

DIRECTORS' REPORT

The Directors present their annual report and the Group's audited consolidated financial statements for the year ended 31 December 2006.

PRINCIPAL ACTIVITIES AND BUSINESS REVIEW

The Group's principal activities are property investment, development and fund management in Britain & Ireland, North America, Continental Europe and Australia Asia Pacific.

The review of the business in accordance with the requirements of Section 234ZZB of the Companies Act 1985 (the "Business Review") can be found in the review section on pages 1 to 53, which is incorporated into this report by reference.

The other information that fulfils the requirements of the Business Review is set out below.

RISKS AND UNCERTAINTIES

We aim to generate returns over the long term (5-10+ years) at or above our cost of capital. Each Operating Company endeavours to maximise its returns in accordance with an agreed stance on risk. We seek to ensure that the risks encountered by the business are identified, quantified, understood and managed in an appropriate way.

The Group's operations are managed under a devolved structure. However, since the activities of property investment, development and fund management are common to each region, the nature of business risks encountered in each region is broadly similar. Set out below is a summary of the principal risks faced by the business, followed by an explanation of each of those risks.

Market risk

Property markets are cyclical, so our businesses will always be subject to variations in the value of our portfolio. Taking a long term view, our focus is less on short term fluctuations and more on the underlying revenue generating potential of the Group.

Our exposure to market risk is mitigated through a balanced allocation of capital to different geographic markets and property sectors, which is explained in more detail under asset allocation below.

Short term market risk is more relevant in our development activity, where market conditions may affect leasing terms. We commit to development projects only after taking careful account of the outlook for our markets. Development exposures are frequently reduced by working in joint ventures. If a trading project completes at a relatively low point in the market cycle, we might retain the asset until the market recovers.

In the future we expect to be able to make use of property derivatives as a further mechanism for managing our exposure to market risk.

Asset allocation

The Group's primary financial objective is to maximise returns at acceptable levels of risk. Fundamental to this is the optimal allocation of equity between each of the Operating Companies and the devolution of property decision-making authority to local boards.

The allocation of equity to regional Operating Companies is a continuous process on an annual cycle. The process includes detailed research of long term (5+ years) macro-economic projections, a review of regional economic and Operating Company historic and projected performance, consideration of wider issues such as climate change, and the use of portfolio theory simulations. From this, the Holding Company determines a range of the desired relative weighting of capital to each region over the long term. Medium term (2-5 year) target weightings are set by reference to long term ranges, adjusted for medium term factors. Actual annual allocations are made consistent with medium term targets and long term ranges, but in response to short term (0-2 year), tactical and opportunistic considerations. The Group retains the financial capacity for unplanned opportunities that may arise.

Long term ranges agreed in January 2007, and actual equity allocations at 31 December 2006, were as follows:

Region	Percentage of Group Equity	
	Long term range %	At 31 December 2006 %
Britain & Ireland	45.0 – 65.0	60.7
Americas	12.5 – 27.5	14.7
Continental Europe	10.0 – 22.5	16.0
Australia Asia Pacific	5.0 – 20.0	7.5
Fund Management	0 – 10.0	1.1

At the Operating Company level, each board reviews the strategy within its region annually. This review takes account of the geographic allocation in the region as well as the allocation between sectors and the split between investment and development.

The current distribution of the Group's portfolio by sector and region is shown in the portfolio summary on pages 112 and 113, and the distribution of total assets under management is shown on pages 4 and 5.

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Property risks

Investment properties

The principal risk in property investment is the loss of income. We ensure that properties are properly maintained and managed, occupancy is maximised and our exposure to individual tenants is managed. Asset management is undertaken by teams with overall responsibility for the properties within their portfolios. Day to day property management is either outsourced to professional property managers or managed in house.

Leasing risk is managed by dedicated in house leasing teams and the use of professional leasing agents. Exposure to individual tenants or sector groups is reduced by maintaining a diversified tenant base and by reviewing the credit worthiness of new tenants.

Developments

In property development the main risks arise in managing the development cycle, including obtaining appropriate planning consents and controlling the construction process. We have dedicated teams involved in site assembly and planning and we limit committed expenditure prior to planning consent being obtained. Construction risk is managed by in house project management teams using external contractors. In many cases construction risk is shared with partners.

Capital raising

We have no plans to seek further equity capital through the issue of new shares. Capital for investment is available from retained earnings. Our preference for working with partners and fund management investors provides access to capital, beyond our own resources, for investment and development opportunities. Recognising the importance of this source of capital we established Grosvenor Fund Management two years ago. Working with like minded investors in property is now a core part of our business.

Acquisitions and sales

When acquiring or selling property the principal risk is in underwriting the future income flows in order to determine an appropriate price. Timing of property transactions is managed as part of the annual asset allocation review within each Operating Company. Estimated price levels are supported by detailed financial appraisals – which are conducted for all property transactions. Where deals occur within joint ventures or funds, they require the approval of an investment committee which is independent from the asset management team. Every property transaction is subject to a due diligence review, including corporate due diligence where properties are acquired within corporate vehicles.

