



EUROCASTLE

REG-Eurocastle Inv. Ltd 1st Quarter Results - Part 2

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Eurocastle Inv. Ltd

Part 2 : For preceding part double-click [nRNSD8714L]

Financial Instruments

Classification

Financial assets and liabilities measured at fair value through the profit and loss account those instruments that the Company principally holds for the purpose of short-term profit taking. These include securities portfolio contracts and forward foreign exchange contracts that are not designated as effective hedging instruments.

Available-for-sale assets are financial assets that are not classified as held for trading purposes, loans and advances, or held to maturity.

Available-for-sale instruments include real estate and other asset backed securities.

Recognition

The Company recognises financial assets held for trading and available-for-sale assets on the date it commits to purchase the assets (trade date). From this date any gains and losses arising from changes in fair value of the assets are recognised.

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

Measurement

Financial instruments are measured initially at fair value plus, in the case of a financial asset or liability not measured at fair value through profit and loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.

Subsequent to initial recognition all trading instruments 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.

Fair value measurement principles

The fair value of financial instruments is based on their 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 estimated using pricing models or discounted cash flow techniques, as applicable.

Where discounted cash flow techniques are used, estimated future cash flows are based on management'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 estimated at the amount that the Company 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 trading instruments 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 cumulative gain or loss previously recognised in equity is included in the income statement for the period.

Derecognition

A financial asset is derecognised when the Company loses control over the contractual rights that comprise that asset. This occurs when the rights are realised, expire or are surrendered. A financial liability is derecognised when it is extinguished.

Assets held for trading and available-for-sale assets that are sold are derecognised and corresponding receivables from the buyer for the payment are recognised as of the date the Company commits to sell the assets. The Company uses the specific identification method to determine the gain or loss on derecognition.

Impairment

The Company 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 estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

In the case of financial assets classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is considered in determining whether the assets are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss - measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss - is removed from equity and recognised in the income statement.

Impairment losses recognised in the income statement on securities and loans are not reversed through the income statement. Subsequent increases in the fair values of debt instruments classified as available-for-sale, which can be objectively related to an event occurring after previous impairment losses have been recognized in the income statement, are recorded in the income statement. Such reversals are then taken through the income statement only to the extent previous impairment losses have been taken through the income statement.

Hedge accounting

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 firm commitment affects the net profit and loss.

Repurchase Agreements

Securities and real estate loans subject to repurchase agreements are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral. The counterparty liabilities have been classified as repurchase agreements.

Cash and Cash Equivalents

Cash and cash equivalents comprise cash at banks and in hand and short-term deposits 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, as well as cash held by the trustees of the CDO I securitisation as a reserve for future trustee expenses. As such, these funds are not available for use by the Group.

Investment Properties

Investment properties comprise 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 acquired at the end of December 2004 has been recognised at cost, being the fair value of the consideration given, including real estate transfer taxes, professional advisory fees and other acquisition costs. After initial recognition, investment properties are measured at fair value, with unrealised gains and losses recognised in the consolidated income statement.

The value of investment properties incorporates five properties which are held by the Company under finance or operating leases. An associated liability is recognised at an amount equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, determined at the inception of the lease.

Fair values for all investment properties have been determined by reference to the existing rental income and operating expenses for each property and the current market conditions in each geographical market. Fair values also incorporate current valuation assumptions which are considered reasonable and supportable by willing and knowledgeable parties.

Deferred Financing Costs

Deferred financing costs represent costs associated with the issuance of financings and are amortised over the term of such financing using the effective interest rate method.

Interest-Bearing Loans and Borrowings

All loans and borrowings, including the Company's repurchase agreements, are initially recognised at fair value, being the fair value of consideration received, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds net of transaction costs and the redemption value is recognised in the income statement over the period of

the borrowings using the effective interest method.

Minority Interests

Minority interests represent interests held by outside parties in the Company's consolidated subsidiaries.

Revenue Recognition

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

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 include 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.

Rental income is recognised on an accruals basis.

Income Tax

The Company is a Guernsey, Channel Islands limited company and is not subject to taxation. The company's subsidiaries, EFL, CDO I, CDO II and CDO III 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 Company's German subsidiary companies, Longwave and Shortwave, are subject to German income tax on income arising from its investment properties, after the deduction of allowable debt financing costs and other allowable expenses. The taxation provision for the quarter ended 31 March 2005 relates to these subsidiaries.

