenses included within property operating expenses in the consolidated income statement. It is shown here as the annualised amount at the period end.

(5) Capitalised expenditures represent actual expenditure for the year.

(6) The total portfolio includes 100% of the Mars Floating Portfolio, in which the Group has a 50% investment.

The financing arrangements on all portfolios additionally require the sale of investment properties to achieve minimum release price thresholds before lenders will release security over the assets being sold. This release pricing varies from portfolio to portfolio. Release pricing in excess of current values will hinder the ability of the Group to sell certain assets without specific lender waivers.

As at the end of 2013, there were 27 vacant properties with a carrying value of €58.8 million and annual operating costs of €0.5 million. The corresponding figures as at 31 December 2012 was 19 properties with a carrying value of €46.8 million and annual operating costs of €1.0 million.

## 20. INTANGIBLE ASSETS

| | 2013<br>€'000 | 2012<br>€'000 |
|---|---|---|
| **Cost** | | |
| Balance at 1 January | 4,106 | 4,106 |
| **Balance at 31 December** | **4,106** | **4,106** |
| | | |
| **Amortisation** | | |
| Balance at 1 January | (3,982) | (3,731) |
| Charge in the year | (82) | (251) |
| **Balance at 31 December** | **(4,064)** | **(3,982)** |
| | | |
| **Carrying amount** | | |
| Balance at 1 January | 124 | 375 |
| **Balance at 31 December** | **42** | **124** |

Intangible assets represent capitalised computer costs and are amortised over a period of 5 years.

## 21. FIXTURE AND FITTINGS

| | 2013<br>€'000 | 2012<br>€'000 |
|---|---|---|
| **Cost** | | |
| Balance at 1 January | 494 | 494 |
| **Balance at 31 December** | **494** | **494** |
| | | |
| **Depreciation** | | |
| Balance at 1 January | (439) | (361) |
| Charge in the year | (51) | (78) |
| **Balance at 31 December** | **(490)** | **(439)** |
| | | |
| **Carrying amount** | | |
| Balance at 1 January | 55 | 133 |
| **Balance at 31 December** | **4** | **55** |

## 22. CDO BONDS PAYABLE

**As at 31 December 2013:**

| | Class | Rating [(1)] | Current face amount €'000 | Carrying amount €'000 | Weighted average cost of financing % | Weighted average margin % | Weighted average maturity (in years) [(2)] |
|---|---|---|---|---|---|---|---|
| Duncannon | X, A, B, C1, C2, D1, D2, D3, E1, E2 | BB/B/ CC/C/C/ C/C/C/ C/C | 300,757 | 299,912 | 1.39% | 0.92% | 3.7 |
| **Total** | | | **300,757** | **299,912** | **1.39%** | **0.92%** | **3.7** |

(1) CDO bonds payable are rated at the lower of S&P and Fitch.

(2) The legal maturity of the portfolio is 20 June 2047.

In 2006, Duncannon acquired a number of asset-backed securities that were financed by the issuance of limited recourse notes which were entirely subscribed by external note holders. The obligation to the external note holders has been recorded as a financial liability in the balance sheet as CDO bonds payable. The carrying value of the financial assets and associated note liabilities as at 31 December 2013 was €308.2 million and €299.9 million (31 December 2012: €378.1 million and €352.9 million) respectively, with a net position of €8.3 million (31 December 2012: €25.2 million). Refer to note 12 for the financial asset disclosures.

The fair value of the financial assets and associated note liabilities as at 31 December 2013 was €192.9 million and €165.3 million (31 December 2012: €221.4 million and €191.9 million) respectively, with a net position of €27.6 million (31 December 2012 €29.5 million). Refer to note 29 for the fair value disclosures.

Duncannon did not repurchase any of its own bonds payable in 2013. For the year ended 31 December 2012, Duncannon repurchased €76.8 million of its own debt with a carrying value of and recognising a net book gain of €46.4 million.

The Group did not repurchase any of the Duncannon bonds payable in 2013. In May 2012, the Group repurchased Class E notes with a face of €0.9 million in Duncannon from an investor for €8,000, realising a gain on purchase of mezzanine debt of €0.9 million.

**As at 31 December 2012:**

| | Class | Rating [(1)] | Current face amount €'000 | Carrying amount €'000 | Weighted average cost of financing % | Weighted average margin % | Weighted average maturity (in years) [(2)] |
|---|---|---|---|---|---|---|---|
| Duncannon | X, A, B, C1, C2, D1, D2, D3, E1, E2 | BB/B/ CC/C/C/ C/C/C/ C/C | 354,867 | 352,905 | 1.16% | 0.98% | 4.0 |
| **Total** | | | **354,867** | **352,905** | **1.16%** | **0.98%** | **4.0** |

(1) CDO bonds payable are rated at the lower of S&P and Fitch.

(2) The legal maturity of the portfolio is 20 June 2047.

## 23. BANK BORROWINGS

The bank borrowings comprise:

| | | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|---|
| Term financing | (note 23.1) | 1,561,858 | 1,898,045 |
| Loans and notes relating to the Mars Portfolios | (note 23.2) | - | - |
| **Total** | | **1,561,858** | **1,898,045** |

**23.1 Term Financing**

| | | Current face amount €'000 | | Carrying amount €'000 | | | | |
|---|---|---|---|---|---|---|---|---|
| **Portfolios** | **Month raised** | **As at 31 December 2013** | **As at 31 December 2012** | **As at 31 December 2013 (1)** | **As at 31 December 2012** | **Hedged weighted average funding cost** | **Weighted average funding cash coupon** | **Maturity** |
| **Debt Investments** | | | | | | | | |
| CDO IV (2) | Jul 2005 | 4,260 | 38,518 | 4,260 | 38,518 | 1.07% | 1.07% | Dec 2014 |
| **Investment Property** | | | | | | | | |
| Drive - Senior (3) (4) | Feb 2006 | 142,265 | 369,346 | 141,980 | 369,298 | 0.62% | 0.62% | Jan 2014 |
| Drive - Junior (3) | Feb 2006 | 308,467 | 308,467 | 307,540 | 308,427 | 3.23% | 3.23% | Jan 2014 |
| Wave (4) | Apr 2007 | 106,759 | 153,534 | 106,715 | 153,211 | 4.94% | 4.78% | Apr 2014 |
| Turret (5) | May 2006 | 147,556 | 147,556 | 147,076 | 146,563 | 4.93% | 4.85% | May 2016 |
| Truss (5) | Dec 2005 | 84,430 | 85,280 | 84,241 | 84,903 | 4.93% | 4.85% | Feb 2016 |
| Mars Fixed 2 | Jun 2008 | 71,603 | 78,303 | 70,993 | 77,894 | 3.51% | 2.79% | Dec 2014 |
| Belfry (5) | Aug 2005 | 54,092 | 54,770 | 53,901 | 54,478 | 4.87% | 4.66% | Oct 2015 |
| Superstella (5) | Aug 2007 | 54,500 | 54,500 | 53,798 | 53,619 | 4.96% | 4.91% | Nov 2017 |
| Tannenberg (5) | May 2007 | 52,960 | 52,960 | 52,736 | 52,456 | 4.87% | 4.66% | Oct 2014 |
| Zama | Feb 2007 | 39,896 | 39,896 | 39,856 | 39,757 | 4.99% | 4.86% | May 2014 |
| **Total investment property excluding Bridge and Mars** | | **1,062,528** | **1,344,612** | **1,058,836** | **1,340,606** | **3.76%** | **3.65%** | |
| Bridge (6) | Oct 2006 | 372,090 | 372,090 | 372,058 | 371,241 | 4.75% | 4.67% | Jan 2014 |
| Mars Floating | Jan 2007 | 126,704 | 147,872 | 126,704 | 147,680 | 1.93% | 1.93% | June 2014 |
| **Total investment property** | | **1,561,322** | **1,864,574** | **1,557,598** | **1,859,527** | **3.85%** | **3.76%** | |
| **Total term financing** | | **1,565,582** | **1,903,092** | **1,561,858** | **1,898,045** | **3.84%** | **4.50%** | |
| Adjustment for costs of Mars refinancing (7) | | | | - | - | | | |
| **Net total term financing** | | | | **1,561,858** | **1,898,045** | | | |

(1) The carrying value is net of disposal proceeds received at year-end and applied at the next interest payment date

(2) The CDO IV facility was repaid in January 2014 - refer to note 35.

(3) Following the restructuring and as per note 29, these loans have been classified as payable in April 2014.

(4) The Drive Senior and Wave loans reflect contractual repayments made in January 2014 following asset sales that were closed as of December 2013.

(5) These portfolios make up the Retail portfolios.

(6) The Bridge portfolio has been disclosed separately as the portfolio was deconsolidated in 2014 (refer note 35).

