

RAMCO GERSHENSON PROPERTIES TRUST

Form 424B5

April 27, 2011

Table of Contents

The information in this prospectus supplement is not complete and may be changed. This prospectus supplement and the accompanying prospectus are not an offer to sell these securities, and we are not soliciting offers to buy these securities, in any jurisdiction where the offer or sale is not permitted.

Filed Pursuant to Rule 424(b)(5)
Registration No. 333-156689

Subject to Completion, Dated April 27, 2011

Prospectus Supplement

(To Prospectus dated February 9, 2009)

Shares

7.25% Series D Cumulative Convertible Perpetual Preferred Shares of Beneficial Interest

We are offering _____ shares of 7.25% Series D Cumulative Convertible Perpetual Preferred Shares of Beneficial Interest (the "Series D Preferred Shares"). The annual dividend on each Series D Preferred Share is \$3.625 and is payable, when, as and if declared by our board of trustees, quarterly in cash, in arrears, on each January 1, April 1, July 1 and October 1, commencing on July 1, 2011. Each Series D Preferred Share has a liquidation preference of \$50.00 per share and is convertible, at the holder's option at any time, initially into 3.4699 of our common shares (equal to an initial conversion price of approximately \$14.41 per share), subject in each case to specified adjustments as set forth in this prospectus supplement. The Series D Preferred Shares are not redeemable by us. If a fundamental change occurs, we may be required to pay a make-whole premium on Series D Preferred Shares converted in connection therewith, through the increase of the applicable conversion rate, as described in this prospectus supplement. On or after April 20, 2018, we may at our option cause all of the outstanding Series D Preferred Shares to be mandatorily converted into that number of common shares for each Series D Preferred Share equal to the then-prevailing conversion rate if the Daily VWAP (as defined herein) of our common shares equals to or exceeds 130% of the then-prevailing conversion price for at least 20 trading days in a period of 30 consecutive trading days, including the last trading day of such 30-day period.

The Series D Preferred Shares are listed on the New York Stock Exchange (the "NYSE"), under the symbol "RPT PrD". Our common shares are traded on the NYSE under the symbol "RPT". On April 26, 2011, the last sale price of our common shares as reported on the NYSE was \$12.84 per share.

Investing in our securities involves risk. You should carefully consider each of the factors described under "Risk Factors" beginning on page S-9 of this prospectus supplement, as well as the accompanying prospectus and our most recent Annual Report on Form 10-K, which is incorporated by reference in this prospectus supplement and the accompanying prospectus, before you make any investment in our Series D Preferred Shares.

Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of the securities or passed upon the accuracy or adequacy of this prospectus supplement or the accompanying prospectus. Any representation to the contrary is a criminal offense.

Per share Total

Public offering price (1)
Underwriting discount

Proceeds, before expenses, to us

(1) Plus accrued dividends from April 6, 2011.

Delivery of our convertible preferred shares to purchasers is expected to occur on or about April 29, 2011.

Joint Book Running Managers

Deutsche Bank Securities

J.P. Morgan

KeyBanc Capital Markets

Stifel Nicolaus Weisel

Comerica Securities

PNC Capital Markets LLC

RBS

The date of this prospectus supplement is April , 2011.

You should rely only on the information contained or incorporated by reference in this prospectus supplement, the accompanying prospectus and any related free writing prospectus required to be filed with the Securities and Exchange Commission (the "SEC"). We have not, and the underwriters have not, authorized anyone to provide you with different information. We are not, and the underwriters are not, offering to sell these securities or soliciting an offer of these securities in any jurisdiction where the offer is not permitted. You should not assume that the information contained in this prospectus supplement or the accompanying prospectus is accurate as of any date other than the date on the front of this prospectus supplement. Our business, financial condition, results of operations and prospects may have changed since that date. Information contained on our web site does not constitute part of this prospectus supplement or the accompanying prospectus.

TABLE OF CONTENTS

Prospectus Supplement

	Page
<u>About This Prospectus Supplement</u>	S- 1
<u>Incorporation of Information We File With the SEC</u>	S- 1
<u>Disclosure Regarding Forward-Looking Statements</u>	S- 2
<u>Summary</u>	S- 3
<u>Risk Factors</u>	S- 9
<u>Use of Proceeds</u>	S-17
<u>Capitalization</u>	S-18
<u>Price Range of Common Shares and Dividends</u>	S-19
<u>Description of the Series D Preferred Shares</u>	S-20
<u>Additional Federal Income Tax Considerations</u>	S-44
<u>Underwriting</u>	S-51
<u>Legal Matters</u>	S-55
<u>Experts</u>	S-55

Prospectus

	Page
About This Prospectus	3
Where You Can Find More Information	3
Incorporation of Information We File With the SEC	3
Special Note Regarding Forward-Looking Statements	4
Who We Are	5
Risk Factors	6
Use of Proceeds	6
Ratios of Earnings to Fixed Charges and Preferred Share Dividends	7
The Securities We May Offer	7
Description of Debt Securities	8
Description of Common Shares	11

Description of Preferred Shares	15
Description of Warrants	20
Description of Rights	21
Certain Provisions of Maryland Law and of Our Declaration of Trust and Amended and Restated Bylaws	21
Certain Federal Income Tax Considerations	25
Legal Matters	46
Experts	46
Disclosure of SEC Position on Indemnification for Securities Act Liabilities	46

(i)

Table of Contents

ABOUT THIS PROSPECTUS SUPPLEMENT

You should read this prospectus supplement along with the accompanying prospectus and any free writing prospectus we authorize to be delivered to you, as well as the information incorporated by reference herein and therein, carefully before you invest in our Series D Preferred Shares. The documents incorporated by reference herein are described under **Where You Can Find More Information** in the accompanying prospectus and **Incorporation of Information We File With the SEC** below. These documents contain important information that you should consider before making your investment decision. This prospectus supplement and the accompanying prospectus contain the terms of this offering of Series D Preferred Shares. The accompanying prospectus contains information about our securities generally, some of which does not apply to the Series D Preferred Shares covered by this prospectus supplement. This prospectus supplement may add, update or change information contained in or incorporated by reference in the accompanying prospectus. If the information in this prospectus supplement is inconsistent with any information contained in or incorporated by reference in the accompanying prospectus, the information in this prospectus supplement will apply and will supersede the inconsistent information contained in or incorporated by reference in the accompanying prospectus.

Unless this prospectus supplement otherwise indicates or the context otherwise requires, the terms **trust**, **company**, **we**, **us** and **our** as used in this prospectus supplement refer to Ramco-Gershenson Properties Trust and/or one or more of a number of separate, affiliated entities, including Ramco-Gershenson Properties, L.P., which we refer to as our **Operating Partnership**.

INCORPORATION OF INFORMATION WE FILE WITH THE SEC

The SEC allows us to incorporate by reference into this prospectus supplement documents that we file with the SEC. This permits us to disclose important information to you by referring you to those filed documents. Any information incorporated by reference this way is considered to be a part of this prospectus, and information filed by us with the SEC subsequent to the date of this prospectus will automatically be deemed to update and supersede this information.

We incorporate by reference into this prospectus supplement the documents listed below, which we have already filed with the SEC:

our Annual Report on Form 10-K for the year ended December 31, 2010 (including the portions of our Proxy Statement on Schedule 14A, filed on April 19, 2011, incorporated by reference therein);

our Current Reports on Form 8-K filed on April 6, 2011 and April 12, 2011; and

the description of our common shares contained in our registration statement on Form 8-A filed with the SEC on November 1, 1988 (which incorporates by reference pages 101-119 of our prospectus/proxy statement filed with the SEC on November 1, 1988), as updated by the description of our common shares contained in our definitive proxy statement on Schedule 14A for our special meeting of shareholders held on December 18, 1997.

Whenever, after the date of this prospectus supplement, we file reports or documents under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended (the **Exchange Act**), those reports and documents will be incorporated by reference and deemed to be a part of this prospectus supplement from the time they are filed (other than Current Reports or portions thereof furnished under Item 2.02 or Item 7.01 of Form 8-K). Any statement made in this prospectus supplement or in a document incorporated or deemed to be

Table of Contents

incorporated by reference into this prospectus supplement will be deemed to be modified or superseded for purposes of this prospectus supplement to the extent that a statement contained in this prospectus supplement or in any other subsequently filed document that is also incorporated or deemed to be incorporated by reference into this prospectus supplement modifies or supersedes that statement. Any statement so modified or superseded will not be deemed, except as so modified or superseded, to constitute a part of this prospectus supplement.

We will provide without charge, upon written or oral request, a copy of any or all of the documents which are incorporated by reference into this prospectus supplement, excluding any exhibits to those documents unless the exhibit is specifically incorporated by reference as an exhibit to the registration statement of which this prospectus supplement forms a part. Requests for documents should be directed to Ramco-Gershenson Properties Trust, 31500 Northwestern Highway, Suite 300, Farmington Hills, Michigan 48334 (telephone number (248) 350-9900).

You should rely only on the information contained or incorporated by reference into this prospectus supplement and the accompanying prospectus. We have not authorized anyone to provide you with different or additional information. If anyone provides you with different or inconsistent information, you should not rely on it.

DISCLOSURE REGARDING FORWARD-LOOKING STATEMENTS

Information included and incorporated by reference in this prospectus supplement and the accompanying prospectus contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. You can identify these forward-looking statements by our use of the words believe, anticipate, plan, expect, may, should, will, intend, estimate, predict and similar expressions, whether in the negative or affirmative. These forward-looking statements represent our expectations or beliefs concerning future events, including: statements regarding future developments and joint ventures, rents, returns, and earnings; statements regarding the continuation of trends; and any statements regarding the sufficiency of our cash balances and cash generated from operating, investing, and financing activities for our future liquidity and capital resource needs. We caution that although forward-looking statements reflect our good faith beliefs and reasonable judgment based upon current information, these statements are not guarantees of future performance and are qualified by important factors that could cause actual results to differ materially from those in the forward-looking statements, because of risks, uncertainties, and factors including, but not limited to: the final terms of the offering and the final size of the offering; our success or failure in implementing our business strategy; economic conditions generally and in the commercial real estate and finance markets specifically; our cost of capital, which depends in part on our asset quality, our relationships with lenders and other capital providers; our business prospects and outlook; changes in governmental regulations, tax rates and similar matters; and our continuing to qualify as a REIT. Further, we have included important factors in this prospectus supplement, particularly under the heading Risk Factors beginning on page S-9, and the accompanying prospectus and the documents incorporated by reference herein, that we believe could cause our actual results to differ materially from the forward-looking statements that we make. All forward-looking statements included or incorporated by reference in this prospectus supplement and the accompanying prospectus are made as of the date hereof or the date specified herein, based on information available to us as of such date. Except as required by law, we do not undertake any obligation to update our forward-looking statements or the risk factors contained herein to reflect new information or future events or otherwise. You are cautioned not to place undue reliance on forward-looking statements.

Table of Contents

SUMMARY

This summary may not contain all the information that may be important to you in deciding whether to invest in our Series D Preferred Shares. You should read the entire prospectus supplement and the accompanying prospectus and the documents incorporated and deemed to be incorporated by reference herein and therein, including the financial statements and related notes before making an investment decision.

The Company

Ramco-Gershenson Properties Trust is a fully integrated, self-administered, publicly-traded REIT specializing in the ownership, management, development and redevelopment of community shopping centers located in the Eastern and Midwestern regions of the United States. At December 31, 2010, we owned and managed, either directly or through our interest in real estate joint ventures, a total of 89 shopping centers and one office building with approximately 20.3 million square feet of gross leasable area (GLA), of which 15.6 million square feet is owned directly by us and our real estate joint ventures.

We conduct substantially all of our business, and hold substantially all of our interests in our properties, through the Operating Partnership. The Operating Partnership, either directly or indirectly through partnerships or limited liability companies, holds fee title to all owned properties. We have the exclusive power to manage and conduct the business of the Operating Partnership. As of December 31, 2010, we owned approximately 92.9% of the interests in the Operating Partnership.

Our executive offices are located at 31500 Northwestern Highway, Suite 300, Farmington Hills, Michigan 48334. Our telephone number is (248) 350-9900. We maintain a web site that contains information about us at www.rgpt.com. The information included on the web site is not, and should not be considered to be, a part of this prospectus supplement or the accompanying prospectus and is not incorporated by reference herein or therein.

If you want to find more information about us, please see the sections entitled "Where You Can Find More Information" in the accompanying prospectus and "Incorporation of Information We File With the SEC" above.

Recent Developments

On April 26, 2011, we announced financial results for the first quarter of 2011.

Funds from Operations (FFO) for the three months ended March 31, 2011 was \$10.1 million or \$0.25 per diluted share, as compared to FFO of \$8.5 million, or \$0.25 per diluted share for the same period in 2010. FFO per share amounts were impacted by a 7.2 million increase in the number of weighted average shares outstanding for the three months ended March 31, 2011, compared to the same period in 2010.

Net loss attributable to our common shareholders for the three months ended March 31, 2011 was \$0.3 million or \$0.01 per diluted share, compared to \$0.7 million or \$0.02 per diluted share for the same period in 2010.

Table of Contents

The Offering

Issuer	Ramco-Gershenson Properties Trust.
Securities Offered	shares of 7.25% Series D Preferred Shares.
Liquidation Preference	\$50.00 per share, plus unpaid accrued and accumulated dividends.
Dividends	<p>Cumulative annual dividends of \$3.625 per share payable in cash quarterly on each January 1, April 1, July 1 and October 1, commencing on July 1, 2011, when, as and if authorized by the board of trustees out of funds legally available for the payment of dividends. Dividends will accumulate and be paid in arrears on the basis of a 360-day year consisting of twelve 30-day months. Dividends on the Series D Preferred Shares will accumulate and be fully cumulative from the most recent date to which dividends have been paid, or if no dividends have been paid, from the original issue date of the Series D Preferred Shares (April 6, 2011). Accumulated dividends on the Series D Preferred Shares will not bear interest. See Description of the Series D Preferred Shares Dividends.</p>
Ranking	<p>The Series D Preferred Shares, with respect to dividend rights and rights upon our liquidation, dissolution or winding-up of our affairs, rank:</p> <p>senior to all of our common shares and all of our other shares of beneficial interest issued in the future, unless the terms of which specifically provide that such shares rank senior to, or on a parity with, the Series D Preferred Shares;</p> <p>on a parity with any of our shares of beneficial interest issued in the future the terms of which specifically provide that such shares will rank on a parity with the Series D Preferred Shares; and</p> <p>junior to all of our shares of beneficial interest issued in the future, the terms of which specifically provide that such</p>

Table of Contents

shares will rank senior to the Series D Preferred Shares.

Maturity

The Series D Preferred Shares have no maturity date, and will not be redeemable by us. Accordingly, the Series D Preferred Shares will remain outstanding indefinitely unless you decide to convert your shares, we exercise our mandatory conversion right or the Series D Preferred Shares are otherwise repurchased or acquired by us.

Conversion Rights

Each Series D Preferred Share will be convertible, at any time, at the option of the holder thereof at an initial conversion rate of 3.4699 common shares per Series D Preferred Share (which represents an initial conversion price of approximately \$14.41 per common share), subject to adjustment as described under **Description of the Series D Preferred Shares Conversion Rate Adjustment**. In certain circumstances, holders of the Series D Preferred Shares may be restricted in their ability to convert their Series D Preferred Shares. See **Description of the Series D Preferred Shares Restrictions on Ownership and Transfer**.

Mandatory Conversion

At any time on or after April 20, 2018, we may at our option cause all (but not less than all) outstanding Series D Preferred Shares to be mandatorily converted into common shares at the then-prevailing conversion rate if the Daily VWAP (as defined herein) of our common shares is equal to or exceeds 130% of the then-prevailing conversion price for at least 20 trading days in a period of 30 consecutive trading days, including the last trading day of such 30-day period, ending on the trading day prior to our issuance of a press release announcing the mandatory conversion as described under **Description of Series D Preferred Shares Mandatory Conversion**.

Fundamental Change

If a holder converts its Series D Preferred Shares at any time beginning at the opening of business on the trading day immediately following the effective date of a fundamental change (as described under **Description of the Series D**

Table of Contents

Preferred Shares Special Rights Upon a Fundamental Change) and ending at the close of business on the 30th trading day immediately following such effective date, the holder will receive a number of our common shares equal to the greater of:

the sum of (i) the applicable conversion rate and (ii) the make-whole premium, if any, described under Description of the Series D Preferred Shares Determination of the Make-Whole Premium; and

the lesser of (i) the liquidation preference divided by the average of the volume-weighted average prices of our common shares for ten days preceding the effective date of a fundamental change and (ii) 7.9808 (subject to adjustment).

Voting Rights

Except as set forth in the articles supplementary relating to the Series D Preferred Shares, the holders of Series D Preferred Shares will have no voting rights. In the event dividends payable on the Series D Preferred Shares are in arrears for six or more quarterly dividends, the holders of the Series D Preferred Shares, voting as a single class with the holders of any other series of our preferred shares having similar voting rights, will be entitled at the next regular or special meeting of our shareholders to elect two trustees and the number of trustees that comprise our board will be increased by the number of trustees so elected. These voting rights and the terms of the trustees so elected will continue until such time as the dividend arrearage on the Series D Preferred Shares has been paid in full.

In addition, subject to certain exceptions, the affirmative vote or consent of holders of at least two-thirds of the Series D Preferred Shares outstanding at the time, given in person or by proxy, either in writing or at a meeting (voting separately as a class), will be required to (i) authorize, create or issue, or increase the authorized or issued amount of, any class or series of our shares of beneficial

Table of Contents

interest ranking senior to the Series D Preferred Shares with respect to the payment of dividends or the distribution of assets upon our liquidation, dissolution or winding up, or reclassify any authorized shares of beneficial interest into any such class or series of our shares of beneficial interest, or create, authorize or issue any obligation or security convertible or exchangeable into or evidencing the right to purchase any such class or series of our shares of beneficial interest; or (ii) amend, alter or repeal the provisions of our declaration of trust or the articles supplementary for the Series D Preferred Shares, whether by merger or consolidation or otherwise, so as to materially and adversely affect any right, preference, privilege or voting power of such Series D Preferred Shares or the holders thereof.

Use of Proceeds

We estimate that the net proceeds from this offering will be approximately \$ million. We intend to use the net proceeds we receive from this offering for working capital and other general corporate purposes. See Use of Proceeds in this prospectus supplement.

Restrictions on Ownership and Transfer

To assist us in complying with certain federal income tax requirements applicable to real estate investment trusts, among other purposes, our declaration of trust imposes certain restrictions on ownership and transfer of our shares of beneficial interest. See Description of the Series D Preferred Shares Restrictions on Ownership and Transfer in this prospectus supplement and Description of Common Shares Restrictions on Ownership and Transfer in the accompanying prospectus.

U.S. Federal Income Tax Consequences

For a discussion of the U.S. federal income tax consequences of purchasing, owning, converting and disposing of the Series D Preferred Shares and any common shares received upon conversion, see Additional Federal Income Tax Considerations in this prospectus supplement. Prospective investors are urged to consult their own tax advisors regarding

Table of Contents

these matters in light of their personal investment circumstances.

Listing

The Series D Preferred Shares are listed on the NYSE under the symbol RPT PrD. We will apply to list the Series D Preferred Shares offered hereby in excess of 240,000 shares, if applicable, on the NYSE under the existing symbol RPT PrD covering the outstanding Series D Preferred Shares.

Book Entry, Delivery and Form

The Series D Preferred Shares will be represented by one or more global certificates in definitive, fully registered form deposited with a custodian for, and registered in the name of, a nominee of the Depository Trust Company.

Risk Factors

Investing in our securities involves risks. See Risk Factors beginning on page S-9 of this prospectus supplement, as well as the accompanying prospectus and our Annual Report on Form 10-K for the year ended December 31, 2010, which is incorporated by reference herein, to read about factors you should consider before deciding whether to invest in our Series D Preferred Shares. Realization of any of those risks or adverse results could have a material adverse effect on our business, financial condition, cash flows and results of operations.

Common Shares

Our common shares are listed for trading on the NYSE under the symbol RPT.

Table of Contents

RISK FACTORS

Before investing in our securities, you should carefully consider the risks and uncertainties described below, as well as such information set forth elsewhere in this prospectus supplement, the accompanying prospectus, and any other information that is incorporated by reference, including the risks described in our reports we file with the SEC that are incorporated by reference herein.

The Series D Preferred Shares rank junior to all of our indebtedness and other liabilities and is effectively junior to all indebtedness and other liabilities of our subsidiaries.

In the event of our bankruptcy, liquidation, dissolution or winding-up of our affairs, our assets will be available to pay obligations on the Series D Preferred Shares, including the conversion of your Series D Preferred Shares into cash, if we so elect, upon a fundamental change, only after all of our indebtedness and other liabilities have been paid. The rights of holders of the Series D Preferred Shares to participate in the distribution of our assets will rank junior to the prior claims of our creditors and any future series or class of preferred shares that ranks senior to the Series D Preferred Shares. In addition, the Series D Preferred Shares effectively rank junior to all existing and future indebtedness and other liabilities of (as well as any preferred equity interests held by others in) our subsidiaries. Our subsidiaries, which owned all of our real estate investments at December 31, 2010, are separate legal entities and have no legal obligation to pay any amounts to us in respect of dividends due on the Series D Preferred Shares. If we are forced to liquidate our assets to pay our creditors, we may not have sufficient assets to pay amounts due on any or all of the Series D Preferred Shares then outstanding. We and our subsidiaries may incur substantial amounts of additional debt and other obligations that will rank senior to the Series D Preferred Shares.

We may not be able to pay dividends on the Series D Preferred Shares.

Our secured credit facility prohibits us from paying cash dividends on the Series D Preferred Shares and our common shares if we default under the credit facility, and other financing agreements that we enter into in the future also may limit our ability to pay cash dividends on our shares of beneficial interest. If we default under the credit facility, or future financing agreements restrict our ability to pay cash dividends, we will be unable to pay cash dividends on the Series D Preferred Shares unless we can refinance amounts outstanding under those agreements.

In addition, no payment or adjustment will be made upon conversion for any undeclared or, subject to limited exceptions, unpaid dividends.

Our ability to pay dividends may be impaired if any of the risks described in this prospectus supplement and the accompanying prospectus or incorporated by reference herein and in the accompanying prospectus, were to occur. In addition, payment of our dividends depends upon our earnings, our financial condition, maintenance of our REIT status and other factors as our board of trustees may deem relevant from time to time.

The price of our common shares may fluctuate significantly, which will affect the price of the Series D Preferred Shares and may make it difficult for you to resell the Series D Preferred Shares or common shares issuable upon conversion of the Series D Preferred Shares when you want or at prices you find attractive.

The price of our common shares on the NYSE has historically fluctuated significantly. Between January 1, 2009 and April 26, 2011, the trading price of our common shares has ranged from \$3.88 to \$13.51 per share. We expect that the market price of our common shares will continue to fluctuate for many reasons, including: our financial condition, performance

Table of Contents

and prospects; general economic and financial market conditions; changes in estimates by analysts; the market for similar securities issued by real estate investment trusts; and our ability to meet analysts' estimates. The market price of our common shares also may be affected by future sales of our securities, including additional issuances of common shares and securities convertible into common shares. In addition, the stock markets in general and companies operating in the real estate industry in particular have experienced extreme volatility that has often been unrelated to the operating performance of specific companies. These factors, among others, could significantly depress the trading price of our common shares. Because the Series D Preferred Shares are convertible into our common shares, volatility or depressed prices for our common shares could have a similar effect on the trading price of the Series D Preferred Shares. Holders who receive common shares pursuant to the terms of the Series D Preferred Shares also will be subject to the risk of volatility and depressed prices.

Market interest rates may affect the price of our Series D Preferred Shares.

One of the factors that will influence the price of our Series D Preferred Shares will be the dividend yield on our Series D Preferred Shares relative to market interest rates. An increase in market interest rates could cause the market price of Series D Preferred Shares to go down. The trading price of our Series D Preferred Shares also will depend on many other factors, which may change from time to time, including:

the market for similar securities;

the attractiveness of REIT securities in comparison to the securities of other companies, taking into account, among other things, the higher tax rates imposed on dividends paid by REITs;

government action or regulation;

general economic conditions or conditions in the financial or real estate markets; and

our financial condition, performance and prospects.

We may issue additional series of preferred shares that rank senior or equally to the Series D Preferred Shares as to dividend rights, rights upon liquidation or voting rights.

The Series D Preferred Shares, with respect to rights to the payment of dividends and the distribution of assets upon our voluntary or involuntary liquidation, dissolution or winding up, will rank (a) senior to our common shares and all other classes or series of our shares of beneficial interest issued in the future that specifically provide that such class or series of shares of beneficial interest ranks junior to the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up, (b) on a parity with all other classes or series of our shares of beneficial interest issued in the future other than those referred to in clauses (a) and (c) that specifically provide that such classes or series of shares of beneficial interest rank on a parity with the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up, and (c) junior to all other classes or series of our shares issued in the future that specifically provide that such classes or series of shares of beneficial interest rank senior to the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up. We also are allowed to issue additional series of preferred shares that would rank equally to the Series D preferred shares as to dividend payments and rights upon our liquidation, dissolution or winding up of our affairs pursuant to our declaration of trust, including the articles supplementary relating to the Series D Preferred Shares. The issuance of additional preferred shares could have the effect of reducing the amounts available to the Series D Preferred Shares issued in this offering upon our liquidation,

S-10

Table of Contents

dissolution or winding up of our affairs. It also may reduce dividend payments on the Series D Preferred Shares if we do not have sufficient funds to pay dividends on all Series D Preferred Shares outstanding and other classes of shares of beneficial interest with equal priority with respect to dividends.

In addition, although holders of Series D Preferred Shares are entitled to limited voting rights, as described in

Description of the Series D Preferred Shares Voting Rights, with respect to such matters, the Series D Preferred Shares will vote separately as a class along with all other series of our preferred shares upon which like voting rights have been conferred and are exercisable (which may include holders of any series of preferred shares we may issue in the future). As a result, the voting rights of holders of Series D Preferred Shares may be significantly diluted, and the holders of such other series of preferred shares may be able to control or significantly influence the outcome of any vote.

Future issuances and sales of preferred shares, or the perception that such issuances and sales could occur, may cause prevailing market prices for the Series D Preferred Shares and our common shares to decline and may adversely affect our ability to raise additional capital in the financial markets at times and prices favorable to us.

Ownership limitations in our declaration of trust, our amended and restated bylaws and the articles supplementary relating to the Series D Preferred Shares may impair the ability of holders to convert Series D Preferred Shares into our common shares.

To maintain our qualification as a REIT for federal income tax purposes, no person or entity may own more than 9.8% of the aggregate number or value of all of our outstanding common shares of beneficial interest nor may any person acquire Series D Preferred Shares such that (i) if such Series D Preferred Shares were converted into common shares, such person would own more than 9.8% of the aggregate number of all of our outstanding common shares; or (ii) he would own more than 9.8% of the aggregate value of our outstanding shares (including common shares and all series and classes of preferred shares). Any acquisition by you of Series D Preferred Shares (whether in this offering or following completion of the offering) or other classes of our shares of beneficial interest (including our common shares) that result in you exceeding any of these thresholds may not be valid. See Description of the Series D Preferred Shares Restrictions on Ownership and Transfer in this prospectus supplement and Description of Common Shares Restrictions on Ownership and Transfer in the accompanying prospectus.

The conversion rate of the Series D Preferred Shares may not be adjusted for all dilutive events that may occur.

As described under Description of the Series D Preferred Shares Conversion Rate Adjustment, we will adjust the conversion rate of the Series D Preferred Shares for certain events, including, among others:

the issuance of share dividends on our common shares;

the issuance of certain rights, options or warrants;

the distribution of shares of beneficial interest, indebtedness or assets, securities or property;

certain subdivisions and combinations of our shares of beneficial interest;

certain cash dividends on our common shares; and

certain tender or exchange offers.

S-11

Table of Contents

We will not adjust the conversion rate for other events, such as an issuance of common shares for cash or in connection with an acquisition, which may adversely affect the trading price of the Series D Preferred Shares or our common shares. If we engage in any of these types of transactions, the value of the common shares into which the Series D Preferred Shares may be convertible may be diluted. In addition, it is possible that an event will adversely affect the value of the Series D Preferred Shares or common shares but does not result in an adjustment to the conversion rate.

The additional common shares issuable to holders of our Series D Preferred Shares in connection with a fundamental change may not adequately compensate you for the lost option time value of your Series D Preferred Shares or otherwise make you whole as a result of such fundamental change.

If a fundamental change occurs, you may be entitled to receive, in certain circumstances, in addition to the number of shares equal to the applicable conversion rate, an additional number of shares upon conversion as described under Description of the Series D Preferred Shares Determination of the Make-Whole Premium. The number of additional common shares will be determined based on the date on which the fundamental change becomes effective, and the price paid per common share in the fundamental change transaction as described under Description of the Series D Preferred Shares Special Rights Upon a Fundamental Change. While the additional common shares upon conversion are designed to compensate you for the lost option time value of your Series D Preferred Shares as a result of the fundamental change, the increase is only an approximation of this lost value and may not adequately compensate you for your loss.

In addition, in certain other circumstances involving a fundamental change, you may be entitled to receive a number of our common shares for each Series D Preferred Share you convert equal to the lesser of (i) the liquidation preference divided by the Market Value (as defined below) of our common shares on the effective date of the fundamental change and (ii) 7.9808 common shares (subject to adjustment) as described under Description of the Series D Preferred Shares Special Rights Upon a Fundamental Change. To the extent the Market Value of our common shares is less than \$12.53 per share at the time of such a fundamental change, the number of shares receivable by you upon conversion in such circumstances will be limited by the 3.9904 share cap, and the value of the shares received by you will likely be less than \$50.00 per Series D Preferred Share.

Further, the fundamental change provisions will not afford protection to holders of the Series D Preferred Shares in the event of certain transactions. For example, transactions such as leveraged recapitalizations, refinancings, restructurings or acquisitions initiated by us may not constitute a fundamental change. In the event of any such transaction, the holders of the Series D Preferred Shares would not have the rights described under Description of the Series D Preferred Shares Special Rights Upon a Fundamental Change, even though each of these transactions could significantly increase the amount of our leverage, or otherwise adversely affect our capital structure, thereby adversely affecting the holders of the Series D Preferred Shares.

Our obligation to issue shares in excess of the conversion rate in connection with a fundamental change as described above could be considered a penalty, in which case its enforceability would be subject to general principles of reasonableness of economic remedies.

Table of Contents

The value of the conversion right associated with the Series D Preferred Shares may be substantially decreased or eliminated if we are party to a merger, consolidation, or other similar transaction.

If we are party to a consolidation, merger, share exchange or sale or lease of all or substantially all of our assets pursuant to which our common shares are converted into the right to receive cash, securities or other property, at the effective time of the transaction, the right to convert the Series D Preferred Shares into our common shares will be changed into a right to convert such shares into the kind and amount of cash, securities or other property which the holder would have received if the holder had converted its Series D Preferred Shares immediately prior to the transaction. This change could substantially lessen or eliminate the value of the conversion privilege associated with the Series D Preferred Shares in the future. For example, if all of our outstanding common shares were acquired for cash in a merger transaction, each of the Series D Preferred Shares would become convertible solely into cash and would no longer be convertible into securities whose value would vary depending on our future prospects and other factors.

An active trading market for the Series D Preferred Shares may not develop.

Although the Series D Preferred Shares are listed on the NYSE, we cannot assure you that a trading market will exist for those securities. Listing of the Series D Preferred Shares on the NYSE does not guarantee that a trading market for the Series D Preferred Shares will develop or, if a trading market for the Series D Preferred Shares does develop, that the depth or liquidity of that market will provide holders the ability to sell their Series D Preferred Shares on any particular basis.

There may be future sales or other dilution of our equity, which may adversely affect the market price of our common shares and the Series D Preferred Shares.

Except as described under "Underwriting" with respect to the lock-up arrangements that we will be subject to for a short period of time following this offering, we are not restricted from issuing additional common shares, including securities that are convertible into or exchangeable for, or that represent the right to receive, common shares, or additional preferred shares. The issuance of additional common shares upon conversion of the Series D Preferred Shares or other issuances of our common shares or convertible securities, including outstanding options, or otherwise will dilute the ownership interest of our common shareholders.

Sales of a substantial number of our common shares or other equity-related securities in the public market could depress the market price of the Series D Preferred Shares, our common shares, or both, and impair our ability to raise capital through the sale of additional equity securities. We cannot predict the effect that future sales of our common shares or other equity-related securities would have on the market price of our common shares or the value of the Series D Preferred Shares. The price of our common shares could be affected by sales of our common shares by investors who view the Series D Preferred Shares as a more attractive means of equity participation in our company and by hedging or arbitrage trading activity that we expect to develop involving our common shares as a result of this offering. The hedging or arbitrage could, in turn, affect the market price of the Series D Preferred Shares.

If you hold our Series D Preferred Shares, you will not be entitled to any rights with respect to our common shares, but you will be subject to all changes made with respect to our common shares.

If you hold our Series D Preferred Shares, you will not be entitled to any rights with respect to our common shares (including, without limitation, voting rights and rights to receive any dividends or other distributions on our common shares), but you will be subject to all

Table of Contents

changes affecting the common shares. You will have rights with respect to our common shares only if and when we deliver common shares to you upon conversion of your Series D Preferred Shares and, in certain cases, under the conversion rate adjustments applicable to our Series D Preferred Shares.

Provisions in the articles supplementary relating to the Series D Preferred Shares or our organizational documents could delay or prevent a change in control of our company, which could adversely affect the price of our common shares and the Series D Preferred Shares.

If a fundamental change occurs, we may be required to increase the number of common shares issuable upon conversion of the Series D Preferred Shares as described under Description of the Series D Preferred Shares Determination of the Make-Whole Premium and Description of the Series D Preferred Shares Special Rights Upon a Fundamental Change. In addition, our declaration of trust and bylaws contain anti-takeover provisions, including REIT ownership limitations, advance-notice requirements for shareholder proposals and a two-thirds shareholder vote requirement for certain amendments to our declaration of trust, that could make it more difficult for or even prevent a third party from acquiring us without the approval of our incumbent board of trustees. Provisions like these, as well as certain terms in our credit facilities and other indebtedness, could reduce the market value of our common shares or the Series D Preferred Shares and inhibit or discourage takeover attempts, even where a takeover could be beneficial to you.

Recent regulatory actions may adversely affect the trading price and liquidity of the Series D Preferred Shares.

We expect that many investors in, and potential purchasers of, the Series D Preferred Shares will employ, or seek to employ, a convertible arbitrage strategy with respect to the Series D Preferred Shares. Investors that employ a convertible arbitrage strategy with respect to convertible instruments often implement that strategy by selling short the common shares underlying the convertible instrument and dynamically adjusting their short position while they hold the convertible instrument. Investors also may implement this strategy by entering into swaps on the common shares in lieu of or in addition to short selling the common shares. As a result, any specific rules regulating equity swaps or short selling of securities or other governmental action that interfere with the ability of market participants to effect short sales or equity swaps with respect to our common shares could adversely affect the ability of investors in, or potential purchasers of, the Series D Preferred Shares to conduct the convertible arbitrage strategy that we believe they may seek to employ with respect to the Series D Preferred Shares. This could, in turn, adversely affect the trading price and liquidity of the Series D Preferred Shares.

Recent regulatory actions that could affect the ability to successfully execute convertible arbitrage and hedging strategies include the SEC's adoption in February 2010 of new short sale-related restrictions through an amendment to Rule 201 of Regulation SHO, the Financial Industry Regulatory Authority's and stock exchanges' circuit breaker pilot that commenced in June 2010, and the July 2010 enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Although the direction and magnitude of the effect that these actions and any additional regulations may have on the trading price and the liquidity of the Series D Preferred Shares will depend on a variety of factors, many of which cannot be determined at this time, past regulatory actions have had a significant impact on the trading prices and liquidity of convertible debt instruments. For example, in September 2008, the SEC issued emergency orders generally prohibiting short sales in the common shares of a variety of financial services companies while Congress worked to provide a comprehensive legislative plan to stabilize the credit and capital markets. The orders made the convertible arbitrage strategy that many

Table of Contents

convertible debt investors employ difficult to execute and adversely affected both the liquidity and trading price of convertible preferred stock issued by many of the financial services companies subject to the prohibition. Any governmental actions that restrict the ability of investors in, or potential purchasers of, the Series D Preferred Shares to effect short sales in our common shares or to implement hedging strategies, including the recently adopted amendments to Regulation SHO, the circuit breaker pilot or the implementation of the Dodd-Frank Wall Street Reform and Consumer Protection Act, could similarly adversely affect the trading price and the liquidity of the Series D Preferred Shares or our common shares.

An adverse rating of the Series D Preferred Shares may cause their trading price to decrease.

If a rating agency rates the Series D Preferred Shares, it may assign a rating that is lower than anticipated. If a rating is assigned to the Series D Preferred Shares, that rating may be lowered in the future. If rating agencies assign a lower-than-expected rating or reduce, or indicate that they may reduce, their ratings in the future, the trading price of the Series D Preferred Shares could significantly decline.

You may have taxable income if we adjust the conversion rate in certain circumstances, even if you do not receive any cash.

We will adjust the conversion rate of the Series D Preferred Shares for share splits and combinations, share dividends, certain cash dividends and certain other events that affect our capital structure. See [Description of the Series D Preferred Shares Conversion Rate Adjustment](#). If we adjust the conversion rate, or if we fail to make certain adjustments, you may be treated as having received a constructive distribution from us, resulting in taxable income to you for U.S. federal income tax purposes, even though you would not receive any cash in connection with the conversion rate adjustment and even though you might not exercise your conversion right. See [Additional Federal Income Tax Considerations](#) in this prospectus supplement. In the case of a non-U.S. shareholder, we may, at our option, withhold U.S. federal income tax with respect to any such deemed distribution from cash payments of dividends and any other payments in respect of the Series D Preferred Shares.

We may not have sufficient earnings and profits in order for distributions on the Series D Preferred Shares to be treated as dividends.

The dividends payable by us on the Series D Preferred Shares may exceed our current and accumulated earnings and profits, as calculated for U.S. federal income tax purposes, at the time of payment. If that were to occur, it would result in the amount of dividends that exceed our earnings and profits being treated first as a return of capital to the extent of the holder's adjusted tax basis in the Series D Preferred Shares and then, to the extent of any excess over such adjusted tax basis, as capital gain. See [Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Taxable Domestic Shareholders Distributions](#) and [Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Non-U.S. Shareholders Non-Dividend Distributions](#) in the accompanying prospectus.

Table of Contents

We believe that the Series D Preferred Shares and any common shares received upon your conversion of the Series D Preferred Shares do not constitute U.S. real property interests and therefore we would not generally be required to withhold from payments to non-U.S. holders under the Foreign Investment in Real Property Act, or FIRPTA. We cannot assure you, however, that the Series D Preferred Shares or our common shares will not constitute U.S. real property interests.

Although we are not currently aware of any facts that would cause our conclusion to change, depending on the facts in existence at the time of any sale, repurchase, conversion, or retirement of Series D Preferred Shares or our common shares, it is possible that the Series D Preferred Shares and common shares could constitute U.S. real property interests. If so, non-U.S. shareholders of Series D Preferred Shares or common shares would be subject to U.S. federal income tax withholding on payments in connection with such a sale, repurchase, conversion, or retirement regardless of whether such non-U.S. shareholders provide certification documenting their non-U.S. status.

If you convert your Series D Preferred Shares into our common shares and we decide to pay taxable share dividends on our common shares to meet the REIT distribution requirements, your tax liability with respect to our common shares may be greater than the amount of cash you receive.

The IRS has issued Revenue Procedure 2010-12, which provides that the IRS will treat share dividends declared on or before December 31, 2012, for taxable years ending before December 31, 2011, as distributions for purposes of satisfying the REIT distribution requirements, if each shareholder can elect to receive the distribution in cash or shares, even if the aggregate cash amount paid to all shareholders is limited, provided certain requirements are met. Taxable holders of our common shares receiving such dividends will be required to include the full amount of the dividend as income for U.S. federal income tax purposes to the extent of our current and accumulated earnings and profits. Accordingly, if we decide to pay a share dividend on our common shares in accordance with Revenue Procedure 2010-12 to you, as a holder of our common shares, your tax liability with respect to such dividend may be significantly greater than the amount of cash you receive. If you decide to sell the shares received as a dividend in order to pay this tax, the sales proceeds you receive may be less than the amount you are required to include in income with respect to the dividend, depending on the market price of the shares at the time of the sale. With respect to non-U.S. shareholders, we may be required to withhold U.S. federal income tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in shares. In addition, if a significant number of our shareholders sell shares in order to pay taxes owed on dividends, such sales may put downward pressure on the trading price of our shares. See **Additional Federal Income Tax Considerations** **Other Federal Income Tax Considerations** **Taxable Stock Dividends** in this prospectus supplement.

Table of Contents

USE OF PROCEEDS

We estimate that our net proceeds from this offering, after deducting the underwriting discount and other estimated offering expenses, will be approximately \$ million. We intend to use the net proceeds we receive from this offering for working capital and other general corporate purposes.

S-17

Table of Contents**CAPITALIZATION**

The following table sets forth our cash and capitalization as of December 31, 2010, on an actual basis and an as adjusted basis to give effect to: (1) the offer and sale of 1,600,000 Series D Preferred Shares that closed on April 6, 2011, after deducting the underwriting discount and transaction costs, (2) the offer and sale of Series D Preferred Shares at the public offering price set forth on the cover page of this prospectus supplement, after deducting the underwriting discount and estimated transaction costs, and (3) the application of the net proceeds of the offerings to retire our \$30.0 million bridge loan and reduce outstanding borrowings under our revolving credit facilities as described in Use of Proceeds in this prospectus supplement.

This table should be read in conjunction with our consolidated financial statements and related notes included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 and incorporated by reference in the accompanying prospectus.

December 31, 2010	Actual	As Adjusted
	(in thousands,	
	except share amounts)	
Cash and cash equivalents	\$ 10,175	\$
Mortgages and Notes Payable:		
Mortgages payable	363,819	363,819
Secured revolving credit facility	119,750	
Secured term loan facility	30,000	30,000
Secured bridge loan	30,000	
Junior subordinated notes	28,125	28,125
Total Mortgages and Notes Payable	\$ 571,694	\$
Shareholders' Equity:		
Preferred Shares of Beneficial Interest, par value \$0.01, 10,000,000 shares authorized:		
0 and Series D Preferred Shares issued and outstanding, at December 31, 2010 and as adjusted, respectively		
Common Shares of Beneficial Interest, par value \$0.01, 45,000,000 shares authorized and 37,947,000 shares issued and outstanding	379	379
Additional paid-in capital and other	563,370	
Accumulated distributions in excess of net income	(161,476)	(161,476)
Noncontrolling interest	37,093	37,093
Total Shareholders' Equity	439,366	
Total Capitalization	\$ 1,011,060	\$

Table of Contents**PRICE RANGE OF COMMON SHARES AND DIVIDENDS**

Our common shares are listed on the NYSE under the symbol RPT. On April 26, 2011, the last reported sales price per share of our common shares on the NYSE was \$12.84. The table below sets forth, for the periods indicated, the high and low closing sales price per share of our common shares, as reported by the NYSE, and the cash dividends declared per share with respect to such periods.

	Price Per Share		Dividends
	High	Low	Per Share
<u>Year Ended December 31, 2011</u>			
First quarter	\$ 13.51	\$ 12.43	\$ 0.1633
Second quarter (through April 26, 2011)	12.84	12.26	
<u>Year Ended December 31, 2010</u>			
First quarter	\$ 11.71	\$ 8.91	\$ 0.1633
Second quarter	12.97	9.62	0.1633
Third quarter	11.94	9.69	0.1633
Fourth quarter	12.45	10.82	0.1633
<u>Year Ended December 31, 2009</u>			
First quarter	\$ 7.16	\$ 3.88	\$ 0.2313
Second quarter	11.60	6.01	0.2313
Third quarter	10.82	8.41	0.1633
Fourth quarter	9.94	7.82	0.1633

Table of Contents

DESCRIPTION OF THE SERIES D PREFERRED SHARES

The following is a summary of certain provisions of the articles supplementary creating Series D Preferred Shares. As used in this section, the terms we, us or our refer to Ramco-Gershenson Properties Trust and not any of its subsidiaries. Please read Description of Common Shares, Description of Preferred Shares and Certain Provisions of Maryland Law and of Our Declaration of Trust and Amended and Restated Bylaws in the accompanying prospectus for a description of general terms applicable to the Series D Preferred Shares, a description of our common shares and certain provisions of our organizational documents and Maryland law.

General

We are offering an additional shares of 7.25% Series D Cumulative Convertible Perpetual Preferred Shares of Beneficial Interest (the Series D Preferred Shares) with the same terms and with the same CUSIP number as the Series D Preferred Shares offered by the Prospectus Supplement dated March 31, 2011. The additional Series D Preferred Shares constitute an additional issuance of, and form a single series with, the outstanding Series D Preferred Shares.

Articles Supplementary to our Declaration of Trust classifying 1,840,000 preferred shares as 7.25% Series D Cumulative Convertible Perpetual Preferred Shares, par value \$.01 per share were filed with the Maryland State Department of Assessments and Taxation on April 5, 2011. When issued, the Series D Preferred Shares offered hereby will be validly issued, fully paid and nonassessable by us and will have no preemptive rights.

We will contribute the net proceeds of the sale of the Series D Preferred Shares offered hereby to our operating partnership, through which we conduct substantially all of our business, in exchange for 7.25% Series D Cumulative Preferred Units, or the Series D preferred units, that have substantially identical economic terms as the Series D Preferred Shares. Our operating partnership will be required to make all required distributions on the Series D preferred units prior to any distribution of cash or assets to the holders of common partnership units or to the holders of any other equity interest of our operating partnership, except for any other series of preferred units ranking on a parity with the Series D preferred units as to distributions and liquidation, except for dividends required to enable us to maintain our qualification as a REIT.

The Series D Preferred Shares are subject to mandatory conversion, as described below in Mandatory Conversion, and are not redeemable by us.

Ranking

The Series D Preferred Shares, with respect to rights to the payment of dividends and the distribution of assets upon our voluntary or involuntary liquidation, dissolution or winding up, will rank (a) senior to our common shares and all other classes or series of our shares of beneficial interest issued in the future that specifically provide that such class or series of shares of beneficial interest ranks junior to the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up, (b) on a parity with all other classes or series of our shares of beneficial interest issued in the future, other than those referred to in clauses (a) and (c), that specifically provide that such classes or series of shares of beneficial interest rank on a parity with the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up, and (c) junior to all other classes or series of our shares of beneficial interest issued in the future that specifically provide that such classes or series of shares of beneficial interest rank senior to the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up.

Table of Contents

Dividends

Subject to the preferential rights of holders of any class or series of our shares of beneficial interest ranking senior to the Series D Preferred Shares as to the payment of dividends, holders of Series D Preferred Shares will be entitled to receive, when, if and as declared by our board of trustees, out of funds legally available for the payment of quarterly cumulative preferential cash dividends, an amount per share equal to 7.25% of the \$50.00 liquidation preference per annum (equivalent to a fixed annual amount of \$3.625 per share), payable in equal amounts of \$0.90625 per share quarterly. Dividends on the Series D Preferred Shares offered hereby shall begin to accrue and will be fully cumulative starting from April 6, 2011 and shall be payable quarterly when, if and as authorized by our board of trustees, in equal amounts in arrears on the first day of each January, April, July and October or, if not a business day, then the next succeeding business day (each, a Dividend Payment Date), and no interest or additional dividends or other sums will accrue on the amount so payable from the Dividend Payment Date to such next succeeding business day. The first dividend on the Series D Preferred Shares offered hereby, which will be paid on July 1, 2011, will be for the entire full quarter and will reflect dividends accumulated from April 6, 2011 up to, and excluding, July 1, 2011. Any dividend payable on the Series D Preferred Shares for any portion of a dividend period that ends prior to a Dividend Payment Date will be prorated and computed on the basis of a 360-day year consisting of twelve 30-day months. Dividends will be payable to holders of record as they appear in our share records at the close of business on the applicable record date, which will be the 20th day of the calendar month immediately preceding the month in which the applicable Dividend Payment Date falls or such other date designated by our board of trustees that is not more than 30 nor less than 10 days prior to such Dividend Payment Date (each, a Dividend Record Date). Notwithstanding any provision to the contrary contained in this prospectus supplement, each outstanding Series D Preferred Share will be entitled to receive a dividend with respect to any dividend record date equal to the dividend paid with respect to each other Series D Preferred Share that is outstanding on such date.

No dividend on the Series D Preferred Shares will be declared or paid or set apart for payment by our board of trustees if such authorization, declaration, payment or setting apart for payment would violate any of our agreements or is restricted or prohibited by law.

When dividends are not paid in full (or a sum sufficient for such full payment is not so set apart) upon the Series D Preferred Shares and any other class or series of our shares of beneficial interest ranking on a parity as to the payment of dividends with the Series D Preferred Shares, all dividends declared upon the Series D Preferred Shares and any other class or series of shares of beneficial interest ranking on a parity as to the payment of dividends with the Series D Preferred Shares will be declared pro rata so that the amount of dividends declared per Series D Preferred Share and such other class or series of our shares of beneficial interest will in all cases bear to each other the same ratio that accumulated dividends per Series D Preferred Share and such other class or series of shares of beneficial interest (which shall not include any accrual in respect of unpaid dividends for prior dividend periods if such class or series of our shares of beneficial interest does not have a cumulative dividend) bear to each other. No interest, or sum of money in lieu of interest, will be payable in respect of any dividend payment or payments on the Series D Preferred Shares which may be in arrears.

Except as provided in the immediately preceding paragraph:

no dividends will be declared or paid or set apart for payment and no other distribution of cash or other property will be declared or made (other than in our common shares or other class or series of shares of beneficial interest ranking on a parity with or junior to the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up) on or with respect to any of our

Table of Contents

common shares or shares of any other class or series of our shares of beneficial interest ranking, as to the payment of dividends or the distribution of assets upon our liquidation dissolution or winding up, on a parity with or junior to the Series D Preferred Shares; and

no common shares or any other class or series of shares of beneficial interest ranking junior to or on a parity with the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up will be redeemed, purchased or otherwise acquired for any consideration (or any money paid or made available for a sinking fund for the redemption of any such class or series of shares of beneficial interest) by us (except by conversion into or exchange for any other class or series of our shares of beneficial interest ranking on a parity with or junior to the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our liquidation, dissolution or winding up or by redemption, purchase or acquisition for the purpose of maintaining our qualification as a REIT);

unless full cumulative dividends on the Series D Preferred Shares have been or contemporaneously are declared and paid or declared and a sum sufficient for the payment thereof set apart for payment for all dividend periods ending on or prior to the date of such declaration, payment, set aside, redemption, purchase or acquisition.

Notwithstanding the foregoing, dividends on the Series D Preferred Shares will accrue whether or not we have earnings, whether or not there are funds legally available for the payment thereof and whether or not such dividends are authorized. Accrued but unpaid dividends on the Series D Preferred Shares will not bear interest and holders of the Series D Preferred Shares will not be entitled to any dividends in excess of full cumulative dividends as described above.

Holders of Series D Preferred Shares will not be entitled to any dividend or other distribution, whether payable in cash, property or shares of any class or series of shares of beneficial interest (including Series D Preferred Shares) in excess of full cumulative dividends on the Series D Preferred Shares as described above. Any dividend payment made on the Series D Preferred Shares will first be credited against the earliest accumulated but unpaid dividend due with respect to such shares which remains payable.

Dividends paid by regular C corporations to persons or entities that are taxed as individuals are now generally taxed at the rate applicable to long-term capital gains, which is a maximum of 15%, subject to certain limitations. Because we are a REIT, however, our dividends, including dividends paid on our Series D Preferred Shares, generally will continue to be taxed at regular ordinary income tax rates, except in limited circumstances that we do not contemplate. See Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Taxable Domestic Shareholders Distributions in the accompanying prospectus.

If, for any taxable year, we elect to designate as capital gain dividends (as defined in Section 857 of the Internal Revenue Code of 1986, as amended, or any successor revenue code or section) any portion, which we refer to as the Capital Gains Amount, of the total dividends (as determined for federal income tax purposes) paid or made available for such taxable year to holders of all classes and series of shares of beneficial interest, then the portion of the Capital Gains Amount that will be allocable to holders of Series D Preferred Shares shall be in the same proportion that the total of the dividends (as determined for U.S. federal income tax purposes) paid or made available to the holders of Series D Preferred Shares for the year bears to the total of all such dividends for the year paid with respect to all classes and series of our outstanding shares of beneficial interest.

Table of Contents

Liquidation Preference

In the event of our voluntary or involuntary liquidation, dissolution or winding up, the holders of the Series D Preferred Shares will be entitled to receive out of our assets legally available for distribution to our shareholders remaining after payment or provisions for payment of all of our debts and other liabilities liquidating distributions, in cash or property at its fair market value as determined by our board of trustees, in the amount of a liquidation preference of \$50.00 per share, plus an amount equal to any accumulated and accrued dividends (whether or not earned or authorized) to (but not including) the date of payment, before any distribution of assets is made to holders of common shares or any other class or series of our shares of beneficial interest ranking junior to the Series D Preferred Shares as to the distribution of assets upon our liquidation, dissolution or winding up, but subject to the preferential rights of the holders of any class or series of our shares of beneficial interest ranking senior to the Series D Preferred Shares as to the distribution of assets upon our liquidation, dissolution or winding up. After payment of the full amount of the liquidating distributions and all such accumulated and accrued dividends to which they are entitled, the holders of Series D Preferred Shares will have no right or claim to any of our remaining assets. None of (i) our consolidation or merger with or into another entity, (ii) a merger of another entity with or into us, (iii) a statutory share exchange by us or (iv) a sale, lease or conveyance of all or substantially all of our property or business shall be considered a liquidation, dissolution or winding up. If, upon our voluntary or involuntary liquidation, dissolution or winding up, our assets legally available for distribution to our shareholders are insufficient to make the full payment due to holders of the Series D Preferred Shares and the corresponding amounts payable on all outstanding shares of other classes or series of shares of beneficial interest ranking on a parity with the Series D Preferred Shares as to the distribution of assets upon our liquidation, dissolution or winding up, then the holders of the Series D Preferred Shares and all other such classes or series of shares of beneficial interest shall share ratably in any such distribution of assets in proportion to the full liquidating distributions (including, if applicable, accumulated and accrued dividends) to which they would otherwise be respectively entitled.

