BROMPTON VIP INCOME FUND

2006
ANNUAL
REPORT

Portfolio of income funds and high-yield debt managed by MFC Global Investment Management.

Management Report of Fund Performance

March 8, 2007

This annual management report of fund performance for Brompton VIP Income Fund (the "Fund") contains financial highlights but does not contain the audited annual financial statements. The audited annual financial statements follow this report.

Unitholders may obtain a copy of the Fund's proxy voting policies and procedures, proxy voting disclosure record, or quarterly portfolio disclosure, at no cost, by calling 866-642-6001, or by sending a request to Brompton Funds, Suite 2930, P.O. Box 793, Bay Wellington Tower, BCE Place, 181 Bay Street, Toronto, Ontario, M5J 2T3.

The Fund

Brompton VIP Income Fund is a closed-end investment trust that is managed by Brompton Funds Management Limited (the "Manager"). The units of the Fund trade on the Toronto Stock Exchange ("TSX") under the symbol VIP.UN.

Investment Objectives and Strategies

The Fund's objectives are to provide unitholders with a high level of income through receipt of monthly cash distributions and to preserve the net asset value per unit. The Fund utilizes an active asset and sector allocation strategy to invest in a diversified portfolio of income trusts and high-yield debt across a broad range of industries and geographic areas. Its investment focus is on business funds with smaller weightings in real estate investment trusts, oil and gas trusts, power and pipeline trusts and high-yield debt and the Fund may invest a portion (less than 10%) in common equities. The Fund is actively managed by MFC Global Investment Management ("MFC"), a subsidiary of Manulife Financial Corp., a top-ranked portfolio manager of income fund investments with extensive experience in income trusts and high-yield fixed income investments. The Fund is RRSP, DPSP, RRIF and RESP eligible.

Risks

Changes to the Fund over the financial year ended December 31, 2006 affected the overall risk associated with an investment in the Fund in the following ways:

(i) As illustrated in the discussion under "Recent Developments – Tax Treatment of Income Trusts," the proposed change in the taxation of income trusts had a negative impact on the net asset value of the Fund.

(ii) The Fund has borrowed amounts to invest in additional portfolio investments to increase the overall distributions of the Fund. If interest rates increase during a period when leverage is utilized, increased interest costs will reduce income available to be distributed. With the rise in short-term US interest rates over the year, the Fund has benefited from the fixing of the interest rates on US$21.0 million of its borrowings. The Fund has mitigated this risk of rising short-term interest rates by fixing the interest rate on US$13.0 million to May 2008 and US$8.0 million to July 2010.

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(iii) Leverage can also impact net asset value of the Fund as it will enhance the net asset value during a period when the Fund's investments have appreciated and will exacerbate the decline of net asset value during a falling market. The greater the amount of leverage, the greater the impact on net asset value of a rise or decline in market prices of the Fund's investments. During 2006, leverage had a negative impact on the net asset value of the Fund as the value of the underlying trusts decreased following the October 31, 2006 announcement by the Department of Finance on the taxation of public income trusts.

(iv) A portion of the Fund's portfolio is invested in high-yield debt, the majority of which is denominated in US dollars. The Fund hedges this foreign currency exposure by borrowing largely in US dollars.

(v) In 2006, $26.0 million of units were redeemed representing 18.5% of the Fund's net assets at that time. As a result, the trading liquidity of the units may be reduced.

Risks associated with an investment in the units of the Fund are discussed in detail in the Fund's annual information form, which is available on the Fund's website at www.bromptongroup.com or on SEDAR at www.sedar.com.

Recent Developments

Tax Treatment of Income Trusts

Notwithstanding a campaign promise made by Prime Minister elect Stephen Harper in January 2006 not to tax income trusts, the Federal Minister of Finance announced a proposal for a new tax on public income trusts on October 31, 2006. The resulting effect was a huge sell-off in the market, which initially erased $30 billion in market capitalization on the TSX. The Fund, which invests in income trusts, had negative overall performance in light of this announced proposal.

Investment funds like the Fund are not subject to this proposed tax, but to the extent an investment fund invests in income trusts (excluding certain REITs) the level of distributions it receives will be less if the proposed taxing provisions come into effect.