(7) Eurocastle transferred 50% of its interest in the Mars Fixed 1 and Floating portfolios to the lender and this is considered to be a cost of refinancing and is amortised over the life of the new loan facility (refer note 23.2). The amortised credit for the year ended 31 December 2013 was €nil (31 December 2012: €5.3 million credit). The cost of refinancing has been fully amortised.

The cash amount of interest paid is calculated by multiplying the weighted average funding cash coupon by the current face amount on an Actual/360 basis.

**Debt Investments**

On 14 July 2005, the Group through Eurocastle CDO IV PLC entered into a €400 million 3 year extendable warehouse facility with a major UK bank and the facility is secured over, inter alia, the collateral making up the portfolio. The facility has been restructured on a number of occasions with the latest agreement completed in December 2011. All excess cashflow after interest and costs are payable to the Group and no amortisation targets are in place. The final maturity date of the facility is December 2014. Following the year-end, further principal proceeds were received and the remaining debt was repaid (refer note 35).

**Investment Property**

In order to finance the investment property portfolios, the Group entered into loan facilities as described in the table in note 23.1. These facilities are secured in the customary manner for German real estate lending granting security over, inter alia, the real estate purchased as well as rent receivables and bank accounts of the borrower. Interest in respect of these facilities is payable quarterly. All facilities are non-recourse to the Company.

On 14 May 2008, the short-term financing on the Mars portfolio of €330 million (the outstanding balance at the time of signing) was signed for a 20 June 2009 maturity, amortising down to €250 million by 30 June 2008 and €200 million by 31 December 2008. The Mars Floating facility of €236 million was refinanced in February 2009. This amended facility was due to mature on 31 December 2012 and had scheduled amortisation payments of €36 million, €50 million, and €75 million at the end of 2009, 2010, and 2011, respectively. In consideration of the extension of this facility, Eurocastle agreed to transfer to the Mars Floating facility lender half of its equity investment in the combined Mars Fixed 1 and Floating portfolios as at 31 January 2009. The Group had also provided an interest top-up guarantee up to a maximum of €10 million, and €10 million credit support to the Mars Floating portfolio allowing assets to be sold in aggregate up to €10 million below their respective facility-allocated loan amounts.

Following an extension of this facility in 2012 to revise the maturity to 31 December 2013 and a subsequent breach of an amortisation target, the loan underwent an additional restructuring in March 2012. All contingent guarantees previously provided by the Company were removed ensuring the loan is fully non-recourse to the Company. The scheduled amortisation payments were also extended. The first payment to reduce the outstanding balance to below the required €120 million was due in December 2012. In May 2013, the Group obtained an amendment to the Mars Floating facility with the 2012 amortisation target being extended to the December 2013 maturity, the financing was subsequently extended a further six months in January 2014.

On 25 June 2008, the Group successfully refinanced three of the properties out of the Mars Floating portfolio, with a major German bank, for an amount of €79.0 million. This facility, referred to as the Mars Fixed 2 facility, is non-recourse to Eurocastle, had an effective interest rate of 5.21% and matured in June 2013. Following the sale of an asset in Hamburg in June 2013 and an injection of a €2.0 million reserve by the Company to fund capital expenditures in July 2013, the remaining Mars Fixed 2 facility of €71.6 million was extended in September 2013 to 31 December 2014. The Group is currently marketing one of the two remaining assets in the portfolio which it expects to sell within the next six months. The sale of that asset would trigger the repayment of the €2.0 million injection and extend the facility for a further six months. The facility now bears a floating interest rate of 3 month Euribor plus a margin of 2.50%.

The Mars Fixed 1 facility was restructured in the second quarter of 2011. The Group transferred control to the junior lender in return for current running fixed asset management fees for the portfolio (refer to notes 6 and 32). In 2012, the remaining 25% interest in this facility was sold and terminated asset management services in respect of this portfolio. As a result of this transaction, the Group has received a net benefit of €6.8 million.

In January 2013, the Group secured a restructuring of the Senior loan on the Drive portfolio extending the loan to 20 January 2014 with interim amortisation targets to be met through an agreed sales programme. Throughout 2013, the Group was successful in meeting all such targets reducing the debt outstanding on the Senior facility to €157.7 million as at 31 December 2013 (€369.3 million as at 31 December 2012), resulting in €7.4 million in sales fees and €2.1 million in asset management fees to the Company. On the maturity date in January 2014, a further €15.5 million was repaid and the remaining debt of €142.2 million was extended on a short term basis to 20 April 2014. In parallel, the Group has signed a binding term sheet with the lending syndicate of the Drive Junior facility to refinance the Senior loan for a term of two years with interim amortisation targets which it expects to document in advance of the April 2014 maturity. In September 2013, the Drive Junior loan maturity was extended to 31 January 2014 and for a further three months in January 2014 for an extension fee of €3.6 million (of which €2.7 million has been expensed in the Company's profit and loss at 31 December 2013). Eurocastle expects to agree a coterminous extension of the Junior facility once the Senior loan refinancing is secured.

On 15 January 2014, the Bridge facility reached its maturity. The outstanding loan balance of €372.1 million had not been repaid and the Group has been unable to negotiate an extension. As such, the Bridge facility has moved into special servicing and following the distribution of €2.6 million of cash in January 2014, the Group has no further interest in the portfolio. Please refer to note 35 for further details.

### 23.2 Loans and notes relating to Mars Portfolio

| | **As at 31 December 2013 €'000** | **As at 31 December 2012 €'000** |
|---|---|---|
| Within Mars Floating Portfolio | | |
| Loan notes and Shareholder Loans | 312,516 | 287,241 |
| Less: Remeasurement adjustment to amortised cost | (342,280) | (301,991) |
| Adjusted amortised cost | (29,764) | (14,750) |
| **Transfer of 50% of the adjusted amortised cost to the lender** | - | - |

In consideration of the extension of the Mars Floating facility, the Group agreed to transfer to the Mars Floating lender half of its equity investment in the combined Mars portfolios. This transfer was legally effected on 27 May 2009 and comprised the transfer of Loan Notes and Shareholder's Loans relating to the lender's financing of the portfolios. The terms and conditions of the loan notes and shareholder loans provide that the holders will receive interest and principal only to the extent that sufficient funds are generated from the underlying investment properties. The priority and amount of claims on the portfolio proceeds are determined in accordance with a strict priority of payments. As at 31 December 2013, no receivable has been recorded for the shortfall of the NAV below zero.

## 24. TRADE AND OTHER PAYABLES

| | **As at 31 December 2013 €'000** | **As at 31 December 2012 €'000** |
|---|---|---|
| Security deposit | 3,978 | 5,538 |
| Interest payable | 24,791 | 14,656 |
| Due to Manager (refer note 32) | 2,139 | 3,403 |
| Capex accruals | 4,676 | 20,763 |
| Accrued expenses and other payables | 47,763 | 14,838 |
| **Total trade and other payables** | **83,347** | **59,198** |

All the trade and other payables are expected to mature in less than one year.

## 25. LOSS PER SHARE

Basic earnings per share is calculated by dividing net loss after taxation by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share is calculated by dividing net loss available to ordinary shareholders by the weighted average number of ordinary shares outstanding plus the additional dilutive effect of potential ordinary shares during the year. The share options and convertible securities are not dilutive as the Group is in a loss position. Therefore, the basic earnings per share and dilutive earnings per share are the same in the current year and in the prior year.

The Group's potential ordinary shares during the year were the share options issued under its share option plan. There have been no other transactions involving ordinary shares or potential ordinary shares since the reporting date and before the completion of the financial statements.

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

| | As at 31 December 2013 | As at 31 December 2012 |
|---|---|---|
| Weighted average number of ordinary shares | 26,506,716 | 484,445 |
| Dilutive effect of ordinary share options and convertible securities | - | 2,713,737 |
| Dilutive effect of ordinary share options | 74,895 | - |
| **Weighted average number of ordinary shares - dilutive** | **26,581,611** | **3,198,182** |

The prior year comparatives have been restated for the share consolidation in the ratio of 200:1.

## 26. SHARE CAPITAL AND RESERVES

As at 31 December 2013, there were 32,632,502 shares (31 December 2012: 127,425,780) issued and outstanding.