Foreign Currency Translation

The functional and presentation currency of the Company and its subsidiaries 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

Share-based payments are accounted for based on their fair value on grant date. In accordance with the transitional provisions of IFRS 2, Share-Based Payment the Company has restated the comparative information by way of adjusting the opening balance of equity for earlier periods. The effect of the transitional provisions is in compliance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

3. OTHER OPERATING EXPENSES

Unaudited Three Months Ended	Three Months Ended
31 March 2005	31 March 2004
e'000	e'000

Securities (including cash to be invested) 1,236,615

CMBS - Commercial Mortgage Backed Securities
Other ABS - Other Asset Backed Securities

The securities within Portfolio I are encumbered by the CDO I securitisation (Note 8). The securities within Portfolio II and Portfolio III are encumbered by the borrowings under the warehouse credit facilities for CDO II and CDO III described in Note 9.

Asset backed securities, available for sale at fair value of e405.1 million have been pledged to third parties in sale and repurchase agreements. In accordance with the revisions to IAS 39 Financial Instruments: Recognition and Measurement, effective 1 January 2005, these securities have been reclassified as pledged securities as follows:

	Unaudited 31 March 2005 e'000	31 December 2004 e'000
	-----	-----
Asset backed securities, available for sale (includes cash to be invested)	831,492	796,522
Asset backed securities pledged under repurchase agreements	405,123	467,962
	-----	-----
Total asset backed securities	1,236,615	1,264,484
	-----	-----

Net unrealised gains on available for-sale-securities and hedge instruments recognised in the statement of changes in equity were as follows:

	Unaudited 31 March 2005 e'000	31 December 2004 e'000
	-----	-----
Unrealised gains on available-for-sale securities	12,251	7,833
Unrealised losses on available-for-sale securities	(1,237)	(1,229)
Unrealised (loss)/gain on hedge instruments (Note 14)	(759)	713
	-----	-----
	10,255	7,317
	=====	=====

5. REAL ESTATE LOANS

	Current Face Amount	Amortised Cost Basis	Gross Unrealised		Carrying Value	Weighted Average			
			Gains	Losses		S&P Rating	Coupon	Yield	Maturity (Years)
	-----	-----	-----	-----	-----	-----	-----	-----	-----
Real estate loans	46,682	46,356	-	-	46,356	*	6.82%	8.07%	4.51
	=====	=====	=====	=====	=====	=====	=====	=====	=====

* Included in real estate loans are loans with a total current face amount of e23,844,000 and with an average rating of BB from Standard and Poors.

Real estate loans with a carrying value of e23.8 million have been pledged to third parties in sale and repurchase agreements. In accordance with the revisions to IAS 39 Financial Instruments: Recognition and Measurement, effective 1 January 2005, these loans have been reclassified as pledged assets

as follows:

	Unaudited 31 March 2005 e'000	31 December 2004 e'000
Real estate loans	22,512	21,938
Real estate loans pledged under repurchase agreements	23,844	-
Total real estate loans	46,356	21,938

6. OTHER ASSETS

	Unaudited 31 March 2005 e'000	31 December 2004 e'000
Interest receivable	9,262	7,800
Rent receivable	461	344
Deferred financing costs	217	217
Prepaid insurance	75	227
Derivative assets	-	990
Other assets	387	-
	10,402	9,578

Deferred financing costs represent costs associated with the issuance of a collateralised debt obligation and will be offset against the proceeds of the issuance.

7. INVESTMENT PROPERTIES

The table below shows the items aggregated under investment property in the consolidated balance sheet:

EUR '000 (unaudited)	Land & Buildings	Leasehold Property	Total
At 1 January 2004	303,480	15,034	318,514
Additions	9	-	9
At 31 March 2005	303,489	15,034	318,523

The property portfolio consists of 96 office and retail assets located throughout metropolitan and regional Germany, predominantly in western Germany. The properties were acquired from Deutsche Bank, which remains the largest occupant of the portfolio, occupying approximately 52% of the portfolio by area. Deutsche Bank's weighted average unexpired lease term is 7.0 years. Additions during the period represent additional purchase costs capitalised in respect of existing properties.