The proposed tax, if enacted, will take effect immediately for new income trust conversions. Existing income trusts have been given a four-year transition period ending on December 31, 2010 before they will be subject to this new tax. Income trusts, with the exception of REITs that meet specific criteria, will be subject to the proposed tax on their distributable income at the corporate tax rate. The effect of this change will be to reduce distributable cash by as much as 31.5% beginning in 2011 for existing public income trusts. To the extent such trusts return capital as a component of their distributions, this portion is not subject to the proposed tax. For taxable investors, the impact of this new tax will be offset by allowing the distribution portion ordinarily received as income to qualify for the more favourable dividend tax treatment. As a result, the proposed changes will have no net effect on an after-tax basis for taxable investors in the highest marginal tax rate bracket. However, tax-deferred investors, such as pension funds and investments held in registered accounts such as RRSPs, and foreign investors do not benefit from the favourable dividend tax treatment, and they will therefore be adversely affected when these new taxes, if enacted, come into effect in 2011.

Certain sectors of the income trust market, such as oil and gas trusts, have been more negatively affected in the market than others due to their greater concentration of foreign and/or tax-deferred holders. Over time, Brompton expects there to be a migration in income trust holders from tax-deferred and foreign investors to the fully taxable investor, which should improve market prices over the longer term.

Shortly after the government's announcement, Brompton began consulting and working with industry participants and advocacy groups and presented to the government an alternative proposal that we felt was equitable and would protect the interests of all investors. A copy of this proposal can be found on our website at www.bromptongroup.com. Brompton continues to work to help influence a more favourable outcome for our investors.

Implementation of Accounting Standard

In the management report of fund performance prepared for the six months ended June 30, 2006, it was reported that, starting January 1, 2007, the Fund would adopt the new accounting standard, Canadian Institute of Chartered Accountants ("CICA") Handbook Section 3855: Financial Instruments – Recognition and Measurement. This standard would cause the Fund to change the way it determines the value of securities it holds in its portfolio. In particular, securities traded in an active market are valued using the last available bid price rather than the closing price for exchange-traded securities or at the average of the latest bid and ask prices for securities traded over-the-counter. This change in determining net asset value would affect the following: (i) the valuation of the Fund's investments for its financial statements; (ii) the weekly posted net asset value per unit of the Fund; and (iii) pricing of the redemption amounts for the units.

Pursuant to requests from the investment fund industry, the Canadian Securities Administrators ("CSA") exempted investment funds, including the Fund, from applying CICA Section 3855 in the calculation of the weekly net asset values and the amount of the net asset value for redemption purposes until September 30, 2007. The exemption was requested to allow further study of whether calculation and use of net asset value in accordance with Canadian GAAP are appropriate for purposes other than financial statements.

Securities Lending

In October 2006, the Fund commenced a securities lending program through its custodian, RBC Dexia Investor Services Trust, in order to generate additional income. Under the program, the aggregate market value of the securities on loan cannot exceed 50% of the assets of the Fund and the Fund receives collateral of at least 102% of the market value of the securities on loan. In 2006 this program generated income of approximately $28,000.

Results of Operations

Distributions

During the year ended December 31, 2006, the Fund made monthly cash distributions which totalled $1.01997 per unit. Since inception in February 2002, the Fund has paid total cash distributions $4.85 per unit. In October 2006, the Fund increased its monthly distribution by 8% to $0.09 per unit ($1.08 per annum) as a result of earning net investment income in excess of distributions for over a year.

A breakdown of the tax characteristics of the 2006 distributions paid by the Fund is provided later in this report under "2006 Tax Information."

The Fund has a distribution reinvestment plan which allows participating unitholders to automatically reinvest monthly distributions in additional units of the Fund. For the year ended December 31, 2006, 41,658 units were acquired in the market pursuant to this plan at an average price of $13.84 per unit.

Net Asset Value

As a result of weakness in the Fund's investment portfolio due to the impact of the proposed tax changes on trusts as discussed above, the net asset value per unit decreased by $1.22 per unit, or 8%, from $14.77 per unit to $13.55 per unit over the year. The aggregate net assets of the Fund declined from $158 million to $113 million as a result of the negative effect of the income trust tax announcement, redemptions and repurchases under the issuer bid program.