The movement in issued share capital is shown as follows:

| | Value of convertible securities €'000 | Number of shares |
|---|---|---|
| **Balance at 1 January 2012** | | **86,577,189** |
| Issued to the Directors per their in-place compensation arrangements on 13 June 2012 for €nil consideration | | 4,000 |
| Issued in exchange for convertible securities | | |
| 5 June 2012 | 111 | 370,443 |
| 19 July 2012 | 300 | 998,755 |
| 6 August 2012 | 3,164 | 10,546,849 |
| 10 August 2012 | 191 | 635,046 |
| 18 September 2012 | 327 | 1,091,125 |
| 27 September 2012 | 178 | 594,634 |
| 3 October 2012 | 748 | 2,493,999 |
| 4 October 2012 | 178 | 594,634 |
| 10 October 2012 | 2,473 | 8,244,053 |
| 29 October 2012 | 648 | 2,159,156 |
| 7 November 2012 | 589 | 1,962,868 |
| 8 November 2012 | 1,107 | 3,691,397 |
| 13 November 2012 | 182 | 606,180 |
| 23 November 2012 | 2,057 | 6,855,452 |
| **Balance at 31 December 2012** | | **127,425,780** |
| Issued in exchange for convertible securities on 12 April 2013 | 168,722 | 3,398,474,717 |
| Share consolidation in the ratio of 200:1 on 8 May 2013 | | (3,508,270,995) |
| Issued on 30 May 2013 at a price of €7.25 | | 15,000,000 |
| Issued to the Directors per their in-place compensation arrangements on 1 October 2013 for €nil consideration | | 3,000 |
| **Balance at 31 December 2013** | | **32,632,502** |

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

**Other reserves**

Other reserves represent the fair value at the grant date of unexercised share options, granted to the Manager in June 2004, June 2005, January 2006, December 2006 and May 2013 (refer note 30).

## 27. HEDGE ACCOUNTING

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

At 31 December 2013, cumulative unrealised losses on hedge instruments were €4.5 million (31 December 2012: €2.6 million). The cumulative unrealised gains comprise the gain in value of the novated swaps of €1.6 million (31 December 2012: €1.7 million) and the fair value loss of the interest rate swaps of €6.3 million (31 December 2012: €4.3 million).

The gain or loss on measurement of the fair value of the interest rate swaps has been recognised in the statement of comprehensive income to the extent that the swaps are effective, while gains and losses related to fair value hedges have been recognised in the income statement.

**Novated swaps**

The novated swaps represent derivatives initially used as cash flow hedges that were subsequently novated to the lending banks. The remaining amount of the cash flow hedge in the reserves is amortised over the remaining life of the loan. The details of the carrying value of swaps novated to lending banks in conjunction with the loans are as follows:

| Portfolio | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Mars | - | 312 |
| Drive | 141 | 25 |
| Bridge | 20 | 532 |
| Rapid | 596 | 751 |
| Tannenberg | 135 | 304 |
| Turret | 200 | 615 |
| Zama | 17 | 65 |
| Truss | 59 | 188 |
| **Total** | **1,168** | **2,792** |

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

**Cash flow hedges**

| 31 December 2013 | Wave |
|---|---|
| Nominal amount (€'000) | 106,759 |
| Pay rate | 4.03% |
| Receive rate | 3 month Euribor |
| Remaining life (years) | 0.3 |
| Fair value of swaps (€'000) | (2,039) |

| 31 December 2012 | Wave |
|---|---|
| Nominal amount (€'000) | 142,637 |
| Pay rate | 4.03% |
| Receive rate | 3 month Euribor |
| Remaining life (years) | 1.3 |
| Fair value of swaps (€'000) | (8,298) |

Please refer to note 29 for details of when the related cash flows are expected to occur. The Wave swap is deemed effective with fair value gains and losses recognised in the consolidated statement of comprehensive income.

**Fair value hedges**

A full paydown was received on the underlying asset before 31 December 2013 realising cash flows of £5.1 million which translated to €7.6 million.

| 31 December 2012 | Feco GBP B Notes | Feco GBP B Notes [1] |
|---|---|---|
| Nominal amount (€'000) | 4,901 | 6,039 |
| Pay rate | 5.11% | - |
| Receive rate | 3 month Libor | - |
| Remaining life (years) | 1.6 | - |
| Fair value of swaps (€'000) | (372) | (458) |
| Fair value of assets attributable to the risk hedged (€'000) | (395) | (486) |

(1) The amount stated is Euro notional, mark-to-market equivalent GBP swaps. The fair value hedge was deemed effective for hedge accounting purposes and the gain €0.5m (2012: €0.2 million) is recorded through the consolidated income statement.

## 28. PERPETUAL SUBORDINATED CONVERTIBLE SECURITIES

| | As at 31 December 2013 €'000 | As at 31 December 2012 €'000 |
|---|---|---|
| Convertible securities issued | 99,750 | 99,750 |
| Accrued interest | 83,441 | 75,233 |
| Capitalised issue costs | (1,200) | (1,200) |
| Convertible securities converted into ordinary shares - prior periods | (13,269) | (5,835) |
| Convertible securities converted into ordinary shares - current year | (168,722) | (7,434) |
| **Total** | **-** | **160,514** |

On 25 June 2009, the Company issued €75 million of perpetual subordinated convertible securities (net of transaction costs of €1.2 million) on the following terms:

- The convertible securities were issued at par and will be entitled to a coupon of 20 per cent, payable annually in arrears. Interest may accrue and is capable of being paid in shares at the conversion price upon conversion. The Company does not currently expect to pay interest on its convertible securities.
- The convertible securities are perpetual but the Company may redeem the securities after 2 years at a premium of 20 per cent.
- The securities will be convertible into shares at the holder's option at a conversion price per ordinary share of €0.30.
- The securities have a minimum denomination of €50,000, are unlisted but can be transferred.
- The interest accrued for the relevant period does not vest until after 30 June of that 12 month period.

On 6 October 2009, the Group raised an additional €15.0 million of capital through the issuance of further convertible securities on terms that economically represented a premium to par. On 19 October 2009, the Group issued a further €9.75 million of convertible securities on the same terms as the prior issuance.

In February 2010, convertible security holders presented €1.5 million of convertible securities for conversion. Eurocastle duly converted these securities and issued 5,000,000 shares. No interest was payable on these converted securities.

In July 2011 and August 2011, convertible security holders presented €6.2 million of convertible securities for conversion. Eurocastle duly converted these securities and issued 20,613.818 shares. No interest was payable on these converted securities.

Further conversions have been completed in 2012. Details of these are provided in note 26.

In 2013, the Company obtained approval from the holders of its convertible securities to lower the conversion price from €0.30 to €0.05 per share in exchange for, inter alia, the right for the Company to require a conversion of all outstanding convertible securities. Conditional upon such conversion, the Company reached agreement with the Manager to rebase the fees under its Management Agreement (refer note 32). On 12 April 2013, the Company converted all outstanding convertible securities to ordinary shares with the effect that the share count was increased by 3,398,474,717 shares on 19 April 2013 resulting in the adjusted fully diluted NAV per share reducing from €0.46 to €0.09.

## 29. FINANCIAL INSTRUMENTS

**Risk Management**

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

**Capital Risk Management**

The Group’s objectives when managing capital are to safeguard the Group’s ability to continue as a going concern in order to support the business and to maximise shareholder value.

The Group recognises the effect on shareholder returns of the level of equity capital employed within the Group and seeks to manage its capital structure and make adjustments to it in the light of changes in economic conditions and the risk characteristics of its activities.

In order to maintain an adequate capital structure in current uncertain market conditions, the Group considers strategies such as refinancing existing loan facilities, raising capital and asset sales to reduce outstanding loan balances. Capital management is under the constant scrutiny of the Board. Please refer to notes 26 and 28 for the changes to the capital structure.

At 31 December 2013, the Group had net equity of €327.0 million (31 December 2012: €292.1 million) and a leverage ratio of 85.2% (31 December 2012: 88.5%). The improvement in the ratio increase from 2012 is primarily as a result of the May share capital raise and settlement of real-estate loans from sales, net of the reduction in fair values of the investments properties and impairments of the debt investment securities.

***Market Risk***

The Group’s real estate investment assets are located in Germany and therefore, the performance of such assets depends on the strength of the German economy and other factors affecting German real estate values. A decline in the German economy or the commercial property market may have an immediate effect on the net income of the properties and could lead to higher rates of delinquency or defaults under leases. The Group is also subject to general property market risks including, among other things, fluctuations in rental levels and property yields. These risks are assessed by the Group at the point of acquisition and are then monitored on an ongoing basis. In addition, external third party valuations of the Group’s real estate assets are obtained during each financial year. These appraisals take current market developments into consideration.

The Group recognises that the significant deterioration in economic conditions on the back of the global credit crisis continues to have adversely impacted the property valuations. This has affected and may continue to affect the Group’s ability to dispose of assets or the level of proceeds received in relation to any such disposals. Due to the current market conditions and the nature of the assets in which the Group has invested, sale of assets by the Group could result in significantly lower proceeds than the carrying value of those assets in the consolidated financial statements included herein. Also, due to the nature of the Group’s assets, asset sales may not be effected swiftly enough to avoid default of the Group’s existing financings. The Group also recognises that the economic situation may result in a lower leasing or renewals volume or in a reduction in rents as a result of tenant defaults. In addition, the Group’s top five tenants accounted for 59.0% of its passing rental income for the Year ended 31 December 2013 (31 December 2012: 58.3%) after excluding Mars Floating and Bridge. Loss of any one of these tenants could have a significant impact on the Group’s performance.