A summary of the location and proportionate value of each property in the portfolio is as follows:

Location	Number of Properties	Proportionate Value
Nordrhein-Westfalen	30	33.71%
Baden-Wurtemberg	20	23.91%
Hesse	9	8.56%
Lower Saxony	8	9.66%
Bayern	7	7.30%
Rhineland-Palatinate	6	4.54%

Saxony-Anhalt	3	4.45%
Thuringia	5	2.68%
Saxony	2	1.63%
Schleswig-Holstein	1	1.33%
Hamburg	1	0.99%
Bremen	1	0.43%
Mecklenburg-West Pomerania	2	0.51%
Brandenburg	1	0.30%

96 100.00%
=====

Fair values for the properties have been assessed by the company to be in line with the initial cost of the properties including acquisition costs, and as such, no profit or loss arising from changes in value has been brought to account in the current period.

8. BONDS PAYABLE

CDO Bonds

As at 31 March 2005 (unaudited)

Class	Rating	Current Face Amount e'000	Carrying Amount e'000	Weighted Average Cost of Financing	Weighted Average Maturity (in years)
A and B Notes	AAA/AA	351,000	347,973	2.78%	7.1

As at 31 December 2004

Class	Rating	Current Face Amount e'000	Carrying Amount e'000	Weighted Average Cost of Financing	Weighted Average Maturity (in years)
A and B Notes	AAA/AA	351,000	347,877	2.78%	7.3

None of the CDO bonds are due to be repaid within one year of the balance sheet date.

9. BANK BORROWINGS

The bank borrowings comprises of:

		31 March 2005 e'000	31 December 2004 e'000
Warehouse borrowing	(Note 9.1)	371,873	350,843
Term finance	(Note 9.2)	243,865	244,006
Revolving credit facility	(Note 9.3)	27,000	14,000
		642,738	608,849

The amounts drawn under the revolving credit facility (e27,000,000) and the warehouse borrowing facility (e371,873,000) are due for repayment within one year of the balance sheet date.

9.1 Warehouse Borrowings

In July 2004, through its subsidiaries CDO II and CDO III, the Company exercised

its option to purchase securities under the securities portfolio contract for an aggregate purchase price of approximately e77.5 million. The Company financed the purchase price through a revolving credit facility arrangement with a major investment bank, whereby the securities purchased, along with any additional securities to be acquired, are financed and held in a custody account by the bank. The Company is using this credit facility as a means of accumulating securities intended to be used in future securitisation transactions. The Company completed the securitisation of CDO III on 28 April 2005 and expects to complete the securitisation of CDO II on 5 May 2005 as described in Note 17 (Subsequent Events).

The terms of the credit facility provide for interest to be calculated with reference to floating rate benchmarks (i.e. Euribor or Sterling Libor) plus 75 basis points. The weighted average financing cost was 2.83% at 31 March 2005.

9.2 Term Financing for Investment Properties

On 23 December 2004, in order to finance the acquisition of investment properties the Company's subsidiaries entered into a e246.5 million term loan facility with a major real estate lending bank. The facility is secured in the customary manner for German real estate lending, granting security over, inter alia, all the real estate purchased as well as over rental streams and bank accounts. The term of the facility is 8.3 years with final maturity in April 2013. The interest rate on the loan is Euribor + 1.18% p.a, payable quarterly.

9.3 Revolving Credit Facility

In December 2004, the Company entered into a revolving e35 million credit facility with a major investment bank as a means of securing access to temporary working capital. The facility is secured by receivables flowing from CDO I, CDO II, CDO III and EFL and with security assignments of the Company's rights under its management agreement with Fortress Investment Group LLC. The facility contains a number of financial covenants including a maximum leverage ratio and a minimum interest cover ratio. The interest rate on drawn amounts is Euribor + 2.5% p.a., while on undrawn amounts it is 0.5% p.a.

10. REPURCHASE AGREEMENTS

In 2004, the Company's consolidated subsidiary EFL entered into a master repurchase agreement with certain major investment banks to finance the purchase of available-for-sale securities. The obligations under those agreements are guaranteed by the Company. The terms of the repurchase agreements provide for interest to be calculated with reference to floating rate benchmarks (i.e. Euribor or Sterling Libor) which resets or rolls monthly or quarterly, with the corresponding security coupon payment dates, plus an applicable spread.

The Company's carrying amount and weighted average financing cost of these repurchase agreements was approximately e403.2 million and 2.28%, respectively at 31 March 2005.