Voting Rights

Holders of Series D Preferred Shares will not have any voting rights, except as provided by law and as described below. Whenever dividends on any Series D Preferred Shares are in arrears for six or more quarterly periods, whether or not such quarterly periods are consecutive, the holders of Series D Preferred Shares (voting together as a single class with all other classes or series of our shares of beneficial interest ranking on a parity with the Series D Preferred Shares as to the payment of dividends and the distribution of assets upon our voluntary or involuntary liquidation dissolution or winding up upon which like voting rights have been conferred and are exercisable) will be entitled to vote for the election of two additional trustees who will each be elected for a one-year term. Such election shall be held at a special meeting of the shareholders and at each subsequent annual meeting until all arrearages and the dividends on the Series D Preferred Shares and such other series of preferred shares upon which like voting rights have been conferred and are exercisable for the then current dividend period have been fully paid or declared and a sum sufficient for the full payment thereof has been set aside. Vacancies for trustees elected by holders of Series D Preferred Shares and any other such series of preferred shares shall be filled by the remaining trustee so elected then in office or, if there is no such remaining trustee, by vote of holders of a majority of the outstanding Series D Preferred Shares, when they have the voting rights described above, and any other such series of preferred shares voting as a single class. A trustee elected by the holders of Series D Preferred Shares and any other such series of preferred shares may be removed with or without cause and only by vote of holders of a

Table of Contents

majority of the outstanding Series D Preferred Shares, when they have the voting rights described above, and any other such series of preferred shares voting as a single class.

So long as any Series D Preferred Shares remain outstanding, we will not, without the affirmative vote or consent of the holders of at least two-thirds of the Series D Preferred Shares outstanding at the time, given in person or by proxy, either in writing or at a meeting (voting separately as a class), (i) authorize, create or issue, or increase the authorized or issued amount of, any class or series of our shares of beneficial interest ranking senior to the Series D Preferred Shares with respect to the payment of dividends or the distribution of assets upon our liquidation, dissolution or winding up, or reclassify any of our authorized shares of beneficial interest into any such class or series of our shares of beneficial interest, or create, authorize or issue any obligation or security convertible or exchangeable into or evidencing the right to purchase any such class or series of our shares of beneficial interest; or (ii) amend, alter or repeal the provisions of our declaration of trust or the articles supplementary for the Series D Preferred Shares, whether by merger or consolidation or otherwise (an Event), so as to adversely affect any right, preference, privilege or voting power of such Series D Preferred Shares or the holders thereof; provided, however, with respect to the occurrence of any of the Events set forth in (ii) above, so long as Series D Preferred Shares remain outstanding, with changes to the terms of the Series D Preferred Shares required pursuant to and made in compliance with the provisions described under Recapitalizations, Reclassifications and Changes of our Common Shares in connection with such Event and, if such transaction also constitutes a fundamental change, the provisions under Special Rights Upon a Fundamental Change are complied with, taking into account that upon the occurrence of an Event, we may not be the surviving entity and such surviving entity may be a non-corporate entity, the occurrence of any such Event will not be deemed to adversely affect such rights, preferences, privileges or voting powers of holders of Series D Preferred Shares; and provided further that (x) any increase in the amount of the authorized preferred shares or the creation or issuance of any other series of preferred shares ranking on a parity with or junior to the Series D Preferred Shares with respect to payment of dividends and the distribution of assets upon our voluntary or involuntary liquidation, dissolution or winding up, or (y) the creation, issuance or increase in the amount of authorized shares of any other class or series of our shares of beneficial interest ranking on a parity with or junior to the Series D Preferred Shares with respect to payment of dividends and the distribution of assets upon our voluntary or involuntary liquidation, dissolution or winding up, or (z) any increase in the amount of authorized Series D Preferred Shares ranking on a parity with or junior to the Series D Preferred Shares with respect to payment of dividends and the distribution of assets upon our voluntary or involuntary liquidation, dissolution or winding up, will not require the consent of the holders of Series D Preferred Shares and will not be deemed to materially and adversely affect such rights, preferences, privileges or voting powers.

Holders of Series D Preferred Shares shall not be entitled to vote with respect to any increase in total number of authorized shares of our common shares or preferred shares, any increase in the amount of the authorized Series D Preferred Shares or the creation or issuance of any other class or series of shares of beneficial interest, or any increase in the number of authorized Series D Preferred Shares or any other class or series of shares of beneficial interest, in each case ranking on a parity with or junior to the Series D Preferred Shares with respect to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up.

In addition, the holders of such Series D Preferred Shares will not have any voting rights with respect to, and the consent of the holders of Series D Preferred Shares is not required for, the taking of any corporate action, including any merger or consolidation involving us or a sale of all or substantially all of our assets, regardless of the effect that such merger, consolidation or sale may have upon the powers, preferences, voting power or other rights or privileges of

Table of Contents

the Series D Preferred Shares, except as set forth in part (ii) of the second preceding paragraph. Except as expressly set forth in the articles supplementary that relate to the Series D Preferred Shares, the Series D Preferred Shares will not have any relative, participatory, optional or other special voting rights and powers.

The foregoing voting provisions will not apply if, at or prior to the time when the act with respect to which such vote would otherwise be required will be effected, all outstanding Series D Preferred Shares have been converted, surrendered for voluntary conversion or called for mandatory conversion and a sufficient number of our common shares shall have been deposited in trust to effect such conversion.

In any matter in which the Series D Preferred Shares may vote (as expressly provided in the articles supplementary that relate to the Series D Preferred Shares), each of the Series D Preferred Shares shall be entitled to one vote, except that when any other class or series of our preferred shares shall have the right to vote with the Series D Preferred Shares as a single class on any matter, the Series D Preferred Shares and such other class or series shall have with respect to such matters one vote per each \$50.00 of stated liquidation preference.

Redemption

The Series D Preferred Shares will not be redeemable by us. However, under certain circumstances, we may at our option cause all outstanding Series D Preferred Shares to be converted into common shares as described below under Mandatory Conversion.

Subject to applicable law, we may purchase Series D Preferred Shares, at any time, in the open market, by tender or by private agreement. Any Series D Preferred Shares that we reacquire will be retired and reclassified as authorized but unissued preferred shares, without designation as to class or series, and may thereafter be reissued as any class or series of preferred shares.

Conversion Rights

Each Series D Preferred Share will be convertible, at any time, at the option of the holder thereof at an initial conversion rate of 3.4699 of our common shares per Series D Preferred Share (the Conversion Rate) (which represents an initial conversion price of approximately \$14.41 per common share). The Conversion Rate, and thus the conversion price, will be subject to adjustment as described below under Conversion Rate Adjustment.

The holders of Series D Preferred Shares at the close of business on a Record Date will be entitled to receive the dividend payment on those shares on the corresponding Dividend Payment Date notwithstanding the conversion of such shares following that Record Date or our failure to pay the dividend due on that Dividend Payment Date. However, Series D Preferred Shares surrendered for conversion at the option of the holder during the period between the close of business on any Record Date and the close of business on the Business Day immediately preceding the applicable Dividend Payment Date must be accompanied by payment of an amount equal to the dividend payable on such shares on that Dividend Payment Date. A holder of Series D Preferred Shares on a Record Date who (or whose transferee) surrenders any shares for conversion on the corresponding Dividend Payment Date will receive the dividend payable by us on the Series D Preferred Shares on that date, and the converting holder need not include payment in the amount of such dividend upon surrender of Series D Preferred Shares for conversion. Except as provided above with respect to a voluntary conversion and as provided under Mandatory Conversion and Special Rights Upon a Fundamental Change, we will make no payment or allowance for unpaid dividends, whether or not in arrears, on converted shares or for dividends on the common shares issued upon conversion.

Table of Contents

The articles supplementary relating to the Series D Preferred Shares require that we at all times reserve and keep available for issuance upon conversion of the Series D Preferred Shares a sufficient number of authorized and unissued common shares to permit the conversion of all outstanding Series D Preferred Shares and that we use our reasonable best efforts to take all action required to increase the authorized number of common shares if at any time there are insufficient unissued common shares to permit such reservation or to permit the conversion of all outstanding Series D Preferred Shares.

In addition, the articles supplementary relating to the Series D Preferred Shares provide that any common shares issued upon conversion of the Series D Preferred Shares will be validly issued, fully paid and nonassessable and that we will use our reasonable best efforts to list the common shares required to be delivered upon conversion of the Series D Preferred Shares, prior to such delivery, upon each national securities exchange, if any, upon which the outstanding common shares are listed at the time of delivery.

Restrictions on Ownership and Transfer

For us to qualify as a REIT under the Code, among other things, not more than 50% in value of our outstanding shares of beneficial interest may be owned, directly or indirectly, by five or fewer individuals (defined in the Code to include certain entities) during the last half of a taxable year (other than the first taxable year), and such shares of beneficial interest must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months (other than the first taxable year) or during a proportionate part of a shorter taxable year. This test is applied by looking through certain shareholders which are not individuals (e.g., corporations or partnerships) to determine indirect ownership of us by individuals.

In order to protect us against the risk of losing our status as a REIT due to a concentration of ownership among our shareholders, our declaration of trust, subject to certain exceptions, provides that no shareholder may own, or be deemed to own by virtue of the attribution provisions of the Code, more than 9.8% (the Ownership Limit) of the lesser of the aggregate number or value of our outstanding common shares. The articles supplementary creating the preferred shares designated as the Series D Preferred Shares will provide that no shareholder may own, or be deemed to own by virtue of the attribution provisions of the Code, nor may any shareholder acquire Series D Preferred Shares such that (i) if such Series D Preferred Shares were converted into common shares, such person would own more than 9.8% of the aggregate number of all of our outstanding common shares; or (ii) he would own, more than 9.8% of the aggregate value of our outstanding shares (including common shares and all series and classes of preferred shares). Any direct or indirect ownership of shares of beneficial interest in excess of the Ownership Limit or the aggregate ownership limit or that would result in our disqualification as a REIT, including any transfer that results in our shares of beneficial interest being owned by fewer than 100 persons or results in us being closely held within the meaning of Section 856(h) of the Code, shall be null and void, and the intended transferee will acquire no rights to the shares of beneficial interest. The foregoing restrictions on transferability and ownership contained in our declaration of trust will not apply if our board of trustees determines that it is no longer in our best interests to attempt to qualify, or to continue to qualify, as a REIT. Our board of trustees may, in its sole discretion, waive the Ownership Limit if evidence satisfactory to our board of trustees and tax counsel is presented that the changes in ownership will not then or in the future jeopardize our REIT status and our board of trustees otherwise decides that such action is in our best interest.

For a discussion of the treatment of shares deemed to be in excess of the Ownership Limit, see Description of Common Shares Restrictions On Ownership And Transfer in the accompanying prospectus.

These restrictions will not preclude settlement of transactions through the NYSE.

Table of Contents

All certificates representing shares of beneficial interest will bear a legend referring to the restrictions described above.

Each shareholder shall upon demand be required to disclose to us in writing any information with respect to the direct, indirect and constructive ownership of our shares of beneficial interest as our board of trustees deems necessary to comply with the provisions of the Code applicable to REITs, to comply with the requirements of any taxing authority or governmental agency or to determine any such compliance.

The Ownership Limit may have the effect of delaying, deferring or preventing our change in control unless our board of trustees determines that maintenance of REIT status is no longer in our best interest.

Conversion Procedures

On the date of any conversion at the option of the holders, if a holder's interest is a beneficial interest in a global certificate representing Series D Preferred Shares, the holder must comply with the Depositary's procedures for converting a beneficial interest in a global security. The Depositary Trust Company initially will act as Depositary.

If a holder's interest is in certificated form, a holder must do each of the following in order to convert:

- complete and manually sign the conversion notice, which is irrevocable, provided by the conversion agent, or a facsimile of the conversion notice, and deliver this notice to the conversion agent;

- surrender the Series D Preferred Shares to the conversion agent;

- if required, furnish appropriate endorsements and transfer documents;

- if required, pay any share transfer, documentary, stamp or similar taxes not payable by us; and

- if required, pay funds equal to any declared and unpaid dividend payable on the next Dividend Payment Date to which such holder is entitled.

The date on which a holder complies with the foregoing procedures is the conversion date.

The conversion agent for the Series D Preferred Shares is initially the transfer agent. A holder may obtain copies of the required form of the conversion notice from the conversion agent. The conversion agent will, on a holder's behalf, convert the Series D Preferred Shares into our common shares, in accordance with the terms of the notice delivered by us. A share certificate or certificates representing the common shares to be delivered in connection with the conversion, together with, if applicable, any payment of cash in lieu of fractional shares, will be delivered by us to the holder, or in the case of global certificates, a book-entry transfer through the Depositary will be made by the conversion agent. Such delivery will be made as promptly as practicable, but in no event later than three Business Days following the conversion date.

The person or persons entitled to receive the common shares issuable upon conversion of the Series D Preferred Shares will be treated as the record holder(s) of such shares as of the close of business on the applicable conversion date. On the conversion date, all rights with respect to the Series D Preferred Shares so converted, including the rights, if any, to receive notices, will terminate, except only the rights of holders thereof to receive the number of whole common shares into which such Series D Preferred Shares have been converted (with such adjustment or cash payment for fractional shares as we may elect, as described under "No Fractional Shares") and, if applicable, any additional common shares or other consideration as

Table of Contents

may be issuable upon conversion in payment of a make-whole premium or otherwise as described under **Special Rights Upon a Fundamental Change** or any reference property that may be issuable in lieu of common shares upon conversion as described under **Recapitalizations, Reclassifications and Changes of our Common Shares** and the rights to which they are otherwise entitled as holders of common shares or other property receivable upon conversion. Prior to the close of business on the applicable conversion date, the common shares issuable upon conversion of the Series D Preferred Shares will not be deemed to be outstanding for any purpose and you will have no rights with respect to the common shares, including voting rights, rights to respond to tender offers and rights to receive any dividends or other distributions on the common shares, by virtue of holding the Series D Preferred Shares.

Mandatory Conversion

At any time on or after April 20, 2018, we may at our option cause all (but not less than all) outstanding Series D Preferred Shares to be mandatorily converted into a number of common shares for each Series D Preferred Shares equal to the then-prevailing Conversion Rate, if the Daily VWAP (as defined below) of our common shares equals or exceeds 130% of the then-prevailing conversion price for at least 20 Trading Days in a period of 30 consecutive Trading Days, including the last Trading Day of such 30-day period, ending on the Trading Day prior to our issuance of a press release announcing the mandatory conversion as described below.

The term **Trading Day** means a day during which (i) trading in securities generally occurs on the NYSE or, if our common shares are not listed on the NYSE, on the other principal national securities exchange on which our common shares are then listed or, if our common shares are not listed on a national securities exchange, on the principal other market on which our common shares are then traded and (ii) there is no Market Disruption Event. A **Trading Day** only includes those days that have a scheduled closing time of 4:00 p.m. (New York City time) or the then standard closing time for regular trading on the relevant exchange or trading system. If our common shares are not so listed or traded, **Trading Day** means a **Business Day**.

Market Disruption Event means (1) a failure by the NYSE or, if our common shares are not listed on the NYSE, the principal U.S. national securities exchange on which our common shares are listed or, if our common shares are not listed on a national securities exchange, on the principal other market on which our common shares are then traded, to open for trading during its regular trading session or (2) the occurrence or existence prior to 1:00 p.m. on any Trading Day for our common shares of an aggregate one half hour period of any suspension or limitation imposed on trading (by reason of movements in price exceeding limits permitted by the stock exchange or otherwise) in our common shares or in any options, contracts or future contracts relating to our common shares.

Daily VWAP means the average of the per share volume-weighted average prices of our common shares for each day, as displayed under the heading **Bloomberg VWAP** on Bloomberg page **RPT.UN <Equity> AQR (NYSE VWAP)** (or its equivalent successor if such page is not available) in respect of the period from scheduled open of trading until the scheduled close of trading of the primary trading session on each such Trading Day (or if such volume-weighted average price is unavailable on any such day, the Closing Sale Price shall be used for such day). The per share volume-weighted average price on each such day will be determined without regard to after hours trading or any other trading outside of the regular trading session trading hours.

The **Closing Sale Price** of our common shares on any date means the closing sale price per share (or if no closing sale price is reported, the average of the closing bid and ask prices or, if more than one in either case, the average of the average closing bid and the average

Table of Contents

closing ask prices) on such date as reported on the NYSE or, if our common shares are not listed on the NYSE, on the principal other national securities exchange on which our common shares are then listed or, if our common shares are not listed on a national securities exchange, on the principal other market on which our common shares are then traded. If our common shares are not so listed, the Closing Sale Price will be an amount determined in good faith by our board of trustees to be the fair value of the common shares.

To exercise the mandatory conversion right described above, we must issue a press release for publication on the Dow Jones News Service or Bloomberg Business News (or if either such service is not available, another broadly disseminated news or press release service selected by us) prior to the opening of business on the first Trading Day following any date on which the conditions described in the first paragraph of this Mandatory Conversion section are met, announcing such a mandatory conversion. We also will give notice by mail or by publication (with subsequent prompt notice by mail) to the holders of the Series D Preferred Shares (not more than four Business Days after the date of the press release) of the mandatory conversion announcing our intention to convert the Series D Preferred Shares. The conversion date will be the date (which we refer to as the Mandatory Conversion Date) that is five Trading Days after the date on which we issue such press release.

In addition to any information required by applicable law or regulation, the press release and notice of a mandatory conversion shall state, as appropriate:

the Mandatory Conversion Date;

the number of our common shares to be issued upon conversion of each Series D Preferred Share;

the number of Series D Preferred Shares to be converted; and

that dividends on the Series D Preferred Shares to be converted will cease to accrue on the Mandatory Conversion Date.

On and after the Mandatory Conversion Date, dividends will cease to accrue on the Series D Preferred Shares that are subject to a mandatory conversion and all rights of holders of such Series D Preferred Shares will terminate except for the right to receive the common shares issuable upon conversion thereof. The dividend payment with respect to any Series D Preferred Shares that are subject to a mandatory conversion on a date during the period between the close of business on any Record Date for the payment of dividends to the close of business on the corresponding Dividend Payment Date will be payable on such Dividend Payment Date to the record holders of such shares on such Record Date if such shares have been converted after such Record Date and prior to such Dividend Payment Date. Except as provided in the immediately preceding sentence, no payment or adjustment will be made upon mandatory conversion of any Series D Preferred Shares for unpaid accrued and accumulated dividends or for dividends with respect to the common shares issued upon such conversion.

We may not authorize or give notice of any mandatory conversion unless, prior to giving the conversion notice, all accumulated and unpaid dividends on the Series D Preferred Shares for all quarterly dividend periods ending on or prior to the date on which we give such notice shall have been paid.

In addition to the mandatory conversion provision described above, if there are fewer than 150,000 Series D Preferred Shares outstanding, we may, at any time on or after April 20, 2018, at our option, cause all such outstanding Series D Preferred Shares to be converted into the number of whole common shares equal to the greater of (i) the then-prevailing Conversion Rate and (ii) the liquidation preference divided by the Market Value of the common shares as determined on the second Trading Day immediately prior to the Mandatory Conversion Date. The provisions of the immediately preceding four paragraphs shall apply to any such

Table of Contents

mandatory conversion pursuant to this paragraph; provided, however, that (1) the Mandatory Conversion Date will not be less than 15 calendar days nor more than 30 calendar days after the date on which we issue a press release announcing such mandatory conversion and (2) the press release and notice of mandatory conversion will not state the number of common shares to be issued upon conversion of each Series D Preferred Share.

The term **Market Value** means the average of the Daily VWAP of our common shares for each day during a 10 consecutive Trading Day period ending immediately prior to the date of determination.

Conversion Rate Adjustment

The applicable Conversion Rate will be subject to adjustment, without duplication, upon the occurrence of any of the following events:

(1) If we issue our common shares as a dividend or distribution on our common shares, or if we effect a share split or share combination, the Conversion Rate will be adjusted based on the following formula:

$$CR_1 = CR_0 \times \frac{OS_1}{OS_0}$$

where,

CR_0 = the Conversion Rate in effect immediately prior to the open of business on the Ex-Date for such dividend or distribution, or the open of business on the effective date of such share split or share combination, as the case may be;

CR_1 = the Conversion Rate in effect immediately after the open of business on the Ex-Date for such dividend or distribution, or the open of business on the effective date of such share split or share combination, as the case may be;

OS_0 = the number of common shares outstanding immediately prior to the open of business on the Ex-Date for such dividend or distribution, or the open of business on the effective date of such share split or share combination, as the case may be; and

OS_1 = the number of common shares outstanding immediately after such dividend or distribution, or such share split or share combination, as the case may be.

Any adjustment made under this clause (1) shall become effective immediately after the open of business on the Ex-Date for such dividend or distribution, or immediately after the open of business on the effective date for such share split or share combination. If any dividend or distribution of the type described in this clause (1) is declared but not so paid or made, or any share split or combination of the type described in this clause (1) is announced but the outstanding common shares are not split or combined, as the case may be, the Conversion Rate shall be immediately readjusted, effective as of the date our board of trustees determines not to pay such dividend or distribution, or not to split or combine our outstanding common shares, as the case may be, to the Conversion Rate that would then be in effect if such dividend, distribution, share split or share combination had not been declared or announced.

Table of Contents

(2) If we distribute to all or substantially all holders of our common shares any rights, options or warrants entitling them, for a period expiring not more than 45 days immediately following the record date of such distribution, to purchase or subscribe for our common shares at a price per share less than the average of the Daily VWAP of our common shares over the 10 consecutive Trading-Day period ending on the Trading Day immediately preceding the Ex-Date for such distribution, the Conversion Rate will be increased based on the following formula:

$$CR_1 = CR_0 \times \frac{OS_0 + X}{OS_0 + Y}$$

where,

CR_0 = the Conversion Rate in effect immediately prior to the open of business on the Ex-Date for such distribution;

CR_1 = the Conversion Rate in effect immediately after the open of business on the Ex-Date for such distribution;

OS_0 = the number of our common shares outstanding immediately prior to the open of business on the Ex-Date for such distribution;

X = the total number of our common shares issuable pursuant to such rights, options or warrants; and

Y = the number of our common shares equal to the aggregate price payable to exercise such rights, options or warrants divided by the average of the Daily VWAP of our common shares over the 10 consecutive Trading-Day period ending on the Trading Day immediately preceding the Ex-Date for such distribution.

Any increase made under this clause (2) will be made successively whenever any such rights, options or warrants are distributed and shall become effective immediately after the open of business on the Ex-Date for such distribution. To the extent that common shares are not delivered after the expiration of such rights, options or warrants, the Conversion Rate shall be readjusted to the Conversion Rate that would then be in effect had the increase with respect to the distribution of such rights, options or warrants been made on the basis of delivery of only the number of common shares actually delivered. If such rights, options or warrants are not so distributed, the Conversion Rate shall be decreased to be the Conversion Rate that would then be in effect if such Ex-Date for such distribution had not occurred.

In determining whether any rights, options or warrants entitle the holders to subscribe for or purchase our common shares at less than such average of the Daily VWAP for the 10 consecutive Trading Day period ending on the Trading Day immediately preceding the Ex-Date for such distribution, and in determining the aggregate offering price of such common shares, there shall be taken into account any consideration received by us for such rights, options or warrants and any amount payable on exercise or conversion thereof, the value of such consideration, if other than cash, to be determined by our board of trustees in its good faith judgment.

(3) If we distribute shares of beneficial interest, evidences of our indebtedness or other assets, securities or property, to all or substantially all holders of our common shares, excluding:

dividends or distributions referred to in the first and second clauses above;

spin-offs to which the provisions set forth in the latter portion of this third clause shall apply; and

Table of Contents

dividends or distributions paid exclusively in cash referred to in the fourth clause below, then the Conversion Rate will be increased based on the following formula:

$$CR_1 = CR_0 \times \frac{SP_0}{SP_0 - FMV}$$

where,

CR_0 = the Conversion Rate in effect immediately prior to the open of business on the Ex-Date for such distribution;

CR_1 = the Conversion Rate in effect immediately after the open of business on the Ex-Date for such distribution;

SP_0 = the average of the Daily VWAP of our common shares over the 10 consecutive Trading-Day period ending on the Trading Day immediately preceding the Ex-Date for such distribution; and

FMV = the fair market value (as determined by our board of trustees in its good faith judgment) of the shares of beneficial interest, evidences of indebtedness, assets, securities or property distributable with respect to each outstanding common share on the Ex-Date for such distribution.

If FMV (as defined above) is equal to or greater than the SP_0 (as defined above), in lieu of the foregoing increase, each holder of a Series D Preferred Share shall receive in respect of each Series D Preferred Share owned by it, at the same time and upon the same terms as holders of our common shares, the amount and kind of our shares of beneficial interest, evidences of our indebtedness, other assets, securities or property of ours that such holder would have received as if such holder owned a number of common shares equal to the Conversion Rate in effect on the Ex-Date for the distribution.

Any increase made under the above portion of this clause (3) will become effective immediately after the open of business on the Ex-Date for such distribution.

With respect to an adjustment pursuant to this third clause where there has been a payment of a dividend or other distribution on our common shares of shares of beneficial interest of any class or series, or similar equity interests, of or relating to a subsidiary or other business unit where such shares of beneficial interest or similar equity interest is listed or quoted (or will be listed or quoted upon consummation of the spin-off (as defined below)) on a national securities exchange, which we refer to as a spin-off, the Conversion Rate in effect immediately before 5:00 p.m., New York City time, on the tenth Trading Day immediately following, and including, the Ex-Date for the spin-off will be increased based on the following formula:

$$CR_1 = CR_0 \times \frac{FMV + MP_0}{MP_0}$$

where,

CR_0 = the Conversion Rate in effect immediately prior to the close of business on the tenth Trading Day immediately following, and including, the Ex-Date for the spin-off;

CR_1 = the Conversion Rate in effect immediately after the close of business on the tenth Trading Day immediately following, and including, the Ex-Date for the spin-off;

FMV = the average of the volume-weighted average sale prices of the shares of beneficial interest or similar equity interest distributed to holders of our common shares applicable to one common share over the 10 consecutive Trading-Day period immediately following, and including, the Ex-Date for the spin-off; and

S-32

Table of Contents

MP_0 = the average of the Daily VWAP of our common shares over the 10 consecutive Trading-Day period immediately following, and including, the Ex-Date for the spin-off.

The adjustment to the Conversion Rate under the preceding paragraph will occur at the close of business on the tenth Trading day immediately following, and including, the Ex-Date for the spin-off; provided that, for purposes of determining the Conversion Rate, in respect of any conversion during the 10 Trading Days following, and including, the effective date of any spin-off, references within the portion of this clause (3) related to spin-offs to 10 consecutive Trading Days shall be deemed replaced with such lesser number of consecutive Trading Days as have elapsed between the effective date of such spin-off and the relevant conversion date.

If the dividend or distribution described in this third clause is declared but not paid or made, the new Conversion Rate shall be readjusted to be the Conversion Rate that would then be in effect if such dividend or distribution had not been declared.

(4) If any cash dividend or distribution is made to all or substantially all holders of our common shares (excluding any dividend or distribution in connection with our liquidation, dissolution or winding up) during any of our quarterly fiscal periods in an aggregate amount that, together with other cash dividends or distributions made during such quarterly fiscal period, exceeds the product of \$0.1633, which we refer to as the reference dividend, multiplied by the number of common shares outstanding on the record date for such distributions, the Conversion Rate will be increased based on the following formula:

$$CR_1 = CR_0 \times \frac{SP_0}{SP_0 - C}$$

where,

CR_0 = the Conversion Rate in effect immediately prior to the open of business on the Ex-Date for such dividend or distribution;

CR_1 = the Conversion Rate in effect immediately after the open of business on the Ex-Date for such dividend or distribution;

SP_0 = the average of the Daily VWAP of our common shares over the 10 consecutive Trading-Day period immediately preceding the Ex-Date for such dividend or distribution; and

C = the amount in cash per common share we distribute to holders of our common shares that exceeds the reference dividend.

Such increase shall become effective immediately after the open of business on the Ex-Date for such dividend or distribution. If such dividend or distribution is not so paid, the Conversion Rate shall be decreased to be the Conversion Rate that would then be in effect if such dividend or distribution had not been declared.

If the total per share amount of cash distributed by us as a dividend or in any other distribution to holders of our common shares that would require an adjustment pursuant to this fourth clause is equal to or greater than SP_0 (as defined above), in lieu of the foregoing increase, each holder of Series D Preferred Shares shall receive in respect of each Series D Preferred Share owned by it, at the same time as holders of our common shares receive their dividend or other distribution, an amount of cash equal to C multiplied by the number of common shares equal to the Conversion Rate in effect on the Ex-Date for such cash dividend or distribution.

Table of Contents

The reference dividend amount is subject to adjustment in a manner inversely proportional to adjustments to the Conversion Rate; provided that no adjustment will be made to the reference dividend amount for any adjustment made to the Conversion Rate under this fourth clause.

Notwithstanding the foregoing, if an adjustment is required to be made under this clause (4) as a result of a distribution that is not a regular quarterly dividend, the reference dividend amount will be deemed to be zero.

(5) If we or any of our subsidiaries makes a payment in respect of a tender offer or exchange offer for our common shares, if the cash and value of any other consideration included in the payment per common share exceeds the average of the Daily VWAP of our common shares over the 10 consecutive Trading-Day period commencing on, and including, the Trading Day next succeeding the last date on which tenders or exchanges may be made pursuant to such tender or exchange offer, the Conversion Rate will be increased based on the following formula:

$$CR_1 = CR_0 \times \frac{AC + (SP_1 \times OS_1)}{OS_0 \times SP_1}$$

where,

CR_0 = the Conversion Rate in effect immediately prior to the close of business on the last Trading Day of the 10 consecutive Trading-Day period commencing on, and including, the Trading Day next succeeding the date such tender or exchange offer expires;

CR_1 = the Conversion Rate in effect immediately after the close of business on the last Trading Day of the 10 consecutive Trading-Day period commencing on, and including, the Trading Day next succeeding the date such tender or exchange offer expires;

AC = the aggregate value of all cash and any other consideration (as determined in good faith by our board of trustees) paid or payable for shares purchased in such tender or exchange offer;

OS_0 = the number of our common shares outstanding immediately prior to the date such tender or exchange offer expires;

OS_1 = the number of our common shares outstanding immediately after the date such tender or exchange offer expires (after giving effect to such tender offer or exchange offer and excluding fractional shares); and

SP_1 = the average of the Daily VWAP of our common shares over the 10 consecutive Trading-Day period commencing on, and including, the Trading Day next succeeding the date such tender or exchange offer expires.

The increase to the Conversion Rate under the preceding paragraph will occur at the close of business on the tenth Trading Day immediately following, but excluding, the date such tender or exchange offer expires; provided that, for purposes of determining the Conversion Rate, in respect of any conversion during the 10 Trading Days immediately following, but excluding, the date that any such tender or exchange offer expires, references within this clause (5) to 10 consecutive Trading Days shall be deemed replaced with such lesser number of consecutive Trading Days as have elapsed between the date such tender or exchange offer expires and the relevant conversion date.

Notwithstanding the foregoing, if (i) a Conversion Rate adjustment pursuant to any of the foregoing becomes effective on any Ex-Date as described above and (ii) a holder converting its Series D Preferred Shares on or after such Ex-Date

and on or prior to the related record date

S-34

Table of Contents

would be treated as the record holder of our common shares as of the related conversion date as described under Conversion Procedures based on an adjusted Conversion Rate for such Ex-Date, then, notwithstanding the foregoing Conversion Rate adjustment provisions, the Conversion Rate adjustment relating to such Ex-Date will not be made for any holder converting Series D Preferred Shares on or after such Ex-Date and on or prior to the related record date. Instead, such holder will be treated as if such holder were the record owner of the common shares on an un-adjusted basis and participate in the related dividend, distribution or other event giving rise to such adjustment.

The Ex-Date as used herein is the first date on which our common shares trade on the applicable exchange or in the applicable market, regular way, without the right to receive the issuance, dividend or distribution in question from us or, if applicable, from the seller of our common shares on such exchange or market (in the form of due bills or otherwise) as determined by such exchange or market.

We are not required to adjust the Conversion Rate for any of the transactions described in the clauses above (other than for share splits or share combinations) if we make provision for each holder of a Series D Preferred Share to participate in the transaction, at the same time as holders of our common shares participate, without conversion, as if such holder held a number of our common shares in respect of each Series D Preferred Share equal to the Conversion Rate in effect on the Ex-Date or effective date.

If we issue rights, options or warrants that are only exercisable upon the occurrence of certain triggering events, then the Conversion Rate will not be adjusted pursuant to the second or third clause above, as applicable, until the earliest of these triggering events occurs and the Conversion Rate shall be readjusted to the extent any of these rights, options or warrants are not exercised before they expire.

If we have in effect a shareholder rights plan while any of the Series D Preferred Shares remains outstanding, holders of the Series D Preferred Shares will receive, upon a conversion of such shares, in addition to such common shares, rights under our shareholder rights agreement unless, prior to conversion, the rights have expired, terminated or been redeemed or unless the rights have separated from our common shares. If the rights provided for in any rights plan that our board of trustees may adopt have separated from our common shares in accordance with the provisions of the applicable shareholder rights agreement so that holders of the Series D Preferred Shares would not be entitled to receive any rights in respect of our common shares that we deliver upon conversion of the Series D Preferred Shares, we will adjust the Conversion Rate at the time of separation as if we had distributed to all holders of our common shares, evidences of indebtedness or other assets or property pursuant to the third clause above, subject to readjustment upon the subsequent expiration, termination or redemption of the rights.

We will not adjust the Conversion Rate pursuant to the clauses above unless the adjustment would result in a change of at least 1% in the then effective Conversion Rate. However, we will carry forward any adjustment that is less than 1% of the Conversion Rate and make such carry forward adjustment in any subsequent adjustment and, regardless of whether the aggregate adjustment is less than 1%, on the conversion date for any Series D Preferred Shares. In addition, at the end of each fiscal year, beginning with the fiscal year ending December 31, 2011, we will give effect to any adjustments that we have otherwise deferred pursuant to this provision, and those adjustments will no longer be carried forward and taken into account in any subsequent adjustment. Adjustments to the Conversion Rate will be calculated to the nearest 1/10,000 of a share.

To the extent permitted by law and the continued listing requirements of NYSE (or any stock exchange on which our common shares may then be listed), we may, from time to time, increase the Conversion Rate by any amount for a period of at least 20 Business Days or any

Table of Contents

longer period permitted or required by law, so long as the increase is irrevocable during that period and our board of trustees determines that the increase is in our best interests. We will mail a notice of the increase to registered holders at least 15 calendar days before the day the increase commences. In addition, we may, but are not obligated to, increase the Conversion Rate as we determine to be advisable in order to avoid or diminish taxes to recipients of certain distributions.

Upon each adjustment to the Conversion Rate, a corresponding adjustment shall be made to the conversion price, calculated by dividing the liquidation preference by the adjusted Conversion Rate.

If certain of the possible adjustments to the Conversion Rate of the Series D Preferred Shares are made (or if failures to make certain adjustments occur), a holder of such shares may be deemed to have received a taxable distribution from us even though such holder has not received any cash or property as a result of such adjustments. In the case of a non-U.S. shareholder, we may, at our option, withhold U.S. federal income tax with respect to any such deemed distribution from cash payments of dividends and any other payments in respect of the Series D Preferred Shares. See **Additional Federal Income Tax Considerations** in this prospectus supplement.

Events That Will Not Result In Adjustment

The Conversion Rate will not be adjusted:

upon the issuance of any of our common shares pursuant to any present or future plan providing for the reinvestment of dividends or interest payable on our securities;

upon the issuance of any of our common shares, restricted shares or restricted share units, nonqualified share options, incentive share options or any other options or rights (including share appreciation rights) to purchase our common shares pursuant to any present or future employee, trustee or consultant benefit plan or program of, or assumed by, us or any of our subsidiaries;

upon the issuance of any common shares pursuant to any option, warrant, right or exercisable, exchangeable or convertible security not described in the preceding clause and outstanding as of the date the Series D Preferred Shares were first issued;

for unpaid accrued and accumulated dividends, if any;

upon the repurchase of any common shares pursuant to an open-market share repurchase program or other buy-back transaction that is not a tender offer or exchange offer; or

for a change in the par value of our common shares.

We shall not take any action that would require an adjustment to the Conversion Rate such that the Conversion Price, as adjusted to give effect to such action, would be less than the then-applicable par value per common share, except we may undertake a share split or similar event if such share split results in a corresponding reduction in the par value per common share such that the as-adjusted new effective conversion price per share would not be below the new as-adjusted par value per common share following such share split or similar transaction and the Conversion Rate is adjusted as provided under the first clause (and/or any such other clause(s) as may be applicable) under **Conversion Rate Adjustment** above. In addition, the articles supplementary relating to the Series D Preferred Shares provide that we may not take any action that would result in an adjustment to the Conversion Rate without complying with any applicable shareholder approval rules of the NYSE or any other stock exchange on which our common shares may be listed at the relevant time.

Table of Contents

Except as described in this prospectus supplement and as provided for in the articles supplementary relating to the Series D Preferred Shares, we will not adjust the Conversion Rate for any issuance of our common shares or any securities convertible into or exchangeable or exercisable for our common shares or rights to purchase our common shares or such convertible, exchangeable or exercisable securities.

Recapitalizations, Reclassifications and Changes of our Common Shares

In the case of any recapitalization, reclassification or change of our common shares (other than changes resulting from a subdivision or combination), a consolidation, merger or combination involving us, a sale, lease or other transfer to a third party of all or substantially all of the assets of us (or us and our subsidiaries on a consolidated basis), or any statutory share exchange, in each case as a result of which our common shares would be converted into, or exchanged for, shares, other securities, other property or assets (including cash or any combination thereof), then, at the effective time of the transaction, the right to convert each Series D Preferred Share will be changed into a right to convert such Series D Preferred Share into the kind and amount of shares, other securities or other property or assets (including cash or any combination thereof) (the reference property) that a holder would have received in respect of common shares issuable upon conversion of such shares immediately prior to such transaction. If such transaction also constitutes a fundamental change, a holder of our Series D Preferred Shares who converts its Series D Preferred Shares in connection with such fundamental change will, if applicable, also be entitled to receive additional common shares in connection with such conversion as described below under Special Rights Upon a Fundamental Change, in which case the converting holder would also receive reference property in lieu of such additional common shares. In the event that our common shareholders have the opportunity to elect the form of consideration to be received in such transaction, the reference property into which the Series D Preferred Shares will be convertible shall be deemed to be the weighted average of elections made by the holders of our Series D Preferred Shares who participate in such determination. The articles supplementary relating to the Series D Preferred Shares provide that we may not become a party to any such transaction unless its terms are consistent with the foregoing.

A change in the conversion right described in this Recapitalizations, Reclassifications and Changes of our Common Shares could substantially lessen or eliminate the value of the conversion right. For example, if a third party acquires us in a cash merger, each Series D Preferred Share would be convertible solely into cash and would no longer be potentially convertible into securities whose value could increase depending on our future financial performance, prospects and other factors. There is no precise, established definition of the phrase all or substantially all under applicable law. Accordingly, there may be uncertainty as to whether the provisions above would apply to a sale, transfer, lease, conveyance or other disposition of less than all of the consolidated property or assets of us or us and our subsidiaries.

No Fractional Shares

No fractional common shares or securities representing fractional common shares will be issued upon conversion of the Series D Preferred Shares, whether voluntary or mandatory. Instead, we may elect to either make a cash payment to each holder that would otherwise be entitled to a fractional share or, in lieu of such cash payment, the number of common shares to be issued to any particular holder upon conversion will be rounded up to the nearest whole share.

Table of Contents

Special Rights Upon a Fundamental Change

We must give notice of each fundamental change (as defined below) to all record holders of the Series D Preferred Shares, by the later of 20 Business Days prior to the anticipated effective date of the fundamental change (the fundamental change effective date) and the first public disclosure by us of the anticipated fundamental change. In addition, we must give notice announcing the effective date of such fundamental change and certain other matters as set forth under Determination of the Make-Whole Premium. If a holder converts its Series D Preferred Shares at any time beginning at the opening of business on the Trading Day immediately following the effective date of such fundamental change and ending at the close of business on the 30th Trading Day immediately following such effective date, such conversion will be deemed to be in connection with the fundamental change and the holder will receive for each Series D Preferred Shares converted, a number of common shares equal to the greater of:

(i) the applicable conversion rate (with such adjustment or cash payment for fractional shares as we may elect, as described under No Fractional Shares) plus (ii) the make-whole premium, if any, described under Determination of the Make-Whole Premium ; and

the lesser of (i) the liquidation preference divided by the Market Value of the Common Shares on the fundamental change effective date and (ii) 7.9808 (subject to adjustment).

In addition, a converting holder will have the right to receive cash in an amount equal to all unpaid accrued and accumulated dividends on such converted Series D Preferred Shares, whether or not declared prior to that date, for all prior dividend periods ending on or prior to the Dividend Payment Date immediately preceding (or, if applicable, ending on) the conversion date (other than previously declared dividends on our Series D Preferred Shares payable to holders of record as of a prior date), provided that we are then legally permitted to pay such dividends.

In lieu of issuing the number of common shares issuable upon conversion pursuant to the foregoing provisions, we may, at our option, make a cash payment equal to the Market Value determined for the period ending on the fundamental change effective date for each such common share otherwise issuable upon conversion. Our notice of fundamental change will specify whether we intend to issue common shares or pay cash upon conversion.

A fundamental change will be deemed to have occurred upon the occurrence of any of the following:

(1) any person is or becomes the beneficial owner, directly or indirectly, through a purchase, merger or other transaction, of 50% or more of the total voting power of all classes of our voting shares of beneficial interest;

(2) we consolidate with, or merge with or into, another person or any person consolidates with or merges with or into us, or we convey, transfer, lease or otherwise dispose of all or substantially all of our assets or all or substantially all of the assets of us and our subsidiaries on a consolidated basis to any person (whether in one transaction or a series of related transactions), other than:

(a) any transaction pursuant to which the holders of our voting shares of beneficial interest immediately prior to the transaction collectively have the entitlement to exercise, directly or indirectly, 50% or more of the total voting power of all classes of voting stock of the continuing or surviving person immediately after the transaction; or

(b) any merger solely for the purpose of changing our jurisdiction of formation and resulting in a reclassification, conversion or exchange of outstanding shares of our common shares solely into common shares of the surviving entity;

Table of Contents

- (3) the first day on which a majority of the members of our board of trustees does not consist of Continuing Trustees ;
- (4) we approve a plan of liquidation or dissolution; or
- (5) our common shares cease to be listed on a national securities exchange.

Continuing Trustees means (i) individuals who on the date of original issuance of the Series D Preferred Shares constituted our board of trustees or (ii) any new trustees whose election to our board of trustees or whose nomination for election by our shareholders was approved by at least a majority of our trustees then still in office (or a duly constituted committee thereof) who were either trustees on the date of original issuance of the Series D Preferred Shares or whose election or nomination for election was previously so approved.

The term beneficially own as used herein means beneficial ownership as determined in accordance with Rule 13d-3 promulgated by the SEC under the Securities Exchange Act of 1934, as amended (the Exchange Act), except that a person will be deemed to own any securities that such person has a right to acquire, whether such right is exercisable immediately or only after the passage of time. The term person includes any syndicate or group that would be deemed to be a person under Section 13(d)(3) of the Exchange Act and the rules of the SEC thereunder.

Voting shares of beneficial interest with respect to any person means the shares of beneficial interest of such person that is at the time entitled, without regard to the occurrence of any contingency, to vote in the election of the board of trustees (or comparable governing body of such person).

Notwithstanding the foregoing, a fundamental change will be deemed not to have occurred in the case of a merger or consolidation if (i) at least 90% of the consideration for our common shares (excluding cash payments for fractional shares and cash payments pursuant to dissenters appraisal rights) in the merger or consolidation consists of common stock of a corporation or other entity organized and existing under the laws of the United States or any state thereof and traded on a national securities exchange (or which will be so traded when issued or exchanged in connection with such transaction) (publicly traded common stock) and (ii) as a result of such transaction or transactions the Series D Preferred Shares become convertible into such publicly traded common stock.

There is no precise, established definition of the phrase all or substantially all under applicable law. Accordingly, there may uncertainty as to whether the provisions above would apply to a sale, transfer, lease, conveyance or other disposition of less than all of the consolidated assets of us or of us and our subsidiaries.

This fundamental change conversion feature may make more difficult or discourage a takeover of us and the removal of incumbent management. We are not, however, aware of any specific effort to accumulate our common shares or to obtain control of us by means of a merger, tender offer, solicitation or otherwise. In addition, the fundamental change conversion feature is not part of a plan by management to adopt a series of anti-takeover provisions. Instead, the fundamental change conversion feature is a result of negotiations between us and the underwriters.

Our obligation to issue shares in excess of the Conversion Rate in connection with a fundamental change as described above could be considered a penalty, in which case its enforceability would be subject to general principles of reasonableness of economic remedies.

Table of Contents**Determination of the Make-Whole Premium**

If you elect to convert your Series D Preferred Shares upon the occurrence of a fundamental change, in certain circumstances, we will increase the Conversion Rate (the "make-whole premium") by reference to the table below.

Holders will be entitled to receive the make-whole premium only with respect to shares surrendered for conversion from and after the opening of business on the Trading Day immediately following the fundamental change effective date until the close of business on the 30th Trading Day following such fundamental change effective date.

The increase in the Conversion Rate will be determined by reference to the table below, based on the fundamental change effective date and the share price (as defined below). If holders of our common shares receive only cash in the transaction constituting a fundamental change, the share price shall be the cash amount paid per share. Otherwise, the share price shall be the average of the Closing Sale Prices of our common shares on the five Trading Days prior to but excluding the effective date of the transaction constituting a fundamental change.

The following table sets forth the share price paid, or deemed paid, per common share in a transaction that constitutes the fundamental change, the fundamental change effective date and the make-whole premium (expressed as the number of additional common shares that will be added to the Conversion Rate) to be paid upon a conversion in connection with a fundamental change:

Fundamental Change Effective Date	Share price (\$)							
	\$12.53	\$13.50	\$14.00	\$15.00	\$16.00	\$17.00	\$18.00	\$20.00
April 6, 2011	0.5205	0.5179	0.4903	0.4399	0.3967	0.3575	0.3239	0.2692
April 15, 2012	0.5205	0.5130	0.4846	0.4339	0.3887	0.3478	0.3141	0.2575
April 15, 2013	0.5205	0.5110	0.4820	0.4293	0.3820	0.3400	0.3048	0.2461
April 15, 2014	0.5205	0.5086	0.4787	0.4227	0.3730	0.3295	0.2922	0.2314
April 15, 2015	0.5205	0.5047	0.4725	0.4130	0.3601	0.3138	0.2742	0.2107
April 15, 2016	0.5205	0.4932	0.4581	0.3933	0.3354	0.2853	0.2425	0.1760
April 15, 2017	0.5205	0.4742	0.4345	0.3607	0.2938	0.2362	0.1869	0.1149
April 15, 2018 and thereafter	0.5205	0.4677	0.4239	0.3431	0.2694	0.1971	0.1168	0.0000

Fundamental Change Effective Date	Share price (\$)							
	\$22.00	\$24.00	\$26.00	\$28.00	\$30.00	\$35.00	\$45.00	\$50.00
April 6, 2011	0.2267	0.1935	0.1670	0.1462	0.1282	0.0960	0.0566	0.0446
April 15, 2012	0.2149	0.1813	0.1554	0.1347	0.1174	0.0867	0.0502	0.0391
April 15, 2013	0.2028	0.1690	0.1434	0.1230	0.1065	0.0774	0.0441	0.0339
April 15, 2014	0.1869	0.1532	0.1279	0.1083	0.0928	0.0661	0.0367	0.0278
April 15, 2015	0.1650	0.1316	0.1073	0.0891	0.0753	0.0522	0.0280	0.0206
April 15, 2016	0.1301	0.0991	0.0778	0.0631	0.0525	0.0358	0.0188	0.0135
April 15, 2017	0.0720	0.0486	0.0356	0.0281	0.0233	0.0163	0.0087	0.0061
April 15, 2018 and thereafter	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000	0.0000

The share prices set forth in the table will be adjusted as of any date on which the Conversion Rate of the Series D Preferred Shares is adjusted by multiplying the applicable price in effect immediately before the adjustment by a fraction:

whose numerator is the Conversion Rate immediately before the adjustment; and

whose denominator is the adjusted Conversion Rate.

S-40

Table of Contents

In addition, we will adjust the number of additional shares in the table at the same time, in the same manner in which, and for the same events for which, we must adjust the Conversion Rate as described under Conversion Rate Adjustment.

The exact share price and fundamental change effective date may not be set forth on the table, in which case:

if the share price is between two share prices on the table or the fundamental change effective date is between two fundamental change effective dates on the table, the make-whole premium will be determined by straight-line interpolation between make-whole premium amounts set forth for the higher and lower share prices and the two effective dates, as applicable, based on a 365-day year;

if the share price is in excess of \$50.00 per share (subject to adjustment in the same manner as the share price) no make-whole premium will be paid; and

if the share price is less than \$12.53 per share (subject to adjustment in the same manner as the share price), no make-whole premium will be paid

However, we will not increase the Conversion Rate as described above to the extent the increase will cause the Conversion Rate to exceed 3.9904. We will adjust this maximum Conversion Rate in the same manner in which, and for the same events for which, we must adjust the Conversion Rate as described under Conversion Rate Adjustment.

Our obligation to pay the make-whole premium could be considered a penalty, in which case the enforceability thereof would be subject to general equitable principles of reasonableness of economic remedies.

No later than the third Business Day after the occurrence of a fundamental change, we will provide to the holders and the transfer agent of the Series D Preferred Shares a notice of the occurrence of the fundamental change. Such notice will state:

the events constituting the fundamental change;

the date of the fundamental change;

the last date on which the holder of our Series D Preferred Shares may convert Series D Preferred Shares in connection with such fundamental change;

the Conversion Rate and, if applicable, the Make-Whole Premium and/or other consideration issuable upon conversions of Series D Preferred Shares in connection with such fundamental change;

whether we will issue common shares or deliver cash upon conversion of Series D Preferred Shares in connection with the fundamental change and whether any of the consideration issuable upon a conversion of Series D Preferred Shares in connection with such fundamental change will consist of reference property (and, in such case, specifying such reference property);

the name and address of the paying agent and the conversion agent; and

the procedures that the holder of Series D Preferred Shares must follow to exercise the fundamental change conversion right.

We will also issue a press release for publication on the Dow Jones News Service or Bloomberg Business News (or if either such service is not available, another broadly disseminated news or press release service selected by us), or post notice on our website containing the information specified above, in any event prior to the opening of business on the first trading day following any date on which we provide such notice to the holders of our Series D Preferred Shares.

S-41

Table of Contents

Book-Entry, Delivery and Form

We will initially issue the Series D Preferred Shares in the form of one or more global securities. The global securities will be deposited with, or on behalf of, the Depositary and registered in the name of the Depositary or its nominee. Except as set forth below, the global securities may be transferred, in whole and not in part, only to the Depositary or another nominee of the Depositary. Investors may hold their beneficial interests in the global securities directly through the Depositary if they have an account with the Depositary or indirectly through organizations which have accounts with the Depositary.

Series D Preferred Shares that are issued as described below under "Certificated Series D Preferred Shares" will be issued in definitive form. Upon the transfer of Series D Preferred Shares in definitive form, such Series D Preferred Shares will, unless the global securities have previously been exchanged for Series D Preferred Shares in definitive form, be exchanged for an interest in global securities representing the liquidation preference of the Series D Preferred Shares being transferred.

The Depositary has advised us as follows: The Depositary is a limited-purpose trust company organized under the laws of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. The Depositary was created to hold securities of institutions that have accounts with the Depositary ("direct participants") and to facilitate the clearance and settlement of securities transactions among its participants in such securities through electronic book-entry changes in accounts of the participants, thereby eliminating the need for physical movement of securities certificates. The Depositary's participants include securities brokers and dealers (which may include the underwriters), banks, trust companies, clearing corporations and certain other organizations. Access to the Depositary's book-entry system is also available to others such as banks, brokers, dealers and trust companies ("indirect participants") that clear through or maintain a custodial relationship with a participant, whether directly or indirectly.

We expect that pursuant to procedures established by the Depositary, upon the deposit of the global securities with, or on behalf of, the Depositary, the Depositary will credit, on its book-entry registration and transfer system, the liquidation preference of the Series D Preferred Shares represented by such global securities to the accounts of participants. The accounts to be credited shall be designated by the underwriters of such Series D Preferred Shares. Ownership of beneficial interests in the global securities will be limited to participants or persons that may hold interests through participants. Ownership of beneficial interests in the global securities will be shown on, and the transfer of those ownership interests will be effected only through, records maintained by the Depositary (with respect to participants' interests) and such participants and indirect participants (with respect to the owners of beneficial interests in the global securities other than participants). The laws of some jurisdictions may require that certain purchasers of securities take physical delivery of such securities in definitive form. Such limits and laws may impair the ability to transfer or pledge beneficial interests in the global securities.