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

At 31 December 2013, a 100 basis point increase / (decrease) in credit spreads would increase / (decrease) net equity by €0.7 million (31 December 2012: €1.8 million).

The Group's securities that were reclassified as Loans and Receivables (see note 12) are predominantly floating rate, are held at amortised cost and subject to impairment tests. The Group is therefore exposed to market risks associated with the underlying assets and their ability to service their financings.

***Interest Rate Risk***

The Group's primary interest rate exposures relate to its real estate and other asset backed securities, loans and floating rate debt obligations, as well as its interest rate swaps. In the event of a significant rising interest rate environment and/or economic downturn, mortgage and loan defaults may increase and result in credit losses. Interest rates are highly sensitive to many factors, including governmental monetary and political conditions, and other factors beyond the Group's control.

Currently, the Group has financed the Zama and Retail real estate portfolios with fixed rate loans. In addition, the Wave portfolio is financed with a floating rate loan which is hedged with an interest rate swap (refer note 24). Changes in interest rates affect the break costs incurred to unwind the financing arrangements and thus affect the gain or loss on disposal of the group's real estate assets and also may affect the Group's ability to sell assets should the net proceeds be insufficient to repay their allocated liability.

Based on the Group's primary interest rate exposure to floating rate financial assets and financial liabilities held at 31 December 2013, including the effect of hedging instruments, a 100 basis point increase / decrease in interest rates would increase / (decrease) earnings by approximately €0.9 million per annum (31 December 2012: €0.9 million per annum). The impact on equity due to the cash flow hedging would be an increase / (decrease) of approximately €0.1 million (31 December 2012: €2.0 million).

Changes in the level of interest rates also can affect the Group's ability to acquire securities and loans and its ability to realise gains from the settlement of such assets. Increasing interest rates would decrease the value of the fixed rate assets because higher required yields result in lower prices on existing fixed rate assets in order to adjust their yield upward to meet the market. At 31 December 2013, a 100 basis point change in interest rates would impact the net equity by €1.2 million (31 December 2012: €0.1 million).

***Foreign Currency Risk***

The Group's primary foreign currency exchange rate exposure relates to its non-Euro denominated portfolio of securities and loans. Changes in the currency exchange rates can adversely impact the fair values and earnings streams of the Group's non-Euro denominated assets and liabilities. In the past, the Group has mitigated this impact through a combination of non-Euro denominated financing; the use of balance guaranteed hedging; and rolling forward foreign exchange contracts to hedge its net non-Euro equity investment.

Recognising the liquidity risk and related margin requirements associated with entering into forward foreign exchange contracts and the increased uncertainty as to the future cash flows from, and value of, its equity investments in the debt portfolio, the Group stopped hedging its net non-Euro equity investments from the beginning of 2009.

No sensitivity analysis is presented for foreign exchange risk, as the impact of reasonably possible market movements on the Group's revenue and equity are not significant. The Group currently match-funds its debt investment portfolios, meaning that any non-Euro denominated debt investments are funded by financings in the same currency, therefore eliminating any material foreign currency exposure.

***Credit Risk***

The Group is subject to credit risk in its real estate business, primarily in relation to its underlying tenants. The Group is also subject to credit risk with respect of its debt investment business (including its investments in Italian loans) by virtue of the risk of delinquency, foreclosure, speed of foreclosure proceedings and loss on the loans underpinning the securities in which the Group invests.

The securities the Group invests in are generally junior in right of payment of interest and principal to one or more senior classes including, among other things, structural features that divert such payments to those classes when the delinquency of the pool exceeds certain levels. The securities do benefit from the support of one or more subordinate classes of securities or other form of credit support within a securitisation transaction but if such support is exhausted, in the event of default, the Group may not be able to recover all of its investment in the securities purchased. While the expected yield on these securities is sensitive to the performance of the underlying assets, the more subordinated securities are designed to bear the first risk of default and loss.

The Group minimises credit risk by assessing the creditworthiness of its larger tenants and its securities portfolio and the underlying credit quality of its holdings and where appropriate, repositioning such investments to upgrade the credit quality and yield on the investments.

The Group's securities portfolio is diversified by asset type, industry, location and issuer. At 31 December 2013, the Group's securities, which serve as collateral for its CDO financing and other borrowings, had an overall weighted average credit rating of approximately CCC (31 December 2012: B-).

The counterparties to the Group's derivative arrangements are major financial institutions with investment grade credit ratings with which the Group and its affiliates may also have other financial relationships. While it is not anticipated that any of these counterparties will fail to meet their obligations, there is no certainty in current market conditions that this will be the case.

The maximum credit risk exposure in respect of debt investments as at 31 December 2013 without taking account of any collateral held or other credit enhancements is the full carrying value of all financial assets on the Balance Sheet, €0.3 billion (31 December 2012: €0.5 billion).

Excluding the Company's Italian loan investments, the Group's loans and receivables, available-for-sale securities and real estate loans portfolios were split between countries within Europe as follows:

| | 31 December 2013 | | | 31 December 2012 | | |
|---|---|---|---|---|---|---|
| | Number of securities / loans | Face value €'000 | Location split % | Number of securities / loans | Face value €'000 | Location split % |
| United Kingdom | 15 | 117,550 | 25.9% | 23 | 190,314 | 34.3% |
| Italy | 6 | 92,558 | 10.3% | 6 | 83,563 | 9.0% |
| Germany | 18 | 137,255 | 31.0% | 20 | 176,165 | 29.9% |
| Pan-European | 11 | 124,192 | 19.0% | 10 | 115,392 | 14.9% |
| France | 5 | 37,289 | 8.6% | 5 | 37,289 | 7.5% |
| Other | 3 | 28,320 | 5.2% | 3 | 28,792 | 4.5% |
| **Total** | **58** | **537,164** | **100.0%** | **67** | **631,515** | **100.0%** |

The Group's hedging and trading transactions using derivative instruments also involve certain additional risks such as counterparty credit risk, the enforceability of hedging contracts and the risk that unanticipated and significant changes in interest rates will cause a significant loss of basis in the contract. The counterparties to the Group's derivative arrangements are major financial institutions with investment grade credit ratings with which the Group and its affiliates may also have other financial relationships. While it is not anticipated that any of these counterparties will fail to meet their obligations, there is no certainty in current market conditions that this will be the case.

***Liquidity risk***

The Group's ability to carry on its business for the long-term depends to a significant degree on the Group's ability to generate sufficient revenue to meet its general corporate expenses.

Eurocastle's liquidity is primarily generated by cash flows (from ordinary operations as well as asset sales) from its real estate portfolios other than its Drive and Mars portfolios, the majority of whose excess net operating cash flow and sale proceeds is and will continue to be retained within the relevant subsidiaries to fund capital expenditure, finance costs and amortisation.

Since the repayment in full by Eurocastle of its two corporate loan facilities in December 2010, debt service costs at the Eurocastle level have been eliminated. All portfolio-level financing is non-recourse to Eurocastle. Cash received at the Eurocastle level is therefore for Eurocastle's corporate purposes. Following the full conversion of the Convertible Securities in 2013, no interest or principal remains outstanding.

The Group expects to meet its long-term liquidity requirements, especially in relation to its term financing maturities through negotiated extensions of its term debt, the refinancing of its term debt and asset sales at or before maturity. However, although the Group has historically been able to obtain and renegotiate many of its financings on acceptable terms, there can be no assurance that future financing and / or renegotiation of existing terms will be available or, if it is, that it will be available on terms that the Group considers acceptable. In particular, should the current difficult financial market conditions persist, the Group may have difficulty in renewing, extending or refinancing its existing facilities in the future.

The Group's debt investments are generally financed long-term, with 89.7% of the debt investment portfolio benefiting from financing maturing beyond the maturity date of the debt investments, and their credit status is continuously monitored.

The Group's investment property portfolio has a number of non-recourse financing facilities which are due to reach maturity within the next 12 months at which time, the outstanding balance of the financings will become due and payable unless such financings can be extended. If proceeds from the sale of the assets which secure the relevant portfolio financing do not equal or exceed the amount outstanding under the relevant portfolio financing, the Group would be unable to repay the outstanding balance of the relevant portfolio financing when it becomes due and payable.