11. TRADE AND OTHER PAYABLES

	31 March 2005 e'000	31 December 2004 e'000
Security deposit	5,006	5,000
Unsettled security purchases	2,625	254,051
Interest payable	4,690	2,283
Accrued expenses	3,099	2,264
Due to affiliates - Manager	964	237
Derivative liabilities	1,235	-
Finance & operating lease payable	2,926	2,925
Other payables	-	127
	20,545	266,887

12. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing net profit (loss) available to ordinary shareholders by the weighted average number of shares of ordinary stock outstanding during the period.

Diluted earnings per share is calculated by dividing net profit (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 period.

The Company's potential ordinary shares during the period were the stock 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.

	Three Months Ended 31 March 2005	Three Months Ended 31 March 2004
Weighted average number of ordinary shares, outstanding basic	18,463,670	11,857,670
Dilutive effect of ordinary share options	710,424	10,480
Weighted average number of ordinary shares outstanding, diluted	19,174,094	11,868,150

13. SHARE CAPITAL AND RESERVES

The Company was registered in Guernsey on 8 August 2003 under the provisions of the Companies (Guernsey) Law, 1994 (as amended). On 21 October 2003, the Company issued 118,576,700 shares at e1.00 each. Pursuant to a written resolution of the Company dated 18 June 2004 the Shareholders resolved to receive one share for every ten shares previously held by them. In June 2004, through its initial public offering, the Company received subscriptions for and issued 6,600,000 ordinary shares at a price of e12 each. At the same time, the Company issued 5,000 shares to Paolo Bassi and 1,000 shares to Keith Dorrian in their capacity of Directors of the Company. The shares issued to the Directors were non-cash shares, and were issued with nil proceeds.

Under the Company's Articles of Association, the Directors have the authority to affect 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 of share options at the grant date, granted to the Manager in December 2003 and June 2004.

14. HEDGE ACCOUNTING - CASH FLOW HEDGES OF INTEREST RATE RISK

The Company's policy is to hedge its exposure to interest rates and foreign currencies on a case-by-case basis. Hedge accounting is only applied to cash flow hedges of interest rate risk exposures. Interest rate swaps under which the Company pays a fixed rate and receives a floating rate have been used to hedge the interest rate risk on floating rate long-term bank borrowing.

The gain or loss on measurement of the fair value of the interest rate swaps has been recognised in the statement of changes in equity to the extent that the swaps are effective.

The details of interest rate swaps entered into by the Company are as follows:

	31 March 2005 e000	31 December 2004 e000
Nominal amount	210,000	210,000
Pay rate	3.47%	3.47%
Receive rate	3 Month Euribor	3 Month Euribor
Remaining life	8.0 years	8.3 years
Fair value of swaps (liabilities) /assets	(759)	713

15. SHARE OPTION PLAN

In December 2003, the Company (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 "Company 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 Company, the Manager was granted options representing the right to acquire 1,185,767 ordinary shares at an exercise price of e10 per share (number of shares and exercise price adjusted for share consolidation). The fair value of the options at the date of grant was e0.2 million and was estimated by reference to an option pricing model.

In June 2004 following the IPO, the Manager was granted an additional 660,000 options at an exercise price of e12 per share. The fair value of the additional options at the date of grant was e0.2 million and was also estimated by reference to an option pricing model. The Manager options represent an amount equal to 10% of the ordinary shares issued by the Company. The options granted to the Manager were fully vested on the date of 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.

16. DIVIDENDS PAID & PROPOSED

	2005 e000
Paid during the 3 months ended 31 March 2005:	
Equity dividends on ordinary shares:	
Fourth quarter dividend for 2004: e0.33 (2003: nil)	6,093
	6,093

Dividend declared on 19 April 2005 (not recognised as a liability at 31 March 2005)

Equity dividends on ordinary shares:	
First quarter dividend for 2005: e0.33 (2004: nil)	6,095

No dividends were declared and/or paid during the three months ended 31 March 2004.

17. SUBSEQUENT EVENTS

Subsequent to quarter end, Eurocastle successfully priced two secured debt offerings to match-fund credit sensitive real estate securities and other asset

backed securities. CDO II is a £200 million collateralized debt obligation which is expected to be issued by Eurocastle CDO II PLC on 5 May 2005 to purchase sterling investments. CDO III is a €400 million financing which was issued by Eurocastle CDO III PLC on 28 April 2005 to purchase euro investments.

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