Health and safety

Grosvenor operates in four regions of the world and across a range of sectors including offices, residential, retail, business parks and light industrial. The Group is committed to achieving high standards of health and safety throughout the business and adhering to best practice.

Overall responsibility for health and safety is taken by the Group Finance Director. Each Operating Company board is responsible for health and safety in its business with the support of the internal Health and Safety Director and external consultants with local expertise to help them achieve compliance.

The Group's objective is to ensure that employees throughout the Group are well informed and consulted on matters regarding health and safety which is treated as a key part of the wider risk management process.

Each Operating Company formally reports its compliance each year and progress is monitored on a regular basis.

The Group continues to review its reporting of performance information and has implemented a health and safety IT management system to assist the business. All accidents and cases of ill health are treated seriously. In 2006 each business had a health and safety action plan and made good progress in completing these plans.

In 2006, there were 170 (2005 – 29) incidents relating to premises and projects that Grosvenor controls that were reportable to statutory authorities. The increase arises from an expansion in our development activities and relates to injuries to third parties.

Grosvenor did not receive any enforcement action from statutory Health and Safety authorities in 2006.

Health and safety targets have been developed by the Group and each Operating Company. These include achieving a full understanding of the risk burden that each business needs to manage and receiving assurances that we have management systems in place to cope with workplace and other risks.

Environment

The Group takes a long term view of its activities and responsibilities. Environmental considerations are therefore an important factor throughout the management of all Group companies. Two main principles are observed:

- Grosvenor seeks to identify and minimise its environmental impact, wherever it occurs, aiming for continuous improvement in performance; and
- Grosvenor seeks to make a positive contribution to sustainable development, giving consideration to environmental, economic and social sustainability in all its operations.

These principles are applied through specific objectives, policies, targets and benchmarks which are managed at Operating Company level. The Director responsible for environmental policy is the Group Chief Executive.

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Reputation and brand

We are aware that the professional reputation of the individuals and businesses within the Group is an important intangible asset, as is the Grosvenor brand. We seek to manage those assets by investing appropriately in them, and by identifying potential reputational or brand risks and acting swiftly to mitigate them whether they be real or perceived. In 2006 we enhanced the expertise available to us by increasing our in house and consultancy resource in reputation management; for 2007 we have initiated a Group-wide project to continue the development of our brand.

Financial risks

Liquidity/cashflow

Grosvenor obtains financing from a number of sources, including secured lending at project level together with secured and unsecured borrowing at the corporate level. To ensure we have sufficient available cash to meet our operating plans, cash flow projections are maintained at Operating Company level. Committed borrowing facilities are maintained as deemed appropriate. At 31 December 2006 the Group had undrawn working capital facilities of £429.1m.

We set limits at each Operating Company to ensure that the interest cost of all projected debt can be met from "sustainable" cash flows, excluding those that are dependent on property sales.

Credit

Surplus cash is deposited with major financial institutions with credit ratings at or above a specified level. We set limits to restrict the total amount of funds that can be deposited with any single counterparty.

Interest rate

Exposure to interest rate movements is controlled through the use of a mixture of floating and fixed rate debt and interest rate derivatives, to achieve the required interest rate profile.

Foreign currency

Our investments outside Britain & Ireland are held for the long term, so it is the Group's policy not to hedge the net investment in these regions. Within each region there is a certain amount of natural currency hedging as debt is drawn in local currency to finance local operations. Short term cash flows between currencies are hedged by the use of foreign exchange derivatives.

Tax

Exposure to tax risk arises as a result of the Group operating across a large number of tax jurisdictions. In addition to different tax filing requirements in each territory, there is also exposure to the impact of future changes in tax legislation. These risks are managed by an in-house team who work alongside a team of external tax advisers.

People

We take considerable care in recruiting, retaining and growing Grosvenor people. We have graduate qualifying programmes and a range of development opportunities exist. Succession planning is overseen by Remuneration Committees. Our compensation is regularly benchmarked against the market and we reward loyalty, excellence and effort.

Information technology

The Group's operations are highly dependent on the effectiveness of IT systems, including communications systems, property databases and financial systems. We have control procedures to protect the integrity and security of our data. These procedures are supported by detailed disaster recovery plans, tested on a regular basis. In 2006 we established the Business Process Group to ensure that the Group achieves business improvement through the efficient delivery of Group-wide process and system changes.

KEY PERFORMANCE INDICATORS AND MEASURES OF RETURN

At Grosvenor we take a long term view so we are less interested in year on year comparisons and more concerned with the overall trend in our performance.