The tables below represent the details of the remaining contractual maturities of financial assets and liabilities, excluding trade receivables and payables as at 31 December 2013:

| Type | Total outstanding at 31 December 2013 €'000 | Within 1 year €'000 | 1 to 5 years €'000 | Over 5 years €'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 193,192 | 193,192 | - | - |
| Interest receivable [(1)] | 848 | 5,588 | 11,822 | 1,901 |
| Asset backed securities, available-for-sale | 26,879 | 4,734 | 21,015 | 1,130 |
| Loans and receivables (includes cash to be invested) | 316,650 | 71,584 | 185,988 | 59,078 |
| Fair value investments | 12,315 | 3,841 | 8,468 | 6 |
| Derivative assets [(2)] | 10,584 | 23 | 5,369 | 5,192 |
| **Total assets** | **560,468** | **278,962** | **232,662** | **67,307** |
| | | | | |
| **Liabilities** | | | | |
| Interest payable [(1)] | 24,791 | 54,503 | 23,701 | - |
| Derivative liabilities [(2)] | 5,297 | 5,297 | - | - |
| CDO bonds payable | 299,912 | - | - | 299,912 |
| Bank borrowings | 1,561,858 | 1,223,904 | 337,954 | - |
| Finance leases payable [(3)] | 23,062 | 1,030 | 3,897 | 18,135 |
| **Total liabilities** | **1,914,920** | **1,284,734** | **365,552** | **318,047** |

(1) Interest receivable and payable reflects the interest receivable and payable over the weighted average life of the assets and financing.

(2) Derivative assets and liabilities reflect the cash flows over the remaining life of the assets.

(3) Finance leases payable represent all lease payments due over the lives of the leases.

| Gross settled derivatives | Total outstanding at 31 December 2013 €'000 | Within 1 year €'000 | 1 to 5 years €'000 | Over 5 years €'000 |
|---|---|---|---|---|
| Contractual amounts payable | (57,387) | (12,830) | (22,376) | (22,181) |
| Contractual amounts receivable | 64,713 | 9,594 | 27,744 | 27,375 |
| **Total undiscounted gross settled derivatives outflow** | **7,326** | **(3,236)** | **5,368** | **5,194** |

**Maturities and mandatory amortisation (current face)**

| Portfolio (€m) | 2014 | 2015 | 2016 | 2017 | Total |
|---|---|---|---|---|---|
| **Non recourse** | | | | | |
| Drive Senior [(1)] | 142.3 | - | - | - | 142.3 |
| Drive Junior [(1)] | 308.5 | - | - | - | 308.5 |
| Wave [(1)] | 106.8 | - | - | - | 106.8 |
| Turret | - | - | 147.6 | - | 147.6 |
| Truss | 0.9 | 0.9 | 82.7 | - | 84.5 |
| Mars Fixed 2 | 71.6 | - | - | - | 71.6 |
| Belfry | 0.5 | 53.5 | - | - | 54.0 |
| Tannenberg | 53.0 | - | - | - | 53.0 |
| Superstella | - | - | - | 54.5 | 54.5 |
| Zama | 39.9 | - | - | - | 39.9 |
| **Real estate portfolio excluding Bridge and Mars Floating** | **723.5** | **54.4** | **230.3** | **54.5** | **1,062.7** |
| Bridge | 372.1 | - | - | - | 372.1 |
| Mars Floating | 126.7 | - | - | - | 126.7 |
| **Real estate portfolio** | **1,222.3** | **54.4** | **230.3** | **54.5** | **1,561.5** |
| CDO IV | 4.3 | - | - | - | 4.3 |
| **Debt Total** | **4.3** | **-** | **-** | **-** | **4.3** |
| **Grand total** | **1,226.6** | **54.4** | **230.3** | **54.5** | **1,565.8** |

(1) The Drive Senior and Wave loans reflect contractual repayments made in January 2014 following asset sales that were closed as of December 2013.

As at 31 December 2012:

| Type | Total outstanding at 31 December 2012 €'000 | Within 1 year €'000 | 1 to 5 years €'000 | Over 5 years €'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 141,344 | 141,344 | - | - |
| Interest receivable [(1)] | 1,720 | 11,318 | 18,362 | 696 |
| Asset backed securities, available-for-sale | 46,098 | - | 37,710 | 8,388 |
| Loans and receivables (includes cash to be invested) | 409,965 | 28,014 | 303,110 | 78,841 |
| Derivative assets [(2)] | 13,360 | 396 | 9,520 | 3,444 |
| **Total assets** | **612,487** | **181,072** | **368,702** | **91,369** |
| **Liabilities** | | | | |
| Interest payable [(1)] | 14,656 | 85,282 | 55,701 | - |
| Derivative liabilities [(2)] | 12,324 | 5,823 | 6,501 | - |
| CDO bonds payable | 352,905 | - | - | 352,905 |
| Bank borrowings [(3)] | 1,898,045 | 581,564 | 1,316,481 | - |
| Finance leases payable [(4)] | 23,216 | 1,040 | 3,858 | 18,318 |
| **Total liabilities** | **2,301,146** | **673,709** | **1,382,541** | **371,223** |

(1) Interest receivable and payable reflects the interest receivable and payable over the weighted average life of the assets and financing.

(2) Derivative assets and liabilities reflect the cash flows over the remaining life of the assets and have been restated to disclose the Pound Sterling asset and Swiss Franc liability on a gross basis.

(3) As at 31 December 2012, the Group was in default of the Mars Floating and Drive Junior loans. Therefore, the loans were reclassified as payable within one year.

(4) Finance leases payable represent all lease payments due over the lives of the leases.

**Gross settled derivatives**

| | Total outstanding at 31 December 2012 €'000 | Within 1 year €'000 | 1 to 5 years €'000 | Over 5 years €'000 |
|---|---|---|---|---|
| Contractual amounts payable | (80,631) | (2,151) | (61,376) | (17,104) |
| Contractual amounts receivable | 90,423 | 2,547 | 67,328 | 20,548 |
| **Total undiscounted gross settled derivatives inflow** | **9,792** | **396** | **5,952** | **3,444** |

**Fair values of financial assets and financial liabilities**

Set out below is a comparison by category of carrying amounts and fair values of the Group's financial instruments that are carried in the financial statements excluding trade and other receivables and payables, and current liabilities whose carrying value is equal to fair value due to the short period before settlement.

| | As at 31 December 2013 Carrying value €'000 | As at 31 December 2012 Carrying value €'000 | As at 31 December 2013 Fair value €'000 | As at 31 December 2012 Fair value €'000 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Cash and cash equivalents | 193,192 | 141,344 | 193,192 | 141,344 |
| Asset backed securities, available-for-sale | 26,879 | 46,098 | 26,879 | 46,098 |
| Loans and receivables (includes cash to be invested) | 316,650 | 409,965 | 192,919 | 227,826 |
| Fair value investments | 12,315 | - | 12,315 | - |
| Derivative assets | 10,584 | 13,360 | 10,584 | 13,360 |
| **Financial liabilities** | | | | |
| CDO bonds payable | 299,912 | 352,905 | 165,276 | 191,867 |
| Bank borrowings | 1,561,858 | 1,898,045 | 1,631,341 | 2,000,902 |
| Finance lease payable | 23,062 | 23,216 | 23,062 | 23,216 |
| Derivative liabilities | 5,297 | 12,324 | 5,297 | 12,324 |

The fair value of loans and receivables is based on market prices of the underlying positions at the balance sheet date (level 1)

The fair value of CDO Borrowings is based on the latest market prices obtained from financial institutions (level 2)

The fair value of bank borrowings is based on the adjustment of facilities with novates swaps such that they are presented at the underlying fixed rate (level 2).

**Fair value hierarchy**

The following table shows an analysis of the fair value of financial instruments recognised in the balance sheet by level of hierarchy (refer next page for definitions):

**31 December 2013:**

| | Level 1 €'000 | Level 2 €'000 | Level 3 €'000 | Total fair value €'000 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Asset backed securities, available-for-sale (refer note 11) | 26,879 | - | - | 26,879 |
| Fair value investments (refer note 13) | - | - | 12,315 | 12,315 |
| Derivative assets (refer note 18) | - | 10,584 | - | 10,584 |
| | | | | |
| **Financial liabilities** | | | | |
| Derivative liabilities (refer note 18) | - | 5,297 | - | 5,297 |

**31 December 2012:**

| | Level 1 €'000 | Level 2 €'000 | Level 3 €'000 | Total fair value €'000 |
|---|---|---|---|---|
| **Financial assets** | | | | |
| Asset backed securities, available-for-sale (refer note 11) | - | - | 46,098 | 46,098 |
| Derivative assets (refer note 18) | - | 13,360 | - | 13,360 |
| | | | | |
| **Financial liabilities** | | | | |
| Derivative liabilities (refer note 18) | - | 12,324 | - | 12,324 |

Explanation of the fair value hierarchy:
- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- Level 2: Use of a model with inputs (other than quoted prices included in Level 1) that are directly and indirectly observable market data.
- Level 3: Use of a model with inputs that are not based on observable market data.

The following table shows reconciliation for the Level 3 fair value measurements:

| | **As at 31 December 2013 €'000** | **As at 31 December 2012 €'000** |
|---|---|---|
| As at 1 January | 46,098 | 49,656 |
| Total losses recognised in the income statement in interest income | (31,012) | (8,771) |
| Reclassification of Asset back securities, available for sale to Level 1 | (26,879) | - |
| Fair value investments acquired in the year | 12,315 | - |
| Total gains recognised in other comprehensive income | 11,793 | 5,213 |
| **As at 31 December** | **12,315** | **46,098** |

During the year ended 31 December 2013, there were no transfers between Level 1 and Level 2 fair value measurements. €46.1 million was reclassified from Level 3 to Level 1 fair value measurements as the valuation of Asset backed securities, available for sale has been based on market prices at year-end.