To facilitate subsequent transfers, all Series D Preferred Shares deposited by direct participants with the Depositary are registered in the name of its nominee. The deposit of Series D Preferred Shares with the Depositary and its registration in the name of the Depositary's nominee do not effect any change in beneficial ownership. The Depositary has no knowledge of the actual beneficial owners of the Series D Preferred Shares; the Depositary's records reflect only the identity of the direct participants to whose accounts such Series D Preferred Shares are credited, which may or may not be the beneficial owners. The direct and indirect participants will remain responsible for keeping account of their holdings on behalf of their customers.

Table of Contents

Purchases of Series D Preferred Shares under the Depositary system must be made by or through direct participants, which will receive a credit for the shares on the Depositary's records. The ownership interest of each actual purchaser of each share is in turn to be recorded on the direct and indirect Participants' records. Beneficial owners will not receive written confirmation from the Depositary of their purchase. Beneficial owners are, however, expected to receive written confirmations providing details of the transaction, as well as periodic statements of their holdings, from the direct or indirect participant through which the beneficial owner entered into the transaction. Transfers of ownership interests in the Series D Preferred Shares are to be accomplished by entries made on the books of direct and indirect participants acting on behalf of beneficial owners.

So long as the Depositary, or its nominee, is the registered holder and owner of the global securities, the Depositary or such nominee, as the case may be, will be considered the sole legal owner and holder of the Series D Preferred Shares evidenced by the global certificates for all purposes of such Series D Preferred Shares and the articles supplementary relating to such Series D Preferred Shares. Except as set forth below, as an owner of a beneficial interest in the global certificates, you will not be entitled to have the Series D Preferred Shares represented by the global securities registered in your name, will not receive or be entitled to receive physical delivery of certificated Series D Preferred Shares in definitive form and will not be considered to be the owner or holder of any Series D Preferred Shares under the global securities. We understand that under existing industry practice, in the event an owner of a beneficial interest in the global securities desires to take any action that the Depositary, as the holder of the global securities, is entitled to take, the Depositary will authorize the participants to take such action, and that the participants will authorize beneficial owners owning through such participants to take such action or would otherwise act upon the instructions of beneficial owners owning through them.

All payments on Series D Preferred Shares represented by the global securities registered in the name of and held by the Depositary or its nominee will be made to the Depositary or its nominee, as the case may be, as the registered owner and holder of the global securities.

We expect that the Depositary or its nominee, upon receipt of any payment on the global securities, will credit participants' accounts with payments in amounts proportionate to their respective beneficial interests in the liquidation preference of the global securities as shown on the records of the Depositary or its nominee. We also expect that payments by participants or indirect participants to owners of beneficial interest in the global securities held through such participants or indirect participants will be governed by standing instructions and customary practices and will be the responsibility of such participants or indirect participants. We will not have any responsibility or liability for any aspect of the records relating to, or payments made on account of, beneficial ownership interests in the global securities for any Series D Preferred Shares or for maintaining, supervising or reviewing any records relating to such beneficial ownership interests or for any other aspect of the relationship between the Depositary and its participants or indirect participants, or the relationship between such participants or indirect participants and the owners of beneficial interests in the global securities owning through such participants or indirect participants.

Although the Depositary has agreed to the foregoing procedures in order to facilitate transfers of interests in the global securities among participants or indirect participants of the Depositary, it is under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. Neither we nor the transfer agent will have any responsibility or liability for the performance by the Depositary or its participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

Table of Contents

The information in this section concerning the Depositary and its book-entry system has been obtained from sources that we believe to be reliable, but we take no responsibility for its accuracy.

Certificated Series D Preferred Shares

Subject to certain conditions, the Series D Preferred Shares represented by the global securities is exchangeable for certificated Series D Preferred Shares in definitive form of like tenor as such Series D Preferred Shares if (1) the Depositary notifies us that it is unwilling or unable to continue as Depositary for the global securities or if at any time the Depositary ceases to be a clearing agency registered under the Exchange Act and, in either case, a successor is not appointed within 90 days or (2) we, in our discretion, at any time determine not to have all of the Series D Preferred Shares represented by the global securities. Any Series D Preferred Shares that are exchangeable pursuant to the preceding sentence are exchangeable for certificated Series D Preferred Shares issuable for such number of shares and registered in such names as the Depositary shall direct. Subject to the foregoing, the global securities are not exchangeable, except for global securities representing the same aggregate number of shares and registered in the name of the Depositary or its nominee.

ADDITIONAL FEDERAL INCOME TAX CONSIDERATIONS

The following is a summary of the additional material federal income tax considerations related to the acquisition, ownership, conversion and disposition of our Series D Preferred Shares that we anticipate may be material to purchasers of our securities offered in this prospectus supplement, and that are not discussed in our accompanying prospectus under the heading Certain Federal Income Tax Considerations. This summary is limited to the tax consequences to those persons who purchase Series D Preferred Shares at their issue price in this offering and who hold such Series D Preferred Shares as capital assets within the meaning of Section 1221 of the Internal Revenue Code of 1986, as amended (the Code). This summary does not purport to deal with all aspects of U.S. federal income taxation that might be relevant to particular shareholders in light of their particular investment circumstances or status, nor does it address specific tax consequences that may be relevant to particular persons (including, for example, financial institutions, broker-dealers, insurance companies, tax-exempt organizations, persons whose functional currency is other than the U.S. dollar or persons in special situations, such as those who have elected to mark securities to market, or those who hold Series D Preferred Shares as part of a straddle, hedge, conversion transaction, or other integrated investment). In addition, this summary does not address U.S. federal alternative minimum tax consequences or consequences under the tax laws of any state, local or foreign jurisdiction. This summary is based upon the Code, the Treasury Department regulations promulgated or proposed thereunder and administrative and judicial interpretations thereof, all as of the date hereof and all of which are subject to change, possibly on a retroactive basis. We have not sought any ruling from the Internal Revenue Service (the IRS) with respect to the statements made and the conclusions reached in this summary, and we cannot assure you that the IRS will agree with such statements and conclusions.

This summary is for general information only. Prospective purchasers of the Series D Preferred Shares are urged to consult their tax advisors concerning the specific tax consequences to them of acquiring, owning, converting, and disposing of the Series D Preferred Shares and of our election to be taxed as a REIT, including the application of state, local and foreign income and other tax laws and potential changes in such laws.

Table of Contents

Certain Federal Income Tax Considerations Relating to the Acquisition, Holding, Conversion, and Disposition of Series D Preferred Shares

Taxation of Distributions on Series D Preferred Shares

For a discussion of the treatment of dividends and other distributions with respect to Series D Preferred Shares, see Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Taxable Domestic Shareholders and Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Non-U.S. Shareholders in the accompanying prospectus.

Taxation of Sale or Exchange of Series D Preferred Shares

U.S. Shareholders

For a discussion of the tax consequences of a sale or exchange of our Series D Preferred Shares, see Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Taxable Domestic Shareholders Disposition of Common and Preferred Shares .

Non-U.S. Shareholders

Unless our common shares or Series D Preferred Shares constitute a USRPI, a sale of such shares by a non-U.S. shareholder generally will not be subject to U.S. taxation under FIRPTA. The shares will not constitute a USRPI if we are a domestically-controlled REIT. A domestically-controlled REIT is a REIT less than 50% in value of the shares of which is held directly or indirectly by non-U.S. shareholders at all times during a prescribed testing period. We believe that we are, and we expect to continue to be, a domestically-controlled REIT and, therefore, the sale of our common shares or Series D Preferred Shares by non-U.S. shareholders is not expected to be subject to taxation under FIRPTA. Because our shares are publicly traded, however, no assurance can be given that we are or will be a domestically-controlled REIT.

In the event that we do not constitute a domestically-controlled REIT, a non-U.S. shareholder's sale of common shares or Series D Preferred Shares nonetheless will not constitute a USRPI and accordingly would not be subject to tax under FIRPTA as a sale of a USRPI, provided that (1) the shares are of a class that are regularly traded (as defined by applicable Treasury Regulations) on an established securities market, and (2) the selling non-U.S. shareholder held 5% or less of such class of shares at all times during a prescribed testing period. In addition, if (1) our Series D Preferred Shares are not regularly traded on an established securities market, (2) our common shares are regularly traded on an established securities market, and (3) the applicable non-U.S. shareholder has not, at the time it acquires the Series D Preferred Shares, and at certain other times described in the applicable Treasury Regulations, directly or indirectly held Series D Preferred Shares (and in certain cases other direct or indirect interests in our shares) that had a fair market value in excess of 5% of the fair market value of all of our outstanding common shares, then such non-U.S. shareholder's sale of our Series D Preferred Shares generally would not be a USRPI and accordingly would not be subject to tax under FIRPTA as a sale of a USRPI. We believe that our common shares are, and expect them to continue to be, regularly traded on an established securities market.

If gain on the sale of our common shares or Series D Preferred Shares were subject to taxation under FIRPTA, the non-U.S. shareholder would be subject to the same treatment as a U.S. shareholder with respect to such gain (see Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Taxable Domestic Shareholders Disposition of Common and Preferred Shares in the accompanying prospectus), subject to applicable alternative minimum tax and a special alternative minimum tax in the case of non-resident alien individuals, and the purchaser of the shares could, unless the

S-45

Table of Contents

shares are of a class that are regularly traded (as defined by applicable Treasury Regulations) on an established securities market, be required to withhold 10% of the purchase price and remit such amount to the IRS. Gain from the sale of our common shares or Series D Preferred Shares that would not otherwise be subject to FIRPTA will nonetheless be taxable in the United States to a non-U.S. shareholder in two cases: (1) if the gain is effectively connected with a U.S. trade or business conducted by such non-U.S. shareholder and, where a treaty applies, such trade or business is conducted through a permanent establishment in the U.S., then the non-U.S. shareholder will be subject to the same treatment as a U.S. shareholder with respect to such gain, except that the non-U.S. shareholder may also be subject to the 30% branch profits tax (or lower tax treaty rate, if applicable) if it is a foreign corporation, or (2) if the non-U.S. shareholder is a nonresident alien individual who was present in the United States for 183 days or more during the taxable year and certain other conditions are satisfied, the nonresident alien individual will be subject to tax on the individual's capital gain at a 30% rate (or lower tax treaty rate, if applicable).

Taxation of Conversion of Series D Preferred Shares into Common Shares

U.S. Shareholders

Conversion of Series D Preferred Shares into Common Shares

Except as provided below, a U.S. shareholder generally will not recognize gain or loss upon the conversion of our Series D Preferred Shares into our common shares. Except as provided below, a U.S. shareholder's basis and holding period in the common shares received upon conversion generally will be the same as those of the converted Series D Preferred Shares (but the basis will be reduced by the portion of adjusted tax basis allocated to any fractional common share exchanged for cash).

Any cash received upon conversion in lieu of a fractional common share generally will be treated as a payment in a taxable exchange for such fractional common share, and gain or loss will be recognized on the receipt of cash in an amount equal to the difference between the amount of cash received and the adjusted tax basis allocable to the fractional common share deemed exchanged. This gain or loss will be long-term capital gain or loss if the U.S. shareholder has held the Series D Preferred Shares for more than one year.

If a U.S. shareholder exercises its right to convert Series D Preferred Shares into our common shares after a Dividend Record Date but before the Dividend Payment Date, then upon conversion, the U.S. shareholder generally will be required to pay to us in cash an amount equal to the portion of such dividend attributable to the current quarterly dividend period. See *Description of the Series D Preferred Shares Conversion Rights*. In this case, the U.S. shareholder will be entitled to receive the dividend payment on the corresponding Dividend Payment Date. Although not entirely free from doubt, we may take the position that any cash payment a U.S. shareholder makes to us in connection with a conversion of Series D Preferred Shares should increase its basis in our common shares received upon conversion, rather than reduce the dividend (the latter being subject to any applicable backup withholding of federal income tax). You should consult your own tax advisor with respect to the treatment of such cash payment, the subsequent receipt of such dividend payment, and your basis and holding period in the common shares acquired in the conversion.

If a U.S. shareholder converts Series D Preferred Shares into our common shares in connection with a fundamental change, the U.S. shareholder may receive cash in an amount equal to all unpaid accrued and accumulated dividends on such converted Series D Preferred Shares. See *Description of the Series D Preferred Shares Special Rights Upon a Fundamental Change*. The U.S. shareholder may recognize gain or dividend income upon the receipt of such cash.

Table of Contents

Adjustment of Conversion Price

The conversion rate of our Series D Preferred Shares is subject to adjustment under specific circumstances. In certain circumstances, U.S. shareholders who hold our Series D Preferred Shares may be deemed to have received a distribution of our shares if and to the extent that the conversion rate is adjusted, resulting in dividend income to the extent not in excess of our current and accumulated earnings and profits. In addition, the failure to provide for such an adjustment may also result in a deemed distribution. Adjustments to the conversion rate made pursuant to a bona fide reasonable adjustment formula which has the effect of preventing the dilution of the interest of the holders of the Series D Preferred Shares generally will not be deemed to result in a constructive distribution. Certain of the possible adjustments (including, without limitation, adjustments in respect of cash dividends on our common shares) do not qualify as being made pursuant to a bona fide reasonable adjustment formula. If such adjustments are made, a holder of Series D Preferred Shares will be deemed to have received constructive distributions from us, even though such shareholder has not received any cash or property as a result of such adjustments. The tax consequences of the receipt of a distribution from us are described in *Certain Federal Income Tax Considerations* *Federal Income Taxation of Shareholders* *Federal Income Taxation of Taxable Domestic Shareholders* in the accompanying prospectus.

Non-U.S. Shareholders

Conversion of Series D Preferred Shares into Common Shares

Except as provided below, a non-U.S. shareholder generally will not recognize gain or loss upon the conversion of our Series D Preferred Shares into our common shares, provided our Series D Preferred Shares do not constitute a USRPI. Even if our Series D Preferred Shares do constitute a USRPI, a non-U.S. shareholder generally will not recognize gain or loss upon a conversion of our Series D Preferred Shares into our common shares, provided our common shares also constitute a USRPI and certain reporting requirements are satisfied. Except as provided below, a non-U.S. shareholder's basis and holding period in the common shares received upon a tax-free conversion will be the same as those of the converted Series D Preferred Shares (but the basis will be reduced by the portion of adjusted tax basis allocated to any fractional common share exchanged for cash).

Cash received upon a conversion in lieu of a fractional common share generally will be treated as a payment in a taxable exchange for such fractional share, and gain or loss will be taxed as described above under *Taxation of Sale or Exchange of Series D Preferred Shares* *Non-U.S. Shareholders*.

If a non-U.S. shareholder exercises its right to convert Series D Preferred Shares into our common shares after a Dividend Record Date but before the Dividend Payment Date, then upon conversion, the non-U.S. shareholder generally will be required to pay to us in cash an amount equal to the portion of such dividend attributable to the current quarterly dividend period. See *Description of the Series D Preferred Shares* *Conversion Rights*. In this case, the non-U.S. shareholder will be entitled to receive the dividend payment on the corresponding Dividend Payment Date. Although not entirely free from doubt, we may take the position that any cash payment a non-U.S. shareholder makes to us in connection with a conversion of Series D Preferred Shares should increase its basis in our common shares received upon a conversion, rather than reduce the dividend (the latter being subject to any applicable withholding of U.S. federal income tax). You should consult your own tax advisor with respect to the treatment of such cash payment, the subsequent receipt of such dividend payment, and your basis and holding period in the shares acquired in the conversion.

If a non-U.S. shareholder converts Series D Preferred Shares into our common shares in connection with a fundamental change, the non-U.S. shareholder may receive cash in an

Table of Contents

amount equal to all unpaid accrued and accumulated dividends on such converted Series D Preferred Shares. See Description of the Series D Preferred Shares Special Rights Upon a Fundamental Change. The non-U.S. shareholder may recognize gain or dividend income upon the receipt of such cash, and we may withhold U.S. federal income tax with respect to such gain or dividend income.

Adjustment of Conversion Price

As described above under U.S. Shareholders Adjustment of Conversion Price, adjustments in the conversion price (or failures to adjust the conversion price) could result in deemed distributions to the non-U.S. shareholder, resulting in dividend income to the extent not in excess of our current and accumulated earnings and profits. It is possible that any withholding tax on such a deemed distribution could be withheld from cash dividends, our common shares, or sale proceeds subsequently paid or credited to you.

Taxation of Cash Redemption of Series D Preferred Shares

U.S. Shareholders

For a discussion of the tax consequences of a cash redemption of our Series D Preferred Shares, see Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Taxable Domestic Shareholders Disposition of Common and Preferred Shares in the accompanying prospectus.

Non-U.S. Shareholders

The U.S. federal income tax treatment of a cash redemption of Series D Preferred Shares from a non-U.S. shareholder can only be determined on the basis of the facts and circumstances at the time of the redemption. As discussed under the heading Certain Federal Income Tax Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Taxable Domestic Shareholders Disposition of Common and Preferred Shares in the accompanying prospectus, a cash redemption may be treated as a distribution taxable as a dividend or as a taxable sale or exchange, depending on the facts and circumstances at the time of the redemption. If the cash redemption is treated as a distribution taxable as a dividend, the U.S. federal income tax treatment to the non-U.S. shareholder will be the same as described in Certain Federal Income Considerations Federal Income Taxation of Shareholders Federal Income Taxation of Non-U.S. Shareholders in the accompanying prospectus. If the cash redemption is treated as a taxable sale or exchange, the U.S. federal income tax treatment to a non-U.S. shareholder will be the same as described in

Taxation of Sale or Exchange of Series D Preferred Shares Non-U.S. Shareholders above.

In the case of a cash redemption of Series D Preferred Shares from a non-U.S. shareholder, we reserve the right to treat the redemption proceeds as though they are dividends (to the extent of our current and accumulated earnings and profits) subject to withholding at a 30% rate or lower applicable treaty rate. The non-U.S. shareholder will receive a credit for the amount withheld against such shareholder's U.S. federal income tax liability, if any, and may be able to obtain a refund of all or a portion of the withheld amount by filing a claim for refund with the IRS (generally on a U.S. federal income tax return).

Other Federal Income Tax Considerations

Taxation of the Company

In connection with the offering of the Series D Preferred Shares, we have received an opinion from Honigman Miller Schwartz and Cohn LLP, our tax counsel, to the effect that since the commencement of our taxable year which began January 1, 2002, we have been organized

Table of Contents

and operated in conformity with the requirements for qualification as a REIT under the Code, and that our proposed method of operation will enable us to continue to meet the requirements for qualification and taxation as a REIT. It must be emphasized that the opinion of Honigman Miller Schwartz and Cohn LLP is based on various assumptions relating to our organization and operation, and is conditioned upon representations and covenants made by our management regarding our assets and the past, present, and future conduct of our business operations. While we intend to operate so that we will qualify as a REIT, given the highly complex nature of the rules governing REITs, the ongoing importance of factual determinations, and the possibility of future changes in our circumstances, no assurance can be given by Honigman Miller Schwartz and Cohn LLP or by us that we will so qualify for any particular year. The opinion was expressed as of the date issued and will not cover subsequent periods. Honigman Miller Schwartz and Cohn LLP will have no obligation to advise us or the holders of our securities of any subsequent change in the matters stated, represented or assumed, or of any subsequent change in the applicable law. You should be aware that opinions of counsel are not binding on the IRS or any court, and no assurance can be given that the IRS will not challenge, or a court will not rule contrary to, the conclusions set forth in such opinions.

Recent Legislation

On March 18, 2010, the President signed into law the Hiring Incentives to Restore Employment Act of 2010, or the HIRE Act. The HIRE Act imposes a U.S. withholding tax at a 30% rate on dividends and gross proceeds of sale in respect of our Series D Preferred Shares received by domestic shareholders who own their shares through foreign accounts or foreign intermediaries and by certain non-U.S. shareholders if certain disclosure requirements related to U.S. accounts or ownership are not satisfied. If payment of withholding taxes is required, non-U.S. shareholders that are otherwise eligible for an exemption from, or reduction of, U.S. withholding taxes with respect to such dividends and proceeds will be required to seek a refund from the IRS to obtain the benefit of such exemption or reduction. We will not pay any additional amounts in respect of any amounts withheld. These new withholding rules are generally effective for payments made after December 31, 2012. Prospective non-U.S. shareholders are encouraged to consult their tax advisors regarding the possible implications of this new legislation on their investment in our Series D Preferred Shares.

On March 30, 2010, the President signed into law the Health Care and Education Reconciliation Act of 2010, or the Reconciliation Act. The Reconciliation Act will require certain domestic shareholders who are individuals, estates or trusts to pay a 3.8% Medicare tax with respect to, among other things, dividends on and capital gains from the sale or other disposition of stock, subject to certain exceptions. This tax will apply for taxable years beginning after December 31, 2012. Prospective shareholders should consult their tax advisors regarding the effect, if any, of the Reconciliation Act on their acquisition, ownership, conversion and disposition of our Series D Preferred Shares.

On December 17, 2010, the President signed the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act, or the 2010 Tax Relief Act. The 2010 Tax Relief Act continues the 15% maximum tax rate for long-term capital gains and qualified dividend income, and continues the maximum 35% tax rate on ordinary income applicable to individuals, for taxable years through December 31, 2012. For taxable years beginning after December 31, 2012, the capital gains tax rate is scheduled to increase to 20%, the rate of tax applicable to ordinary income of individuals is scheduled to increase to a maximum of 39.6%, and the rate applicable to dividends is scheduled to increase to the tax rate then applicable to ordinary income. In addition, the backup withholding rate remains at 28% through December 31, 2012. As noted in the accompanying prospectus, because we are not generally subject to federal income tax on the portion of our REIT taxable income or capital gains distributed to

Table of Contents

our shareholders, our dividends will generally not be eligible for the 15% tax rate on qualified dividends. As a result, our ordinary REIT dividends will continue to generally be taxed at the higher tax rates applicable to ordinary income.

Taxable Stock Dividends

Although we have always paid and intend to continue to pay dividends solely in cash, we may distribute taxable dividends on our common shares that are payable in cash and common shares of beneficial interest at the election of each shareholder. Under IRS Revenue Procedure 2010-12, up to 90% of any such taxable dividend for 2011 could be payable in our common shares (including dividends paid after the close of the year to which they relate). Taxable U.S. shareholders receiving such dividends will be required to include the full amount of the dividend as ordinary income to the extent of our current and accumulated earnings and profits for U.S. federal income tax purposes. As a result, a U.S. shareholder may be required to pay income taxes with respect to such dividends in excess of the cash dividends received. If a U.S. shareholder sells the shares that it receives as a dividend in order to pay this tax, the sales proceeds may be less than the amount included in income with respect to the dividend, depending on the market price of our stock at the time of the sale. Furthermore, with respect to non-U.S. shareholders, we may be required to withhold U.S. tax with respect to such dividends, including in respect of all or a portion of such dividend that is payable in shares, and we may have to withhold or dispose of part of the shares in such distribution and use such withheld shares or the proceeds of such disposition to satisfy any withholding tax imposed. In addition, if a significant number of our shareholders determine to sell shares in order to pay taxes owed on dividends, it may put downward pressure on the trading price of our shares.

Moreover, because Revenue Procedure 2010-12 applies only to taxable dividends payable in cash or shares for 2010 and 2011, it is unclear whether and to what extent we will be able to pay taxable dividends in cash and shares for later years.

For a discussion of the additional material federal income tax consequences relating to the acquisition, holding, conversion, and disposition of our Series D Preferred Shares and our common shares, and of our election to be taxed as a REIT, please see the description in the accompanying prospectus under the heading Certain Federal Income Tax Considerations.

Table of Contents

UNDERWRITING

Subject to the terms and conditions of the underwriting agreement, the underwriters named below, through their representatives Deutsche Bank Securities Inc. and J.P. Morgan Securities LLC, have severally agreed to purchase from us the following respective number of Series D Preferred Shares at a public offering price less the underwriting discounts and commissions set forth on the cover page of this prospectus:

Underwriters	Number of Shares
Deutsche Bank Securities Inc.	
J.P. Morgan Securities LLC	
KeyBanc Capital Markets Inc.	
Stifel, Nicolaus & Company, Incorporated	
Comerica Securities, Inc.	
PNC Capital Markets LLC	
RBS Securities Inc.	

Total

The underwriting agreement provides that the obligations of the several underwriters to purchase the Series D Preferred Shares offered hereby are subject to certain conditions precedent and that the underwriters will purchase all of the Series D Preferred Shares offered by this prospectus if any of these shares are purchased.

We have been advised by the representatives of the underwriters that the underwriters propose to offer the Series D Preferred Shares to the public at the public offering price set forth on the cover of this prospectus and to dealers at a price that represents a concession not in excess of \$.90 per share under the public offering price. The underwriters may allow, and these dealers may re-allow, a concession of not more than \$0 per share to other dealers. After the initial offering of the Series D Preferred Shares, the representatives of the underwriters may change the public offering price and other selling terms.

The Series D Preferred Shares are listed on the NYSE under the symbol RPT PrD . We will apply to list the Series D Preferred Shares offered hereby in excess of 240,000 shares, if applicable, on the NYSE under the existing symbol RPT PrD covering the outstanding Series D Preferred Shares. No assurance can be given as to the liquidity of the trading market for the Series D Preferred Shares.

The underwriting discounts and commissions per share are equal to the public offering price per Series D Preferred Share less the amount paid by the underwriters to us per Series D

S-51

Table of Contents

Preferred Share. The underwriting discounts and commissions are 3.0% of the public offering price. We have agreed to pay the underwriters the following discounts and commissions:

	Fee per share	Total Fees
Discounts and commissions paid by us		

In addition, we estimate that our share of the total expenses of this offering, excluding underwriting discounts and commissions, will be approximately \$50,000. The underwriters have agreed to reimburse us for certain of our expenses in connection with this offering.

We have agreed to indemnify the underwriters against some specified types of liabilities, including liabilities under the Securities Act, and to contribute to payments the underwriters may be required to make in respect of any of these liabilities.

We, our trustees and executive officers have entered into a lock-up agreement with the underwriters prior to the commencement of this offering pursuant to which we and each of these persons for a period of 33 days after the date of this prospectus supplement, may not, subject to limited exceptions, without the prior written consent of Deutsche Bank Securities Inc. (1) offer, pledge, announce the intention to sell, sell, contract to sell, sell any option or contract to purchase, purchase any option or contract to sell, grant any option, right or warrant to purchase, or otherwise transfer or dispose of, directly or indirectly, any of our common shares, Series D Preferred Shares or any securities convertible into or exercisable or exchangeable for our common shares or Series D Preferred Shares (including without limitation, common shares or Series D Preferred Shares which may be deemed to be beneficially owned by the lock-up signatory in accordance with the rules and regulations of the SEC and securities which may be issued upon exercise of a stock option or warrant) or (2) enter into any swap or other agreement that transfers, in whole or in part, any of the economic consequences of ownership of our common shares or Series D Preferred Shares, whether any such transaction described in clause (1) or (2) above is to be settled by delivery of common shares, Series D Preferred Shares or such other securities, in cash or otherwise). Notwithstanding the foregoing, if (i) during the last 17 days of the 33-day restricted period, we issue an earnings release or material news or a material event relating to our company occurs; or (ii) prior to the expiration of the 33-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 33-day period, the restrictions described above shall continue to apply until the expiration of the 18-day period beginning on the issuance of the earnings release or the occurrence of the material news or material event.

The representatives of the underwriters have advised us that the underwriters do not intend to confirm sales to any account over which they exercise discretionary authority.

In connection with the offering, the underwriters may purchase and sell our Series D Preferred Shares in the open market. These transactions may include short sales, purchases to cover positions created by short sales and stabilizing transactions.

Short sales involve the sale by the underwriters of a greater number of shares than they are required to purchase in the offering. Stabilizing transactions consist of various bids for or purchases of our Series D Preferred Shares made by the underwriters in the open market prior to the completion of the offering.

The underwriters may impose a penalty bid. This occurs when a particular underwriter repays to the other underwriters a portion of the underwriting discount received by it because the representatives of the underwriters have repurchased shares sold by or for the account of that underwriter in stabilizing or short covering transactions.

Purchases to cover a short position and stabilizing transactions may have the effect of preventing or slowing a decline in the market price of our Series D Preferred Shares. Additionally, these purchases, along with the imposition of the penalty bid, may stabilize, maintain or

S-52

Table of Contents

otherwise affect the market price of our Series D Preferred Shares. As a result, the price of our Series D Preferred Shares may be higher than the price that might otherwise exist in the open market. These transactions may be effected on the NYSE, in the over-the-counter market or otherwise.

A prospectus in electronic format is being made available on Internet web sites maintained by one or more of the lead underwriters of this offering and may be made available on web sites maintained by other underwriters. Other than the prospectus in electronic format, the information on any underwriter's web site and any information contained in any other web site maintained by an underwriter is not part of the prospectus or the registration statement of which the prospectus forms a part.

Certain of the underwriters and their affiliates have provided in the past to us and our affiliates and may provide from time to time in the future certain commercial banking, financial advisory, investment banking and other services for us and such affiliates in the ordinary course of their business, for which they have received and may continue to receive customary fees and commissions. The underwriters and their affiliates may provide similar services in the future. Affiliates of certain of the underwriters are lenders and/or agents under our secured revolving credit facility and secured term loan facility. On March 18, 2010, we closed a \$31.3 million CMBS loan with an affiliate of J.P. Morgan Securities LLC. This loan is secured by our West Oaks II shopping center in Novi, Michigan and our Spring Meadows Place center in Holland, Ohio. The \$31.3 million financing has a ten year term with a fixed interest rate of 6.5%. In addition, from time to time, certain of the underwriters and their affiliates may effect transactions for their own account or the account of customers, and hold on behalf of themselves or their customers, long or short positions in our debt or equity securities or loans, and may do so in the future.

Notice To Prospective Investors In European Economic Area

In relation to each member state of the European Economic Area that has implemented the Prospectus Directive (each, a relevant member state), other than Germany, with effect from and including the date on which the Prospectus Directive is implemented in that relevant member state (the relevant implementation date), an offer of securities described in this prospectus may not be made to the public in that relevant member state other than:

to any legal entity which is a qualified investor as defined in the Prospectus Directive;

by the underwriters to fewer than 100, or, if the Relevant Member State has implemented the relevant provisions of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the underwriters for any such offer; or

in any other circumstances falling within Article 3(2) of the Prospectus Directive.

provided that no such offer of securities shall require us or any underwriter to publish a prospectus pursuant to Article 3 of the Prospectus Directive.

For purposes of this provision, the expression an offer of securities to the public in any relevant member state means the communication in any form and by any means of sufficient information on the terms of the offer and the securities to be offered so as to enable an investor to decide to purchase or subscribe for the securities, as the expression may be varied in that member state by any measure implementing the Prospectus Directive in that member state, and the expression Prospectus Directive means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State, and includes any relevant implementing measure in each relevant member state. The expression 2010 PD Amending Directive means Directive 2010/73/EU.

Table of Contents

We have not authorized and do not authorize the making of any offer of securities through any financial intermediary on their behalf, other than offers made by the underwriters with a view to the final placement of the securities as contemplated in this prospectus. Accordingly, no purchaser of the securities, other than the underwriters, is authorized to make any further offer of the securities on behalf of us or the underwriters.

The EEA selling restriction is in addition to any other selling restrictions set out in this prospectus.

Notice To Prospective Investors In Switzerland

We have not and will not register with the Swiss Financial Market Supervisory Authority (FINMA) as a foreign collective investment scheme pursuant to Article 119 of the Federal Act on Collective Investment Scheme of 23 June 2006, as amended (CISA), and accordingly the shares being offered pursuant to this prospectus have not and will not be approved, and may not be licensable, with FINMA. Therefore, the shares have not been authorized for distribution by FINMA as a foreign collective investment scheme pursuant to Article 119 CISA and the shares offered hereby may not be offered to the public (as this term is defined in Article 3 CISA) in or from Switzerland. The shares may solely be offered to qualified investors, as this term is defined in Article 10 CISA, and in the circumstances set out in Article 3 of the Ordinance on Collective Investment Scheme of 22 November 2006, as amended (CISO), such that there is no public offer. Investors, however, do not benefit from protection under CISA or CISO or supervision by FINMA. This prospectus and any other materials relating to the shares are strictly personal and confidential to each offeree and do not constitute an offer to any other person. This prospectus may only be used by those qualified investors to whom it has been handed out in connection with the offer described herein and may neither directly or indirectly be distributed or made available to any person or entity other than its recipients. It may not be used in connection with any other offer and shall in particular not be copied and/or distributed to the public in Switzerland or from Switzerland. This prospectus does not constitute an issue prospectus as that term is understood pursuant to Article 652a and/or 1156 of the Swiss Federal Code of Obligations. We have not applied for a listing of the shares on the SIX Swiss Exchange or any other regulated securities market in Switzerland, and consequently, the information presented in this prospectus does not necessarily comply with the information standards set out in the listing rules of the SIX Swiss Exchange and corresponding prospectus schemes annexed to the listing rules of the SIX Swiss Exchange.

Notice To Prospective Investors In The Dubai International Financial Centre

This document relates to an exempt offer in accordance with the Offered Securities Rules of the Dubai Financial Services Authority. This document is intended for distribution only to persons of a type specified in those rules. It must not be delivered to, or relied on by, any other person. The Dubai Financial Services Authority has no responsibility for reviewing or verifying any documents in connection with exempt offers. The Dubai Financial Services Authority has not approved this document nor taken steps to verify the information set out in it, and has no responsibility for it. The shares which are the subject of the offering contemplated by this prospectus may be illiquid and/or subject to restrictions on their resale. Prospective purchasers of the shares offered should conduct their own due diligence on the shares. If you do not understand the contents of this document you should consult an authorized financial adviser.

LEGAL MATTERS

Certain matters of Maryland law will be passed upon for us by Ballard Spahr LLP, Baltimore, Maryland. Certain tax matters related to our qualification as a REIT will be passed upon for us by Honigman Miller Schwartz and Cohn LLP, Detroit, Michigan. Skadden, Arps,

Table of Contents

Slate, Meagher & Flom LLP, New York, New York, is representing the underwriters with respect to this offering.

EXPERTS

The consolidated financial statements and schedules of Ramco-Gershenson Properties Trust as of December 31, 2010 and 2009, and for each of the years in the three-year period ended December 31, 2010, and management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2010 have been incorporated by reference herein in reliance upon the reports of Grant Thornton, LLP, independent registered public accounting firm, incorporated by reference herein, and upon the authority of said firm as experts in accounting and auditing.

S-55

Table of Contents

PROSPECTUS

\$300,000,000

**RAMCO-GERSHENSON PROPERTIES TRUST
DEBT SECURITIES
PREFERRED SHARES
COMMON SHARES
WARRANTS
RIGHTS**

Ramco-Gershenson Properties Trust may offer, issue and sell from time to time our debt securities, which may be in one or more class or series and may be senior debt securities or subordinated debt securities; our preferred shares, which we may issue in one or more class or series; our common shares; warrants to purchase our preferred shares or common shares; rights to purchase our common shares; and any combination of these securities. The securities will have an aggregate initial offering price of up to \$300,000,000. We may sell any combination of the securities described in this prospectus in one or more offerings. We may offer the securities separately or together, in separate classes or series and in amounts, at prices and on terms described in one or more supplements to this prospectus and other offering material.

This prospectus describes some of the general terms that may apply to these securities. We will provide the specific terms of these securities in supplements to this prospectus. We may describe the terms of these securities in a term sheet which will precede the prospectus supplement. You should read this prospectus and the accompanying prospectus supplement carefully before you make your investment decision.

This prospectus may not be used to sell securities unless accompanied by a prospectus supplement.

The securities may be offered through one or more underwriters, dealers and agents or directly to purchasers on a continuous or delayed basis. The prospectus supplement for each offering of securities will describe in detail the plan of distribution for that offering.

Our common shares are traded on the New York Stock Exchange (the "NYSE") under the symbol "RPT". On February 6, 2009, the closing sale price of our common shares as reported on the NYSE was \$4.82 per share.

Our principal executive offices are located at 31500 Northwestern Highway, Suite 300, Farmington Hills, Michigan 48334, and our telephone number is (248) 350-9900.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED WHETHER THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is February 9, 2009

Table of Contents

TABLE OF CONTENTS

About this Prospectus	3
Where You Can Find More Information	3
Incorporation of Information We File With the SEC	3
Special Note Regarding Forward-Looking Statements	4
Who We Are	5
Risk Factors	6
Use of Proceeds	6
Ratios of Earnings to Fixed Charges and Preferred Share Dividends	7
The Securities We May Offer	7
Description of Debt Securities	8
Description of Common Shares	11
Description of Preferred Shares	15
Description of Warrants	20
Description of Rights	21
Certain Provisions of Maryland Law and Our Declaration of Trust and Amended and Restated Bylaws	21
Certain Federal Income Tax Considerations	25
Legal Matters	46
Experts	46
Disclosure of SEC Position on Indemnification for Securities Act Liabilities	46

You should rely only on the information provided or incorporated by reference in this prospectus or any applicable prospectus supplement. We have not authorized anyone to provide you with different or additional information. We are not making an offer to sell these securities in any jurisdiction where the offer or sale of these securities is not permitted. You should not assume that the information appearing in this prospectus, any accompanying prospectus supplement or the documents incorporated by reference herein or therein is accurate as of any date other than their respective dates. Our business, financial condition, results of operations and prospects may have changed since those dates.

You should read carefully the entire prospectus, as well as the documents incorporated by reference in the prospectus, before making an investment decision.

Table of Contents

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement on Form S-3 that we filed with the Securities and Exchange Commission, or the SEC, using a shelf registration process. Under this shelf registration process, we may, from time to time, sell any combination of the securities described in this prospectus, in one or more offerings, up to a maximum aggregate offering price of \$300,000,000.

This prospectus provides you with a general description of the securities offered by us, which is not meant to be a complete description of each security. Each time we sell securities, we will provide a prospectus supplement containing specific information about the terms of that offering, including the specific amounts, prices and terms of the securities offered. The prospectus supplement and any other offering material may also add to, update or change information contained in this prospectus or in documents we have incorporated by reference into this prospectus. To the extent inconsistent, information in or incorporated by reference in this prospectus is superseded by the information in the prospectus supplement and any other offering material related to such securities.

This prospectus and any applicable prospectus supplement does not constitute an offer to sell, or a solicitation of an offer to purchase, the securities offered by such documents in any jurisdiction to or from any person to whom or from whom it is unlawful to make such an offer or solicitation of an offer in such jurisdiction.

You should not assume that the information contained in this prospectus or any prospectus supplement is accurate as of any date other than the date on the front cover of such documents. Neither the delivery of this prospectus or any applicable prospectus supplement nor any distribution of securities pursuant to such documents shall, under any circumstances, create any implication that there has been no change in the information set forth in this prospectus or any applicable prospectus supplement or in our affairs since the date of this prospectus or any applicable prospectus supplement.

In this prospectus and any prospectus supplement hereto, unless the context suggests otherwise, references to the Company, we, RPT, us, our Company, and our mean Ramco-Gershenson Properties Trust.

WHERE YOU CAN FIND MORE INFORMATION

We file annual, quarterly and periodic reports, proxy statements and other information with the SEC. You may read and copy any of these documents at the SEC's Public Reference Room located at 100 F Street, N.E., Washington, D.C. 20549. Information regarding the operation of the Public Reference Room may be obtained by calling 1-800-SEC-0330. The SEC maintains a website that contains reports, proxy and information statements and other information regarding registrants that file electronically with the SEC. The address of the SEC's website is <http://www.sec.gov>. Our SEC filings also are available through the New York Stock Exchange, 20 Broad Street, New York, New York 10005.

We have filed a registration statement on Form S-3 with the SEC covering the securities that may be sold under this prospectus. For further information on us and the securities being offered, you should refer to our registration statement and its exhibits. This prospectus summarizes material provisions of contracts and other documents that we refer you to. The rules and regulations of the SEC allow us to omit from this prospectus certain information that is included in the registration statement. Because the prospectus may not contain all the information that you may find important, you should review the full text of these documents. We have included, or incorporated by reference, copies of these documents as exhibits to our registration statement of which this prospectus is a part.

INCORPORATION OF INFORMATION WE FILE WITH THE SEC

The SEC allows us to incorporate by reference into this prospectus documents that we file with the SEC. This permits us to disclose important information to you by referring you to those filed documents. Any information incorporated by reference this way is considered to be a part of this prospectus, and information filed by us with the SEC subsequent to the date of this prospectus will automatically be deemed to update and supersede this information.

Table of Contents

We incorporate by reference into this prospectus the documents listed below, which we have already filed with the SEC:

our Annual Report on Form 10-K for the year ended December 31, 2007;

the following sections from our Proxy Statement on Form DEF14A for our 2008 annual meeting of shareholders held on June 11, 2008: Trustees and Executive Officers , The Board of Trustees , Committees of the Board , Trustee Compensation , Corporate Governance , Compensation Discussion and Analysis , Compensation Committee Report , Report of the Audit Committee , and Section 16(a) Beneficial Ownership Reporting Compliance ;

our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2008, June 30, 2008, and September 30, 2008;

our Current Reports on Form 8-K filed on February 21, 2008, April 30, 2008, July 30, 2008, October 8, 2008, October 22, 2008, October 23, 2008, December 3, 2008 and January 13, 2009; and

the description of our common shares contained in our registration statement on Form 8-A filed with the SEC on November 1, 1988 (which incorporates by reference pages 101-119 of our prospectus/proxy statement filed with the SEC on November 1, 1988), as updated by the description of our common shares contained in our definitive proxy statement on Schedule 14A for our special meeting of shareholders held on December 18, 1997.

Whenever, after the date of this prospectus, we file reports or documents under Section 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended (the Exchange Act), those reports and documents will be incorporated by reference and deemed to be a part of this prospectus from the time they are filed (other than Current Reports or portions thereof furnished under Item 2.02 or Item 7.01 of Form 8-K). Any statement made in this prospectus or in a document incorporated or deemed to be incorporated by reference into this prospectus will be deemed to be modified or superseded for purposes of this prospectus to the extent that a statement contained in this prospectus or in any other subsequently filed document that is also incorporated or deemed to be incorporated by reference into this prospectus modifies or supersedes that statement. Any statement so modified or superseded will not be deemed, except as so modified or superseded, to constitute a part of this prospectus.

We will provide without charge, upon written or oral request, a copy of any or all of the documents which are incorporated by reference into this prospectus, excluding any exhibits to those documents unless the exhibit is specifically incorporated by reference as an exhibit to the registration statement of which this prospectus forms a part. Requests for documents should be directed to Ramco-Gershenson Properties Trust, 31500 Northwestern Highway, Suite 300, Farmington Hills, Michigan 48334 (telephone number (248) 350-9900).

You should rely only on the information contained or incorporated by reference into this prospectus and any applicable prospectus supplement. We have not authorized anyone to provide you with different or additional information. If anyone provides you with different or inconsistent information, you should not rely on it.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This prospectus and the information incorporated by reference contain certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Exchange Act. Statements that do not relate strictly to historical or current facts are forward-looking and are generally identifiable by use of forward-looking terminology such as may, will, should, potential, intend, expect, end

seek, anticipate, estimate, overestimate, underestimate, believe, could, project, predict, continue, pipeline, comfortable, current, position, assume, outlook, remain, maintain, sustain, achieve, words or expressions. Such statements are based on assumptions and expectations which may not be realized and are inherently subject to risks and uncertainties, many of which cannot be predicted with accuracy and some of which might not even be anticipated.

Table of Contents

Forward-looking statements speak only as of the date they are made, and we assume no duty to and do not undertake to update forward-looking statements. Our future events, financial condition, business or other results may differ materially from those anticipated and discussed in the forward-looking statements. Risks and other factors that might cause differences, some of which could be material, include, but are not limited to, changes in political, economic or market conditions generally and the real estate and capital markets specifically; availability of capital; tenant bankruptcies; concentration of our credit risk; REIT distribution requirements; inability to successfully identify or complete suitable acquisitions and new developments; inability of our redevelopment projects to yield anticipated returns; competition for both the acquisition and development of real estate properties and the leasing operations; existing exclusivity lease provisions; lack of complete control and conflicts of interests in our joint ventures; potential bankruptcy of our joint venture partners; rising operating expenses; illiquidity of our real estate investments; potential losses that are not covered by insurance; our debt obligations; our financial covenants may restrict our operating or acquisition activities; mortgage debt obligations; a failure to qualify as a REIT; potential tax obligations; legislative or other actions affecting REITs; environmental laws and obligations; changes in generally accepted accounting principles or interpretations thereof; terrorist activities and international hostilities, which may adversely affect the general economy, domestic and global financial and capital markets, specific industries and us; the unfavorable resolution of legal proceedings; the impact of future acquisitions and divestitures; significant costs related to environmental issues as well as other risks listed from time to time in the Company's other reports and statements filed with the SEC.

When considering forward-looking statements, you should keep in mind the risk factors and other cautionary statements in this prospectus and any prospectus supplement hereto and in reports of the Company filed with the SEC. Readers are cautioned not to place undue reliance on any of these forward-looking statements, which reflect our management's views as of the date of this prospectus, or, if applicable, the date of a document incorporated by reference. All subsequent written and oral forward-looking statements attributable to us are expressly qualified in their entirety by the cautionary statements contained or referenced to in this section. Although we believe that the expectations reflected in the forward-looking statements are based on reasonable assumptions, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or the occurrence of unanticipated events except as required by applicable law.

WHO WE ARE

Ramco-Gershenson Properties Trust is a fully integrated, self-administered, publicly-traded Maryland real estate investment trust organized on October 2, 1997. The terms Company, we, our or us refer to Ramco-Gershenson Properties Trust, the Operating Partnership (defined below) and/or its subsidiaries, as the context may require. Our principal office is located at 31500 Northwestern Highway, Suite 300, Farmington Hills, Michigan 48334. Our predecessor, RPS Realty Trust, a Massachusetts business trust, was formed on June 21, 1988 to be a diversified growth-oriented REIT. In May 1996, RPS Realty Trust acquired the Ramco-Gershenson interests through a reverse merger, including substantially all of the shopping centers and retail properties as well as the management company and business operations of Ramco-Gershenson, Inc. and certain of its affiliates. The resulting trust changed its name to Ramco-Gershenson Properties Trust and Ramco-Gershenson, Inc.'s officers assumed management responsibility. The trust also changed its operations from a mortgage real estate investment trust (REIT) to an equity REIT and contributed certain mortgage loans and real estate properties to Atlantic Realty Trust, an independent, newly formed liquidating REIT. In 1997, with approval from our shareholders, we changed our state of organization by terminating the Massachusetts trust and merging into a newly formed Maryland real estate investment trust.

We conduct substantially all of our business, and hold substantially all of our interests in our properties, through our operating partnership, Ramco-Gershenson Properties, L.P. (the Operating Partnership). The Operating Partnership, either directly or indirectly through partnerships or limited liability companies, holds fee title to all owned properties.

We have the exclusive power to manage and conduct the business of the Operating Partnership. As of September 30, 2008, we owned approximately 86.4% of the interests in the Operating Partnership.

Table of Contents

We are a REIT under the Internal Revenue Code of 1986, as amended (the Code), and are therefore required to satisfy various provisions under the Code and related Treasury regulations. We are generally required to distribute annually at least 90% of our REIT taxable income (as defined in the Code), excluding any net capital gain, to our shareholders. Additionally, at the end of each fiscal quarter, at least 75% of the value of our total assets must consist of real estate assets (including interests in mortgages on real property and interests in other REITs) as well as cash, cash equivalents and government securities. We are also subject to limits on the amount of certain types of securities we can hold. Furthermore, at least 75% of our gross income for the tax year must be derived from certain sources, which include rents from real property and interest on loans secured by mortgages on real property. An additional 20% of our gross income must be derived from these same sources or from dividends and interest from any source, gains from the sale or other disposition of stock or securities or any combination of the foregoing.

Certain of our operations, including property management and asset management, are conducted through taxable REIT subsidiaries (each, a TRS). A TRS is a C corporation that has not elected REIT status and, as such, is subject to federal corporate income tax. We use the TRS format to facilitate our ability to provide certain services and conduct certain activities that are not generally considered as qualifying REIT activities. Our executive offices are located at 31500 Northwestern Highway, Suite 300, Farmington Hills, Michigan 48334 (telephone number (248) 350-9900).

RISK FACTORS

Before you invest in any of our securities, in addition to the other information included or incorporated by reference into this prospectus and any applicable prospectus supplement, you should carefully consider the risk factors under the section entitled Risk Factors in any prospectus supplement as well as our most recent Annual Report on Form 10-K and in our Quarterly Reports on Form 10-Q filed subsequent to the Annual Report on Form 10-K, which are incorporated by reference into this prospectus and any prospectus supplement in their entirety, as the same may be amended, supplemented or superseded from time to time by other reports we file with the SEC in the future. In addition, new risks may emerge at any time and we cannot predict such risks or estimate the extent to which they may affect our business, financial condition, results of operations and prospects. For more information, see the sections entitled, Where You Can Find More Information and Incorporation of Information We File With the SEC in this prospectus.

Recent disruptions in the financial markets could affect our ability to obtain financing for development or redevelopment of our properties and other purposes on reasonable terms and have other adverse effects on us and the market price of our common shares.

The United States financial and credit markets have recently experienced significant price volatility, dislocations and liquidity disruptions, which have caused market prices of many financial instruments to fluctuate substantially and the spreads on prospective debt financings to widen considerably. These circumstances have materially impacted liquidity in the financial markets, making terms for certain financings less attractive, and in some cases have resulted in the unavailability of financing.

Continued uncertainty in the stock and credit markets may negatively impact our ability to access additional financing for development and redevelopment of our properties and other purposes at reasonable terms, which may negatively affect our business. It may also be more difficult or costly for us to raise capital through the issuance of our common shares or preferred shares. The disruptions in the financial markets may have a material adverse effect on the market value of our common shares and other adverse effects on us and our business. In addition, there can be no assurance that the actions of the U.S. government, U.S. Federal Reserve, U.S. Treasury and other governmental and regulatory bodies for the purpose of stabilizing the financial markets will achieve the intended effects or that such actions will not result in adverse market developments.

USE OF PROCEEDS

Unless otherwise set forth in a prospectus supplement, we intend to use the net proceeds from the sale of the securities for working capital and other general corporate purposes, which may include repaying debt, financing capital commitments, and financing future acquisitions, redevelopment and development activities. We will have significant discretion in the use of any net proceeds. We may provide additional information on the use of the net proceeds from the sale of our securities in an applicable prospectus supplement or other offering materials relating to the offered securities.

Table of Contents**RATIOS OF EARNINGS TO FIXED CHARGES AND PREFERRED SHARES DIVIDENDS****Ratio of Earnings to Combined Fixed Charges**

The following table sets forth the historical ratios of earnings to fixed charges for the periods indicated:

	Years Ended December 31,				
2007	2006	2005	2004	2003	
1.31	1.36	1.45	1.43	1.37	

**Nine Months Ended,
September 30, 2008**

1.40

For purposes of computing the ratio of earnings to combined fixed charges, earnings have been calculated by adding fixed charges (excluding capitalized interest and preferred share dividends) to income adjusted to remove minority interest in unconsolidated entities and income or loss from equity investees. Fixed charges consist of interest costs, whether expensed or capitalized, the interest component of rental expense, and amortization of deferred financing costs (including amounts capitalized) paid or accrued for the respective period.

The ratios are based solely on historical financial information, and no pro forma adjustment has been made thereto.

Ratio of Earnings to Combined Fixed Charges and Preferred Share Dividends

The following table sets forth the historical ratios of earnings to combined fixed charges and preferred share dividends for the periods indicated:

	Years Ended December 31,				
2007	2006	2005	2004	2003	
1.22	1.19	1.26	1.26	1.27	

**Nine Months Ended,
September 30, 2008**

1.40

For purposes of computing the ratio of earnings to combined fixed charges and preferred share dividends, earnings have been calculated by adding fixed charges (excluding capitalized interest and preferred share dividends) to income adjusted to remove minority interest in unconsolidated entities and income or loss from equity investees. Fixed charges consist of interest costs, whether expensed or capitalized, the interest component of rental expense, amortization of deferred financing costs (including amounts capitalized) and preferred dividends paid or accrued for the respective period.

The ratios are based solely on historical financial information, and no pro forma adjustment has been made thereto.

THE SECURITIES WE MAY OFFER

We may sell from time to time, in one or more offerings, common shares of beneficial interest, preferred shares of beneficial interest, and/or warrants in a dollar amount that does not exceed \$300,000,000. This prospectus contains only a summary of the securities we may offer. The specific terms of any securities actually offered for sale, together with the terms of that offering, the initial price and the net proceeds to us from the sale of such securities, will be set forth in an accompanying prospectus supplement. That prospectus supplement also will contain information, if applicable, about material United States federal income tax considerations relating to the securities and the securities exchange, if any, on which the securities will be listed. This prospectus may not be used to consummate a sale of securities unless it is accompanied by a prospectus supplement.

The following description of our common shares and preferred shares, together with the additional information we include in any applicable prospectus supplements, summarizes the material terms and provisions of the common

Table of Contents

shares and preferred shares that we may offer under this prospectus. For the complete terms of our common shares and preferred shares, please refer to our Articles of Amendment and Restatement of Declaration of Trust (the "Declaration of Trust"), as supplemented by the articles supplementary for each series of preferred shares, that are incorporated by reference into the registration statement which includes this prospectus. Maryland law will also affect the terms of these securities and the rights of holders thereof. While the terms we have summarized below will apply generally to any future common shares or preferred shares that we may offer, we will describe the particular terms of any class or series of these securities in more detail in the applicable prospectus supplement. If we so indicate in any applicable prospectus supplement, the terms of any common shares or preferred shares we offer may differ from the terms we describe below.