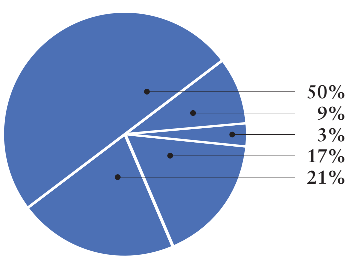
Investment Portfolio

As of December 31, 2006, the Fund's investments included a total of 45 income funds and 70 fixed income investments, which provide diversification by issuer, industry, and asset class. The breakdown of the portfolio is shown in the pie chart below, and a detailed listing of the Fund's security holdings is provided in the financial statements.

The table below shows the net gains (losses) in the portfolio by sector. The Fund's portfolio experienced net losses of $13.8 million. REITs were the best performing sector as they generally will not be subject to the announced tax on income trusts.

The Fund's fixed income securities reduced the impact on the portfolio of the announced changes to taxing income trusts by appreciating over the year. The fixed income securities are high-yield debt and are mostly denominated in US dollars. In order to hedge the foreign exchange exposure, an amount approximately equal to these US dollar denominated assets has been borrowed under the Fund's credit facilities in US dollars. As a result, gains or losses on the US dollar foreign exchange hedging are included with the gains or losses on the fixed income securities to show the net gain from this investment activity.

Portfolio Sectors



Net Gains (Losses) by Sector (millions)	Realized	Unrealized	Total
Business funds	$ 5.3	$ (16.9)	$ (11.6)
Oil and gas funds	0.4	(7.3)	(6.9)
Power and pipeline funds	—	(0.5)	(0.5)
Real estate investment trusts	3.3	1.5	4.8
Fixed income securities and foreign exchange	(0.8)	1.2	0.4
Total	**$ 8.2**	**$ (22.0)**	**$ (13.8)**

Liquidity and Capital Resources

As of December 31, 2006, the Fund had total borrowings of $41 million under its three credit facilities, which represented 22.6% of total assets or 36.1% of net assets. The Fund currently has a 364-day revolving credit facility and two term credit facilities. The current revolving credit facility provides for maximum borrowings of $23.0 million, with borrowings in Canadian currency at either the prime rate of interest or the bankers' acceptance rate plus a fixed percentage or in US currency at the LIBOR rate plus a fixed percentage. At December 31, 2006, the Fund had LIBOR based borrowings in the amount of $5.9 million (US$5.1 million) and borrowings based on the bankers' acceptance rate of $10.6 million outstanding under its revolving facility. Under its term credit facilities, the Fund has borrowed US$13.0 million at a fixed rate of interest of 3.89% for a five-year period ending May 28, 2008 and US$8.0 million with a five-year term to July 14, 2010 and a fixed rate of interest of 4.86%. These loans represent $24.4 million of the total borrowings at December 31, 2006. With the rise of US short-term interest rates over the past year, the Fund benefited from having the interest rate fixed on a significant portion of its borrowings. At December 31, 2006, borrowings in US dollars had an unrealized foreign exchange gain of $2.5 million which hedges foreign exchange losses on the Fund's US dollar securities. The term loans have been used to invest in additional portfolio investments to increase the overall distributions paid by the Fund. The revolving credit facility has also been used to invest in additional portfolio investments as well as for working capital purposes. During the year ended December 31, 2006, the minimum and maximum amounts of borrowings were $28.8 million and $44.7 million, respectively.

To provide liquidity, units of the Fund are listed on the TSX under the symbol VIP.UN. The Fund's normal course issuer bid program allows it to purchase its units on the TSX when they trade below net asset value per unit. As a result, purchases under the issuer bid are accretive to the net asset value per unit. A total of 415,543 units were purchased in 2006 under this program at an average price of $13.35 per unit. In 2006, units of the Fund traded at an average discount to their net asset value per unit of 4.8%. Investors may also redeem their units annually in accordance with their redemption provisions.

Related Party Transactions

Pursuant to a management agreement, the Manager provides management and administrative services to the Fund, for which it is paid a management fee equal to 0.85% per annum of the net asset value of the Fund plus applicable taxes. The Manager is responsible for paying the fees of MFC for the portfolio management services it provides the Fund. The Fund also pays to the Manager a service fee equal to 0.40% per annum of the net asset value of the Fund. The service fee is in turn paid by the Manager to investment dealers in proportion to the number of units held by clients of each dealer at the end of each calendar quarter. In 2006, management and service fees amounted to $1.4 million and $0.6 million, respectively.