## 30. SHARE OPTION PLAN

In December 2003, the Group (with the approval of the Board of Directors and pursuant to the confidential information memorandum dated August 2003) adopted a nonqualified share option plan (the "Group Option Plan") for officers, Directors, employees, consultants and advisors, including the Manager. In December 2003, for the purpose of compensating the Manager for its successful efforts in raising capital for the Group, the Manager was granted options representing the right to acquire 1,185,767 ordinary shares at an exercise price of €10 per share (number of shares and exercise price adjusted for share consolidation). The fair value of the options at the date of grant was €0.2 million and was calculated by reference to an option pricing model. The options granted to the Manager were fully vested on the date of grant and expire ten years from the date of issuance. These options have lapsed as at 31 December 2013.

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

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

In December 2006, following the fourth public offering, the Manager was granted an additional 1,783,748 options at €37.00 per share. The fair value of the additional options at the date of grant was €9.4 million. The Manager's options represent an amount equal to 10% of the ordinary shares issued by the Group. The options granted to the Manager were fully vested on the date of grant and expire ten years from the date of issuance.

In May 2013, the Manager was granted an additional 1,500,000 options at €7.25 per share which represents 10% of the ordinary shares issued by the Group at this time. The options granted to the Manager remain fully vested on the date of the grant and expire ten years from the date of issuance.

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

The weighted average fair value of the options at date of grant was determined using a trinomial model. The significant inputs into the model were the weighted average share price at the grant date (€7.30) , the exercise price (€7.25), volatility (32.0%) , expected option life (10 years), historic dividend yield (2.0%) and a risk free rate. The volatility is measured at the standard deviation of continuously compounded share returns based on statistical analysis of daily share price since the date of the initial public offering of Eurocastle Investment Limited.

Movement in the number of share options outstanding and their related weighted average exercise prices are as follows:

| Date of grant | Options outstanding at 1 January 2013 | Change in number of options as a result of share consolidation | Options lapsed | New options issued | Options remaining at 31 December (1) 2013 | Fair value at grant date €'000 | Exercise price (1) € | Date of expiration |
|---|---|---|---|---|---|---|---|---|
| 31 Dec 2003 | 984,783 | (979,860) | (4,923) | - | - | - | 2,000.00 | 31 Dec 2013 |
| 23 Jun 2004 | 600,600 | (597,597) | - | - | 3,003 | 200 | 2,400.00 | 23 Jun 2014 |
| 24 Jun 2005 | 504,356 | (501,835) | - | - | 2,521 | 620 | 3,450.00 | 24 Jun 2015 |
| 27 Jan 2006 | 791,286 | (787,330) | - | - | 3,956 | 4,800 | 3,600.00 | 27 Jan 2016 |
| 27 Jan 2006 | 1,220,325 | (1,214,224) | - | - | 6,101 | 2,100 | 6,000.00 | 27 Jan 2016 |
| 1 Dec 2006 | 1,765,945 | (1,757,116) | - | - | 8,829 | 9,400 | 7,400.00 | 1 Dec 2016 |
| 30 May 2013 | - | - | - | 1,500,000 | 1,500,000 | 4,968 | 7.25 | 30 May 2023 |
| **Total** | **5,867,295** | **(5,837,962)** | **(4,923)** | **1,500,000** | **1,524,410** | **22,088** | | |

(1) The number of options and exercise price of share options issued prior to 2013 have been restated for the share consolidation in the ratio of 200:1.

## 31. DIVIDENDS PAID AND DECLARED

The following dividends were declared and paid for the year ended 31 December 2013 (31 December 2012: €nil):

| Declaration date | Dividend per share | Ex-dividend date | Record date | Payment date | Amount €'000 |
|---|---|---|---|---|---|
| 30 September 2013 | € 0.125 | 7 October 2013 | 9 October 2013 | 31 October 2013 | 4,079 |
| 18 December 2013 | € 0.125 | 27 December 2013 | 31 December 2013 | 30 January 2014 | 4,079 |
| **Total** | | | | | **8,158** |

## 32. MANAGEMENT AGREEMENT AND RELATED PARTY TRANSACTIONS

The Group entered into the Management Agreement with the Manager in August 2003, which provides for an initial term of ten years with automatic three year extensions, subject to certain termination rights. The Management Agreement may be terminated by the Group by payment of a termination fee, as defined in the Management Agreement, equal to the amount of management fees earned by the Manager during the 12 consecutive calendar months immediately preceding the termination, upon the vote of a majority of the holders of the outstanding ordinary shares. In addition, unless an arrangement is made between the Group and the Manager, incentive compensation (as outlined below) will continue to be payable to the Manager post termination. Pursuant to the Management Agreement, the Manager, under the supervision of the Group's Board of Directors, will formulate investment strategies, arrange for the acquisition of assets, arrange for financing, monitor the performance of the Group's assets and provide certain advisory, administrative and managerial services in connection with the operations of the Group. For performing these services, Eurocastle will pay the Manager an annual fee (payable monthly in arrear) of 1.5% of the gross equity of the Group, as described in the Management Agreement. As at 31 December 2013, gross equity was €1.74 billion.

With effect from 28 February 2013, an amendment agreement between the Group and Manager was entered into in relation to the original agreement described above. The agreed amendments took effect on 12 April 2013 to (i) reduce the amount payable by Eurocastle to Fortress as annual management fee by resetting the capital base upon which such fee is calculated from an amount equal to aggregate equity proceeds raised to €300 million plus an amount equal to the proceeds of any future issue of equity share capital; and (ii) similarly reset the capital base upon which Fortress's entitlement to incentive compensation is calculated; in both cases, in respect of the period commencing 1 April 2013. As at 31 December 2013, the amount on which the fee is based is €403.8 million.

The Management Agreement provides that Eurocastle will reimburse the Manager for various expenses incurred by the Manager or its officers, employees and agents on the Group's behalf, including the cost of legal, accounting, tax, auditing, finance, administrative, asset management, property management and other similar services rendered for the Group by providers retained by the Manager or, if provided by the Manager's or its affiliates' employees, in amounts which are no greater than those that would be payable to external professionals or consultants engaged to perform such services pursuant to agreements negotiated on an arms-length basis. Such expenses have been included in the consolidated income statement.

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

FFO is used to compute the Company's incentive compensation to the Manager. FFO, for these purposes, represents net income (computed in accordance with International Financial Reporting Standards), excluding changes in fair value of investment properties net of attributable deferred taxation, changes in fair value of interest rate swaps that are taken to the income statement, unrealised movements on currency swaps (net of translation gains/losses of related assets), and accounting losses on investments made with non-recourse financing to the extent they exceed the net amount invested, but including realised gains or losses on the sale of investment properties.

At 31 December 2013, management fees, incentive fees and expense reimbursements of approximately €2.1 million (refer note 24) (31 December 2012: €3.4 million) were due to the Manager. For the year ended 31 December 2013 management fees of €9.7 million (refer note 6) (31 December 2012: €21.8 million), no incentive fees (31 December 2012: €nil), and expense reimbursements of €5.4 million (31 December 2012: €7.3 million) were charged to the income statement.

Total annual remuneration for Eurocastle directors is €0.1 million (2012: €0.2 million) payable quarterly in equal instalments. Randal A. Nardone and Peter Smith do not receive any remuneration from the Group.

As a result of the investment in Italian performing and non-performing loans, the Group is party to various servicing agreements with Italfondario S.p.A. ("Italfondario") which is majority owned by Fortress Investment Group LLC funds and affiliates. The terms of the agreements have been approved by the Independent Directors. Italfondario will provide portfolio servicing, cash management and corporate services as part of the agreements in return for an agreed fee. The fee is made up of a fixed annual amount, a percentage of the outstanding portfolio balance as well as a percentage of the amount collected. The total fee paid in the year was €1.9 million (31 December 2012: €nil). The fee is deducted from the collections prior to distribution. As such, there is no amount outstanding at 31 December 2013.

The Group's joint investment in the BNL portfolio is with a credit fund managed by the Manager. The purchase price and operating expenses were shared evenly between the two parties; as are all current and expected returns.

## 33. SEGMENTAL REPORTING

The Group operates in one geographical segment, being Europe. The Group is organised into three business units and conducts business through three primary segments: debt investments (relating to the Irish entities that it consolidates under IAS 27), German investment properties and Italian investments. The debt investments consist of investments in European real estate related debt. The investment properties segment includes investing in, financing and management of high-quality German commercial properties. The Italian Investments are currently made up of non-performing and performing loan portfolios.