Our authorized shares consist of an aggregate 55,000,000 shares of beneficial interest, par value \$0.01 per share, consisting of 45,000,000 common shares and 10,000,000 preferred shares which may be issued in one or more classes or series, each with such terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption, as are permitted by Maryland law and as our board of trustees may determine by resolution. As of December 31, 2008, we had issued and outstanding 18,583,362 common shares and no preferred shares.

DESCRIPTION OF DEBT SECURITIES

We may issue debt securities either separately, or together with, or upon the conversion of or in exchange for, other securities. The debt securities may be our unsecured and unsubordinated obligations or our subordinated obligations. We use the term "senior debt securities" to refer to the unsecured and unsubordinated obligations. We use the term "subordinated debt securities" to refer to the subordinated obligations. The subordinated debt securities of any class or series may be our senior subordinated obligations, subordinated obligations, junior subordinated obligations or may have such other ranking as is described in the relevant prospectus supplement. We may issue any of these types of debt securities in one or more classes or series.

Our senior debt securities may be issued from time to time under a senior debt securities indenture with a trustee to be named in the senior debt securities indenture. Our subordinated debt securities may be issued from time to time under a subordinated debt securities indenture with a trustee to be named in the subordinated debt securities indenture, which will describe the specific terms of the debt class or series. We use the term "indenture" to refer to the senior debt securities indenture or the subordinated debt securities indenture. We use the term "trustee" to refer to the trustee named in the senior debt securities indenture or the subordinated debt securities indenture.

Some of our operations are conducted through our subsidiaries. Accordingly, our cash flow and our ability to service our debt, including the debt securities, are dependent upon the earnings of our subsidiaries and the distribution of those earnings to us, whether by dividends, loans or otherwise. The payment of dividends and the making of loans and advances to us by our subsidiaries may be (i) subject to statutory or contractual restrictions, (ii) contingent upon the earnings of our subsidiaries, and (iii) subject to various business considerations. Our right to receive assets of any of our subsidiaries upon their liquidation or reorganization (and the consequent right of the holders of the debt securities to participate in those assets) will be effectively subordinated to the claims of that subsidiary's creditors (including trade creditors), except to the extent that we are recognized as a creditor of that subsidiary, in which case our claims would still be subordinate to any security interests in the assets of the subsidiary and any indebtedness held by a subsidiary that is senior to indebtedness held by us.

The following summary of selected provisions that will be included in indentures and in the debt securities is not complete. Before making an investment in our debt securities, you should review the applicable prospectus supplement and the form of applicable indenture, which will be filed with the SEC in connection with the offering of the specific debt securities.

General

We can issue debt securities of any class or series with terms different from the terms of debt securities of any other class or series and the terms of particular debt securities within any class or series may differ from each other,

Table of Contents

all without the consent of the holders of previously issued classes or series of debt securities. The debt securities of each class or series will be our direct, unsecured obligations.

The applicable prospectus supplement relating to the class or series of debt securities will describe the specific terms of each class or series of debt securities being offered, including, where applicable, the following:

the title;

the aggregate principal amount and whether there is any limit on the aggregate principal amount that we may subsequently issue;

whether the debt securities will be senior, senior subordinated, subordinated or junior subordinated;

the name of the trustee and its corporate trust office;

any limit on the amount of debt securities that may be issued;

any subordination provisions;

any provisions regarding the conversion or exchange of such debt securities with or into other securities;

any default provisions and events of default applicable to such debt securities;

any covenants applicable to such debt securities;

whether such debt securities are issued in certificated or book-entry form, and the identity of the depository for those issued in book-entry form;

whether such debt securities are to be issuable in registered or bearer form, or both, and any restrictions applicable to the exchange of one form or another and to the offer, sale and delivery of such debt securities in either form;

whether such debt securities may be represented initially by a debt security in temporary or permanent global form, and, if so, the initial depository and the circumstances under which beneficial owners of interests may exchange such interests for debt securities of like tenor and of any authorized form and denomination and the authorized newspapers for publication of notices to holders of bearer securities;

any other terms required to establish a class or series of bearer securities;

the price(s) at which such debt securities class or series will be issued;

the person to whom any interest will be payable on any debt securities, if other than the person in whose name the debt security is registered at the close of business on the regular record date for the payment of interest;

any provisions restricting the declaration of dividends or requiring the maintenance of any asset ratio or maintenance of reserves;

the date or dates on which the principal of and premium, if any, is payable or the method(s), if any, used to determine those dates;

the rate(s) at which such debt securities will bear interest or the method(s), if any, used to calculate the rate(s);

the date(s), if any, from which any interest will accrue, or the method(s), if any, used to determine the dates on which interest will accrue and date(s) on which interest will be payable;

any redemption or early repayment provisions applicable to such debt securities;

the stated maturities of installments of interest, if any, on which any interest on such debt securities will be payable and the regular record dates for any interest payable on any debt securities which are registered securities;

Table of Contents

the places where and the manner in which the principal of and premium and/or interest, if any, will be payable and the places where the debt securities may be presented for transfer;

our obligation or right, if any, to redeem, purchase or repay such debt securities of the class or series pursuant to any sinking fund amortization or analogous provisions or at the option of a holder of such debt securities and other related provisions;

the denominations in which any registered securities are to be issuable;

the currency, currencies or currency units, including composite currencies, in which the purchase price for, the principal of and any premium and interest, if any, on such debt securities will be payable;

the time period within which the manner in which and the terms and conditions upon which the purchaser of any of such debt securities can select the payment currency;

if the amount of payments of principal, premium, if any, and interest, if any, on such debt securities is to be determined by reference to an index, formula or other method, or based on a coin or currency or currency unit other than that in which such debt securities are stated to be payable, the manner in which these amounts are to be determined and the calculation agent, if any, with respect thereto;

if other than the principal amount thereof, the portion of the principal amount of the debt securities of the class or series which will be payable upon declaration or acceleration of the maturity thereof pursuant to an event of default;

if we agree to pay any additional amounts on any of the debt securities, and coupons, if any, of the classes or series to any holder in respect of any tax, assessment or governmental charge withheld or deducted, the circumstances, procedures and terms under which we will make these payments;

any terms applicable to debt securities of any class or series issued at an issue price below their stated principal amount;

whether such debt securities are to be issued or delivered (whether at the time of original issuance or at the time of exchange of a temporary security of such class or series or otherwise), or any installment of principal or any premium or interest is to be payable only, upon receipt of certificates or other documents or satisfaction of other conditions in addition to those specified in the applicable indenture;

any provisions relating to covenant defeasance and legal defeasance;

any provisions relating to the satisfaction and discharge of the applicable indenture;

any special applicable United States federal income tax considerations;

any provisions relating to the modification of the applicable indenture both with and without the consent of the holders of the debt securities of the class or series issued under such indenture; and

any other material terms not inconsistent with the provisions of the applicable indenture.

The above is not intended to be an exclusive list of the terms that may be applicable to any debt securities and we are not limited in any respect in our ability to issue debt securities with terms different from or in addition to those described above or elsewhere in this prospectus, provided that the terms are not inconsistent with the applicable indenture. Any applicable prospectus supplement will also describe any special provisions for the payment of additional amounts with respect to the debt securities. United States federal income tax consequences and special considerations, if any, applicable to any such class or series will be described in the applicable prospectus supplement.

Debt securities may be issued where the amount of principal and/or interest payable is determined by reference to one or more currency exchange rates, commodity prices, equity indices or other factors. Holders of such securities may receive a principal amount or a payment of interest that is greater than or less than the amount of principal or interest otherwise payable on such dates, depending upon the value of the applicable currencies, commodities, equity indices or other factors. Information as to the methods for determining the amount of principal or interest, if any, payable on any date, the currencies, commodities, equity indices or other factors to which the

Table of Contents

amount payable on such date is linked and certain additional United States federal income tax considerations will be set forth in the applicable prospectus supplement.

Subject to the limitations provided in the indenture and in the prospectus supplement, debt securities that are issued in registered form may be transferred or exchanged at the corporate office of the trustee maintained in the City of New York or the principal corporate trust office of the trustee, without the payment of any service charge, other than any tax or other governmental charge payable in connection therewith.

Global Securities

The debt securities of a class or series may be issued in whole or in part in the form of one or more global securities that will be deposited with, or on behalf of, a depositary identified in the prospectus supplement. Global securities will be issued in registered form and in either temporary or definitive form. Unless and until it is exchanged in whole or in part for the individual debt securities, a global security may not be transferred except as a whole by the depositary for such global security to a nominee of such depositary or by a nominee of such depositary to such depositary or another nominee of such depositary or by such depositary or any such nominee to a successor of such depositary or a nominee of such successor. The specific terms of the depositary arrangement with respect to any debt securities of a class or series and the rights of and limitations upon owners of beneficial interests in a global security will be described in the applicable prospectus supplement.

DESCRIPTION OF COMMON SHARES

This section describes the general terms and provisions of our common shares of beneficial interest, par value \$.01 per share. This summary is not complete. We have incorporated by reference our Declaration of Trust and our amended and restated bylaws (our Bylaws) as exhibits to the registration statement of which this prospectus is a part. We have also incorporated by reference in this prospectus a description of our common shares which is contained in other documents we have filed with the SEC. You should read these other documents before you acquire any common shares.

Common Shares

All common shares offered by any applicable prospectus supplement will be duly authorized, fully paid and nonassessable. All rights that accompany the ownership of our common shares are subject to the preferential rights of any other class or series of our shares and to the provisions of our Declaration of Trust regarding restrictions on transfer of our shares.

General

As of December 31, 2008 our authorized capital included 45,000,000 common shares, of which 18,583,362 shares were issued and outstanding. All common shares offered pursuant to any prospectus supplement will, when issued, be duly authorized, fully paid and non-assessable. This means that the full price for our common shares will be paid at issuance and that you, as a purchaser of such common shares will not be later required to pay us any additional monies for such common shares.

Dividends

Subject to the preferential rights of any shares or class or series of beneficial interest that we may issue in the future, and to the provisions of the Declaration of Trust regarding the restriction on transfer of common shares, holders of common shares are entitled to receive dividends on such shares out of our funds that we can legally use to pay

dividends, when and if such dividends are declared by our board of trustees.

Voting Rights

Subject to the provisions of our Declaration of Trust regarding restrictions on the transfer and ownership of shares of beneficial interest, the holders of common shares have the exclusive power to vote on all matters presented to our shareholders unless the terms of any outstanding preferred shares gives the holders of preferred shares the

Table of Contents

right to vote on certain matters or generally. Each outstanding common share entitles the holder to one vote on all matters submitted to a vote of shareholders, including the election of trustees. There is no cumulative voting in the election of our trustees, which means that the holders of a majority of the outstanding common shares can elect all of the trustees then standing for election, and the votes held by the holders of the remaining common shares, if any, will not be sufficient to elect any trustee.

Other Rights

Subject to the provisions of our Declaration of Trust regarding restrictions on the transfer and ownership of shares of beneficial interest, each common share has equal distribution, liquidation and other rights, and has no preference, conversion, sinking fund, redemption or preemptive rights.

Pursuant to our Declaration of Trust and Maryland law, any merger, consolidation or sale of all or substantially all of our assets or dissolution requires the affirmative vote of at least two-thirds of all the votes entitled to be cast by our shareholders on the matter. Any amendment to our Declaration of Trust, other than an amendment of any of the sections of our Declaration of Trust which provide that the matters described in the foregoing sentence must be approved by a two-thirds vote, requires the affirmative vote of at least a majority of all the votes entitled to be cast by our shareholders on the matter. Subject to any rights of holders of one or more classes or series of our preferred shares to elect one or more trustees, at a meeting of our shareholders, the affirmative vote of at least two-thirds of our shareholders entitled to vote in the election of trustees is required in order to remove a trustee. Our Declaration of Trust authorizes our board of trustees to increase or decrease the aggregate number of our authorized shares of beneficial interest and the number of shares of any class or series of beneficial interest.

Transfer Agent and Registrar

The transfer agent and registrar for our common shares is the American Stock Transfer & Trust Company.

Power To Reclassify Our Shares

Our Declaration of Trust authorizes our board of trustees to classify and reclassify any of our unissued common shares and preferred shares into other classes or series of shares. Prior to issuance of shares of each class or series, our Board is required by Maryland law and by our Declaration of Trust to set, subject to the restrictions on transfer of shares contained in our Declaration of Trust, the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption for each class or series. Thus, our board of trustees could authorize the issuance of preferred shares with terms and conditions which could have the effect of delaying, deferring or preventing a transaction or a change in control that might involve a premium price for holders of our common shares or otherwise be in their best interest.

Power To Increase Our Authorized Capital and to Issue Additional Common Shares And Preferred Shares

Our Declaration of Trust authorizes our board of trustees, without the approval of our shareholders, to amend our Declaration of Trust from time to time to increase or decrease the aggregate number of common shares and/or preferred shares or the number of shares of any class or series that we have authority to issue.

We believe that the power to increase our authorized capital, to issue additional common shares or preferred shares and to classify or reclassify unissued common or preferred shares and thereafter to issue the classified or reclassified shares provides us with increased flexibility in structuring possible future financings and acquisitions and in meeting other needs which might arise. These actions can be taken without shareholder approval, unless shareholder approval is required by applicable law or the rules of any stock exchange or automated quotation system on which our

securities may be listed or traded.

The description of the limitations on the liability of shareholders of ours set forth under Description of Preferred Shares is applicable to holders of common shares.

Table of Contents

Restrictions On Ownership And Transfer

In order for us to qualify as a REIT, we must not be closely held as determined under Section 856(h) of the Code. We will not be considered closely held if no more than 50% in value of our outstanding shares is actually or constructively owned by five or fewer individuals (as determined by applying certain attribution rules under the Code) during the last half of a taxable year (other than the first year for which an election to be treated as a REIT has been made) or during a proportionate part of a shorter taxable year. In addition, in order for us to qualify as a REIT, we must satisfy two gross income tests that require us to derive a certain percentage of our income from certain qualifying sources, including rents from real property. If we, or an owner of 10% or more of our shares, actually or constructively owns 10% or more of one of our tenants (or a tenant of any partnership in which we are a partner), the rent we receive (either directly or through any such partnership) from such tenant (referred to in this section as a Related Party Tenant) will not be treated as qualifying rent for purposes of the REIT gross income tests. Moreover, in order for us to qualify as a REIT, at least 100 persons must beneficially own our shares during 335 or more days of a taxable year of twelve months or during a proportionate part of a shorter taxable year (other than the first year for which we elected to be treated as a REIT).

In order to assist us in preserving our REIT status, our Declaration of Trust prohibits:

any person from actually or constructively owning our shares that would cause us to be closely held under Section 856(h) of the Code or otherwise cause us to fail to qualify as a REIT, including by reason of receiving rents from tenants that are Related Party Tenants in an amount that would cause us to fail to satisfy one or both of the REIT gross income tests, and

any person from transferring our shares if the transfer would cause our shares to be owned by fewer than 100 persons.

In addition, to assist us in avoiding a transfer of shares that would cause us to become closely held or the receipt of rent from a Related Party Tenant, our Declaration of Trust, as amended, subject to customary exceptions, provides that no holder may actually or constructively own more than the ownership limit as determined by applying certain attribution rules under the Code. The ownership limit means:

with respect to our common shares, 9.8%, in value or number of shares, whichever is more restrictive, of our outstanding common shares, and

with respect to any class or series of our preferred shares, 9.8%, in value or number of shares, whichever is more restrictive, of the outstanding shares of the applicable class or series of our preferred shares.

The attribution rules under the Code are complex and may cause common shares actually or constructively owned by a group of related individuals and/or entities to be treated as being constructively owned by one individual or entity. As a result, the acquisition by an individual or entity of less than 9.8% of our common shares (or the acquisition by an individual or entity of an interest in an entity that actually or constructively owns our common shares) could cause such individual or entity, or another individual or entity, to constructively own in excess of 9.8% of our outstanding common shares and, thus, subject those common shares to the ownership limit.

Our board of trustees may, in its sole discretion and upon the vote of 75% of its members, grant an exemption from the ownership limit with respect to a person (or more than one person) who would not be treated as an individual for purposes of the Code if such person submits to the board information satisfactory to the board, in its reasonable discretion, demonstrating that:

such person is not an individual for purposes of the Code,

such person's share ownership will not cause a person who is an individual to be treated as owning common shares in excess of the ownership limit, applying the attribution rules under the Code, and

such person's share ownership will not otherwise jeopardize our REIT status.

As a condition of a waiver, our board of trustees may, in its reasonable discretion, require undertakings or representations from such person to ensure that the conditions described above are satisfied and will continue to be satisfied for as long as such person owns shares in excess of the ownership limit.

Table of Contents

Under some circumstances, our board of trustees may, in its sole discretion and upon the vote of 75% of its members, grant an exemption for individuals to acquire preferred shares in excess of the ownership limit.

Our board of trustees also has the authority to increase the ownership limit from time to time, but it does not have the authority to do so to the extent that, after giving effect to an increase, five beneficial owners of our common shares could beneficially own in the aggregate more than 49.5% of our outstanding common shares.

Any person who acquires, or attempts or intends to acquire, actual or constructive ownership of our shares that violates or may violate any of the foregoing restrictions on transferability and ownership will be required to give notice to us immediately and provide us with any information that we may request in order to determine the effect of the transfer on our REIT status.

If any purported transfer of our shares or any other event would otherwise result in any person violating the ownership limit or the other restrictions in our Declaration of Trust, then the purported transfer will be void and of no force or effect with respect to the purported transferee as to that number of shares that exceeds the ownership limit and the purported transferee will acquire no right or interest (or, in the case of any event other than a purported transfer, the person or entity holding record title to any shares in excess of the ownership limit will cease to own any right or interest) in those excess shares. Any excess shares described above will be transferred automatically, by operation of law, to a trust, the beneficiary of which will be a qualified charitable organization selected by us. This automatic transfer will be deemed to be effective as of the close of business on the business day (as defined in our Declaration of Trust) prior to the date of the violating transfer.

Within 20 days of receiving notice from us of the transfer of shares to the trust, the trustee of the trust (who will be designated by us and will be unaffiliated to us and the purported transferee or owner) will be required to sell the excess shares to a person or entity who could own those shares without violating the ownership limit and distribute to the purported transferee an amount equal to the lesser of the price paid by the purported transferee for the excess shares or the sales proceeds received by the trust for the excess shares. In the case of any excess shares resulting from any event other than a transfer, or from a transfer for no consideration (such as a gift), the trustee will be required to sell the excess shares to a qualified person or entity and distribute to the purported owner an amount equal to the lesser of the fair market value of the excess shares as of the date of the event or the sales proceeds received by the trust for the excess shares. In either case, any proceeds in excess of the amount distributable to the purported transferee or owner, as applicable, will be distributed to the beneficiary of the trust.

Prior to a sale of any excess shares by the trust, the trustee will be entitled to receive, in trust for the beneficiary, all dividends and other distributions paid by us with respect to the excess shares, and also will be entitled to exercise all voting rights with respect to the excess shares. Subject to Maryland law, effective as of the date that the shares have been transferred to the trust, the trustee will have the authority (at the trustee's sole discretion and subject to applicable law) (1) to rescind as void any vote cast by a purported transferee prior to the discovery by us that its shares have been transferred to the trust and (2) to recast votes in accordance with the desires of the trustee acting for the benefit of the beneficiary of the trust. Any dividend or other distribution paid to the purported transferee or owner (prior to the discovery by us that its shares had been automatically transferred to a trust as described above) will be required to be repaid to the trustee upon demand for distribution to the beneficiary of the trust.

If the transfer to the trust as described above is not automatically effective (for any reason) to prevent violation of the ownership limit, then our Declaration of Trust provides that the transfer of the excess shares will be void.

In addition, our shares held in the trust will be deemed to have been offered for sale to us, or our designee, at a price per share equal to the lesser of (1) the price per share in the transaction that resulted in the transfer to the trust (or, in the case of a devise or gift, the fair market value at the time of that devise or gift) and (2) the fair market value of such

shares on the date we, or our designee, accept the offer. We will have the right to accept the offer until the trustee has sold the shares of beneficial interest held in the trust. Upon the sale to us, the interest of the beneficiary in the shares sold will terminate and the trustee will distribute the net proceeds of the sale to the purported owner.

All certificates evidencing our shares will bear a legend referring to the restrictions described above and a statement that we will furnish a copy of our Declaration of Trust to a shareholder on request and without charge.

Table of Contents

All persons who own, either actually or constructively by application of the attribution rules under the Code, more than 5% (or other percentage between 1/2 of 1% and 5% as provided in applicable rules and regulations under the Code) of the lesser of the number or value of our outstanding shares must give a written notice to us by January 30 of each year. In addition, each shareholder will, upon demand, be required to disclose to us in writing information with respect to the direct, indirect and constructive ownership of our shares that our board of trustees deems reasonably necessary to comply with the provisions of the Code applicable to a REIT, to comply with the requirements of any taxing authority or governmental agency or to determine our compliance with such provisions or requirements.

DESCRIPTION OF PREFERRED SHARES

The following description of the preferred shares, which may be offered pursuant to a prospectus supplement, sets forth certain general terms and provisions of the preferred shares to which any prospectus supplement may relate. The particular terms of the preferred shares being offered and the extent to which such general provisions may or may not apply will be described in a prospectus supplement relating to such preferred shares. The statements below describing the preferred shares are in all respects subject to and qualified in their entirety by reference to the applicable provisions of our Declaration of Trust, as amended (including any articles supplementary setting forth the terms of the preferred shares), and our Bylaws.

Subject to limitations prescribed by Maryland law and our Declaration of Trust, as amended, our board of trustees is authorized to fix the number of shares constituting each class or series of preferred shares and to set or fix the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms or conditions of redemption of each such class or series. The preferred shares will, when issued, be fully paid and nonassessable and will have no preemptive rights.

Pursuant to our Declaration of Trust, our board of trustees may authorize the issuance of up to 10,000,000 preferred shares of beneficial interest, par value \$.01 per share, in one or more classes or series and may classify any unissued preferred shares and reclassify any previously classified but unissued preferred shares of any class or series. All previously issued and outstanding preferred shares have been reacquired by us and restored to the status of undesignated preferred shares.

The register and transfer agent for any preferred shares will be set forth in the applicable prospectus supplement.

Reference is made to the prospectus supplement relating to the preferred shares offered thereby for specific terms, including:

the title and stated value of such preferred shares;

the number of such preferred shares being offered, the liquidation preference per share and the offering price of such preferred shares;

the distribution rate(s), period(s) and/or payment date(s) or method(s) of calculation thereof applicable to such preferred shares;

the date from which distributions on such preferred shares shall accumulate, if applicable;

the procedures for any auction and remarketing, if any, for such preferred shares;

the provision for a sinking fund, if any, for such preferred shares;

the provisions for redemption, if applicable, of such preferred shares;

any listing of such preferred shares on any securities exchange;

the terms and conditions, if applicable, upon which such preferred shares will be convertible into common shares, including the conversion price (or manner of calculation thereof);

a discussion of United States federal income tax considerations applicable to such preferred shares;

Table of Contents

the relative ranking and preferences of such preferred shares as to distribution rights (including whether any liquidation preference as to the preferred shares will be treated as a liability for purposes of determining the availability of assets of ours for distributions to holders of common or preferred shares remaining junior to the preferred shares as to distribution rights) and rights upon liquidation, dissolution or winding up of our affairs;

any limitations on issuance of any class or series of preferred shares ranking senior to or on a parity with such class or series of preferred shares as to distribution rights and rights upon liquidation, dissolution or winding up of our affairs;

any limitations on direct or beneficial ownership and restrictions on transfer of such preferred shares, in each case as may be appropriate to preserve our status as a REIT; and

any other specific terms, preferences, rights, limitations or restrictions of such preferred shares.

Rank

Unless otherwise specified in the applicable prospectus supplement, the preferred shares will, with respect to distribution rights and/or rights upon liquidation, dissolution or winding up, rank (i) senior to all classes or series of common shares, and to all equity securities ranking junior to such preferred shares with respect to our distribution rights and/or rights upon liquidation, dissolution or winding up of, as the case may be; (ii) on a parity with all equity securities issued by us the terms of which specifically provide that such equity securities rank on a parity with the preferred shares with respect to distribution rights and/or rights upon liquidation, dissolution or winding up, as the case may be; and (iii) junior to all equity securities issued by us the terms of which specifically provide that such equity securities rank senior to the preferred shares with respect to distribution rights and/or rights upon liquidation, dissolution or winding up, as the case may be.

Distributions

Unless otherwise specified in the applicable prospectus supplement, holders of preferred shares will be entitled to receive, when, as and if authorized by our board of trustees, out of assets of ours legally available for payment, cash distributions at such rates (or method of calculation thereof) and on such dates as will be set forth in the applicable prospectus supplement. Each such distribution shall be payable to holders of record as they appear on our stock transfer books on such record dates as shall be fixed by our board of trustees.

Distributions on any class or series of the preferred shares may be cumulative or non-cumulative, as provided in the applicable prospectus supplement. Distributions, if cumulative, will be cumulative from and after the date set forth in the applicable prospectus supplement. If our board of trustees fails to authorize a distribution payable on a distribution payment date on any class or series of the preferred shares for which distributions are noncumulative, then the holders of such class or series of the preferred shares will have no right to receive a distribution in respect of the distribution period ending on such distribution payment date, and we will have no obligation to pay the distribution accrued for such period, whether or not distributions on such class or series are authorized for payment on any future distribution payment date.

Unless otherwise specified in the applicable prospectus supplement, if any preferred shares of any class or series are outstanding, no full distributions will be authorized or paid or set apart for payment on the preferred shares of ours of any other class or series ranking, as to distributions, on a parity with or junior to the preferred shares of such class or series for any period unless (i) if such class or series of preferred shares has a cumulative distribution, full cumulative distributions have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the

payment thereof set apart for such payment on the preferred shares of such class or series for all past distribution periods and the then current distribution period or (ii) if such class or series of preferred shares does not have a cumulative distribution, full distributions for the then current distribution period have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment thereof set apart for such payment on the preferred shares of such class or series. When distributions are not paid in full (or a sum sufficient for such full payment is not so set apart) upon the preferred shares of any class or series and the shares of any other class or series of preferred shares ranking on a parity as to distributions with the preferred shares of such

Table of Contents

class or series, all distributions authorized upon the preferred shares of such class or series and any other class or series of preferred shares ranking on a parity as to distributions with such preferred shares shall be authorized pro rata so that the amount of distributions authorized per share on the preferred shares of such class or series and such other class or series of preferred shares shall in all cases bear to each other the same ratio that accrued and unpaid distributions per share on the preferred shares of such class or series (which shall not include any accumulation in respect of unpaid distributions for prior distribution periods if such preferred shares do not have a cumulative distribution) and such other class or series of preferred shares bear to each other. No interest, or sum of money in lieu of interest, shall be payable in respect of any distribution payment or payments on preferred shares of such class or series which may be in arrears.

Except as provided in the immediately preceding paragraph, or in the applicable prospectus supplement, unless (i) if such class or series of preferred shares has a cumulative distribution, full cumulative distributions on the preferred shares of such class or series have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment thereof set apart for payment for all past distribution periods and the then current distribution period and (ii) if such class or series of preferred shares does not have a cumulative distribution, full distributions on the preferred shares of such class or series have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment thereof set apart for payment for the then current distribution period, no distributions (other than in common shares or other shares of beneficial interest ranking junior to the preferred shares of such class or series as to distributions and upon liquidation, dissolution or winding up of our affairs) shall be authorized or paid or set aside for payment or other distribution upon the common shares or any other shares of beneficial interest of us ranking junior to or on a parity with the preferred shares of such class or series as to distributions or upon liquidation, dissolution or winding up of our affairs, nor shall any common shares or any other shares of beneficial interest ranking junior to or on a parity with the preferred shares of such class or series as to distributions or upon liquidation, dissolution or winding up of our affairs be redeemed, purchased or otherwise acquired for any consideration (or any moneys be paid to or made available for a sinking fund for the redemption of any shares of beneficial interest) by us (except by conversion into or exchange for other shares of beneficial interest ranking junior to the preferred shares of such class or series as to distributions and upon liquidation, dissolution or winding up of our affairs).

Any distribution payment made on a class or series of preferred shares shall first be credited against the earliest accrued but unpaid distribution due with respect to shares of such class or series which remains payable.

Redemption

If so provided in the applicable prospectus supplement, the preferred shares of any class or series will be subject to mandatory redemption or redemption at our option, as a whole or in part, in each case upon the terms, at the times and at the redemption prices set forth in such prospectus supplement.

The prospectus supplement relating to a class or series of preferred shares that is subject to mandatory redemption will specify the number of such preferred shares that will be redeemed by us in each year commencing after a date to be specified, at a redemption price per share to be specified, together with an amount equal to all accrued and unpaid distributions thereon (which shall not, if such preferred shares does not have a cumulative distribution, include any accumulation in respect of unpaid distributions for prior distribution periods) to the date of redemption. The redemption price may be payable in cash or other property, as specified in the applicable prospectus supplement. If the redemption price for preferred shares of any class or series is payable only from the net proceeds of the issuance of shares of beneficial interest, the terms of such preferred shares may provide that, if no such shares of beneficial interest shall have been issued or to the extent the net proceeds from any issuance are insufficient to pay in full the aggregate redemption price then due, such preferred shares shall automatically and mandatorily be converted into shares of the applicable shares of beneficial interest pursuant to conversion provisions specified in the applicable

prospectus supplement.

Notwithstanding the foregoing, but subject to the provisions of the applicable prospectus supplement, unless (i) if such class or series of preferred shares has a cumulative distribution, full cumulative distributions on all shares of such class or series have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment thereof set apart for payment for all past distribution periods and the then current distribution period

Table of Contents

and (ii) if such class or series of preferred shares does not have a cumulative distribution, full distributions on all shares of such class or series have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment thereof set apart for payment for the then current distribution period, no shares of such class or series of preferred shares shall be redeemed unless all outstanding preferred shares of such class or series are simultaneously redeemed; provided, however, that the foregoing shall not prevent the purchase or acquisition of preferred shares of such class or series pursuant to a purchase or exchange offer made on the same terms to holders of all outstanding preferred shares of such class or series, and, unless (a) if such class or series of preferred shares has a cumulative distribution, full cumulative distributions on all outstanding shares of such class or series have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment thereof set apart for payment for all past distribution periods and the then current distribution period and (b) if such class or series of preferred shares does not have a cumulative distribution, full distributions on all shares of such class or series have been or contemporaneously are authorized and paid or authorized and a sum sufficient for the payment thereof set apart for payment for the then current distribution period, we shall not purchase or otherwise acquire directly or indirectly any preferred shares of such class or series (except by conversion into or exchange for shares of beneficial interest ranking junior to the preferred shares of such class or series as to distributions and upon liquidation).

If fewer than all of the outstanding preferred shares of any class or series are to be redeemed, the number of shares to be redeemed will be determined by us and such shares may be redeemed pro rata from the holders of record of such shares in proportion to the number of such shares held by such holders (with adjustments to avoid redemption of fractional shares) or any other equitable method determined by us.

Unless otherwise provided in the applicable prospectus supplement, a notice of redemption will be mailed at least 30 days but not more than 60 days before the redemption date to each holder of record of preferred shares of any class or series to be redeemed at the address shown on our stock transfer books. Each notice shall state: (i) the redemption date, (ii) the number of shares and class or series of the preferred shares to be redeemed, (iii) the redemption price, (iv) the place or places where certificates for such preferred shares are to be surrendered for payment of the redemption price, (v) that distributions on the shares to be redeemed will cease to accrue on such redemption date, and (vi) the date upon which the holder's conversion rights, if any, as to such shares shall terminate. If fewer than all the preferred shares of any class or series are to be redeemed, the notice mailed to each such holder thereof shall also specify the number of preferred shares to be redeemed from each such holder. If notice of redemption of any preferred shares has been properly given and if the funds necessary for such redemption have been irrevocably set aside by us in trust for the benefit of the holders of any preferred shares so called for redemption, then from and after the redemption date distributions will cease to accrue on such preferred shares, such preferred shares shall no longer be deemed outstanding and all rights of the holders of such shares will terminate, except the right to receive the redemption price. Any moneys so deposited which remain unclaimed by the holders of such preferred shares at the end of two years after the redemption date will be returned by the applicable bank or trust company to us.

Liquidation Preference

Unless otherwise provided in the applicable prospectus supplement, upon any voluntary or involuntary liquidation, dissolution or winding up of our affairs, then, before any distribution or payment shall be made to the holders of any common shares or any other class or series of shares of beneficial interest ranking junior to any class or series of preferred shares in the distribution of assets upon our liquidation, dissolution or winding up, the holders of such class or series of preferred shares shall be entitled to receive, after payment or provision for payment of our debts and other liabilities, out of our assets legally available for distribution to shareholders, liquidating distributions in the amount of the liquidation preference per share (set forth in the applicable prospectus supplement), plus an amount equal to all distributions accrued and unpaid thereon (which shall not include any accumulation in respect of unpaid distributions for prior distribution periods if such preferred shares do not have a cumulative distribution). After payment of the full amount of the liquidating distributions to which they are entitled, the holders of such class or series of preferred shares

will have no right or claim to any of the remaining assets of ours. In the event that, upon any such voluntary or involuntary liquidation, dissolution or winding up, our legally available assets are insufficient to pay the amount of the liquidating distributions on all such outstanding preferred shares and

Table of Contents

the corresponding amounts payable on all of our shares of other classes or series of shares of beneficial interest of ranking on a parity with such class or series of preferred shares in the distribution of assets upon liquidation, dissolution or winding up, then the holders of such class or series of preferred shares and all other such classes or series of shares of beneficial interest shall share ratably in any such distribution of assets in proportion to the full liquidating distributions to which they would otherwise be respectively entitled.

If the liquidating distributions shall have been made in full to all holders of a class or series of preferred shares, the remaining assets of ours shall be distributed among the holders of any other classes or series of shares of beneficial interest ranking junior to such class or series of preferred shares upon liquidation, dissolution or winding up, according to their respective rights and preferences and in each case according to their respective number of shares. For purposes of this section, a distribution of assets in any dissolution, winding up or liquidation will not include (i) any consolidation or merger of us with or into any other corporation, (ii) our dissolution, liquidation, winding up, or reorganization immediately followed by organization of another entity to which such assets are distributed or (iii) a sale or other disposition of all or substantially all of our assets to another entity; provided that, in each case, effective provision is made in the charter of the resulting and surviving entity or otherwise for the recognition, preservation and protection of the rights of the holders of preferred shares.

Voting Rights

Holders of any class or series of preferred shares will not have any voting rights, except as set forth below or as otherwise indicated in the applicable prospectus supplement.

Unless provided otherwise for any class or series of preferred shares, so long as any preferred shares remain outstanding, we will not, without the affirmative vote or consent of the holders of a majority of the shares of each class or series of preferred shares outstanding at the time, given in person or by proxy, either in writing or at a meeting (such class or series voting separately as a class or series), (i) authorize, create or issue, or increase the authorized or issued amount of, any class or series of shares of beneficial interest ranking prior to such class or series of preferred shares with respect to payment of distributions or the distribution of assets upon liquidation, dissolution or winding up, or reclassify any authorized shares of beneficial interest into any such shares, or create, authorize or issue any obligation or security convertible into or evidencing the right to purchase any such shares; or (ii) amend, alter or repeal the provisions of the Declaration of Trust, as amended, including the applicable articles supplementary for such class or series of preferred shares, whether by merger, consolidation or otherwise, so as to materially and adversely affect any right, preference, privilege or voting power of such class or series of preferred shares or the holders thereof; provided, however, that any increase in the amount of the authorized preferred shares or the creation or issuance of any other class or series of preferred shares, or any increase in the amount of authorized shares of such class or series or any other class or series of preferred shares, in each case ranking on a parity with or junior to the preferred shares of such class or series with respect to payment of distributions or the distribution of assets upon liquidation, dissolution or winding up, shall not be deemed to materially and adversely affect such rights, preferences, privileges or voting powers.

The foregoing voting provisions will not apply if, at or prior to the time when the act with respect to which such vote would otherwise be required shall be affected, all outstanding shares of such class or series of preferred shares shall have been redeemed or called for redemption upon proper notice and sufficient funds shall have been irrevocably deposited in trust to effect such redemption.

Whenever distributions on any preferred shares shall be in arrears for six or more consecutive quarterly periods, the holders of such preferred shares (voting together as a class or series with all other class or series of preferred shares upon which like voting rights have been conferred and are exercisable) will be entitled to vote for the election of two additional trustees of ours until, (i) if such class or series of preferred shares has a cumulative distribution, all

distributions accumulated on such preferred shares for the past distribution periods and the then current distribution period shall have been fully paid or authorized and a sum sufficient for the payment thereof set aside for payment or (ii) if such class or series of preferred shares does not have a cumulative distribution, four consecutive quarterly distributions shall have been fully paid or authorized and a sum sufficient for the payment thereof set aside for payment. In such case, our entire board of trustees will be increased by two trustees.

Table of Contents

Conversion Rights

The terms and conditions, if any, upon which any class or series of preferred shares are convertible into common shares will be set forth in the applicable prospectus supplement relating thereto. Such terms will include the number of common shares into which the preferred shares are convertible, the conversion price (or manner of calculation thereof), the conversion period, provisions as to whether conversion will be at the option of the holders of the preferred shares or us, the events requiring an adjustment of the conversion price and provisions affecting conversion in the event of the redemption of such preferred shares.

Restrictions on Transfer

For us to qualify as a REIT under the Code, not more than 50% in value of its outstanding shares of beneficial interest may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code) during the last half of a taxable year, and the shares of beneficial interest must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months (or during a proportionate part of a shorter taxable year). Therefore, the Declaration of Trust, as amended, imposes certain restrictions on the ownership and transferability of preferred shares. For a general description of such restrictions, see [Description of Common Shares](#) [Restrictions on Ownership and Transfer](#). All certificates evidencing preferred shares will bear a legend referring to these restrictions.

DESCRIPTION OF WARRANTS

We have no outstanding warrants to purchase our common shares or outstanding warrants to purchase our preferred shares. We may issue warrants for the purchase of common shares or preferred shares. We may issue warrants independently or together with any other securities offered by any prospectus supplement, and the warrants may be attached to or separate from such securities. Each series of warrants will be issued under a separate warrant agreement, which we will enter into with a warrant agent specified in the applicable prospectus supplement. The warrant agent will act solely as our agent in connection with the applicable warrants and will not assume any obligation or relationship of agency or trust for or with any holders or beneficial owners of the warrants. The following summary is not complete and is subject to and qualified in its entirety by the provisions of the warrant agreement and the warrant certificates relating to each series of warrants which will be filed with the SEC and incorporated by reference as an exhibit to the registration statement of which this prospectus is a part at or prior to the time of the issuance of such series of warrants.

The prospectus supplement relating to any warrants we are offering will describe the specific terms relating to the offering, including some or all of the following:

the title of the warrants,

the offering price,

the exercise price of the warrants,

the aggregate number of common or preferred shares purchasable upon exercise of the warrants and, in the case of warrants for preferred shares, the designation, aggregate number and terms of the class or series of preferred shares purchasable upon exercise of the warrants,

the designation and terms of any class or series of preferred shares with which the warrants are being offered and the number of warrants being offered with such preferred shares,

the date, if any, on and after which the warrants and any related class or series of common shares or preferred shares will be transferable separately,

the date on which the right to exercise the warrants will commence and the date on which such right shall expire,

any federal income tax considerations, and

any other material terms of the warrants.

Table of Contents

DESCRIPTION OF RIGHTS

We may from time to time, issue rights to our shareholders for the purchase of common shares, preferred shares or other securities. Each series of rights will be issued under a separate rights agreement to be entered into between the Company, from time to time, and a bank or trust company, as rights agent, all as set forth in the prospectus supplement relating to the particular issue of rights. The rights agent will act solely as an agent of ours in connection with the certificates relating to the rights and will not assume any obligation or relationship of agency or trust for or with any holders of rights certificates or beneficial owners of rights. The rights agreement and the rights certificates relating to each series of rights will be filed with the SEC and incorporated by reference as an exhibit to the registration statement of which this prospectus is a part at or prior to the time of the issuance of such series of rights.

The applicable prospectus supplement will describe the terms of the rights to be issued, including the following where applicable:

the date for determining the shareholders entitled to the rights distribution;

the aggregate number of common shares or other securities purchasable upon exercise of the rights and the exercise price and any adjustments to such exercise price;

the aggregate number of rights being issued;

the date, if any, on and after which the rights may be transferable separately;

the date on which the right to exercise the rights shall commence and the date on which the right shall expire;

any special United States federal income tax consequences; and

any other terms of the rights, including terms, procedures and limitations relating to the distribution, exchange and exercise of the rights.

CERTAIN PROVISIONS OF MARYLAND LAW AND OF OUR DECLARATION OF TRUST AND AMENDED AND RESTATED BYLAWS

The following description of certain provisions of Maryland law and of our Declaration of Trust and Bylaws is only a summary. For a complete description, we refer you to Maryland law, our Declaration of Trust and our Bylaws. See [Where You Can Find More Information](#).

Classification Of The Board Of Trustees

Our Declaration of Trust and Bylaws provide that our board of trustees will establish the number of trustees. Our board of trustees currently comprises seven trustees. Our Bylaws also provide that a majority of the entire board of trustees may increase or decrease the number of trustees serving on our board of trustees. Any vacancy on our board of trustees, other than a vacancy created as a result of the removal of any trustee by the action of the shareholders, shall be filled, at any regular meeting or at any special meeting called for that purpose, by the majority of the remaining trustees.

Pursuant to our Declaration of Trust, our board of trustees is divided into three classes of trustees. Trustees of each class are chosen for three-year terms upon the expiration of their current terms and each year one class of trustees will be elected by the shareholders. We intend to propose an amendment to our Declaration of Trust to declassify our board of trustees (so that trustees would be elected annually, for one year terms) at our 2009 annual meeting of shareholders. Holders of our common shares have no right to cumulative voting in the election of trustees. Consequently, at each annual meeting of shareholders, the holders of a majority of our common shares are able to elect all of the successors of the class of trustees whose terms expire at that meeting.

The classified board provision could have the effect of making the replacement of incumbent trustees more time-consuming and difficult. At least two annual meetings of shareholders, instead of one, will generally be required to effect a change in a majority of the board of trustees. Thus, the classified board provision could increase the likelihood that incumbent trustees will retain their positions. The staggered terms of trustees may delay, defer or

Table of Contents

prevent a tender offer or an attempt to change control, even though the tender offer or change in control might be in the best interest of our shareholders.

Removal Of Trustees

Our Declaration of Trust provides that, subject to any rights of holders of one or more classes or series of preferred shares to elect one or more trustees, any trustee may be removed at any time, with or without cause, at a meeting of the shareholders, by the affirmative vote of the holders of not less than two-thirds of the shares then outstanding and entitled to vote generally in the election of trustees. If any trustee shall be so removed, our shareholders may take action to fill the vacancy so created. An individual so elected as trustee by the shareholders shall hold office for the unexpired term of the trustee whose removal created the vacancy.

Business Combinations

Under Maryland law, business combinations between a Maryland real estate investment trust and an interested shareholder or an affiliate of an interested shareholder are prohibited for five years after the most recent date on which the interested shareholder becomes an interested shareholder. These business combinations include, among other things specified in the statute, a merger, consolidation, share exchange, or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested shareholder is defined as:

any person who beneficially owns ten percent or more of the voting power of the trust's shares; or

an affiliate or associate of the trust who, at any time within the two-year period prior to the date in question, was the beneficial owner of ten percent or more of the voting power of the then outstanding voting shares of the trust.

A person is not an interested shareholder under the statute if the board of trustees approved in advance the transaction by which such person or entity otherwise would have become an interested shareholder. However, in approving a transaction, the board of trustees may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the board of trustees.

After the five-year prohibition, any business combination between the Maryland trust and an interested shareholder generally must be recommended by the board of trustees of the trust and approved by the affirmative vote of at least:

80% of the votes entitled to be cast by holders of outstanding voting shares of the trust; and

two-thirds of the votes entitled to be cast by holders of voting shares of the trust other than shares held by the interested shareholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested shareholder.

These super-majority vote requirements do not apply if the trust's common shareholders receive a minimum price, as defined under Maryland law, for their shares in the form of cash or other consideration in the same form as previously paid by the interested shareholder for its shares.

The statute permits various exemptions from its provisions, including business combinations that are exempted by the board of trustees before the time that the interested shareholder becomes an interested shareholder. Pursuant to the statute, our board of trustees has adopted a resolution that any business combination between us and any other person or entity is exempted from the provisions of the statute described in the preceding paragraphs. This resolution, however, may be altered or repealed, in whole or in part, by our board of trustees at any time.

The business combination statute may discourage others from trying to acquire control of us and increase the difficulty of consummating any offer.

Control Share Acquisitions

Maryland law provides that control shares of a Maryland real estate investment trust acquired in a control share acquisition have no voting rights except to the extent approved by a vote of two-thirds of the votes entitled to be cast

Table of Contents

on the matter. Shares owned by the acquiror, by officers or by trustees who are employees of the trust are excluded from shares entitled to vote on the matter. Control shares are voting shares which, if aggregated with all other shares owned by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to exercise voting power in electing trustees within one of the following ranges of voting power:

one-tenth or more but less than one-third;

one-third or more but less than a majority; or

a majority or more of all voting power.

Control shares do not include shares the acquiring person is then entitled to vote as a result of having previously obtained shareholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the board of trustees of the trust to call a special meeting of shareholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction of certain conditions, including an undertaking to pay the expenses of the meeting. If no request for a meeting is made, the trust may itself present the question at any shareholders meeting.

If voting rights are not approved at the meeting or if the acquiring person does not deliver an acquiring person statement as required by the statute, then the trust may redeem for fair value any or all of the control shares, except those for which voting rights have previously been approved. The right of the trust to redeem control shares is subject to certain conditions and limitations. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of shareholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a shareholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other shareholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the highest price per share paid by the acquiror in the control share acquisition.

The control share acquisition statute does not apply (i) to shares acquired in a merger, consolidation or share exchange if the trust is a party to the transaction or (ii) to acquisitions approved or exempted by the declaration of trust or bylaws of the trust.

Our Bylaws contain a provision exempting from the control share acquisition statute any and all acquisitions by any person of our shares. This provision of our Bylaws may not be repealed or amended, nor may another provision that is inconsistent with this provision be adopted in either our Bylaws or our Declaration of Trust, except upon the affirmative vote of a majority of all the votes cast by our shareholders at a meeting of shareholders duly called and at which a quorum is present.

Merger; Amendment To The Declaration Of Trust

Under Maryland law, a Maryland REIT generally cannot amend its declaration of trust or merge with another entity, unless approved by t; COLOR: #231f20; FONT-FAMILY: arial"> 22,745 22,403

Total liabilities

1,067,833 809,895 785,151 535,502

Equity

Minority interests				23	152	396	—	—
Shareholders' equity								
Called up share capital				24	5,483	5,482	5,483	5,482
Reserves								
				25	42,200	32,454	25,606	16,949
Total equity	47,835	38,332	31,089	22,431				
Total liabilities and equity	1,115,668	848,227	816,240	557,933				

The accounts were approved by the Board of directors on 28 March 2008 and signed on its behalf by:

Sir Tom McKillop	Sir Fred Goodwin	Guy Whittaker
Chairman	Group Chief Executive	Group Finance Director

Statements of recognised income and expense for the year ended 31 December 2007

	2007	Group	2005	2007	Bank	2005
	£m	2006	£m	£m	2006	£m
		£m			£m	
Available-for-sale investments						
Net valuation gains/(losses) taken direct to equity	511	340	(160)	249	122	(3)
Net profit taken to income on sales	(465)	(196)	(561)	(231)	(71)	(38)
Cash flow hedges						
Net (losses)/gains taken direct to equity	(408)	(108)	20	60	(138)	(80)
Net (gains)/losses taken to earnings	(141)	(143)	(91)	25	2	(37)
Exchange differences on translation of foreign operations	9	(1,347)	787	5	1	(2)
Actuarial gains/(losses) on defined benefit plans	2,153	1,776	(792)	2	2	(1)
Income/(expense) before tax on items recognised direct in equity	1,659	322	(797)	110	(82)	(161)
Tax on items recognised direct in equity	(449)	(512)	517	(34)	13	81
Net income/(expense) recognised direct in equity	1,210	(190)	(280)	76	(69)	(80)
Profit for the year	7,252	5,921	5,026	7,255	3,519	1,544
Total recognised income and expense for the year	8,462	5,731	4,746	7,331	3,450	1,464
Attributable to:						
Equity shareholders	8,420	5,756	4,721	7,331	3,450	1,464
Minority interests	42	(25)	25	—	—	—
	8,462	5,731	4,746	7,331	3,450	1,464

Cash flow statements for the year ended 31 December 2007

	Note	2007 £m	Group 2006 £m	2005 £m	2007 £m	Bank 2006 £m	2005 £m
Operating activities							
Operating profit before tax		9,155	8,354	7,293	7,759	4,039	2,067
Adjustments for:							
Depreciation and amortisation		1,438	1,415	1,560	485	390	403
Interest on subordinated liabilities		1,452	1,161	978	1,200	878	704
Charge for defined benefit pension schemes		479	578	460	5	8	3
Cash contribution to defined benefit pension schemes		(536)	(533)	(450)	(16)	(1)	(2)
Elimination of foreign exchange differences		(2,137)	4,515	(2,359)	(2,034)	1,345	499
Other non-cash items		(833)	(1,134)	(2,208)	(575)	218	526
Net cash inflow from trading activities		9,018	14,356	5,274	6,824	6,877	4,200
Changes in operating assets and liabilities		6,869	3,292	6,240	8,578	16,815	(3,076)
Net cash flows from operating activities before tax		15,887	17,648	11,514	15,402	23,692	1,124
Income taxes paid		(1,802)	(2,122)	(1,830)	(526)	(298)	(437)
Net cash flows from operating activities	32	14,085	15,526	9,684	14,876	23,394	687
Investing activities							
Sale and maturity of securities		23,775	25,810	38,549	17,268	15,240	20,635
Purchase of securities		(26,160)	(17,803)	(36,107)	(20,726)	(10,609)	(16,888)
Sale of property, plant and equipment		5,596	2,926	2,188	857	180	87
Purchase of property, plant and equipment		(3,886)	(3,938)	(4,423)	(449)	(509)	(797)
Net investment in business interests and intangible assets	33	(430)	(19)	(209)	(590)	(445)	(1,374)
Net cash flows from investing activities		(1,105)	6,976	(2)	(3,640)	3,857	1,663
Financing activities							
Issue of equity preference shares		3,650	1,092	2,028	3,650	1,092	2,028
Issue of subordinated liabilities		1,018	3,027	1,234	968	2,936	943
Proceeds of minority interests issued		—	427	70	—	—	—
Redemption of minority interests		(247)	(81)	(121)	—	—	—
Repayment of subordinated liabilities		(1,708)	(1,318)	(1,553)	(1,288)	(672)	(1,513)
Dividends paid		(2,362)	(3,531)	(2,098)	(2,331)	(3,502)	(2,082)
Interest on subordinated liabilities		(1,431)	(1,181)	(1,027)	(1,173)	(890)	(739)
Net cash flows from financing activities		(1,080)	(1,565)	(1,467)	(174)	(1,036)	(1,363)
Effects of exchange rate changes on cash and cash equivalents		2,714	(3,475)	1,659	2,601	(2,036)	312
Net increase in cash and cash equivalents		14,614	17,462	9,874	13,663	24,179	1,299
Cash and cash equivalents 1 January		70,147	52,685	42,811	63,586	39,407	38,108
Cash and cash equivalents 31 December		84,761	70,147	52,685	77,249	63,586	39,407

Accounting policies

1. Presentation of accounts

The accounts are prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (“IASB”), and interpretations issued by the International Financial Reporting Interpretations Committee of the IASB (together “IFRS”) as adopted by the European Union (“EU”). The EU has not adopted the complete text of IAS 39 'Financial Instruments: Recognition and Measurement'; it has relaxed some of the standard's hedging requirements. The Group has not taken advantage of this relaxation and has adopted IAS 39 as issued by the IASB: the Group's financial statements are prepared in accordance with IFRS as issued by the IASB. The date of transition to IFRS for the Group and the Bank and the date of their opening IFRS balance sheets was 1 January 2004.

The Group has adopted IFRS 7 'Financial Instruments: Disclosures' for the accounting period beginning 1 January 2007. This has had no effect on the results, cash flows or financial position of the Group or the Bank. However, there are changes to the notes on the accounts and comparative information is presented accordingly.

The Bank is incorporated in the UK and registered in Scotland. The accounts are prepared on the historical cost basis except that the following assets and liabilities are stated at their fair value: derivative financial instruments, held-for-trading financial assets and financial liabilities, financial assets and financial liabilities that are designated as at fair value through profit or loss, available-for-sale financial assets and investment property. Recognised financial assets and financial liabilities in fair value hedges are adjusted for changes in fair value in respect of the risk that is hedged.

The Bank accounts are presented in accordance with the Companies Act 1985.

2. Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Bank and entities (including certain special purpose entities) that continue to be controlled by the Group (its subsidiaries). Control exists where the Group has the power to govern the financial and operating policies of the entity; generally conferred by holding a majority of voting rights. On acquisition of a subsidiary, its identifiable assets, liabilities and contingent liabilities are included in the consolidated accounts at their fair value. Any excess of the cost (the fair value of assets given, liabilities incurred or assumed and equity instruments issued by the Group plus any directly attributable costs) of an acquisition over the fair value of the net assets acquired is recognised as goodwill. The interest of minority shareholders is stated at their share of the fair value of the subsidiary's net assets.