Financial Highlights

The following tables show selected key financial information about the Fund and are intended to help readers understand the Fund's financial performance for the fiscal periods indicated. This information is derived from the Fund's audited annual financial statements. The information in the following tables is presented in accordance with National Instrument ("NI") 81-106 and, as a result, does not act as a continuity of opening and closing net asset value per unit. The increase (decrease) in net assets from operations is based on average units outstanding during the period, and all other numbers are based on actual units outstanding at the relevant point in time.

Net Asset Value per Unit

	2006	2005	2004	2003	2002
Net asset value, beginning of year[2]	$ **14.77**	$ 13.70	$ 11.36	$ 9.29	$ 9.37
Increase (decrease) from operations:[1][3]					
Total revenue	**1.48**	1.32	1.25	1.26	0.96
Total expenses	**(0.39)**	(0.31)	(0.28)	(0.25)	(0.20)
Realized gain (loss) for the year	**0.80**	0.71	0.25	0.01	(0.16)
Unrealized gain (loss) for the year	**(2.12)**	0.30	2.20	2.04	0.05
Total increase (decrease) in net assets from operations	$ **(0.23)**	$ 2.02	$ 3.42	$ 3.06	$ 0.65
Distributions to unitholders:[1][2]					
From net investment income (excluding dividends)	$ **0.71**	$ 0.61	$ 0.48	$ 0.52	$ 0.35
From dividends	**0.05**	0.06	0.05	0.07	0.04
From net realized gain on investments	**—**	—	0.14	—	—
Return of capital	**0.26**	0.33	0.43	0.41	0.34
Total distributions to unitholders	$ **1.02**	$ 1.00	$ 1.10	$ 1.00	$ 0.73
Net asset value, end of year[2]	$ **13.55**	$ 14.77	$ 13.70	$ 11.36	$ 9.29

[1] Period from February 19, 2002 (commencement of operations) to December 31, 2002.

[2] Net asset value per unit and distributions per unit are based on the actual number of units outstanding at the relevant time.

[3] The increase (decrease) in net assets from operations per unit is based on the weighted average number of units outstanding over the fiscal period.

Ratios and Supplemental Data

	2006	2005	2004	2003	2002
Net assets (in 000s)	$ **113,349**	$ 157,761	$ 111,913	$ 103,102	$ 90,690
Number of units outstanding (in 000s)	**8,365**	10,683	8,170	9,077	9,763
Management expense ratio ("MER")[1][2]	**2.69%**	2.24%	2.45%	2.47%	9.09%
MER excluding interest expense and issuance costs[1][3]	**1.46%**	1.52%	1.51%	1.56%	1.59%
Portfolio turnover rate[4]	**14.68%**	17.75%	14.34%	28.04%	N/A
Trading expense ratio[5]	**0.05%**	0.05%	N/A	N/A	N/A
Closing market price	$ **12.61**	$ 13.80	$ 13.30	$ 11.20	$ 9.50

[1] Annualized for the period from February 19, 2002 (commencement of operations) to December 31, 2002.

[2] Management expense ratio is based on the requirements of NI 81-106 and includes the total expenses of the Fund for the stated period, including interest expense and issuance costs, and is expressed as an annualized percentage of the average net assets of the period.

[3] MER, excluding interest expense and issuance costs, has been presented separately as it expresses only the ongoing management and administrative expenses of the Fund as a percentage of average net assets.

[4] The Fund's portfolio turnover rate indicates how actively the Fund's portfolio advisor manages its portfolio investments. A portfolio turnover rate of 100% is equivalent to the Fund buying and selling all of the securities in its portfolio once in the course of the year. The higher a fund's portfolio turnover rate in a year, the greater the trading costs payable by the fund in the year, and the greater the chance of an investor receiving taxable capital gains in the year. There is not necessarily a relationship between a high turnover rate and the performance of the Fund. The portfolio turnover rate is not provided when a fund is less than one year old. Portfolio turnover rate is calculated by dividing the lesser of the cost of purchases and the proceeds of sales of portfolio securities for the period, excluding cash and short-term investments maturing in less than one year, by the average market value of investments during the period.