The debt investment segment derives its income primarily from interest on the available-for-sale securities and loans and receivables.

The investment properties segment derives its income primarily from rental income and service charge income.

The Italian investments segment derives its income from loan collection and includes the investment in the joint venture.

Segment assets for the debt investment segment include available-for-sale securities and loans and receivables. Segment assets for the investment properties segment represent investment properties (including investment properties available-for-sale).

Segment liabilities for the debt investment segment include CDO bonds payable and bank borrowings. Bank borrowings are also included as segment liabilities within the investment properties segment.

The major tenants of the Group (including all portfolios) whose rental income exceed 10% of the Groups total rental income are:

| | 31 December 2013 | | 31 December 2012 | |
|---|---|---|---|---|
| | Passing rent €'000 | % of total portfolio | Passing rent €'000 | % of total portfolio |
| Commerzbank AG | 22,751 | 20.4% | 24,962 | 18.9% |

Summary financial data of the Group's business segments is provided below:

| **Year ended 31 December 2013** | **European Real Estate Debt €'000** | **German Commercial Real Estate €'000** | **Italian Investments €'000** | **Unallocated €'000** | **Total Adjusted Eurocastle €'000** | **Bridge, Mars Floating and Minorities €'000** | **Total Eurocastle €'000** |
|---|---|---|---|---|---|---|---|
| Revenue [1] | 14,419 | 113,673 | 5 | 32 | 128,129 | 42,364 | 170,493 |
| Impairment losses | (54,534) | - | - | - | (54,534) | - | (54,534) |
| Other operating income / (loss) | 1,535 | (22,346) | 4,285 | (115) | (16,641) | (21,427) | (38,068) |
| **Total operating income** | **(38,580)** | **91,327** | **4,290** | **(83)** | **56,954** | **20,937** | **77,891** |
| Interest expense | (5,278) | (46,721) | (1) | - | (52,000) | (20,820) | (72,820) |
| Other operating expense | (1,968) | (58,848) | (44) | (16,226) | (77,086) | (14,568) | (91,654) |
| **Total operating expenses** | **(7,246)** | **(105,569)** | **(45)** | **(16,226)** | **(129,086)** | **(35,388)** | **(164,474)** |
| **Net operating (loss) / profit** | **(45,826)** | **(14,242)** | **4,245** | **(16,309)** | **(72,132)** | **(14,451)** | **(86,583)** |
| Taxation expense / (credit) | (3) | 611 | (9) | - | 599 | 101 | 700 |
| **Net (loss) / income after taxatio** | **(45,829)** | **(13,631)** | **4,236** | **(16,309)** | **(71,533)** | **(14,350)** | **(85,883)** |
| Minority interest | - | - | - | - | - | (983) | (983) |
| **Net (loss) / income** | **(45,829)** | **(13,631)** | **4,236** | **(16,309)** | **(71,533)** | **(15,333)** | **(86,866)** |
| Decrease / (increase) in fair valu | 4 | 25,733 | (2,205) | - | 23,532 | 21,869 | 45,401 |
| Realised losses on sale | - | - | - | - | - | - | - |
| Deferred tax | - | 890 | - | - | 890 | - | 890 |
| **Funds from operations** | **(45,825)** | **12,992** | **2,031** | **(16,309)** | **(47,111)** | **6,536** | **(40,575)** |

(1) Included within revenue income is interest income of €12.7 million within the debt investment segment and €0.1 million within the investment properties segment.

| **Year ended 31 December 2012** | **European Real Estate Debt €'000** | **German Commercial Real Estate €'000** | **Italian Investments €'000** | **Unallocated €'000** | **Total Adjusted Eurocastle €'000** | **Bridge and Mars Floating €'000** | **Total Eurocastle €'000** |
|---|---|---|---|---|---|---|---|
| Revenue [1] | 23,772 | 125,682 | - | 129 | 149,583 | 41,983 | 191,566 |
| Impairment losses | (16,710) | - | - | - | (16,710) | - | (16,710) |
| Other operating income / (loss) | 31,858 | (43,938) | - | - | (12,080) | (43,876) | (55,956) |
| **Total operating income** | **38,920** | **81,744** | **-** | **129** | **120,793** | **(1,893)** | **118,900** |
| Interest expense | (8,041) | (59,474) | - | - | (67,515) | (22,067) | (89,582) |
| Other operating expenses | (2,421) | (54,253) | - | (29,448) | (86,122) | (15,642) | (101,764) |
| **Total operating expenses** | **(10,462)** | **(113,727)** | **-** | **(29,448)** | **(153,637)** | **(37,709)** | **(191,346)** |
| **Net operating profit / (loss)** | **28,458** | **(31,983)** | **-** | **(29,319)** | **(32,844)** | **(39,602)** | **(72,446)** |
| Taxation expense | - | (8,810) | - | | - | (8,810) | (416) | (9,226) |
| **Net income / (loss)** | **28,458** | **(40,793)** | **-** | **(29,319)** | **(41,654)** | **(40,018)** | **(81,672)** |
| Decrease in fair values | - | 50,778 | - | - | 50,778 | 43,880 | 94,658 |
| Realised gains on sale | - | 10,801 | - | - | 10,801 | 296 | 11,097 |
| Deferred tax | - | 1,515 | - | - | 1,515 | - | 1,515 |
| **Funds from operations** | **28,458** | **22,301** | **-** | **(29,319)** | **21,440** | **4,158** | **25,598** |

(1) Included within revenue income is interest income of €23.8 million within the debt investment segment and €0.2 million within the investment properties segment.

**Segmental Balance Sheet:**

| As at 31 December 2013 | European Real Estate Debt €'000 | German Commercial Real Estate €'000 | Italian Investments €'000 | Unallocated €'000 | Total Adjusted Eurocastle €'000 | Bridge, Mars Floating and Minorities €'000 | Total Eurocastle €'000 |
|---|---|---|---|---|---|---|---|
| Total assets | 359,171 | 1,289,629 | 17,984 | 140,313 | 1,807,097 | 506,844 | 2,313,941 |
| Total liabilities | (307,925) | (1,147,334) | (3,882) | (10,163) | (1,469,304) | (510,821) | (1,980,125) |
| **Segment net assets / (liabilities)** | **51,246** | **142,295** | **14,102** | **130,150** | **337,793** | **(3,977)** | **333,816** |
| Tax liabilities | (1) | (9,434) | - | - | (9,435) | (243) | (9,678) |
| Non-controlling interest | (2) | (4) | - | - | (6) | 2,848 | 2,842 |
| **Net assets / (liabilities)** | **51,243** | **132,857** | **14,102** | **130,150** | **328,352** | **(1,372)** | **326,980** |

| As at 31 December 2012 (restated) | European Real Estate Debt €'000 | German Commercial Real Estate €'000 | Italian Investments €'000 | Unallocated €'000 | Total Adjusted Eurocastle €'000 | Bridge, Mars Floating and Minorities €'000 | Total Eurocastle €'000 |
|---|---|---|---|---|---|---|---|
| Total assets [(1)] | 496,865 | 1,590,815 | - | 17,521 | 2,105,201 | 550,066 | 2,655,267 |
| Total liabilities | (396,058) | (1,412,848) | - | (6,694) | (1,815,600) | (530,089) | (2,345,689) |
| **Segment net assets / (liabilities)** | **100,807** | **177,967** | **-** | **10,827** | **289,601** | **19,977** | **309,578** |
| Tax liabilities | - | (17,265) | - | - | (17,265) | (201) | (17,466) |
| Non-controlling interest | (2) | (4) | - | - | (6) | - | (6) |
| **Net assets** | **100,805** | **160,698** | **-** | **10,827** | **272,330** | **19,776** | **292,106** |

(1) Corporate cash of €17.1m has been reallocated from German Commercial Real Estate to Unallocated to provide a relevant comparison against 2013.