The results of subsidiaries acquired are included in the consolidated income statement from the date control passes to the Group. The results of subsidiaries are included up until the Group ceases to control them through sale or significant change in circumstances.

All intra-group balances, transactions, income and expenses are eliminated on consolidation. The consolidated accounts are prepared using uniform accounting policies.

3. Revenue recognition

Interest income on financial assets that are classified as loans and receivables, available-for-sale or held-to-maturity and interest expense on financial liabilities other than those at fair value through profit or loss are determined using

the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of financial assets or liabilities) and of allocating the interest income or interest expense over the expected life of the asset or liability. The effective interest rate is the rate that exactly discounts estimated future cash flows to the instrument's initial carrying amount. Calculation of the effective interest rate takes into account fees payable or receivable, that are an integral part of the instrument's yield, premiums or discounts on acquisition or issue, early redemption fees and transaction costs. All contractual terms of a financial instrument are considered when estimating future cash flows.

Financial assets and financial liabilities held-for-trading or designated as at fair value through profit or loss are recorded at fair value. Changes in fair value are recognised in profit or loss together with dividends and interest receivable and payable.

Commitment and utilisation fees are determined as a percentage of the outstanding facility. If it is unlikely that a specific lending arrangement will be entered into, such fees are taken to profit or loss over the life of the facility otherwise they are deferred and included in the effective interest rate on the advance.

Fees in respect of services are recognised as the right to consideration accrues through the provision of the service to the customer. The arrangements are generally contractual and the cost of providing the service is incurred as the service is rendered. The price is usually fixed and always determinable. The application of this policy to significant fee types is outlined below.

Payment services: this comprises income received for payment services including cheques cashed, direct debits, Clearing House Automated Payments (the UK electronic settlement system) and BACS payments (the automated clearing house that processes direct debits and direct credits). These are generally charged on a per transaction basis. The income is earned when the payment or transaction occurs. Charges for payment services are usually debited to the customer's account, monthly or quarterly in arrears. Accruals are raised for services provided but not charged at period end.

Card related services: fees from credit card business include:

Commission received from retailers for processing credit and debit card transactions: income is accrued to the income statement as the service is performed.

Interchange received: as issuer, the Group receives a fee (interchange) each time a cardholder purchases goods and services. The Group also receives interchange fees from other card issuers for providing cash advances through its branch and Automated Teller Machine networks. These fees are accrued once the transaction has taken place.

An annual fee payable by a credit card holder is deferred and taken to profit or loss over the period of the service i.e. 12 months.

Insurance brokerage: this is made up of fees and commissions received from the agency sale of insurance. Commission on the sale of an insurance contract is earned at the inception of the policy as the insurance has been arranged and placed. However, provision is made where commission is refundable in the event of policy cancellation in line with estimated cancellations.

Investment management fees: fees charged for managing investments are recognised as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are deferred and charged as expense as the related revenue is recognised.

4. Pensions and other post-retirement benefits

The Group provides post-retirement benefits in the form of pensions and healthcare plans to eligible employees.

For defined benefit schemes, scheme liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate that reflects the current rate of return on a high quality corporate bond of equivalent term and currency to the scheme liabilities. Scheme assets are measured at their fair value. Any surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). The current service cost and any past service costs together with the expected return on scheme assets less the unwinding of the discount on the scheme liabilities is charged to operating expenses. Actuarial gains and losses are recognised in full in the period in which they occur outside profit or loss and presented in the statement of recognised income and expense.

Contributions to defined contribution pension schemes are recognised in the income statement when payable.

5. Intangible assets and goodwill

Intangible assets that are acquired by the Group are stated at cost less accumulated amortisation and impairment losses. Amortisation is charged to profit or loss over the assets' estimated economic lives using methods that best reflect the pattern of economic benefits and is included in depreciation and amortisation. The estimated useful economic lives are as follows:

Core deposit intangibles	6 to 10 years
Other acquired intangibles	5 to 10 years
Computer software	3 to 5 years

Expenditure on internally generated goodwill and brands is written-off as incurred. Direct costs relating to the development of internal-use computer software are capitalised once technical feasibility and economic viability have

been established. These costs include payroll, the costs of materials and services, and directly attributable overhead. Capitalisation of costs ceases when the software is capable of operating as intended. During and after development, accumulated costs are reviewed for impairment against the projected benefits that the software is expected to generate. Costs incurred prior to the establishment of technical feasibility and economic viability are expensed as incurred as are all training costs and general overhead. The costs of licences to use computer software that are expected to generate economic benefits beyond one year are also capitalised.

Acquired goodwill being the excess of the cost of an acquisition over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the subsidiary, associate or joint venture acquired is initially recognised at cost and subsequently at cost less any accumulated impairment losses. Goodwill arising on the acquisition of subsidiaries and joint ventures is included in the balance sheet caption 'Intangible assets' and that on associates within their carrying amounts. The gain or loss on the disposal of a subsidiary, associate or joint venture includes the carrying value of any related goodwill.

On implementation of IFRS, the Group did not restate business combinations that occurred before January 2004. Under previous GAAP, goodwill arising on acquisitions after 1 October 1998 was capitalised and amortised over its estimated useful economic life. Goodwill arising on acquisitions before 1 October 1998 was deducted from equity. The carrying amount of goodwill in the Group's opening IFRS balance sheet (1 January 2004) was £12,342 million, its carrying value under previous GAAP.

Accounting policies continued

6. Property, plant and equipment

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses. Where an item of property, plant and equipment comprises major components having different useful lives, they are accounted for separately. Property that is being constructed or developed for future use as investment property is classified as property, plant and equipment and stated at cost until construction or development is complete, at which time it is reclassified as investment property.

Depreciation is charged to profit or loss on a straight-line basis so as to write-off the depreciable amount of property, plant and equipment (including assets owned and let on operating leases (except investment property – see accounting policy 20 below)) over their estimated useful lives. The depreciable amount is the cost of an asset less its residual value. Land is not depreciated. Estimated useful lives are as follows:

Freehold and long leasehold buildings	50 years
Short leaseholds	unexpired period of the lease
Property adaptation costs	10 to 15 years
Computer equipment	up to 5 years
Other equipment	4 to 15 years

Under previous GAAP, the Group's freehold and long leasehold property occupied for its own use was recorded at valuation on the basis of existing use value. The Group elected to use this valuation as at 31 December 2003 as deemed cost for its opening IFRS balance sheet (1 January 2004).

7. Impairment of intangible assets and property, plant and equipment

At each reporting date, the Group assesses whether there is any indication that its intangible assets, or property, plant and equipment are impaired. If any such indication exists, the Group estimates the recoverable amount of the asset and the impairment loss if any. Goodwill is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired. If an asset does not generate cash flows that are independent from those of other assets or groups of assets, recoverable amount is determined for the cash-generating unit to which the asset belongs. The recoverable amount of an asset is the higher of its fair value less cost to sell and its value in use. Value in use is the present value of future cash flows from the asset or cash-generating unit discounted at a rate that reflects market interest rates adjusted for risks specific to the asset or cash generating unit that have not been reflected in the estimation of future cash flows. If the recoverable amount of an intangible or tangible asset is less than its carrying value, an impairment loss is recognised immediately in profit or loss and the carrying value of the asset reduced by the amount of the loss. A reversal of an impairment loss on intangible assets (excluding goodwill) or property, plant and equipment is recognised as it arises provided the increased carrying value does not exceed that which it would have been had no impairment loss been recognised. Impairment losses on goodwill are not reversed.

8. Foreign currencies

The Group's consolidated financial statements are presented in sterling which is the functional currency of the Bank.

Transactions in foreign currencies are translated into sterling at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at the rates of exchange ruling at the balance sheet date. Foreign exchange differences arising on translation are reported in income

from trading activities except for differences arising on cash flow hedges and hedges of net investments in foreign operations. Non-monetary items denominated in foreign currencies that are stated at fair value are translated into sterling at foreign exchange rates ruling at the dates the values were determined. Translation differences arising on non-monetary items measured at fair value are recognised in profit or loss except for differences arising on available-for-sale non-monetary financial assets, for example equity shares, which are included in the available-for-sale reserve in equity unless the asset is the hedged item in a fair value hedge.

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into sterling at foreign exchange rates ruling at the balance sheet date. The revenues and expenses of foreign operations are translated into sterling at average exchange rates unless these do not approximate to the foreign exchange rates ruling at the dates of the transactions. Foreign exchange differences arising on the translation of a foreign operation are recognised directly in equity and included in profit or loss on its disposal.

9. Leases

Contracts to lease assets are classified as finance leases if they transfer substantially all the risks and rewards of ownership of the asset to the customer. Other contracts to lease assets are classified as operating leases.

Finance lease receivables are stated in the balance sheet at the amount of the net investment in the lease being the minimum lease payments and any unguaranteed residual value discounted at the interest rate implicit in the lease. Finance lease income is allocated to accounting periods so as to give a constant periodic rate of return before tax on the net investment. Unguaranteed residual values are subject to regular review to identify potential impairment. If there has been a reduction in the estimated unguaranteed residual value, the income allocation is revised and any reduction in respect of amounts accrued is recognised immediately.

Rental income from operating leases is credited to the income statement on a receivable basis over the term of the lease. Operating lease assets are included within Property, plant and equipment and depreciated over their useful lives (see accounting policy 6 above).

10. Taxation

Provision is made for taxation at current enacted rates on taxable profits, arising in income or in equity, taking into account relief for overseas taxation where appropriate. Deferred taxation is accounted for in full for all temporary differences between the carrying amount of an asset or liability for accounting purposes and its carrying amount for tax purposes, except in relation to overseas earnings where remittance is controlled by the Group, and goodwill.

Deferred tax assets are only recognised to the extent that it is probable that they will be recovered.

11. Financial assets

On initial recognition financial assets are classified into held-to-maturity investments; available-for-sale financial assets; held-for-trading; designated as at fair value through profit or loss; or loans and receivables.

Held-to-maturity investments – a financial asset may be classified as a held-to-maturity investment only if it has fixed or determinable payments, a fixed maturity and the Group has the positive intention and ability to hold to maturity. Held-to-maturity investments are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see accounting policy 3 above) less any impairment losses.

Held-for-trading – a financial asset is classified as held-for-trading if it is acquired principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial assets are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses on held-for-trading financial assets are recognised in profit or loss as they arise.

Designated as at fair value through profit or loss – financial assets may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

Financial assets that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss and are subsequently measured at fair value. Gains and losses on financial assets that are designated as at fair value through profit or loss are recognised in profit or loss as they arise.

The Group has designated financial assets as at fair value through profit or loss principally: (a) where the assets are economically hedged by derivatives and fair value designation eliminates the measurement inconsistency that would arise if the assets were carried at amortised cost or classified as available-for-sale and (b) financial assets held in the Group's venture capital portfolio managed on a fair value basis.

Loans and receivables – non-derivative financial assets with fixed or determinable repayments that are not quoted in an active market are classified as loans and receivables except those that are classified as available-for-sale or as held-for-trading, or designated as at fair value through profit or loss. Loans and receivables are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at amortised cost using the effective interest method (see accounting policy 3 above) less any impairment losses.

Available-for-sale – financial assets that are not classified as held-to-maturity; held-for-trading; designated as at fair value through profit or loss; or loans and receivables are classified as available-for-sale. Financial assets can be designated as available-for-sale on initial recognition. Available-for-sale financial assets are initially recognised at fair value plus directly related transaction costs. They are subsequently measured at fair value. Unquoted equity investments whose fair value cannot be measured reliably are carried at cost and classified as available-for-sale financial assets. Impairment losses and exchange differences resulting from retranslating the amortised cost of currency monetary available-for-sale financial assets are recognised in profit or loss together with interest calculated using the effective interest method (see accounting policy 3 above). Other changes in the fair value of available-for-sale financial assets are reported in a separate component of shareholders' equity until disposal, when the cumulative gain or loss is recognised in profit or loss.

Regular way purchases of financial assets classified as loans and receivables are recognised on settlement date; all other regular way purchases are recognised on trade date.

Fair value for a net open position in a financial asset that is quoted in an active market is the current bid price times the number of units of the instrument held. Fair values for financial assets not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial assets.

Accounting policies continued

12. Impairment of financial assets

The Group assesses at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets classified as held-to-maturity, available-for-sale or loans and receivables is impaired. A financial asset or portfolio of financial assets is impaired and an impairment loss incurred if there is objective evidence that an event or events since initial recognition of the asset have adversely affected the amount or timing of future cash flows from the asset.

Financial assets carried at amortised cost – if there is objective evidence that an impairment loss on a financial asset or group of financial assets classified as loans and receivables or as held-to-maturity investments has been incurred, the Group measures the amount of the loss as the difference between the carrying amount of the asset or group of assets and the present value of estimated future cash flows from the asset or group of assets discounted at the effective interest rate of the instrument at initial recognition.

Impairment losses are assessed individually for financial assets that are individually significant and individually or collectively for assets that are not individually significant. In making collective assessment of impairment, financial assets are grouped into portfolios on the basis of similar risk characteristics. Future cash flows from these portfolios are estimated on the basis of the contractual cash flows and historical loss experience for assets with similar credit risk characteristics. Historical loss experience is adjusted, on the basis of current observable data, to reflect the effects of current conditions not affecting the period of historical experience.

Impairment losses are recognised in profit or loss and the carrying amount of the financial asset or group of financial assets reduced by establishing an allowance for impairment losses. If in a subsequent period the amount of the impairment loss reduces and the reduction can be ascribed to an event after the impairment was recognised, the previously recognised loss is reversed by adjusting the allowance. Once an impairment loss has been recognised on a financial asset or group of financial assets, interest income is recognised on the carrying amount using the rate of interest at which estimated future cash flows were discounted in measuring impairment.

Financial assets carried at fair value – when a decline in the fair value of a financial asset classified as available-for-sale has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss is removed from equity and recognised in profit or loss. The loss is measured as the difference between the amortised cost of the financial asset and its current fair value. Impairment losses on available-for-sale equity instruments are not reversed through profit or loss, but those on available-for-sale debt instruments are reversed, if there is an increase in fair value that is objectively related to a subsequent event.

13. Financial liabilities

A financial liability is classified as held-for-trading if it is incurred principally for the purpose of selling in the near term, or forms part of a portfolio of financial instruments that are managed together and for which there is evidence of short-term profit taking, or it is a derivative (not in a qualifying hedge relationship). Held-for-trading financial liabilities are recognised at fair value with transaction costs being recognised in profit or loss. Subsequently they are measured at fair value. Gains and losses are recognised in profit or loss as they arise.

Financial liabilities that the Group designates on initial recognition as being at fair value through profit or loss are recognised at fair value, with transaction costs being recognised in profit or loss, and are subsequently measured at fair value. Gains and losses on financial liabilities that are designated as at fair value through profit or loss are

recognised in profit or loss as they arise.

Financial liabilities may be designated as at fair value through profit or loss only if such designation (a) eliminates or significantly reduces a measurement or recognition inconsistency; or (b) applies to a group of financial assets, financial liabilities or both that the Group manages and evaluates on a fair value basis; or (c) relates to an instrument that contains an embedded derivative which is not evidently closely related to the host contract.

The principal category of financial liabilities designated as at fair value through profit or loss is structured liabilities issued by the Group: designation significantly reduces the measurement inconsistency between these liabilities and the related derivatives carried at fair value.

All other financial liabilities are measured at amortised cost using the effective interest method (see accounting policy 3 above).

Fair value for a net open position in a financial liability that is quoted in an active market is the current offer price times the number of units of the instrument held or issued. Fair values for financial liabilities not quoted in an active market are determined using appropriate valuation techniques including discounting future cash flows, option pricing models and other methods that are consistent with accepted economic methodologies for pricing financial liabilities.

14. Derecognition

A financial asset is derecognised when it has been transferred and the transfer qualifies for derecognition. A transfer requires that the Group either: (a) transfers the contractual rights to receive the asset's cash flows; or (b) retains the right to the asset's cash flows but assumes a contractual obligation to pay those cash flows to a third party. After a transfer, the Group assesses the extent to which it has retained the risks and rewards of ownership of the transferred asset. If substantially all the risks and rewards have been retained, the asset remains on the balance sheet. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been neither retained nor transferred, the Group assesses whether or not it has retained control of the asset. If it has not retained control, the asset is derecognised. Where the Group has retained control of the asset, it continues to recognise the asset to the extent of its continuing involvement.

A financial liability is removed from the balance sheet when the obligation is discharged, or cancelled, or expires.

15. Sale and repurchase transactions

Securities subject to a sale and repurchase agreement under which substantially all the risks and rewards of ownership are retained by the Group continue to be shown on the balance sheet and the sale proceeds recorded as a deposit. Securities acquired in a reverse sale and repurchase transaction under which the Group is not exposed to substantially all the risks and rewards of ownership are not recognised on the balance sheet and the consideration is recorded in Loans and advances to banks or Loans and advances to customers as appropriate.

Securities borrowing and lending transactions are usually secured by cash or securities advanced by the borrower. Borrowed securities are not recognised on the balance sheet or lent securities derecognised. Cash collateral received or given is treated as a loan or deposit; collateral in the form of securities is not recognised. However, where securities borrowed are transferred to third parties, a liability for the obligation to return the securities to the stock lending counterparty is recorded.

16. Netting

Financial assets and financial liabilities are offset and the net amount presented in the balance sheet when, and only when, the Group currently has a legally enforceable right to set off the recognised amounts; and it intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. The Group is party to a number of arrangements, including master netting agreements, that give it the right to offset financial assets and financial liabilities but where it does not intend to settle the amounts net or simultaneously and therefore the assets and liabilities concerned are presented gross.

17. Capital instruments

The Group classifies a financial instrument that it issues as a financial asset, financial liability or an equity instrument in accordance with the substance of the contractual arrangement. An instrument is classified as a liability if it is a contractual obligation to deliver cash or another financial asset, or to exchange financial assets or financial liabilities on potentially unfavourable terms. An instrument is classified as equity if it evidences a residual interest in the assets of the Group after the deduction of liabilities. The components of a compound financial instrument issued by the Group are classified and accounted for separately as financial assets, financial liabilities or equity as appropriate.

18. Derivatives and hedging

Derivative financial instruments are recognised initially, and subsequently measured, at fair value. Derivative fair values are determined from quoted prices in active markets where available. Where there is no active market for an instrument, fair value is derived from prices for the derivative's components using appropriate pricing or valuation models.

A derivative embedded in a contract is accounted for as a stand-alone derivative if its economic characteristics are not closely related to the economic characteristics of the host contract; unless the entire contract is carried at fair value through profit or loss.

Gains and losses arising from changes in the fair value of a derivative are recognised as they arise in profit or loss unless the derivative is the hedging instrument in a qualifying hedge. The Group enters into three types of hedge relationship: hedges of changes in the fair value of a recognised asset or liability or firm commitment (fair value hedges); hedges of the variability in cash flows from a recognised asset or liability or a forecast transaction (cash flow hedges); and hedges of the net investment in a foreign operation.

Hedge relationships are formally documented at inception. The documentation includes identification of the hedged item and the hedging instrument, details the risk that is being hedged and the way in which effectiveness will be assessed at inception and during the period of the hedge. If the hedge is not highly effective in offsetting changes in fair values or cash flows attributable to the hedged risk, consistent with the documented risk management strategy, hedge accounting is discontinued.

Fair value hedge – in a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss. The gain or loss on the hedged item attributable to the hedged risk is recognised in profit or loss and adjusts the carrying amount of the hedged item. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting or if the hedging instrument expires or is sold, terminated or exercised or if hedge designation is revoked. If the hedged item is one for which the effective interest rate method is used, any cumulative adjustment is amortised to profit or loss over the life of the hedged item using a recalculated effective interest rate.

Accounting policies continued

Cash flow hedge – where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability or a highly probable forecast transaction, the effective portion of the gain or loss on the hedging instrument is recognised directly in equity. The ineffective portion is recognised in profit or loss. When the forecast transaction results in the recognition of a financial asset or financial liability, the cumulative gain or loss is reclassified from equity in the same periods in which the asset or liability affects profit or loss. Otherwise the cumulative gain or loss is removed from equity and recognised in profit or loss at the same time as the hedged transaction. Hedge accounting is discontinued if the hedge no longer meets the criteria for hedge accounting; if the hedging instrument expires or is sold, terminated or exercised; if the forecast transaction is no longer expected to occur; or if hedge designation is revoked. On the discontinuance of hedge accounting (except where a forecast transaction is no longer expected to occur), the cumulative unrealised gain or loss recognised in equity is recognised in profit or loss when the hedged cash flow occurs or, if the forecast transaction results in the recognition of a financial asset or financial liability, in the same periods during which the asset or liability affects profit or loss. Where a forecast transaction is no longer expected to occur, the cumulative unrealised gain or loss is recognised in profit or loss immediately.

Hedge of net investment in a foreign operation – in the hedge of a net investment in a foreign operation, the portion of foreign exchange differences arising on the hedging instrument determined to be an effective hedge is recognised directly in equity. Any ineffective portion is recognised in profit or loss. Non-derivative financial liabilities as well as derivatives may be the hedging instrument in a net investment hedge.

19. Share-based payments

Options over shares in The Royal Bank of Scotland Group plc are granted to Group employees under various share option schemes. The Group has applied IFRS 2 ‘Share-based Payment’ to grants under these schemes after 7 November 2002 that had not vested on 1 January 2005. The expense for these transactions is measured based on the fair value on the date the options are granted. The fair value is estimated using valuation techniques which take into account the option’s exercise price, its term, the risk free interest rate and the expected volatility of the market price of The Royal Bank of Scotland Group plc’s shares. Vesting conditions are not taken into account when measuring fair value, but are reflected by adjusting the number of options included in the measurement of the transaction such that the amount recognised reflects the number that actually vest. The fair value is expensed on a straight-line basis over the vesting period.

20. Investment property

Investment property comprises freehold and leasehold properties that are held to earn rentals or for capital appreciation or both. It is not depreciated but is stated at fair value based on valuations by independent registered valuers. Fair value is based on current prices for similar properties in the same location and condition. Any gain or loss arising from a change in fair value is recognised in profit or loss. Rental income from investment property is recognised on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income.

21. Cash and cash equivalents

Cash and cash equivalents comprises cash and demand deposits with banks together with short-term highly liquid investments that are readily convertible to known amounts of cash and subject to insignificant risk of change in value.

22. Shares in Group entities

The Bank's investments in its subsidiaries are stated at cost less any impairment.

Critical accounting policies and key sources of accounting judgements

The reported results of the Group are sensitive to the accounting policies, assumptions and estimates that underlie the preparation of its financial statements. UK company law and IFRS require the directors, in preparing the Group's financial statements, to select suitable accounting policies, apply them consistently and make judgements and estimates that are reasonable and prudent. In the absence of an applicable standard or interpretation, IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors', requires management to develop and apply an accounting policy that results in relevant and reliable information in the light of the requirements and guidance in IFRS dealing with similar and related issues and the IASB's Framework for the Preparation and Presentation of Financial Statements. The judgements and assumptions involved in the Group's accounting policies that are considered by the Board to be the most important to the portrayal of its financial condition are discussed below. The use of estimates, assumptions or models that differ from those adopted by the Group would affect its reported results.

Loan impairment provisions

The Group's loan impairment provisions are established to recognise incurred impairment losses in its portfolio of loans classified as loans and receivables and carried at amortised cost. A loan is impaired when there is objective evidence that events since the loan was granted have affected expected cash flows from the loan. The impairment loss is the difference between the carrying value of the loan and the present value of estimated future cash flows at the loan's original effective interest rate.

At 31 December 2007, gross loans and advances to customers totalled £555,682 million (2006 – £472,433 million) and customer loan impairment provisions amounted to £4,233 million (2006 –£3,927 million).

There are two components to the Group's loan impairment provisions: individual and collective.

Individual component – all impaired loans that exceed specific thresholds are individually assessed for impairment. Individually assessed loans principally comprise the Group's portfolio of commercial loans to medium and large businesses. Impairment losses are recognised as the difference between the carrying value of the loan and the discounted value of management's best estimate of future cash repayments and proceeds from any security held. These estimates take into account the customer's debt capacity and financial flexibility; the level and quality of its earnings; the amount and sources of cash flows; the industry in which the counterparty operates; and the realisable value of any security held. Estimating the quantum and timing of future recoveries involves significant judgement. The size of receipts will depend on the future performance of the borrower and the value of security, both of which will be affected by future economic conditions; additionally, collateral may not be readily marketable. The actual amount of future cash flows and the date they are received may differ from these estimates and consequently actual losses incurred may differ from those recognised in these financial statements.

Collective component – this is made up of two elements: loan impairment provisions for impaired loans that are below individual assessment thresholds (collective impaired loan provisions) and for loan losses that have been incurred but have not been separately identified at the balance sheet date (latent loss provisions). These are established on a portfolio basis using a present value methodology taking into account the level of arrears, security, past loss experience, credit scores and defaults based on portfolio trends. The most significant factors in establishing these provisions are the expected loss rates and the related average life. These portfolios include credit card receivables and other personal advances including mortgages. The future credit quality of these portfolios is subject to uncertainties that could cause actual credit losses to differ materially from reported loan impairment provisions. These uncertainties include the economic environment, notably interest rates and their effect on customer spending, the unemployment level, payment behaviour and bankruptcy trends.

Pensions

The Group operates a number of defined benefit pension schemes as described in Note 3 on the accounts. The assets of the schemes are measured at their fair value at the balance sheet date. Scheme liabilities are measured using the projected unit method, which takes account of projected earnings increases, using actuarial assumptions that give the best estimate of the future cash flows that will arise under the scheme liabilities. These cash flows are discounted at the interest rate applicable to high-quality corporate bonds of the same currency and term as the liabilities. Any recognisable surplus or deficit of scheme assets over liabilities is recognised in the balance sheet as an asset (surplus) or liability (deficit). In determining the value of scheme liabilities, assumptions are made as to price inflation, dividend growth, pension increases, earnings growth and employees. There is a range of assumptions that could be adopted in valuing the schemes' liabilities. Different assumptions could significantly alter the amount of the deficit recognised in the balance sheet and the pension cost charged to the income statement. The assumptions adopted for

the Group's pension schemes are set out in Note 3 on the accounts. A pension asset of £566 million and a liability of £334 million were recognised in the balance sheet at 31 December 2007 (2006 – liability £1,971 million).

Fair value – financial instruments

Financial instruments classified as held-for-trading or designated as at fair value through profit or loss and financial assets classified as available-for-sale are recognised in the financial statements at fair value. All derivatives are measured at fair value. Gains or losses arising from changes in the fair value of financial instruments classified as held-for-trading or designated as at fair value through profit or loss are included in the income statement. Unrealised gains and losses on available-for-sale financial assets are recognised directly in equity unless an impairment loss is recognised.

Financial instruments measured at fair value include:

Loans and advances (held-for-trading and designated as at fair value through profit or loss) – principally comprise reverse repurchase agreements (reverse repos) and syndicated loans. In repurchase agreements one party agrees to sell securities to another and simultaneously agrees to repurchase the securities at a future date for a specified price. The repurchase price is fixed at the outset, usually being the original sale price plus an amount representing interest for the period from the sale to the repurchase. Syndicated loans measured at fair value are amounts retained, from syndications where the Group was lead manager or underwriter, in excess of the Group's intended long term participation.

Treasury and other eligible bills and debt securities (held-for-trading, designated as at fair value through profit or loss and available-for-sale) – treasury bills are British and foreign government treasury bills and other bank bills eligible for refinancing with central banks. Debt securities include those issued by governments, municipal bodies, mortgage agencies and financial institutions as well as corporate bonds, debentures and residual interests in securitisations.

Accounting policies continued

Equity securities (held-for-trading, designated as at fair value through profit or loss and available-for-sale) – comprise equity shares of companies or corporations both listed and unlisted.

Deposits by banks and customer accounts (held-for-trading and designated as at fair value through profit or loss) – deposits measured at fair value principally comprise repurchase agreements (repos) discussed above.

Debt securities in issue (held-for-trading and designated as at fair value through profit or loss) – measured at fair value principally comprise medium term notes.

Short positions (held-for-trading) – arise in dealing and market making activities where Treasury and other eligible bills, debt securities and equity shares are sold which the Group does not currently possess.

Derivatives – these include swaps, forwards, futures and options. They may be traded on an organised exchange (exchange-traded) or over-the-counter (OTC). Holders of exchange traded derivatives are generally required to provide margin daily in the form of cash or other collateral.

Swaps include currency swaps, interest rate swaps, credit default swaps, total return swaps and equity and equity index swaps. A swap is an agreement to exchange cash flows in the future in accordance with a pre-arranged formula. In currency swap transactions, interest payment obligations are exchanged on assets and liabilities denominated in different currencies; the exchange of principal may be notional or actual. Interest rate swap contracts generally involve exchange of fixed and floating interest payment obligations without the exchange of the underlying principal amounts.

Forwards include forward foreign exchange contracts and forward rate agreements. A forward contract is a contract to buy (or sell) a specified amount of a physical or financial commodity, at an agreed price, on an agreed future date. Forward foreign exchange contracts are contracts for the delayed delivery of currency on a specified future date.

Forward rate agreements are contracts under which two counterparties agree on the interest to be paid on a notional deposit of a specified term starting on a specific future date; there is no exchange of principal.

Futures are exchange-traded forward contracts to buy (or sell) standardised amounts of underlying physical or financial commodities. The Group buys and sells currency, interest rate and equity futures. Options include exchange-traded options on currencies, interest rates and equities and equity indices and OTC currency and equity options, interest rate caps and floors and swaptions. They are contracts that give the holder the right but not the obligation to buy (or sell) a specified amount of the underlying physical or financial commodity at an agreed price on an agreed date or over an agreed period.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Fair values are determined from quoted prices in active markets for identical financial assets or financial liabilities where these are available. Fair value for a net open position in a financial asset or financial liability in an active market is the current bid or offer price times the number of units of the instrument held. Where a trading portfolio contains both financial assets and financial liabilities which are derivatives of the same underlying instrument, fair value determined by valuing the gross long and short positions at current mid market prices, with an adjustment at portfolio level to the net open long or short position to amend the valuation to bid or offer as appropriate. Where the market for a financial instrument is not active, fair value is established using a valuation technique. These valuation techniques involve a degree of estimation, the extent of which depends on the instrument's complexity and the availability of market-based data.

The table below analyses the Group's financial instruments carried at fair value as at 31 December 2007.

	Quoted prices in active markets(1)	Valuation techniques based on observable market data(2)	Valuation techniques incorporating information other than observable market data(3)	Total
	£bn	£bn	£bn	£bn
Financial instruments measured at fair value				
Assets				
Fair value through profit or loss				
Loans and advances to banks	—	72.6	0.1	72.7
Loans and advances to customers	—	94.9	13.1	108.0
Treasury and other eligible bills and debt securities	59.0	70.2	10.4	139.6
Equity shares	3.7	—	0.2	3.9
Derivatives	1.0	245.8	3.1	249.9
Available for sale				
Treasury and other eligible bills and debt securities	2.2	21.8	0.3	24.3
Equity shares	0.1	1.0	0.5	1.6
	66.0	506.3	27.7	600.0
Liabilities				
Deposits by banks and customer accounts	—	134.1	1.5	135.6
Debt securities in issue	—	13.3	5.2	18.5
Short positions	43.3	3.7	—	47.0
Derivatives	1.3	243.4	2.3	247.0
Other financial liabilities (4)	—	0.4	0.2	0.6
	44.6	394.9	9.2	448.7

Note:

- (1) Financial assets and financial liabilities which are valued using unadjusted quoted prices in active markets for identical assets or liabilities. This category includes listed equity shares, exchange-traded derivatives, UK, US and certain other government securities, and US agency securities in active markets.
- (2) Financial assets and financial liabilities valued using techniques based on observable data. Instruments in this category have been valued using:
 - (a) quoted prices for similar assets or liabilities, or identical assets or liabilities in markets which are considered to be active; or
 - (b) valuation techniques where all the inputs that have a significant effect on the valuation are directly or indirectly based on observable market data.

Financial assets and financial liabilities in this category include repos, reverse repos, structured and US commercial mortgage loans, structured deposits, corporate and municipal debt securities, most debt securities in issue, certain unlisted equity shares for which recent market data are available, the majority of the Group's OTC derivatives and certain instruments listed in (1) above where markets are considered to be less than active.

(3)

Valuation techniques incorporating information other than observable market data are used for instruments where at least one input (which could have a significant effect on the instrument's valuation) cannot be based on observable market data. Where inputs can be observed from market data without undue cost and effort, the observed input is used, if not the input is estimated. Financial assets and liabilities in this category include certain syndicated and commercial mortgage loans, unlisted equity shares, certain residual interests in securitisations, super senior tranches of high grade and mezzanine collateralised debt obligations (CDOs), sub-prime trading inventory, less liquid debt securities, certain structural debt securities in issue and OTC derivatives where valuation depends upon unobservable inputs such as certain long dated and exotic contracts. No gain or loss is recognised on the initial recognition of a financial instrument valued using a technique incorporating significant unobservable data.

- (4) Other financial liabilities comprise subordinated liabilities and provisions relating to undrawn syndicated loan facilities.

Accounting policies continued

The Group uses a number of methodologies to determine the fair value of financial instruments for which observable prices in active markets for identical instruments are not available. These techniques include: relative value methodologies based on observable prices for similar instruments; present value approaches where future cash flows from the asset or liability are estimated and then discounted using a risk-adjusted interest rate; and Black-Scholes, Monte-Carlo and binomial option pricing models. The principal inputs to these valuation techniques are listed below. Values between and beyond available data points are obtained by interpolation and extrapolation.

- Bond prices – quoted prices are generally available for government bonds, certain corporate securities and some mortgage-related products.
- Credit spreads – where available, these are derived from prices of credit default swaps or other credit based instruments, such as debt securities. For others, credit spreads are obtained from pricing services.
- Interest rates – these are principally benchmark interest rates such as the London Inter-Bank Offered Rate (LIBOR) and quoted interest rates in the swap, bond and futures markets.
- Foreign currency exchange rates – there are observable markets both spot and forward and in futures in the world's major currencies.
- Equity and equity index prices – quoted prices are generally readily available for equity shares listed on the world's major stock exchanges and for major indices on such shares.
- Commodity prices – many commodities are actively traded in spot, forward and futures on exchanges in London, New York and other commercial centres.
- Price volatilities and correlations – volatility is a measure of the tendency of a price to change with time. Correlation measures the degree to which two or more prices or other variables are observed to move together. If they move in the same direction there is positive correlation; if they move in opposite directions there is negative correlation. Volatility is a key input in valuing options and the value of certain products such as derivatives with more than one underlying is correlation-dependent. Volatility and correlation values are obtained from broker quotations, pricing services or derived from option prices.
- Prepayment rates – the fair value of a financial instrument that can be prepaid by the issuer or borrower differs from that of an instrument that cannot be prepaid. In valuing prepayable instruments that are not quoted in active markets the Group incorporates the value of the prepayment option.
- Counterparty credit spreads – adjustment is made to market prices (or parameters) when the creditworthiness of the counterparty differs from that of the assumed counterparty in the market price or parameter; for example many OTC derivative price quotations are for transactions with a counterparty with an 'AA' credit rating.

The Group refines and modifies its valuation techniques as markets and products develop and the pricing for individual products become more transparent.

Whilst the Group believes its valuation techniques are appropriate and consistent with other market participants, the use of different methodologies or assumptions could result in different estimates of fair value at the balance sheet date. Portfolios whose fair values are based on valuation techniques incorporating information other than observable market

data and related sensitivity analysis on portfolios at 31 December 2007 are summarised below.

Portfolio	Assets				Liabilities				Total
	Loans and advances £bn	Securities £bn	Derivatives £bn	Total £bn	Debt		Other		£bn
					Deposits £bn	securities in issue £bn	Derivatives £bn	financial liabilities £bn	
Syndicated loans	4.6	—	—	4.6	—	—	—	—	—
Commercial mortgages	2.2	—	—	2.2	—	—	—	—	—
Super senior tranches of ABS									
CDOs	—	2.4	—	2.4	—	—	—	—	—
Other debt securities	—	8.4	—	8.4	—	—	—	—	—
Exotic derivatives	—	—	3.1	3.1	—	—	2.3	—	2.3
Other portfolios	6.4	0.6	—	7.0	1.5	5.2	—	0.2	6.9
	13.2	11.4	3.1	27.7	1.5	5.2	2.3	0.2	9.2

Syndicated loans (Group and Bank) – syndicated loans are valued by considering recent syndication prices in the same or similar assets, prices in the secondary loan market, and with reference to relevant indices for credit products and credit default swaps such as the LevX, LCDX, ITraxx and CDX. Assumptions relating to the expected refinancing period are based on market experience and market convention. Adjustments to observed prices are made for differences between instruments, such as counterparty creditworthiness, term, and quality of any collateral.

The fair value of drawn syndicated loans valued using techniques other than by considering recent syndication prices in the same or similar assets and prices in the secondary loan market was £4,624 million. Using reasonably possible alternative assumptions about refinancing periods (which were stressed by one year) and the value attributed to potentially favourable flexible loan conditions (which are attributed no value in reported figures) would reduce the fair values by up to £46 million or increase the fair value by up to £83 million.

Commercial mortgages – senior and mezzanine commercial mortgages of the Group's US subsidiary are loans secured on commercial land and buildings that were originated or acquired by the Group for securitisation. Senior commercial mortgages carry a variable interest rate and mezzanine or more junior commercial mortgages may carry a fixed or variable interest rate. Factors affecting the value of these loans may include, but are not limited to, loan type, underlying property type and geographic location, loan interest rate, loan to value ratios, debt service coverage ratios, prepayment rates, cumulative loan loss information, yields, investor demand, market volatility since the last securitisation, and credit enhancement.

Where observable market prices for a particular loan are not available, the fair value will typically be determined with reference to observable market transactions in other loans or credit related products including debt securities and credit derivatives. Assumptions are made about the relationship between the loan and the available benchmark data. Using reasonably possible alternative assumptions for credit spreads (taking into account all other applicable factors) would reduce the fair value by up to £52 million or increase the fair value by up to £49 million.

Super senior tranches of asset-backed CDOs (Group and Bank) – the Group is a participant in the US asset-backed securities ('ABS') market: buying residential mortgage-backed securities ('RMBS'), including securities backed by US sub-prime mortgages, and repackaging them into collateralised debt obligations ('CDOs') for sale to investors. The Group retains exposure to some of the super senior tranches of these CDOs. In the second half of 2007, rising mortgage delinquencies and expectations of declining house prices in the US have led to a deterioration of the estimated fair value of these exposures.

An analysis of the Group's open super senior tranche exposures to these CDOs is shown below:

	High grade	Mezzanine
Exposure (£m)	3,396	3,040
Exposure after hedges (£m)	1,246	1,790
Weighted average attachment point (1)	30%	46%
% of underlying RMBS sub-prime assets	58%	91%
Of which originated in:		
– 2005 and earlier	53%	23%
Table of Contents		156

– 2006	41%	69%
– 2007	6%	8%
Collateral by rating:		
– investment grade	97%	31%
– non-investment grade	3%	69%
Net exposure (£m)	1,099	1,253
Effective attachment point post write down	37%	62%

Note:

- (1) Attachment point is the minimum level of losses in a portfolio to which a tranche is exposed, as a percentage of the total notional size of the portfolio. For example, a 5-10% tranche has an attachment point of 5% and a detachment point of 10%. When the accumulated loss of the reference pool is no more than 5% of the total initial notional of the pool, the tranche will not be affected. However, when the loss has exceeded 5%, any further loss will be deducted from the tranche's notional principal until the detachment point, 10%, is reached.

Accounting policies continued

The Group's valuation of the ABS CDO super senior exposures takes into consideration outputs from a proprietary model, market data and prudent valuation adjustments. There is significant subjectivity in the valuation with very little market activity to provide support for fair value levels at which willing buyers and sellers would transact.

The Group's proprietary model predicts the expected cash-flows of the underlying mortgages using assumptions about future economic conditions (including house price appreciation and depreciation), defaults/delinquencies on these underlying mortgages and discounting the resulting cash flows using a risk adjusted rate.

Alternative valuations have been produced using reasonably possible alternative assumptions about macro-economic conditions including house price appreciation and depreciation, and the effect of regional variations. In addition, the discount rate applied to the model output has been stressed. The output from using these alternative assumptions has been compared with inferred pricing information from other published data.

The Group believes that reasonably possible alternative assumptions could reduce or increase predicted cumulative losses from the notes by up to 20%. Using these alternative loss assumptions would reduce the fair value by up to £356 million or increase the fair value by up to £217 million.

Other debt securities – where observable market prices for a particular debt security are not available, the fair value will typically be determined with reference to observable market transactions in other credit related products including debt securities and credit derivatives. Assumptions are made about the relationship between the individual debt security and the available benchmark data. Using differing assumptions about this relationship would result in different fair values for these assets. We consider that, using reasonably possible alternative assumptions for credit spread (taking into account the underlying currency, tenor and rating), would reduce the fair value by up to £46 million (Bank – £45 million) or increase the fair value by up to £64 million (Bank – £62 million).

Derivatives (Group and Bank) – derivatives are priced using quoted prices for the same or similar instruments where these are available. However, the majority of derivatives are valued using pricing models. Inputs for these models are usually observed directly in the market, or derived from observed prices. However, it is not always possible to observe or corroborate all model inputs.

Unobservable inputs used are based on management estimates taking into account a range of available information including historic analysis, historic traded levels, market practice, comparison to other relevant benchmark observable data and consensus pricing data. Using reasonably possible alternative assumptions, including the relative impact of unobservable inputs as compared to those which may be observed, would reduce the fair value by £48 million or increase the fair value by up to £48 million.

Other portfolios – other than the portfolios discussed above, there are other financial instruments which are held at fair value determined from data which are not market observable, or incorporating a material adjustment to market observed data. Using reasonably possible alternative assumptions appropriate to the financial asset or liability in question, would reduce the fair value by up to £47 million (Bank – £42 million) or increase the fair value by up to £47 million (Bank – £42 million).

Goodwill

The Group capitalises goodwill arising on the acquisition of businesses, as disclosed in accounting policy 5. The carrying value of goodwill as at 31 December 2007 was £16,783 million (2006 – £16,834 million).

Goodwill is the excess of the cost of an acquired business over the fair value of its net assets. The determination of the fair value of assets and liabilities of businesses acquired requires the exercise of management judgement; for example those financial assets and liabilities for which there are no quoted prices, and those non-financial assets where valuations reflect estimates of market conditions such as property. Different fair values would result in changes to the goodwill arising and to the post-acquisition performance of the acquisition. Goodwill is not amortised but is tested for impairment annually or more frequently if events or changes in circumstances indicate that it might be impaired.

For the purposes of impairment testing, goodwill acquired in a business combination is allocated to each of the Group's cash-generating units or groups of cash-generating units expected to benefit from the combination. Goodwill impairment testing involves the comparison of the carrying value of a cash-generating unit or group of cash generating units with its recoverable amount. The recoverable amount is the higher of the unit's fair value and its value in use. Value in use is the present value of expected future cash flows from the cash-generating unit or group of cash-generating units. Fair value is the amount obtainable for the sale of the cash-generating unit in an arm's length transaction between knowledgeable, willing parties. Impairment testing inherently involves a number of judgmental areas: the preparation of cash flow forecasts for periods that are beyond the normal requirements of management reporting; the assessment of the discount rate appropriate to the business; estimation of the fair value of cash-generating units; and the valuation of the separable assets of each business whose goodwill is being reviewed.

Accounting developments

International Financial Reporting Standards

The International Financial Reporting Interpretations Committee ('IFRIC') issued interpretation IFRIC 11 'Group and Treasury Share Transactions' in November 2006. Entities which buy their own shares, or whose shareholders buy shares in the reporting entity, in order to provide incentives to employees shall account for those incentives on an equity-settled basis. This principle applies also to the accounting by subsidiaries. The interpretation is effective for accounting periods beginning on or after 1 March 2007 and is not expected to have a material effect on the Group or the Bank.

The IFRIC issued interpretation IFRIC 12 'Service Concession Arrangements' in November 2006. Entities providing infrastructure and services to governments under concession arrangements shall account for each component of the arrangement separately. Infrastructure provided under these arrangements may be recognised as either a financial asset or an intangible asset. The interpretation is effective for accounting periods beginning on or after 1 January 2008 and is not expected to have a material effect on the Group or the Bank.

The IASB issued IFRS 8 'Operating Segments' in November 2006. This will replace IAS 14 'Segment Reporting' for accounting periods beginning on or after 1 January 2009. IFRS 8 requires entities to report segment information as reported to management and reconcile it to the financial statements and is not expected to have a material effect on the Group or the Bank.

The IASB issued a revised IAS 23 'Borrowing Costs' in March 2007. Entities are required to capitalise borrowing costs attributable to the development or construction of intangible assets or property plant or equipment. The standard is effective for accounting periods beginning on or after 1 January 2009 and is not expected to have a material effect on the Group or the Bank.

The IFRIC issued interpretation IFRIC 13 'Customer Loyalty Programmes' in June 2007. Entities that provide customers with benefits ancillary to a sale of goods or services should apportion the sales proceeds to those benefits on the basis of relative fair values. The interpretation is effective for accounting periods beginning on or after 1 July 2008 and is not expected to have a material effect on the Group or the Bank.

The IFRIC issued interpretation IFRIC 14 'IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' in July 2007. The net pension asset that may be recognised by a sponsoring entity is limited to the amount to which it has an unconditional right of refund or can be recovered through the settlement of plan liabilities. Entities legally bound to minimum funding requirements should not overlook those obligations when recognising the net asset or liability for an employee benefit scheme. The interpretation is effective for accounting periods beginning on or after 1 January 2008 and is not expected to have a material effect on the Group or the Bank.

The IASB issued a revised IAS 1 'Presentation of Financial Statements' in September 2007 effective for accounting periods beginning on or after 1 January 2009. The amendments to the presentation requirements for financial statements are not expected to have a material effect on the Group or the Bank.

The IASB published a revised IFRS 3 'Business Combinations' and related revisions to IAS 27 'Consolidated and Separate Financial Statements' following the completion in January 2008 of its project on the acquisition and disposal of subsidiaries. The standards improve convergence with US GAAP and provide new guidance on accounting for changes in interests in subsidiaries. The cost of an acquisition will comprise only consideration paid to vendors for equity; other costs will be expensed immediately. Groups will only account for goodwill on acquisition of a

subsidiary; subsequent changes in interest will be recognised in equity and only on a loss of control will there be a profit or loss on disposal to be recognised in income. The changes are effective for accounting periods beginning on or after 1 July 2009 but both standards may be adopted together for accounting periods beginning on or after 1 July 2007. These changes will affect the Group's accounting for future acquisitions and disposals of subsidiaries.

The IASB published revisions to IAS 32 'Financial Instruments: Presentation' and consequential revisions to other standards in February 2008 to improve the accounting for and disclosure of puttable financial instruments. The revisions are effective for accounting periods beginning on or after 1 January 2009 but together they may be adopted earlier. They are not expected to have a material affect on the Group or the Bank.

Notes on the accounts

1 Income from trading activities

	2007	Group 2006	2005
	£m	£m	£m
Foreign exchange (1)	798	612	661
Interest rates (2)	1,796	967	951
Credit (3)	(1,620)	841	666
Equities and commodities (4)	168	123	85
	1,142	2,543	2,363

The analysis of trading income is based on how the business is organised and the underlying risks managed.

Notes:

Trading income comprises gains and losses on financial instruments held for trading, both realised and unrealised, interest income and dividends and the related funding costs. The types of instruments include:

- (1) Foreign exchange: spot foreign exchange contracts, currency swaps and options, emerging markets and related hedges and funding.
- (2) Interest rates: interest rate swaps, forward foreign exchange contracts, forward rate agreements, interest rate options, interest rate futures and related hedges and funding.
- (3) Credit: asset-backed securities, corporate bonds, credit derivatives and related hedges and funding.
- (4) Equities and commodities: equity derivatives, commodity contracts and related hedges and funding.

2 Operating expenses

	2007	Group 2006	2005
	£m	£m	£m
Wages, salaries and other staff costs	5,249	5,285	4,632
Social security costs	357	342	304
Shared-based compensation	65	65	44
Pension costs (see Note 3)			
– defined benefit schemes	479	578	460
– defined contribution schemes	31	10	11
Staff costs	6,181	6,280	5,451
Premises and equipment	1,521	1,405	1,261
Other administrative expenses	2,147	2,241	2,400
Property, plant and equipment (see Note 17)	1,021	1,055	1,075
Intangible assets (see Note 16)	417	360	485
Depreciation and amortisation	1,438	1,415	1,560
	11,287	11,341	10,672

Integration costs included in operating expenses comprise expenditure incurred in respect of cost reduction and revenue enhancement programmes set in connection with the various acquisitions made by the Group:

	2007	Group 2006	2005
	£m	£m	£m
Staff costs	18	76	67
Premises and equipment	4	10	22
Other administrative expenses	10	18	127
Depreciation and amortisation	60	16	133
	92	120	349

The average number of persons employed by the Group during the year, excluding temporary staff, was 123,500 (2006 – 122,600; 2005 – 121,900). The number of persons employed by the Group at 31 December, excluding temporary staff, was as follows:

	Group		
	2007	2006	2005
Global Banking & Markets	9,300	7,400	6,700
UK Corporate Banking	9,600	8,800	8,200
Retail	41,400	42,900	43,400
Wealth Management	5,000	4,600	4,300
Ulster Bank	6,400	5,600	5,200
Citizens	23,900	24,600	26,000
Manufacturing	26,300	26,300	26,500
Centre	2,700	2,500	2,300
Total	124,600	122,700	122,600
UK	88,600	88,300	87,700
USA	25,600	26,200	27,500
Europe	7,600	6,900	6,500
Rest of the World	2,800	1,300	900
Total	124,600	122,700	122,600

	Bank		
	2007	2006	2005
	£m	£m	£m
Wages, salaries and other staff costs	2,910	2,847	2,316
Social security costs	203	193	160
Share-based compensation	65	65	44
Pension costs (see Note 3)			
– defined benefit schemes	5	8	3
– defined contribution schemes	310	295	252
Staff costs	3,493	3,408	2,775

The average number of persons employed by the Bank during the year, excluding temporary staff, was 63,700 (2006 – 60,900; 2005 – 59,700). The number of persons employed by the Bank at 31 December, excluding temporary staff, was as follows:

	Bank		
	2007	2006	2005
Global Banking & Markets	7,800	5,000	4,800
UK Corporate Banking	7,600	6,900	6,400
Retail	22,200	21,900	21,800
Manufacturing	25,100	25,000	25,300
Centre	2,700	2,500	2,300
Total	65,400	61,300	60,600
UK	61,700	60,100	59,400

USA	400	—	—
Europe	1,300	1,100	1,100
Rest of the World	2,000	100	100
Total	65,400	61,300	60,600

Notes on the accounts continued

3 Pension costs

Members of the Group sponsor a number of pension schemes in the UK and overseas, predominantly of the defined benefit type, whose assets are independent of the Group's finances. Defined benefit pensions generally provide a pension of one-sixtieth of final pensionable salary for each year of service prior to retirement up to a maximum of 40 years. Employees do not make contributions for basic pensions but may make voluntary contributions to secure additional benefits on a money-purchase basis. Since October 2006 the defined benefit section of The Royal Bank of Scotland Group Pension Fund ('Main Scheme') has been closed to new entrants.

The Group also provides post-retirement benefits other than pensions, principally through subscriptions to private healthcare schemes in the UK and the US and unfunded post-retirement benefit plans. Provision for the costs of these benefits is charged to the income statement over the average remaining future service lives of the eligible employees. The amounts are not material.

There is no contractual agreement or policy on the way that the cost of The Royal Bank of Scotland Group defined benefit pension schemes and healthcare plans are allocated to the Bank. The Bank therefore accounts for the charges it incurs as payments to a defined contribution scheme.

Interim valuations of the Group's schemes were prepared to 31 December by independent actuaries, using the following assumptions:

Principal actuarial assumptions at 31 December (weighted average)	2007	2006	2005
Discount rate	6.0%	5.3%	4.8%
Expected return on plan assets	6.9%	6.9%	6.5%
Rate of increase in salaries	4.4%	4.1%	3.9%
Rate of increase in pensions in payment	3.1%	2.8%	2.6%
Inflation assumption	3.2%	2.9%	2.7%
Major classes of plan assets as a percentage of total plan assets	2007	2006	2005
Equities	61.3%	60.7%	61.5%
Index-linked bonds	16.9%	16.1%	16.8%
Government fixed interest bonds	2.3%	3.3%	2.6%
Corporate and other bonds	14.8%	13.9%	14.6%
Property	4.0%	4.5%	3.7%
Cash and other assets	0.7%	1.5%	0.8%

Ordinary shares of the holding company with a fair value of £69 million (2006 – £89 million; 2005 – £78 million) are held by the Group's pension schemes together with holdings of other financial instruments issued by the Group with a value of £606 million (2006 – £258 million; 2005 – £299 million).