[5] The trading expense ratio represents total commissions expressed as an annualized percentage of daily average net assets of the Fund during the period. This disclosure was a new requirement in 2005 under NI 81-106 and was not applied retroactively.

Expense Ratio

The MER of the Fund increased from 2.24% in 2005 to 2.69% in 2006. This ratio is exaggerated by the inclusion of interest expense on borrowings used to purchase additional portfolio investments to increase the distributions of the Fund. In 2006, interest rates on the Fund's short-term borrowings increased and the Fund had a higher level of leverage over the year, which caused the increase in the ratio.

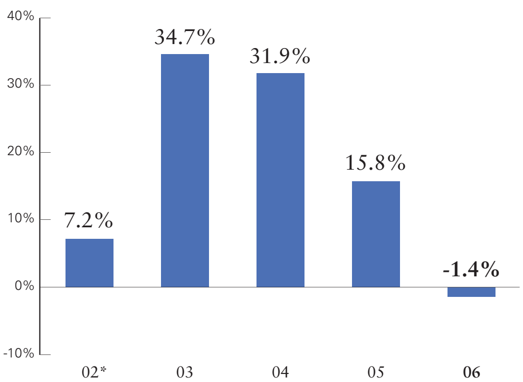
The MER, excluding interest expenses, declined to 1.46% in 2006 from 1.52% in 2005. This latter rate is more representative of the ongoing efficiency of the administration of the Fund.

Past Performance

The following chart and table show the past performance of the Fund. Past performance does not necessarily indicate how the Fund will perform in the future. The information shown is based on net asset value per unit and assumes that distributions made by the Fund on its units in the periods shown were reinvested (at net asset value per unit) in additional units of the Fund.

The bar chart shows the Fund's annual return in each year since inception to December 31, 2006. The chart shows, in percentage terms, how an investment held on the first day of each fiscal year would have increased or decreased by the last day of the fiscal year.

Year-by-Year Returns



* Period from February 19, 2002 (commencement of operations) to December 31, 2002.

The following table shows the Fund's annual compound return for each period indicated, compared with the S&P/TSX Capped Income Trust Index ("Income Trust Index"). The Income Trust Index is a broad-based composite index which may encompass any or all Global Industry Classification Standard ("GICS") sectors of the income trust marketplace. Income trusts that qualify for inclusion must derive their distribution income from actual operating entities. The Income Trust Index is calculated without the burden of management fees and fund expenses whereas the performance of the Fund is calculated after deducting such fees and expenses.

Annual Compound Returns

	1 Year	3 Year	Since Inception(1)
Brompton VIP Income Fund(2)	(1.4)%	14.6%	17.3%
S&P/TSX Capped Income Trust Index	(2.8)%	17.3%	20.7%

(1) Period from February 19, 2002 (commencement of operations) to December 31, 2006.

(2) Based on net asset value per unit and assuming that distributions made by the Fund on its units in the periods shown were reinvested (at net asset value per unit) in additional units of the Fund.

The Fund experienced a slightly negative return in 2006 due largely to the proposed tax on income trusts. The Fund did outperform the Income Trust Index, particularly in the second half of the year due to its approximately 20% weighting in US fixed income investments. Since inception, the Fund has provided investors with robust compound annual returns of 17.3%. The Fund has achieved these strong returns, while being overweight business trusts, significantly underweight oil and gas trusts and allocating a significant portion of the portfolio to fixed income investments.

Summary of Investment Portfolio

As at December 31, 2006

Total net asset value	$ 113,348,931

Portfolio Composition	% of Portfolio	% of NAV
Business funds	44.5%	70.5%
Fixed income investments	18.4%	29.1%
Real estate investment trusts	15.2%	24.1%
Cash and short-term investments	10.4%	16.5%
Oil and gas funds	8.3%	13.2%
Power and pipeline funds	3.2%	5.1%
Total investment portfolio	100.0%	158.5%
Other net liabilities		(58.5%)
Total net asset value		100.0%