**Segmental Cashflows:**

| As at 31 December 2013 | European Real Estate Debt €'000 | German Commercial Real Estate €'000 | Italian Investments €'000 | Unallocated €'000 | Total Adjusted Eurocastle €'000 | Bridge, Mars Floating and Minorities €'000 | Total Eurocastle €'000 |
|---|---|---|---|---|---|---|---|
| Cashflows from operating activities | 12,604 | 16,413 | (43) | (17,073) | 11,901 | 7,328 | 19,229 |
| Cashflows from investing activities | 59,929 | 231,701 | (5,910) | - | 285,720 | 22,454 | 308,174 |
| Cashflows from financing activities | (56,235) | (316,122) | (1,458) | 103,844 | (269,971) | (26,480) | (296,451) |
| **Net increase / (decrease) in cash and cash equivalents** | **16,298** | **(68,008)** | **(7,411)** | **86,771** | **27,650** | **3,302** | **30,952** |

| As at 31 December 2012 | European Real Estate Debt €'000 | German Commercial Real Estate €'000 | Italian Investments €'000 | Unallocated €'000 | Total Adjusted Eurocastle €'000 | Bridge, Mars Floating and Minorities €'000 | Total Eurocastle €'000 |
|---|---|---|---|---|---|---|---|
| Cashflows from operating activities | 12,659 | 16,631 | - | (29,318) | (28) | 1,943 | 1,915 |
| Cashflows from investing activities | 68,110 | 93,732 | - | - | 161,842 | 8,082 | 169,924 |
| Cashflows from financing activities | (49,322) | (64,051) | - | - | (113,373) | (14,368) | (127,741) |
| **Net increase / (decrease) in cash and cash equivalents** | **31,447** | **46,312** | **-** | **(29,318)** | **48,441** | **(4,343)** | **44,098** |

## 34. INVESTMENT IN SUBIDIARIES

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

The significant operating subsidiaries, in which the Group owns directly or indirectly a 100% equity interest (unless otherwise stated), are listed by jurisdiction below

***Luxembourg:***
Turret Lux Participation S.à r.l
Zama (Windhoek) S.à r.l
Sulzbach (Bridge) S.à r.l
Wiesbaden (Bridge) S.à r.l
Berlin (Bridge) S.à r.l
Galluspark (Bridge) S.à r.l
Dusseldorf Bridge) S.à r.l
Eschborn (Bridge) S.à r.l
Superstella S.à r.l
Tannenberg S.à r.l
Mars PropCo 2-39 S.à r.l
(23 real estate holding companies numbered 2, 4 - 5, 7, 9 - 24, 33, 38 - 39)
Drive S.à r.l
Italy Investment S.à r.l

***Italy:***
FMIL S.r.l
Palazzo Finance S.r.l. (Group holding of 80.66%)
SPV Ieffe S.r.l. (Group holding of 80.66%)
SPV Ieffe Due S.r.l. (Group holding of 80.66%)
SPV Ieffe Tre S.r.l. (Group holding of 80.66%)

***Germany:***
ECTGPROP1 (formerly known as Dresdner Grund-Fonds)
Shortwave Acquisition GmbH
Longwave Acquisition GmbH
Belfry GmbH & Co.KG
Truss GmbH & Co.KG

Additionally the Group has investments in Eurocastle Funding Limited, CDO IV PLC, Duncannon CRE CDO I PLC and FECO SUB SPV PLC.

Following the restructuring of the Mars Floating finance facility during 2009, the Mars Floating lender has acquired a 50% interest in the Mars Floating portfolio. The Mars Fixed 1 portfolio was restructured and deconsolidated in the second quarter of 2011. The remaining equity interest was sold in 2012.

## 35. SUBSEQUENT EVENTS

The Group has sold the remaining securities in the CDO IV portfolio for an average price of 96.4% of face value, equivalent to a yield of approximately 2.60%. After repaying the CDO IV facility in full, the sale has realised €22.5 million of NAV, resulting in a gain of €1.2 million since the third quarter. The remaining pool now consists of two junior loan investments with a total carrying value of €6.3 million.

Following the year-end, the Group has completed 555 sqm of new leases and 573 sqm of renewals. A further 3,970 sqm of new leases and 15,925 sqm of renewals are currently under negotiation. These amounts exclude the Bridge and Mars Floating portfolios.

The Group has sold a further 5 properties subsequent to year-end of €26.4 million generating €0.2 million of cash after repayment of asset level financings, and has entered into binding agreements to sell a further 8 properties for estimated total sale proceeds of €72.3 million. Once completed, these properties are expected to not to generate any cash, after repayment of asset level financings.

Subsequent to the year-end, the Company has deposited €62 million in to a reserve account in connection with a tender offer it has made for certain listed Italian real estate fund units.

**Bridge Portfolio**

On 15 January 2014, the Bridge Portfolio financing matured without any agreement on an extension or a refinancing. Following the execution of the Lender's security shares in the Company's subsidiaries holding the Bridge portfolio were transferred out of the Group. Consequently, the Group deconsolidated the Bridge portfolio.

Prior to deconsolidation, the Group received €2.6 million of surplus cash that was consequently suspended within the portfolio pending agreement around an extension which was not ultimately reached.

The impact of the deconsolidation on the balance sheet as at 31 December 2013 is as follows:

| | Balance sheet as at 31 December 2013 €'000 | Adjust for deconsolidation of Bridge Portfolio €'000 | Cash distribution received in January 2014 €'000 | Proforma balance sheet as at 31 December 2013 €'000 |
|---|---|---|---|---|
| **Assets** | | | | |
| Cash and cash equivalents | 193,192 | (8,480) | 2,613 | 187,325 |
| Investment properties held for sale | 94,402 | - | - | 94,402 |
| Other assets | 32,896 | (1,247) | - | 31,649 |
| Available-for-sale securities | 26,879 | - | - | 26,879 |
| Loans and receivables | 316,650 | - | - | 316,650 |
| Fair value investments | 12,315 | - | - | 12,315 |
| Fixture and fittings | 4 | - | - | 4 |
| Derivative assets | 10,584 | - | - | 10,584 |
| Investment property | 1,628,104 | (398,729) | - | 1,229,375 |
| Investment in Joint Venture | 2,173 | - | - | 2,173 |
| Intangible assets | 42 | - | - | 42 |
| **Total assets** | **2,317,241** | **(408,456)** | **2,613** | **1,911,398** |
| **Equity and Liabilities** | | | | |
| **Capital and reserves** | | | | |
| Issued capital, no par value, unlimited number of shares authorised | 1,714,425 | - | - | 1,714,425 |
| Accumulated loss | (1,399,529) | (28,629) | 2,613 | (1,425,545) |
| Net unrealised loss on available-for-sale securities and loans and receivables | (11,976) | - | - | (11,976) |
| Hedging reserve | (870) | - | - | (870) |
| Perpetual subordinated convertible securities | - | - | - | - |
| Other reserves | 22,088 | - | - | 22,088 |
| **Total shareholders' equity** | **324,138** | **(28,629)** | **2,613** | **298,122** |
| Non-controlling interest | 2,842 | - | - | 2,842 |
| **Total equity** | **326,980** | **(28,629)** | **2,613** | **300,964** |
| **Liabilities** | | | | |
| Trade and other payables | 83,347 | (7,608) | - | 75,739 |
| Current taxation payable | 9,678 | (161) | - | 9,517 |
| CDO bonds payable | 299,912 | - | - | 299,912 |
| Bank borrowings | 1,561,858 | (372,058) | - | 1,189,800 |
| Derivative liabilities | 5,297 | - | - | 5,297 |
| Finance lease payable | 23,062 | - | - | 23,062 |
| Deferred taxation liability | 7,107 | | - | 7,107 |
| **Total liabilities** | **1,990,261** | **(379,827)** | **-** | **1,610,434** |
| **Total equity and liabilities** | **2,317,241** | **(408,456)** | **2,613** | **1,911,398** |
| NAV per share | 10.02 | -0.88 | 0.08 | 9.22 |

The impact of the deconsolidation on the reconciliation of FFO and normalised FFO as at 31 December 2013 is as follows:

| | For the year ended 31 December 2013 | Adjust for deconsolidation of Bridge Portfolio | Proforma for the year ended 31 December 2013 |
|---|---|---|---|
| Net loss after taxation | (86,866) | 1,284 | (85,582) |
| Decrease in fair values of investment properties | 44,759 | (8,420) | 36,339 |
| Realised gain / (loss) on sale of investment properties | 2,489 | - | 2,489 |
| Realised gain on sale of investment properties | (2,205) | - | (2,205) |
| Unrealised movements on currency swaps (net of translation gains on related assets) | - | - | - |
| Increase in fair value of interest rate swaps | 4 | - | 4 |
| Deferred tax charge on investment properties | 890 | - | 890 |
| Eliminate the Funds from Operations attributable to the Mars Floating Portfolio | 602 | - | 602 |
| **Funds from operations (FFO)** | **(40,327)** | **(7,136)** | **(47,463)** |
| | | | |
| Net realised (gains) / losses on investment property sales after sales costs and closure of swaps | 2,488 | - | 2,488 |
| Losses / (gains) on foreign currency contracts, translation and swaps | (1,424) | - | (1,424) |
| Impairment losses | 54,534 | - | 54,534 |
| Realised gain on disposal of loans and receivables | - | - | - |
| Amortisation of costs of Mars Refinancing (2) | - | - | - |
| Interest rate swap adjustments | 571 | - | 571 |
| Gain on repurchase of mezzanine financing | - | - | - |
| (Gain) / loss on transfer of investment in Mars Fixed 1 Portfolio | - | - | - |
| Gain on repurchase of debt financing | - | - | - |
| **Normalised funds from operations** | **15,842** | **(7,136)** | **8,706** |

## 36. COMMITMENTS

As at 31 December 2013, the Group has no material commitments that were not disclosed in these financial statements (31 December 2012: none).