The expected return on plan assets at 31 December 2007 is based upon the weighted average of the following assumed returns on the major classes of plan assets:

	2007	2006	2005
Equities	8.1%	8.1%	7.7%

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Index-linked bonds	4.5%	4.5%	4.1%
Government fixed interest bonds	4.6%	4.5%	4.1%
Corporate and other bonds	5.5%	5.3%	4.8%
Property	6.3%	6.3%	5.9%
Cash and other assets	4.3%	4.4%	3.7%
Post-retirement mortality assumptions (Main scheme)	2007	2006	2005
Longevity at age 60 for current pensioners (years)			
Males	26.0	26.0	25.4
Females	26.8	28.9	28.2
Longevity at age 60 for future pensioners (years)			
Males	28.1	26.8	26.2
Females	28.2	29.7	29.0

These post-retirement mortality assumptions are derived from standard mortality tables used by the scheme actuary to value the liabilities for the main scheme. Following a comprehensive review of the mortality experience of the main scheme over the last three years by the scheme actuary, different standard mortality tables (adjusted as appropriate) have been used in valuing the scheme liabilities as at 31 December 2007.

	Fair value of plan assets £m	Present value of defined benefit obligations £m	Net pension deficit/ (surplus) £m
Changes in value of net pension liability			
At 1 January 2006	17,331	21,040	3,709
Currency translation and other adjustments	(58)	(65)	(7)
Income statement:			
Expected return	1,069		(1,069)
Interest cost		981	981
Current service cost		643	643
Past service cost		23	23
	1,069	1,647	578
Statement of recognised income and expense:			
Actuarial gains and losses	585	(1,191)	(1,776)
Contributions by employer	533	—	(533)
Benefits paid	(538)	(538)	—
Expenses included in service cost	(28)	(28)	—
At 1 January 2007	18,894	20,865	1,971
Currency translation and other adjustments	38	45	7
Income statement:			
Expected return	1,297		(1,297)
Interest cost		1,105	1,105
Current service cost		649	649
Past service cost		22	22
	1,297	1,776	479
Statement of recognised income and expense:			
Actuarial gains and losses	140	(2,013)	(2,153)
Contributions by employer	536	—	(536)
Contributions by plan participants	4	4	—
Benefits paid	(605)	(605)	—
Expenses included in service cost	(40)	(40)	—
At 31 December 2007	20,264	20,032	(232)
Net pension surplus comprises:			£m
Net assets of schemes in surplus (included in Prepayments, accrued income and other assets, Note 18)			(566)
Net liabilities of schemes in deficit			334
			(232)

The Group expects to contribute £477 million to its defined benefit pension schemes in 2008. Of the net pension liability, £94 million (2006 – £106 million) relates to unfunded schemes.

Cumulative net actuarial gains of £1,536 million (2006 – £617 million losses; 2005 – £2,393 million losses) have been recognised in the statement of recognised income and expense.

	2007	2006	2005	2004
	£m	£m	£m	£m
History of defined benefits schemes				
Fair value of plan assets	20,264	18,894	17,331	14,752
Present value of defined benefit obligations	20,032	20,865	21,040	17,674
Net surplus/(deficit)	232	(1,971)	(3,709)	(2,922)
Experience losses on plan liabilities	(204)	(20)	(68)	(631)
Experience gains on plan assets	140	585	1,654	408
Actual return on pension schemes assets	1,437	1,654	2,667	1,327

Notes on the accounts continued

4 Auditors' remuneration

Amount paid to the Bank's auditors for statutory audit and other services were as follows

	Group 2007 £m	2006 £m	2005 £m
Fees payable for the audit of the Group's annual accounts	3.7	3.6	2.9
Fees payable for the audit and their associates for other services to the Group:			
– The audit of the Bank's subsidiaries pursuant to legislation	5.3	5.2	5.1
Total audit fees	9.0	8.8	8.0

Fees payable to the auditors for non-audit services are disclosed in the consolidated financial statements of The Royal Bank of Scotland Group plc.

5 Tax

	2007 £m	Group 2006 £m	2005 £m
Current taxation:			
Charge for the year	2,373	2,355	2,254
Over provision in respect of prior periods	(25)	(167)	(132)
Relief for overseas taxation	(198)	(147)	(171)
	2,150	2,041	1,951
Deferred taxation:			
Charge for the year	89	365	404
(Over)/under provision in respect of prior periods	(336)	27	(88)
Tax charge for the year	1,903	2,433	2,267

The actual tax charge differs from the expected tax charge computed by applying the standard rate of UK corporation tax of 30% as follows:

	2007 £m	2006 £m	2005 £m
Expected tax charge	2,747	2,506	2,188
Non-deductible items	259	280	310
Non-taxable items	(568)	(252)	(154)
Taxable foreign exchange movements	4	(33)	75
Foreign profits taxed at other rates	(13)	61	74
Reduction in deferred tax liability following change in the rate of UK Corporation Tax	(156)	—	—
Unutilised losses brought forward and carried forward	(9)	11	(6)

Adjustments in respect of prior periods	(361)	(140)	(220)
Actual tax charge for the year	1,903	2,433	2,267

The effective tax rate for the year was 20.8% (2006 – 29.1%; 2005 – 31.1%) . The tax rate benefited from a reduction of £156 million in the deferred tax liability following the change in the rate of UK Corporation Tax from 30% to 28% from 1 April 2008.

6 Profit attributable to preference shareholders

	2007	Group 2006	2005
	£m	£m	£m
Dividends paid to equity preference shareholders			
Non-cumulative preference shares of US\$0.01	210	160	103
Non-cumulative preference shares of €0.01	110	92	51
Non-cumulative preference shares of £1	11	—	—
Total	331	252	154

Notes:

- (1) In accordance with IAS 32, several of the Group's preference share issues are included in subordinated liabilities and the related finance cost in interest payable.
- (2) Between 1 January 2008 and the date of approval of these accounts, dividends amounting to US\$202 million have been declared in respect of equity preference shareholders for payment on 31 March 2008.

7 Ordinary dividends

	2007	2006	2005
	£m	£m	£m
Ordinary dividend paid to holding company	2,000	3,250	1,928

8 Profit dealt with in the accounts of the Bank

As permitted by section 230(3) of the Companies Act 1985, no income statement for the Bank has been presented as a primary financial statement. Of the profit attributable to ordinary shareholders, £6,924 million (2006 – £3,267 million; 2005 – £1,390 million) has been dealt with in the accounts of the Bank.

9 Financial instruments

The following tables analyse the financial assets and financial liabilities in accordance with the categories of financial instruments in IAS 39. Assets and liabilities outside the scope of IAS 39 are shown separately.

	Group								
	Held-for-trading	Designated as at fair value through profit or loss	Hedging derivatives	Available- for-sale	Loans and receivables	Other (amortised cost)	Finance leases	Non financial assets/ liabilities	Total
2007	£m	£m	£m	£m	£m	£m	£m	£m	£m
Assets									
Cash and balances at central banks	—	—		—	5,559		—		5,559
Treasury and other eligible bills (1)	16,316	—		202	—		—		16,518
Loans and advances to banks (2)	72,697	—		—	23,649		—		96,346
Loans and advances to customers (3)	105,420	2,622		—	430,837		12,570		551,449
Debt securities	120,469	2,854		24,091	500		—		147,914
Equity shares	3,786	156		1,567	—		—		5,509
Settlement balances	—	—		—	5,326		—		5,326
Derivatives	248,986	—	919	—	—		—		249,905
Intangible assets								17,761	17,761
								13,025	13,025

Property, plant and equipment									
Prepayments, accrued income and other assets	—	—		—	19		—	6,337	6,356
	567,674	5,632	919	25,860	465,890		12,570	37,123	1,115,668
Liabilities									
Deposits by banks (4)	71,714	—				79,794	—		151,508
Customer accounts (5, 6)	61,990	1,920				379,072	—		442,982
Debt securities in issue (7, 8)	9,455	9,021				111,656	—		130,132
Settlement balances and short positions	47,058	—				6,791	—		53,849
Derivatives	245,732	—	1,270			—	—		247,002
Accruals, deferred income and other liabilities	210	—				1,545	19	10,393	12,167
Retirement benefit liabilities								334	334
Deferred taxation								2,063	2,063
Subordinated liabilities (9)	—	358				27,438		—	27,796
	436,159	11,299	1,270			606,296	19	12,790	1,067,833
Equity									47,835
									1,115,668

Notes on the accounts continued

9 Financial instruments (continued)

	Group								Total £m
	Held-for-trading £m	Designated as at fair value through profit or loss	Hedging derivatives £m	Available-for-sale £m	Loans and receivables £m	Other (amortised cost) £m	Finance leases £m	Non financial assets/ liabilities £m	
2006									
Assets									
Cash and balances at central banks	—	—		—	6,121		—		6,121
Treasury and other eligible bills (1)	4,516	—		982	—		—		5,498
Loans and advances to banks (2)	52,735	376		—	25,425		—		78,536
Loans and advances to customers (3)	73,696	1,327		—	381,962		11,521		468,506
Debt securities	95,193	3,433		21,991	561		—		121,178
Equity shares	3,038	590		1,815	—		—		5,443
Settlement balances	—	—		—	7,425		—		7,425
Derivatives	115,542	—	1,181	—	—		—		116,723
Intangible assets								17,771	17,771
Property, plant and equipment								15,050	15,050
Prepayments, accrued income and other assets	—	—		—	16		—	5,960	5,976
	344,720	5,726	1,181	24,788	421,510		11,521	38,781	848,227
Liabilities									
Deposits by banks (4)	57,452	—				74,290	—		131,742
Customer accounts (5), (6)	48,057	1,677				334,986	—		384,720
Debt securities in issue (7, 8)	2,141	10,499				69,966	—		82,606

Settlement							
balances and							
short positions	43,809	—		5,667	—		49,476
Derivatives	117,278	—	835	—	—		118,113
Accruals,							
deferred income							
and other							
liabilities	—	—		1,453	89	10,021	11,563
Retirement							
benefit liabilities						1,971	1,971
Deferred							
taxation						1,918	1,918
Subordinated							
liabilities (9)	—	124		27,662	—	—	27,786
	268,737	12,300	835	514,024	89	13,910	809,895
Equity							38,332
							848,227

Notes:

- (1) Comprises treasury bills and similar securities of £14,604 million (2006 – £5,407 million) and other eligible bills of £1,914 million (2006 – £91 million).
- (2) Includes reverse repurchase agreements of £67,619 million (2006 – £54,152 million), items in the course of collection from other banks of £2,729 million (2006 – £3,471 million) and amounts due from fellow subsidiaries of £1,966 million (2006 – nil).
- (3) Includes reverse repurchase agreements of £79,056 million (2006 – £62,908 million), amounts due from holding company of £5,572 million (2006 – £738 million) and amounts due from fellow subsidiaries of £3,516 million (2006 – £2,299 million).
- (4) Includes repurchase agreements of £75,154 million (2006 – £76,376 million) and items in the course of transmission to other banks of £372 million (2006 – £799 million).
- (5) Includes repurchase agreements of £75,029 million (2006 – £63,984 million), amounts due to holding company of £1,012 million (2006 – £653 million) and amounts due to fellow subsidiaries of £2,105 million (2006 – £2,146 million).
- (6) The carrying amount of other customer accounts designated as at fair value through profit or loss is £77 million (2006 – £140 million) greater than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premium payable.
- (7) Comprises bonds and medium term notes of £40,945 million (2006 – £40,689 million) and certificates of deposit and other commercial paper of £89,187 million (2006 – £41,917 million).
- (8) £152 million (2006 – nil) has been recognised in profit or loss for changes in credit risk associated with these liabilities measured as the change in fair value from movements in the period in the credit risk premium payable by the Group. The carrying amount is £317 million (2006 – £383 million) lower than the principal amount.
- (9) Includes amounts due to holding company of £6,113 million (2006 – £6,527 million).

Amounts included in the income statement:

	2007 £m	Group 2006 £m	2005 £m
Gains on financial assets/liabilities designated as at fair value through profit or loss	721	344	62
Gains on disposal or settlement of loans and receivables	10	21	25

On the initial recognition of financial assets and liabilities valued using valuation techniques incorporating information other than observable market data, any difference between the transaction price and that derived from the valuation technique is deferred. Such amounts are recognised in profit or loss over the life of the transaction; when market data become observable; or when the transaction matures or is closed out as appropriate. At 31 December 2007, net gains of £62 million (2006 – £15 million) were carried forward in the balance sheet. During the year net gains of £57 million (2006 – £3 million) were deferred and £10 million (2006 – £4 million) released to profit or loss.

	Bank							
	Held-for-trading £m	Designated as at fair value through profit or loss £m	Hedging derivatives £m	Available- for-sale £m	Loans and receivables £m	Other (amortised cost) £m	Non financial assets/ liabilities £m	Total £m
2007								
Assets								
Cash and balances at central banks	—	—		—	3,333			3,333
Treasury and other eligible bills (1)	14,044	—		156	—			14,200
Loans and advances to banks (2)	60,640	—		—	31,342			91,982
Loans and advances to customers (3)	109,992	791		—	218,364			329,147
Debt securities	83,411	996		8,643	—			93,050
Equity shares	3,634	10		375	—			4,019
Investments in								
Group undertakings	—	—		—	—		22,210	22,210
Settlement balances	—	—		—	2,046			2,046
Derivatives	251,196	—	647	—	—			251,843
Intangible assets							295	295
Property, plant and equipment							2,116	2,116
Prepayments, accrued income and other assets	—	—		—	—		1,999	1,999
	522,917	1,797	647	9,174	255,085		26,620	816,240

Liabilities						
Deposit by banks						
(4)	71,261	—		125,707		196,968
Customer accounts						
(5, 6)	57,823	54		140,049		197,926
Debt securities in						
issue (7, 8)	9,455	8,895		61,527		79,877
Settlement balances						
and						
short positions	30,567	—		3,110	—	33,677
Derivatives	247,663	—	501	—	—	248,164
Accruals, deferred						
income						
and other liabilities	210	—		1,080	4,493	5,783
Retirement benefit						
liabilities	—	—		—	11	11
Subordinated						
liabilities	—	358		22,387	—	22,745
	416,979	9,307	501	353,860	4,504	785,151
Equity						31,089
						816,240

Notes on the accounts continued

9 Financial instruments (continued)

	Bank								
	Designated as at fair value through profit or loss	Hedging derivatives	Available- for-sale	Loans and receivables	Other (amortised cost)	Finance leases	Non financial assets/ liabilities	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	£m
2006									
Assets									
Cash and balances at central banks	—	—	—	3,694	—	—	—	3,694	
Treasury and other eligible bills (1)	4,437	—	933	—	—	—	—	5,370	
Loans and advances to banks (2)	46,248	—	—	32,255	—	—	—	78,503	
Loans and advances to customers (3)	55,667	243	—	188,908	—	—	—	244,818	
Debt securities	68,050	938	5,290	—	—	—	—	74,278	
Equity shares	2,996	—	372	—	—	—	—	3,368	
Investments in Group undertakings	—	—	—	—	—	—	21,918	21,918	
Settlement balances	—	—	—	3,829	—	—	—	3,829	
Derivatives	116,368	—	719	—	—	—	—	117,087	
Intangible assets	—	—	—	—	—	—	172	172	
Property, plant and equipment	—	—	—	—	—	—	2,022	2,022	
Prepayments, accrued income and other assets	—	—	—	—	—	—	2,874	2,874	
	293,766	1,181	719	6,595	228,686	—	26,986	557,933	
Liabilities									
Deposits by banks (4)	66,805	—	—	—	82,934	—	—	149,739	
Customer accounts (5, 6)	37,151	14	—	—	135,539	—	—	172,704	
Debt securities in issue (7, 8)	2,058	10,355	—	—	29,401	—	—	41,814	
Settlement balances and short positions	22,341	—	—	—	2,866	—	—	25,207	
Derivatives	117,624	—	633	—	—	—	—	118,257	
Accruals, deferred income and other liabilities	—	—	—	—	1,048	45	4,258	5,351	
Retirement benefit liabilities	—	—	—	—	—	—	27	27	
Subordinated liabilities	—	124	—	—	22,279	—	—	22,403	
	245,979	10,493	633	—	274,067	45	4,285	535,502	
Equity								22,431	
								557,933	

Notes:

- (1) Comprises treasury bills and similar securities of £14,200 million (2006 – £5,369 million) and other eligible bills of nil (2006 – £1 million).
- (2) Includes reverse repurchase agreements of £52,128 million (2006 – £41,703 million), items in the course of collection from other banks of £530 million (2006 – £793 million) and amounts due from subsidiaries of £22,367 million (2006 – £19,159 million) and amounts due from fellow subsidiaries of £1,748 million (2006 – nil).
- (3)

Includes reverse repurchase agreements of £58,785 million (2006 – £39,924 million), amounts due from subsidiaries of £66,102 million (2006 – £50,970 million), amounts due from fellow subsidiaries of £2,666 million (2006 – £2,189 million) and amounts due from holding company of £5,572 million (2006 – nil).

- (4) Includes repurchase agreements of £59,955 million (2006 – £52,134 million), items in the course of transmission to other banks of £68 million (2006 – £425 million), amounts due to subsidiaries of £74,006 million (2006 – £60,675 million) and amounts due to fellow subsidiaries of £8,473 million (2006 – nil).
- (5) Includes repurchase agreements of £30,177 million (2006 – £24,165 million), amounts due to fellow subsidiaries of £123 million (2006 – £1,517 million), amounts due to holding company of £1,013 million (2006 – £653 million) and amounts due to subsidiaries of £53,565 million (2006 – £55,530 million).
- (6) The carrying amount of other customer accounts designated as at fair value through profit or loss is £15 million lower (2006 – £140 million greater) than the principal amount. No amounts have been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premium payable.
- (7) Comprises bonds and medium term notes of £17,274 million (2006 – £18,774 million) and certificates of deposit and other commercial paper of £62,603 (2006 – £23,040 million).
- (8) £152 million (2006 – nil) has been recognised in profit or loss for changes in credit risk associated with these liabilities as the changes are immaterial measured as the change in fair value from movements in the period in the credit risk premium payable by the Group. The carrying amount is £252 million (2006 – £383 million) lower than the principal amount.

The following table shows the carrying values and the fair values of financial instruments on the balance sheets carried at amortised cost.

	Group				Bank			
	2007	2007	2006	2006	2007	2007	2006	2006
	Carrying	Fair	Carrying	Fair	Carrying	Fair	Carrying	Fair
	value	value	value	value	value	value	value	value
	£m	£m	£m	£m	£m	£m	£m	£m
Financial assets								
Cash and balances at central banks	5,559	5,559	6,121	6,121	3,333	3,333	3,694	3,694
Loans and advances to banks								
Loans and receivables	23,649	23,644	25,425	25,401	31,342	31,343	32,255	32,234
Loans and advances to customers								
Loans and receivables	430,837	433,655	381,962	383,046	218,364	218,490	188,908	189,027
Finance leases	12,570	12,376	11,521	11,504	—	—	—	—
Debt securities								
Loans and receivables	500	500	561	561	—	—	—	—
Settlement balances	5,326	5,326	7,425	7,425	2,046	2,046	3,829	3,829
Financial liabilities								
Deposits by banks								
Amortised cost	79,794	79,614	74,290	74,107	125,707	125,697	82,934	82,933
Customer accounts								
Amortised cost	379,072	378,793	334,986	334,767	140,049	139,985	135,539	135,511
Debt securities in issue								
Amortised cost	111,656	111,676	69,966	70,229	61,527	61,530	29,401	29,401
Settlement balances and short positions	6,791	6,791	5,667	5,667	3,110	3,110	2,866	2,866
Subordinated liabilities								
Amortised cost	27,438	26,206	27,662	28,738	22,387	21,137	22,279	22,861

Notes on the accounts continued

9 Financial instruments (continued)

Remaining maturity

	2007			Group 2006		
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m
Assets						
Cash and balances at central banks	5,559	—	5,559	6,121	—	6,121
Treasury and other eligible bills	16,397	121	16,518	5,498	—	5,498
Loans and advances to banks	91,951	4,395	96,346	78,148	388	78,536
Loans and advances to customers	251,553	299,896	551,449	262,835	205,671	468,506
Debt securities	18,196	129,718	147,914	24,060	97,118	121,178
Equity shares	—	5,509	5,509	—	5,443	5,443
Settlement balances	5,298	28	5,326	7,425	—	7,425
Derivatives	45,698	204,207	249,905	28,007	88,716	116,723
Liabilities						
Deposits by banks	143,919	7,589	151,508	124,349	7,393	131,742
Customer accounts	430,297	12,685	442,982	374,157	10,563	384,720
Debt securities in issue	79,552	50,580	130,132	39,620	42,986	82,606
Settlement balances and short positions	30,597	23,252	53,849	26,450	23,026	49,476
Derivatives	49,628	197,374	247,002	30,081	88,032	118,113
Subordinated liabilities	811	26,985	27,796	675	27,111	27,786

	2007			2006			Bank
	Less than 12 months £m	More than 12 months £m	Total £m	Less than 12 months £m	More than 12 months £m	Total £m	
Assets							
Cash and balances at central banks	3,333	—	3,333	3,694	—	3,694	
Treasury and other eligible bills	14,079	121	14,200	5,365	5	5,370	
Loans and advances to banks	85,920	6,062	91,982	74,730	3,773	78,503	
Loans and advances to customers	185,992	143,155	329,147	189,082	55,736	244,818	
Debt securities	12,966	80,084	93,050	22,589	51,689	74,278	
Equity shares	—	4,019	4,019	—	3,368	3,368	

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Settlement balances	2,018	28	2,046	3,829	—	3,829
Derivatives	46,016	205,827	251,843	27,745	89,342	117,087
Liabilities						
Deposits by banks	190,825	6,143	196,968	145,745	3,994	149,739
Customer accounts	183,887	14,039	197,926	159,739	12,965	172,704
Debt securities in issue	58,420	21,457	79,877	22,963	18,851	41,814
Settlement balances and short positions	26,100	7,577	33,677	22,778	2,429	25,207
Derivatives	49,633	198,531	248,164	29,750	88,507	118,257
Subordinated liabilities	603	22,142	22,745	538	21,865	22,403

10 Asset quality

Asset grades

Internal reporting and oversight of risk assets is principally differentiated by credit ratings. Internal ratings are used to assess the credit quality of borrowers. Customers are assigned credit ratings based on various credit grading models that reflect the probability of default. All credit ratings across the Group map to a Group level asset quality scale.

Expressed as an annual probability of default, the upper and lower boundaries and the midpoint for each of these Group level asset quality grades are as follows:

Asset quality grade	Annual probability of default		
	Minimum %	Midpoint %	Maximum %
AQ1	0.00	0.10	0.20
AQ2	0.21	0.40	0.60
AQ3	0.61	1.05	1.50
AQ4	1.51	3.25	5.00
AQ5	5.01	52.50	100.00

The following table provides an analysis of the credit quality of financial assets by the Group's internal credit ratings.

	Group									
	Balances with Accruing					Group past		Impairment		Total
	AQ1	AQ2	AQ3	AQ4	AQ5	companies	non-	accrual	provision	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2007										
Cash and balances at central banks	5,559	—	—	—	—	—	—	—	—	5,559
Treasury and other eligible bills	16,507	—	11	—	—	—	—	—	—	16,518
Loans and advances to banks*	89,357	1,772	426	94	2	1,966	—	2	(2)	93,617
Loans and advances to customers	191,451	109,460	163,792	46,293	19,850	9,088	9,083	6,665	(4,233)	551,449
Debt securities	136,884	8,026	1,372	466	1,165	—	—	1	—	147,914
Settlement balances	3,228	98	344	21	68	—	1,567	—	—	5,326
Derivatives	219,700	21,166	4,801	894	394	2,950	—	—	—	249,905
Other financial instruments	19	—	—	—	—	—	—	—	—	19
	662,705	140,522	170,746	47,768	21,479	14,004	10,650	6,668	(4,235)	1,070,307
Commitments	95,664	73,221	60,895	19,797	12,177	—	—	—	—	261,754

Contingent liabilities	7,658	7,915	4,989	1,214	1,100	—	—	—	—	22,876
Total off-balance sheet	103,322	81,136	65,884	21,011	13,277	—	—	—	—	284,630
2006										
Cash and balances at central banks	6,121	—	—	—	—	—	—	—	—	6,121
Treasury and other eligible bills	5,498	—	—	—	—	—	—	—	—	5,498
Loans and advances to banks*	73,443	748	416	346	111	—	1	2	(2)	75,065
Loans and advances to customers	149,226	85,511	124,215	72,622	23,283	3,037	8,324	6,215	(3,927)	468,506
Debt securities	116,079	2,707	1,206	345	841	—	—	3	(3)	121,178
Settlement balances	4,936	473	261	454	—	—	1,301	—	—	7,425
Derivatives	89,292	18,827	7,776	505	281	42	—	—	—	116,723
Other financial instruments	16	—	—	—	—	—	—	—	—	16
	444,611	108,266	133,874	74,272	24,516	3,079	9,626	6,220	(3,932)	800,532
Commitments	112,705	52,279	46,742	18,954	14,577	—	—	—	—	245,257
Contingent liabilities	6,172	7,870	3,453	1,468	883	—	—	—	—	19,846
Total off-balance sheet	118,877	60,149	50,195	20,422	15,460	—	—	—	—	265,103

* Excluding items in the course of collection of £2,729 million (2006 – £3,471 million).

Notes on the accounts continued

10 Asset quality (continued)

The following table provides an analysis of the credit quality of financial assets by the Group's internal credit ratings.

	AQ1	AQ2	AQ3	AQ4	AQ5	Bank Balances with Group	Accruing past Non-	Impairment accrual provision		Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
2007										
Cash and balances at central banks	3,333	—	—	—	—	—	—	—	—	3,333
Treasury and other eligible bills	14,189	—	11	—	—	—	—	—	—	14,200
Loans and advances to banks*	66,418	574	275	70	—	24,115	—	—	—	91,452
Loans and advances to customers	97,715	59,825	75,432	12,645	5,874	74,340	2,501	2,088	(1,273)	329,147
Debt securities	84,114	5,699	1,243	338	1,044	612	—	—	—	93,050
Settlement balances	1,273	89	130	—	39	—	515	—	—	2,046
Derivatives	218,218	20,879	4,575	795	367	7,009	—	—	—	251,843
	485,260	87,066	81,666	13,848	7,324	106,076	3,016	2,088	(1,273)	785,071
Commitments	61,866	39,825	31,604	6,478	5,784	258	—	—	—	145,815
Contingent liabilities	5,876	5,187	2,962	278	703	—	—	—	—	15,006
Total off-balance sheet	67,742	45,012	34,566	6,756	6,487	258	—	—	—	160,821
2006										
Cash and balances at central banks	3,694	—	—	—	—	—	—	—	—	3,694
Treasury and other eligible bills	5,222	—	—	—	—	148	—	—	—	5,370
Loans and advances to banks*	57,453	566	379	50	103	19,159	—	—	—	77,710
Loans and advances to customers	56,563	45,225	49,707	26,994	10,614	53,159	1,709	2,200	(1,353)	244,818
Debt securities	69,798	1,490	401	267	410	1,912	—	3	(3)	74,278

Settlement										
balances	3,010	345	10	358	—	—	106	—	—	3,829
Derivatives	88,128	18,608	7,594	474	273	2,010	—	—	—	117,087
	283,868	66,234	58,091	28,143	11,400	76,388	1,815	2,203	(1,356)	526,786
Commitments	75,976	26,139	19,938	6,793	6,560	786	—	—	—	136,192
Contingent										
liabilities	3,591	5,108	2,433	728	643	—	—	—	—	12,503
Total off-balance										
sheet	79,567	31,247	22,371	7,521	7,203	786	—	—	—	148,695

* Excluding items in the course of collection of £530 million (2006 – £793 million).

Industry risk – geographical analysis

The following tables analyse financial assets by location of office and by industry type.

	Group					
	Loans and advances to banks and customers £m	Treasury bills, debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset(2) £m
2007						
UK						
Central and local government	4,722	15,280	1,157	—	21,159	1,531
Manufacturing	19,574	211	1,517	—	21,302	4,031
Construction	12,249	3	741	—	12,993	1,684
Finance	173,741	74,137	229,971	1,678	479,527	234,246
Service industry and business activities	69,011	5,125	4,412	—	78,548	6,690
Agriculture, forestry and fishing	2,564	1	58	—	2,623	104
Property	59,821	603	969	7	61,400	2,033
Individuals						
Home mortgages	72,726	—	5	—	72,731	—
Other	27,408	260	15	—	27,683	7
Finance leases and instalment credit	15,632	131	27	—	15,790	—
Interest accruals	2,202	857	—	—	3,059	—
Total UK	459,650	96,608	238,872	1,685	796,815	250,326
US						
Central and local government	347	22,982	—	212	23,541	—
Manufacturing	5,412	236	—	—	5,648	—
Construction	793	96	—	—	889	—
Finance	26,722	36,843	9,470	2,800	75,835	7,417
Service industry and business activities	14,254	1,388	233	—	15,875	1
Agriculture, forestry and fishing	20	—	—	—	20	—
Property	6,339	—	—	—	6,339	—
Individuals						
Home mortgages	27,882	—	—	—	27,882	—
Other	10,879	—	—	—	10,879	—
Finance leases and instalment credit	2,228	—	—	—	2,228	—
Interest accruals	619	379	—	—	998	2
Total US	95,495	61,924	9,703	3,012	170,134	7,420
Europe						
Central and local government	551	960	10	—	1,521	—
Manufacturing	5,868	—	—	—	5,868	—

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Construction	3,519	—	—	—	3,519	—
Finance	10,984	790	1,011	28	12,813	—
Service industry and business activities	13,391	19	7	—	13,417	16
Agriculture, forestry and fishing	588	—	—	—	588	—
Property	12,971	67	—	—	13,038	—
Individuals						
Home mortgages	16,276	18	—	—	16,294	—
Other	5,111	—	—	—	5,111	—
Finance leases and instalment credit	1,620	—	—	—	1,620	—
Interest accruals	277	1	—	—	278	—
Total Europe	71,156	1,855	1,028	28	74,067	16
Rest of the World						
Central and local government	239	1,054	—	—	1,293	—
Manufacturing	214	—	—	—	214	—
Construction	463	4	—	—	467	1
Finance	18,176	8,477	38	575	27,266	69
Service industry and business activities	3,103	1	9	—	3,113	2
Agriculture, forestry and fishing	11	—	—	—	11	—
Property	1,751	52	1	—	1,804	—
Individuals						
Home mortgages	477	—	—	—	477	—
Other	1,149	—	—	—	1,149	—
Finance leases and instalment credit	18	—	254	45	317	—
Interest accruals	128	11	—	—	139	—
Total Rest of the World	25,729	9,599	302	620	36,250	72

Notes on the accounts continued

10 Asset quality (continued)

	Group					
	Loans and advances to banks and customers £m	Treasury bills, debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset (2) £m
2007						
Total						
Central and local government	5,859	40,276	1,167	212	47,514	1,531
Manufacturing	31,068	447	1,517	—	33,032	4,031
Construction	17,024	103	741	—	17,868	1,685
Finance	229,623	120,250	240,490	5,081	595,444	241,732
Service industry and business activities	99,759	6,533	4,661	—	110,953	6,709
Agriculture, forestry and fishing	3,183	1	58	—	3,242	104
Property	80,882	719	970	7	82,578	2,033
Individuals						
Home mortgages	117,361	18	5	—	117,384	—
Other	44,547	260	15	—	44,822	7
Finance leases and instalment credit	19,498	131	281	45	19,955	—
Interest accruals	3,226	1,248	—	—	4,474	2
	652,030	169,986	249,905	5,345	1,077,266	257,834

Notes:

- (1) Includes settlement balances of £5,326 million.
- (2) This column shows the amount by which the Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

	Group					
	Loans and advances to banks and customers £m	Treasury bills, debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset (2) £m
2006						
UK						
Central and local government	7,629	27,446	345	1,624	37,044	1,553
Manufacturing	15,259	482	915	15	16,671	4,540

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Construction	9,667	60	179	3	9,909	1,458
Finance	127,513	43,019	80,619	1,513	252,664	93,403
Service industry and business activities	57,895	2,865	2,616	642	64,018	5,289
Agriculture, forestry and fishing	2,819	1	3	—	2,823	99
Property	51,303	486	646	11	52,446	1,291
Individuals						
Home mortgages	70,884	—	1	—	70,885	—
Other	27,269	221	29	—	27,519	61
Finance leases and instalment credit	14,218	5	—	—	14,223	189
Interest accruals	1,823	62	—	—	1,885	—
Total UK	386,279	74,647	85,353	3,808	550,087	107,883
US						
Central and local government	435	24,006	—	102	24,543	1
Manufacturing	3,842	251	157	—	4,250	52
Construction	790	48	12	—	850	—
Finance	31,785	28,260	29,989	3,495	93,529	26,037
Service industry and business activities	10,678	1,247	168	—	12,093	22
Agriculture, forestry and fishing	64	—	—	—	64	—
Property	5,781	—	24	—	5,805	19
Individuals						
Home mortgages	34,230	—	—	—	34,230	—
Other	11,643	—	—	—	11,643	—
Finance leases and instalment credit	2,282	—	—	—	2,282	—
Interest accruals	526	343	—	—	869	2
Total US	102,056	54,155	30,350	3,597	190,158	26,133

	Group Loans and advances to banks and customers £m	Treasury bills, debt securities and equity shares £m	Derivatives £m	Other(1) £m	Total £m	Netting offset(2) £m
2006						
Europe						
Central and local government	488	423	—	3	914	—
Manufacturing	4,067	—	—	—	4,067	—
Construction	2,751	—	—	—	2,751	—
Finance	5,989	1,297	860	17	8,163	7
Service industry and business activities	9,608	87	7	8	9,710	—
Agriculture, forestry and fishing	469	2	—	—	471	—
Property	8,781	21	—	—	8,802	—
Individuals						
Home mortgages	13,661	—	—	—	13,661	—
Other	3,733	—	—	—	3,733	—
Finance leases and instalment credit	1,325	—	—	—	1,325	—
Interest accruals	221	—	—	—	221	—
Total Europe	51,093	1,830	867	28	53,818	7
Rest of the World						
Central and local government	185	921	16	—	1,122	1
Manufacturing	129	—	3	—	132	3
Construction	80	—	—	—	80	—
Finance	6,113	587	106	7	6,813	2,271
Service industry and business activities	2,664	10	27	1	2,702	2
Agriculture, forestry and fishing	13	—	—	—	13	—
Property	1,250	19	1	—	1,270	—
Individuals						
Home mortgages	273	—	—	—	273	—
Other	782	—	—	—	782	—
Finance leases and instalment credit	10	—	—	—	10	—
Interest accruals	44	—	—	—	44	—
Total Rest of the World	11,543	1,537	153	8	13,241	2,277
Total						
Central and local government	8,737	52,796	361	1,729	63,623	1,555
Manufacturing	23,297	733	1,075	15	25,120	4,595
Construction	13,288	108	191	3	13,590	1,458
Finance	171,400	73,163	111,574	5,032	361,169	121,718
Service industry and business activities	80,845	4,209	2,818	651	88,523	5,313
Agriculture, forestry and fishing	3,365	3	3	—	3,371	99
Property	67,115	526	671	11	68,323	1,310
Individuals						
Home mortgages	119,048	—	1	—	119,049	—

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Other	43,427	221	29	—	43,677	61
Finance leases and instalment credit	17,835	5	—	—	17,840	189
Interest accruals	2,614	405	—	—	3,019	2
	550,971	132,169	116,723	7,441	807,304	136,300

Note:

- (1) Includes settlement balances of £7,425 million.
- (2) This column shows the amount by which the Group's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Group a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Group holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Group obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

units

Notes on the accounts continued

10 Asset quality (continued)

Industry risk – geographical analysis

				Bank		
	Loans and advances to banks and customers £m	Treasury bills, debt securities and equity shares £m	Derivatives £m	Other £m	Total £m	Netting offset(1) £m
2007						
UK						
Central and local government	2,396	13,379	1,158	—	16,933	387
Manufacturing	11,470	209	1,416	—	13,095	1,775
Construction	5,834	3	716	—	6,553	768
Finance	178,673	73,290	232,670	1,673	486,306	233,878
Service industry and business activities	42,694	5,710	4,228	—	52,632	2,143
Agriculture, forestry and fishing	800	—	56	—	856	87
Property	33,741	545	866	7	35,159	588
Individuals						
Home mortgages	35,710	—	1	—	35,711	—
Other	8,213	—	6	—	8,219	—
Finance leases and instalment credit	708	128	27	—	863	—
Interest accruals	1,554	854	—	—	2,408	—
Total UK	321,793	94,118	241,144	1,680	658,735	239,626
US						
Central and local government	73	1,892	—	—	1,965	—
Manufacturing	2,307	124	—	—	2,431	—
Construction	217	48	—	—	265	—
Finance	31,867	10,799	10,400	321	53,387	4,932
Service industry and business activities	6,640	558	—	—	7,198	—
Property	724	—	—	—	724	—
Finance leases and instalment credit	36	—	—	—	36	—
Interest accruals	67	83	—	—	150	—
Total US	41,931	13,504	10,400	321	66,156	4,932
Europe						
Central and local government	389	—	10	—	399	—
Manufacturing	3,910	—	—	—	3,910	—
Construction	630	—	—	—	630	—
Finance	18,964	37	—	—	19,001	—
	6,897	—	—	—	6,897	—

Service industry and business activities						
Property	4,938	—	—	—	4,938	—
Individuals						
Home mortgages	3	—	—	—	3	—
Other	1	—	—	—	1	—
Finance leases and instalment credit	113	—	—	—	113	—
Interest accruals	100	1	—	—	101	—
Total Europe	35,945	38	10	—	35,993	—
Rest of the World						
Central and local government	239	1,053	—	—	1,292	—
Manufacturing	214	—	—	—	214	—
Construction	443	—	—	—	443	1
Finance	6,211	2,530	24	—	8,765	69
Service industry and business activities	13,497	—	10	—	13,507	2
Agriculture, forestry and fishing	11	—	—	—	11	—
Property	1,751	26	1	—	1,778	—
Individuals						
Home mortgages	280	—	—	—	280	—
Other	3	—	—	—	3	—
Finance leases and instalment credit	18	—	254	45	317	—
Interest accruals	66	—	—	—	66	—
Total Rest of the World	22,733	3,609	289	45	26,676	72

	Bank					
	Loans and advances to banks and customers £m	Treasury bills, debt securities and equity shares £m	Derivatives £m	Other £m	Total £m	Netting offset(1) £m
2007						
Total						
Central and local government	3,097	16,324	1,168	—	20,589	387
Manufacturing	17,901	333	1,416	—	19,650	1,775
Construction	7,124	51	716	—	7,891	769
Finance	235,715	86,656	243,094	1,994	567,459	238,879
Service industry and business activities	69,728	6,268	4,238	—	80,234	2,145
Agriculture, forestry and fishing	811	—	56	—	867	87
Property	41,154	571	867	7	42,599	588
Individuals						
Home mortgages	35,993	—	1	—	35,994	—
Other	8,217	—	6	—	8,223	—
Finance leases and instalment credit	875	128	281	45	1,329	—
Interest accruals	1,787	938	—	—	2,725	—
	422,402	111,269	251,843	2,046	787,560	244,630

Note:

(1) This column shows the amount by which the Bank's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Bank a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Bank holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Bank obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

	Bank					
	Loans and advances to banks and customers £m	Treasury bills, debt securities and equity shares £m	Derivatives £m	Other £m	Total £m	Netting offset(1) £m
2006						
UK						
Central and local government	5,258	26,016	341	1,624	33,239	504
Manufacturing	7,222	466	837	15	8,540	1,366
Construction	4,330	56	146	3	4,535	691
Finance	163,937	41,747	82,097	1,502	289,283	93,087
Service industry and business activities	34,137	2,388	2,421	642	39,588	1,582

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Agriculture, forestry and fishing	786	—	2	—	788	65
Property	29,824	429	720	11	30,984	546
Individuals						
Home mortgages	35,549	—	—	—	35,549	—
Other	8,635	30	26	—	8,691	1
Finance leases and instalment credit	1,085	1	—	—	1,086	83
Interest accruals	1,304	60	—	—	1,364	—
Total UK	292,067	71,193	86,590	3,797	453,647	97,925
US						
Central and local government	93	365	—	—	458	1
Manufacturing	1,189	2	157	—	1,348	52
Construction	259	—	12	—	271	—
Finance	6,925	9,071	29,770	29	45,795	24,771
Service industry and business activities	4,355	604	109	—	5,068	23
Property	385	—	24	—	409	19
Finance leases and instalment credit	113	—	—	—	113	—
Interest accruals	45	47	—	—	92	—
Total US	13,364	10,089	30,072	29	53,554	24,866

50

Notes on the accounts continued

10 Asset quality (continued)

Industry risk – geographical analysis

	Loans and advances to banks and customers	Treasury bills, debt securities and equity shares	Derivatives	Other	Bank Total	Netting offset(1)
	£m	£m	£m	£m	£m	£m
2006						
Europe						
Central and local government	220	114	—	3	337	—
Manufacturing	2,936	—	—	—	2,936	—
Construction	437	—	—	—	437	—
Finance	1,206	95	272	—	1,573	4
Service industry and business activities	4,515	—	1	—	4,516	—
Property	2,697	—	—	—	2,697	—
Individuals						
Home mortgages	2	—	—	—	2	—
Other	1	—	—	—	1	—
Finance leases and instalment credit	—	—	—	—	—	—
Interest accruals	76	—	—	—	76	—
Total Europe	12,090	209	273	3	12,575	4
Rest of the World						
Central and local government	185	920	16	—	1,121	1
Manufacturing	129	—	3	—	132	3
Construction	61	—	—	—	61	—
Finance	2,636	587	107	—	3,330	2,271
Service industry and business activities	2,644	2	25	—	2,671	1
Agriculture, forestry and fishing	13	—	—	—	13	—
Property	1,250	19	1	—	1,270	—
Individuals						
Home mortgages	183	—	—	—	183	—
Other	1	—	—	—	1	—
Finance leases and instalment credit	10	—	—	—	10	—
Interest accruals	41	—	—	—	41	—
Total Rest of the World	7,153	1,528	152	—	8,833	2,276
Total						
Central and local government	5,756	27,415	357	1,627	35,155	506
Manufacturing	11,476	468	997	15	12,956	1,421
Construction	5,087	56	158	3	5,304	691
Finance	174,704	51,500	112,246	1,531	339,981	120,133
Service industry and business activities	45,651	2,994	2,556	642	51,843	1,606
Agriculture, forestry and fishing	799	—	2	—	801	65
Property	34,156	448	745	11	35,360	565

Individuals

Home mortgages	35,734	—	—	—	35,734	—
Other	8,637	30	26	—	8,693	1
Finance leases and instalment credit	1,208	1	—	—	1,209	83
Interest accruals	1,466	107	—	—	1,573	—
	324,674	83,019	117,087	3,829	528,609	125,071

Note:

- (1) This column shows the amount by which the Bank's credit risk exposure is reduced through arrangements, such as master netting agreements, which give the Bank a legal right to set-off the financial asset against a financial liability due to the same counterparty. In addition, the Bank holds collateral in respect of individual loans and advances to banks and customers. This collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower. The Bank obtains collateral in the form of securities in reverse repurchase agreements. Cash and securities are received as collateral in respect of derivative transactions.

11 Past due and impaired financial assets

The following tables show the movement in the provision for impairment losses for loans and advances.

	Individually assessed £m	Collectively assessed £m	Latent £m	Group Total 2007 £m	2006 £m	2005 £m
At 1 January	697	2,639	593	3,929	3,886	4,171
Implementation of IAS 39 on 1 January 2005	—	—	—	—	—	(28)
Currency translation and other adjustments	19	12	(1)	30	(62)	52
Acquisitions	—	—	6	6	—	—
Amounts written-off (1)	(265)	(1,387)	—	(1,652)	(1,841)	(2,040)
Recoveries of amounts previously written-off	19	226	—	245	215	170
Charged to the income statement	197	1,644	2	1,843	1,873	1,705
Unwind of discount	(28)	(138)	—	(166)	(142)	(144)
At 31 December (2)	639	2,996	600	4,235	3,929	3,886

Notes:

(1) Amounts written-off include £2 million in 2005 relating to loans and advances to banks.

(2) Impairment losses at 31 December 2007 include £2 million relating to loans and advances to banks (2006 – £2 million; 2005 – £3 million).

	Individually assessed £m	Collectively assessed £m	Latent £m	Bank Total 2007 £m	2006 £m	2005 £m
At 1 January	362	796	195	1,353	1,219	1,350
Implementation of IAS 39 on 1 January 2005	—	—	—	—	—	(23)
Currency translation and other adjustments	11	20	(40)	(9)	76	25
Acquisitions	—	—	—	—	—	2
Amounts written-off	(114)	(439)	—	(553)	(634)	(803)
Recoveries of amounts previously written-off	3	73	—	76	63	48
Charged to the income statement	29	415	27	471	692	677
Unwind of discount	(14)	(51)	—	(65)	(63)	(57)
At 31 December	277	814	182	1,273	1,353	1,219

	2007 £m	Group 2006 £m	2005 £m
Impairment losses charged to the income statement			
Loans and advances to customers	1,843	1,873	1,705
Debt securities	20	—	—

Equity shares	2	—	4
	22	—	4
	1,865	1,873	1,709

Group	2007 £m	2006 £m	2005 £m
Gross income not recognised but which would have been recognised under the original terms of non-accrual and restructured loans			
Domestic	390	370	334
Foreign	64	77	62
	454	447	396
Interest on non-accrual and restructured loans included in net interest income			
Domestic	165	142	130
Foreign	16	15	14
	181	157	144

Notes on the accounts continued

11 Past due and impaired financial assets (continued)

The following tables show analyses of impaired financial assets.

Group	2007			2006		
	Cost £m	Provision £m	Net book value £m	Cost £m	Provision £m	Net book value £m
Impaired financial assets						
Loans and advances to banks (1)	2	2	—	2	2	—
Loans and advances to customers (2)	6,665	3,633	3,032	6,215	3,334	2,881
Debt securities (1)	1	—	1	3	3	—
Equity shares (1)	54	45	9	60	47	13
	6,722	3,680	3,042	6,280	3,386	2,894

Bank	2007			2006		
	Cost £m	Provision £m	Net book value £m	Cost £m	Provision £m	Net book value £m
Impaired financial assets						
Loans and advances to customers (3)	2,088	1,091	997	2,200	1,158	1,042
Debt securities (1)	—	—	—	3	3	—
	2,088	1,091	997	2,203	1,161	1,042

Notes:

- (1) Impairment provisions individually assessed.
 (2) Impairment provisions individually assessed on balances of £1,226 million (2006 – £1,196 million).
 (3) Impairment provisions individually assessed on balances of £518 million (2006 – £642 million).

The Group and Bank hold collateral in respect of certain loans and advances to banks and to customers that are past due or impaired. Such collateral includes mortgages over property (both personal and commercial); charges over business assets such as plant, inventories and trade debtors; and guarantees of lending from parties other than the borrower.

The following table shows financial and non-financial assets, recognised on the Group's balance sheet, obtained during the year by taking possession of collateral or calling on other credit enhancements.

Group	2007	2006
	£m	£m
Residential property	31	12
Cash	18	9
Other assets	4	3
	53	24

2007 2006

Bank	£m	£m
Cash	15	8

In general, the Group seeks to dispose of property and other assets obtained by taking possession of collateral that are not readily convertible into cash as rapidly as the market for the individual asset permits.

The following loans and advances to customers were past due at the balance sheet date but not considered impaired:

	Group				Total	Bank				Total
	Past due 1-29 days £m	Past due 30-59 days £m	Past due 60-89 days £m	Past due 90 days or more £m		Past due 1-29 days £m	Past due 30-59 days £m	Past due 60-89 days £m	Past due 90 days or more £m	
2007	6,233	1,613	981	256	9,083	1,703	440	190	168	2,501
2006	6,254	1,300	665	105	8,324	1,100	432	167	10	1,709

These balances include loans and advances to customers that are past due through administrative and other delays in recording payments or in finalising documentation and other events unrelated to credit quality.

Loans that have been renegotiated in the past 12 months that would otherwise have been past due or impaired amounted to £577 million (Bank – £259 million) as at 31 December 2007 (2006: Group – £744 million; Bank – £511 million).

12 Derivatives

Companies in the Group transact derivatives as principal either as a trading activity or to manage balance sheet foreign exchange, credit and interest rate risk.

The Group enters into fair value and cash flow hedges and hedges of net investments in foreign operations. Fair value hedges principally involve interest rate swaps hedging the interest rate risk in recognised financial assets and financial liabilities. Similarly the majority of the Group's cash flow hedges relate to exposure to variability in future interest payments and receipts on forecast transactions and on recognised financial assets and financial liabilities and hedged by interest rate swaps for periods of up to 25 years. The Group hedges its net investments in foreign operations with currency borrowings and forward exchange contracts.

For cash flow hedge relationships of interest rate risk the hedged items are actual and forecast variable interest rate cash flows arising from financial assets and financial liabilities with interest rates linked to LIBOR or the Bank of England Official Bank Rate. The financial assets are customer loans and the financial liabilities are customer deposits and LIBOR linked medium-term notes and other issued securities.

For cash flow hedging relationships, the initial and ongoing prospective effectiveness is assessed by comparing movements in the fair value of the expected highly probable forecast interest cash flows with movements in the fair value of the expected changes in cash flows from the hedging interest rate swap. Prospective effectiveness is measured on a cumulative basis i.e. over the entire life of the hedge relationship. The method of calculating hedge ineffectiveness is the hypothetical derivative method. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the cash flows and actual movements in the fair value of the hedged cash flows from the interest rate swap over the life to date of the hedging relationship.

For fair value hedge relationships of interest rate risk the hedged items are typically large corporate fixed rate loans, fixed rate finance leases, fixed rate medium-term notes or preference shares classified as debt. The initial and ongoing prospective effectiveness of fair value hedge relationships is assessed on a cumulative basis by comparing movements in the fair value of the hedged item attributable to the hedged risk with changes in the fair value of the hedging interest rate swap. Retrospective effectiveness is assessed by comparing the actual movements in the fair value of the hedged items attributable to the hedged risk with actual movements in the fair value of the hedging derivative over the life to date of the hedging relationship.

	Group					
	2007			2006		
	Notional amounts £bn	Assets £m	Liabilities £m	Notional amounts £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	1,669	16,486	18,091	1,168	11,295	11,806
Currency swaps	359	8,231	7,628	261	5,060	4,734
Options purchased	450	11,943	—	361	7,408	—
Options written	469	—	11,317	364	—	6,646
Interest rate contracts						
Interest rate swaps	20,479	159,858	158,729	12,056	76,671	78,980
Options purchased	3,886	27,609	—	1,763	10,852	—
Options written	3,424	—	27,553	1,589	—	10,490
Futures and forwards	2,805	708	876	1,823	285	328

Credit derivatives	1,112	21,234	18,537	346	2,336	2,338
Equity and commodity contracts	110	3,836	4,271	82	2,816	2,791
		249,905	247,002		116,723	118,113
Included in the above are derivatives held for hedging purposes as follows:						
Fair value hedging:						
Interest rate swaps		546	379		804	384
Cash flow hedging:						
Exchange rate contracts		4	24		41	—
Interest rate swaps		369	777		336	451
Net investment hedging:						
Exchange rate contracts		—	90		—	—
Amounts above include:						
Due from/to holding company		179	173		42	—
Due from/to fellow subsidiaries		2,771	2,740		—	2

Notes on the accounts continued

12 Derivatives (continued)

Hedge ineffectiveness recognised in other operating income comprised:

	2007 £m	Group 2006 £m	2005 £m
Fair value hedging:			
Gains on the hedged items attributable to the hedged risk	66	219	56
Losses on the hedging instruments	(72)	(215)	(80)
Fair value ineffectiveness	(6)	4	(24)
Cash flow hedging ineffectiveness	9	4	12
	3	8	(12)

	2007			Bank 2006		
	Notional amounts £bn	Assets £m	Liabilities £m	Notional amounts £bn	Assets £m	Liabilities £m
Exchange rate contracts						
Spot, forwards and futures	1,683	16,877	18,061	1,158	11,464	11,758
Currency swaps	363	8,896	7,927	263	5,562	4,756
Options purchased	452	12,022	—	361	7,416	—
Options written	471	—	11,400	364	—	6,626
Interest rate contracts						
Interest rate swaps	20,544	160,563	159,071	11,904	76,504	79,119
Options purchased	3,816	27,549	—	1,603	10,831	—
Options written	3,364	—	27,545	1,488	—	10,473
Futures and forwards	2,781	707	876	1,627	284	328
Credit derivatives	1,124	21,539	18,998	357	2,345	2,333
Equity and commodity contracts	109	3,690	4,286	82	2,681	2,864
		251,843	248,164		117,087	118,257
Included in the above are derivatives held for hedging purposes as follows:						
Fair value hedging:						
Interest rate swaps		372	241		451	219
Cash flow hedging						
Exchange rate contracts		4	24		41	—
Interest rate swaps		271	236		227	414

Amounts above include:

Due from/to holding company	179	173	42	—
Due from/to fellow subsidiaries	2,771	2,740	—	2
Due from/to subsidiaries	4,059	2,443	1,968	1,596

55

13 Debt securities

	Group								Total
	US government UK	US state and federal agency	US government Other	US government sponsored entity	Bank and building society	Mortgage- backed securities (1)	Corporate	Other	
	government £m	agency £m	government £m	entity £m	society £m	£m	£m	£m	£m
2007									
Held-for-trading	7,746	11,544	21,457	18,422	1,016	34,888	25,026	370	120,469
Designated as at fair value through profit or loss	1,881	397	6	–	123	203	140	104	2,854
Available-for-sale	605	5,249	1,390	5,831	5,816	3,091	1,368	741	24,091
Loans and receivables	–	–	–	–	–	500	–	–	500
At 31 December 2007	10,232	17,190	22,853	24,253	6,955	38,682	26,534	1,215	147,914
Available-for-sale									
Gross unrealised gains	23	13	7	3	4	11	8	1	70
Gross unrealised losses	–	(35)	(2)	(66)	(29)	(59)	(5)	–	(196)
2006									
Held-for-trading	8,122	10,965	13,839	10,065	34	28,658	23,194	316	95,193
Designated as at fair value through profit or loss	1,285	–	85	–	470	98	1,203	292	3,433
Available-for-sale	307	6,227	1,210	6,651	4,019	2,760	493	324	21,991
Loans and receivables	–	–	–	–	–	–	21	540	561
At 31 December 2006	9,714	17,192	15,134	16,716	4,523	31,516	24,911	1,472	121,178
Available-for-sale									
Gross unrealised gains	–	6	4	1	1	5	9	–	26
Gross unrealised losses	(1)	(88)	(20)	(142)	(8)	(46)	(2)	(13)	(320)

Note:

(1) Excludes securities issued by US federal agencies and government sponsored entities.