Top 25 Holdings	% of Portfolio	% of NAV
Cash and short-term investments	10.4%	16.5%
BFI Canada Income Fund	4.5%	7.1%
Northern Property REIT	4.4%	7.0%
Davis + Henderson Income Fund	4.0%	6.4%
Gateway Casinos Income Fund	3.7%	5.8%
RioCan REIT	3.6%	5.6%
Energy Savings Income Fund	3.4%	5.4%
Canadian Oil Sands Trust	3.1%	5.0%
Boston Pizza Royalties Income Fund	2.7%	4.3%
Livingston International Income Fund	2.4%	3.7%
Altus Group Income Fund	2.3%	3.6%
Cineplex Galaxy Income Fund	2.2%	3.5%
Northland Power Income Fund	2.2%	3.5%
TimberWest Forest Corp.	2.1%	3.3%
ARC Energy Trust	1.9%	3.1%
SIR Royalty Income Fund	1.8%	2.9%
Focus Energy Trust	1.8%	2.8%
The Keg Royalties Income Fund	1.7%	2.6%
InnVest REIT	1.6%	2.5%
Yellow Pages Income Fund	1.4%	2.2%
Huntingdon REIT	1.4%	2.2%
Chemtrade Logistics Income Fund	1.4%	2.2%
Primaris Retail REIT	1.3%	2.1%
H&R REIT	1.3%	2.1%
The Data Group Income Fund	1.1%	1.7%

The investment portfolio may change due to ongoing portfolio transactions of the investment fund. Quarterly updates are available within 60 days of each quarter end.

2006 Tax Information

The following information is applicable to holders who, for the purpose of the Income Tax Act (Canada), are resident in Canada and hold Fund units as capital property outside of an RRSP, RRIF or DPSP. Unitholders should receive a T3 slip from their investment dealer providing this information.

T3 supplementary slips for holdings of the Fund will indicate Foreign Non-Business Income in Box 25, Other Taxable Income in Box 26, Capital Gains in Box 21 and Dividend Income in Box 23. Dividend income is subject to the standard gross-up and federal dividend tax credit rules.

The return of capital component is a non-taxable amount that serves to reduce the adjusted cost base of Fund units and is reported on the T3 supplementary slips in Box 42.

The following table outlines the breakdown of the Fund's distributions declared in 2006 on a per unit basis.

Record Date	Payment Date	Return of Capital	Foreign Non-Business Income	Other Taxable Income	Dividend Income	Capital Gains	Total Distribution
Jan. 31, 2006	Feb. 14, 2006	$ 0.02160	$ 0.01770	$ 0.03999	$ 0.00404	$ —	$ 0.08333
Feb. 28, 2006	Mar. 14, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
Mar. 31, 2006	Apr. 17, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
Apr. 28, 2006	May 12, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
May 31, 2006	June 14, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
June 30, 2006	July 17, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
July 31, 2006	Aug. 15, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
Aug. 31, 2006	Sep. 15, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
Sep. 29, 2006	Oct. 16, 2006	0.02160	0.01770	0.03999	0.00404	—	0.08333
Oct. 31, 2006	Nov. 14, 2006	0.02333	0.01911	0.04319	0.00437	—	0.09000
Nov. 30, 2006	Dec. 14, 2006	0.02333	0.01911	0.04319	0.00437	—	0.09000
Dec. 29, 2006	Jan. 15, 2007	0.02333	0.01911	0.04319	0.00437	—	0.09000
Total		**$ 0.26439**	**$ 0.21663**	**$ 0.48948**	**$ 0.04947**	**$ —**	**$ 1.01997**

This information is of a general nature only and does not constitute legal or tax advice to any particular investor. Accordingly, investors are advised to consult their own tax advisors with respect to their individual circumstances.

Portfolio Manager

MFC Global Investment Management
The Fund is actively managed by MFC, a subsidiary of Manulife Financial Corp. and a top-ranked portfolio manager of income fund investments with extensive experience in income trusts and high-yield fixed income investments. The portfolio management team has provided investors with top percentile risk-adjusted returns over the past five years based on the universe of Canadian mutual funds rated by Morningstar. With over 100 years of experience and $230 billion in assets under management, MFC is a leading investment management company.