We monitor total return on property assets and growth in revenue profit. We calculate total return on a proportional basis, including our share of joint ventures and associates. We define it as profit before tax and interest payable, plus revaluations and after exchange movements, as a percentage of average property assets (before current year revaluations) including cash. Revenue profit is shown in note 4.

Our achievement against these indicators is set out in the Finance Director's report on pages 12 to 15. We currently employ numerous key performance indicators throughout the Group to help achieve ambitious goals and our philosophy of continuous improvement.

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RESULTS AND DIVIDENDS

The results for the year are set out in the consolidated income statement on page 66. Profit for the year was £364.2m (2005 – £265.1m). Dividends paid during the year amounted to £9.4m (2005 – £8.5m). Subsequent to the year end a dividend of £6.7m (2005 – £6.1m) was proposed, but in accordance with IFRS has not been provided in these financial statements.

On 14 March 2007 the Company purchased the following shares from shareholders representing 6.56% of its called up share capital:

Ordinary shares	Nominal value £1	399,047
Non-voting ordinary shares	Nominal value £1	3,192,376
12% Non-cumulative irredeemable preference shares	Nominal value £1	399,047

The total consideration for the purchase of the above shares was £40.3m, funded from available cash. The reason for the purchase of the shares is to better align the shareholders' interests with the Group's activities.

DIRECTORS

Details of the Directors of the Company and their biographies are given on pages 16 and 17. All Directors served throughout the year with the exception of those set out below.

Jonathan O Hagger (resigned 31 May 2006)
 Nicholas R Scarles (appointed 1 June 2006)
 Mark R Preston (appointed 15 June 2006)
 Stephen H R Musgrave (resigned 30 June 2006)

DIRECTORS' INTERESTS IN SECURITIES

The interests of the Directors who served during the year in the share and loan capital of Grosvenor Group Limited are shown below.

	Ordinary shares		Non-voting ordinary shares		12% Non-cumulative irredeemable preference shares	
	At 1 January 2006	At 31 December 2006	At 1 January 2006	At 31 December 2006	At 1 January 2006	At 31 December 2006
Beneficial						
The Duke of Westminster	6,083,924	6,083,924	48,671,392	48,671,392	6,083,924	6,083,924
Non-beneficial						
The Earl of Home	1,515,529	1,515,529	12,124,233	12,124,233	1,515,529	1,515,529
Jeremy H M Newsum	4,290,433	4,290,433	34,323,463	34,323,463	4,290,433	4,290,433
Robin S Broadhurst	4,052,363	4,052,363	32,418,904	32,418,904	4,052,363	4,052,363

The non-beneficial interests above represent the shares owned by the respective Directors in their capacity as Trustees of the Grosvenor Trusts. There have been no changes in beneficial or non-beneficial interests since 31 December 2006 other than the beneficial interests of the Duke of Westminster, which have reduced as a result of the purchase of shares noted above.

Where a Director has a joint interest in securities, the above disclosures include for each Director the number of securities that are jointly held.

5,438 ordinary shares of Grosvenor Continental Europe Holdings S.A., representing 0.2% of its share capital, have been awarded but not yet issued to Neil Jones in connection with a long term incentive scheme.

Except as disclosed above, none of the Directors of the Company who served during the year had any interests in the securities of the Company or any of its subsidiary undertakings.

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CHARITABLE AND POLITICAL CONTRIBUTIONS

Charitable contributions during the year amounted to £1.5m (2005 – £1.3m). £1.2m was donated to the Westminster Foundation (2005 – £1.0m) which supports a wide range of charitable causes. No political contributions were made during the year (2005 – £nil).

POLICY ON PAYMENT OF SUPPLIERS

Payment terms are agreed with suppliers on an individual basis. It is the policy of both the Company and the Group to abide by the agreed terms, provided that the suppliers also comply with all relevant terms and conditions. In respect of the Group's activities in the UK, trade creditors at 31 December 2006 represented 8 days' purchases (2005 – 8 days). The Company has no trade creditors.

EMPLOYEES

The Group gives full and fair consideration to applications by disabled persons for employment. Disabled employees and those who become disabled are afforded the same training, career development and promotion opportunities as other staff. The Directors recognise the importance of good communications and relations with the Group's employees. Each part of the Group maintains employee relationships appropriate to its own particular needs and environment.

AUDITORS

The Company has elected to dispense with the obligation to appoint auditors annually and, accordingly, Deloitte & Touche LLP shall be deemed to be re-appointed as auditors for a further term under the provisions of section 386(2) of the Companies Act 1985.

In so far as the Directors are aware:

- a) there is no relevant audit information of which the auditors are unaware; and
- b) the Directors have taken all reasonable steps that they ought to have taken to make themselves aware of any relevant information and to establish that the Company's auditors are aware of that information.

This information is given in accordance with s.234ZA of the Companies Act 1985.

Judith Ball
Company Secretary
15 March 2007

UK Company registration number 3219943
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