Gross gains of £56 million (2006 – £33 million) and gross losses of £5 million (2006 – £16 million) were realised by the Group on the sale of available-for-sale securities.

	Bank								Total
	US government UK	US state and federal agency	US government Other	US government sponsored entity	Bank and building society	Mortgage- backed securities	Corporate	Other	
	government	agency	government	entity	society				

	securities (1)								
	£m	£m	£m	£m	£m	£m	£m	£m	£m
2007									
Held-for-trading	7,746	3,210	15,856	230	1,016	30,667	24,320	366	83,411
Designated as at fair value									
through profit or loss	–	241	–	–	–	202	553	–	996
Available-for-sale	605	2	450	–	4,918	505	2,016	147	8,643
At 31 December 2007	8,351	3,453	16,306	230	5,934	31,374	26,889	513	93,050
Available-for-sale									
Gross unrealised gains	23	–	7	–	4	7	22	–	63
Gross unrealised losses	–	–	–	–	(3)	(1)	(3)	–	(7)
2006									
Held-for-trading	8,122	725	13,752	1	34	22,136	22,969	311	68,050
Designated as at fair value									
through profit or loss	–	–	–	–	–	98	840	–	938
Available-for-sale	307	566	286	–	3,207	601	323	–	5,290
At 31 December 2006	8,429	1,291	14,038	1	3,241	22,835	24,132	311	74,278
Available-for-sale									
Gross unrealised gains	–	2	–	–	1	5	9	–	17
Gross unrealised losses	(1)	–	–	–	(2)	(4)	–	–	(7)

Note:

(1) Excludes securities issued by US federal agencies and government sponsored entities.

Notes on the accounts continued

14 Equity shares

	Group					
	Listed	2007 Unlisted	Total	Listed	2006 Unlisted	Total
	£m	£m	£m	£m	£m	£m
Held-for-trading	3,617	169	3,786	3,033	5	3,038
Designated as at fair value through profit or loss	32	124	156	35	555	590
Available-for-sale	76	1,491	1,567	87	1,728	1,815
	3,725	1,784	5,509	3,155	2,288	5,443
Available-for-sale						
Gross unrealised gains	27	108	135	35	178	213
Gross unrealised losses	(3)	(7)	(10)	–	(6)	(6)
	24	101	125	35	172	207

Gross gains of £415 million (2006 – £239 million) and gross losses of £0.2 million (2006 – £3 million) were realised by the Group on the sale of available-for-sale equity shares.

Dividend income from available-for-sale equity shares was £70 million (2006 – £67 million; 2005 – £90 million).

The Group's private equity investments are generally unquoted. They are held for capital appreciation over the medium term. In December 2007, the Group disposed of a significant proportion of its private equity portfolio to private equity funds managed by the Group.

Unquoted equity investments whose fair value cannot be reliably measured are carried at cost and classified as available-for-sale financial assets. They include the Group's investments in the Federal Home Loans Bank and Federal Reserve Bank that are redeemable at cost of £0.5 billion (2006 – £0.8 billion) and in a fellow subsidiary £129 million (2006 – £129 million), together with a number of individually small shareholdings. Disposals in the year generated gains of £0.5 million (2006 – £56 million; 2005 – £85 million) based on cost of sales of £4 million (2006 – £14 million; 2005 – £17 million).

	Bank					
	Listed	2007 Unlisted	Total	Listed	2006 Unlisted	Total
	£m	£m	£m	£m	£m	£m
Held-for-trading	3,605	29	3,634	2,991	5	2,996
Designated as at fair value through profit or loss	–	10	10	–	–	–
Available-for-sale	5	370	375	51	321	372
	3,610	409	4,019	3,042	326	3,368
Available-for-sale						
Gross unrealised gains	4	53	57	20	64	84

Disposals in the year of unquoted equity instruments classified as available-for-sale financial assets generated losses of £0.1 million (2006 – £21 million gains; 2005 – £58 million gains) based on cost of sales of nil (2006 – nil; 2005 – £3

million).

15 Investments in Group undertakings

Investments in Group undertakings are carried at cost less impairment. Movements during the year were as follows:

	2007	Bank 2006
	£m	£m
At 1 January	21,918	21,965
Currency translation and other adjustments	23	(391)
Additions	137	235
Additional investments in Group undertakings	424	449
Repayment of investments	(281)	(340)
Increase in provisions	(11)	—
At 31 December	22,210	21,918

The principal subsidiary undertakings of the Bank are shown below. Their capital consists of ordinary and preference shares, which are unlisted with the exception of certain preference shares issued by NatWest. All of the subsidiary undertakings are owned directly or indirectly through intermediate holding companies and are all wholly-owned. All of these subsidiaries are included in the Group's consolidated financial statements and have an accounting reference date of 31 December.

	Nature of business	Country of incorporation and principal area of operation
National Westminster Bank Plc (1)	Banking	Great Britain
Citizens Financial Group, Inc.	Banking	US
Coutts & Co (2)	Private Banking	Great Britain
Greenwich Capital Markets Inc (3)	Broker dealer	US
Ulster Bank Limited (3, 4)	Banking	Northern Ireland

Notes:

- (1) The Bank does not hold any of the NatWest preference shares in issue.
 (2) Coutts & Co is incorporated with unlimited liability. Its registered office is 440 Strand, London WC2R 0QS.
 (3) Shares are not directly held by the Bank.
 (4) Ulster Bank Limited and its subsidiaries also operate in the Republic of Ireland.

The above information is provided in relation to the principal related undertakings as permitted by section 231(5) of the Companies Act 1985. Full information on all related undertakings will be included in the Annual Return delivered to the Registrar of Companies for Scotland.

Notes on the accounts continued

16 Intangible assets

	Goodwill	Core deposit intangibles	Group Other purchased intangibles	Internally generated software	Total
	£m	£m	£m	£m	£m
2007					
Cost:					
At 1 January 2007	16,834	265	275	2,518	19,892
Currency translation and other adjustments	(77)	(2)	–	4	(75)
Acquisitions of subsidiaries	66	12	–	–	78
Additions	–	–	6	445	451
Impairment of goodwill	(40)	–	–	–	(40)
Disposals and write-off of fully amortised assets	–	–	(3)	(84)	(87)
At 31 December 2007	16,783	275	278	2,883	20,219
Accumulated amortisation:					
At 1 January 2007	–	127	97	1,897	2,121
Currency translation and other adjustments	–	–	–	1	1
Disposals and write-off of fully amortised assets	–	–	(1)	(80)	(81)
Charge for the year	–	49	35	333	417
At 31 December 2007	–	176	131	2,151	2,458
Net book value at 31 December 2007	16,783	99	147	732	17,761
2006					
Cost:					
At 1 January 2006	17,766	299	325	2,209	20,599
Currency translation and other adjustments	(922)	(34)	(48)	(1)	(1,005)
Additions	–	–	19	337	356
Disposal of subsidiaries	(10)	–	(1)	–	(11)
Disposals and write-off of fully amortised assets	–	–	(20)	(27)	(47)
At 31 December 2006	16,834	265	275	2,518	19,892
Accumulated amortisation:					
At 1 January 2006	–	85	65	1,639	1,789
Currency translation and other adjustments	–	(12)	(8)	–	(20)
Disposals and write-off of fully amortised assets	–	–	–	(8)	(8)
Charge for the year	–	54	40	266	360
At 31 December 2006	–	127	97	1,897	2,121
Net book value at 31 December 2006	16,834	138	178	621	17,771

	Goodwill £m	Bank Internally generated software £m	Total £m
2007			
Cost:			
At 1 January 2007	10	617	627
Currency translations and other adjustments	1	–	1
Additions	–	307	307
Disposals and write-off of fully amortised assets	–	(80)	(80)
At 31 December 2007	11	844	855
Accumulated amortisation:			
At 1 January 2007	–	455	455
Disposals and write-off of fully amortised assets	–	(79)	(79)
Charge for the year	–	184	184
At 31 December 2007	–	560	560
Net book value at 31 December 2007	11	284	295
2006			
Cost:			
At 1 January 2006	10	520	530
Additions	–	105	105
Disposals and write-off of fully amortised assets	–	(8)	(8)
At 31 December 2006	10	617	627
Accumulated amortisation:			
At 1 January 2006	–	352	352
Disposals and write-off of fully amortised assets	–	(8)	(8)
Charge for the year	–	111	111
At 31 December 2006	–	455	455
Net book value at 31 December 2006	10	162	172

Notes on the accounts continued

16 Intangible assets (continued)

Impairment review

The Group's goodwill acquired in business combinations is reviewed annually at 30 September for impairment by comparing the recoverable amount of each cash generating unit (CGU) to which goodwill has been allocated with its carrying value.

CGUs where goodwill is significant were as follows:

		Goodwill at 30 September	
		2007	2006
		£m	£m
Global Banking & Markets	Basis		
	Fair value less costs to sell	2,346	2,341
UK Corporate Banking	Fair value less costs to sell	1,630	1,630
Retail	Fair value less costs to sell	4,278	4,365
Wealth Management	Fair value less costs to sell	1,100	1,105
Citizens – Retail Banking	Value in use	2,067	–
Citizens – Commercial Banking	Value in use	2,274	–
Citizens – Consumer Financial Services	Value in use	1,701	–
Citizens – Midstates	Value in use	–	5,598

The recoverable amounts for all CGUs, except for Citizens were based on fair value less costs to sell. Fair value was based upon a price-earnings methodology using current earnings for each unit. Approximate price earnings multiples, validated against independent analyst information were applied to each CGU. The multiples used for both 2007 and 2006 were in the range 9.5 – 13.0 times earnings after charging manufacturing costs.

The goodwill allocated to Global Banking & Markets, UK Corporate Banking, Retail and Wealth Management principally arose from the acquisition of NatWest in 2000. The recoverable amount of these cash generating units exceeds their carrying value by over £15 billion. The multiples or earnings would have to be less than one third of those used to cause the value in use of the units to equal their carrying value.

Further developments in the Group's US businesses have led to divisionalisation on a product basis instead of the geographical basis used in 2006. The recoverable amount was based on a value in use methodology using management forecasts to 2012 (2006 – 2014). A terminal growth rate of 5% (2006 – 5%) and a discount rate of 11% (2006 – 10%) was used. The recoverable amount of Citizens exceeds its carrying value by over \$5 billion. The profit growth rate would have to be approximately half the projected rate to cause the value in use of the unit to equal its carrying amount.

17 Property, plant and equipment

	Investment properties £m	Freehold premises £m	Long leasehold premises £m	Group Short leasehold premises £m	Computers and other equipment £m	Operating lease assets £m	Total £m
2007							
Cost or valuation:							
At 1 January 2007	4,884	2,420	276	1,254	2,959	7,151	18,944
Currency translation and other adjustments	96	5	1	3	5	(63)	47
Reclassifications	3	(4)	(2)	1	2	—	—
Additions	449	276	35	231	569	2,328	3,888
Expenditure on investment properties	41	—	—	—	—	—	41
Change in fair value of investment properties	288	—	—	—	—	—	288
Held-for-sale in disposal group	—	(4)	(13)	—	—	(422)	(439)
Disposals and write-off of fully depreciated assets	(2,330)	(482)	(89)	(44)	(149)	(2,609)	(5,703)
Acquisition of subsidiaries	—	14	6	—	1	—	21
At 31 December 2007	3,431	2,225	214	1,445	3,387	6,385	17,087
Accumulated depreciation and amortisation:							
At 1 January 2007	—	435	95	374	1,630	1,360	3,894
Currency translation and other adjustments	—	1	—	1	5	(4)	3
Held-for-sale in disposal groups	—	—	—	—	—	(52)	(52)
Disposals and write-off of fully depreciated assets	—	(124)	(30)	(25)	(109)	(518)	(806)
Acquisition of subsidiaries	—	—	2	—	—	—	2
Charge for the year	—	64	7	88	362	500	1,021
At 31 December 2007	—	376	74	438	1,888	1,286	4,062
Net book value at 31 December 2007	3,431	1,849	140	1,007	1,499	5,099	13,025
2006							
Cost or valuation:							
At 1 January 2006	4,346	2,495	337	1,046	3,220	7,311	18,755
Currency translation and other adjustments	14	(38)	(1)	(29)	(98)	(579)	(731)
Reclassifications	—	26	(41)	12	—	3	—
Additions	632	287	26	266	525	2,219	3,955
Expenditure on investment properties	16	—	—	—	—	—	16
Change in fair value of investment properties	486	—	—	—	—	—	486

Disposals and write-off of fully depreciated assets	(610)	(350)	(45)	(41)	(685)	(1,803)	(3,534)
Disposals of subsidiaries	—	—	—	—	(3)	—	(3)
At 31 December 2006	4,884	2,420	276	1,254	2,959	7,151	18,944
Accumulated depreciation and amortisation:							
At 1 January 2006	—	383	122	320	1,867	1,321	4,013
Currency translation and other adjustments	—	(2)	—	(11)	(41)	(94)	(148)
Reclassifications	—	4	(6)	3	(1)	—	—
Disposals and write-off of fully depreciated assets	—	(6)	(28)	(16)	(536)	(438)	(1,024)
Disposals of subsidiaries	—	—	—	—	(2)	—	(2)
Charge for the year	—	56	7	78	343	571	1,055
At 31 December 2006	—	435	95	374	1,630	1,360	3,894
Net book value at 31 December 2006	4,884	1,985	181	880	1,329	5,791	15,050

	2007 £m	2006 £m
Contracts for future capital expenditure not provided for in the accounts at the year end (excluding investment properties)	108	117
Contractual obligations to purchase, construct or develop investment properties or to repair, maintain or enhance investment property	9	6
Property, plant and equipment pledged as security	—	42

Notes on the accounts continued

17 Property, plant and equipment (continued)

Investment properties are valued to reflect fair value, that is, the market value of the Group's interest at the reporting date excluding any special terms or circumstances relating to the use or financing of the property and transaction costs that would be incurred in making a sale. Observed market data such as rental yield, replacement cost and useful life, reflect relatively few transactions involving property that, necessarily, is not identical to property owned by the Group.

Valuations are carried out by qualified surveyors who are members of the Royal Institution of Chartered Surveyors, or an equivalent overseas body. The 31 December 2007 valuation for a significant majority of the Group's investment properties was undertaken by external valuers.

The fair value of investment properties includes £234 million (2006 – £450 million) of appreciation since purchase.

Rental income from investment properties was £291 million (2006 – £270 million). Direct operating expenses of investment properties were £49 million (2006 – £54 million).

Property, plant and equipment, excluding investment properties include £382 million (2006 – £436 million) assets in the course of construction.

Freehold and long leasehold properties with a net book value of £374 million (2006 – £161 million; 2005 – £58 million) were sold subject to operating leases.

	Freehold premises	Long leasehold premises	Bank Short leasehold premises	Computers and other equipment	Operating lease assets	Total
	£m	£m	£m	£m	£m	£m
2007						
Cost or valuation:						
At 1 January 2007	1,017	55	509	1,786	124	3,491
Currency translation and other adjustments	–	–	–	2	–	2
Additions	15	8	140	369	7	539
Disposals and write-off of fully depreciated assets	(172)	(11)	(21)	(74)	(5)	(283)
At 31 December 2007	860	52	628	2,083	126	3,749
Accumulated depreciation and amortisation:						
At 1 January 2007	164	23	144	1,044	94	1,469
Disposals and write-off of fully depreciated assets	(72)	(3)	(10)	(46)	(6)	(137)
Charge for the year	30	2	33	223	13	301
At 31 December 2007	122	22	167	1,221	101	1,633
Net book value at 31 December 2007	738	30	461	862	25	2,116

2006

Cost or valuation:						
At 1 January 2006	922	57	414	2,114	124	3,631
Currency translation and other adjustments	(1)	–	(4)	(2)	–	(7)
Additions	108	1	93	268	(1)	469
Disposals and write-off of fully depreciated assets	(12)	(3)	(1)	(597)	1	(612)
Transfer from subsidiary	–	–	7	3	–	10
At 31 December 2006	1,017	55	509	1,786	124	3,491
Accumulated depreciation and amortisation:						
At 1 January 2006	135	21	113	1,347	75	1,691
Currency translation and other adjustments	–	–	(2)	(1)	–	(3)
Disposals and write-off of fully depreciated assets	1	–	–	(510)	3	(506)
Transfer from subsidiary	–	–	5	3	–	8
Charge for the year	28	2	28	205	16	279
At 31 December 2006	164	23	144	1,044	94	1,469
Net book value at 31 December 2006	853	32	365	742	30	2,022

	2007 £m	2006 £m
Contracts for future capital expenditure not provided for in the accounts at the year end (excluding investment properties)	22	–

18 Prepayments, accrued income and other assets

	2007	Group	2007	Bank
	£m	2006	£m	2006
		£m	£m	£m
Prepayments	730	662	270	243
Accrued income	962	659	685	470
Deferred expenses	47	37	30	27
Deferred tax asset	240	156	319	549
Pension schemes in net surplus	566	—	—	—
Other assets	3,811	4,462	695	1,585
	6,356	5,976	1,999	2,874
Amounts above include:				
Due from fellow subsidiaries	—	—	—	4

19 Settlement balances and short positions

	2007	Group	2007	Bank
	£m	2006	£m	2006
		£m	£m	£m
Settlement balances (amortised cost)	6,791	5,667	3,110	2,866
Short positions (held-for-trading):				
Debt securities – Government	40,376	36,901	26,285	17,747
– Other issuers	5,561	5,843	3,433	3,820
Treasury and other eligible bills	672	654	400	416
Equity shares	449	411	449	358
	53,849	49,476	33,677	25,207

20 Accruals, deferred income and other liabilities

	2007	Group	2007	Bank
	£m	2006	£m	2006
		£m	£m	£m
Notes in circulation	1,545	1,453	1,080	1,048
Current taxation	1,017	738	159	315
Accruals	4,155	4,241	2,807	2,544
Deferred income	601	482	143	276
Other liabilities	4,849	4,649	1,594	1,168
	12,167	11,563	5,783	5,351
Amounts above include:				
Due to subsidiaries	—	—	—	24

Note:

(1) Other liabilities include £9 million (2006 – £10 million) in respect of share-based compensation.

Included in other liabilities are provisions
for liabilities and charges as follows:

	Group £m	Bank £m
At 1 January 2007	199	65
Currency translation and other movements	1	1
Charge to income statement	182	86
Releases to income statement	(39)	(11)
Provisions utilised	(200)	(65)
At 31 December 2007	143	76

Note:

(1) Comprises property provisions and other provisions arising in the normal course of business.

Notes on the accounts continued

21 Deferred taxation

Provision for deferred taxation has been made as follows:

	2007 £m	Group 2006 £m	2007 £m	Bank 2006 £m
Deferred tax liability	2,063	1,918	–	–
Deferred tax asset (included in Prepayments, accrued income and other assets, Note 18)	(240)	(156)	(319)	(549)
Net deferred tax	1,823	1,762	(319)	(549)

	Group									
	Accelerated capital Pension allowance	Provisions	Deferred gains	Deferred transition	Fair value of IAS instrument	Fair value of Intangibles	Hedging	Other	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2006	(1,177)	3,085	(613)	122	(328)	(118)	139	(44)	(129)	937
Charge to income statement	56	230	315	131	(362)	(36)	91	(4)	4	425
Charge to equity directly	517	–	–	12	7	2	–	(41)	(14)	483
Acquisitions/(disposals) of subsidiaries	–	3	–	(1)	3	–	–	–	9	14
Other	(20)	(94)	20	2	16	9	(20)	(5)	(5)	(97)
At 1 January 2007	(624)	3,224	(278)	266	(664)	(143)	210	(94)	(135)	1,762
Charge to income statement	33	(130)	(29)	(141)	45	65	16	(57)	(49)	(247)
Charge to equity directly	661	–	–	(17)	–	30	–	(108)	57	623
Acquisitions/(disposals) of subsidiaries	–	(284)	–	(3)	–	–	–	–	–	(287)
Other	(4)	(12)	2	–	4	1	(4)	–	(15)	(28)
At 31 December 2007	66	2,798	(305)	105	(615)	(47)	222	(259)	(142)	1,823

	Bank									
	Accelerated capital Pension allowance	Provisions	Deferred gains	Deferred transition	Fair value of IAS instrument	Fair value of Intangibles	Hedging	Other	Total	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January 2006	(117)	68	(181)	28	(177)	(40)	26	(103)	(61)	(557)
Charge to income statement	52	(20)	64	9	(84)	40	(26)	(7)	(3)	25

Charge to equity directly	1	–	–	–	9	(1)	–	(26)	(14)	(31)
Acquisitions/(disposals)										
of subsidiaries	–	–	–	19	–	–	–	–	–	19
Other	(3)	–	–	–	(5)	–	–	–	3	(5)
At 1 January 2007	(67)	48	(117)	56	(257)	(1)	–	(136)	(75)	(549)
Charge to income										
statement	57	20	36	(26)	42	–	–	–	8	137
Charge to equity directly	–	–	–	–	–	–	–	36	57	93
At 31 December 2007	(10)	68	(81)	30	(215)	(1)	–	(100)	(10)	(319)

Notes:

- (1) Deferred tax assets of £34 million (2006 – £47 million) have not been recognised in respect of tax losses carried forward of £110 million (2006 – £142 million) as it is not considered probable that taxable profits will arise against which they could be utilised. Of these losses, £45 million will expire within one year. The balance of tax losses carried forward has no time limit.
- (2) Deferred tax liabilities of £972 million (2006 – £649 million) have not been recognised in respect of retained earnings of overseas subsidiaries and held-over gains on the incorporation of overseas branches. Retained earnings of overseas subsidiaries are expected to be reinvested indefinitely or remitted to the UK free from further taxation. No taxation is expected to arise in the foreseeable future in respect of held-over gains.

22 Subordinated liabilities

	2007 £m	Group 2006 £m	2007 £m	Bank 2006 £m
Dated loan capital	14,605	13,776	11,892	11,123
Undated loan capital	10,240	10,473	8,206	8,189
Preference shares	2,951	3,537	2,647	3,091
	27,796	27,786	22,745	22,403

Certain preference shares are classified as liabilities; these securities remain subject to the capital maintenance rules of the Companies Act 1985.

The following tables analyse the remaining maturity of subordinated liabilities by (1) the final redemption date; and (2) the next callable date.

	2008 £m	2009 £m	Group 2010-2012 £m	2013-2017 £m	Thereafter £m	Perpetual £m	Total £m
2007 - final redemption							
Sterling	186	—	—	771	389	5,942	7,288
US\$	183	747	620	4,003	233	3,987	9,773
Euro	417	220	815	3,731	937	2,567	8,687
Other	25	—	—	1,560	—	463	2,048
Loan Capital	811	967	1,435	10,065	1,559	12,959	27,796

	Currently £m	2008 £m	2009 £m	Group 2010-2012 £m	Group 2013-2017 £m	Thereafter £m	Perpetual £m	Total £m
2007 - call date								
Sterling	—	186	—	1,463	1,822	3,652	165	7,288
US\$	1,348	543	1,795	3,235	1,681	1,171	—	9,773
Euro	—	1,265	591	2,495	4,075	222	39	8,687
Other	—	25	431	837	652	103	—	2,048
Loan Capital	1,348	2,019	2,817	8,030	8,230	5,148	204	27,796

	2007 £m	2008 £m	Group 2009-2011 £m	Group 2012-2016 £m	Thereafter £m	Perpetual £m	Total £m
2006 - final redemption							
Sterling	352	—	—	772	391	6,085	7,600
US\$	112	87	1,123	3,941	230	4,896	10,389
Euro	187	173	955	2,656	1,578	2,381	7,930
Other	24	—	—	984	445	414	1,867
Loan Capital	675	260	2,078	8,353	2,644	13,776	27,786

	Currently £m	2007 £m	2008 £m	Group 2009-2011 £m	Group 2012-2016 £m	Thereafter £m	Perpetual £m	Total £m
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2006 - call date	£m	£m	£m	£m	£m	£m	£m	£m
Sterling	–	502	–	1,103	2,161	3,668	166	7,600
US\$	1,843	1,200	469	3,838	1,862	1,177	–	10,389
Euro	–	274	948	1,634	4,473	565	36	7,930
Other	–	24	–	701	1,043	99	–	1,867
Loan Capital	1,843	2,000	1,417	7,276	9,539	5,509	202	27,786

Notes on the accounts continued

22 Subordinated
liabilities (continued)

	2008	2009	2010-2012	Bank 2013-2017	Thereafter	Perpetual	Total
	£m	£m	£m	£m	£m	£m	£m
2007 – final redemption							
Sterling	132	–	–	429	–	4,973	5,534
US\$	75	199	159	4,004	233	3,077	7,747
Euro	376	220	–	3,731	937	2,157	7,421
Other	20	–	–	1,560	–	463	2,043
Total	603	419	159	9,724	1,170	10,670	22,745

	Currently	2008	2009	Bank 2010-2012	2013-2017	Thereafter	Total
	£m	£m	£m	£m	£m	£m	£m
2007 – call date							
Sterling	–	132	–	1,129	1,415	2,858	5,534
US\$	425	449	1,247	2,774	1,681	1,171	7,747
Euro	–	1,224	220	1,680	4,075	222	7,421
Other	–	20	431	837	652	103	2,043
Total	425	1,825	1,898	6,420	7,823	4,354	22,745

	2007	2008	2009-2011	Bank 2012-2016	Thereafter	Perpetual	Total
	£m	£m	£m	£m	£m	£m	£m
2006 – final redemption							
Sterling	293	–	–	429	–	5,112	5,834
US\$	79	–	362	3,701	230	3,575	7,947
Euro	150	173	204	2,656	1,578	2,002	6,763
Other	16	–	–	984	445	414	1,859
Total	538	173	566	7,770	2,253	11,103	22,403

	Currently	2007	2008	Bank 2009-2011	2012-2016	Thereafter	Total
	£m	£m	£m	£m	£m	£m	£m
2006 – call date							
Sterling	–	443	–	768	1,753	2,870	5,834
US\$	762	651	382	3,331	1,644	1,177	7,947
Euro	–	237	948	540	4,473	565	6,763
Other	–	16	–	701	1,043	99	1,859
Total	762	1,347	1,330	5,340	8,913	4,711	22,403

	2007 £m	2006 £m
Dated loan capital		
The Bank		
£150 million 8.375% subordinated notes 2007 (redeemed January 2007)	—	162
€255 million 5.25% subordinated notes 2008	192	177
€300 million 4.875% subordinated notes 2009	228	212
CAD700 million 4.25% subordinated notes 2010 (callable March 2010)	358	307
US\$350 million floating rate subordinated notes 2012 (redeemed July 2007)	—	184
US\$500 million floating rate subordinated notes 2012 (redeemed July 2007)	—	254
€130 million floating rate subordinated notes 2012 (redeemed July 2007)	—	88
CHF200 million 2.75% subordinated notes 2012 (callable December 2012)	89	84
€1,000 million floating rate subordinated notes 2013 (callable October 2008)	744	677
US\$50 million floating rate subordinated notes 2013	26	25
€1,000 million 6.0% subordinated notes 2013	790	745
€500 million 6.0% subordinated notes 2013	374	342
£150 million 10.5% subordinated bonds 2013 (2)	169	168
US\$1,250 million floating rate subordinated notes 2014 (callable July 2009)	630	643
AUD590 million 6.0% subordinated notes 2014 (callable October 2009)	254	235
AUD410 million floating rate subordinated notes 2014 (callable October 2009)	182	167
£250 million 9.625% subordinated bonds 2015	286	287
US\$750 million floating rate subordinated notes 2015 (callable September 2010)	374	381
€750 million floating rate subordinated notes 2015	564	531
CHF400 million 2.375% subordinated notes 2015	166	160
CHF100 million 2.375% subordinated notes 2015	41	43
CHF200 million 2.375% subordinated notes 2015	86	81
US\$500 million floating rate subordinated notes 2016 (callable October 2011)	252	257
US\$1,500 million floating rate subordinated notes 2016 (callable April 2011)	757	773
€500 million 4.5% subordinated notes 2016 (callable January 2011)	379	350
€100 million floating rate subordinated notes 2017	73	67
€500 million floating rate subordinated notes 2017 (callable June 2012)	371	337
€750 million 4.35% subordinated notes 2017 (callable October 2017)	548	502
AUD450 million 6.5% subordinated notes 2017 (callable February 2012)	202	184
AUD450 million floating rate subordinated notes 2017 (callable February 2012)	199	182
US\$125.6 million floating rate subordinated notes 2020	64	65
€1,000 million 4.625% subordinated notes 2021 (callable September 2016)	724	687
US\$1,500 million floating rate subordinated callable step-up notes 2017 (issued May 2007; callable August 2012)	752	—
€300 million CMS linked floating rate subordinated notes 2022 (issued June 2007)	228	—
Due to the holding company		
US\$400 million 6.4% subordinated notes 2009 (1)	202	206
US\$300 million 6.375% subordinated notes 2011(1)	163	163
US\$750 million 5% subordinated notes 2013 (1)	384	377
US\$750 million 5% subordinated notes 2014 (1)	386	373
US\$250 million 5% subordinated notes 2014 (1)	123	125
US\$675 million 5.05% subordinated notes 2015 (1)	358	352
US\$350 million 4.7% subordinated notes 2018 (1)	174	170

	11,892	11,123
National Westminster Bank Plc		
US\$1,000 million 7.375% subordinated notes 2009	507	516
€600 million 6.0% subordinated notes 2010	474	440
€500 million 5.125% subordinated notes 2011	376	343
£300 million 7.875% subordinated notes 2015	349	350
£300 million 6.5% subordinated notes 2021	330	332
Charter One Financial, Inc.		
US\$400 million 6.375% subordinated notes 2012	212	218
Greenwich Capital Holdings, Inc.		
US\$100 million 5.575% senior subordinated revolving credit 2009 (issued June 2007)	50	—
US\$170 million subordinated loan capital floating rate notes 2008	85	87
US\$500 million subordinated loan capital floating rate notes 2010 (callable on any interest payment date)	249	256
First Active plc		
US\$35 million 7.24% subordinated bonds 2012 (redeemed December 2007)	—	22
£60 million 6.375% subordinated bonds 2018 (callable April 2013)	65	65
Other minority interest subordinated issues	16	24
	14,605	13,776

Notes:

- (1) On-lent to The Royal Bank of Scotland Group plc on a subordinated basis.
- (2) Unconditionally guaranteed by The Royal Bank of Scotland Group plc.
- (3) In the event of certain changes in tax laws, dated loan capital issues may be redeemed in whole, but not in part, at the option of the issuer, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
- (4) Except as stated above, claims in respect of the Group's dated loan capital are subordinated to the claims of other creditors. None of the Group's dated loan capital is secured.
- (5) Interest on all floating rate subordinated notes is calculated by reference to market rates.

Notes on the accounts continued

22 Subordinated liabilities (continued)

	2007	2006
	£m	£m
Undated loan capital		
The Bank		
£150 million 5.625% undated subordinated notes (callable June 2032)	144	144
£175 million 7.375% undated subordinated notes (callable August 2010)	183	183
€152 million 5.875% undated subordinated notes (callable October 2008)	114	105
£350 million 6.25% undated subordinated notes (callable December 2012)	354	350
£500 million 6.0% subordinated notes (callable September 2014)	517	512
€500 million 5.125% subordinated notes (callable July 2014)	371	350
€1,000 million floating rate subordinated notes (callable July 2014)	742	675
£500 million 5.125% undated subordinated notes (callable March 2016)	499	493
£200 million 5.625% undated subordinated notes (callable September 2026)	210	210
£600 million 5.5% subordinated notes (callable December 2019)	595	594
£500 million 6.2% undated subordinated notes (callable March 2022)	543	546
£200 million 9.5% undated subordinated bonds (callable August 2018) (3)	228	229
£400 million 5.625% undated subordinated notes (callable September 2026)	397	397
£300 million 5.625% undated subordinated notes (callable September 2026)	318	326
£350 million 5.625% undated subordinated notes (callable June 2032)	363	362
£150 million undated subordinated floating rate step-up notes (redeemed March 2007)	—	150
£400 million 5% undated subordinated notes (callable March 2011)	402	395
JPY25 billion 2.605% subordinated notes (callable November 2034)	103	99
CAD700 million 5.37% undated subordinated notes (callable May 2016)	363	317
Due to the holding company		
US\$350 million undated floating rate primary capital notes (callable on any interest payment date) (1)	175	178
US\$75 million floating rate perpetual capital securities (redeemed October 2007)	—	38
€1,250 million 6.467% perpetual regulatory tier one securities (callable June 2012) (1)	979	918
US\$1,200 million 7.648% perpetual regulatory tier one securities (callable September 2031) (1, 2)	606	618
	8,206	8,189
National Westminster Bank Plc		
US\$500 million primary capital floating rate notes, Series A (callable on any interest payment date)	251	256
US\$500 million primary capital floating rate notes, Series B (callable on any interest payment date)	256	267
US\$500 million primary capital floating rate notes, Series C (callable on any interest payment date)	255	254
US\$500 million 7.75% reset subordinated notes (redeemed October 2007)	—	262
€400 million 6.625% fixed/floating rate undated subordinated notes (callable October 2009)	303	280
€100 million floating rate undated subordinated step-up notes (callable October 2009)	74	68
£325 million 7.625% undated subordinated step-up notes (callable January 2010)	357	359
£200 million 7.125% undated subordinated step-up notes (callable October 2022)	205	205
£200 million 11.5% undated subordinated notes (callable December 2022) (4)	269	272
First Active plc		

	£20 million 11.75% perpetual tier two capital	23	23
€38 million 11.375% perpetual tier two capital		39	36
	£1.3 million floating rate perpetual tier two capital	2	2
		10,240	10,473

Notes:

- (1) On lent to The Royal Bank of Scotland Group plc on a subordinated basis.
- (2) The company can satisfy interest payment obligations by issuing ordinary shares to appointed Trustees sufficient to enable them, on selling those shares, to settle the interest payment.
- (3) Guaranteed by the company.
- (4) Exchangeable at the option of the issuer into 200 million 8.392% (gross) non-cumulative preference shares of £1 each of National Westminster Bank Plc at any time.
- (5) Except as stated above, claims in respect of the Group's undated loan capital are subordinated to the claims of other creditors. None of the Group's undated loan capital is secured.
- (6) In the event of certain changes in tax laws, undated loan capital issues may be redeemed in whole, but not in part, at the option of the Group, at the principal amount thereof plus accrued interest, subject to prior regulatory approval.
- (7) Interest on all floating rate subordinated notes is calculated by reference to market rates.

	2007 £m	2006 £m
Preference shares		
The Bank		
Non-cumulative preference shares of US\$0.01 (1)		
Series E US\$200 million 8.1% (redeemed January 2007)	—	102
Series F US\$200 million 7.65% (redeemable at option of issuer)	100	102
Series G US\$250 million 7.4% (redeemed January 2007)	—	126
Series H US\$300 million 7.25% (redeemable at option of issuer)	150	153
Series K US\$400 million 7.875% (redeemed January 2007)	—	203
Series L US\$750 million 6.8% (redeemable March 2008)	374	382
Series M US\$850 million 4.709% (redeemable July 2013)	421	409
Series N US\$650 million 6.425% (redeemable January 2034)	344	341
Series R US\$850 million 5.75% (redeemable September 2009)	424	433
Series 1 US\$1,000 million 9.118% (redeemable March 2010)	508	515
Non-cumulative preference shares of £1		
Series 1 £200 million 7.387% (redeemable December 2010) (1)	201	200
£125 million 7.25%	125	125
	2,647	3,091
National Westminster Bank Plc		
Non-cumulative preference shares of £1		
Series A £140 million 9% (non-redeemable)	143	142
Non-cumulative preference shares of US\$25		
Series B US\$250 million 7.8752% (redeemed January 2007)	—	141
Series C US\$300 million 7.7628% (2)	161	163
	2,951	3,537

Notes:

- (1) Issued by the Bank to the holding company on terms which, in general, mirror the original issues by the holding company.
- (2) Series C preference shares each carry a gross dividend of 8.625% inclusive of associated tax credit. Redeemable at the option of the issuer at US\$25 per share.

Notes on the accounts continued

23 Minority interests

	Group	
	2007	2006
	£m	£m
At 1 January	396	104
Currency translation adjustments and other movements	(11)	(70)
Profit attributable to minority interests	53	45
Dividends paid	(31)	(29)
Equity raised	–	427
Equity withdrawn	(255)	(81)
At 31 December	152	396

24 Share capital

	Allotted, called up and fully paid			Authorised
	2007	2006	2007	2006
	£m	£m	m	m
Ordinary shares of £1	5,481	5,481	£7,980	£7,980
Non-cumulative preference shares of US\$0.01	2	1	\$3	\$3
Non-cumulative preference shares of €0.01	–	–	–	–
Perpetual zero coupon preference shares of £1	–	–	£100	£100
Non-cumulative preference shares of £1	126	126	£2,200	£2,200

	Allotted, called up and fully paid			Authorised
	2007	2006	2007	2006
Number of shares – millions				
Ordinary shares of £1	5,481	5,481	7,980	7,980
Non-cumulative preference shares of US\$0.01	313	245	349	349
Non-cumulative preference shares of €0.01	3	3	66	66
Perpetual zero coupon preference shares of £1	–	–	100	100
Non-cumulative preference shares of £1	126	126	2,200	2,200

Ordinary shares

No ordinary shares were issued during the year ended 31 December 2007.

Preference shares

The non-cumulative preference shares have been issued by the Bank to the holding company on terms which, in general, mirror the original issues by the holding company.

In January 2007, the Bank redeemed the 8 million Series E, the 10 million Series G and the 16 million Series K non-cumulative preference shares of US\$0.01 each at US\$25 per share.

In June 2007, the Bank issued 38 million Series W non-cumulative preference shares of US\$0.01 each to the holding company at US\$25 per share, the net proceeds being US\$920 million.

In September 2007, the Bank issued 64 million Series X non-cumulative preference shares of US\$0.01 each to the holding company at US\$25 per share, the net proceeds being US\$1,550 million.

In October 2007, the Bank issued to the holding company:

- (a) 26,000 Series 4 non-cumulative preference shares of €0.01 at 50,000 each, the net proceeds being €1,287 million;
- (b) 750,000 Series B non-cumulative preference shares of £1 at £1,000 each, the net proceeds being £742 million; and
- (c) 15,000 Series Y non-cumulative preference shares of US\$0.01 at US\$100,000 each, the net proceeds being US\$1,485 million.

Under IFRS certain of the Group's preference shares are classified as debt and are included in subordinated liabilities on the balance sheet.

25 Shareholders' equity

	2007	Group	2005	2007	Bank	2005
	£m	2006	£m	£m	2006	£m
Called-up share capital						
At 1 January	5,482	5,481	5,607	5,482	5,481	5,607
Implementation of IAS 32 on 1 January 2005	—	—	(126)	—	—	(126)
Shares issued during the year	1	1	—	1	1	—
At 31 December	5,483	5,482	5,481	5,483	5,482	5,481
Share premium account						
At 1 January	12,526	11,435	13,131	12,526	11,435	13,131
Reclassification of preference shares on implementation of IAS 32 on 1 January 2005	—	—	(3,724)	—	—	(3,724)
Shares issued during the year	3,649	1,091	2,028	3,649	1,091	2,028
At 31 December	16,175	12,526	11,435	16,175	12,526	11,435
Merger reserve						
At 1 January and 31 December	10,881	10,881	10,881	—	—	—
Available-for-sale reserve						
At 1 January	(65)	(198)	—	52	12	—
Implementation of IAS 32 and IAS 39 on 1 January 2005	—	—	300	—	—	33
Unrealised gains/(losses) in the year	511	365	(155)	249	123	(2)
Realised gains in the year	(465)	(196)	(561)	(231)	(71)	(38)
Taxation	(16)	(36)	218	2	(12)	19
At 31 December	(35)	(65)	(198)	72	52	12
Cash flow hedging reserve						
At 1 January	(142)	68	—	(260)	(150)	—
Implementation of IAS 32 and IAS 39 on 1 January 2005	—	—	77	—	—	(95)
Amount recognised in equity during the year	(408)	(108)	20	60	(138)	(80)
Amount transferred from equity to earnings in the year (1)	(141)	(143)	(91)	25	2	(37)
Taxation	180	41	62	(36)	26	62
At 31 December	(511)	(142)	68	(211)	(260)	(150)
Foreign exchange reserve						
At 1 January	(833)	469	(320)	(2)	(2)	—
Retranslation of net assets	287	(2,117)	1,588	5	—	(2)
	(267)	815	(799)	—	—	—

Foreign currency (losses)/gains on hedges of net assets						
Taxation	31	—	—	—	—	—
At 31 December	(782)	(833)	469	3	(2)	(2)
Retained earnings						
At 1 January	10,087	6,374	5,021	4,633	4,535	5,260
Implementation of IAS 32 and IAS 39 on 1 January 2005	—	—	(1,121)	—	—	(298)
Profit attributable to ordinary and equity preference shareholders	7,199	5,876	4,999	7,255	3,519	1,544
Ordinary dividends paid	(2,000)	(3,250)	(1,928)	(2,000)	(3,250)	(1,928)
Equity preference dividends paid	(331)	(252)	(154)	(331)	(252)	(154)
Actuarial gains/(losses) recognised in retirement benefit schemes, net of tax	1,509	1,259	(555)	2	1	(1)
Share-based payments, net of tax	8	80	112	8	80	112
At 31 December	16,472	10,087	6,374	9,567	4,633	4,535
Shareholders' equity at 31 December	47,683	37,936	34,510	31,089	22,431	21,311

Note:

(1) The amounts transferred to earnings were included in net interest income.

Notes on the accounts continued

25 Shareholders' equity (continued)

The merger reserve comprises the premium on shares issued to acquire NatWest less goodwill amortisation charged under previous GAAP. No share premium was recorded in the Bank financial statements through the operation of the merger relief provisions of the Companies Act 1985.

UK law prescribes that only reserves of the Bank are taken into account for the purpose of making distributions and the permissible applications of the share premium account.

The Group optimises capital efficiency by maintaining reserves in subsidiaries, including regulated entities. Certain preference shares and subordinated debt are also included within regulatory capital. The remittance of reserves to the parent or the redemption of shares or subordinated capital by regulated entities may be subject to maintaining the capital resources required by the relevant regulator.

26 Leases

Minimum amounts receivable and payable under non-cancellable leases

	2007				2006			
	Year in which receipt or payment will occur				Year in which receipt or payment will occur			
	Within 1 year	After 1 year but within 5 years	After 5 years	Total	Within 1 year	After 1 year but within 5 years	After 5 years	Total
Group	£m	£m	£m	£m	£m	£m	£m	£m
Finance lease assets:								
Amounts receivable	1,297	4,968	11,648	17,913	1,235	4,331	11,166	16,732
Present value adjustment	(390)	(1,766)	(3,187)	(5,343)	(453)	(1,648)	(3,110)	(5,211)
Other movements	(23)	(144)	(288)	(455)	(22)	(80)	(295)	(397)
Present value amounts receivable	884	3,058	8,173	12,115	760	2,603	7,761	11,124
Operating lease assets:								
Future minimum lease receivables:	670	1,612	682	2,964	430	1,522	1,661	3,613
Operating lease obligations:								
Future minimum lease payables:								

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Premises	341	1,179	3,010	4,530	328	1,137	1,860	3,325
Equipment	9	14	–	23	7	6	–	13
	350	1,193	3,010	4,553	335	1,143	1,860	3,338

Amounts above
include:

Obligations to fellow
subsidiaries –

Premises	7	28	56	91	7	28	63	98
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2007

Year in which receipt or payment will
occur

2006

Year in which receipt or payment will occur

	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m	Within 1 year £m	After 1 year but within 5 years £m	After 5 years £m	Total £m
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Bank

Operating lease
obligations:

Future minimum
lease payables:

Premises	141	525	1,758	2,424	110	403	970	1,483
Equipment	–	–	–	–	1	1	–	2
	141	525	1,758	2,424	111	404	970	1,485

Amounts above
include:

Obligations to fellow
subsidiaries –

Premises	7	28	56	91	7	28	63	98
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Group	2007 £m	2006 £m
Nature of operating lease assets in balance sheet		
Transportation	3,502	4,296
Cars and light commercial vehicles	1,282	1,204
Other	315	291
	5,099	5,791
Amounts recognised as income and expense		
Finance lease receivables – contingent rental income	(23)	(37)
Operating lease payables – minimum payments	305	352
Contracts for future capital expenditure not provided for at the year end		
Operating leases	78	1,141
Finance lease receivables		
Unearned finance income	5,343	5,211
Accumulated allowance for uncollectable minimum lease receivables	63	67
Bank		
Amounts recognised as expense		
Operating lease payables – minimum payments	116	95

Residual value exposures

The table below gives details of the unguaranteed residual values included in the carrying value of finance lease receivables (see above) and operating lease assets (see Note 17).

	Group Year in which residual value will be recovered				Total £m
	Within 1 year £m	After 1 year but within 2 years £m	After 2 years but within 5 years £m	After 5 years £m	
2007					
Operating leases					
Transportation	259	207	758	1,535	2,759
Cars and light commercial vehicles	331	467	118	–	916
Other	26	47	64	18	155
Finance leases	23	29	115	288	455
	639	750	1,055	1,841	4,285
2006					
Operating leases					
Transportation	78	51	1,031	1,543	2,703
Cars and light commercial vehicles	168	295	329	–	792
Other	13	30	77	24	144
Finance leases	22	22	58	295	397

281	398	1,495	1,862	4,036
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The Group provides asset finance to its customers through acting as a lessor. It purchases plant, equipment and intellectual property; renting them to customers under lease arrangements that, depending on their terms, qualify as either operating or finance leases.

74

Notes on the accounts continued

27 Collateral

Securities repurchase agreements and lending transactions

The Group enters into securities repurchase agreements and securities lending transactions under which it receives or transfers collateral in accordance with normal market practice. Generally, the agreements require additional collateral to be provided if the value of the securities falls below a predetermined level. Under standard terms for repurchase transactions in the UK and US markets, the recipient of collateral has an unrestricted right to sell or repledge it, subject to returning equivalent securities on settlement of the transaction.

The fair value (and carrying value) of securities transferred under repurchase transactions included within securities on the balance sheet were as follows:

	Group 2007 £m	2006 £m	Bank 2007 £m	2006 £m
Treasury and other eligible bills	7,090	1,426	4,819	1,201
Debt securities	67,911	58,874	25,814	26,488
	75,001	60,300	30,633	27,689

All of the above securities could be sold or repledged by the holder. Securities received as collateral under reverse repurchase agreements amounted to £159.8 billion (2006 – £124.7 billion), of which £128.4 billion (2006 – £107.2 billion) had been resold or repledged as collateral for the Group's own transactions.

Other collateral given

	Group 2007 £m	2006 £m	Bank 2007 £m	2006 £m
Group assets charged as security for liabilities				
Loans and advances to customers	55,227	44,966	5,411	5,610
Debt securities	8,911	8,560	—	—
Property, plant and equipment	—	42	—	—
Loans to banks	—	469	—	469
Other	—	33	—	32
	64,138	54,070	5,411	6,111

	Group 2007 £m	2006 £m	Bank 2007 £m	2006 £m
Liabilities secured by charges on Group assets				
Deposits by banks	6,171	11,492	—	—
Customer accounts	6,670	7,095	5,398	5,893
Debt securities in issue	34,090	27,368	—	—
Other	—	45	—	21
	46,931	46,000	5,398	5,914

Of the assets above, £36.4 billion (2006 – £30.1 billion) relate to securitisations (see Note 28). The remaining balances primarily relate to assets charged as security against deposits from federal banks and other public sector bodies.

28 Securitisations and other asset transfers

The Group engages in securitisation transactions and other transfers of its financial assets including commercial and residential mortgage loans, commercial and residential mortgage related securities, US Government agency collateralised mortgage obligations, and other types of financial assets.

In the normal course of business, the Group arranges securitisations to facilitate client transactions and undertakes securitisations to sell financial assets or to fund specific portfolios of assets. The Group also acts as an underwriter and depositor in securitisation transactions involving both client and proprietary transactions. In a securitisation, assets, or interests in a pool of assets, are transferred generally to a special purpose entity ("SPE") which then issues liabilities to third party investors.

SPEs are vehicles set up for a specific, limited purpose, usually do not carry out a business or trade and typically have no employees. They take a variety of legal forms – trusts, partnerships and companies – and fulfil many different functions. As well as being a key element of securitisations, SPEs are also used in fund management activities to segregate custodial duties from the fund management advice provided by the Group.

Securitisations may, depending on the individual arrangement, result in continued recognition of the securitised assets; continued recognition of the assets to the extent of the Group's continuing involvement in those assets; or derecognition of the assets and the separate recognition, as assets or liabilities, of any rights and obligations created or retained in the transfer (see Accounting policy on page 24). The Group has securitisations in each of these categories.

Continued recognition

The table below sets out the asset categories together with the carrying amounts of the assets and associated liabilities for those securitisations and other asset transfers where substantially all of the risks and rewards of the asset have been retained by the Group.

Asset type	2007		Group	
	Assets	Liabilities	Assets	Liabilities
	£m	£m	£m	£m
Residential mortgages	19,657	19,441	15,698	15,375
Credit card receivables	2,948	2,664	2,891	2,685
Other loans	1,703	1,149	1,931	1,346
Commercial paper conduits	11,043	11,092	8,360	8,284
Finance lease receivables	1,038	823	1,211	953

Residential mortgages securitisations – the Group has securitised portfolios of residential mortgages. Mortgages have been transferred to SPEs, held ultimately by charitable trusts, funded principally through the issue of floating rate notes. The Group has entered into arm's length fixed/floating interest rate swaps and cross-currency swaps with the securitisation SPEs and provides mortgage management and agency services to the SPEs. On repayment of the financing, any further amounts generated by the mortgages will be paid to the Group. The SPEs are consolidated and the mortgages remain on the Group's balance sheet.

Credit card securitisations – credit card receivables in the UK have been securitised. Notes have been issued by an SPE. The note holders have a proportionate interest in a pool of credit card receivables that have been equitably assigned by the Group to a receivables trust. The Group continues to be exposed to the risks and rewards of the transferred receivables through its right to excess spread (after charge-offs). The SPE is consolidated and the credit card receivables remain on the Group's balance sheet.

Other securitisations – other loans originated by the Group have been transferred to SPEs funded through the issue of notes. Any proceeds from the loans in excess of the amounts required to service and repay the notes are payable to the Group after deduction of expenses. The SPEs are consolidated and the loans remain on the Group's balance sheet.

Commercial paper conduits – the Group sponsors commercial paper conduits. Customer assets are transferred into SPEs which issue notes in the commercial paper market. The Group supplies certain services and contingent liquidity support to these SPEs on an arm's length basis as well as programme credit enhancement. The SPEs are consolidated.

Finance lease receivables – certain finance lease receivables (leveraged leases) in the US involve the Group as lessor obtaining non-recourse funding from third parties. This financing is secured on the underlying leases and the provider of the finance has no recourse whatsoever to the other assets of the Group. The transactions are recorded gross of third-party financing.

Continuing involvement

In certain securitisations of US residential mortgages, substantially all the risks and rewards have been neither transferred nor retained, but the Group has retained control, as defined by IFRS, of the assets and continues to recognise the assets to the extent of its continuing involvement which takes the form of retaining certain subordinated

bonds issued by the securitisation vehicles. These bonds have differing rights and depending on their terms, they may expose the Group to interest rate risk where they carry a fixed coupon or to credit risk depending on the extent of their subordination. Certain bonds entitle the Group to additional interest if the portfolio performs better than expected and others give the Group the right to prepayment penalties received on the securitised mortgages. At 31 December 2007, securitised assets were £17.6 billion (2006 – £37.3 billion); retained interests £888 million (2006 – £930 million); subordination assets £314 million (2006 – £694 million) and related liabilities £314 million (2006 – £694 million).

Derecognition

Other securitisations of the Group's financial assets in the US qualify for derecognition as substantially all the risks and rewards of the assets have been transferred. The Group continues to recognise any retained interests in the securitisation vehicles.

Notes on the accounts continued

29 Risk management

Risk Management is conducted on an overall basis within the RBS Group. Therefore in the discussion on risk management (pages 77 to 83) references to "the Group" or "Group" Board and committees are to the RBS Group.

Governance framework

The Group Board of directors sets overall risk appetite and philosophy for the Group; the risk and capital framework underpins delivery of the Board's strategy. The Board is supported by three committees.

Group Audit Committee ("GAC") comprising independent non-executive directors focuses on financial reporting and application of accounting policies as part of the internal control and risk assessment framework. GAC monitors the identification, evaluation and management of all significant risks throughout the Group. This work is supported by Group Internal Audit which provides an independent assessment of the design, adequacy and effectiveness of internal controls.

Advances Committee ("AC") reporting to the Board deals with all transactions that exceed the Group Credit Committee's delegated authority.