Portfolio Manager's Report

Results of Operations
On October 31, 2006, Ottawa announced it would impose a tax on income trust distributions effective in 2011. Brompton VIP Income Fund portfolio, similar to most other portfolios concentrated in income trusts, was negatively impacted as a result of the government's announcement. The S&P/TSX Capped Income Trust Index returned -8.6% in the following two-month period ending December 31, 2006. Analysts estimate that approximately $25 to $30 billion in market value was erased as a direct result of the government's decision. On October 31, 2006 the Brompton VIP Income Fund had an Income Trust Index weighting of 79%, primarily weighted to the Business Trust sector, with 18% of the portfolio in high-yield debt. The income trust sector exposures at that time were: business 50%, REITs 13%, infrastructure 2% and energy 14%. While the Fund outperformed the Index, net of fees, due to its allocation to high-yield debt and to REITs, which were largely unaffected by the proposed tax, Brompton VIP Income Fund nonetheless had a negative return of 1.4% over the year.

The Brompton VIP Income Fund increased its monthly distribution by 8% to $0.09 per unit ($1.08 per annum) commencing with the distribution paid to unitholders of record on October 31, 2006 due to higher income from the underlying portfolio.

Investment Performance

During the 12-month period, income trusts, as measured by the S&P/TSX Capped Income Trust Index, posted a negative compound annual return of 2.8% due to deteriorating fundamentals in the energy sector and the effect of the government's decision on income trust taxation.

Declining natural gas prices throughout the year proved difficult for some energy trusts. The price of Nymex natural gas declined by approximately 45% during 2006, and as a result, 19 income trusts announced decreases to their distributions. The Fund benefited from an underweight position in the energy trust sector. However, the Fund did hold three of the 19 trusts that cut distributions. A focus on high quality, long-life assets, sustainable business models and a balanced exposure to both natural gas and oil helped to mitigate some of the downside.

The high-yield market bond returned 10.76% during 2006, as measured by the Merrill Lynch Master II Index. Consequently, the Fund's 18% exposure to the high-yield market proved advantageous during 2006.

Portfolio Construction

The exposure to energy trusts decreased from 18% in 2005 to 8% as at December 31, 2006. The Business trust and REIT weightings remained relatively unchanged. The high-yield bond weight was increased by 3% and ended the year at 18%.

Although the energy trust weight was already well below the market weight, the Fund portfolio managers took advantage of speculative rallies post October 31, 2006 in the energy trust sector to reduce their holdings in names such as Shiningbank Energy Income Fund and ARC Energy Trust.

Throughout the year, the managers took profits by selling names such as North West Company and units of Summit REIT, which were tendered to a takeover offer at a large premium.

Recent Developments and Outlook

The most significant recent development was the announcement of the taxation of income trusts. This has caused uncertainty as to how the sector will evolve over the next four years. The portfolio managers expect heightened volatility in this sector. However, the sell-off in the wake of the announcement has resulted in the fundamental valuations of some trusts, primarily in the business trust sector, becoming attractive again even after considering the potential tax implications. The portfolio managers believe that their thorough due diligence and strict value discipline allow the Fund to benefit from such investment opportunities as they arise. The Fund's decreased exposure to energy trusts combined with diversification across assets not affected by the tax change should continue to mitigate potential negative impacts.

The bond portfolio managers expect that interest rates will remain range-bound with a bias towards lower rates during the latter half of 2007, given the anticipated economic slowdown in the US and Canada.

The portfolio manager's disciplined investment style and the portfolio's diversified holdings make it well-positioned to continue meeting its target monthly payouts while preserving the underlying capital of the trust.

Forward-Looking Statements

Some of the statements contained herein including, without limitation, financial and business prospects and financial outlooks may be forward-looking statements which reflect management's expectations regarding future plans and intentions, growth, results of operations, performance and business prospects and opportunities. Words such as "may," "will," "should," "could," "anticipate," "believe," "expect," "intend," "plan," "potential," "continue" and similar expressions have been used to identify these forward-looking statements. These statements reflect management's current beliefs and are based on information currently available to management. Forward-looking statements involve significant risks and uncertainties. A number of factors could cause actual results to differ materially from the results discussed in the forward-looking statements including, but not limited to, changes in general economic and market conditions and other risk factors. Although the forward-looking statements contained herein are based upon what management believes to be reasonable assumptions, we cannot assure that actual results will be consistent with these forward-looking statements. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.