Group Executive Management Committee ("GEMC") an executive committee ensures that implementation of strategy and operations are in line with the agreed risk appetite. GEMC is supported by the following:

Group Risk Committee ("GRC") recommends and approves limits, processes and policies that ensure the effective management of all material non-balance sheet risks across the Group.

Group Credit Committee ("GCC") approves credit proposals under authority delegated to it by the Board and/or Advances Committee.

Group Asset and Liability Management Committee ("GALCO") is responsible for identifying, managing and controlling the Group balance sheet risks. These risks are managed by setting limits and controls for capital adequacy, funding and liquidity intra-group exposure and non-trading interest rate equity and foreign currency risk.

Risk and capital

It is the Group's policy to optimise return to shareholders while maintaining a strong capital base and credit rating to support business growth and meet regulatory capital requirements at all times.

Risk appetite is measured as the maximum level of retained risk the Group will accept to deliver its business objectives. Risk appetite is generally defined through both quantitative and qualitative techniques including stress testing, risk concentration, value-at-risk and risk underwriting criteria, ensuring that appropriate principles, policies and procedures are in place and applied.

The main financial risks facing the Group are as follows:

Credit risk: is the risk arising from the possibility that the Group will incur losses from the failure of customers to meet their obligations.

- Funding and liquidity risk: is the risk that the Group is unable to meet its obligations as they fall due.

Market risk: the Group is exposed to market risk because of positions held in its trading portfolios and its non-trading businesses.

- Equity risk: reflects the variability in the value of equity investments resulting in gains or losses.

Credit risk

Credit risk is managed to achieve sustainable and superior risk-reward performance whilst maintaining exposures within acceptable risk appetite parameters. This is achieved through the combination of governance, policies, systems and controls, underpinned by sound commercial judgement as described below.

Policies and risk appetite: policies provide a clear framework for the assessment, approval, monitoring and management of credit risk where risk appetite sets the tolerance of loss. Limits are used to manage concentration risk by single name, sector and country.

Decision makers: credit authority is granted to independent persons or committees with the appropriate experience, seniority and commercial judgement. Credit authority is not extended to relationship managers. Specialist internal credit risk departments independently oversee the credit process and make credit decisions or recommendations to the appropriate credit committee.

Models: credit models are used to measure and assess risk decisions and to aid on-going monitoring. Measures, such as Probability of Default, Exposure at Default, Loss Given Default (see below) and Expected Loss are calculated using duly authorised models. All credit models are subject to independent review prior to implementation and existing models are reviewed on at least an annual basis.

Mitigation techniques to reduce the potential for loss: credit risk may be mitigated by the taking of financial or physical security, the assignment of receivables or the use of credit derivatives, guarantees, risk participations, credit insurance, set off or netting.

Risk systems and data quality: systems are well organised to produce timely, accurate and complete inputs for risk reporting and to administer key credit processes.

Analysis and reporting: portfolio analysis and reporting are used to ensure the identification of emerging concentration risks and adverse movements in credit risk quality.

Stress testing: stress testing forms an integral part of portfolio analysis, providing a measure of potential vulnerability to exceptional but plausible economic and geopolitical events which assists management in the identification of risk not otherwise apparent in more benign circumstances. Stress testing informs risk appetite decisions.

Portfolio management: active management of portfolio concentrations as measured by risk reporting and stress testing, where credit risk may be mitigated through promoting asset sales, buying credit protection or curtailing risk appetite for new transactions.

Credit stewardship: customer transaction monitoring and management is a continuous process, ensuring performance is satisfactory and that documentation, security and valuations are complete and up to date.

Problem debt identification: policies and systems encourage the early identification of problems and the employment of specialised staff focused on collections and problem debt management.

Provisioning: independent assessment using best practice models for collective and latent loss. Professional evaluation is applied to individual cases, to ensure that such losses are comprehensively identified and adequately provided for.

- **Recovery:** maximising the return to the Group through the recovery process.

Credit risk models

Credit risk models are used throughout the Group to support the analytical elements of the credit risk management framework, in particular the risk assessment part of the credit approval process, ongoing monitoring as well as portfolio analysis and reporting. Credit risk models used by the Group can be broadly grouped into three categories.

Probability of default ("PD"): the likelihood that a customer will fail to make full and timely repayment of credit obligations over a one year time horizon. Customers are assigned an internal credit grade which corresponds to probability of default. Every customer credit grade across all grading scales in the Group can be mapped to a Group level credit grade (see page 44).

Exposure at default ("EAD"): such models estimate the expected level of utilisation of a credit facility at the time of a borrower's default. The EAD is typically higher than the current utilisation (e.g. in the case where further drawings are made on a revolving credit facility prior to default) but will not typically exceed the total facility limit.

Loss given default ("LGD"): models estimate the economic loss that may occur in the event of default, being the debt that cannot be recovered. The Group's LGD models take into account the type of borrower, facility and any risk mitigation such as security or collateral held.

Impairment loss provision methodology

Provisions for impairment losses are assessed under three categories as described below:

Individually assessed provisions are the provisions required for individually significant impaired assets which are assessed on a case by case basis, taking into account the financial condition of the counterparty and any guarantor. This incorporates an estimate of the discounted value of any recoveries and realisation of security or collateral. The asset continues to be assessed on an individual basis until it is repaid in full, transferred to the performing portfolio or written-off.

Collectively assessed provisions are the provisions on impaired credits below an agreed threshold which are assessed on a portfolio basis, to reflect the homogeneous nature of the assets, such as credit cards or personal loans. The provision is determined from a quantitative review of the relevant portfolio, taking account of the level of arrears, security and average loss experience over the recovery period.

Latent loss provisions are the provisions held against the estimated impairment in the performing portfolio which has yet to be identified as at the balance sheet date. To assess the latent loss within the portfolio, the Group has developed methodologies to estimate the time that an asset can remain impaired within a performing portfolio before it is identified and reported as such.

Provision analysis

The Group's consumer portfolios, which consist of small value, high volume credits, have highly efficient, largely automated processes for identifying problem credits and very short timescales, typically three months, before resolution or adoption of various recovery methods.

Corporate portfolios consist of higher value, lower volume credits, which tend to be structured to meet individual customer requirements. Provisions are assessed on a case by case basis by experienced specialists, with input from professional valuers and accountants as appropriate. The Group operates a provisions governance framework which sets thresholds whereby suitable oversight and challenge is undertaken. These opinions and levels of provision are overseen by each division's Provision Committee. Significant cases are presented to, and challenged by, the Group Problem Exposure Review Forum.

Early and active management of problem exposures ensures that credit losses are minimised. Specialised units are used for different customer types to ensure that the appropriate risk mitigation is taken in a timely manner.

Portfolio provisions are reassessed regularly as part of the Group's ongoing monitoring process.

Notes on the accounts continued

29 Risk management (continued)

Liquidity risk

The Group's liquidity policy is designed to ensure that it can at all times meet its obligations as they fall due.

Liquidity management within the Group focuses on both overall balance sheet structure and the control, within prudent limits, of risk arising from the mismatch of maturities across the balance sheet and from exposure to undrawn commitments and other contingent obligations. The management of liquidity risk within the Group is undertaken within limits and other policy parameters set by GALCO. Compliance is monitored and coordinated by Group Treasury both in respect of internal policy and the regulatory requirements of the Financial Services Authority. In addition, all subsidiaries and branches outside the UK ensure compliance with any local regulatory liquidity requirements and are subject to Group Treasury oversight.

Diversification of funding sources

The structure of the Group's balance sheet is managed to maintain substantial diversification, to minimise concentration across its various deposit sources, and to limit the reliance on total short-term wholesale sources of funds (gross and net of repos) within prudent levels.

Management of term structure

The Group evaluates on a regular basis its structural liquidity risk and applies a variety of balance sheet management and term funding strategies to maintain this risk within its normal policy parameters.

The degree of maturity mismatch within the overall long-term structure of the Group's assets and liabilities is managed within internal policy guidelines, to ensure that term asset commitments may be funded on an economic basis over their life. In managing its overall term structure, the Group analyses and takes into account the effect of retail and corporate customer behaviour on actual asset and liability maturities where they differ materially from the underlying contractual maturities.

Stress testing

The Group performs stress tests to simulate how events may impact the Groups' funding and liquidity capabilities. Such tests inform the overall balance sheet structure and help define prudent limits for control of the risk arising from the mismatch of maturities across the balance sheet and from undrawn commitments and other contingent obligations. The nature of stress tests is kept under review in line with evolving market conditions.

Daily management

The short-term maturity structure of the Group's liabilities and assets is managed daily to ensure that all material or potential cash flow obligations arising from undrawn commitments and other contingent obligations, can be met. Potential sources include cash inflows from maturing assets, new borrowing or the sale or repurchase of debt securities held (after allowing for appropriate haircuts).

Short-term liquidity risk is generally managed on a consolidated basis with internal liquidity mismatch limits set for all subsidiaries and non-UK branches which have material local treasury activities, thereby assuring that the daily maintenance of the Group's overall liquidity risk position is not compromised. Citizens Financial Group manages liquidity locally, given the different regulatory regime, its policies and framework being reviewed and monitored

centrally by Group Treasury.

The following tables show cash flows payable on financial liabilities up to a period of 20 years including future payments of interest.

		The Bank and its subsidiaries				
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
	£m	£m	£m	£m	£m	£m
2007						
Deposits by banks	71,944	4,739	1,539	2,344	39	48
Customer accounts	367,881	6,043	1,833	1,697	4,732	2,488
Debt securities in issue	73,927	20,638	15,256	7,789	4,884	2,200
Derivatives held for hedging	38	357	531	227	210	97
Subordinated liabilities	402	1,909	4,686	3,305	15,770	9,540
Settlement balances and other liabilities	7,242	5	14	6	12	7
	521,434	33,691	23,859	15,368	25,647	14,380
2006						
Deposits by banks	62,629	5,544	3,656	2,550	1,129	15
Customer accounts	326,326	5,754	1,349	1,297	2,521	1,290
Debt securities in issue	43,224	9,436	14,556	7,538	7,033	4,776
Derivatives held for hedging	25	199	300	178	210	108
Subordinated liabilities	610	1,194	4,270	4,504	14,134	10,715
Settlement balances and other liabilities	7,142	20	26	16	9	4
	439,956	22,147	24,157	16,083	25,036	16,908

	Bank					
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
	£m	£m	£m	£m	£m	£m
2007						
Deposits by banks	115,262	6,782	2,170	1,859	901	58
Customer accounts	125,043	4,170	3,978	3,197	4,840	2,673
Debt securities in issue	39,694	17,282	8,155	1,801	2,478	2,123
Derivatives held for hedging	36	143	157	101	110	31
Subordinated liabilities	328	1,172	2,994	2,681	14,536	7,889
Settlement balances and other liabilities	3,093	1	8	4	8	—
	283,456	29,550	17,462	9,643	22,873	12,774
2006						
Deposits by banks	74,852	4,779	1,583	1,815	842	—
Customer accounts	121,633	4,556	5,231	2,936	2,567	1,423
Debt securities in issue	16,045	6,575	9,615	4,153	3,666	2,382
Derivatives held for hedging	31	200	215	137	149	29
Subordinated liabilities	528	930	3,024	2,987	12,548	8,743
Settlement balances and other liabilities	3,944	1	3	3	6	2
	217,033	17,041	19,671	12,031	19,778	12,579

The tables above show the timing of cash outflows to settle financial liabilities. They have been prepared on the following basis:

Prepayable liabilities – where a financial liability can be prepaid by the counterparty, the cash outflow has been included at the earliest date on which the counterparty can require repayment regardless of whether or not such early repayment results in a penalty. If the repayment of a financial liability is triggered by, or is subject to, specific criteria such as market price hurdles being reached, it is included at the earliest possible date that the conditions could be fulfilled without considering the probability of the conditions being met. For example, if a structured note is automatically prepaid when an equity index exceeds a certain level, the cash outflow will be included in the less than three months period whatever the level of the index at the year end. The settlement date of debt securities in issue issued by certain securitisation vehicles consolidated by the Bank depends on when cash flows are received from the securitised assets. Where these assets are prepayable, the timing of the cash outflow relating to securities assumes that each asset will be prepaid at the earliest possible date.

Liabilities with a contractual maturity of greater than 20 years – the principal amounts of financial liabilities that are repayable after 20 years or where the counterparty has no right to repayment of the principal are excluded from the table as are interest payments after 20 years.

Held-for-trading liabilities – held-for-trading liabilities amounting to £436.2 billion (2006 – £268.7 billion) (Bank £417.0 billion (2006 – £246.0 billion)) have been excluded from the table in view of their short term nature.

Financial assets held by the Bank and its subsidiaries to meet these cash outflows include cash, balances at central banks and treasury bills of £22.1 billion (2006 – £11.6 billion), loans to banks and customers of £647.8 billion (2006 – £547.0 billion) including £276.0 billion (2006 – £287.1 billion) repayable within 3 months. The Bank and its subsidiaries also held debt securities with a market value of £147.9 billion (2006 – £121.2 billion) of which £76.8 billion (2006 – £67.4 billion) were pledged to secure liabilities. Funds can be raised in the short-term from highly liquid securities held by the Bank and its subsidiaries by sale or by disposal or by sale and repurchase transactions regardless of their stated maturity.

As explained above the table is prepared on the basis that prepayable liabilities are called at the earliest possible date. In practice, the average maturity of these liabilities significantly exceeds that shown in the table. In addition, although many customer accounts are contractually repayable on demand or at short notice, the short-term deposit base of the Bank and its subsidiaries is stable over the long term as deposit rollovers and new deposits offset cash outflows.

Notes on the accounts continued

29 Risk management (continued)

Other contractual cash obligations

Other contractual obligations are summarised by payment date in the tables below

	The Bank and its subsidiaries					
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
	£m	£m	£m	£m	£m	£m
2007						
Operating leases	89	261	638	555	1,073	1,937
Contractual obligations to purchase goods or services	371	815	526	194	3	2
	460	1,076	1,164	749	1,076	1,939
2006						
Operating leases	84	251	617	526	820	1,040
Contractual obligations to purchase goods or services	161	483	853	90	153	—
	245	734	1,470	616	973	1,040
	Bank					
	0-3 months	3-12 months	1-3 years	3-5 years	5-10 years	10-20 years
	£m	£m	£m	£m	£m	£m
2007						
Operating leases	35	106	269	256	582	1,176
Contractual obligations to purchase goods or services	100	249	199	34	2	—
	135	355	468	290	584	1,176
2006						
Operating leases	28	83	216	187	440	529
Contractual obligations to purchase goods or services	88	264	173	89	—	—
	116	347	389	276	440	529

Undrawn formal facilities, credit lines and other commitments to lend were £259,263 million (2006 – £242,855 million) for the Bank and its subsidiaries. Undrawn formal facilities, credit lines and other commitments to lend for the Bank were £144,185 million (2006 – £135,356 million). While commitments have been given to provide these funds, some may be subject to certain conditions being met by the counterparty. Not all facilities are expected to be drawn, and some may lapse before drawdown.

Market risk

Market risk is defined as the risk of loss resulting from adverse changes in risk factors including interest rates, foreign currency and equity prices together with related factors such as market volatilities.

The Group is exposed to market risk because of positions held in its trading portfolios as well as its non-trading business including the Group's treasury operations.

Value-at-risk (“VaR”)

VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group’s VaR assumes a time horizon of one day and a confidence level of 95%. The Group uses historical simulation models in computing VaR. This approach, in common with many other VaR models, assumes that risk factor changes observed in the past are a good estimate of those likely to occur in the future and is, therefore, limited by the relevance of the historical data used. The Group’s method, however, does not make any assumption about the nature or type of underlying loss distribution. The Group typically uses the previous 500 trading days of market data.

The Group calculates both general market risk (ie the risk due to movement in general benchmarks) and idiosyncratic market risk (ie the risk due to movements in the value of securities by reference to specific issuers) using its VaR models.

The Group’s VaR should be interpreted in light of the limitations of the methodology used. These limitations include:

- Historical data may not provide the best estimate of the joint distribution of risk factor changes in the future and may fail to capture the risk of possible extreme adverse market movements which have not occurred in the historical window used in the calculations.
- VaR using a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day.
- VaR using a 95% confidence level does not reflect the extent of potential losses beyond that percentile.

The Group largely computes the VaR of trading portfolios at the close of business and positions may change substantially during the course of the trading day. Further controls are in place to limit the Group’s intra-day exposure; such as the calculation of the VaR for selected portfolios. These limitations and the nature of the VaR measure mean that the Group cannot guarantee that losses will not exceed the VaR amounts indicated. The Group undertakes stress testing to identify the potential for losses in excess of VaR.

Trading

The primary focus of the Group's trading activities is client facilitation – providing products to the Group's client base at competitive prices. The Group also undertakes: market making – quoting firm bid (buy) and offer (sell) prices with the intention of profiting from the spread between the quotes; arbitrage – entering into offsetting positions in different but closely related markets in order to profit from market imperfections; and proprietary activity – taking positions in financial instruments as principal in order to take advantage of anticipated market conditions. The principal risk factors are interest rates, credit spreads, equity prices, and foreign exchange. Financial instruments held in the Group's trading portfolios include, but are not limited to debt securities, loans, deposits, equity shares, securities sale and repurchase agreements and derivative financial instruments (futures, forwards, swaps and options). For a discussion of the Group's accounting policies for derivative financial instruments, see Accounting policies on page 24.

The VaR for the trading portfolios of the Bank and its subsidiaries segregated by type of market risk exposure, including idiosyncratic risk, is presented in the table below.

	2007				2006			
	Average	Period end	Maximum	Minimum	Average	Period end	Maximum	Minimum
	£m	£m	£m	£m	£m	£m	£m	£m
Interest rate	11.7	9.6	17.6	7.6	8.7	10.2	15.0	5.7
Credit spread	17.7	37.9	44.0	12.6	13.2	14.1	15.7	10.4
Currency	2.6	2.6	6.9	1.1	2.2	2.5	3.5	1.0
Equity	2.4	1.9	6.8	1.4	1.1	1.6	4.4	0.5
Commodity	0.2	0.1	1.6	—	0.2	—	1.1	—
Diversification		(12.4)				(12.8)		
Total trading VaR	20.3	39.7	45.5	13.2	14.2	15.6	18.9	10.4

Non-trading

The principal market risks arising from the Group's non-trading activities are interest rate risk, currency risk and equity risk.

Treasury activity and mismatches between the repricing of assets and liabilities in its retail and commercial banking operations account for most of the non-trading interest rate risk. Non-trading currency risk derives from the Group's investments in overseas subsidiaries, associates and branches.

The Group's venture capital portfolio is the principal source of non-trading equity price risk. The Group's portfolios of non-trading financial instruments mainly comprise loans (including finance leases), debt securities, equity shares, deposits, certificates of deposits and other debt securities issued, loan capital and derivatives.

Interest rate risk

Non-trading interest rate risk arises from the Group's treasury activities and retail and commercial banking businesses.

Treasury

The Group's treasury activities include its money market business and the management of internal funds flow within the Group's businesses. Money market portfolios include cash instruments (principally debt securities, loans and deposits) and related hedging derivatives.

Retail and commercial banking

Non-trading interest rate risk is calculated in each business on the basis of establishing the repricing behaviour of each asset, liability and off-balance sheet product. For many products, the actual interest rate repricing characteristics differ from the contractual repricing. In most cases, the repricing maturity is determined by the market interest rate that most closely fits the historical behaviour of the product interest rate. For non-interest bearing current accounts, the repricing maturity is determined by the stability of the portfolio. The repricing maturities used are approved by Group Treasury and divisional asset and liability committees at least annually. Key conventions are reviewed annually by GALCO.

A static maturity gap report is produced as at the month-end for each division, in each functional currency based on the behaviouralised repricing for each product. It is Group policy to include in the gap report, non-financial assets and liabilities, mainly property, plant and equipment and the Group's capital and reserves, spread over medium and longer term maturities. This report also includes hedge transactions, principally derivatives.

Any residual non-trading interest rate exposures are controlled by limiting repricing mismatches in the individual business balance sheets. Potential exposures to interest rate movements in the medium to long term are measured and controlled using a version of the same VaR methodology that is used for the Group's trading portfolios but without discount factors. Net accrual income exposures are measured and controlled in terms of sensitivity over time to movements in interest rates.

Risk is managed within limits approved by GALCO through the execution of cash and derivative instruments. Execution of the hedging is carried out by the relevant division through the Group's treasury function. The residual risk position is reported to divisional asset and liability committees, GALCO and the Board.

Notes on the accounts continued

29 Risk management (continued)

Non-trading interest rate VaR

Non-trading interest rate VaR for the Bank and its subsidiaries treasury and retail and commercial banking activities was £65.1 million at 31 December 2007 (2006 – £61.8 million) with the major exposure being to changes in longer term US dollar interest rates. During the year, the maximum VaR was £71.8 million (2006 –£119.4 million), the minimum £51.5 million (2006 – £61.8 million) and the average £62.9 million (2006 – £100.0 million).

Citizens was the main contributor to overall non-trading interest rate VaR. It invests in a portfolio of highly rated and liquid investments, principally mortgage-backed securities issued by US Government-backed entities. This balance sheet management approach is common for US retail banks where mortgages are originated and then sold to Federal agencies for funding through the capital markets.

Currency risk

The Group does not maintain material non-trading open currency positions other than the structural foreign currency translation exposures arising from its investments in foreign subsidiaries and associated undertakings and their related currency funding. The Group's policy in relation to structural positions is to match fund the structural foreign currency exposure arising from net asset value, including goodwill, in foreign subsidiaries, equity accounted investments and branches, except where doing so would materially increase the sensitivity of either the Group's or the subsidiary's regulatory capital ratios to currency movements. The policy requires structural foreign exchange positions to be reviewed regularly by GALCO. Foreign exchange differences arising on the translation of foreign operations are recognised directly in equity together with the effective portion of foreign exchange differences arising on hedging instruments.

The table below sets out the structural foreign currency exposures of the Bank and its subsidiaries.

	2007			2006		
	Net	Net	Structural	Net	Net	Structural
	investments		foreign	investments		foreign
	in foreign	investment	currency	in foreign	investment	currency
	operations	hedges	exposures	operations	hedges	exposures
	£m	£m	£m	£m	£m	£m
US dollar	13,919	2,437	11,482	15,034	4,475	10,559
Euro	3,483	—	3,483	2,942	1,616	1,326
Swiss franc	563	561	2	462	457	5
Other non-sterling	185	153	32	132	107	25
	18,150	3,151	14,999	18,570	6,655	11,915

Retranslation gains and losses on the Group's net investments in foreign operations together with those on instruments hedging these investments are recognised directly in equity. Changes in foreign currency exchange rates will affect equity in proportion to the structural foreign currency exposure. For the Bank and its subsidiaries, a five percent strengthening of foreign currencies would result in a gain of £750 million (2006 – £596 million) recognised in equity. A five percent weakening of foreign currencies would result in a loss of £714 million (2006 – £567 million) recognised in equity.

Equity risk

Non-trading equity positions can result in changes in the Group's non-trading income and reserves arising from changes in equity prices/income. These movements may crystallise during the course of normal business activities or in stress market conditions.

There are several reasons for retaining equity positions in the Group's non-trading book, including achieving strategic objectives, expected capital gain and supporting venture capital transactions. These investments are carried at fair value with changes in fair value recorded in profit or loss, or in equity.

The types, nature and amounts of exchange-traded exposures, private equity exposures, and other exposures vary significantly. Such exposures may take the form of listed and unlisted equity shares, equity warrants and options, linked equity fund investments, private equity and venture capital investments, preference shares classified as equity and capital stock in the Federal Home Loans Bank and the Federal Reserve Bank.

30 Capital resources

The Group's regulatory capital resources at 31 December in accordance with Financial Services Authority ('FSA') definitions were as follows:

	2007 £m	2006 £m
Composition of regulatory capital		
Tier 1 capital:		
Shareholders' funds and minority interests	47,761	38,196
Innovative tier 1 securities and preference shares transferred from subordinated liabilities	4,448	4,440
Goodwill capitalised and intangible assets	(17,761)	(17,771)
Pension deficit and other regulatory adjustments	295	1,798
Total qualifying tier 1 capital	34,743	26,663
Tier 2 capital:		
Unrealised gains on available-for-sale equities	75	136
Collective impairment allowances, net of taxes	2,582	2,320
Qualifying subordinated debt	20,896	21,108
Minority and other interests in tier 2 capital	315	276
Total qualifying tier 2 capital	23,868	23,840
Supervisory deductions:		
Unconsolidated investments	130	49
Investments in other banks	14	20
Other deductions	2,310	2,044
Total supervisory deductions	2,454	2,113
Total regulatory capital	56,157	48,390

In the management of capital resources, the Group is governed by RBS Group's policy which is to maintain a strong capital base, to expand it as appropriate and to utilise it efficiently throughout its activities to optimise the return to shareholders while maintaining a prudent relationship between the capital base and the underlying risks of the business. In carrying out this policy, the Group has regard to the supervisory requirements of the FSA. The FSA uses Risk Asset Ratio ("RAR") as a measure of capital adequacy in the UK banking sector, comparing a bank's capital resources with its risk-weighted assets (the assets and off-balance sheet exposures are 'weighted' to reflect the inherent credit and other risks); by international agreement, the RAR should be not less than 8% with a tier 1 component of not less than 4%. The Group has complied with the FSA's capital requirements throughout the year.

A number of subsidiaries and sub-groups within the Group, principally Banking entities, are subject to various individual regulatory capital requirements in the UK and overseas.

Notes on the accounts continued

31 Memorandum items

Contingent liabilities and commitments

The amounts shown in the table below are intended only to provide an indication of the volume of business outstanding at 31 December. Although the Group is exposed to credit risk in the event of non-performance of the obligations undertaken by customers, the amounts shown do not, and are not intended to, provide any indication of the Group's expectation of future losses.

	Group		Bank	
	2007	2006	2007	2006
	£m	£m	£m	£m
Contingent liabilities:				
Guarantees and assets pledged as collateral security	11,661	10,725	6,838	6,363
Other contingent liabilities	11,215	9,121	8,168	6,140
	22,876	19,846	15,006	12,503
Commitments:				
Undrawn formal standby facilities, credit lines and other commitments to lend				
– less than one year	153,348	140,942	61,582	58,427
– one year and over	105,915	101,913	82,603	76,929
Other commitments	2,491	2,402	1,630	836
	261,754	245,257	145,815	136,192

Note:

In the normal course of business, the Bank guarantees specified third party liabilities of certain subsidiaries; it also gives undertakings that individual subsidiaries will fulfil their obligations to third parties under contractual or other arrangements.

Banking commitments and contingent obligations, which have been entered into on behalf of customers and for which there are corresponding obligations from customers, are not included in assets and liabilities. The Group's maximum exposure to credit loss, in the event of non-performance by the other party and where all counterclaims, collateral or security proves valueless, is represented by the contractual nominal amount of these instruments included in the table above. These commitments and contingent obligations are subject to the Group's normal credit approval processes.

Contingent liabilities

Guarantees – the Group gives guarantees on behalf of customers. A financial guarantee represents an irrevocable undertaking that the Group will meet a customer's obligations to third parties if the customer fails to do so. The maximum amount that the Group could be required to pay under a guarantee is its principal amount as disclosed in the table above. The Group expects most guarantees it provides to expire unused.

Other contingent liabilities – these include standby letters of credit, supporting customer debt issues and contingent liabilities relating to customer trading activities such as those arising from performance and customs bonds, warranties and indemnities.

Commitments

Commitments to lend – under a loan commitment the Group agrees to make funds available to a customer in the future. Loan commitments, which are usually for a specified term may be unconditionally cancellable or may persist, provided all conditions in the loan facility are satisfied or waived. Commitments to lend include commercial standby facilities and credit lines, liquidity facilities to commercial paper conduits and unutilised overdraft facilities.

Other commitments – these include forward asset purchases, forward deposits placed and undrawn note issuance and revolving underwriting facilities, documentary credits and other short-term related transactions.

Regulatory enquiries and investigations

In the normal course of business the Group and its subsidiaries co-operate with regulatory authorities in various jurisdictions in their enquiries or investigations into alleged or possible breaches of regulations.

Certain of the Group's subsidiaries have received requests for information from various US governmental agencies and self-regulatory organisations including in connection with sub-prime mortgages and securitisations, collateralised debt obligations and synthetic products related to sub-prime mortgages. The Group and its subsidiaries are cooperating with these various requests for information and investigations.

Trustee and other fiduciary activities

In its capacity as trustee or other fiduciary role, the Group may hold or place assets on behalf of individuals, trusts, companies, pension schemes and others. The assets and their income are not included in the Group's financial statements. The Group earned fee income of £507 million (2006 – £472 million; 2005 – £366 million). The Bank earned fee income of £49 million (2006 – £42 million; 2005 – £34 million).

Litigation

Proceedings, including consolidated class actions on behalf of former Enron securities holders, have been brought in the United States against a large number of defendants, including the Group, following the collapse of Enron. The claims against the Group could be significant; the class plaintiff's position is that each defendant is responsible for an entire aggregate damage amount less settlements – they have not quantified claimed damages against the Group in particular. The Group considers that it has substantial and credible legal and factual defences to these claims and will continue to defend them vigorously. Recent Supreme Court and Fifth Circuit decisions provide further support for the Group's position. The Group is unable reliably to estimate the liability, if any, that might arise or its effect on the Group's consolidated net assets, its operating results or cash flows in any particular period.

On 27 July 2007, following discussions between the Office of Fair Trading ('OFT'), the Financial Ombudsman Service, the Financial Services Authority and all the major UK banks (including the Group) in the first half of 2007, the OFT issued proceedings in a test case against the banks including the Group to determine the legal status and enforceability of certain charges relating to unauthorised overdrafts. The hearing of the test case commenced on 17 January 2008. The Group maintains that its charges are fair and enforceable and is defending its position vigorously. It cannot, however, at this stage predict with any certainty the outcome of the test case and is unable reliably to estimate the liability, if any, that may arise or its effect on the Group's consolidated net assets, operating results or cash flows in any particular period.

Members of the Group are engaged in other litigation in the United Kingdom and a number of overseas jurisdictions, including the United States, involving claims by and against them arising in the ordinary course of business. The Group has reviewed these other actual, threatened and known potential claims and proceedings and, after consulting with its legal advisers, does not expect that the outcome of these other claims and proceedings will have a material adverse effect on its consolidated net assets, operating results or cash flows in any particular period.

Additional contingent liabilities arise in the normal course of the Group's business. It is not anticipated that any material loss will arise from these transactions.

32 Net cash inflow from operating activities

	Group			Bank		
	2007	2006	2005	2007	2006	2005
	£m	£m	£m	£m	£m	£m
Operating profit before tax	9,155	8,354	7,293	7,759	4,039	2,067
(Increase)/decrease in prepayments and accrued income	(411)	55	3,534	(221)	76	2,995
Interest on subordinated liabilities	1,452	1,161	978	1,200	878	704
(Decrease)/increase in accruals and deferred income	(248)	701	(3,949)	220	682	(2,142)
Provisions for impairment losses	1,865	1,873	1,709	473	692	676
Loans and advances written-off net of recoveries	(1,407)	(1,626)	(1,870)	(477)	(571)	(755)
Unwind of discount on impairment losses	(166)	(142)	(144)	(65)	(63)	(57)
(Profit)/loss on sale of property, plant and equipment	(672)	(215)	(90)	(740)	(1)	9
(Profit)/loss on sale of subsidiaries and associates	(67)	(41)	78	8	(2)	7
Loss/(profit) on sale of securities	496	(252)	(646)	231	(92)	(96)
Charge for defined benefit pension schemes	479	578	460	5	8	3
Cash contribution to defined benefit pension schemes	(536)	(533)	(450)	(16)	(1)	(2)
Other provisions utilised	(200)	(40)	(29)	(65)	(11)	(9)
Depreciation and amortisation	1,438	1,415	1,560	485	390	403
Elimination of foreign exchange differences	(2,137)	4,515	(2,359)	(2,034)	1,345	499
Other non-cash items	(23)	(1,447)	(801)	61	(492)	(102)

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Net cash inflow from trading activities	9,018	14,356	5,274	6,824	6,877	4,200
Increase in loans and advances to banks and customers	(92,494)	(46,036)	(30,361)	(88,570)	(24,025)	(21,619)
Increase in securities	(25,033)	(16,632)	(28,118)	(16,069)	(13,136)	(22,180)
(Increase)/decrease in other assets	(5,122)	404	(3,703)	(3,003)	(1,068)	(745)
Increase in derivative assets	(133,182)	(21,051)	(3,849)	(134,756)	(21,446)	(3,893)
Changes in operating assets	(255,831)	(83,315)	(66,031)	(242,398)	(59,675)	(48,437)
Increase in deposits by banks and customers	79,408	63,733	32,979	72,435	76,496	16,244
Increase/(decrease) in debt securities in issue	47,526	(3,616)	22,640	38,056	(22,990)	12,785
Increase in other liabilities	405	814	2,970	325	532	827
Increase in derivative liabilities	128,889	21,608	3,356	129,907	21,418	3,929
Increase in settlement balances and short positions	6,472	4,068	10,326	10,253	1,034	11,576
Changes in operating liabilities	262,700	86,607	72,271	250,976	76,490	45,361
Total income taxes paid	(1,802)	(2,122)	(1,830)	(526)	(298)	(437)
Net cash inflow from operating activities	14,085	15,526	9,684	14,876	23,394	687

Notes on the accounts continued

33 Analysis of the net investment in business interests and intangible assets

	2007	Group	2005	2007	Bank	2005
	£m	2006	£m	£m	2006	£m
		£m			£m	
Fair value given for businesses acquired	(147)	(21)	(44)	(6)	(236)	(228)
Additional investments in Group undertakings	5	-	-	(560)	(449)	(1,312)
Non-cash consideration	-	-	25	-	-	-
Net outflow of cash in respect of purchases	(142)	(21)	(19)	(566)	(685)	(1,540)
Cash and cash equivalents in businesses sold	21	229	10	-	-	(25)
Other assets sold	16	41	208	-	-	245
Repayment of investments	-	-	-	281	340	8
Non-cash consideration	(2)	(3)	(30)	-	-	-
Profit/(loss) on disposal	67	41	(78)	(8)	2	(7)
Net inflow of cash in respect of disposals	102	308	110	273	342	221
Dividends received from joint ventures	9	29	16	2	3	3
Cash expenditure on intangible assets	(399)	(335)	(316)	(299)	(105)	(58)
Net outflow	(430)	(19)	(209)	(590)	(445)	(1,374)

34 Interest received and paid

	2007	Group	2005	2007	Bank	2005
	£m	2006	£m	£m	2006	£m
		£m			£m	
Interest received	27,641	25,284	21,910	12,897	12,669	10,364
Interest paid	(15,482)	(15,189)	(12,190)	(10,071)	(9,534)	(7,857)
	12,159	10,095	9,720	2,826	3,135	2,507

35 Analysis of changes in financing during the year

	Group		Bank
Share capital	Subordinated	Share capital	Subordinated

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	and share premium		liabilities		and share premium		liabilities	
	2007	2006	2007	2006	2007	2006	2007	2006
	£m	£m	£m	£m	£m	£m	£m	£m
At 1 January	18,008	16,916	27,786	28,422	18,008	16,916	22,403	22,001
Issue of equity preference shares	3,650	1,092			3,650	1,092		
Net proceeds from issue of subordinated liabilities			1,018	3,027			968	2,936
Repayment of subordinated liabilities			(1,708)	(1,318)			(1,288)	(672)
Net cash inflow/(outflow) from financing	3,650	1,092	(690)	1,709	3,650	1,092	(320)	2,264
Currency translation and other adjustments	-	-	700	(2,345)	-	-	662	(1,862)
At 31 December	21,658	18,008	27,796	27,786	21,658	18,008	22,745	22,403

36 Analysis of cash and cash equivalents

	Group			Bank		
	2007	2006	2005	2007	2006	2005
	£m	£m	£m	£m	£m	£m
At 1 January						
- cash	28,175	25,333	23,534	16,025	9,629	14,754
- cash equivalents	41,972	27,352	19,277	47,561	29,778	23,354
Net cash inflow	14,614	17,462	9,874	13,663	24,179	1,299
At 31 December	84,761	70,147	52,685	77,249	63,586	39,407
Comprising:						
Cash and balances at central banks	5,121	5,752	4,460	3,003	3,424	1,928
Treasury bills and debt securities	6,818	1,596	986	6,521	1,595	985
Loans and advances to banks	72,822	62,799	47,239	67,725	58,567	36,494
Cash and cash equivalents	84,761	70,147	52,685	77,249	63,586	39,407

The Bank and certain subsidiaries are required to maintain balances with the Bank of England which, at 31 December 2007, amounted to £330 million (2006 - £369 million). Certain subsidiary undertakings are required by law to maintain reserve balances with the Federal Reserve Bank in the US. Such reserve balances amounted to US\$1 million at 31 December 2007 (2006 - US\$13 million).

37 Segmental analysis

(a) Divisions

The directors manage the Group primarily by class of business and present the segmental analysis on that basis. The Group's activities are organised as follows:

◆ Global Banking & Markets is a leading banking partner to major corporations and financial institutions around the world, providing an extensive range of debt financing, risk management and investment services to its customers.

◆ UK Corporate Banking provides banking, finance and risk management services to UK corporate customers. Through its network of relationship managers across the country it distributes the full range of Corporate Markets-products and services to companies.

◆ Retail comprises both the Royal Bank and NatWest retail brands, and a number of direct providers offering a full range of banking products and related financial services to the personal, premium and small business markets across several distribution channels. Retail also includes the Group's non-branch based retail business, such as Tesco Personal Finance that issues a comprehensive range of credit and charge cards to personal and corporate customers and provides card processing services for retail businesses.

◆ Wealth Management provides private banking and investment services to its global clients through Coutts Group, Adam & Company, The Royal Bank of Scotland International and NatWest Offshore.

◆ Ulster Bank Group brings together the Ulster Bank and First Active businesses. Retail Markets serves personal customers through both brands and Corporate Markets caters for the banking needs of business and corporate customers.

◆ Citizens is engaged in retail and corporate banking activities through its branch network in 13 states in the United States and through non-branch offices in other states. Citizens includes the two Citizens Banks, RBS Lynk, our merchant acquiring business, and Kroger Personal Finance, the credit card joint venture with the second largest US supermarket group.

◆ Manufacturing supports the customer-facing businesses and provides operational technology, customer support in telephony, account management, lending and money transmission, global purchasing, property and other services.

Segments charge market prices for services rendered to other parts of the Group with the exception of Manufacturing and central items. The expenditure incurred by Manufacturing relates to costs principally in respect of the Group's banking operations in the UK and Ireland. These costs reflect activities that are shared between the various customer-facing divisions. These shared costs and related assets and liabilities are not allocated to divisions in the day-to-day management of the businesses but they are allocated to customer-facing divisions for financial reporting purposes on a basis the directors consider to be reasonable. Funding charges between segments are determined by Group Treasury, having regard to commercial demands. The results of each division before amortisation of purchased intangible assets, integration costs and net gain on sale of strategic investments and subsidiaries, and where appropriate, allocation of Manufacturing costs ('Contribution') and after allocation of Manufacturing costs ('Operating profit before tax') are shown below.

Group						Total Income															
Revenue																					
External	Inter	Total	External	Inter	Total	Operating	Depreciation	Impairment	Contribution	Allocation	Operating	External	Inter	Total	Operating	Depreciation	Impairment	Contribution	Allocation	Operating	External
	segment			segment		expenses	and	losses			profit									before	

							amortisation			Manufacturing costs		
2007	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Global Banking & Markets	12,092	9,571	21,663	8,226	(1,994)	6,232	(2,222)	(255)	(39)	3,716	(145)	3,571
UK Corporate Banking	7,277	44	7,321	5,980	(2,238)	3,742	(836)	(328)	(180)	2,398	(437)	1,961
Retail Wealth Management	11,279	1,717	12,996	7,403	(425)	6,978	(1,794)	(22)	(1,196)	3,966	(1,603)	2,363
Ulster Bank	922	2,218	3,140	(1,046)	2,074	1,028	(455)	(11)	(4)	558	(145)	413
Citizens	2,841	197	3,038	1,774	(477)	1,297	(437)	(24)	(104)	732	(219)	513
Manufacturing Central items	5,528	-	5,528	3,178	(56)	3,122	(1,340)	(118)	(341)	1,323	-	1,323
Eliminations	41	1	42	(135)	(4)	(139)	(2,004)	(552)	-	(2,695)	2,695	-
	1,017	8,906	9,923	(3,073)	3,120	47	(689)	16	(1)	(627)	(146)	(773)
	-	(22,654)	(22,654)	-	-	-	-	-	-	-	-	-
Amortisation of intangibles	40,997	-	40,997	22,307	-	22,307	(9,777)	(1,294)	(1,865)	9,371	-	9,371
Integration costs	-	-	-	-	-	-	(40)	(84)	-	(124)	-	(124)
	-	-	-	-	-	-	(32)	(60)	-	(92)	-	(92)
	40,997	-	40,997	22,307	-	22,307	(9,849)	(1,438)	(1,865)	9,155	-	9,155

Note:

(1) Revenue represents total income included in the income statement grossed-up for interest payable and commissions payable.

Notes on the accounts continued

37 Segmental analysis (continued)

	Group Revenue			Total Income			Depreciation and impairment losses			Allocation of manufacturing costs	
	External £m	Inter segment £m	Total £m	External £m	Inter segment £m	Total £m	Operating Expenses £m	amortisation £m	£m	Contributions £m	£m
2006											
Global Banking & Markets	10,997	7,627	18,624	8,143	(1,607)	6,536	(2,322)	(255)	(85)	3,874	(144)
UK Corporate Banking	5,962	18	5,980	5,231	(1,769)	3,462	(742)	(338)	(189)	2,193	(431)
Retail	10,374	1,533	11,907	7,257	(417)	6,840	(1,742)	(26)	(1,310)	3,762	(1,580)
Wealth Management	991	1,430	2,421	(507)	1,396	889	(415)	(11)	(1)	462	(144)
Ulster Bank	2,361	196	2,557	1,278	(153)	1,125	(364)	(21)	(104)	636	(215)
Citizens	5,872	2	5,874	3,399	(82)	3,317	(1,398)	(156)	(181)	1,582	-
Manufacturing	49	5	54	(108)	(21)	(129)	(2,009)	(520)	-	(2,658)	2,658
Central items	315	6,900	7,215	(3,125)	2,653	(472)	(830)	22	(3)	(1,283)	(144)
Eliminations	-	(17,711)	(17,711)	-	-	-	-	-	-	-	-
	36,921	-	36,921	21,568	-	21,568	(9,822)	(1,305)	(1,873)	8,568	-
Amortisation of intangibles	-	-	-	-	-	-	-	(94)	-	(94)	-
Integration costs	-	-	-	-	-	-	(104)	(16)	-	(120)	-
	36,921	-	36,921	21,568	-	21,568	(9,926)	(1,415)	(1,873)	8,354	-
2005											
Global Banking & Markets	8,161	3,501	11,662	5,377	(103)	5,274	(1,780)	(248)	(139)	3,107	(139)
UK Corporate Banking	6,104	101	6,205	4,699	(1,527)	3,172	(646)	(343)	(196)	1,987	(416)
Retail	9,924	1,484	11,408	6,727	(183)	6,544	(1,724)	(31)	(1,135)	3,654	(1,526)
Wealth Management	858	1,114	1,972	(254)	1,038	784	(369)	(14)	(13)	388	(139)
Ulster Bank	1,820	150	1,970	1,043	(40)	1,003	(314)	(25)	(95)	569	(208)
Citizens	4,878	4	4,882	3,353	(89)	3,264	(1,407)	(151)	(131)	1,575	-
Manufacturing	55	6	61	(114)	(5)	(119)	(1,927)	(523)	-	(2,569)	2,569
Central items	248	3,829	4,077	(1,490)	909	(581)	(638)	5	-	(1,214)	(141)
Eliminations	-	(10,189)	(10,189)	-	-	-	-	-	-	-	-
	32,048	-	32,048	19,341	-	19,341	(8,805)	(1,330)	(1,709)	7,497	-

Amortisation of intangibles	-	-	-	-	-	-	-	(97)	-	(97)	-
Integration costs	-	-	-	-	-	-	(216)	(133)	-	(349)	-
Net gain on sale of strategic investments and subsidiaries	333	-	333	333	-	333	(91)	-	-	242	-
	32,381	-	32,381	19,674	-	19,674	(9,112)	(1,560)	(1,709)	7,293	-

Note:

(1) Revenue represents total income included in the income statement grossed-up for interest payable and commissions payable.

Group								Cost to acquire fixed assets and intangible assets - before allocationAllocation		Cost to acquire fixed assets and intangible assets
	Assets - before allocation		Liabilities - before allocation			Allocation				
	ofAllocation		of			of				
	Manufacturing assets	Manufacturing of	Manufacturing Assets	Manufacturing liabilities	Manufacturing liabilities	Manufacturing Liabilities	Manufacturing assets		Manufacturing assets	
	£m	£m	£m	£m	£m	£m	£m	£m	£m	
2007										
Global Banking & Markets	739,088	267	739,355	682,055	-	682,055	1,792	91	1,883	
UK Corporate Banking	102,637	460	103,097	88,155	-	88,155	1,320	131	1,451	
Retail Wealth Management	111,726	2,968	114,694	97,586	1,076	98,662	26	480	506	
Ulster Bank	14,043	199	14,242	35,171	-	35,171	33	59	92	
Citizens	55,868	255	56,123	45,185	-	45,185	35	77	112	
Manufacturing	80,416	-	80,416	68,545	-	68,545	171	-	171	
Central items	5,375	(5,375)	-	1,951	(1,951)	-	1,001	(1,001)	-	
Group	6,515	1,226	7,741	49,185	875	50,060	2	163	165	
	1,115,668	-	1,115,668	1,067,833	-	1,067,833	4,380	-	4,380	
2006										
Global Banking & Markets	499,456	228	499,684	447,425	-	447,425	1,737	14	1,751	
UK Corporate Banking	88,709	417	89,126	80,305	-	80,305	1,284	46	1,330	
Retail Wealth Management	107,994	3,546	111,540	88,090	1,014	89,104	13	186	199	
Ulster Bank	11,039	196	11,235	29,392	-	29,392	79	19	98	
Citizens	44,793	265	45,058	34,875	-	34,875	166	24	190	
Manufacturing	82,704	-	82,704	69,840	-	69,840	203	-	203	
Central items	5,709	(5,709)	-	1,884	(1,884)	-	361	(361)	-	
Group	7,823	1,057	8,880	58,084	870	58,954	484	72	556	
	848,227	-	848,227	809,895	-	809,895	4,327	-	4,327	

Segmental analysis of goodwill is as follows:

Group	
Global Banking & Corporate	UK Wealth Ulster Central

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	Markets £m	Banking £m	Retail £m	Management £m	Bank £m	Citizens £m	items £m	Total £m
At 1 January 2006	31	55	263	137	414	7,444	9,422	17,766
Currency translation and other adjustments	4	-	(8)	(7)	(9)	(904)	2	(922)
Disposals	-	-	-	(3)	-	(7)	-	(10)
At 1 January 2007	35	55	255	127	405	6,533	9,424	16,834
Currency translation and other adjustments	2	(7)	10	7	38	(126)	(1)	(77)
Arising on acquisitions during the year	-	-	-	-	-	66	-	66
Impairment of goodwill	-	-	(40)	-	-	-	-	(40)
Transfer between divisions	-	-	(54)	-	54	-	-	-
At 31 December 2007	37	48	171	134	497	6,473	9,423	16,783

Notes on the accounts continued

(b) Geographical segments

The geographical analyses in the tables below have been compiled on the basis of location of office where the transactions are recorded.

	Group				
	UK	USA	Europe	Rest of	Total
	£m	£m	£m	the World	£m
2007					
Total revenue	27,057	7,488	4,658	1,794	40,997
Net interest income	8,150	2,098	756	112	11,116
Fees and commissions (net)	4,299	1,140	435	149	6,023
Income from trading activities	1,582	(567)	73	54	1,142
Other operating income	3,167	241	562	56	4,026
Total income	17,198	2,912	1,826	371	22,307
Operating profit before tax	7,533	721	797	104	9,155
Total assets	732,539	268,277	78,419	36,433	1,115,668
Total liabilities	702,156	255,108	74,363	36,206	1,067,833
Net assets attributable to equity shareholders and minority interests	30,383	13,169	4,056	227	47,835
Contingent liabilities and commitments	170,361	66,283	40,135	7,851	284,630
Cost to acquire property, plant and equipment and intangible assets	2,864	238	1,255	23	4,380
2006					
Total revenue	22,644	9,001	4,249	1,027	36,921
Net interest income	7,418	2,212	697	65	10,392
Fees and commissions (net)	3,883	1,245	412	94	5,634
Income from trading activities	1,453	939	108	43	2,543
Other operating income	2,186	295	506	12	2,999
Total income	14,940	4,691	1,723	214	21,568
Operating profit before tax	5,299	2,267	762	26	8,354
Total assets	573,576	201,134	59,784	13,733	848,227
Total liabilities	553,309	187,145	55,797	13,644	809,895

Net assets attributable to equity shareholders and minority interests	20,267	13,989	3,987	89	38,332
Contingent liabilities and commitments	186,827	57,873	13,244	7,159	265,103
Cost to acquire property, plant and equipment and intangible assets	2,708	254	1,346	19	4,327

	Group				
	UK	USA	Europe	Rest of the World	Total
2005	£m	£m	£m	£m	£m
Total revenue	20,968	7,419	3,219	775	32,381
Net interest income	6,741	2,225	707	38	9,711
Fees and commissions (net)	3,852	1,100	263	80	5,295
Income from trading activities	1,283	959	56	65	2,363
Other operating income	1,670	211	420	4	2,305
Total income	13,546	4,495	1,446	187	19,674
Operating profit before tax	4,654	2,032	584	23	7,293
Total assets	474,297	205,587	61,310	16,128	757,322
Total liabilities	457,750	191,264	57,724	15,970	722,708
Net assets attributable to equity shareholders and minority interests	16,547	14,323	3,586	158	34,614
Contingent liabilities and commitments	169,275	51,392	10,714	1,164	232,545
Cost to acquire property, plant and equipment and intangible assets	2,824	337	1,601	17	4,779

38 Directors' and key management remuneration

The directors of the Bank are also directors of the holding company and are remunerated for their services to the RBS Group as a whole. The remuneration of the directors is disclosed in the Report and Accounts of the RBS Group.

Compensation of key management

The aggregate remuneration of directors and other members of key management during the year was as follows:

	2007	RBS Group
	£000	2006
	£000	£000
Short-term benefits	37,763	41,003
Post-employment benefits	10,051	11,264
Other long-term benefits	708	3,309
Share-based payments	5,165	2,787
	53,687	58,363

39 Transactions with directors, officers and others

(a) At 31 December 2007, the amounts outstanding in relation to transactions, arrangements and agreements entered into by authorised institutions in the Group, as defined in UK legislation, were £527,021 in respect of loans to 15 persons who were directors of the Bank (or persons connected with them) at any time during the financial period

and £1,221,958 to 5 people who were officers of the Bank at any time during the financial period.

(b) For the purposes of IAS 24 'Related Party Disclosures', key management comprise directors of the Bank and members of RBS Group's Group Executive Management Committee. The captions in the Group's primary financial statements include the following amounts attributable, in aggregate, to key management:

	2007	2006
	£000	£000
Loans and advances to customers	2,023	2,188
Customer accounts	13,309	18,575

Key management have banking relationships with Group entities which are entered into in the normal course of business and on substantially the same terms, including interest rates and security, as for comparable transactions with other persons of a similar standing or, where applicable, with other employees. These transactions did not involve more than the normal risk of repayment or present other unfavourable features.

Key management had no reportable transactions or balances with the holding company except for dividends.

Notes on the accounts continued

40 Related parties

- (a) Group companies and the Bank provide development and other types of capital support to businesses in their roles as providers of finance. These investments are made in the normal course of business and on arm's-length terms. In some instances, the investment may extend to ownership or control over 20% or more of the voting rights of the investee company. However, these investments are not considered to give rise to transactions of a materiality requiring disclosure under IAS 24.
- (b) The Group recharges The Royal Bank of Scotland Group Pension Fund with the cost of administration services incurred by it. The amounts involved are not material to the Group.
- (c) In accordance with IAS 24, transactions or balances between Group entities that have been eliminated on consolidation are not reported.
- (d) The captions in the primary financial statements of the Bank include amounts attributable to subsidiaries. These amounts have been disclosed in aggregate in the relevant notes to the financial statements. The table below discloses items included in income and operating expenses on transactions between the Group and fellow subsidiaries of the RBS Group.

	2007 £m	2006 £m
Income		
Interest receivable	175	79
Interest payable	498	509
Fees and commissions receivable	200	151
Fees and commissions payable	4	5
Expenses		
Premises and equipment	7	7

41 Ultimate holding company

The Group's ultimate holding company and ultimate controlling party is The Royal Bank of Scotland Group plc which is incorporated in Great Britain and registered in Scotland. As at 31 December 2007, The Royal Bank of Scotland Group plc heads the largest group in which the Group is consolidated. Copies of the consolidated accounts may be obtained from The Secretary, The Royal Bank of Scotland Group plc, Gogarburn, PO Box 1000, Edinburgh EH12 1HQ.

42 Post balance sheet events

There have been no significant events between the year end and the date of approval of these accounts which would require a change to or disclosure in the accounts.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorised.

Date: 26 June 2008

The Royal Bank of Scotland Group plc
Registrant

/s/ Guy Robert Whittaker

Guy Robert Whittaker
Group Finance Director
